

Dispute Resolution Hotline

August 26, 2009

LIABILITY OF THE SURETY AND THE PRINCIPAL-DEBTOR IS CO-EXTENSIVE

The question as to liability of a surety, its extent and the manner of its enforcement has always been a highly controversial issue. In a recent judgment, the Supreme Court of India, in the case of *Industrial Investment Bank of India Ltd* (“**Appellant**”) v. *Biswanth Jhunjhunwala* (“**Respondent**”) ¹, has reiterated that the liability of the guarantor / surety and principal debtor is co-extensive and not in the alternative.

FACTS OF THE CASE

The Appellant sanctioned a short term working capital loan of INR 30 million in favour of Modern Malleables Limited (“**Borrower Company**”) on September 27, 1994. This loan agreement was signed by the Director of the Borrower Company, the Respondent herein, on behalf of the Borrower Company. The Respondent executed a demand promissory note for INR 30 million drawn in favour of the Appellant along with a deed of undertaking to create mortgage in respect of the immovable properties of the Borrower Company. Following this, a deed of personal guarantee² was also executed by the Respondent in respect of the said loan.

The Appellant further sanctioned a second term working capital loan of INR 30 million on March 15, 1995 in favour of the Borrower Company, in respect of which the Respondent again executed a promissory note and a deed of undertaking to create mortgage in respect of the immovable properties of the Borrower Company.

Thereafter, the Borrower Company committed defaults in the repayment of the principal amount of the loan, the accrued interest and the liquidated damages arising thereof. Some of the cheques issued on behalf of the Borrower Company by the Respondent were dishonored for want of funds. Consequently proceedings were initiated against the Respondent under section 138 of the Negotiable Instruments Act, 1881³.

In view of the defaults committed by the Borrower Company, the Appellant issued a demand notice to the Borrower Company and subsequently filed an application in the High Court of Calcutta under Section 40 of the Industrial Reconstruction Bank of India Act, 1984⁴ for attachment and sale of the assets of the Borrower Company. Pursuant to the above, the High Court of Calcutta issued an injunction restraining the Borrower Company from parting with any possession, disposing of or alienating or encumbering any of its said assets in any manner. The Respondent was not made party to these proceedings.

The Appellant thereafter invoked the personal guarantee given by the Respondent and served a notice upon the Respondent, calling upon him to pay a sum of INR 54 million together with further interest and liquidated damages and also filed an application against the Respondent in the Debts Recovery Tribunal⁵, Calcutta for a certificate against the Respondent for a sum of INR 54 million along with further interest and liquidated damages.

While rejecting the plea of the Respondent that the rights of the Appellant against the Respondent as guarantor did not crystallize till the rights of the Appellant against the Borrower Company are established, the Presiding Officer of the Tribunal held that the Appellant cannot be forced to exhaust remedies elsewhere before proceeding against the guarantor and clarified that the liability of the guarantor is co-extensive with that of the principal debtor.

Aggrieved by this order, the Respondent filed an application under Article 227⁶ of the Constitution of India in the High Court of Calcutta against the order, which was allowed and stay of proceedings before the Debt Recovery Tribunal was granted. Subsequently, the Appellant preferred an appeal to the Supreme Court.

JUDGMENT

The counsel on behalf of the Appellant, *inter alia*, relied upon the earlier decision of the Supreme Court in the case of *Bank of Bihar vs. Damodar Prasad & Another*⁷ in which case it was held by the Supreme Court that a creditor is not bound to exhaust his remedy against the principal debtor before suing the surety and that when a decree is obtained against a surety, it may be enforced in the same manner as a decree for any other debt.

The decision of the Division Bench of the Bombay High Court in the case of *Jagannath Ganeshram Agarwala vs. Shivnarayan Bhagirath and Ors.*⁸ was also relied upon wherein it was held that both the principal debtor and the surety are liable to the creditor at the same time.

In view of the arguments advanced and authorities cited, it was held by the Supreme Court that the liability of the guarantor and the principal debtor is co-extensive and not in the alternative. Notwithstanding the fact that they stem out from the same transaction, the two liabilities are separate and distinct.

The Supreme Court, therefore, set aside the impugned order of the High Court of Calcutta and awarded costs of INR 0.05 million to the Appellant.

ANALYSIS

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The legal position with regard to the liability of a guarantor or a surety, as crystallized by a series of judicial pronouncements⁹ is settled. The liability of the guarantor and a principal debtor is co-extensive and not in alternative. Therefore a guarantor's liability to pay the debt is not dissolved simply due to the creditor's omission to sue the principal debtor and a suit may be maintained against the guarantor even though the principal debtor has not been sued at all. This judgment provides further clarity and will strengthen the enforcement of rights of a creditor.

- Harshita Srivastava, Sahil Kanuga & Vyapak Desai

Vaibhav Parikh, Partner, Nishith Desai Associate on Tech, M&A, and Ease of Doing Business

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¹ Civil appeal No. 4613 of 2009 decided on July 9, 2009

2 Relevant clauses of the deed of guarantee read as follows:

1. "7.This guarantee shall be enforceable against the guarantor notwithstanding that any security or securities comprised in any instrument(s) executed by the borrower in favour of the Industrial Reconstruction Bank of India Ltd (for short IRBI) at the time when the proceedings are taken against the guarantor on this guarantee, be outstanding or un-realized or lost."

2. "11. To give effect to this guarantee, the IRBI may act as though the guarantors were the principal debtor to the IRBI"

3 Section 138 of the Negotiable Instruments Act, 1881 states that where any cheque drawn by a person on an account maintained by him with a banker, for payment of any amount of money to another person, from out of that account for the discharge, in whole or in part, of any debt or other liability, is returned by the bank unpaid, either because of the amount of money standing to the credit of that account is insufficient to honour the cheque or that it exceeds the amount arranged to be paid from that account by an agreement made with that bank, such person shall be deemed to have committed an offence and shall, without prejudice to any other provisions of this Act, be punished with imprisonment for a term which may be extended to two years, or with fine which may extend to twice the amount of the cheque, or with both. Provided that nothing contained in this section shall apply unless—

(a) the cheque has been presented to the bank within a period of six months from the date on which it is drawn or within the period of its validity, whichever is earlier;

(b) the payee or the holder in due course of the cheque, as the case may be, makes a demand for the payment of the said amount of money by giving a notice in writing, to the drawer of the cheque, within thirty days of the receipt of information by him from the bank regarding the return of the cheque as unpaid; and

(c) the drawer of such cheque fails to make the payment of the said amount of money to the payee or, as the case may be, to the holder in due course of the cheque, within fifteen days of the receipt of the said notice.

4 Section 40 of the IRBI, 1984 states in detail the procedure for "Enforcement of claims by the Reconstruction Bank".

5 Under section 19 of the Recovery of Debts Due to Bank and Financial Institutions Act, 1993.

6 Article 227 of the Constitution of India deals with the Power of superintendence over all courts by the High Court.

7 (1969) 1 SCR 620

8 AIR 1940 Bombay 247

9 *Lachhman Joharimal vs. Bapu Khandu and Tukaram Khandoji* (1869) 6 Bombay High Court Reports 241; *The Hukumchand Insurance Co. Ltd. vs. The Bank of Baroda & Others* AIR 1977 Kant 204.

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