AMRIT LAL GOVERDHAN LALAN

v.

STATE BANK OF TRAVANCORE & ORS.

April 11, 1968

[J. C. SHAH AND V. RAMASWAMI, JJ.]

Indian Contract Act (9 *of* 1872), *ss.* 133, 135 *and* 141—*Variance in terms of contract—When to be inferred—'Promise to give time to principal debtor', in s.* 135—*What amounts to—Scope of s.* 141.

In February 1956, respondents 3 to 6, as partners of respondent 2 firm, entered into an agreement with a Bank (Predecessor-in-interest of the first respondent-bank), undertaking to open in the Bank a cash credit account to the extent of Rs. 100,000 to be secured by goods to be pledged with the Bank. Clause 9 of the agreement provided that the borrowers shall be responsible for the quantity and quality of goods pledged. The appellant executed a letter of guarantee in favour of the Bank guaranteeing the liability of the borrowers in respect of the account upto a limit Rs. 100,000. Under cl. 5 of the letter of guarantee, the appellant agreed that the Bank may enforce and recover upon the guarantee the full amount guaranteed notwithstanding any other security the Bank may hold. The weekly statement dated 15th March 1957 showed that the stock pledged was valued at about Rs. 99,991 but when the quantity of the goods actually in stock was verified with the weekly statement dated 18th April 1957, shortage of goods to the value of Rs. 35,690 was found. It was admitted on behalf of the Bank that it was not known how the shortage occurred and that respondents 2 to 6 must have taken away the goods. Respondents 2 to 6 were granted one month's time to make up the deficit, and in spite of the time being extended, the deficit was never made up. In May 1958, after adjusting the money realised on the sale of the goods pledged and other adjustments, a sum of Rs. 40,933.58 was found due to the Bank from respondents 2 to 6. The Bank filed a suit against them and the appellant, and the suit was decreed. The decree was confirmed by the High Court.

In appeal to this Court, it was contended that : (1) Certain entries in the account books of the Bank showed that the maximum limit of credit was reduced to Rs. 50,000 and again raised to Rs. 100,000 without consulting the appellant, that therefore there was a variation in the terms of the contract without the surety's (appellant's) consent and, under s. 133 of the Indian Contract Act the liability of the appellant was discharged; (2) Under s. 135 of the Act, the conduct of the Bank in giving time to respondents 2 to 6 to make up the deficit in the quantity of goods absolved the appellant of all liability; and (3) under s. 141 of the Act, since a portion of the security was parted with or lost by the creditor without surety's consent, the liability of the appellant was discharged to the extent of the value of the security so lost.

HELD : (1) The entries in the books of account were mere internal instructions not legally binding on the respondents, and in view of the formal record in the original agreement and letter of guarantee, there could not have been a variation in the terms without a proper written agreement. Therefore, there was no variance in the terms of the contract between the creditor and the principal debtor and the provisions of s. 133 of the Act were not attracted. [729 B-C, E]

A (2) What really constitutes a promise to give time within the meaning of s. 135 of the Act is the extension of the period at which, the principal debtor was by the original contract obliged to pay the creditor, by substituting a new and valid contract between them, or, whenever the taking of a new security from the principal debtor operates as giving time. Therefore, the act of the Bank in giving time to the principal debtor to make up the quantity of goods pledged is not tantamount to giving of time to the principal debtor for making payment of the money, within the meaning of the B section. [730 E-F]

Rouse v. *Broadford Banking Co.* [1894] 2 Ch. 32, referred to.

(3) Under s. 140 of the Contract Act the surety is, on payment of the amount due by the principal debtor, entitled to be put in the same position in which the creditor stood in relation to the principal debtor. Under s. 141 of the Act the surety has a right to the securities held by the creditor C at the date when he became surety. The word 'security' is not used in any technical sense and includes all rights which the creditor has against the property at the date of the contract. Therefore, if the creditor has lost or parted with the security without the consent of the surety, the latter is by the express provision contained in s. 141, discharged to the extent of the value of the security lost or parted with. [731 F; 732 D-F; 733 C-D]

In the present case, the shortage of goods of the value of Rs. 35,690 was brought about by the negligence of the Bank and to that extent there D must be deemed to be a loss by the Bank of the security which the Bank had at the time when the contract of surety was entered into; and there is nothing in cl. 5 of the letter of guarantee to indicate that the appellant was not entitled to invoke the provisions of s. 141. The words 'any other security' in the clause meant any security other than the pledge of goods mentioned in the primary agreement. Therefore, the principle of the section applies and the surety was discharged of his liability to the Bank E to the extent of Rs. 35,690. [731 D-E; 733 E-F]

State of M.P. v. *Kaluram*, [1967] 1 S.C.R. 266, followed.

Wulff and Billing v. *Jay*, L.R. [1872] 7 Q.B. 756, referred to.

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 930 of 1965.

F Appeal by special leave from the judgment and order dated September 11, 1963 of the Kerala High Court in Appeal Suit No. 444 of 1960.

K. Viswanatha Iyer, Kutty Krishna Menon and *R. Gopalakrishnan*, for the appellant.

G *C. K. Daphtary, Attorney-General, H. L. Anand*, and *K. B. Mehta*, for respondent No. 1.

The Judgment of the Court was delivered by

Ramaswami, J.—This appeal is brought, by special leave, from the judgment of the High Court of Kerala dated September 11, 1963 in Appeal Suit No. 444 of 1960.

H On February 27, 1956 respondents 3 to 6, as partners of respondent No. 2 firm, entered into an agreement with the then Travancore Forward Bank Ltd. undertaking to open in the books

of the Bank at Ernakulam a Cash Credit Account to the extent of Rs. 1,00,000 to remain in force until closed by the Bank and to be secured by goods to be pledged with the Bank. The said respondents also agreed that if they failed or neglected to repay the Bank on demand the amount due to the Bank, it shall be lawful for the Bank, without any notice to them, to sell or otherwise dispose of all securities, either by public auction or by private contract and to apply the net proceeds of such sale towards the liquidation of the debt. It was also agreed that if any balance was still left the Bank shall be at liberty to apply any other money in the hands of the Bank standing to the credit of the said respondents towards repayment of the debt. The agreement between the Bank and the said respondents is Ex. P1. By cl. 2 of the document the borrowers agreed not to pledge or encumber the security nor permit any act whereby the security hereinbefore expressed to be given to the bank shall be in any way prejudicially affected. Clause 3 provided as follows:

> "That the Borrowers shall with the consent of the Bank be at liberty from time to time to withdraw any of the goods for the time being pledged to the Bank and forming part of the Securities the subject of this Agreement provided the advance value of the said goods is paid into the said account or goods of a similar nature and of at least equal value, are substituted for the goods so withdrawn. Provided always that with the previous consent of the Bank the Borrowers shall be at liberty to withdraw any of the goods for the time being pledged to the Bank without paying into the said account such advance value as aforesaid or substituting any goods as aforesaid provided the necessary margin required hereunder is fully maintained."

Clauses 8 and 9 are to the following effect:

> "8. That the Borrowers shall make and furnish to the Bank such statements and returns of the cost and market value of the securities and a full description thereof and produce such evidence in support thereof as the Bank may from time to time require and shall maintain, in favour of the Bank a margin of 10 per cent at Bank's discretion between the market value from time to time of the Securities and the balance due to the Bank for the time being. Such margin shall be calculated on such valuation of the Securities as fixed by the Bank from time to time and shall be maintained by the Borrowers either by the delivery of further securities to be approved by the Bank or by cash payment by the Borrowers immediately on the market value for the time

A being of the securities becoming less than the aggregate of the balance due to the Bank plus the amount of the margin as calculated above;

9. That the Borrowers shall be responsible for the quantity and quality of the goods pledged with the Bank and also for the correctness of Statements and Returns B furnished by them to the Bank from time to time as mentioned above. The Borrowers have assured the Bank that all information regarding the quantity, quality, value etc., and other description of the goods pledged with the Bank as given in the said statements and returns is or would be correct and the Bank has agreed to advance C monies under the above account on such representations. The Borrowers further declare and agree that the goods pledged with the Bank have not been actually weighed and/or valued and in order to verify the quantity or quality of the goods pledged or Statements and Returns furnished by the Borrowers, the Bank D shall be at liberty at any time, in its discretion, to get the goods weighed and valued at the expense of the Borrowers and the Borrowers agree to accept as conclusive proof the result of such weighment and valuation as certified by an authorised officer of the Bank. If, on such weighment and valuation the goods pledged are found to be short or less than the weight as shown by E the Borrowers, or of a lower value so as to effect the stipulated margin, the Borrowers undertake to make up the deficit on demand and to re-imburse the Bank for all losses, damages or expenses incurred by the Bank on that account."

F On March 7, 1956, the appellant executed Ex. P-4, the letter of guarantee in favour of the Bank, guaranteeing the liability of the borrowers in respect of the cash credit account up to a limit of Rs. 1,00,000 and in respect of liability under bills discounted up to a limit of Rs. 45,000. Clause 5 of the letter of guarantee reads as follows:

G "To the intent that you may obtain satisfaction of the whole of your claim against the customer, I agree that you may enforce and recover upon this guarantee the full amount hereby guaranteed and interest thereon notwithstanding any such proof or composition as aforesaid, and notwithstanding any other guarantee, H security or remedy, guarantees, securities or remedies, which you may hold or be entitled to in respect of the sum intended to be hereby secured or any part thereof, and notwithstanding any charges or interest which may

be debited in your account current with the customer, or in any other account upon which he may be liable."

A

Respondents 2 to 6 neglected to pay the amount due to the Bank in the said account and the goods pledged with the Bank were consequently sold with notice to the said respondents and the proceeds were credited to the account of the respondents. The amount due to the Bank as on September 30, 1957 was Rs. 73,931.35. Respondents 3 to 5 had a Suspense Account with the Bank to the extent of Rs. 5,000 and the said amount was adjusted in the account. Respondent No. 6 had a deposit of Rs. 5,000 with the Bank and the same was also adjusted in the said account. Under the Cash Credit Account, the balance due to the Bank as on May 21, 1958, stood at Rs. 40,856.34. A sum of Rs. 77.24 was due to the Bank from respondents 2 to 6 as per short bills account as on April 23, 1958. The Bank served registered notices of demand on respondents 2 to 6 as well as the Appellant and on their failure to make the payment of the amount due the Bank filed a civil suit against the said respondents and the appellant, being Original Suit No. 171 of 1958 for recovery of Rs. 40,933.58 in the court of the Subordinate Judge at Ernakulam. Respondents 2 to 6 did not contest the suit. The appellant, however, contested and filed a Written Statement exonerating himself from the liability on the allegation that the contract of guarantee was discharged on account of the misconduct of the creditor-bank. The Subordinate Judge of Ernakulam granted a decree in favour of the Bank as against respondents 2 to 6 and also against the appellant by his judgment dated December 9, 1958. The judgment of the Subordinate Judge was confirmed in appeal by the High Court of Kerala on September 11, 1963 in Appeal Suit No. 444 of 1960.

B

C

D

E

During the pendency of the proceedings in the High Court, respondent No. 1, State Bank of Travancore, a subsidiary of the State Bank of India was substituted in place of the Travancore Forward Bank Limited as successor-in-interest of the said Bank.

F

On behalf of the appellant it was contended in the first place that there was a variation made in the terms of the contract between the principal-debtor and the creditor in the present case and the appellant was accordingly discharged of his liability under the contract of guarantee. Reference was made to s. 133 of the Indian Contract Act which states :

G

"Any variance, made without the surety's consent in the terms of the contract between the principal debtor(s) and the creditor, discharges the surety as to transactions subsequent to the variance".

H

It was pointed out that the maximum limit of Rs. 1,00,000 allowed as credit in Ex. P-1 was reduced to Rs. 50,000 and that it was

again raised to Rs. 1,00,000 subsequently without consulting the appellant. The only evidence in support of this contention is certain entries in the pages of accounts maintained by the Bank of the "limit" as Rs. 50,000. It was also pointed out that the appellant had withdrawn Rs. 5,000 out of Rs. 10,000 deposited by him with the Bank towards security for advances to the firm. But there is no written agreement between respondent no. 1 Bank on the one side and the respondent-firm on the other side reducing the limit of cash-credit accommodation under Ex. P-1. In view of the formal record in the agreements, Ex. P-1 and Ex. P-4 it is difficult to hold that the variation of the terms would have been made without any written record. The High Court has taken the view that the entry in the books of account of the Bank might well be a private instruction to the Cashier that advances were not to be made by him beyond Rs. 50,000 which instruction may not be legally binding upon the other respondents. No inference may also be drawn from the withdrawal of Rs. 5,000 from the initial deposit of Rs. 10,000 by the appellant. The reason is that there is no obligation under Ex. P-4 imposed upon the appellant to make any deposit of money with the Bank and the circumstance that he made an initial deposit of Rs. 10,000 to reinforce his guarantee or that he withdrew Rs. 5,000 out of the deposit appears to be quite immaterial. In our opinion, the High Court was right in reaching the conclusion that there was no variation of the contract between the creditor and the principal debtor without the consent of the appellant and the provisions of s. 133 of the Indian Contract Act are not attracted. We accordingly hold that the Counsel for the appellant has been unable to make good his argument on this aspect of the case.

It was contended, in the second place, on behalf of the appellant that respondent no. 1 Bank had given time to respondents 2 to 6 to make up the shortage of the goods pledged to the value of Rs. 35,690. It appears that under the agreement, Ex. P-1 respondents 2 to 6 had pledged goods which were verified by the employees of the Bank. When the quantity of the goods actually in stock was verified with the weekly statement dated April 18, 1957, the shortage of goods to the value of Rs. 35,690 was found. The Bank immediately requested respondents 2 to 6 to make up the deficit. On April 23, 1957 the respondent firm intimated that the deficit will be made up within one month (See Ex. P-13). According to the Bank, one month's time was granted by it to enable respondents 2 to 6 to make up the deficit in the quantity of goods. P.W. 1, the Agent of the respondent Bank admitted that within one month the deficit was not made up and thereafter even though the time for making up the deficit was extended, respondents 2 to 6 did not, in fact, make up the deficit by supplying goods to the value of Rs. 35,690. It was contended on behalf

of the appellant that the conduct of the Bank in giving time to the principal-debtor to make up the deficit in the quantity of goods absolved the appellant of all liability under the guarantee. Reference was made to s. 135 of the Indian Contract Act which states :

> "A contract between the creditor and the principal debtor, by which the creditor makes a composition with, or promises to give time to, or not to sue, the principal debtor discharges the surety, unless the surety assents to such contract."

In our opinion, there is no warrant for the argument of the appellant. It is manifest that the act of giving time to the borrowers to make up the quantity of the goods found to be short on weighment by the Bank cannot be considered to be a "promise to give time" to the borrowers as contemplated by s. 135 of the Indian Contract Act. In this connection reference should be made to cl. 9 of Ex. P-1 which provides that the borrowers shall be responsible for the quantity and quality of goods pledged and also for the correctness of the statements and returns furnished to the Bank from time to time. It is stated in Ex. P-1 that the borrowers have declared and agreed that the goods pledged with the Bank have not been actually weighed or valued in order to verify the quantity and quality of the goods pledged. It is in the light of these clauses of the agreement that the act of giving time to the principal debtor has to be considered. The act of the Bank in giving time to the principal debtor to make up the quantity of the goods pledged is not tantamount to the giving of time to the principal debtor for making the payment of the money within the meaning of s. 135 of the Indian Contract Act. What really constitutes giving of time is the extension of the period at which, by the contract between them, the principal debtor was originally obliged to pay the creditor by substituting a new and valid contract between the creditor and the principal debtor to which the surety does not assent. The reason why an agreement to give time discharges the surety is because if, after making such an agreement, the creditor were to sue the surety the latter would at once be turned on the principal debtor in breach of the agreement to give time, so that the effect of such an agreement is to prevent the surety from either requiring the creditor to call upon the principal debtor to pay off the debt, or himself paying off the debt, and then suing the principal debtor, thereby causing prejudice to the surety [*Rouse* v. *Bradford Banking Co.*(1), per A. L. Smith, L.J.]. "Thus, to substitute for payment in one sum payment by instalments amounts to a giving of time. Again, whenever the taking of a new security from the principal debtor by the creditor operates as a giving of time, the surety is no longer liable, but not where that transaction has no such effect." (Halsbury's

(1) [1894] 2 Ch. 32, 75.

A *Laws of England*, Vol. 18, p. 509). In our opinion, the provisions of s. 135 of the Indian Contract Act are not attracted to the present case and the argument of the appellant on this point must be rejected.

We proceed to consider the next important question arising B in this case, namely, whether a portion of the security was lost by the creditor or parted with without the surety's consent and whether the surety is discharged to the extent of the value of the security so lost. It was pointed out on behalf of the appellant that when the quantity of the goods actually in stock was verified with the weekly statement dated April 18, 1957, shortage of goods to the value of Rs. 35,690 was found. The weekly statement C dated March 15, 1957 shows that the stock was valued at Rs. 99,991 and odd and in the course of his evidence the Agent of the respondent Bank said that "he did not know how the shortage occurred" and "there was a possibility of defendants 1 to 5 taking away the goods". On behalf of the respondent Bank reference was made to cl. 5 of Ex. P-4 which has already been D quoted. It was contended that on account of this clause in Ex. P-4 the appellant has opted out of the benefit of s. 141 of the Indian Contract Act. We are unable to accept the argument put forward by the Attorney-General on behalf of the respondent Bank. In our opinion, the expression "any security" in cl. 5 of Ex. P-4 should be properly construed as "any security other than E the pledge of goods mentioned in the primary agreement, Ex. P-1 between the Bank and the firm." We consider that there is nothing in cl. 5 of Ex. P-4 to indicate that the appellant is not entitled to invoke the provisions of s. 141 of the Indian Contract Act. In this connection it is necessary to consider the provisions of s. 140 of the Indian Contract Act, 1872 which states :

F "Where a guaranteed debt has become due, or default of the principal debtor to perform a guaranteed duty has taken place, the surety, upon payment or performance of all that he is liable for is invested with all the rights which the creditor had against the principal debtor(s)."

G This section embodies the general rule of equity expounded by Sir Samuel Romilly as counsel and accepted by the Court of Chancery in *Craythorne* v. *Swinburne*[1], namely :

"The surety will be entitled to every remedy which the creditor has against the principal debtor; to enforce H every security and all means of payment; to stand in the place of the creditor; not only through the medium of contract, but even by means of securities entered into

(1) [1 807] 14 Ves. 160.

without the knowledge of the surety; having a right to have those securities transferred to him, though there was no stipulation for that; and to avail himself of all those securities against the debtor. This right of a surety also stands, not upon contract, but upon a principle of natural justice."

The language of the section which employs the words "is invested with all the rights which the creditor had against the principal debtor" makes it plain that even without the necessity of a transfer, the law vests those rights in the surety. Section 141 of the Indian Contract Act, 1872 states:

"A surety is entitled to the benefit of every security which the creditor has against the principal debtor at the time when the contract of suretyship is entered into, whether the surety knows of the existence of such security or not; and, if the creditor loses, or, without the consent of the surety, parts with such security, the surety is discharged to the extent of the value of the security."

As pointed out by this Court in *State of Madhya Pradesh* v. *Kaluram*(1), the expression "security" in this section is not used in any technical sense; it includes all rights which the creditor has against the property at the date of the contract. The surety is entitled on payment of the debt or performance of all that he is liable for to the benefit of the rights of the creditor against the principal debtor which arise out of the transaction which gives rise to the right or liability. The surety is therefore on payment of the amount due by the principal debtor entitled to be put in the same position in which the creditor stood in relation to the principal debtor. If the creditor has lost or parted with the security without the consent of the surety, the latter is by the express provision contained in s. 141, discharged to the extent of the value of the security lost or parted with. In *Wulff and Billing* v. *Jay*(2) Hannen, J. stated the law as follows:

"........I take it to be established that the defendant became surety upon the faith of there being some real and substantial security pledged, as well as his own credit, to the plaintiff; and he was entitled, therefore, to the benefit of that real and substantial security in the event of his being called on to fulfil his duty as a surety, and to pay the debt for which he had so become surety. He will, however, be discharged from his liability as surety if the creditors have put it out of their power to hand over to the surety the means of recouping himself by the security given by the principal. That

(1) [1967] 1 S.C.R. 266. (2) L.R. (1872) 7 Q.B. 756.

A doctrine is very clearly expressed in the notes in *Rees* v. *Barrington*—2 White & Tudor's L.C., 4th Edn. at p. 1002—'As a surety, on payment of the debt, is entitled to all the securities of the creditor, whether he is aware of their existence or not, even though they were given after the contract of suretyship, if the creditor who has B had, or ought to have had, them in his full possession or power, loses them or permits them to get into the possession of the debtor, or does not make them effectual by giving proper notice, the surety to the extent of such security will be discharged. A surety, moreover, will be released if the creditor, by reason of what he has C done, cannot, on payment by the surety, give him the securities in exactly the same condition as they formerly stood in his hands.' "

It is true that s. 141 of the Indian Contract Act has limited the surety's right to securities held by the creditor at the date of his becoming surety and has modified the English rule that the surety D is entitled to the securities given to the creditor both before and after the contract of surety. But subject to this variation, s. 141 of the Indian Contract Act incorporates the rule of English law relating to the discharge from liability of a surety when the creditor parts with or loses the security held by him. Upon the evidence adduced by the parties in this case we are satisfied that there was shortage of goods of the value of Rs. 35,690 brought about E by the negligence of the Bank or for some other reason and to that extent there must be deemed to be a loss by the Bank of the securities which the Bank had at the time when the contract of surety was entered into. It follows therefore that the principle of s. 141 of the Indian Contract Act applies to this case and the surety is discharged of the liability to the Bank to the extent of F Rs. 35,690. We accordingly hold that the respondent Bank is entitled to a decree against respondent 6, the appellant only to the extent of Rs. 5,243.58 and not to the sum of Rs. 40,933.58 and to proportionate costs.

For these reasons we allow the appeal to the extent indicated above and modify the decree of the High Court accordingly. The G parties will bear their respective costs in this Court.

V.P.S. *Appeal allowed.*