12
Guarantee

DEFINITION

"Contract of guarantee" is defined in Section 126 of the Act as follows:

126. "Contract of guarantee", "surety", "principal debtor" and "creditor".—A "contract of guarantee" is a contract to perform the promise, or discharge the liability, of a third person in case of his default. The person who gives the guarantee is called the "surety"; the person in respect of whose default the guarantee is given is called the "principal debtor", and the person to whom the guarantee is given is called the "creditor". A guarantee may be either oral or written.

Economic functions of guarantee

The function of a contract of guarantee is to enable a person to get a loan, or goods on credit, or an employment. Some person comes forward and tells the lender, or the supplier or the employer that he (the person in need) may be trusted and in case of any default, "I undertake to be responsible". For example, in the old case of *Birkmyr* v *Darnell*[1] the Court said:

> "If two come to a shop and one buys, and the other to give him credit, promises the seller, 'If he does not pay you, I will.'."

This type of collateral undertaking to be liable for the default of another is called a "contract of guarantee". In English law a guarantee is defined as "a promise to answer for the debt, default or miscarriage of another".[2] It is a collateral engagement to be liable for the debt of another in case of his default. "Guarantees are usually taken to provide a second pocket to pay if the first should be empty."[3]

Parties

The person who gives the guarantee is called the "surety", the person in respect of whose default the guarantee is given is called the "principal debtor" and the person to whom the guarantee is given is called the "creditor".[4]

Independent liability different from guarantee

There must be a conditional promise to be liable on the default of the principal debtor. A liability which is incurred independently of a "default" is not within the definition of guarantee.[5] To refer again to *Birkmyr* v *Darnell*,[6] where referring to the

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1. (1704) 91 ER 27: 1 Salk 27.
2. S. 4, Statute of Frauds 1677, 29 Car, II, C 3. .
3. Wood, LAW AND PRACTICE OF INTERNATIONAL FINANCE, 295 (1980).
4. See *Punjab National Bank* v *Sri Vikram Cotton Mills*, (1970) 1 SCC 60: (1970) 2 SCR 462: AIR 1970 SC 1973: 40 Comp Cas 927.
5. See *Punjab National Bank* v *Sri Vikram Cotton Mills*, (1970) 1 SCC 60: (1970) 2 SCR 462: AIR 1970 SC 1973: 40 Comp Cas 927. The liability of both (the principal debtor and surety) is just the same. *Francis* v *Central Bank of India*, (1990) 2 Ker LT 983; *Guild & Co* v *Conrod*, (1894) 2 QB 885.
6. Note 1 *supra*.

buyer's companion, the court further said that if the companion had said: "Let him have the goods, 'I will be your pay master' or 'I will see you paid'." "This would have been an undertaking as for himself and is not a guarantee."[7] This principle was applied in *Taylor* v *Lee*[8] decided in the United States of America:

> A landlord and his tenant went to the plaintiff's store. The landlord said to the plaintiff: Mr Parker will be on our land this year, and you will sell him anything he wants, and I will see it paid.

This was held to be an original promise, and not a collateral promise to be liable for the default of another and, therefore, not a guarantee.[9]

ESSENTIAL FEATURES OF GUARANTEE

The following are the requisites of a valid guarantee:

1. Principal debt

Recoverable Debt Necessary

The purpose of a guarantee being to secure the payment of a debt, the existence of a recoverable debt is necessary.[10] It is of the essence of a guarantee that there should be someone liable as a principal debtor and the surety undertakes to be liable on his default.[11] If there is no principal debt, there can be no valid guarantee.[12] "A contract of guarantee is a tripartite agreement which contemplates the principal debtor, the creditor and the surety."[13] This was so held by the House of Lords in the Scottish case of *Swan* v *Bank of Scotland*[14], decided as early as 1836.

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7. Observations to the same effect appear in *Punjab National Bank* v *Sri Vikram Cotton Mills*, (1970) 1 SCC 60: (1970) 2 SCR 462: AIR 1970 SC 1973. *Nanak Ram* v *Mehin Lal*, (1877) 1 All 487; *Varghese* v *Abraham*, AIR 1952 TC 202, undertaking to see that the creditor would be paid.
8. Supreme Court of North Carolina, (1924) 121 SE 659: 187 NC 393. Collected from Shepherd & Wellington: CONTRACTS AND CONTRACT REMEDIES, (1957, 4th edn) 373; *see* also *Juggutt Indar Narain Ray Chowdery* v *Nistiarinee Dassee*, (1931) 151 IC 981 (PC).
9. *See* also *Whitehurst* v *Pagett*, 157 NC 424, 73 SE 240 and *Mountstephen* v *Lakeman*, 1871 LR 7 QB 196; affd 1874 LR 7 HL 17 where the chairman of a Board, speaking personally, assured payment to a contractor for certain works. This was held to be a personal undertaking and not a guarantee. An undertaking to discharge the liability of another without any request from him creates an independent liability and not collateral as that of a guarantor. *N.S. Varghese* v *Dhanlakshmi Bank Ltd* (1997) AIHC 1820 Ker, repayment of bank loan *en route* co-operative society, did not make the latter a guarantor for the loan. *Chanana Steel Tubes P Ltd* v *Jain Steel Tubes P Ltd*, AIR 2000 HP 48, a party introduced to a businessman a certain person as a customer. It did not mean that the introducer became a guarantor for the person.
10. *Mountstephen* v *Lakeman*, 1871 LR 7 QB 196, 202 Ex, *affirmed*, LR 7 HL 17.
11. *Harburg India Rubber Comb Co* v *Martin*, (1902) 1 KB 778 CA.
12. A guarantee for a debt already barred by time, held, void. *Manju & Mahadeo* v *Shivappa*, (1918) 42 Bom 444.
13. *Mahabir Shum Sher* v *Lloyds Bank*, AIR 1968 Cal 371, 377 *per* RAY J Reiterated by the Supreme Court in the case cited in Note 5 above. The surety agrees to run the risk on express or implied request. *Pariamanna Marakkayar* v *Banians & Co*, (1925) 49 Mad 156: AIR 1926 Mad 544; *Ramachandra* v *Shapurji*, AIR 1940 Bom 315; *Jagannath Baksh* v *Chandra Bhushan*, AIR 1937 Oudh 19: 12 Luck 484. The signing of a solvency certificate does not make one a guarantor for the debt of the person whose solvency is certified. *Joseph Abraham* v *Tehsildar Meenachi*, AIR 1971 Ker 334.
14. (1836) 10 Bligh NS 627. *See* also *Lima Leitao & Co* v *Union of India*, AIR 1968 Goa 29; *Mahabir Shum Sher* v *Lloyds Bank*, AIR 1968 Cal 371; *A.V. Varadarajulu* v *K.V. Thavasi Nadar*, AIR 1963 Mad 413.

> The payment of the overdraft of a banker's customer was guaranteed by the defendant. The overdrafts were contrary to a statute[15], which not only imposed penalty upon the parties to such drafts but also made them void. The customer having defaulted, the surety was sued for the loss.

But he was held not liable. The court said that "if there is nothing due, no balance, the obligation to make that nothing good amounts itself to nothing. If no debt is due, if the banker is forbidden from having any claim against his customer, there is no liability incurred by the co-obligers".[16]

Guarantee for Void Debt, when Enforceable

But sometimes a guarantee even for a void debt may be held enforceable. Where, for example, the directors of a company guaranteed their company's loan which was void as being *ultra vires*, the directors were nevertheless held liable.[17] The reason "may be that the voidness of a contract to guarantee the debt of a company acting *ultra vires* is different in its consequence from the voidness brought about by the express and emphatic language of a statute".[18]

Guarantee of Minor's Debt

A similar problem arises when the debt of a minor has been guaranteed. The debt being void, is the surety liable? The Court of King's Bench considered the question in *Coutts & Co* v *Brown Lecky*[19] and held that no liability should be incurred by the surety. The head note to the report says:

> "A loan, by way of overdraft made by a bank to an infant being void under Section 1, of the Infants' Relief Act, 1874, the guarantors of the loan, where the fact of infancy is known to all parties, cannot be made liable in an action on the guarantee."

OLIVER J said:[20] "Apart from authority it would certainly seem strange if a contract to make the debt default or miscarriage of another, could be binding where, by statute, the loan guaranteed is, in terms, made absolutely void. Looking at the matter broadly, how, in these circumstances, can the omission by an infant to pay what is made void by statute be described as either a debt, a default or a miscarriage? There is no debt here because the Act of 1874 says so;[21] there is no default, for the infant is entitled to omit to pay, and there is no miscarriage for the same reason."[22]

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15. 55 Geo 3, C 184, S. 13.
16. 10 Bligh NS 634, 636, *per* Lord BROUGHAM. *See* also *Lima Leitao & Co* v *Union of India*, AIR 1968 Goa 29; *Agencia National* v *Chowgule & Cia*, AIR 1967 Goa 88.
17. *Yorkshire Railway Wagon Co* v *Maclure*, 19 Ch D 478; *Garrard* v *James*, (1925) Ch 616; *Chambers* v *Manchester & Mildford Rly Co*, (1964) 5 B&S 588.
18. OLIVER J in *Coutts* v *Brown Lecky*, (1947) 1 KB 106, 111. The learned Judge drew this conclusion from a consideration of the authorities.
19. (1947) 1 KB 106; (1946) 2 All ER 207. *See* also *Eldridge & Morris* v *Taylor*, (1931) 2 KB 416, Furmston, 24 Mod LR 648; *Stadium Finance Co Ltd* v *Helm*, (1965) 109 Sol Jo 471; Stein, 90 LQR 246.
20. At p 106.
21. The Infants' Relief Act, 1874, S. 1.
22. For a criticism of this decision *see* E.J. Cohn, *Validity of Guarantees for Debts of Minors*, (1947) 10 Mod LR 40.

In India it has been held, following earlier English authorities, that where a minor's debt has been knowingly guaranteed, the surety should be held liable as a principal debtor himself.[23] In *Kashiba* v *Shripat*[24] the Bombay High Court observed:

> "A surety to a bond passed by a minor for moneys borrowed for purposes of litigation not found to be necessary, is liable to be sued on it whether the contract of the minor is considered to be void or voidable. We see no reason why a person cannot contract to guarantee the performance by a third person of a duty of imperfect obligation. If the debt is void, the contract of the so-called surety is not collateral, but a principal contract."[25]

2. Consideration

Like every other contract, a contract of guarantee should also be supported by some consideration. A guarantee without consideration is void.[26] But there need be no direct consideration between the surety and the creditor.[27] Section 127 clearly says that—

127. Consideration for guarantee.—Anything done, or any promise made, for the benefit of the principal debtor, may be a sufficient consideration to the surety for giving the guarantee.

Illustrations

(a) *B* requests *A* to sell and deliver to him goods on credit. *A* agrees to do so, provided *C* will guarantee the payment of the price of the goods. *C* promises to guarantee the payment in consideration of *A's* promise to deliver the goods. This is a sufficient consideration for *C's* promise.

(b) *A* sells and delivers goods to *B*. *C* afterwards requests *A* to forbear to sue *B* for the debt for a year, and promises that, if he does so, *C* will pay for them in default of payment by *B*. *A* agrees to forbear as requested. This is a sufficient consideration for *C's* promise.[28]

(c) *A* sells and delivers goods to *B*. *C* afterwards, without consideration, agrees to pay for them in default of *B*. The agreement is void.

Thus where a loan is given or goods sold on credit on the basis of a guarantee that is sufficient consideration.[29] Similarly, where a credit has already been given

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23. *Kashiba* v *Shripat* (1894) 19 Bom 697, following *Harris* v *Huniback*, (1757) 1 Burr 373, *Wathier* v *Wilson*, (1911) 27 TLR 582. For other decision see *Sohan Lal* v *Puran Singh*, (1916) 54 Punj Rec 165; *Tirhilal* v *Komal Chand*, AIR 1940 Nag 327.
24. (1895) 19 ILR Bom 697. *See* also *Inder Singh* v *Thakur Singh*, (1921) 2 Lah 207; *Jagannath Ganeshram* v *Shivnarayan*, 1940 Bom 387: 42 Bom LR 451: AIR 1940 Bom 247.
25. In England also it has been held that in such cases the guarantor should be held liable as an indemnifier, *Yeoman Credit Ltd* v *Latter*, (1961) 2 All ER 294: (1961) 1 WLR 828, CA.
26. *Janaki Paul* v *Dhokar Mall Kidarbux*, (1935) 156 IC 200; *Ram Narain* v *Hari Singh*, AIR 1964 Raj 76: ILR 1963 Raj 973.
27. BEST CJ observed in *Marely* v *Boothby*, (1825) 3 Bing 107 that "no court of common law has ever said that there should be a consideration directly between the persons giving and receiving the guarantee. It is enough if the person for whom the guarantor becomes surety receives a benefit, or the person to whom the guarantee is given suffers inconvenience, as an inducement to the surety to become guarantor for the principal debtor".
28. The Patna High Court has similarly held that a guarantee on the implied request of the principal debtor is binding. A guarantee given after the execution of the loan document is valid. *Prasanjit Mahtha* v *United Commercial Bank*, AIR 1979 Pat 151.
29. *State Bank of India* v *Kusum Vallabhdas Thakkar*, (1994) 1 Guj LH 62, guarantee under a mortgage transaction, held good consideration. *State Bank of India* v *Kusum Vallabhdas*

and the payment having become due, the creditor refrains from suing the principal debtor, that would be a sufficient consideration for giving a guarantee.

Guarantee for Past Debt

But a guarantee for a past debt should be invalid. The section says that "anything done... for the benefit of the principal debtor" is good consideration.[30]

But will the words "anything done" include things done before the guarantee was given? The Oudh High Court in *Gulam Husain* v *Faiyaz Ali*[31] answered this question in the affirmative.

> A lessee agreed to pay the sum due under a lease by certain instalments and after a few days a person executed a surety bond binding himself to pay a certain amount in default of the payment of instalments.

The court held that the bond was not without consideration.[32] The decision has been criticised in Pollock and Mulla. The learned editors observe:

> "This seems to attribute an unnatural meaning to the word, which, it is submitted and as the rest of the section shows, refers to an executed as distinguished from an executory consideration."[33]

The decision also seems to be contrary to the third illustration to the section.[34]

Thakkar, (1994) 1 Guj LR 655, guarantee under a mortgage transaction, forbearance on the part of the creditor in filing a suit against one of the debtors was held to be a good consideration for the guarantee.

30. It is not necessary that the guarantor should draw some personal benefit. *Sornaling* v *Pachai Naickan*, (1915) 38 Mad 680; *Pestonji* v *Bal Meherbai*, (1928) 30 Bom LR 1407: AIR 1928 Bom 539. The consideration must also be lawful. *Cooper* v *Joel*, (1859) 45 ER 350, a consideration which failed; *Het Ram* v *Devi Prasad*, (1881) 1 All WN 2, withdrawal of a non-compoundable case.
31. AIR 1940 Oudh 346. *State Bank of India* v *Premco Saw Mills*, AIR 1984 Guj 93, forbearance to sue on the part of the creditor is a good consideration for a guarantee.
32. Reliance was placed upon the following decisions: *Mathura Das* v *Shamboo Nath*, AIR 1929 Lah 203; *Kalicharan* v *Abdul Rehman*, AIR 1918 PC 226: 23 CWN 545.
33. INDIAN CONTRACT AND SPECIFIC RELIEF ACTS, 8th edn by Setalvad and Gooderson, (1957), p 517.
34. The Andhra Pradesh High Court has supported the view that past consideration is not good. *M.N.A. Khan* v *Commercial & Industrial Bank*, AIR 1969 AP 294. But the judicial opinion is still in conflict. See *Kalicharan* v *Abdul Rehman*, AIR 1918 PC 226. A guarantee for leasing transactions was held not to cover leasing agreements which were concluded before the date of the guarantee. *Perrylease Ltd* v *Imecar A.G.*, (1987) 5 All ER 373 QBD. The Bombay High Court has observed in *Union Bank of India* v *Avinash P. Bhonsle*, (1991) Mh LJ 1004 that: It is well settled that just as illustrations should not be read as extending the meaning of a section, they should also not be read as restricting its operation, especially so, when the effect would be to curtail a right which the plain words of the section would confer. It is, therefore, clear that when the language of the text of Section 127 of the Contract Act is clear and unambiguous, the sweep of the text cannot be curtailed by using Illustration (*c*) to impose a limitation on the expression "any thing done or any promise made for the benefit of the principal debtor" that it should be done at the time of giving the guarantee. The language is wide enough to include any thing that was done or a promise made before giving the guarantee and would not restrict the application of the section only to what was contemporaneously done. *See* further *Allahabad Bank* v *S.M. Engg Industries*, (1992) 1 Cal LJ 448 where the bank was not allowed to sue the surety without further or any advance made after the date of the guarantee.

Past as well as future debt

A guarantee for a past as well as a future debt is enforceable provided some further debt is incurred after the guarantee. But there should be a clear undertaking to be liable for a past debt[35] and as soon as some fresh obligation is incurred, the liability for all the obligations is coupled up.[36]

Benefit of Principal Debtor, enough Consideration

If the principal debtor gets a benefit, that suffices to sustain the guarantee. It will be of no consequence to say that the principal debtor had never requested for a guarantee or that it was given without his knowledge or consent. A contention of this kind was refuted by the Patna High Court in a case[37] where the directors of a company who guaranteed the company's loans argued that the company had never asked for the guarantee. The court relied upon the following statement of Lord LOREBURN:[38]

> "There are three possible variations in the parties to contract of suretyship. The first and the simplest case is that in which all the three parties concerned are parties to the contract in the sense that both the principal debtor and creditor agree that the surety's liability is a secondary liability only, and that the principal debtor is primarily liable for the obligations guaranteed. But it is also possible that the contract of suretyship may be recognised only as between the principal debtor and the surety, or as between the creditor and the surety, in which event the rights and duties arising out of the contract of suretyship only affect those parties."

3. Misrepresentation and concealment

A contract of guarantee is not a contract *uberrimae fides* or one of absolute good faith.[39] Thus where a banker received a guarantee with knowledge of circumstances seriously affecting the credit of the customer, it was held that there was no duty to disclose this fact to the surety.[40] Yet "it is the duty of a party taking a guarantee to put the surety in possession of all the facts likely to affect the degree of his responsibility; and if he neglects to do so, it is at his peril. A surety ought to be acquainted with the whole contract entered into with his principal". Sections 142 and 143 implement these principles. Sections 142 and 143 provides that:

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35. *Morrel* v *Cowan*, (1877) 7 Ch D 151.
36. *See*, e.g., *Carlesbery Brewery Malaysia* v *Soon Heng A.W. & Sons*, (1989) 1 Mal LJ 104 HC Kota Bahri, where the court on going through the guarantee found that it was within the contemplation of the parties that the guarantors were to be saddled with the liabilities not only after but also before the signing of the guarantee. Following, *Esso Standard Malaya* v *Southern Cross Airways*, (1972) 1 Mal LJ 168.
37. *Prasanjit Mahtha* v *United Commercial Bank*, AIR 1979 Pat 151.
38. *Duncan Fox & Co* v *North & South Wales Bank*, (1880) 6 AC 1, 11-12; *cited by* AGARWAL J at p 154, *supra*.
39. See *Davies* v *London & Provincial Marine Insurance Co*, (1878) 8 Ch D 469.
40. *National Provincial Bank of England* v *Glanusk*, (1913) 3 KB 335. *See* also *Bank of Scotland* v *Morrison*, (1911) SC 593; *Cooper* v *National Provincial Bank Ltd*, (1945) 2 All ER 642; (1946) KB 1. A creditor's failure to disclose to a guarantor a material fact known to him will vitiate the guarantee if the non-disclosure amounts to a misrepresentation. The suppression of a fact will amount to misrepresentation if the fact is inconsistent with the presumed basis of the contract of guarantee, *Westpac Securities* v *Dickie*, (1991) 1 NZ LR 657 CA.

142. Guarantee obtained by misrepresentation, invalid.—Any guarantee obtained by means of misrepresentation made by the creditor or with his knowledge and assent, concerning a material part of the transaction, is invalid.

143. Guarantee obtained by concealment, invalid.—Any guarantee which the creditor has obtained by means of keeping silence as to material circumstances is invalid.

Illustrations

(a) *A* engages *B* as clerk to collect money for him. *B* fails to account for some of his receipts, and *A* in consequence calls upon him to furnish security for his duly accounting. *C* gives his guarantee for *B's* duly accounting. *A* does not acquaint *C* with *B's* previous conduct. *B* afterwards makes default. The guarantee is invalid.

(b) *A* guarantees to *C* payment for iron to be supplied by him to *B* to the amount of 2000 tons. *B* and *C* have privately agreed that *B* should pay five rupees per ton beyond the market price, such excess to be applied in liquidation of an old debt. This agreement is concealed from *A*. *A* is not liable as a surety.

Guarantees for the good conduct of a servant have invited more frequent applications of this principle. A very illustrative case is *London General Omnibus Co* v *Holloway*[41].

> The defendant was invited to give a guarantee for the fidelity of a servant. The employer had earlier dismissed him for dishonesty, but did not disclose this fact to the surety. The servant committed another embezzlement.

The surety was held not liable. "The surety believed that he was making himself answerable for a presumably honest man, not for a known thief." Every surety undertakes the risk of default, which is more in some cases and less in others depending upon circumstances. If the creditor is aware of circumstances affecting the risk, he should make the surety equally aware. Similarly, in a case before the Lahore High Court, fresh guarantees were obtained for the fidelity of a manager of a bank without disclosing his previous defalcations, the sureties were held not liable for further defalcation.[42]

Lord CHELMSFORD observed with regard to a guarantee other than a guarantee of fidelity that a creditor is under no obligation to inform an intended surety of matters affecting the credit of the debtor, or of any circumstances connected with the transaction in which he is about to engage which will render the position hazardous.[43] To the same effect is an observation in a Scottish case. There is nothing in "authorities for holding that the fact that suspicious circumstances arise to the knowledge of a creditor, and are not communicated at once to the cautioner is a ground for holding a cautioner freed from his obligation".[44] Referring to the

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41. (1912) 2 KB 72.
42. *Co-operative Commission Shop Ltd* v *Udham Singh*, AIR 1944 Lah 424.
43. *Wythes* v *Labouchere*, (1859) 3 De G&J 593.
44. *Bank of Scotland* v *Morrison*, (1911) SC 593, Scotland. Where the nature of the transaction showed that the whole tenor of guarantee papers was concealed from the surety and he was made to sign the last page only, the court held that the guarantee letter did not seem to be

position of a bank, it was observed in the same case: "There is no authority for the view that it is the duty of a bank, whenever it becomes aware of any circumstances seriously affecting the credit of a customer, to communicate at once with any of that customer's friends who may have cash credits on his behalf or guarantees for his pecuniary obligation."[45]

4. Writing not necessary

Section 126 expressly declares that a guarantee may be either oral or written.[46] But in England under the provisions of the Statute of Frauds a guarantee is not enforceable unless it is "in writing and signed by the party to be charged".[47]

EXTENT OF SURETY'S LIABILITY

The fundamental principle about the surety's liability, as laid down in Section 128, is that the liability of the surety is co-extensive with that of the principal debtor. The surety may, however, by an agreement place a limit upon his liability. The section is as follows:

128. Surety's liability.—The liability of the surety is co-extensive with that of the principal debtor, unless it is otherwise provided by the contract.

Illustration

A guarantees to *B* the payment of a bill of exchange by *C*, the acceptor. The bill is dishonoured by *C*. *A* is liable not only for the amount of the bill but also for any interest and charges which may have become due on it.

1. Co-extensive

The first principle governing surety's liability is that it is co-extensive with that of the principal debtor. The expression "co-extensive with that of the principal debtor" shows the maximum extent of the surety's liability. He is liable for the whole of the amount for which the principal debtor is liable and he is liable for no more.[48] The only illustration appended to the section says that if the payment of a

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genuine. Facts further showed that the borrower was prosecuting a criminal case against the surety. *Union Bank of India* v *MP Streedharan Kartha*, AIR 1993 Ker 285.

45. The creditor (a bank in this case) is under a duty to disclose to the surety contractual arrangements between the principal debtor and the creditor which made the terms of the principal contract something materially different in a particularly disadvantgeous respect to those which the surety might actually expect, *Levett* v *Barclays Bank plc*, (1995) 2 All ER 615 CA. In a suit on a deed of guarantee, the plea that the blanks in the deed were filled in subsequently was not sustainable because all entries were initialled.

46. Since an oral guarantee is also valid, a person who otherwise appeared to be a guarantor was held liable though his signature did not appear on guarantee papers. *P.J. Rajappan* v *Associate Industries P Ltd*, (1990) 1 Ker LJ 77. A written guarantee may be spelled out from more than one documents. *S. Chattantha* v *Central Bank of India*, AIR 1965 SC 1856: (1965) 3 SCR 318. A written guarantee would have to satisfy the requirements of the Stamp Act.

47. Section 4. Where a transaction is spread over to several documents, the court may see whether their combined effect produces a guarantee. *S. Chattantha Karayalar* v *Central Bank of India*, (1965) 3 SCR 318: AIR 1965 SC 1856: (1965) 35 Comp Cas 610.

48. Thus a guarantor of rent was held not liable for interest on rent because the principal debtor himself was not so liable. *Maharaja of Banaras* v *Har Narain Singh*, (1909) 28 All 25. Under the agreement in this case, and even otherwise, the surety is liable not only for the principal amount but for interest on the principal amount and charges incurred in enforcing the liability. The court held that the trial court erred in decreeing the suit against the surety

loan bond is guaranteed, the surety is liable not only for the amount of the loan, but also for any interest and charges which may have become due on it.[49]

Where the overdrafts of a company were guaranteed by the company's directors and the banker had recovered a part of the loan by disposing of certain goods belonging to the company, the Madras High Court held that the liability of the surety had gone down accordingly.[50]

Condition Precedent

Where there is a condition precedent to the surety's liability, he will not be liable unless that condition is first fulfilled. A partial recognition of this principle is to be found in Section 144 which says:[51]

144. Guarantee on contract that creditor shall not act on it until co-surety joins.—Where a person gives a guarantee upon a contract that creditor shall not act upon it until another person has joined in it as co-surety, the guarantee is not valid if that other person does not join.

An illustration in point is *National Provincial Bank of England* v *Brackenbury*.[52]

> The defendant signed a guarantee which on the face of it was intended to be a joint and several guarantee of three other persons with him. One of them did not sign. There being no agreement between the bank and the co-guarantors to dispense with his signature, the defendant was held not liable.

The same result followed where the signature of the co-guarantor was forged so as to make it appear that he had joined.[53] The facts were:

> The plaintiff supplied timber to a company of which the defendant was a director. The company being unable to pay, the plaintiff agreed to suspend the claim for a year provided that the debt was jointly and severally guaranteed by the company's three directors. A guarantee apparently signed by the defendant and

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for only the principal amount excluding interest and costs. *Indian Overseas Bank* v *G. Ramulu*, (1999) 2 Andh LD 104.

49. For a parallel case see *Nand Lal* v *Suraj Mal*, AIR 1932 Nag 62. The expression "co-extensive" also shows the nature of liability. Thus where in a suit against the principal debtor and surety, the principal debtor was ordered to pay in instalments and the suit against the surety was dismissed, this dismissal was held to be not proper. *State Bank of India* v *Sajita Engg Works*, AIR 1992 Ori 237. The court *followed* the decision of the Supreme Court in *Bank of Bihar Ltd* v *Damodar Prasad*, AIR 1969 SC 297: 1969 All LJ 475 and *Nanda Dulal Sen* v *Rao & Sons*, (1972) 38 Cal LT 959 where it was held that the decree against the surety would not be executed till the principal debtor paid off the dues by instalments allowed by the court and thus the liability of the guarantor was not wiped out. In all proceedings against the principal debtor, his sureties are a proper party. *Industrial Finance Corpn of India* v *P.V.K. Papers Ltd*, AIR 1992 All 239. This is so because the liability is joint and several. *Suresh Narain* v *Akhauri*, AIR 1957 Pat 256; *Madho Sah* v *Sitaram*, AIR 1962 Pat 405. The period of limitation against the principal debtor and the surety is the same, *Union Bank of India* v *Suresh Bhailal Mehta*, AIR 1997 Guj 48. *D. Pandi* v *Dhanalakshmi Bank Ltd*, AIR 2001 Mad 243, signature of the surety on bank loan and guarantee documents proved, surety liable. *E.P. George* v *Bank of India*, AIR 2001 Ker 107, a guarantor is also a debtor and if the creditor is demanding a security from the surety also, he should be able to provide security by an equitable mortgage of his property.

50. *Harigopal Agarwal* v *State Bank of India*, AIR 1956 Mad 211.

51. Seems to be based upon the principle laid down in *Evans* v *Bremridge*, (1856) 8 DMG 100.

52. (1906) 22 TLR 797.

53. *James Graham & Co* v *Southgate Sands*, (1985) 2 All ER 344 CA.

other directors was duly provided. The company went into liquidation. The plaintiff sought to enforce the guarantee. Before the trial of the action it was discovered that the signature of one of the directors had been forged.

The court said: "A joint guarantor under a guarantee which showed on its fact that the other joint guarantors were intended to be parties is not liable at law if the signature of one of the other guarantors is forged, since there is no contract of guarantee unless all the anticipated parties to the contract in fact became bound."

Proceeding against Surety without exhausting Remedies against Debtor

Where the liability is otherwise unconditional, the court cannot of its own introduce a condition into it. This was pointed out by the Supreme Court in *Bank of Bihar* v *Damodar Prasad*.[54]

The defendant guaranteed a bank's loan. A default having taken place, the defendant was sued. The trial court decreed that the bank shall enforce the guarantee in question only after having exhausted its remedies against the principal debtor. The Patna High Court confirmed the decree. But the Supreme Court overruled it.

Explaining that a condition of this kind would defeat the parties' intention, the court said:

"The very object of the guarantee is defeated if the creditor is asked to postpone his remedies against the surety. Is the creditor to ask for imprisonment of the principal? Is he bound to discover at his peril all the properties of the principal and sell them; if he cannot, does he lose his remedy against the surety? Has he to file an insolvency petition against the principal? The trial court gave no reason for this extraordinary direction. It said that the principal

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54. AIR 1969 SC 297: (1969) 1 SCR 620: (1969) 39 Comp Cas 133: 1969 All LJ 475. *See* also *Lakhi Ram Ram Dass* v *Har Prasad Syal*, (1972) 3 SCC 337: AIR 1971 SC 1956. In *Satwant Singh Kochhar* v *Punjab National Bank*, (1985) 27 Del LT 441, where it was held that there was nothing wrong in directing the sale of guarantor's share in the property first. In *Chalamani Narasa Reddy* v *Collector, Ongole, Prakasam Distt*, (1987) 2 Andh LT 969, where it was held that it was not legal for the mortgagee to proceed against guarantor straightaway. *Triputi Plywood Products P Ltd* v *Pradeshik Industrial Investment Corpn of U.P. Ltd*, AIR 1997 All 364, guarantor can be sued directly without seeking remedies against principal debtor. *Naba Kishor Sahoo* v *United Bank of India*, (1995) AIHC 2176 Ori, the guarantor cannot say that the decree should first be executed against the borrower and against him only for the balance. *P.C. Ravi* v *Union Bank of India*, (1995) AIHC 2168 Ker, failure to implead legal representatives of the principal debtor is not a ground for setting aside the suit against the surety. *Pawan Kumar Jain* v *P.I.C.U.P.*, (1998) AIHC 1360 All, initiation of recovery proceedings only against the guarantor held to be illegal. *Vasundhara Oil Industries P Ltd* v *Collector, Kanpur*, (1998) 33 All ER 29, recovery officers first proceeding against the pledged and mortgaged property of the guarantors, held, nothing illegal. *Govt of AP* v *State Bank of Hyderabad*, (1993) 2 Andh WR 65 DB, Government guarantor, could not say that other avenues of liability should be tried first. *Kantilal R. Shah* v *Central Bank of India*, (1995) 2 Guj LH 952, proceedings against surety alone, maintainable. *D.F.C. Financial Services* v *Coffey*, (1991) BCC 218 PC, guarantor of a debenture allowed to be proceeded against without making any demand on the company for payment. *P.N. Ravi* v *Kottayam, Co-op Urban Bank*, (1993) 1 Ker LJ 538, notice of default to the surety and proof of default are necessary. *Hiranyaprava Samantray* v *Orissa State Financial Corpn*, AIR 1995 Ori 1, guarantor is entitled to prior notice on principles of natural justice. Without such notice an action against the guarantor for shortfall cannot be instituted. Such notice should have been given before the auction sale of security. *Varghese* v *Dhanalakshmi Bank Ltd*, (1997) 1 Ker LT 843, the secretary of a society guaranteed a loan in his individual capacity, it was not necessary to join the society as a pro forma defendant.

was solvent. But the solvency of the principal is not a sufficient ground for restraining execution of the decree against the surety. It is the duty of the surety to pay the decretal amount. On such payment he will be subrogated to the rights of the creditors."[55]

And as so subrogated may exhaust his remedies against the creditor. "Before payment the surety has no right to dictate terms to the creditor and ask him to pursue his remedies against the principal in the first instance. The surety is a guarantor; and it is his business to see that the principal pays, and not that of the creditor."

The Allahabad High Court[56] has also taken the similar view although without reference to the Supreme Court ruling. The loans of a company were guaranteed. The guarantee stipulated that the liability of the surety would arise on demand. There was no condition that the financial corporation should first proceed to recover the amount from the hypothecated property. The corporation could straightaway proceed against the surety without first proceeding against the company. The order directing the corporation to first proceed against the company was held to be not proper.

In a subsequent case, the Supreme Court held that the creditor must proceed against the mortgaged property first and then only against the surety for the balance,[57] even if the decree is a composite one against the principal debtor, mortgaged property and the guarantor. In that case only a portion of the decree was covered by the mortgage and the court did not consider it relevant whether the two portions of the decree were severable or not. This decision has been overruled by the Supreme Court in *State Bank of India* v *Indexport Registered*.[58] In this case a composite decree was passed against the surety, the borrower and the mortgaged

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55. *Bank of Bihar* v *Damodar Prasad*, AIR 1969 SC 297 (299). *Followed* in *Sukur Pradhan* v *Orissa State Financial Corpn*, AIR 1992 Ori 281, exhausting remedies against the principal debtor, not a condition precedent and other decisions to the same effect, *Wright* v *Simpson*, 31 ER 1272; *Lachhman Joharimal* v *Bapu Khandu*, (1869) 6 Bom HCR 241; *Sreenath* v *Peary Mohan*, AIR 1917 Cal 154; *Swaminath* v *S.L. Lakshmana*, AIR 1935 Mad 748, suit against surety without first exhausting remedies against principal debtor; *Kuckreja Ltd* v *Said Alam*, AIR 1941 Lah 16; The court also *cited* the following passage from HALSBURY'S LAWS OF ENGLAND (para 819, Vol 22, 3rd edn): "819. Proceedings by assured against debtor. Except where the policy so provides, the creditor is not bound to sue the debtor or to enforce his security first, he is entitled, as soon as there is a default within the meaning of the policy, to claim payment from the insurers. The policy may, however, be limited to cover only the deficiency which remains after the creditor has exhausted his remedies against the debtor or his sureties." *Nagpur Nagrik Sahakari Bank Ltd* v *Union of India*, AIR 1981 AP 153. Also to the same effect, *Sunder Singh* v *Punjab National Bank*, AIR 1992 All 132, execution of decree against surety before proceeding against principal debtor and hypothecated property. *Kerala State Financial Corpn Ltd* v *C.J. Thampi*, AIR 2000 Ker 36, it was not proper for the court to direct that an order against the surety should not be passed because the defaulting chitty subscriber's husband was financially well off.

56. *Uttar Pradesh Financial Corpn* v *Garlon Polyfeb Industries*, AIR 2001 All 286.

57. *Union of India* v *Manku Narayana*, (1987) 2 SCC 335: AIR 1987 SC 1078. In contrast to this see *Kwong Yik Finance* v *Mutual Endeavour*, (1989) 1 Mal LJ 135 HC Kuala Lumpur where it was held that guarantors' liabilities are personal liabilities and are in no way affected by the charge created in favour of the creditor and, therefore, the guarantors cannot say that the creditors could only proceed against them if there was a shortfall in the proceeds of the sale realised by the foreclosure of the charged property; *Punjab National Bank* v *Surendra Prasad Sinha*, AIR 1992 SC 1815 where the Supreme Court permitted the securities deposited by the guarantor to be realised though the debt had become time-barred.

58. (1992) 3 SCC 159: AIR 1992 SC 1740.

property of the borrower. The High Court of Delhi[59] directed that the decree-holder should first proceed against the mortgaged property and levy execution against the surety only for the balance. YOGESHWAR DAYAL J said:[60]

> "In the present case the decree does not postpone the execution. The decree is simultaneous and it is jointly and severally (passed) against all the defendants including the guarantor. It is the right of the decree-holder to proceed with it in a way he likes."

The court cited the following passage from CHITTY ON CONTRACTS:[61]

> "Prima facie the surety may be proceeded against without demand against him, and without first proceeding against the principal debtor."

The court also cited the following passage from HALSBURY'S LAWS OF ENGLAND:[62]

> "It is not necessary for the creditor, before proceeding against the surety, to request the principal debtor to pay, or to sue him, although solvent, unless this is expressly stipulated for."[63]

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59. In its decision of 23-4-90, Civil Appeal No. 7434 of 1990.
60. *State Bank of India* v *Indexport Registered*, (1992) 3 SCC 159: AIR 1992 SC 1740 (1743). *Followed* by the Kerala High Court in *State Bank of India* v *G.J. Herman*, AIR 1998 Ker 161 where the court held that in the case of a composite decree, the court or the co-surety cannot insist that the creditor should proceed against other sureties before proceeding against him. It is the creditor's option to decide for himself against whom he should proceed first. The surety so selected for recovery would have the right to recover contribution from the co-sureties and indemnity from the principal debtor. *See* also *Vyasa Bank Ltd* v *Kalapurachal Industries*, (1995) 2 KLT 1: AIR 1996 Ker 117. The absence of decree against the principal borrower is no ground for setting aside the decree against the surety, *Balakrishnan* v *H. Chunnilal*, AIR 1998 Mad 175. *State Bank of India* v *MP Iron and Steel Works P Ltd*, AIR 1998 MP 93, action against directors guaranteeing the company's loan was held to be maintainable even when proceedings against the principal debtor company were pending. The bank was not bound to wait for the result of the action against the company. The application of the bank to attach the proceeds of the director's personal account in the bank were allowed. *Permata Merchant Bank* v *Glove Seal*, (1994) 1 Current LJ 389 (Malaysia), the bank was not bound to exhaust other remedies before embarking on the action based on the guarantee agreement. The lending bank was under no duty to the guarantors as to how it dealt with the other securities. The Supreme Court decision was also *followed* in *B. Yuvaraj Shetty* v *Maharashtra Apex Corpn Ltd*, 2000 AIHC 2181 (Kant), the decree-holder creditor was held to be entitled to proceed against any one of the judgment-debtors, namely the surety or the principal debtor. *State Bank of India* v. *Govind Devi Gupta*, AIR 2002 SC 61, the decree holder cannot be directed to proceed against the hypothecated property first.
61. 1031, para 4831, Vol 2 (24th edn).
62. 87, para 159 (4th edn).
63. The court cited *Hukum Chand Ins Co Ltd* v *Bank of Baroda*, AIR 1977 Kant 204 where it is emphasised that the two liabilities are distinct and separate though they may arise out of the same transaction; *Jagannath Ganeshram Agarwala* v *Shivnarayan Bhagirath*, AIR 1948 Bom 247 where it was emphasised that the liability being co-extensive does not mean that it is in the alternative. Both the principal debtor and the surety are liable at the same time to the creditor; *Mathuvelappa Goundan* v *Palaniapa Chettiar*, 1937 Mad WR 373. *Sunder Singh* v *Punjab National Bank*, AIR 1992 All 132, execution of decree against security before proceeding against the principal debtor and hypothecated property; *K.T. Sulochna* v *M.D., Orissa State Financial Corpn*, AIR 1992 Ori 157, on default by loanee, the corporation can take possession of the property of the guarantor which was mortgaged by him. A suit can be maintained against the surety without proceeding against the principal debtor. *Sankara* v *Virupakshapa*, (1883) 7 Bom 146; *Deepak Das Chaudhari* v *Secy of State*, AIR 1929 Lah 393; *Badri Batan* v *Vindhya Pradesh*, AIR 1952 VP 18; *Asharfibi* v *Prashadilal*, AIR 1959 MP 26. *See* also *State Bank of India* v *Madras Bolts and Nuts P Ltd*, (1998) 8 SCC 433: (1998) 93 Comp Cas 103, subsequent to the close of the guarantee period, the bank made further transactions with the borrower in respect of which it received back some money, the

The court conceded that the way in which a decree is drawn up is an important fact to be considered. "If the composite decree is a decree which is both a personal decree as well as a mortgage decree, without any limitation on its execution, the decree-holder, in principle, cannot be forced to first exhaust the remedy by way of execution of the mortgage decree alone and told that only if the amount recovered is insufficient, he can be permitted to take recourse to the execution of the personal decree.

Where, on the other hand, the sale proceeds of the hypothecated truck were already realised and adjusted against the decreed amount, it was held that the guarantor had no right to say that the decree-holder should have first tried to recover the balance of the decreed amount by enforcing the decree against the guarantor. The decree-holder may at his choice enforce the decree either against the principal debtor or surety.[64]

The Supreme Court[65] has also held that where the management of a company has been taken over under an Act[66], that does not discharge the guarantors of the company's loans. VENKATRAMIAH J said:[67]

> "Under Section 128 of the Indian Contract Act, 1872, save as provided in the contract, the liability of the surety is coextensive with that of the principal debtor. The surety thus became liable to pay the entire amount. Their liability was immediate and it was not deferred until the creditor exhausted his remedies against the principal debtor. The Act does not say that when a notification is issued under Section 7(1)(*b*) the remedies against the guarantors also stood suspended."

Action against Principal Debtor alone

The creditor can proceed against the principal debtor alone. His suit cannot be rejected on the ground that he has not joined the guarantor as a defendant to the suit.[68]

Suit against Surety alone

A suit against the surety without even impleading the principal debtor has been held to be maintainable. In this case, the creditor, in his affidavit, had shown sufficient reasons for not proceeding against the principal debtor.[69] A contract of guarantee was made enforceable by its terms against the guarantors severally and jointly with that of the principal debtor company. It was held that the creditor had

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surety was not allowed to claim the benefit of such payments. The surety could also not claim under S. 141 the benefit of any security to the extent to which it was delivered under the subsequent transactions.

64. *Nikunja Kishore Pradhan* v *S.B.I.*, (1990) 70 CLT 416 Ori.
65. *State Bank of India* v *Saksaria Sugar Mills Ltd*, (1986) 2 SCC 145: AIR 1986 SC 868: (1986) 59 Comp Cas 861: 1986 All LJ 621.
66. Sugar Undertaking (Taking over of Management) Act, 1978.
67. *State Bank of India* v *Saksaria Sugar Mills Ltd*, (1986) 2 SCC 145 (146).
68. *Union Bank of India* v *Noor Dairy Farms*, (1997) 3 Bom CR 126. *Ashok Mohansing Bajaj* v *Elegant Pharmaceuticals Ltd*, (2000) 2 Mh LJ 855, the liability of the acceptor of a bill of exchange is independent since he is the principal debtor himself. It is open to the creditor to sue him alone for recovery of the amount due on the bill.
69. *Pradip D. Kothari* v *Ceat Financial Services Ltd*, 2000 AIHC 4247 (Mad).

the option to sue the company along with guarantors as co-defendants or guarantors alone.[70]

Death of Principal Debtor

A suit was filed against the principal debtor and surety. The suit against the principal debtor was found to be void *ab initio* because of his death even before institution of the suit. The surety was held to be not discharged. The suit could proceed against him. It was in the interest of the surety to implead under Order 1, Rule 10, CPC, the legal representatives of the deceased principal debtor, because if the suit was decreed against him, the surety could enforce against the legal representatives his rights under Section 145.[71]

2. Surety's right to limit his liability or make it conditional

The above principle applies only where the surety undertakes to be liable for the whole debt. But it is open to him to place a limit upon his liability. He may expressly declare his guarantee to be limited to a fixed amount, for example, that "my liability under this guarantee shall not at any time exceed the sum of £250".[72] In such a case, whatever may be owing from the principal debtor, the liability of the surety cannot go beyond the sum so specified. Thus in a case before the Andhra Pradesh High Court,[73] a clause in a contract of suretyship making the surety liable up to Rs 15,000 further declared that he would be liable for any amount that might be finally decreed. It was held that the clause should be construed as meaning not exceeding Rs 15,000.

A surety can attach any other condition to his liability. Thus where the letter of guarantee made it a condition precedent to the guarantor's liability that on default on the part of the borrower a demand for payment should be made upon the guarantor, it was held that an independent demand was necessary and the mere service on the guarantor of the carbon copies of the demand meant for the borrower was not sufficient.[74]

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70. *Vijay Singh Padole* v *Sicom Ltd*, (2000) 4 Mh LJ 772.

71. *Syndicate Bank* v *A.P. Manjunath*, (1999) 2 Kar LJ 362. The court *followed* the decision in *Orissa Agro Industries Corpn Ltd* v *Sarbeswar Guru*, AIR 1985 Ori 270, where also the suit was allowed to proceed against the surety. Since the creditor has the option of suing either the principal debtor or the surety or any one of the sureties without impleading the principal debtor, it cannot be said that the dismissal of the suit under Order 1, CPC against the principal debtor would automatically discharge the surety. Another ruling to the same effect is *Lokam Ramchandra Rao* v *Bank of Baroda*, (1999) 2 All LD 250.

72. See *Hobson* v *Bass*, (1871) 6 Ch A 792; *Ellis* v *Emanuel*, (1876) 1 Ex D 157. The surety may insert any other condition to his liability, e.g. that he would be liable if the performance was defective in certain respects. See *Nanyang Ins Co* v *A Chin Kim Hin*, (1992) 1 Current LJ 454, HC Borneo, Malaysia, following, *Edward Owen Engg Ltd* v *Barclays Bank*, (1978) QB 159; *Malayan United Bank* v *Straits Central Agencies (Sarwak)*, (1990) 2 Mal LJ 254.

73. *Yarlagadda Bapanna* v *Devata China Yerkayya*, AIR 1966 AP 151. *Aditya Narayan Chouresia* v *Bank of India*, AIR 2000 Pat 222, the guarantors bound themselves to a particular maximum limit. Their liability was limited to that amount and not beyond that.

74. *Orang Kaya Mentri Paduka Wan* v *Kwong Yik Bank Berhad*, (1989) 3 Mal LJ 155 SC Kuala Lumpur. Following, *Mokffin With* v *U.M.B.C.*, (1987) 2 Mal LJ 610, *see* also *T.C.B. Ltd* v *Gray*, (1988) 1 All ER 108 CA, where the condition was that the lender should obtain from the borrower company a collateral security and he obtained a debenture, it was held that the condition was satisfied even if the debenture turned out to be invalid. The court applied *Traill* v *Gibbons*, (1861) 2 F&F 358; *Ward* v *National Bank of New Zealand Ltd*, (1883) 8 App Cas 755 and *Greer* v *Kettle*, (1937) 4 All ER 396. To the same effect, *Ganga Lahari* v

Guarantor's Insistence upon Collateral Security

Whether the obtaining of a collateral security by a lender is a term or condition precedent to liability being imposed on a guarantor under his guarantee depends on a proper analysis of the contractual relationship between the lender and the guarantor. Where a guarantor seeks to make his guarantee dependent on a third party giving some other valid collateral security he has to establish that the giving of the security by the third party formed part of the contract under which the guarantee was given and, accordingly, in the absence of that being established, the guarantor was not permitted to rely on any failure by the lender to provide himself with a valid collateral security even though he might have indicated that he was going to do so. In this case the guarantor, who was also the director and principal shareholder of the company, of his company's debts was not allowed to escape saying that the collateral security in the shape of a company's debenture obtained by the company was not a valid security, the court finding that no proof was available to show that there was any such condition that there should be a valid debenture.[75] The court surveyed authorities on the point.

The authorities appear to be clear that in the final event whether the obtaining of a collateral security by the lender is a term of or a condition precedent to liability on a guarantor under his guarantee is to be determined by a proper analysis of the contractual relationship between the lender and the guarantor. The starting point is *Traill* v *Gibbons*.[76] The direction to the jury of ERLE CJ was in these terms:

> "Then as to the equitable plea, it states an agreement with the defendant that Nixey should sign the deed as co-surety with him; that the society should procure him to execute it, and that if they should not do so the defendant should not be liable. Has such an agreement been proved? The *lender* is usually the party who requires an additional surety, and so it seems to have been here. Still it may be sometimes for the interest of a surety to say, 'unless you get co-sureties to join with me, I will not become surety'. And that is the defence set up here. Has it been proved? The evidence is very slight of any such agreement with the defendant. The defendant himself does not say that *he* required that Nixey should join, but merely that he knew that the society had required it. Did the defendant require it for his own benefit or security, or was there any agreement or understanding on his part, as a condition of his own execution, that Nixey should join? Does it appear that the defendant, before he signed, looked to Nixey at all ? On the contrary, he says he did not know until some time afterwards that Nixey had *not* signed." (ERLE CJ's emphasis.)

The same approach was taken in the opinion of the Privy Council expressed by Sir Robert Collier in *Ward* v *National Bank of New Zealand Ltd.*[77]

Har Narain, 1986 Raj LR 538, where the court said that if the decree was not fully satisfied by execution against the principal debtors (also judgment-debtors), then execution petition should be filed against the surety. The court referred to *Tankin* v *Y. Sichi S.I.*, AIR 1925 Rang 135 where on the basis of Section 145, CPC it was held that a notice required to be given to a surety under this section is a condition precedent to the validity of the order for execution against him.

75. *T.C.B. Ltd* v *Gray*, (1988) 1 All ER 108 CA.
76. (1861) 2 F&F 358: 175 ER 1095.
77. (1883) 8 App Cas 755, 765.

'But where it is no part of the contract of the surety that other persons shall join in it, in other words, where he contracts only severally, the creditor does not break that contract by releasing another several surety, the surety cannot, therefore, claim to be released on the ground of breach of contract. It is true that he is entitled to contribution against other several sureties to the same extent as if they had been joint, but the right of contribution among such sureties depends not upon contract but on principles established by Courts of Equity.'

In *Greer* v *Kettle*,[78] the agreement under which the guarantee was given related to a debt 'effectively secured by (*inter alia*) 275,000 fully paid shares in the I. company' and this fact was specifically referred to in the recital to the guarantee agreement.

'The agreement of guarantee must be referred to in greater detail. In it, Mercantile Marine is called 'the corporation', while the words 'the guarantors' mean Parent Trust. It contains one recital only, which runs thus: 'Whereas the corporation have at the request of the guarantors advanced to the Austin Friar Trust, Ltd the sum of £2,50,000 on the security of a charge dated March 20, 1929, on the shares particulars of which are set out in the schedule hereto.'. . . In these circumstances, it would seem that the legal rights and liabilities of these parties depend upon the true construction and effect of the agreement of guarantee. Indeed, this view was not disputed by either side.... Once it is realised that the debt which Parent Trust are undertaking to guarantee is a debt described as a debt the repayment of which by the principal debtor is secured by a charge on (amongst other shares) the 275,000 shares in Iron Industries Ltd, the case (apart from the question of estoppel) becomes, in my opinion, a simple one. It is not a case, as BENNETT J seems to have treated it, of seeking to imply a condition the implication of which is alleged to be inconsistent with other provisions in the document. In other words, as ROMER L.J. said, it is not a case of Parent Trust being released from a contractual engagement. It is a case of an attempt to impose upon them a liability which they have never undertaken. The only debt the repayment of which by the principal debtor they undertook to guarantee was a debt secured by a charge on the 2,75,000 shares in Iron Industries, and a debt so secured never in fact existed.'

These authorities were considered again in *Byblos Bank S.A.L.* v *Al-Khudhairy*:[79]

Bank's failure to Obtain other Securities

'Counsel for the defendant submitted that where an underlying transaction envisages additional security for the principal indebtedness, a guarantor is released if the additional security is not taken, at least where it is shown that it was the intention of the guarantor that such additional security should be taken. In this case the additional security envisaged but not taken was Al Bunnia's personal guarantee, the deposit by Ron Holdings and (validly executed) charges on Rushingdale's property. In the course of the hearing before this court we were referred to many authorities in support of rival submissions on the formulation of the applicable legal principles, counsel's initial submission for the defendant as set out above being plainly too wide. It is too wide because it would include a case where a lender stipulated for additional security for its

78. (1937) 4 All ER 396; (1938) AC 156.
79. (1987) BCLC 232, 239 *per* NICHOLLS LJ.

own protection and nothing was said or done to cause the lender acting reasonably to know or suspect that the intention of the guarantor was that the giving of such security was a fundamental prerequisite to the validity of his guarantee. [There is] no principle, at law or in equity, why in such a case the giving of the additional security should be treated as an essential prerequisite to the validity of the guarantee, and none of the authorities to which we were referred establishes or supports the existence of such a principle. [U]ltimately counsel for the defendant accepted that to succeed on this appeal on this point he had to show that he had an arguable case on the facts under one or other of the three heads: (*a*) that on the true scope and ambit of the contract made between the bank and Al-Khudhairy it was an implied term (counsel accepted that it was not an express term) of the contract that Al-Khudhairy's liability on his guarantee was conditional on one or more of the three items of additional security being taken by the bank, (*b*) that it was the continuing common intention of both the bank and Al-Khudhairy that Al-Khudhairy's liability should be conditional in this way; or (*c*) estoppel. It is clearly impossible to spell out of the documentary evidence that it was a precondition of Al-Khudhairy's liability under his guarantee that the bank should obtain a guarantee from Al Bunnia.'

Impossibility of main contract

A loan for development and maintenance of bee culture was guaranteed. The surety undertook to be liable jointly and severally to pay off instalments in case of failure on the part of the debtor. The bees died in consequence of a viral infection. There was a total failure of business. The debtor became disabled from paying instalments. The surety could not escape liability under the doctrine of impossibility of performance.[80]

The guarantors of a company's loans could not escape liability by reason only of the fact that the company's management had totally changed.[81]

Liability under Continuing Guarantee

129. "Continuing guarantee".—A guarantee which extends to a series of transactions, is called a "continuing guarantee".

Illustrations

(*a*) *A*, in consideration that *B* will employ *C* in collecting the rent of *B*'s zamindari, promises *B* to be responsible, to the amount of 5000 rupees, for the due collection and payment by *C* of those rents. This is a continuing guarantee.

(*b*) *A* guarantees payment to *B*, a tea-dealer, to the amount of £100, for any tea he may from time to time supply to *C*. *B* supplies *C* with tea to the above value of £100, and *C* pays *B* for it. Afterwards *B* supplies *C* with tea to the value of £200. *C* fails to pay. The guarantee given by *A* was a continuing guarantee, and he is accordingly liable to *B* to the extent of £100.

(*c*) *A* guarantees payment to *B* of the price of five sacks of flour to be delivered by *B* to *C* and to be paid for in a month. *B* delivers five sacks to *C*. *C* pays for them. Afterwards *B* delivers four sacks to *C*, which *C* does not pay for. The

80. *Florence Mabel R.J.* v *State of Kerala*, AIR 2001 Ker 19.

81. *Punjab National Bank* v *Lakshmi Industrial & Trading Co P Ltd*, AIR 2001 All 28.

guarantee given by *A* was not a continuing guarantee, and accordingly he is not liable for the four sacks.

A guarantee of this kind is intended to cover a number of transactions over a period of time. The surety undertakes to be answerable to the creditor for his dealings with the debtor for a certain time. A guarantee for a single specific transaction comes to an end as soon as the liability under that transaction ends. Take, for instance, the old case of *Kay* v *Groves*,[82] on which the third illustration given in the section is based. The guarantee was in these terms:

> "I hereby agree to be answerable to *K* for the amount of five sacks of flour to be delivered to *T*, payable in one month." Five sacks were actually supplied and *T* paid for them. Further supplies were made during the same month, for which *T* failed to pay.

The surety was then sued. The court held that it was not a continuing guarantee and, therefore, there was no liability for parcels delivered for various subsequent periods.

Following is an illustration of a continuing guarantee:[83]

> I do hereby guarantee the payment of goods to be delivered in umbrellas and parasols to *J* in the sum of £200.

Another instance of a continuing guarantee is:

> Messrs Sea & Co., Sirs, the bearer, Mr Thomas Horan, wishes to deal with you for produce, and he asked me to speak for him. I can highly recommend him, and in fact, I will stand good for him to the amount of £ 50.[84]

The essence of a continuing guarantee is that it applies not to a specific number of transactions, but to any number of them and makes the surety liable for the unpaid balance at the end of the guarantee.[85] In Chorley & Tucker the distinction is thus explained:[86]

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82. (1829) 80 ER 1274.
83. *Hargreave* v *Smee*, (1829) 6 Bing 244: 8 LJCP 46: 31 RR 407.
84. *See* v *Farey*, (1889) 13 LR NSW 72.
85. The liability of the guarantor to pay remains alive as long as the principal debtor does not clear the account. *Union Bank of India* v *T.J. Stephens*, AIR 1990 Ker 180. *Following* the Supreme Court decision in *Margaret Lalita* v *Indo-Commercial Bank Ltd.* (1979) 2 SCC 396: AIR 1979 SC 102, the Court held that the period of limitation commences from the time when the payment is demanded and refused or otherwise denied by the surety. An example of continuing guarantee was in *Estate of the Debtors* v *A. Ramalingam*, (1995) 2 Mad LJ 264, executants bound themselves, their legal heirs, etc, by a guarantee which was to continue until terminated by notice by registered post, undertaking to pay the balance amount at the moment of demand, held a continuing guarantee. Executants became liable for demands made before termination by notice by registered post. Surety becomes liable from the date of demand on him and time starts running from that moment. In *Bradford Old Bank Ltd* v *Sutecliffe*, (1918) 2 KB 833 it was pointed out that the contract of the surety is collateral and, therefore, a demand on him is necessary to complete the cause of action and set the statute running. In *Union Bank of India* v *Stephen*, AIR 1990 Ker 180, a Bench of the High Court held that in the case of a continuing guarantee so long as the debt is alive, the guarantors will be liable to pay. *Relying* on *Popular Bank Ltd* v *Union Coir Factories*, ILR (1961) 1 Ker 493. The decision of the Supreme Court in *Lilavati* v *Bank of Baroda*, ILR 1987 Karn 964 at p 969 is authority for the proposition that in the case of a continuing guarantee, the question of limitation does not crop up at all. *Punjab National Bank* v *Surinder Singh Mandyal*, AIR 1996 HP 1, guarantee for loan for purchase of bus, debtor became irregular with his repayments, guarantor proposed to pay back if the bank would transfer the bus to him, no response from bank, guarantor not discharged by that reason

"A specific guarantee provides for securing of a specific advance or for advances up to a fixed sum, and ceases to be effective on the repayment thereof, while a continuing guarantee covers a fluctuating account such as an ordinary current account at a bank, and secures the balance owing at any time within the limits of the guarantee...."[87]

A guarantee for a cash-credit account has been held to be a continuing guarantee. The sureties could not claim to be discharged from their liability by reason of the fact that the goods in the hypothecated store were changed.[88]

A guarantee for the conduct of a servant appointed to collect rents has been held by the Calcutta High Court to be a continuing guarantee.[89] But a guarantee for the conduct of a tenant in paying rent due under the tenancy, whether it be a repeated payment or a single lump sum, has been held to be a guarantee for one transaction and not of continuing nature.[90] The employment of a person is one transaction and the guarantee for his good conduct is not a continuing guarantee.[91]

Liability under Bank Guarantee

A bank guarantee is a sort of an absolute undertaking to pay the amount whenever demanded by the guarantee-holder. It has nothing to do with the state of relations between the guarantee-holder and the person on whose behalf the guarantee was given. While ordinary guarantees are linked to and dependent on the underlying transaction, a bank guarantee is an arrangement where the guarantee is independent of the underlying transaction. There are professional guarantors for whom the issue of guarantees or bonds is a financial service, namely, banks, insurance companies or bond companies who issue guarantees at a certain fee.[92] In a case on the subject before the Supreme Court:[93]

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alone. *N.R. Vegad & Co* v *Union of India*, AIR 1995 Bom 337, interim relief in respect of a bank guarantee is not to be refused only because the bank is not a party to the proceeding.

86. LEADING CASES ON MERCANTILE LAW, (4th edn by Lord Chorley & Giles, 1962), p 332.

87. The learned writers draw this conclusion from a consideration of the following cases: *Allnutt* v *Ashendun*, (1843) 5 M&G 392; *Wood* v *Priestner*, (1867) LR 2 Exch 282. Guarantee for payment of instalments of hire under a hire-purchase is a continuing guarantee and, therefore, there could be a novation and the fact that the taxi-car which was the subject-matter of the hire-purchase was allowed to remain with the hirer even after novation of the guarantee did not amount to variation or impairment of the security. *Khandu Bhai Mistri* v *Bank of Baroda*, (1988) 2 Raj LR 903.

88. *State Bank of India* v *Gemini Industries*, (2001) 3 Guj CD 1885 (Guj).

89. *Durga Priya Chowdhary* v *Durga Pada Roy*, AIR 1928 Cal 204. Liability under a continuing guarantee can be enforced only after ascertaining the final amount due. See *Punjab National Bank* v *Vikram Cotton Mills*, (1970) 1 SCC 60: AIR 1970 SC 1973 and *United Commercial Bank Ltd* v *Okara Grain Buyers Syndicate*, (1968) 3 SCR 396: AIR 1968 SC 1115, bank held liable in respect of its branches in Pakistan for amounts not forfeited by that Government.

90. *Hasan Ali* v *Waliullah*, AIR 1930 All 730.

91. *Sen* v *Bank of Bengal*, (1920) 47 IA 164. A guarantee for a sum certain though payable in instalments is not continuing guarantee. *Bhagwandas* v *Secy of State*, AIR 1926 Bom 465.

92. *State Trading Corpn of India Ltd* v *Golodetz Ltd*, (1989) 2 Lloyd's Rep 277, large transactions involve both documentary credit (bank guarantee and letters of credit) and guarantees. *Kisan Sahkari Chini Mills Ltd* v *A.T.V.*, (1998) AIHC 1713 All, an order prohibiting invocation of bank guarantee held not justified. *K.L. Steels Ltd* v *M.S.E.B.*, (1998) 2 Bom CR 31, independent nature of the transaction emphasised and no stay granted

A bank undertook to pay to the SEB a sum not exceeding Rs 50,000 within 48 hours of demand. The guarantee was submitted on behalf of a supplier who had deposited with the bank sufficient securities. There was no condition to the bank's liability except demand by the Board. The Board demanded payment. The supplier was a company which went into liquidation. The liquidator sought to prevent the Board from realising the guarantee and the bank from paying it.

No such relief was allowed. The Board had the right to enforce payment of the guarantee and the bank had the right to reimburse itself out of the securities. If the liquidator thought that the Board's conduct in realising the guarantee was not proper, he should proceed against the Board.[94] Stating the reasons for the same the

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because there was no plea of irretrievable loss or fraud by the beneficiary. Also to the same effect, *Dwarikesh Sugar Industries Ltd* v *Prem Heavy Engg Works P Ltd*, AIR 1997 SC 2477. *Orissa Construction Corpn Ltd* v *B. Engineers & Builders P Ltd*, (1996) 81 Cal LT 126, the sub-contractor executed 42% of the total work, the total bank guarantee of 50 lakhs could not be encashed. The court permitted encashment only up to Rs 35.40 lakh. *State of Bihar* v *Hindustan Construction Co Ltd*, (1998) 3 Bom CR 495: AIR 1998 Bom 331, enforcement not stayed in spite of serious dispute. *S.A. Sattar* v *Kuruvilla*, AIR 1998 Ker 292, invocation of bank guarantee after complying with requirements, held, invocation proper and enforceable, the court followed *U.P. Sugar Corpn* v *Sumac International Ltd*: (1997) 1 SCC 568: AIR 1997 SC 1644; *National Thermal Power Corpn Ltd* v *Flowmore P Ltd*, (1995) 4 SCC 515: (1995) AIR SCW 4360; *I.T.C. Ltd* v *Debt Recovery Appellate Tribunal*, (1997) 10 JT (SC) 334. The bank is not a party to the underlying contract, *State of Maharashtra* v *National Construction Co Ltd, Bombay*, AIR 1996 SC 2367: (1996) 1 JT (SC) 156. *Regional Science Centre* v *Varghese K. Putuyath*, (1994) 2 Ker LJ 682: (1994) 2 Ker LT 921, encashment of bank guarantee not stayed, though the letter demanding encashment was not in the prescribed language, but in substance it was within the terms of the guarantee. *Ultra Dyetech Engineers P Ltd* v *Niraj Petro Chemicals Ltd*, (1993) Mh LJ 805, encashment not stayed because no proof of fraud or irretrievable injustice. *Dodsal Ltd* v *Krishak Bharati Co-op Ltd*, AIR 1997 Bom 3, fraud not made out, encashment not stayed. *Krishna Electrical Industries P Ltd* v *State Bank of India*, AIR 1996 MP 188, amount recoverable quantified, requisite notice, opportunity to show cause not required, encashment not stayed. *Food Corpn of India* v *Arosan Enterprises Ltd*, AIR 1996 Del 176, bank guarantee encashment by buyer not stayed on the allegation that the seller had delivered the goods. *Union Bank of India* v *J.B. Khanna & Co*, AIR 1996 Bom 409, enforcement irrespective of the state of relations. The court *dissented* from *Nangia Construction (India) P Ltd* v *National Buildings Corpn Ltd*, (1990) 2 Comp LJ 265 because the facts were distinguishable. *Unique Alliance Industries* v *Anupama Agencies*, AIR 1995 Ker 52, encashment of bank guarantee not restrained.

93. *Maharashtra State Electricity Board* v *Official Liquidator, Ernakulam*, (1982) 3 SCC 358: AIR 1982 SC 1497. The money is payable on demand and not on breach. *Dena Bank* v *Fertiliser Corpn of India*, AIR 1990 Pat 221. Suspension of the contract between the Department and the contractor on account of the latter's defaults did not have the effect of suspending the enforcement of the bank guarantee given by another person for the contractor's due performance. *SCIL (India) Ltd* v *Indian Bank*, AIR 1992 Bom 131. *National Building Construction Ltd* v *State Bank of Patiala*, AIR 1993 Del 89, enforcement not stayed. *Sri Palmar Development and Construction* v *Transmetric*, (1994) 1 Current LJ 224 (Malaysia), a performance bond between a contractor company and its sub-contractor, stay not granted, the court taking the bond as it found it.

94. To the same effect, *Banwari Lal Radhey Mohan* v *P.S. Co-op Ltd*, AIR 1982 Del 257 where the court said that a bank guarantee being absolute, the pendency of arbitration proceedings cannot stand in the way of payment: *Pesticides India* v *State Chemicals and Pharmaceuticals Corpn of India Ltd*, AIR 1982 Del 78, bank guarantee enforceable regardless of dispute between parties. *H. Mohamed Khan* v *Andhra Bank Ltd*, AIR 1983 Kant 73, assignment of a letter of guarantee. *Har Prasad & Co* v *Sudarshan Steel Rolling Mills*, AIR 1983 Del 128, enforcement of guarantee should not be stayed; *Road Machines (India) P Ltd* v *P&E Corpn of India*, AIR 1983 Cal 91; *Bird & Co* v *Tribunal Jute Mills*, (1979) 83 Cal WN 802; *Texmaco Ltd* v *State Bank of India*, (1979) 83 Cal WN 807;

Delhi High Court said that if scrutiny is commenced in respect of the underlying contract, obviously the autonomy and independence of an absolute guarantee would be lost. Its enforcement would depend upon the result of an inquiry. This would defeat the very purpose of a bank guarantee.[95]

In *Hindustan Steel Works Corpn Ltd* v *Tarapore & Co*[96] the Supreme Court laid down the law in terms of the following propositions:

> "(A) A bank guarantee is an independent and distinct contract between the bank and the beneficiary and is not qualified by the underlying transaction and the primary contract between the person at whose instance the bank guarantee is given and the beneficiary.
>
> (B) In the case of an unconditional bank guarantee the nature of the obligation of the bank is absolute and not dependent upon any dispute or proceeding between the party at whose instance the bank guarantee is given and the beneficiary.
>
> (C) . . . . . .
>
> (D) The commitment by banks must be honoured free from interference by the court and it is only in exceptional cases, that is to say, in case of fraud, or in a case where irretrievable injustice would be done if bank guarantee is allowed to be encashed, that the court would interfere."

Some litigation in connection with bank or demand guarantees is generated by the fact that there can be abusive or unfair callings, which is to a large extent due to the independent nature of both documentary credits and unconditional on demand guarantees. The beneficiary's right to payment is absolute or almost absolute. Apart from the court stay order, one method which has been suggested and which has been put to actual use is the requirement that the beneficiary has to state in his letter invoking bank guarantee that there has been some kind of breach of the underlying transaction and what is the type of breach which is involved.[97] The person claiming

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Harprashad & Co v *Sudarshan Steel Mills*, AIR 1980 Del 174, *overruled* by subsequent decisions including the decision of the Supreme Court in *United Commrl. Bank* v *Bank of India*, (1981) 2 SCC 766: AIR 1981 SC 1426; *Shreeram Cloth Stores* v *Trading Corpn of Bangladesh*, (1980) 1 Cal HC Notes 132. The courts do not interfere with the operation of letters of credit due to their importance in international trade and also because the beneficiary is assured by the bank that he would be paid as soon as he complies with the terms of the letter of credit. This is irrespective of his non-compliance with the terms of his contract with the other party. Letters of credit become autonomous documents. *State Bank of India* v *Economic Trading Co*, AIR 1975 Cal 145. *Kunjannamma* v *Kerala Fisheries Corpn*, 1986 Ker LT 37.

95. *Banwari Lal* v *Punjab State Co-op Ltd*, AIR 1983 Del 86, 89; *Nangia Construction (India) Ltd* v *International Airports Authority of India*, AIR 1992 Del 243, enforcement not stayed.

96. AIR 1996 SC 2268: (1996) 5 Scale 186, *cited* in *Lloyds Steel Industries Ltd* v *Indian Oil Corpn Ltd*, AIR 1999 Delhi at p 255.

97. *See* Lars Gordon, *Draft UNCITRAL Convention on Independent Guarantees*, (1997) JBL 240 at 244. Writ cannot be issued in the matter of enforcement of bank guarantee unless some public law element is involved, *A.C. Roy & Co* v *Union of India*, AIR 1995 Cal 246. *See*, for example, *National Telecom of India Ltd* v *Union of India*, AIR 2001 Delhi 236, the Government was required to show at least one of two conditions for invoking guarantee, i.e., either that the amount had become due because of loss caused by breach or that the amount was being forfeited by reason of the contractor's failure to perform his commitment. The letter invoking the guarantee stated that purchase orders had not been complied with despite extension of time. Another letter alleged breach. The court said that all this showed that the circumstances for invoking the guarantee were made out. The court further said that even if the beneficiary was made the sole judge of the circumstances, the bank was obliged to pay because the bank could not sit in judgment.

under the guarantee must establish that conditions for invoking the guarantee do exist. In this case the Government made a counter-offer to the highest bidder and entered into negotiations which did not materialise into a contract. Hence, the guarantee could not be invoked.[1] A contract was held to have been formed where the parties, though not accepting all the printed terms, agreed to some of them. A contract thus came into existence outside the form. Stay of encashment of bank guarantee could not be ordered on the ground that no contract was formed.[2] Where the bank guarantee is conditional, the beneficiary cannot have unfettered right to invoke the guarantee and the court can issue an injunction against invocation on the facts of the case.[3]

The Supreme Court has again emphasised in *U.P. Co-operative Federation Ltd* v *Singh Consultants and Engineers Ltd*[4] that the operation of a bank guarantee should be stayed only in cases of serious dispute, fraud or special equities.

> Two bank guarantees were furnished by a contractor for the proper construction and successful commissioning of a vanaspati plant. The bank was not to revoke the guarantees up to a fixed date and was to make unconditional payment on demand. The Board was to be the sole judge of the fact whether the contractor had fulfilled the terms of the contract. Disputes arose between the contractor and the Board as to the erection and performance of the plant.

The contractor sought an injunction to restrain the Board from enforcing the guarantee. The court found no serious ground for doing so. The court felt that respectability and reliability of the assured mode of payment through confirmed letters of credit in international trade and bank guarantees in national trade is necessary for the growth and promotion of trade. SHETTY J[5] cited Lord DIPLOCK:[6]

> "The whole commercial purpose for which the system of confirmed irrevocable documentary credits has been developed in international trade is to give to the seller an assured right to be paid before he parts with control of the

1. *Basic Tele Services Ltd* v *Union of India*, AIR 2000 Delhi 1.
2. *International (India)* v *Indian Sugar & General Industries Export Import Corpn*, AIR 2001 Guj 227. Another case in which the contract was to be concluded and, therefore, no stay was allowed is *Adani Export Ltd* v *Hindustan Organic Chemical*, (2000) 3 Guj LR 2759.
3. *Hindustan Construction Co Ltd* v *State of Bihar*, (1999) 8 SCC 436: AIR 1999 SC 3710. But here there was a concluded contract and the guarantee was also absolute. *Crest Communications Ltd* v *State Bank of India*, (2000) 3 Mh LJ 163, the contract was performed and accepted to the extent of 100% satisfaction and full payment made, an attempt to encash the bank guarantee was stayed.
4. (1988) 1 SCC 174. Refusal to take the material because of allegations as to quality is not a fraud in itself so as to prevent invocation of bank guarantee, *EMCO Pressmaster P Ltd* v *Union of India*, AIR 2000 Delhi 37. Conditions stated in the contract but not in the bank guarantee could not be used for staying encashment. *Association of Corpn and Apex Societies of Handlooms* v *State of Bihar*, AIR 2000 Delhi 106. Breach of contract is not by itself enough to bring about stay of encashment, the bank cannot sit in judgment for deciding the question of breach, *Federal Bank Ltd* v *V M Jog Engg Ltd*, AIR 2000 SC 3166; *Larsen & Tubro Ltd* v *Maharashtra State Electricity Board*, (1995) 6 SCC 68: AIR 1996 SC 334, where fraud or irretrievable injustice was not pleaded and the only plea was that there was no concluded contract. *Hindustan Copper Ltd* v *Rana Builders Ltd*, AIR 1999 Cal 229, the applicable principles are not those in respect of stay of tenders but those in respect of injunctions in reference to bank guarantees.
5. *U P Co-operative Federation Ltd* v *Singh Consultants & Engineers Ltd*, (1988) 1 SCC 174 (194).
6. *U.C.M. (Investments)* v *Royal Bank of Canada*, (1982) 2 All ER 720 HL.

goods and that does not permit of any dispute with the buyer as to the performance of the contract of sale being used as a ground for non-payment or reduction or deferment of payment."

His Lordship cited American authorities[7] to the effect that the fraudulent use of guarantee papers by the seller is the only case in which court should stay misuse of a credit system.

"The exception for fraud on the part of the beneficiary seeking to avail himself of the credit is a clear application of the maxim *ex turpi causa non oritur actio*, or, if plain English is to be preferred, 'fraud unravels all'."[8]

The court alleviated the feelings of contractors and buyers who provide guarantees which go beyond their reach by saying that no irretrievable injustice is likely to be done because the party withdrawing the amount would remain accountable and, if he cannot justify himself, he would have to offer restitution or compensation.[9]

"The wholly exceptional case where an injunction may be granted is where it is proved that the bank knows that any demand for payment already made or which may hereafter be made will clearly be fraudulent. But the evidence must be clear both as to the fact of fraud and as to the bank's knowledge. It would certainly not normally be sufficient that this rests on the uncorroborated statement of the customer. A bank acting on such a statement may cause irreparable damage to its credit."[10]

In reference to the meaning of irretrievable injury, the Supreme Court said that it must be of the kind which was the subject-matter of the decision in *Itek Corpn* v *First National Bank of Boston*[11]: "To avail of the exception, therefore, exceptional circumstances which make it impossible for the guarantor to reimburse himself if he ultimately succeeds will have to be decisively

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7. *Sztojn* v *J. Henry Schroder Banking Corpn*, 31 NYS 2d 631, *referred* to with approval by the English Court of Appeal in *Edward Owen Engineering Ltd* v *Barclays Bank International Ltd*, (1978) 1 All ER 976 CA; *Bolivinter* v *Chase Manhattan Bank*, (1984) 1 All ER 351.

8. The Supreme Court *surveyed* the whole range of authorities: *Hamzeh Melas & Sons* v *British Imex Industries Ltd*, (1958) 2 QBD 127, payment under letters of credit not stayed on the allegation that the first instalment contained defective goods; *Elian and Rabbath* v *Matsas and Matsas*, (1966) 2 Lloyd's List Law Rep 495, where payment was stayed because the shipowners resorted to a new lien without any justification; *R.D. Harbottle* v *Nation Westminster Bank*, (1977) 2 All ER 862, performance bond; *Edward Owen Engg Ltd* v *Barclays Bank International Ltd*, (1978) 1 All ER 976, a case of unconditional guarantee.

The court noted that in India also trend of law is on the same lines: *Tarapore & Co* v *U/o Tractors Export*, (1969) 1 SCC 233 : (1969) 2 SCR 920 : AIR 1970 SC 891, irrevocable letter of credit had a definite implication; *Centax (India) Ltd* v *Vinmar Impex Inc*, (1986) 4 SCC 136 : AIR 1986 SC 1924. The court *overruled* the decision of the Allahabad High Court in *Union of India* v *Mena Steels Ltd*, AIR 1985 All 282.

9. *See* the judgment of MUKHARJI J at p 186. (1988) 1 SCC 174. A bank cannot justifiably pay under a guarantee, where it has expired or the business in respect of which it was given has been suspended, and, therefore, payment can be stayed. See *J.R. Enterprises* v *S.T.C.*, AIR 1987 Del 188. Similarly, the payment under a bank guarantee submitted along with a bid can be stayed if the bid is withdrawn before acceptance. *Kirloskar Pneumatic Co Ltd* v *National Thermal Power Corpn*, AIR 1987 Bom 308.

10. SIR JOHN DONALDSON MR in *Bolivinter Oil SA* v *Chase Manhattan Bank*, (1984) 1 All ER 351 *cited* by the Supreme Court in (1988) 1 SCC 174.

11. 566 Federal Supp 1210.

established. Clearly, a mere apprehension that the other party will not be able to pay is not enough."[12]

In *General Electric Technical Services Co Inc* v *Punj Sons P Ltd*,[13] while dealing with a case of bank guarantee given for securing mobilisation advance, it was held that the right of a contractor to recover certain amounts under running bills would have no relevance to the liability of the bank under the guarantee given by it.[14]

A bank guarantee was unequivocal and unconditional. The bank agreed to pay without any demur and on demand the court did not accept the agreement that the beneficiary must show that he had suffered loss by reason of non-fulfilment of the contract. If such contentions were to be accepted the very purpose of such guarantees would be defeated. The court would have to record a finding and give a verdict in each case.[15]

The High Court of Delhi followed this decision so as to hold that the enforcement of the bank guarantee would not be stayed but that the authority would be told that they should enforce the guarantee only for the balance amount minus the amount already recovered from the contractor's running account payments.[16]

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12. Observations to the same effect are to be seen, among others, in *Hindustan Steel Works Construction Ltd* v *G.S. Atwal & Co Engrs P Ltd*, AIR 1996 SC 131: (1995) 7 JT (SC) 2; *Larsen & Toubro Ltd* v *Maharashtra State Electricity Board*, (1995) 6 SCC 68: AIR 1996 SC 334.
13. (1991) 4 SCC 230.
14. Another ruling to the same effect is *Coronation Construction P Ltd* v *Indian Oil Corpn Ltd*, AIR 1999 Delhi 268, no pleading that there was fraud in the main contract, the only allegation was that the other party was trying to encash the guarantee for an amount which it had already recovered; that was sufficient for establishing the exception of fraud or irretrievable injustice. Some of the cases which the court *noted* on the point are *Svenska Handlesbanken* v *Indian Charge Chrome*, (1994) 1 SCC 502: AIR 1994 SC 626; *Ansal Engineering Projects Ltd* v *Tehri Hydro Development Corpn Ltd*, (1996) 5 SCC 450; *I.T.C. Ltd* v *Debt Recovery Appellate Tribunal*, AIR 1998 SC 634: JT 1997 (10) SC 334; *Saw Pipes Ltd* v *Gas Authority of India Ltd*, AIR 1999 Delhi 308, a bald assertion of fraud without anything more and the allegation that the owner was trying to encash the guarantee for an amount which it had already recovered, held not sufficient to stay encashment; *J.T. Mobiles Ltd* v *Deutsche Bank Ltd*, AIR 1999 Delhi 358, an injunction was vacated on the Attorney General giving undertaking that in the event of the party's suit being decreed, the Union of India will pay the amount. *ALN Narayanan Chettiyar* v *Official Assignee*, AIR 1941 PC 93, observations to the effect that "fraud like any other charge of criminal proceedings must be established beyond reasonable doubt". A finding as to fraud cannot be based on suspicion and conjecture. *Cited* in *DLF Cement Ltd* v *Inspector of Police*, AIR 1999 AP 359 : (1999) 2 Andh LD 45, stay of encashment was held to be not proper where neither of the grounds was made out. The court, on directing the parties for reference to arbitration in terms of their agreement, stayed the encashment of the guarantee, this was held to be illegal. It is not the function of the courts to examine the merits of the dispute at that stage.
15. *Amrok Logistics Trading P Ltd* v *Digvijay Cement Co Ltd*, AIR 2001 Guj 299, there was no proof of fraud or irretrievable injustice. The court *followed* its own earlier decision in *Gujarat Sidhee Cement Ltd* v *Caldyn Apparetaby*, GmbH (1997) 3 Guj LR 2357 where also the guarantee was absolute and payable without demur. Also to the same effect, *Vijay Singh Amarsingh & Co* v *Hindustan Zinc Ltd*, (1992) 1 Guj LR 639, the beneficiary must be allowed to have the advantage of the guarantee and the court should not ordinarily grant an injunction against encashment.
16. *Madan Gopal* v *Union of India*, AIR 1992 Del 253.

In *Escorts Ltd* v *Modern Insulators Ltd*[17] the High Court of Delhi refused to stay the payment because the alleged ground only showed an inconsistency in the two letters about the installation and working of machines and not a fraud or the possibility of an irretrievable injustice. The Supreme Court dealt with this matter at great length in *U.P. Co-operative Federation Ltd* v *Singh Consultants and Engineers Pvt Ltd*[18] The court reiterated that the bank must pay except in case of fraud or irretrievable injustice. There should be minimum interference in trade. Commitments of banks must be honoured free from interference by the courts. Otherwise, trust in commerce, internal and international, would be irreparably damaged.

The Supreme Court approved the observations of Lord DIPLOCK in *U.C.M. (Investments) Ltd* v *Royal Bank of Canada*[19] where it was observed that "to this general statement of principle as to the commercial obligation of the confirming bank to the seller, there is one established exception, that is, where the seller, for the purpose of drawing on the credit, fraudulently presents to the confirming bank documents that contain, expressly or by implication, material representation of facts that to his knowledge are untrue.... The courts will not allow their process to be used by a dishonest person to carry out a fraud". An example of a fraud of this kind was before the Bombay High Court in *Dai-ichi Karkaria P Ltd* v *Oil and Natural Gas Commission*.[20] The court emphatically asserted that the law cannot allow the benefit of a bank guarantee to be claimed by unscrupulous methods. Here the party in question was compelled at the pain of stopping business with him to drop from his bank guarantee the original requirement that it would be encashable only when the parallel amount of import duty paid by him was refunded to him. As soon as ONGC attempted to enforce the altered guarantee, he applied for and was granted a stay against such encashment. He was the victim of undue influence bordering on fraud and the special equities thus generated created the necessity of rescuing the party from being victimised.

Where the terms of a bank guarantee required that the letter of invocation must mention the amount of loss caused, it was held that a letter of invocation which only stated that the contractor had failed to perform his contract was not a sufficient compliance with the requirements of invocation. Hence, encashment was stayed.[21]

In a case before the Calcutta High Court:[22]

> The contract was for dredging and deepening a reservoir. Advance payment was made to the contractor for purchase of essential machinery on bank guarantee. SAIL sought encashment on account of the contractor's

17. AIR 1988 Del 345.
18. (1988) 1 SCC 174. *See* also *Fenner India Ltd* v *Punjab and Sindh Bank*, AIR 1997 SC 3450, encashment of bank guarantee on failure of payment up to a certain limit, not stayed.
19. (1982) 2 All ER 720.
20. AIR 1992 Bom 309.
21. *Ansal Properties and Industries P Ltd* v *Engineering Projects (India) Ltd*, AIR 1998 Delhi 176. A suit for invoking encashment was dismissed as withdrawn, a second suit for the same purpose was not allowed because there could not be fresh cause of action though the second suit was moulded into a different shape of seeking remittance of the amount mentioned in the guarantee, *Modi Korea Telecommunications Ltd* v *IndusInd Bank*, AIR 2001 Delhi 254.
22. *D.T.H. Construction P Ltd* v *S.A.I.L.*, AIR 1986 Cal 31. *See* also *Basant Rlymers* v *State Chemicals and Pharmaceutical Corpn*, AIR 1986 Raj 1. bank guarantee must be treated as encashable like cash with normally no interference.

default. The contractor tried to prevent it on the ground that the work assigned to him was impossible and that important facts were suppressed from him. These grounds were held to be not sufficient to prevent encashment.

Where the provision in the contract was that the guarantee would be enforceable on the failure of the purchaser to take delivery and that the supplier's decision as to this would be final, the court did not interfere in the decision of the supplier to enforce the guarantee.[23] Even where the matter under dispute was referred to arbitration, the court did not stay the enforcement of the bank guarantee.[24] A bank guarantee was invoked where the contractor failed to make contribution towards certain welfare funds. The terms of the guarantee made the owner as the sole judge of the fact whether the contractor committed breach. The court did not oblige the contractor with an injunction restraining invocation of the guarantee.[25]

Variation in terms of contract

The High Court of Delhi has expressed the view that a clause in a bank guarantee to the affect that the parties may vary the terms of the contract without affecting the liability of the bank would be valid. All that is necessary is that the guarantor's ultimate remedy against the principal debtor should remain unimpaired.[26]

Letters of credit and bank guarantees

SEN J of the Supreme Court has observed in *Centax (India) Ltd* v *Vinmar Impex Inc.*[27] that: "Commitments of banks must be allowed to be honoured free from interference from the courts. Otherwise, trust in international commerce would be irreparably damaged."[28] The court did not grant an injunction to stay the enforcement of letters of guarantee on the grounds that the goods were of inferior quality and the sellers had not sent the original shipping documents. The court cited the following statement of JENKINS LJ in *Hamzeh Malas* v *British Imex Industries Ltd*:[29]

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23. *Allied Resins of India Ltd* v *M.&M. Trading Corpn of India Ltd*, AIR 1986 Cal 346.
24. *Jute Corpn of India Ltd* v *Konark Jute Ltd*, AIR 1986 Ori 238. The enforcement of bank guarantee cannot be stayed by means of a writ petition. *Modi Vanijya* v *Metal Scrap Trading Corpn Ltd*, (1991) 1 Cal LT 156.
25. *Geo Tech Construction Co P Ltd* v *Hindustan Steel Works Construction Ltd*, AIR 1999 Ker 72.
26. *Lloyd's Steel Industries Ltd* v *Indian Oil Corpn Ltd*, AIR 1999 Delhi 248, citing *Babu Rao Ramchandra Rao* v *Babu Manaklal Nehrmal*, AIR 1938 Nag 413.
27. (1986) 4 SCC 136 : AIR 1986 SC 1924.
28. At p 1986 *citing* DENNING MR in *Elan* v *Maipas*, (1966) Li LR 595. *Akai Impex Ltd* v *General Steel Export*, (1998) 2 Bom CR 199, letters of credit are like bank guarantees. They are a dealing in documents. The banks are not concerned with the quality or quantities of the goods. Those things have to be sorted out between the parties. Their encashment can be stopped only in cases of fraud or irretrievable loss.
29. (1958) 2 QB 127, 129. The House of Lords in *United City Merchants (Investments) Ltd* v *Royal Bank of Canada*, (1982) 2 All ER 720 held that the principles enunciated in the cases dealing with confirmed irrevocable letters of credit were equally applicable to cases of bank guarantees in internal trade within country; *United Coconut Oil Mills* v *Indian Overseas Bank*, (1991) 3 Current L J 2345, HC Singapore. *Sri Hanuman Steel Rolling Mills* v *C.E.S.C. Ltd*, AIR 1996 Cal 449 : supply of electricity is not a contract of bailment, so that the consumer is not a bailee of the meter installed. *Swiss Bank Corpn* v *Jai Hind Oil Mills Co*, (1994) 1 Bom CR 37 : there is no privity of relationship between the vendor and the confirming bank.

> "...the opening of a confirmed letter of credit constitutes a bargain between the banker and the vendor of the goods which imposes on the banker an absolute obligation to pay . . . and that this was not a case in which the court ought to exercise its discretion and grant the injunction."

The court emphasised that a bank guarantee attracts the same consideration as a letter of credit and added: "A letter of credit sometimes resembles and is analogous to a contract of guarantee.[30] A bank guarantee is very much like a letter of credit. The courts will do their utmost to enforce it according to its terms. They will not, in the ordinary course of things, interfere by way of injunction to prevent its implementation." The court also cited an observation of KERR J in *R.D. Harbottle (Mercantile) Ltd* v *National Westminster Bank Ltd*:[31]

> "It is only in exceptional cases that the court will interfere with the machinery of irrevocable obligations assumed by banks. They are the life-blood of international commerce."

The type of rare case in which a court may intervene was before the Calcutta High Court in *Banerjee & Banerjee* v *H.S.W. Construction Ltd*[32] Here the party claiming under the guarantee failed to point out the precise amount of his claim although he had the means to quantify it, his intention being to suppress vital information, the court held that his conduct being fraudulent, enforcement of the guarantee ought to be stayed.

Another example would be where the encashment of the guarantee would be contrary to law. For example, where a contractor gave a bank guarantee along with his bid as was required by the tender notice, the bidder, having the right to do so, withdrew his bid before its acceptance, the Department was restrained from encashing the guarantee. There was no contract yet about which it could be said that there was a breach.[33]

Where the sub-letting of a Government contract was allowed only in respect of three items and the principal contractor in fraud of his sub-lettee handed over the entire work to him and obtained from him a bank guarantee for due performance, the enforcement of the guarantee was stayed by reason of the fraud, for otherwise the sub-lettee would have suffered an irreparable loss.[34]

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30. *Citing* DENNING MR in *supra* note 28. *A.V.N. Tubes Ltd* v *Steel Authority of India Ltd*, AIR 1996 MP 53, stay possible only when there is fraud or documents are defective.
31. (1977) 3 WLR 752.
32. AIR 1986 Cal 374.
33. *Kirloskar Pneumatic Co Ltd* v *National Thermal Power Corpn*, AIR 1987 Bom 308. Another case of stay because of special equities is *Arul Marugan Traders* v *Rashtriya Chemicals and Fertilisers Ltd, Bombay*, AIR 1986 Mad 161. Still another is *Sztein* v *J. Henry Schorder Bkg Corpn*, (1941) 3 HYS 2d 631 where the enforcement was stayed because the shipment was not that of real but of worthless waste material.
34. *Sagina Constructions (India) P Ltd* v *National Building Construction Corpn Ltd*, AIR 1990 (NOC) Delhi. Short of fraud, the court would not grant an injunction on grounds like breach of contract or repudiation. *National Thermal Power Corpn Ltd* v *Hind Galvanising & Engg Co Ltd*, AIR 1990 Cal 421; writ jurisdiction is not a proper remedy for demanding stay, *Rayalseema Paper Mills Ltd* v *A P State Trading Corpn*, AIR 1990 (NOC) 124 AP; *National Projects Construction Corpn* v *Sadhu & Co*, AIR 1990 P&H 300.

Bank Guarantee and Arbitration Clause

The enforcement of a bank guarantee cannot be made the subject-matter of arbitration proceeding.[35] But where a bank found that there was a pending arbitration under which the liability of all the parties had to be ascertained, the Karnataka High Court upheld the decision of the bank to withhold payment.[36] In another Karnataka case[37] it was held that the right of the beneficiary of the guarantee to recover the guaranteed amount could not be stayed pending arbitration and the bank could not be restrained from honouring its obligation. But the amount encashed is subject to adjustment under the final award to be passed by the arbitrator.

Period of Limitation

The period of limitation for enforcing a guarantee is three years from the date on which the letter of guarantee was executed.[38]

Joint-debtors and Suretyship [S. 132]

132. Liability of two persons, primarily liable, not affected by arrangement between them that one shall be surety in other's default.—Where two persons contract with a third person to undertake a certain liability, and also contract with each other that one of them shall be liable only on the default of the other, the third person not being a party to such contract, the liability of each of such two persons to the third person under the first contract is not affected by the existence of the second contract, although such third person may have been aware of its existence.

Illustration

A and *B* make a joint and several promissory note to *C*. *A* makes it, in fact, as surety for *B*, and *C*, knows this at the time when the note is made. The fact that *A*, to the knowledge of *C*, made the note as surety for *B*, is no answer to a suit by *C* against *A* upon the note.

The section is based upon the principle that the liability of persons who are primarily liable as joint-debtors is not affected by any arrangement between them as to the order of their liability. A creditor is not affected by any private arrangement entered into as between his two debtors that one will be the surety of the other even

35. *National Project Constn Corpn* v *G. Ranjan*, AIR 1985 Cal 23; *U.C.O.* v *Hanuman Synthetics*, AIR 1985 Cal 86; *Scrap Mould Will* v *Metal Scrap Trade Corpn*, (1989) 2 Cal LT 350, where the court cited *United City Merchants (Investments) Ltd* v *Royal Bank of Canada*, (1982) 2 All ER 720; *United Commercial Bank* v *Hanuman Synthetics Ltd*, AIR 1985 Cal 96; *Synthetic Foams Ltd* v *Simplex Concrete Pipes (India) P Ltd*, AIR 1988 Del 207; *Hindustan Paper Corpn* v *Keneilhouse Angami*, (1990) 1 Cal LT 200. The court *referred* to *Union of India* v *Raman Iron Foundry*, AIR 1974 SC 1265; *Centax (India) Ltd* v *Vinmar Impex Inc*, (1986) 4 SCC 136 : AIR 1986 SC 1924.

36. *Kudremukh Iron Ore Co* v *Karola Rubber Co Ltd*, AIR 1987 Kant 139.

37. *HVS Technologies Inc, USA* v *Aeronautical Development Agency*, (2001) 4 Kar LJ 211.

38. *New Bank of India* v *Sajitha Textiles*, AIR 1997 Ker 201, the guarantee deed was not allowed to b enforced against the guarantor under a suit filed after expiry of the period. Aticle 55 of the Limitation Act, 1963 is applicable. The court followed *United Commercial Bank* v *B.M. Mahadeva Babu*, AIR 1992 Kant 294.

if the creditor knows of this arrangement. The creditor may not be a consenting party to the arrangement.[39]

The principle of the section is that whatever be the arrangement between joint-debtors as to their liability to the creditor they remain joint debtors. The creditor is not concerned with their mutual agreement that one would be a principal and the other a surety. Where, however, the creditor knows of any such arrangement, he must refrain from doing anything which would have the effect of discharging the surety under Sections 133, 134 or 135.[40]

DISCHARGE OF SURETY FROM LIABILITY

A surety is said to be discharged from liability when his liability comes to an end. The Act recognises the following modes of discharge:

1. By Revocation [S.130]

Ordinarily a guarantee is not revocable when once it is acted upon. But Section 130 provides for revocation of continuing guarantees.

130. Revocation of continuing guarantee.—A continuing guarantee may at any time be revoked by the surety, as to future transactions, by notice to the creditor.

Illustrations

(a) *A*, in consideration of *B's* discounting, at *A's* request, bills of exchange for *C*, guarantee to *B*, for twelve months, the due payment of all such bills to the extent of 5000 rupees. *B* discounts bills for *C* to the extent of 2000 rupees. Afterwards, at the end of three months, *A* revokes the guarantee. This revocation discharges *A* from all liability to *B* for any subsequent discount. But *A* is liable to *B* for the 2000 rupees, on default of *C*.

(b) *A* guarantees to *B*, to the extent of 10,000 rupees, that *C* shall pay all the bills that *B* shall draw upon him. *B* draws upon *C*. *C* accepts the bill. *A* gives notice of revocation. *C* dishonours the bill at maturity. *A* is liable upon his guarantee.

Revocation becomes effective for the future transactions while the surety remains liable for transactions already entered into.[41] *Offord* v *Davies*[42] is a suitable illustration:

> The defendants guaranteed the repayment of bills to be discounted by the plaintiffs for *Davies & Co* for twelve months not exceeding £600. The defendants revoked the guarantee before any bill was discounted. But the plaintiffs discounted the bills which remained unpaid.

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39. *Duncan Fox & Co* v *N.&S.W. Bank*, 6 App Cas 1.

40. *Ockeley* v *Pasheller*, (1836) 4 Cl & F 207 : 42 RR 1 and *Overend, Gurney & Co* v *Oriental Financial Corpn*, 1874 LR 7 HL 348; *Rouse* v *Bradford Bkg Co*, 1894 AC 586. In two Indian cases the same view has been taken. *Punchanun Ghose* v. *Dally*, (1875) 15 BLR 331; *Harjiban Das* v *Bhagwan Das*, (1871) 7 BLR 535; *followed* in *Moolji Murarji* v *M.C. Pinto*, AIR 1926 Sind 156; *Biharilal* v *Allahabad Bank*, AIR 1929 All 664 and *Pogose* v *Bank of Bengal*, ILR 3 Cal 174.

41. *Indian Overseas Bank* v *Goh Teng Hoon*, (1989) 1 Current LJ 554 HC Singapore. The court *referred* to *Egbert* v *National Crown Bank*, (1918) AC 908.

42. (1862) 6 LT 579, 133 RR 491: 142 ER 1336. A guarantee for money to be advanced from time to time is a continuing guarantee. *Laurie* v *Scholefield*, LR 4 CP 622.

The question was whether the surety had a right to revoke. The court said: "We are of opinion that they had and consequently they were not liable. In the case of a simple guarantee for a proposed loan, the right of revocation before the proposal has been acted on did not appear to be disputed." In the case of a continuing guarantee, every credit given is a separate transaction which makes the surety irrevocably liable, but he may free himself from further liability.[43]

The employment of a servant is one transaction. A guarantee for his good behaviour is not a continuing one and is not revocable as long as he continues in the job.[44] At any rate the employer is entitled to such notice as will enable him to determine the employment without liability. Nor is such a guarantee determined by the surety's death unless there is an agreement to the contrary.[45]

Whether a guarantee for the payment of rent can be revoked depends upon the facts of each case and the language employed by the parties to express their intention.[46] In a guarantee of this kind where the surety died, the court held that neither he could have revoked the guarantee during his lifetime nor was his estate released from liability.[47] JOYCE J said:

> "The right to determine or withdraw a guarantee by notice forthwith cannot possibly exist when the consideration for it is indivisible, so to speak, and moves from person to whom the guarantee is given once for all, as in the case of the consideration being the giving or conferring an office or employment upon any person whose integrity is guaranteed."

As against it when a person guaranteed the payment of rent by his servant and revoked the guarantee as soon as the servant left his employment, he was held not liable for rents which became due after the revocation.[48]

Where the directors of a company guaranteed the payment of the company's overdrafts and subsequently resigned their office and the bank was informed, it was held that the liability of the directors would be confined to the amount due up to the date of their resignation.[49]

'Notice to the creditor' means a clear and specific notice intended to terminate liability under the guarantee. A denial of liability in a previous suit was held to be not serving as a notice.[50]

2. By Death of Surety [S. 131]

A continuing guarantee is also determined by the death of the surety unless there is a contract to the contrary. Once again, the termination becomes effective

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43. *Anil Kumar* v *Central Bank of India*, AIR 1997 HP 5, a co-surety gave notice to the bank and cancelled his guarantee, held, no liability for anything after such notice; the liability of the other co-sureties not affected.
44. *Lloyds* v *Harper*, (1880) 16 Ch D 290.
45. *Crace, Re, Balfour* v *Crace*, (1902) 1 Ch 733.
46. *Coles* v *Pack*, (1869) LR 5 CP 65, 70.
47. *Balfour* v *Crace*, (1902) 1 Ch 733.
48. *Windfield* v *De St Croin*, (1919) 35 TLR 432.
49. *Hargopal Agarwal* v *State Bank of India*, AIR 1956 Mad 211. A yearly renewable guarantee for the conduct of a treasurer, held, continuing, *Lala Bansidhar* v *Govt of Bengal*, (1872) 9 Beng LR 364 : 14 MIA 86.
50. *Bhikabhai* v *Bai Bhuri*, ILR 27 Bom 418. A request for release also does not have the effect of a notice of revocation, *Perwatra Habib Bank* v *Sehatian Development*, (1994) 1 Current 394 (Malaysia).

only for the future transactions.[51] The surety's heirs can be sued for liability already incurred. The section clearly points this out.

131. Revocation of continuing guarantee by surety's death.— The death of the surety operates, in the absence of any contract to the contrary, as a revocation of a continuing guarantee, so far as regards future transactions.

3. By Variance [S. 133]

Courts of law and equity have always taken zealous care of a surety's interest. "A surety is considered a favoured debtor and his liability is in *strictissimi juris*."[52] Initially a contract of guarantee may not be one of utmost good faith, but once formed the duty of utmost good faith is imposed upon the creditor. The result of this concern of the courts for the surety's interest is that a surety is held discharged when, without his consent, the creditor makes any change in the nature or terms of his contract with the principal debtor.[53] "The surety is discharged as soon as the original contract is altered without his consent."[54] Section 133 of the Indian Contract Act incorporates this principle.

133. Discharge of surety by variance in terms of contract.— Any variance, made without the surety's consent, in the terms of the contract between the principal [55][debtor] and the creditor, discharges the surety as to transactions subsequent to the variance.

Illustrations

(a) *A* becomes surety to *C* for *B's* conduct as a manager in *C's* bank. Afterwards, *B* and *C* contract, without *A's* consent, that *B's* salary shall be raised, and that he shall become liable for one-fourth of the losses on overdrafts. *B* allows a customer to overdraw, and the bank loses a sum of money. *A* is discharged from his suretyship by the variance made without his consent, and is not liable to make good this loss.

(b) *A* guarantees *C* against the misconduct of *B* in an office to which *B* is appointed by *C*, and of which the duties are defined by an Act of the

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51. Termination becomes effective on the creditor receiving the notice. *Coulthart* v *Clementson*, (1879) 5 QBD 42. But under the section there is automatic termination on death. A term of the guarantee that the legal heirs may terminate by notice after death would be a provision to the contrary. *Durga Priya Chowdhury* v *Durga Pd Roy*, (1928) 55 Cal 154.

52. *See* judgment of KAY LJ in *Rouse* v *Bradford Banking Corpn.* (1894) 2 Ch 32, 74, *followed* by the Supreme Court in *State of Maharashtra* v *M.N. Kaul*, AIR 1967 SC 1634 : (1968) 38 Comp Cas 1, where a guarantee was not allowed to be enforced after the expiry of its term. Noted: I.C. Saxena, *Mercantile Law*, 143, ANNUAL SURVEY OF INDIAN LAW, 1967-68: a guarantor cannot be made liable beyond the terms of his engagement.

53. A variance with consent either given in advance or at the time of variance would maintain the liability of the surety intact. Thus he can agree that he would not claim the benefit of Ss. 133, 134, 135, 139 and 141 and that agreement would be valid. *T. Raju Setty* v *Bank of Baroda*, AIR 1992 Kant 108: (1991) 4 Kar LJ 475. The court did not agree with the contrary view as expressed in *Union of India* v *Pearl Hosiery Mills*, AIR 1961 Punj 281 to the effect that S. 133 cannot be excluded by an agreement to the contrary. The court *agreed with* the view expressed in *Citibank N.A., New Delhi* v *J.K. Jute Mills Co Ltd*, AIR 1982 Del 487 and *R. Lilavati* v *Bank of Baroda*, AIR 1987 Kant 2.

54. *Pratapsingh Moholalbhai* v *Keshavlal Harilal Setalwad*, AIR 1935 PC 21.

55. This word was *inserted* by S. 2 and Sch. 1 of the Repealing and Amending Act, 1917 (XXIV of 1917).

Legislature. By a subsequent Act, the nature of the office is materially altered. Afterwards, *B* misconducts himself. *A* is discharged by the change from future liability under his guarantee, though the misconduct of *B* is in respect of a duty not affected by the latter Act.

(c) *C* agrees to appoint *B* as his clerk to sell goods at a yearly salary, upon *A's* becoming surety to *C* for *B's* duly accounting for moneys received by him as such clerk. Afterwards, without *A's* knowledge or consent, *C* and *B* agree that *B* should be paid by a commission on the goods sold by him and not by a fixed salary. *A* is not liable for subsequent misconduct of *B*.

(d) *A* gives to *C* a continuing guarantee to the extent of 3000 rupees for any oil supplied by *C* to *B* on credit. Afterwards *B* becomes embarrassed, and, without the knowledge of *A*, *B* and *C* contract that *C* shall continue to supply *B* with oil for ready money, and that the payment shall be applied to the then existing debts between *B* and *C*. *A* is not liable on his guarantee for any goods supplied after this new arrangement.

(e) *C* contracts to lend *B* 5000 rupees on the first March. *A* guarantees repayment, *C* pays the 5000 rupees to *B* on the first January. *A* is discharged from his liability, as the contract has been varied, inasmuch as *C* might sue *B* for the money before the first of March.

Bonar v *Macdonald*[56] is one of the early illustrations.

The defendant guaranteed the conduct of a manager of a bank. The bank afterwards raised his salary on the condition that he would be liable for one-fourth of the losses on discounts allowed by him. No communication of this new arrangement was made to the surety. The manager allowed a customer to overdraw his account and the bank lost a sum of money.

It was held that the surety could not be called on to make good the loss as the fresh agreement was a substitution of a new agreement for the former which discharged the surety.

Similarly, where the payment of rent was guaranteed, and the rent was increased without the consent of the surety;[57] where the creditor on default of payment took a promissory note from the principal debtor without reference to the surety;[58] where the position of a partner in a firm was guaranteed and the business of the firm was extended without knowledge of the surety, the sureties were held to be discharged.[59]

One of the questions that concerns the courts is that where a variation is not substantial or material, or is beneficial to the surety, will he be discharged? A problem of this kind was before the Supreme Court in *M.S. Anirudhan* v *Thomco's Bank Ltd.*[60]

The defendant guaranteed the repayment of a loan of Rs 20,000 given by the plaintiff bank to the principal debtor. The guarantee paper showed the loan to be Rs 25,000. The bank refused to accept. The principal then reduced the amount to Rs 20,000 and without intimation to the surety gave it to the bank

56. (1850) 3 HLC 226 : 88 RR 60 : 10 ER 87; *Brahmayya & Co* v *K. Srinivasan*, AIR 1959 Mad 122.
57. *Khatun Bibi* v *Abdullah*, (1880) 3 All 9.
58. *Creet* v *Seth & Seth*, 1887 All WN 136.
59. *Jowand Singh* v *Tirath Ram*, AIR 1939 Lah 193.
60. (1963) 1 SCR 63 : AIR 1963 SC 746 : (1963) 33 Comp Cas 185.

which was then accepted. The principal debtor failed to pay and the bank sued the surety. The question was whether the alteration had discharged him.

It was held by a majority that the surety was not discharged. KAPUR J and HIDAYATULLAH J (afterwards CJ) were of this view, but SARKAR J dissented. HIDAYATULLAH J (afterwards CJ) considered the authorities.[61]

Lord WESTBURY LC in *Blest* v *Brown*[62] stated the liability in the following terms:

"It must always be recollected in what manner the surety is bound. You bind him to the letter of his engagement. Beyond the proper interpretation of that engagement you have no hold upon him. He receives no benefit and no consideration. He is bound, therefore, merely according to the proper meanings and effect of the written engagement that he has entered into. If that written engagement is altered in a single line, no matter whether the alteration be innocently made, he has a right to say: 'The contract is no longer for that for which I engaged to be surety; you have put an end to the contract that I guaranteed, and my obligation, therefore, is at an end.' "

The statement of the law in *Blest* v *Brown*[63] was considered by the Court of Appeal in *Holme* v *Brunskill*.[64] COTTON LJ stated the law in these words:

"The true rule in my opinion is that if there is any agreement between the principals with reference to the contract guaranteed, the surety ought to be consulted, and that if he has not consented to the alteration, although in cases where it is without inquiry evident that the alteration is unsubstantial, or that it cannot be otherwise than beneficial to the surety, the surety may not be discharged; yet that if it is not self-evident that the alteration is unsubstantial or one which cannot be prejudicial to the surety, the court will not in an action against the surety, go into inquiry as to the effect of the alteration."

"There is a noticeable difference between the strict rule stated by Lord WESTBURY and that stated by COTTON LJ and the law now accepts that unsubstantial alterations which are to the benefit of the surety do not discharge the surety from the liability. Of course, if the alteration is to the disadvantage of the surety, or its unsubstantial character is not self-evident the surety can claim to be discharged. The court will not then inquire whether it in fact harmed the surety. That dictum of COTTON LJ was quoted with approval by the Judicial Committee in *Ward* v *National Bank of New Zealand Ltd.*"[65]

An attempted variation which does not become effective leaves the surety bound by his guarantee.[66]

Another effect is that an alteration not only discharges the surety from his personal liability but also releases the property, if any, which the surety had

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61. *M. S. Anirudhan* v *Thomco's Bank Ltd*, (1963) 1 SCR 63, 78-79.
62. (1862) 4 De GF & J 365 : 45 ER 1225.
63. (1862) 4 De GF & J 365 : 45 ER 1225.
64. (1877) 3 QBD 495.
65. (1883) 8 App Cas 755.
66. *Egbert* v *National Croten Bank*, (1918) AC 903. The acceptance of claims by a liquidator in the winding up of a company does not have the effect of discharging the surety. *P.N.B.* v *Mehra Bros*, AIR 1983 Cal 335. The amount of arrears due was mentioned in a guarantee. Subsequently the amount was found to be less than that mentioned. Held, did not amount to variation. *N. Sulichna* v *State of AP*, AIR 1984 AP 173.

included in the contract.[67] This was the situation in *Bolton* v *Salmon*.[68] The defendant was a surety for a loan and also brought in some of her own property as security. The principal debtor, without her knowledge, borrowed from the creditor further still and executed a new deed consolidating all the loans. The defendant was held to have been discharged and her property released from the bond.

Where a guarantee was given for the loan account of the principal debtor with a bank and the bank opened a second account in the name of the principal debtor into which considerable payments were received, the surety was held to have been discharged.[69] The terms of guarantee provided interest at 9 per cent and that the surety's consent would not be necessary for any grant by the creditor to the principal debtor "of time or any other indulgence or consideration". The creditor extended the time of payment by one year and increased the interest to 16 per cent. This discharged the surety. The court said that the substantial increase of interest could not be covered by the words "any indulgence or consideration".[70] The liability under a guarantee ceased to exit where the guarantee was substituted by another guarantee bond covering the whole amount and signed by other guarantors.[71]

Advance Authorisation of Alteration

The Madhya Pradesh High Court has been of the view that an authority given by the surety in advance enabling the creditor and the principal debtor to make any alteration in the terms and conditions of the transaction guaranteed would be contrary to the provision of Section 133 and, therefore, of no effect. The consent of the surety of which the section talks must be consent taken at the time of variance so as to be simultaneous with the proposed variance. The court also said that the provisions of Sections 134, 135, 139 and 141 cannot be nullified in advance.[72]

Consent may be either prior or subsequent to the alteration.[73] All that the above decision means to say is that there should be either a proposed alteration for prior consent or an alteration already effected for subsequent consent. There should not be consent to variation in vacuum. The High Court of Delhi has expressed the view that a term in a bank guarantee providing that variations in the underlying contract may be made without affecting the liability of the bank would be valid.[74]

Effect of Decree against Surety

In a case before the High Court of Delhi,[75] the creditor obtained a decree both against the principal debtor and the surety making them collectively and severally liable to pay the amount to the decree-holder. He then entered into a settlement with

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67. *Bolton* v *Salmon*, (1891) 2 Ch 48. *See* also *Manohar Lal* v *Harkishan Lal*, AIR 1968 Del 108; *Kahn Singh* v *Tek Chand*, AIR 1968 J&K 93, compromise of decreed debt, surety discharged.
68. (1891) 2 Ch 48.
69. *National Bank of Nigeria Ltd* v *Awolesi*, (1964) 1 WLR 1311.
70. (1981) 1 WLR 805, PC, on appeal from Wales.
71. *Punjab National Bank* v *Yarlapadda*, (1998) AIHC 3052 AP.
72. *Central Bank of India* v *Ali Mohd*, (1993) Mh LJ 1092.
73. *Lloyds Steel Industries Ltd* v *Indian Oil Corpn Ltd*, AIR 1999 Delhi 248.
74. *Ibid.*; *Indian Bank* v *S. Krishnaswamy*, AIR 1990 Mad 115, comparing the effect of varaition under S. 62 with that under S. 133 the court cited *British Motor Trust Co Ltd* v *Hyams*, (1934) 50 TLR 230, normally speaking any alteration in the contract between the creditor and the debtor is sufficient to release the surety but that effect can be excluded.
75. *Charan Singh* v *Security Finance P Ltd*, AIR 1988 Del 130.

the principal debtor agreeing to accept from him a less amount and not to enforce the decree against him for the balance. The surety claimed a discharge on this basis. The court did not agree with him. Once the liability is converted into a decreed-debt, the earlier constraints of the underlying contract cease to be applicable. The subsequent dealing with the principal debtor does not operate to discharge the surety from a liability under which he is no longer liable as a surety, but under the decree.[76]

Earlier the Madras High Court[77] had observed in a case of this kind:

> "We are not, after a joint decree has been passed against principal and surety, any longer dealing with a principal and surety but with a joint debtor."

In still another Madras case,[78] a loan due to a co-operative society was guaranteed by a surety and an award was obtained by the society against the principal debtor as well as the surety. The principal debtor obtained a discharge from the debt. The decree-holder sought to enforce the decree against the surety, who contended that he was no more liable under the award as the liability of the principal debtor stood extinguished. But the court found no merit in this contention and said:

> "After a decree has been passed the characters of the principal debtor and that of the surety change into those of co-judgment-debtors. The provisions of Sections 133-139 of the Contract Act apply only where no decree has been passed. These provisions which govern the rights and liabilities of the creditor, the principal debtor and surety, cease to operate after the rights and liabilities are determined and declared by a decree. The liability as determined by the decree cannot thereafter be modified by anything which the decree-holder may do or omit to do."[79]

An alteration which does not disturb the basic structure of liability created by a guarantee would not render the guarantee unenforceable. Two directors of a company guaranteed the company's obligation under a leasing transaction for photocopying equipment. Later someone dropped the word "company" from the borrowing company's name and initialled the alteration in the names of the

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76. *Quoting* from *Jenkins* v *Roberton*, (1854) 2 Drew 351; *Union Bank of India* v *Manku Narayana*, (1987) 2 SCC 335. The decision in this case was *overruled* by the Supreme Court in *State Bank of India* v *Indexport Registered*, (1992) 3 SCC 159 : AIR 1992 SC 1740 by holding that the decree-holder obtaining a composite decree can proceed at his choice to execute the decree either against security or person. *See* also under S. 128. This was *followed* in *Sharad R. Khanna* v *Industrial Credit and Investment Corpn of India (ICICI)*, (1993) 1 Bom CR 546, decree against mortgage property and against surety. Enforcement of decree against surety personally not to be prevented. The decree-holder not compellable to proceed against mortgage property first, *State Bank of India* v *Balak Raj Abrol*, AIR 1989 HP 41.

77. *Meenakshi Sundaram Chettiar* v *Velambal Ammal*, AIR 1944 Mad 423. Compare with *Kahn Singh* v *Tek Chand*, AIR 1968 J&K 93, compromise of a decreed debt operated as a discharge of the surety.

78. *Nellore Co-operative Urban Bank Ltd* v. *Akili Mallikarjunayya*, AIR 1948 Mad 252.

79. *Relying* upon *A Debtor, Re*, (1913) 3 KB 11. *Followed* by Kerala High Court in *Velappa Kumar* v *Kosammattom Chit Fund*, 1978 Ker LT 10 and *dissenting* from *Sardar Kahn Singh* v *Tek Chand Nanda*, AIR 1968 J&K 93. Enforcement against the surety of the composite decree does not have the effect of discharging the surety. The decree can be executed against him for the amount, if any, remaining unpaid. *Chittur Service Co-op Bank Ltd* v *Pankunny*, (1988) 1 Ker LT 358.

directors. It was held that though the alteration was a forgery, the guarantee remained enforceable.[80]

4. Release or Discharge of Principal Debtor [S. 134]

134. Discharge of surety by release or discharge of principal debtor.—The surety is discharged by any contract between the creditor and the principal debtor, by which the principal debtor is released, or by any act or omission of the creditor, the legal consequence of which is the discharge of the principal debtor.

Illustrations

(a) *A* gives a guarantee to *C* for goods to be supplied by *C* to *B*. *C* supplies goods to *B*, and afterwards *B* becomes embarrassed and contracts with his creditors (including *C's* to assign to them his property in consideration of their releasing him from their demands). Here *B* is released from his debt by the contract with *C*, and *A* is discharged from his suretyship.

(b) *A* contracts with *B* to grow a crop of indigo on *A's* land and to deliver it to *B* at a fixed rate, and *C* guarantees *A's* performance of this contract. *B* diverts a stream of water which is necessary for irrigation of *A's* land and thereby prevents him from raising the indigo. *C* is no longer liable on his guarantee.

(c) *A* contracts with *B* for a fixed price to build a house for *B* within a stipulated time, *B* supplying the necessary timber. *C* guarantees *A's* performance of the contract. *B* omits to supply the timber. *C* is discharged from his suretyship.

(i) Release of Principal Debtor

The section provides for two kinds of discharge from liability. In the first place, if the creditor makes any contract with the principal debtor by which the latter is released, the surety is discharged. Where, for example, the creditor accepts a compromise and releases the principal debtor, the surety is likewise released. Any release of the principal debtor is a release of the surety also.[81]

Effect of Debt Relief Acts.—Where the liability of the principal debtor is reduced under the provisions of a statute, an important question arises whether the liability of the surety is also diminished thereby. Facing this problem probably for the first time in 1938 and again in 1944 the Nagpur High Court held that the intention of the statute is to relieve the principal debtor and not the surety.[82] But a

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80. *Lombard Finance* v *Brookplain Trading*, (1991) 1 WLR 271 CA.

81. For a recent illustration see *Kahn Singh* v *Tek Chand*, AIR 1968 J&K 93; and *see* Illustration *(a)* to S. 134; *Manohar Lal* v *Harkishan Lal*, AIR 1968 Del 108. Also see *Radha Thiagarajan* v *South Indian Bank Ltd*, Case No. 43, Short Notes, 1985 Ker LT 29 where it is pointed out that the discharge of the principal debtor is not discharge of the surety where it is not brought about by the voluntary act of the creditor, but by operation of law; *Bank of India* v *R.F. Cowasjee*, AIR 1955 Bom 419. Similarly, the creditor, while discharging the principal debtor, may reserve his rights against the surety and in that event the surety would not be discharged. *Cutler* v *McPhail*, (1962) 2 QB 292. Accepting new promissory note in place of the old loan system which was guaranteed discharged the old loan and with that also the surety, *P.C. Ravi* v *Union Bank of India*, (1995) AIHC 2168; *Balbir Sound* v *Indian Bank*, (1996) MPLJ 853.

82. *Balkrishna* v *Atmaram*, AIR 1944 Nag 277. *See* also *Babu Rao Ramachandra Rao* v *Babu*

Full Bench of the Madras High Court, applying the provisions of the Madras Agriculturists' Debt Relief Act[83], held that "the surety is liable only for the reduced amount".[84] This view of the Madras High Court has now been supported by the Kerala High Court in *Aypunni Mani* v *Devassy Kochouseph*.[85] Explaining the purpose of the debt-relieving statutes, GOPALAN NAMBIYARE J observed as follows:

> "It appears to us, that to hold otherwise, would be to altogether deny the benefit of the ameliorative provisions of the Act to the agriculturist debtor. On any other view it would be open to the creditor to recover the debt as scaled down from the agriculturist debtor, and the balance from the surety, and the latter in his turn could seek reimbursement from the principal debtor *(vide* Section 144 of the Contract Act).[86] Such a construction would completely nullify the benefits of the ameliorative legislation to indebted agriculturists."

This is indeed the most desirable interpretation of Section 128 which makes the liability of the surety coextensive with that of the principal debtor. In view of this decision the effect of the section is "that a statutory reduction or extinguishment of the principal debtor's liability will operate as a *pro tanto* reduction or extinguishment of surety's debt". The mere suspension of a debt for a short period and that too with a clause that the period of limitation will not run during the period of suspension, will not affect the liability of the guarantor.[87]

Application of Insolvency Laws

The Supreme Court has laid down that though under Section 134 the surety is discharged by release or discharge of the principal debtor, a discharge which the principal debtor may secure by reason of winding up or insolvency does not absolve the surety of his liability. A bank guarantee for a sum of Rs 50,000 was submitted by a supplier of the Electricity Board. The bank was liable under the guarantee to pay the amount within 48 hours of demand by the Board. The Board demanded payment. The bank made it. The bank was now trying to realise the amount out of the securities deposited by the supplier for securing the guarantee. The supplier company went into liquidation. The liquidator sought to restrain the bank from realising the securities. But the court allowed the bank to go ahead. The bank was a secured creditor and was entitled to the benefit of securities. The bank had nothing to do with the state of the relations between the company and the Electricity Board.[88]

Manaklal, AIR 1938 Nag 413 and also *Iyyer* v *Kanhavi*, 33 Cochin LR 458 which followed the Nagpur view.

83. Act 4 of 1938.

84. *Subramania Chettiar* v *MP Narayanaswami Gounder*, AIR 1951 Mad 48, overruling *Subramania* v *Batcha Rowther*, AIR 1942 Mad 145; *Narayan Singh* v *Chhatar Singh*, AIR 1973 Raj 347; *Aypunni Mani* v *Devassy*, AIR 1966 Ker 203; *Babu Rao* v *Babu Manaklal*, AIR 1938 Nag 413; *Gopilal* v *Trac Industries and Components Ltd*, AIR 1978 Mad 134.

85. AIR 1966 Ker 203.

86. This section enables the surety to recover from principal debtor the amount which he has lawfully paid to the creditor under the contract of guarantee.

87. This has been so held by the Madras High Court in *Gopilal* v *Trac Industries & Components Ltd*, AIR 1978 Mad 134.

88. *Maharashtra State Electricity Board* v *Official Liquidator*, (1982) 3 SCC 358 : AIR 1982 SC 1497. Similarly, the takeover of undertakings under statutory power, such as Sick Textiles Undertakings Notification Act, 1974, does not discharge the sureties of the borrowings from such undertakings. *Bank of Madura Ltd* v *Bank of Baroda*, (1987) 1 Mad LJ 393; *State of AP*

(ii) Act or Omission

The second ground of discharge provided in Section 134 is that when the creditor does "any act or omission the legal consequence of which is the discharge of the principal debtor", the surety would also be discharged from his liability. Where, for example, there is a contract for the construction of a building the performance of which is guaranteed by a surety. Under the contract, the creditor has to supply the building material. An omission on his part to do so would discharge the contractor and so would the surety be discharged. Similarly, where the payment of rent due under a lease is guaranteed and the creditor terminates the lease, or where the payment of instalments due under a hire-purchase is guaranteed and the creditor prematurely determines the agreement, the effect would be the release of the surety also.[89] The act of the creditor in terminating the agreement, e.g., in determining the agreement of hire-purchase by taking possession of the goods, discharged the surety.[90]

The effect of omission to sue is considered later.[91]

5. Composition, Extension of Time and Promise not to Sue [S. 135]

135. Discharge of surety when creditor compounds with, gives time to, or agrees not to sue principal debtor.—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.

The section provides for three modes of discharge from liability:

(1) Composition;

(2) Promise to give time, and

(3) Promise not to sue the principal debtor.

Composition

If the creditor makes a composition with the principal debtor, without consulting the surety, the latter is discharged. Composition inevitably involves variation of the original contract, and, therefore, the surety is discharged.[92] A

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v *Central Bank of India*, (1982) 1 Andh WR (SN) 10. Suspension of the contract between the creditor and the principal's on account of the latter's defaults does not have the effect of absolving the surety from his liability. *SCIL (India) Ltd* v *Indian Bank*, AIR 1992 Bom 131.

89. See *Unity Finance Ltd* v *Woodcock*, (1963) 1 WLR 455.

90. *Hewison* v *Rickelts*, (1894) 63 LJQB 711. *See* also *Hastings Corpn* v *Letton*, (1908) 1 KB 378, where a lease under which payment of rent was guaranteed, the lessor terminated the lease, the surety was held discharged.

91. *See* under S. 137. The Supreme Court has laid down that a creditor is entitled to recover the debt from the surety, even though a suit on the guarantee against the principal debtor is time barred. See *Bombay Dyeing and Mfg Co* v *State of Bombay*, 1958 SCR 1122 : AIR 1958 SC 328.

92. See *Bolton* v *Salmon*, (1891) 2 Ch 48; *Kahn Singh* v *Tek Chand*, AIR 1968 J&K 93, where after decrees had been passed against the principal debtor and sureties, the principal debtor compromised without consulting the sureties. This discharged them. *Mahomedialli Ibrahimji* v *Lakhmibai Anant Palande*, AIR 1930 Bom 122, compromise of the suit by the principal debtor undertaking to pay the dues by instalments, discharge of surety.

compromise in terms of a court decree is different from private composition. That does not discharge the surety,[93] unless the decree is collusive.

Promise to Give Time

When the time for the payment of the guaranteed debt comes, the surety has the right to require the principal debtor to pay off the debt. Accordingly, it is one of the duties of the creditor towards the surety not to allow the principal debtor more time for payment. "The creditor has no right, it is against the faith of his contract, to give time to the principal, even though manifestly for the benefit of the surety, without the consent of the surety."[94] "It is very undesirable that there should be any dispute or controversy about whether it is for his benefit or not; there shall be the broad principle that if the creditor does intentionally violate any rights the surety had when he entered into the suretyship, even though the damage be nominal only, he shall forfeit the whole remedy."[95]

Thus, where the principal debtor was to make payment for gas supplied within fourteen days and on one occasion he having failed to pay, the supplier took a promissory note from him, this amounted to extension of time and thereupon the surety was discharged.[96] Similarly, where the price of a motor car was to be paid in instalments and payment of which was guaranteed, the buyer fell into arrears and the dealer settled with the buyer that he should pay a certain sum immediately and the balance by the end of the month. This discharged the surety.[97] The Supreme Court of India has held that where a bank gave time to the principal debtor to make up the quantity of the goods pledged, it did not have the effect of giving time for payment within the meaning of Section 135.[98]

136. Surety not discharged when agreement made with third person to give time to principal debtor.—Where a contract to give time to the principal debtor is made by the creditor with a third person, and not with the principal debtor, the surety is not discharged.

Illustration

C, the holder of an overdue bill of exchange drawn by *A* as surety for *B*, and accepted by *B*, contracts with *M* to give time to *B*. *A* is not discharged.

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93. *City Bank N.A.* v *J.K. Jute Mills*, AIR 1982 Del 487.

94. *See* Lord ELDON in *Samuel* v *Howarth*, 3 Mer 272, 279.

95. BLACKBURN J in *Blake* v *Everett*, (1876) 1 QBD 669. *See* also *Rouse* v *Bradford Banking Corporation*, (1894) 2 Ch 32. A unilateral extension of time without any contract with the principal debtor does not discharge the surety. At best it is a forbearance to sue. *Usha Devi* v *Bhagwan Das*, AIR 1967 MP 250.

96. *Croydon Gas Co* v *Dickinson*, (1876) 2 CPD 46.

97. *Midland Motor Showrooms* v *Newman*, (1929) 2 KB 256. *Permata Merchant Bank* v *Glove Seal*, (1994) 1 Current LJ 389 (Malaysia), here the original guarantee executed by the parties clearly showed that the sureties were not to be discharged or released by the restructuring of the mode of repayment of the loan by instalments.

98. *Amritlal Goverdhan Lallan* v *State Bank of Travancore*, (1968) 3 SCR 724 : AIR 1968 SC 1432 : 38 Comp Cas 751. Where the principal debtor acknowledged the debt which had the effect of extending the period of limitation, it was held that the surety would continue to be liable for the extended period. *Wandoor Jupiter Chits* v *K.P. Mathew*, AIR 1980 Ker 190. Where by an arrangement between the principal judgment-debtor and the decree-holder, the time for discharge of the debt was extended by the former, it was held that its effect upon discharge of surety depends upon the discretion of the court. *Ram Chand Diwan Chand* v *Sant Singh*, AIR 1930 Lah 896.

Promise not to Sue

If the creditor under an agreement with the principal debtor promises not to sue him, the surety is discharged. "The main reason is that a surety is entitled at any time to require the creditor to call upon the principal debtor to pay off the debt" when it is due and this right is positively violated when the creditor promises not to sue the principal debtor.

Forbearance to Sue

This is, however, subject to two important qualifications. In the first place, a promise not to sue should be distinguished from a mere "forbearance to sue". "A promise not to sue is an engagement which ties the hands of the creditor. It is not negatively refraining; not exacting the money at the time, but it is the act of the creditor depriving himself of the power of suing. . . ."[1] Section 137 incorporates this principle.

137. Creditor's forbearance to sue does not discharge surety.— Mere forbearance on the part of the creditor to sue the principal debtor or to enforce any other remedy against him does not, in the absence of any provision in the guarantee to the contrary, discharge the surety.

Illustration

B owes to *C* a debt guaranteed by *A*. The debt becomes payable. *C* does not sue *B* for a year after the debt has become payable. *A* is not discharged from his suretyship.

Thus "mere forbearance to sue" does not discharge the surety.[2] But suppose that the forbearance continues up to the expiry of the period of limitation and consequently the action against the principal debtor becomes time barred, will the surety be discharged ? According to Section 134 if the creditor is guilty of any act or omission the legal consequence of which is the discharge of the principal debtor, the surety is also discharged. The omission to sue the principal debtor within the period of limitation definitely discharges him. Thus if Section 134 stood alone the surety would be discharged. But Section 137 declares that "mere forbearance to sue" does not discharge the surety. These two provisions naturally created a conflict of decisions which was ultimately resolved by the decision of the Privy Council in *Mahanth Singh* v *U Ba Yi*.[3] Lord PORTER observed as follows:

> ". . . a failure to sue the principal debtor until recovery is barred by the statutes of limitation does not operate as a discharge of the surety in England.[4] The same view prevails in most of the High Courts in India....[5] With these

1. *See* Lord HANWORTH MR in *Midland Motor Showrooms* v *Newman*, (1929) 2 KB 256, 263, *quoting* from *Howell* v *Jones*, (1834) 1 Cr & MR 97, 107 and *Orne* v *Young*, (1815) Holl, NPC 84, 85.
2. Dissolution of a company which was the principal debtor, death of one of the sureties and the creditor not proceeding against the company did not discharge the remaining sureties. *Union of India* v *Modern Stores India Ltd*, AIR 1988 Cal 18.
3. (1939) 181 IC 1 (PC) : 66 IA 198 : AIR 1939 PC 410; *affirmed* by the Supreme Court in *Bombay Dyeing & Mfg Co Ltd* v *State of Bombay*, 1958 SCR 1122, 1134-35 : AIR 1958 SC 328.
4. See *Carter* v *White*, (1883) 25 Ch D 666.
5. See *Sankara Kalana* v *Virupakshapa Ganeshapa*, ILR (1883) 1 Bom 146; *Krishto Kishori* v *Radha Romun Munshi*, (1885) ILR 12 Cal 330; *Subramania Aiyar* v *Gopala Aiyar*, (1910) ILR 33 Mad 308; *Hajarimao* v *Krishnarao*, ILR 5 Bom 647; *Nur Din* v *Allah Ditta*, AIR

decisions of the other High Courts in India may be contrasted the case of *Ranjit Singh* v *Naubat*,[6] which decides that in spite of the provisions of Section 137, the creditor's right against the surety is not preserved unless he sues the principal debtor within the period of limitation. Such a decision is inconsistent with the views held by the courts in England and majority of the courts in India. In this conflict, their Lordships prefer the reasoning of the majority."[7]

Reserving Rights against Surety

The decision further points out that an agreement not to sue the principal debtor or to give time with a reservation of the right against the surety, would not discharge the surety. The *Mahanth Singh* case[8] was decided on this principle.

> The plaintiff was engaged as a contractor by certain trustees of a pagoda for construction work. The payment by the trustees was guaranteed by the defendants. The trustees defaulted and, therefore, the plaintiff sued the trustees and the surety. The beneficiaries of the trust replaced their trustees and the plaintiff dropped his case against them and was not allowed subsequently to sue them in their personal capacity. But the suit against the surety was maintained.

It was held that the surety was not discharged. "The appellant's act in continuing to sue the surety though he withdrew his action against the principal debtors was a clear reservation of his rights. The remedy of the surety against the principal debtor is not impaired and his liability is, therefore, not discharged."[9]

Promise to give time to Debtor made with Third Person

Secondly, Section 136 provides that "where a contract to give time to the principal debtor is made by the creditor with a third person, and not with the principal debtor, the surety is not discharged".

6. By Impairing Surety's Remedy [S. 139]

139. Discharge of surety by creditor's act or omission impairing surety's eventual remedy.—If the creditor does any act which is inconsistent with the right of the surety, or omits to do any act which his duty to the surety requires him to do, and the eventual remedy of the surety himself against the principal debtor is thereby impaired, the surety is discharged.

Illustrations

(a) *B* contracts to build a ship for *C* for a given sum, to be paid by instalments as the work reaches certain stages. *A* becomes surety to *C* for *B's* due

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1932 Lah 419; *Aziz Ahmed* v *Shed Ali*, AIR 1956 All 8 FB; *Dass Bank Ltd* v *Kalikumari*, AIR 1958 Cal 530 DB; *Bombay Dyeing & Mfg Co* v *State of Bombay*, AIR 1958 SC 328.

6. (1902) ILR 24 All 504.
7. 66 IA at pp. 206-207. *See* further *Usha Devi* v *Bhagwandas*, AIR 1967 MP 250; *Punjab National Bank* v *Surendra Prasad Sinha*, 1993 Supp (1) SCC 499: AIR 1992 SC 1815 to the effect that where the debt becomes time barred, the securities deposited by the guarantor can be used towards realisation.
8. *Mahanth Singh* v *UBa Yi*, (1939) 181 IC 1 (PC): 66 IA 198: AIR 1939 PC 410.
9. *See* further, *Orissa Agro Industries Corpn* v *Sakeswara Guru*, AIR 1985 Ori 270, where the suit against the principal debtor was dismissed, but it was allowed against the surety.

performance of the contract. *C*, without the knowledge of *A*, prepays to *B* the last two instalments. *A* is discharged by this prepayment.

(b) *C* lends money to *B* on the security of a joint and several promissory note, made in *C*'s favour by *B*, and *A* as surety for *B*, together with a bill of sale of *B*'s furniture, which gives power to *C* to sell the furniture, and apply to proceeds in discharge of the note. Subsequently, *C* sells the furniture, but, owing to his misconduct and wilful negligence, only a small price is realized. *A* is discharged from liability on the note.

(c) *A* puts *M* as apprentice to *B*, and gives a guarantee to *B* for *M*'s fidelity. *B* promises on his part that he will, at least once a month, see *M* make up the cash. *B* omits to see this done as promised, and *M* embezzles. *A* is not liable to *B* on his guarantee.

If the creditor does any act which is inconsistent with the rights of the surety, or omits to do any act which his duty to the surety requires him to do, and the eventual remedy of the surety himself against the principal debtor is impaired, the surety is discharged. It is the plain duty of the creditor not to do anything inconsistent with the rights of the surety. A surety is entitled, after paying off the creditor, to his indemnity from the principal debtor. If the creditor's act or omission deprives the surety of the benefit of this remedy, the surety is discharged.[10] Thus, where the integrity of a cashier is guaranteed and the employer undertakes to check his work once in a month but neglects to do so, the cashier embezzles, the surety is not liable. The same duty requires the creditor to preserve the securities, if any, which he has against the principal debtor. If he loses or parts with the securities, the surety is discharged to that extent.[11] Similarly, where against the terms of the guarantee the Government allowed the contractor to remove felled trees from a forest without payment of price, the surety was held to be discharged.[12]

Another suitable illustration is *Darwen & Pearce, Re*:[13]

> The principal debtor was a shareholder in a company. His shares were partly paid and the payment of the unpaid balance was guaranteed by the surety. The shareholder defaulted in the payment of calls and the company forfeited his shares.

By reason of the forfeiture the shares became the property of the company. If they had not been forfeited they would have belonged to the surety on payment of

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10. *See*, for example, *Unity Finance Ltd* v *Woodcock*, (1963) 1 WLR 455.
11. *State Bank of India* v *Praveen Tanneries*, (1992) 2 Andh LT 5 (notes on recent cases) where the surety was discharged because the bank was not able to give to the surety the securities in the same condition as they formerly stood in his hands; *State Bank of Saurashtra* v *Chitranjan Raja*, (1980) 4 SCC 516: AIR 1980 SC 1528 where the security of the pledged goods was lost because the bank was found to be highly negligent in the keeping and handling of those goods.
12. *State of MP* v *Kaluram*, AIR 1967 SC 1105. *See* also *Amrit Lal* v *State Bank of Travancore*, AIR 1968 SC 1432, where the creditor's negligence in allowing the goods (securities) to fall short was held sufficient to discharge the surety. *M.R. Chakrapani Iyengar* v *Canara Bank*, AIR 1997 Kant 216, the principal debtor disposed of the hypothecated property, the surety submitted all the particulars to the creditor but the latter took no steps to seize the property or to issue criminal process against the debtor, the surety became discharged. *Union Bank of India* v *Suresh Bhailal Mehta*, AIR 1997 Guj 48, security in the form of hypothecated goods, lost on account of bank's negligence and not in existence at the time of the suit against the surety, the suit liable to be dismissed.
13. (1937) 1 Ch 13

the outstanding calls. Thus, the forfeiture deprived the surety of his right to the shares and he was accordingly discharged.

Failure on the part of the supplier of a lorry to seize it after an accident, particularly when it was under repairs and under lien for repair charges, is not the same thing as impairing the surety's remedy who had guaranteed payment of the remaining instalments of the price.[14] To the same effect is a decision of the Rajasthan High Court.[15] The payment of the price of a liquor shop was spread into ten instalments and these payments were guaranteed by the defendant. The principal debtor defaulted with the instalments. The State could have cancelled the licence and re-auctioned the shop, but did not do so. The guarantor contended that this inaction should put an end to his liability. But he was held liable. The State inaction had in no way impaired his ultimate remedy against the principal debtor. Similarly, where the surety repeatedly asked the bank to do something against the principal debtor who was rapidly disposing of his assets and even so the bank did nothing, the surety was not allowed to claim any discharge.[16]

The creditor also owes to the surety the duty of realising the proper value of the securities in case he exercises his power of sale.[17] "Any improper dealing with the collateral deposited to secure an indebtedness guaranteed by another is available to the guarantor as a defence."[18] In a New York case[19] the guarantor pleaded in defence that the collateral security (skins in this case) was sold before maturity of the debt without notice for 200 dollars although worth 12,500 dollars at the time of sale. The guarantor was allowed corresponding reduction in his liability. Where, on the other hand, the assets of a company, whose debt was secured by mortgaging the assets and also guaranteed by a director, were taken over by the receiver appointed by the mortgagee, the receiver was held to be under no duty towards the surety to realise proper value of the assets. The guarantor sued the receiver for the loss caused to him by not obtaining proper value of the assets. But the action was not allowed.[20] The decision proceeded on the ground that the receiver is an agent of the creditor or,

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14. *V. Seetharamaiah* v *Srirama Motor Finance Corpn*, AIR 1977 AP 164.
15. *Dulichand* v *State of Rajasthan*, AIR 1976 Raj 112. Where the creditor gets the security sold in execution of a court decree, it does not amount to parting with security so as to discharge the surety. *City Bank N.A.* v *J.K. Jute Mills*, AIR 1982 Del 487.
16. *Bhabani Shankar Patra* v *S.B.I.*, AIR 1986 Ori 247.
17. *Bumiputra Merchant Banker Berhad* v *Melewar Corpn*, (1990) 2 Current LJ 30 HC Kuala Lumpur, a mortgagee has the right to choose the time to sell and when he has decided to sell, he owes a common law duty to the mortgagor to realise the true value of the property sold. The court cited *Farrar* v *Farrar Ltd*, (1989) 40 Ch D 395; *Cuckmere Brick Co* v *Mutual Finance Ltd*, (1971) 2 All ER 63 and *Standard Chartered Bank Ltd* v *Walker*, (1982) 3 All ER 938, where Lord DENNING described this duty as only a particular application of the general duty of care to your neighbour which was stated by Lord ATKIN in *Donoghue* v *Stevenson*, (1932) AC 562. The mortgagor and guarantor are clearly in very close 'proximity' to those who conduct sale. *Shri Mahadev Rama Bhonsle* v *Central Bank of India*, (1998) 2 Bom CR 244, the bank realising the value of hypothecated vehicles after a lapse of five years, the bank was liable to reduce the recovery from the surety to the extent of recoverable loss. *Chistovan Vaz* v *Indian Overseas Bank*, (1998) 2 Bom CR 522, sale of vehicles after four years' exposure to sun and rains, considerable diminution in value, liability of surety to be reduced to that extent.
18. *Vose* v *Florida Railroad Co*, 50 NY 369, (1872).
19. *New Netherlands Bank of N.Y.* v *Dernburg*, 200 NYS (2d) 57[illegible] (1967).
20. *Latchford* v *Beirne* [1981] 3 All ER 705.

at the most, of the company, but not that of the surety. But the decision has been criticised.[21]

In a case before the Supreme Court:

> A bank granted a loan on the security of the stock in godown. The loan was also guaranteed by a surety. The goods were lost from the godown on account of the negligence of bank officials. The surety was discharged to the extent of the value of the stock so lost.[22]

This has been further supplemented by the Supreme Court by the declaration in a subsequent case that the creditor must proceed in the first place against the security and then only against the surety for the balance.[23]

In a case before the Privy Council,[24] their Lordships observed that the creditor owed no duty to the surety to exercise his power of sale of the mortgaged securities and could decide in its own interest whether to sell and when to do so. The security was neither surrendered, nor lost, nor imperfect, nor altered in condition by reason of what was done by the creditor. The creditor bank had three sources of repayment. The creditor could sue the debtor, sell the mortgaged securities or sue the surety. All those remedies could be exercised at any time or times simultaneously or contemporaneously or successively or not at all. If the creditor chose to sue the surety and not pursue any other remedy, the creditor on being paid in full was bound to assign the mortgaged securities to the surety. If the creditor chose to exercise his power of sale over the mortgaged security, he must sell for the correct market value,

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21. *See* P.J. Davies, *No Duty of care to a Company Guarantor*, (1982) 98 LQR 351, where it has been maintained that the decision is contrary to the present trend of expanding the professional men's, duty of care towards those who have inevitably to rely on them. See *Yianni* v *Edwin Ewans & Co*, (1981) 3 All ER 592. *See* also *Barclays Bank Ltd* v *Thienel*, (1978) 122 SJ 472: 247 EG 385, where also it was held that no duty was owed to a mortgage guarantor when the mortgagee exercised the power of sale.

22. *State Bank of Saurashtra* v *Chitranjan Rangnath Raja*, (1980) 4 SCC 516: AIR 1980 SC 1528, following *State of MP* v *Kaluram*, AIR 1967 SC 1105 and *Amritlal* v *State Bank of Travancore*, AIR 1968 SC 1432, where the creditor's negligence in allowing the goods (securities) to fall short was held sufficient to discharge the surety. As against this where the hypothecated goods were in the possession of the borrower himself and the bank was neither exercising control over the goods nor the borrower was under a duty to give a periodic account and the bank was also not aware of any disposal of the goods otherwise than in the course of business, the surety was held to be not discharged because there was no connection between the bank's negligence and the loss of security. *Union Bank of India* v *MP Sreedharan Kartha*, AIR 1993 Ker 285, distinguishing *State Bank of India* v *Quality Bread Factory*, AIR 1983 P&H 244. *Indian Bank* v *M. Ambika*, (2001) 1 Kar LJ 478, *following* the *Kalu Ram* case H.N. TILHARI J emphasised the duty of the bank in this connection. The bank failed to prevent transfer of the hypothecated stock by the principal to a third party despite having the power under the terms of the loan to do so. The bank was under duty to inspect periodically, take account, evaluate and give directions regarding disposal of the hypothecated stock. Failure of the bank in this respect faciliated illegal alienation. The surety was discharged to the extent of such loss of the stock. *Punjab National Bank* v *Lakshmi Industrial & Trading Co P Ltd*, AIR 2001 All 28, a receiver was appointed on the application of the bank for pledged goods. The bank claimed that the goods were damaged or destroyed due to natural decay while in the custody of the bank. No evidence was offered to show the quantity or quality of the goods at the initial stage. The bank's suit against the sureties was decreed after adjusting the value of the goods lost.

23. *Union Bank of India* v *Manku Narayana*, (1987) 2 SCC 335: AIR 1987 SC 1078.

24. *China and South Sea Bank Ltd* v *Tan Soon Gin*, (1990) 2 WLR 56 on appeal from the Court of Appeal of Hong Kong.

but the creditor must decide in his own interest if and when he should sell. The creditor does not become a trustee of the mortgaged securities and the power of sale for the surety unless and until the creditor is paid in full and the surety, having paid the whole of the debt, is entitled to a transfer of the mortgaged securities to procure recovery of the whole or part of the sums he has paid to the creditor.

Waiver of Rights

There are contradictory rulings on the point whether a surety can give up the benefit of provisions designed to relieve him from liability. The Karnataka High Court[25] has been of the view that the rights under Sections 133, 134, 135, 139 and 141 are of variable nature and, therefore, a surety can waive the benefit of these provisions by a clause in the guarantee. There is, however, a ruling to the effect that the operation of Section 133 relating to discharge by variance cannot be ousted.[26]

RIGHTS OF SURETY

A surety has certain rights against the debtor, creditor and co-sureties.

Rights against Principal Debtor

Following are the rights of the surety against the principal debtor:

1. Right of Subrogation [S. 140]
2. Right to Indemnity [S. 145]

1. Right of Subrogation [S. 140]

Section 140 provides for the right of subrogation:

140. Rights of surety on payment or performance.—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.

When the surety has paid all that he is liable for he is invested with all the rights which the creditor had against the principal debtor. The surety steps into the shoes of the creditor. The creditor had the right to sue the principal debtor. "If the liability of the surety is coextensive with that of the principal debtor, his right is not less coextensive with that of the creditor after he satisfies the creditor's debt.[27] The surety may, therefore, sue the principal debtor in the rights of the creditor. For example in *Re Lampleigh Iron Ore Co Ltd*:[28]

> A director of a company in liquidation guaranteed and paid the rents due from the company before the date of the liquidation. It was held that he was entitled to stand in the place of the creditor, and to use all remedies, if need be, in the name of the creditor in any action to obtain indemnification from the principal debtor for the loss sustained.

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25. *T. Raju Shetty* v *Bank of Baroda*, AIR 1992 Kant 108. This ruling was *followed* in *Central Bank of India* v *Multi Block P Ltd*, AIR 1997 Bom 109 and *Corporation Bank* v *B. Mohandas Baliga*, (1993) 1 Kar LJ 308 DB.
26. *Union of India* v *Pearl Hosiery Mills*, AIR 1961 Punj 281.
27. *Babu Rao Ramchandra Rao* v *Babu Manaklal Nehmal*, AIR 1938 Nag 413.
28. (1927) 1 Ch 308.

The Supreme Court has laid down that "the surety will be entitled to every remedy which the creditor had against the principal debtor; to enforce every security and all means of payment; to stand in the place of the creditor; to have the 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 stands not merely upon contract, but also upon natural justice. The language of Section 140 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".[29]

This may not always be to the advantage of the surety. Where the principal debtor becomes insolvent, the surety cannot ask the creditor first to pursue his remedy against the principal debtor. The Supreme Court has pointed out that even then the surety should pay. He will be subrogated to the rights of the creditor against the principal debtor, though such rights against an insolvent debtor may not be of much use. "The very object of guarantee is defeated if the creditor is asked to postpone his remedies against the surety."[30]

Rights before Payment

Under the right of subrogation the surety may get certain rights even before payment. The Calcutta High Court examined this possibility in a case where the surety found, that the amount having become due, the principal debtor was disposing of his personal properties one after the other lest the surety, after paying, may seize them and sought a temporary injunction to prevent the principal debtor from doing so. The Court granted the injunction. Relying upon an authoritative work, SUKUMAR CHAKRAVARTY J said[31] that if in any suit it is proved by affidavit or otherwise that the defendant threatens, or is about to remove or dispose of his property with intent to defraud his creditors, the court may grant a temporary injunction to restrain such act or to give such other order for the purpose of staying or preventing the removal or disposition of the property.

Listing the other rights of the surety which arise in his favour before payment, the court cited the following passage from STORY ON EQUITY:[32]

> "Sureties, also, are entitled to come into a court of equity, after a debt has become due, to compel the debtor to exonerate them from their liability by paying the debt; or sue in the creditor's name, and collect the debt from the principal, if he will indemnify the creditor against the risk, delay and expense of the suit."

The court brought out from SNELL'S PRINCIPLES OF EQUITY[33] a passage which discusses the remedies of the surety under two heads, viz., before payment and after payment:

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29. *Amrit Lal Goverdhan Lallan* v *State Bank of Travancore*, (1968) 3 SCR 724, 731: AIR 1968 SC 1432.
30. *Bank of Bihar Ltd* v *Damodar Prasad*, (1969) 1 SCR 620, 623: AIR 1969 SC 297. *Jugalkishore Rampratapji Rathi* v *Brijmohan*, (1994) 2 Bom CR 537, the surety's application is maintainable, the court must consider it on merits, it should not be rejected mechanically. *See* also *C.R. Aboobacker* v *K.P. Ayishu*, AIR 2000 NOC 29 (Ker): (1999) 3 Ker LT 530, the principal had paid to a very large extent, only the balance allowed to be recovered from the surety, for which he was entitled to indemnity from the principal debtor.
31. *Mamata Ghose* v *United Industrial Bank*, AIR 1987 Cal 280, 283 *relying* upon WOODRUFF'S *Tagor Law Lectures*, 1897 on THE LAW RELATING TO INJUNCTIONS, 215 (6th edn).
32. 138 (para 327, 3rd edn) at p 283, AIR 1987 Cal.
33. 467 (28th edn by) P.V. Baker and P. St. J. Langan.

"It has been stated there that the surety has an equitable right to compel the principal debtor to pay the debt and so relieve the surety from the necessity of paying it out of his pocket. It is in the nature of *quia timet*, and is based on the principle that it is unreasonable that a man should always have a cloud hang over him, so that he ought to be entitled to remove it. It is, therefore, immaterial that the creditor has refused to sue or that he has made no demand. *A fortiori*, the action lies where the principal debtor threatens to commit a breach of the obligations which the surety has guaranteed and an order may be made even though the principal debtor is without funds. But an action will not lie where the debt is not an actual, accrued or definite debt or, if on its true construction, the guarantee precludes action before the creditor demands payment."[34]

In a suit against the principal debtor and sureties for recovery of the mortgage money the sureties paid the amount on passing of preliminary decree. The court said that this amounted to payment during the pendency of the suit. The court further said that, by operation of law, the suit became assigned in their favour and they could continue it against the principal debtor by virtue of the subrogation.[35]

2. *Right to Indemnity* [S. 145]

145. Implied promise to indemnify surety.—In every contract of guarantee there is an implied promise by the principal debtor to indemnify the surety; and the surety is entitled to recover from the principal debtor whatever sum he has rightfully paid under the guarantee, but no sums which he has paid wrongfully.

Illustrations

(a) *B* indebted to *C*, and *A* is surety for the debt. *C* demands payment from *A*, and on his refusal sues him for the amount. *A* defends the suit, having reasonable grounds for doing so, but is compelled to pay the amount of the debt with costs. He can recover from *B* the amount paid by him for costs, as well as the principal debt.

(b) *C* lends *B* a sum of money, and *A*, at the request of *B*, accepts a bill of exchange drawn by *B* upon *A* to secure the amount. *C*, the holder of the bill, demands payment of it from *A*, and, on *A*'s refusal to pay, sues him upon the bill. *A*, not having reasonable grounds for so doing, defends the suit, and has to pay the amount of the bill and costs. He can recover from *B* the amount of the bill, but not the sum paid for costs, as there was no real ground for defending the action.

(c) *A* guarantees to *C*, to the extent of 2000 rupees, payment for rice to be supplied by *C* to *B*. *C* supplies to *B* rice to a less amount than 2000 rupees, but obtains from *A* payment of the sum of 2000 rupees in respect of the rice supplied. *A* cannot recover from *B* more than the price of the rice actually supplied.

Thus in every contract of guarantee there is an implied promise by the principal debtor to indemnify the surety. The right enables the surety to recover from the principal debtor whatever sum he has rightfully paid under the guarantee[36], but not sums which he paid wrongfully. An example of wrongful payment is a case where a surety had guaranteed the payment of four motor vehicles delivered on hire-purchase. The surety contended that he had paid Rs 4000 in discharge of his liability, but he failed to give an account of the price which the motor vehicles might have realised on resale. He was not allowed to recover his indemnity.[37]

Rights against Creditor

The surety enjoys the following rights against the creditor:

1. Right to securities [S. 141]
2. Right to share reduction
3. Right of set off

1. Right to Securities [S. 141]

141. Surety's right to benefit of creditor's securities.—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.

Illustrations

C advances to *B*, his tenant, 2000 rupees on the guarantee of *A*. *C* has also a further security for the 2000 rupees by a mortgage of *B's* furniture. *C* cancels the mortgage. *B* becomes insolvent, and *C* sues *A* on his guarantee. *A* is discharged from liability to the amount of the value of the furniture.

(b) *C*, a creditor, whose advance to *B* is secured by a decree, receives also a guarantee for that advance from *A*. *C* afterwards takes *B's* goods in execution under the decree, and then, without the knowledge of *A*, withdraws the execution. *A* is discharged.

A, as surety for *B*, makes a bond jointly with *B* to *C*, to secure a loan from *C* to *B*. Afterwards, *C* obtains from *B* a further security for the same debt. Subsequently *C* gives up the further security. A is not discharged.

On paying off the creditor the surety steps into his shoes and gets the right to have curities, if any, which the creditor has against the principal debtor.[38] The right irrespective of the fact whether the surety knows of the existence of such

36. *Supreme Leasing* v *Low Chuan Heny*, 1989 Current LJ 809 HC Kuala Lumpur. *See* also *C.R. Aboobacker* v *K.P. Ayishu*, AIR 2000 NOC 29 (Ker): 2000 AIHC 1229, the principal debtor paid the substantial portion of the debt, the guarantor had to pay only the balance amount for which he was allowed to recover indemnity from the principal debtor.
37. *Chekkeva Ponnamma* v *A.S. Thammayya*, AIR 1983 Kant 124.
38. See *Bechervaise* v *Lewis*, (1872) LR 8 CP 372. WILL'S J at p 377. The term 'security' is not used in any technical sense but as including all rights which the creditor has against the property of the principal. *State of MP* v *Kaluram*, (1967) 1 SCR 266: AIR 1967 SC 1105.

security or not. "It is the duty of the creditor to keep the securities intact; not to give them up or to burden with further advances."[39]

> The plaintiffs lent to *B* and *P*, who were traders, £300 for the payment of which the defendant became surety. At the time of the loan *B* and *P* assigned by deed as security for the debt, the lease of their business premises and plant, fixtures and things thereon. The plaintiff had the right to sell on default by giving a month's notice. The default took place, but the defendant did not enter into possession. He received notice of the debtors' insolvency but allowed them to continue in possession. Consequently the assets were seized and sold by the receiver. It was held that the plaintiffs, by their omission to seize the property assigned on default, had deprived themselves of the power to assign the security to the surety. He was, therefore, discharged to the amount that the goods were worth.[40]

Where certain bills of exchange were given by way of collateral security and they being dishonoured, the creditor made them useless by not doing anything within the period of limitation, the surety was discharged to the extent of their value.[41]

If the securities are burdened with further advances it will not affect the rights of the surety. For example, in *Forbes* v *Jackson*:[42]

> The principal debtor borrowed £200 on mortgaging his leasehold premises and a policy of life insurance, the defendant joining as a surety. The principal debtor borrowed further sums from the creditor on the same securities, the surety knowing nothing about it. The principal debtor failed to pay. The surety paid off £200 and interest and claimed both the securities. The creditor demanded payment of the further advances also. But it was held that the surety's right to the securities was not affected by the further advances and, therefore, he was entitled to both the securities.

According to English law, the surety has a right to securities which the creditor in fact has against the principal debtor, whether the surety knew of them or not and whether they were received before or after the guarantee.

"The expression 'security' in Section 141 is not used in any technical sense; it includes all rights which the creditor had against the property at the date of contract." This statement occurs in the judgment of SHAH J (afterwards CJ) of the Supreme Court in *State of MP* v *Kaluram*.[43]

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39. *Forbes* v *Jackson*, (1882) 19 Ch D 615, 621. *See* also *Amritlal* v *State Bank of India*, AIR 1968 SC 1432. Where a car was delivered on hire-purchase, the payment of instalments of hire guaranteed by the surety and the car was seized because of the hirer's default but returned to him on his paying a small amount and under no information to the surety, the surety was held to be absolved from liability. *Kunjuvareeth* v *Union of India*, (1991) 1 Ker LT 49 SN.
40. *Wuff & Billing* v *Jay*, (1872) 7 QB 756.
41. *M. Ramnarain P Ltd* v *S.T.C.*, AIR 1988 Bom 45.
42. (1882) 19 Ch D 615.
43. AIR 1967 SC 1105, 1108: (1967) 1 SCR 266, 272; reaffirmed, *Amrit Lal Goverdhan Lallan* v *State Bank of Travancore*, (1968) 3 SCR 724: AIR 1968 SC 1432. In ignorance of this decision the Karnataka High Court has held in *Karnataka Bank Ltd* v *Gajanan Shankararao*, AIR 1977 Kant 14 and again in *R. Lilavati* v *Bank of Baroda*, AIR 1987 Kant 2 that a mere passive activity or passive negligence on the part of the creditor by failing to realise the debt from the collateral security is not sufficient in itself to discharge the surety. If this view is correct, the effect would be that the creditor can passively permit the securities

> The State sold a lot of felled timber to a person for a fixed price payable in four equal instalments, the payment of which was guaranteed by the defendant. The contract further provided that if a default was made in the payment of an instalment, the State would get the right to prevent further removal of the timber and to sell the remaining timber for the realisation of the price. The buyer defaulted but even so the State allowed him to remove the timber.

The surety was then sued for the loss. But he was held not liable. "The State had a charge over the goods sold as well as to remain in possession till payment of the instalments. When the goods were removed by the buyer that security was lost and to the extent of the value of the security lost, the surety stood discharged."[44] The court also pointed out that it was immaterial that the loss of securities was due to a mere inaction and not to a positive action.

The difference between the English law and the principle laid down in Section 141 was explained by the Supreme Court in *Amritlal* v *State Bank of Travancore*:[45]

> "It is true that Section 141 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 is entitled to the securities given to the creditor both before and after the contract of guarantee. But subject to this variation, Section 141 incorporates the rule of English law relating to discharge from liability of a surety when the creditor parts with or loses the security held by him."

WHEN RIGHT TO SECURITIES ACCRUES.—When is the surety entitled to the securities? Obviously, only on paying the debt. Difficulty, however, arises when the surety has guaranteed only a part of the debt and consequently even when he has paid all that he was liable for, the creditor's claim against the principal debtor is not yet fully satisfied. The Bombay High Court considered the question in *Goverdhan Das* v *Bank of Bengal*.[46]

> Certain mortgages were given to a bank as security for debts amounting to Rs 3,15,000. The plaintiff, who was a surety in part, paid Rs 1,25,000 and claimed that he was entitled to that extent to stand in the place of the Bank and to receive a share of the proceeds of the said securities proportioned to the sum which he had paid.

FARRAN J considered the English authorities[47] and following them, said: "A surety who has paid the debt, which he has guaranteed, has a right to the securities held by the creditors, because as between the principal debtor and surety the principal is under an obligation to indemnify the surety. The equity between the creditor and the surety is that the creditor shall not do anything to deprive the surety of that right. But the creditor's right to hold his securities is paramount to the surety's claim upon such securities, which only arises when the creditor's claim against such securities has been satisfied."

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to be lost, but should not do something active to destroy them. The court proceeded on the logic that the surety can himself take steps to seize the security by paying out the creditor.

44. *Ibid.* at p 1107, where the learned Judge cited passages from *Wulf & Billing* v *Jay*, (1872) 7 QB 756 and *Rees* v *Barrington*, 2 White & Tudor's LC, 4th edn at p 1002.
45. (1968) 3 SCR 724, 733: AIR 1968 SC 1432.
46. (1891) 15 Bom 48.
47. The learned Judge considered *Young* v *Regnell*, 9 Hare 809 and *Duncan, Fox & Co* v *North and South Wales Bank*, (1880) LR 6 App Cas 1.

The Madras High Court has differed not only from this opinion but also from the fact whether this is the effect of the English decisions.[48] The case before it was *Bhushayya* v *Suryanarayana.*[49]

> The Imperial Bank advanced three different loans to a person with three different sureties for each loan. The principal debtor did not repay the loans in time and, therefore, the bank obtained mortgage of his property. Ultimately the bank had to file suits and three different decrees were obtained against the principal debtor and the surety on each loan. The first two sureties paid off the decrees for which they were sureties but the third did not.

The question on these facts was whether the first two sureties who had paid off their obligations were entitled to a proportionate share in the mortgage, while a part of the bank's claim against the principal was still unsatisfied. KRISHNASWAMI AYYANGER J held that they were so entitled. He said: "Section 140 . . . expressly says that the surety upon payment of all that he is liable for is invested, that is, immediately invested, with all the rights which the creditor had against the principal debtor. The condition laid down by the section for this right to arise is the payment by the surety of all that he is liable for, and not the payment of all that may be due to the creditor who holds the securities. Where the guaranteed debt is fraction only of the debt, the surety's right comes into existence immediately on payment of that fraction, for that fraction is, so far as he is concerned, the whole."[50] The learned Judge then considered Indian and English authorities and came to the conclusion that "the result of the discussion on a careful consideration of the decided cases is that a surety for a part only of a debt is on payment of that part entitled *pro tanto* to the security held by the creditor as a cover for the debt as a whole".[51]

Where the evidence did not disclose that the creditor had anything to do with the loss of the hypothecated properties, the surety was not permitted to claim any reduction of liability in that respect. This decision of the Karnataka High Court[52] was on the basis of a surety bond which provided that the surety would not claim the benefit of Section 141. The section does not carry the words "notwithstanding anything contained to the contrary, etc.", but even so the court held that by reason of the provision in Section 128, which permits liability to be regulated by agreement, a surety can waive the benefit of any of the provisions touching his liability.[53]

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48. For a contrary decision, see *Goodvin* v *Gray*, (1874) 22 WR 312.
49. (1944) ILR Mad 340: 1944 Mad 195.
50. See *Sass, Ex parte National Provincial Bank of England Ltd, Re*, (1896) 2 QB 12. *Ibid*, at p 204.
51. *Bhushayya* v *Suryanarayana*, AIR 1944 Mad 195 at 206. The learned Judge considered the decision of the Privy Council on appeal from the Calcutta High Court in *C.L. Phillips Ltd* v *A.E. Mitchell*, AIR 1930 Cal 17: 57 Cal 764. On appeal, *sub. nom* (1931) 58 IA 306: AIR 1931 PC 224. Following English authorities were considered: *Rushforth, Ex parte*, (1805) 10 Ves 409: 8 RR 10; *Hobson* v *Bass*, (1871) 6 Ch App 792; *Duncan, Fox & Co* v *North and South Wales Bank*, (1880) 6 App Cas 1.
52. *R. Lilavati* v *Bank of Baroda*, AIR 1987 Kant 2; *following* its own decision in *Karnataka Bank Ltd* v *Gajanan S. R. Kulkarni*, AIR 1977 Kant 14.
53. *See* also *Perwatra Habib Bank* v *Sehatian Development*, (1994) 1 Current LJ 394 (Malaysia) where a clause in the contract of guarantee enabled the creditor to vary the terms of the agreement without any need for reference to the guarantors.

Hypothecation is only Equitable Charge

The section is not applicable to hypothecation, it being only an equitable charge. The goods remain with the borrower and normally the question of their being lost by the creditor does not arise.[54]

2. *Right to Share Reduction*

This right may be illustrated by the case of *Hobson* v *Bass*:[55]

> *J* gave a guarantee to *B* in the following words: "I hereby guarantee to you the payment of all goods you may supply to *E.H.*, but so as my liability to you under this or any other guarantee shall not at any time exceed the sum of £250." *E* gave a similar guarantee. *B* supplied goods to *E.H.*, to the amount of £ 657. *E.H.* became bankrupt. *B* proved the whole sum in the insolvency of *E.H.* and then called on the guarantors who paid him £250 each. Subsequently *B* received from the receiver a sum of 2s, and, 1*d* . . . in the pound on £657. It was held that each of the guarantors was entitled to a part of the dividend bearing to the whole the same proportion as £250 to 657.[56]

3. *Right of Set-off*

If the creditor sues the surety, the surety may have the benefit of the set-off, if any, that the principal debtor had against the creditor. He is entitled to use the defences of the debtor against the creditor. If, for example, the creditor owes him something, or the creditor has in his hand something belonging to the debtor for which the debtor could have counter-claimed, the surety can also put up that counter-claim.[57]

He can claim such a right not only against the creditor, but also against third parties who have derived their title from the creditor. Thus where a mercantile agent sold the goods of his principal and, being a surety for payment of the price to the principal, had to pay it, he was held to have become entitled to the unpaid seller's lien against the buyer and those deriving title from him.[58]

Rights against Co-sureties

Where a debt has been guaranteed by more than one person, the are called co-sureties. Some of their rights against each other are:

1. Effect of releasing a surety;
2. Right to contribution.

1. *Effect of Releasing a Surety* [S. 138]

138. Release of one co-surety does not discharge others.— Where there are co-sureties, a release by the creditor of one of them does not discharge the others; neither does it free the surety so released from his responsibility to the other sureties.

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54. *Bank of India* v *Y.K. Wadhera*, AIR 1987 P&H 176.
55. (1871) 6 Ch A 792.
56. *See* also *Bardwell* v *Lydall*, (1831) 33 RR 540.
57. *Bechervaise* v *Lewis*, (1872) LR 7 CP 372.
58. *Wolmershausen* v *Gullick*, (1893) 2 Ch 514.

The creditor may at his will release any of the co-sureties from his liability. But that will not operate as a discharge of his co-sureties. However, the released co-surety will remain liable to the others for contribution in the event of default.[59]

2. *Right to Contribution* [Ss. 146-147]

146. Co-sureties liable to contribute equally.—Where two or more persons are co-sureties for the same debt or duty, either jointly or severally, and whether under the same or different contracts, and whether with or without the knowledge of each other, the co-sureties, in the absence of any contract to the contrary, are liable, as between themselves, to pay each an equal share of the whole debt, or of that part of it which remains unpaid by the principal debtor.

Illustrations

(a) *A*, *B* and *C* as sureties to *D*, for the sum of 3000 rupees lent to *E*. *E* makes default in payment. *A*, *B* and *C* are liable, as between themselves, to pay 1000 rupees each.

(b) *A*, *B* and *C* are sureties to *D* for the sum of 1000 rupees lent to *E*, and there is a contract between *A*, *B* and *C* that *A* is to be responsible to the extent of one-quarter, *B* to the extent of one-quarter, and *C* to the extent of one-half. *E* makes default in payment. As between the sureties, *A* is liable to pay 250 rupees, *B* 250 rupees and *C* 500 rupees.

147. Liability of co-sureties bound in different sums.—Co-sureties who are bound in different sums are liable to pay equally as far as the limits of their respective obligations permit.

Illustrations

(a) *A*, *B* and *C* as sureties for *D*, enter into three several bonds each in a different penalty, namely, *A* in the penalty of 10,000 rupees, *B* in that of 20,000 rupees, *C* in that of 40,000 rupees, conditioned for *D's* duly accounting to *E*. *D* makes default to the extent of 30,000 rupees. *A*, *B* and *C* are liable to pay 10,000 rupees.

(b) *A*, *B* and *C*, as sureties for *D*, enter into three several bonds, each in a different penalty, namely, *A* in the penalty of 10,000 rupees, *B* in that of 20,000 rupees, *C* in that of 40,000 rupees conditioned for *D's* duly accounting to *E*. *D* makes default to the extent of 40,000 rupees. *A* is liable to pay 10,000 rupees, and *B* and *C* 15,000 rupees each.

(c) *A*, *B* and *C*, as sureties for *D*, enter into three several bonds, each in a different penalty, namely, *A* in the penalty of 10,000 rupees, *B* in that of 20,000 rupees, *C* in that of 40,000 rupees, conditioned for *D's* duly accounting to *E*. *D* makes default to the extent of 70,000 rupees. *A*, *B* and *C* have to pay each the full penalty of his bond.

Where there are several sureties for the same debt and the principal debtor has committed a default, each surety is liable to contribute equally to the extent of the default.[60] If one of them has been compelled to pay more than his share, he

59. *Sri Chand* v *Jagdish Parshad Kishan Chand*, (1966) 3 SCR 451, 456-57: AIR 1966 SC 1427.

60. *State Bank of India* v *Prem Dass*, AIR 1998 Delhi 49, a bank loan was guaranteed by more than one guarantors, they were held jointly and severally liable to pay the principal debt.

can recover contribution from his co-sureties so as to equalise the loss as between all of them.[61] Thus, if there are three sureties and a default of three thousand rupees has taken place, each surety must contribute one thousand rupees. The principle will apply whether their liability is joint or several, under the same or different contracts, and whether with or without the knowledge of each other.

The principle was applied by the English Court of Appeal even to a case in which payment was made by one of the co-sureties even before there was any formal demand by the creditor as required by the guarantee. The court said that it was necessary for this purpose that the co-surety must not have acted officiously or voluntarily. A demand is not a precondition for liability under a guarantee. It is rather a procedural and evidentiary requirement. It is there for the benefit of the surety alone. He could waive it. Where the creditor is entitled to proceed against either co-surety without notifying the other, such waiver by one co-surety would not deprive him of his entitlement to contribution from the other who has not been specially disadvantaged.[62] PETER GIBSON LJ summarised the law thus:[63]

> "Let me start by setting out certain uncontroversial principles applicable in this area of the law:
>
> (1) Where more than one person guarantee to the creditor the payment of the same debt, an equity arises such that if one of them pays more than his due proportion of the debt, he is entitled to a contribution from his co-guarantor or co-guarantors.
>
> (2) It is immaterial whether the co-guarantors are bound jointly or severally or jointly and severally, or by the same instrument or by separate instruments, or in the same sum, or different sums, or at the same time or different times, or whether the co-guarantor making payment knows of the existence of the other co-guarantor or co-guarantors, as the right of contribution is not dependent upon agreement, express or implied.
>
> (3) Normally an action for contribution cannot be brought until payment has been made by a co-guarantor of more than his share of the common liability.
>
> (4) In particular circumstances an action for contribution will lie even before payment is made; thus when judgment has been entered by the creditor against one guarantor, who has paid nothing in respect of the judgment, he can maintain an action in equity against his co-guarantor and obtain an order requiring payment of the co-guarantor's due share to the creditor (if a party to the action) or (if the creditor is not a party) an order that the co-guarantor indemnify the judgment-debtor, on payment of his own share, against further liability.
>
> These principles are all subject to any contractual terms which may limit or extend the entitlement of an interested person.
>
> Is the service of a demand in writing in accordance with the guarantee, a precondition of liability under the guarantee? It would be surprising if an

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61. *Shirley* v *Burdett*, (1911) 2 Ch 418; *Wolmershausen* v *Gullick*, (1893) 2 Ch 514.
62. *Stimpson* v *Smith*, (1999) 2 All ER 833 (CA).
63. *Ibid.* at p 837, citing *Wolmershausen* v *Gullick*, (1893) 2 Ch 514: (1891-4) All ER Rep 740 and *Thomas* v *Notts Incorporated Football Club Ltd*, (1972) 1 All ER 1176 at 1182 on the point of waiver.

evidentiary or procedural requirement of service of a written demand in the guarantee was a precondition.

The only textbook which deals with the specific point is Andrews and Millett, LAW OF GUARANTEES.[64] The editors say:[65]

> 'It is submitted that strictly speaking there is no restriction upon the time at which a surety can apply for relief against his co-sureties, provided that the account between the principal (debtor) and the creditor is closed and there is an immediate liability due and payable under the guarantee such that the amount of the contribution can be properly ascertained. It is immaterial that the creditor has not yet demanded payment, or even that the creditor is obliged under the terms of the guarantee to make a demand before the surety is liable. It is enough that the creditor could enforce the guarantee, either forthwith or after making a demand for more than the surety's rateable share. This is certainly the case with *quia times* relief against the principal debtor for an indemnity, and there is no reason why the same should not apply against the co-surety for contribution.' ''[66]

The principle of equal contribution is subject to the maximum limit, if any, fixed by a surety to his liability. This is so because Section 147 lays down that "co-sureties who are bound in different sums are liable to pay equally as far as the limits of their respective obligations permit". Suppose that *A*, *B* and *C* are three sureties for a debt. *A* undertakes to be liable up to Rs 200, *B* up to Rs 400 and *C* for Rs 600. The principal debtor makes a default of Rs 600. Each surety must contribute Rs 200. But if the default is of Rs 900, then according to the principle of equal contribution, each would be liable for Rs 300; this being more than the limit of *A's* obligation, he can be required to contribute only Rs 200. The remaining seven hundred will be apportioned between *B* and *C* equally.

Indemnity and Guarantee distinguished

Indemnity and guarantee have this common feature that both are devices for providing protection against a probable loss. In either case the loss may arise due to human conduct. However, the technique of providing protection, the need and occasion for protection and the number of parties involved mark some differences between them. "Guarantees and indemnities, which are also described as securities, are distinct arrangements under which a third party, the surety, agrees to assume liability if the debtor defaults or causes loss to the creditor. The former arrangement is a guarantee, the latter involves an indemnity."[67]

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64. 2nd edn, 1994.
65. At p 360.
66. The learned Lord Justice added that this was entirely consistent with WRIGHT J's approach in *Wolmershausen* v *Gullick*, (1893) 2 Ch 514.
67. Ellinger, MODERN BANKING LAW, 259 (1987). *See* also *Northwood Development Co* v *Aegon Insurance Co (UK)*, (1994) 10 Construction LJ (Const LJ) 157, where the building contract provided that there would be automatic breach if resolution was passed by the contractor company for its winding up. That resolution having been passed, the person who had entered into a bond with the owner for due performance, became liable to pay under the bond and it was not necessary that there should be proof of any breach or default. As against this, where the bond provided for payment if there was a default on the part of the contractor, this was held to be a guarantee entitling the surety to avail the defence against the owner which would have been available to the contractor. See *Trafalgar House Construction (Regions)* v *General Surety and Guarantee Co*, (1995) 3 WLR 204 HL. For further

1. The liability under a contract of indemnity is contingent in the sense that it may or may not arise.[68] Under a guarantee, on the other hand, the liability is subsisting in the sense that once a guarantee has been acted upon, the liability of the surety automatically arises, though it remains in suspended animation till the principal debtor commits default.

2. The undertaking in a guarantee is collateral, in an indemnity it is original. The purpose of a guarantee is to support the primary liability of a third person. In an indemnity, there being no third person, the indemnifier's liability is in itself "primary".[69]

3. In a contract of indemnity there are only two parties, namely, the indemnifier and the indemnity-holder. But there are three parties to a guarantee, the creditor, the principal debtor and the surety. It is a tripartite arrangement.

4. In an indemnity there is only one contract, that is, the contract of indemnity against loss between the indemnity-holder and the indemnifier. But in a guarantee there are three contracts, namely, a contract of loan between the principal debtor and the creditor; a contract of guarantee between the creditor and the surety and finally an implied contract of indemnity between the principal debtor and the surety.

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discussion on the points of difference between indemnity and guarantee and the rights of the promisee in a contract of indemnity see *Jayakrishna Trading Co* v *Kandasamy Weaving Factory & Co*, (1995) 2 Mad LJ 255. In this case guarantee was given not at the request of the principal debtor, no liability for the default of the principal debtor in such a case.

68. *Eldridge and Morris* v *Taylor*, (1931) 2 KB 416; *Temperance Loan Fund Ltd* v *Rose*, (1932) 2 KB 522; *Unity Finance Ltd* v *Woodcock*, (1963) 1 WLR 455.

69. *See* Cheshire and Fifoot, LAW OF CONTRACT, 181 (9th edn by Furmston, 1976).

13
Bailment

Bailment implies a sort of relationship in which the personal property of one person temporarily goes into the possession of another. The ownership of the articles or goods is in one person and the possession in another. The circumstances in which this happens are numerous. Delivering a cycle, watch or any other article for repair, or leaving a cycle or car, etc, at a stand, depositing luggage or books in a cloakroom, delivering gold to a goldsmith for making ornaments, delivering garments to a dry-cleaner, delivering goods for carriage, warehousing or storage and so forth, are all familiar situations which create the relationship of bailment. Thus bailment is a subject of considerable public importance.[1]

DEFINITION

"Bailment" is defined in Section 148 of the Indian Contract Act in the following words:

148. "Bailment", "bailor" and "bailee" defined.—A ''bailment'' is the delivery of goods by one person to another for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them. The person delivering the goods is called the ''bailor''. The person to whom they are delivered is called the ''bailee''.

Explanation.—If a person already in possession of the goods of another contracts to hold them as a bailee, he thereby becomes the bailee, and the owner becomes the bailor of such goods, although they may not have been delivered by way of bailment.

ESSENTIAL FEATURES

The following essential features of "bailment" are emphasised by this definition.

1. Delivery of Possession

The first important characteristic of bailment is "the delivery of possession" by one person to another. "Delivery of possession" for this purpose should be distinguished from a mere "custody". "One who has custody without possession, like a servant, or a guest using his host's goods is not a bailee."[2] The goods must be handed over to the bailee for whatever is the purpose of bailment. Once this is done, a bailment arises, irrespective of the manner in which this happens.

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1. *See*, for example, C.V. Davidge, *Bailment*, (1925) 41 LQR 433.
2. Pollock and Mulla: THE INDIAN CONTRACT AND SPECIFIC RELIEF ACTS, (1957), p 560. *See* also *Reaves* v *Capper*, (1838) 5 Bing NC 136 : 132 ER 1057, where the custody of a servant is distinguished from delivery of possession to a bailee.

An old customer went into a restaurant for the purpose of dining there. When he entered the room a waiter took his coat, without being asked, and hung it on a hook behind him. When the customer rose to leave the coat was gone.[3]

What the waiter did might be no more than an act of voluntary courtesy towards the customer, yet the restaurant-keeper was held liable as a bailee. The waiter by taking the coat into his possession had relieved the plaintiff of its care and had thus assumed the responsibility of a bailee. It was he who selected the place where the coat should be put.

If the customer had instructed the servant where and how the coat should be put, the result, perhaps, would have been otherwise. To take, for instance, a decision of the Madras High Court.[4]

A lady handed over to a goldsmith certain jewels for the purpose of being melted and utilized for making new jewels. Every evening as soon as the goldsmith's work for the day was over, the lady used to receive half-made jewels from the goldsmith and put them into a box in the goldsmith's room and keep the key in her possession. The jewels were lost one night.

But the lady's action against the goldsmith failed, the court saying: "Any bailment that could be gathered from the facts must be taken to have come to an end as soon as the plaintiff was put in possession of the melted gold. Delivery is necessary to constitute bailment. The mere leaving of box in a room in the defendant's house, when the plaintiff herself took away the key, cannot certainly amount to delivery within the meaning of the provision in Section 149."

Actual or Constructive Delivery

Section 149 explains the meaning of delivery of possession.

149. Delivery to bailee how made.—The delivery to the bailee may be made by doing anything which has the effect of putting the goods in the possession of the intended bailee or of any person authorised to hold them on his behalf.

An explanation to Section 148 provides that "if a person already in possession of the goods of another contracts to hold them as a bailee, he thereby becomes the bailee and the owner becomes the bailor although they may not have been delivered by way of bailment".

Delivery of possession is thus of two kinds, namely:

(1) actual delivery, and

(2) constructive delivery.

When the bailor hands over to the bailee physical possession of the goods, that is called "actual delivery". "Constructive delivery" takes place when there is no change of physical possession, goods remaining where they are, but something is done which has the effect of putting them in the possession of the bailee. For example, delivery of a railway receipt amounts to delivery of the goods.[5]

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3. *Ultzen* v *Nicolls*, (1894) 1 QB 92.
4. *Kaliaperumal Pillai* v *Visalakshmi*, AIR 1938 Mad 32.
5. See *Morvi Mercantile Bank* v *Union of India*, AIR 1965 SC 1954.

Similarly, where a person pledged the projector machinery of his cinema under an agreement which allowed him to retain the machinery for the use of the cinema, the Andhra Pradesh High Court[6] observed:

> "It must be held that there was a constructive delivery, or delivery by attornment to the bank. Since then there was a change in the legal character of the possession of goods, though not in the actual and physical custody. Even though the bailor continued to remain in possession, it was the possession of the bailee."[7]

Another illustration of constructive delivery is *Fazal* v *Salamat Rai*.[8]

> The defendant was holding the plaintiff's mare under the execution of a decree. The plaintiff satisfied the decree and the court ordered redelivery of the mare to the plaintiff. The defendant, however, refused to do so unless his maintenance charges were also paid. The mare was stolen from his custody.

Holding him liable, the court said that after the delivery order had been passed, the relation of bailor and bailee was established by virtue of the Explanation to Section 148.

In a case before the Supreme Court the owner of a car involved in an accident delivered it under the policy on behalf of the insurer to the nearest garage for repairs. This delivery was regarded as sufficient to constitute the insurance company as a bailee and the garage as a sub-bailee. They became responsible for the loss of the car in a fire on the premises.[9]

2. Delivery should be upon contract

Delivery of goods should be made for some purpose and upon a contract that when the purpose is accomplished the goods shall be returned to the bailor. When a person's goods go into the possession of another without any contract, there is no bailment within the meaning of its definition in Section 148. A well-known illustration is the decision of the Allahabad High Court in *Ram Gulam* v *Government of UP*.[10]

> The plaintiff's ornaments, having been stolen, were recovered by the police and, while in police custody, were stolen again. The plaintiff's action against the State for the loss was dismissed.

SETH J said: "... the obligation of a bailee is a contractual obligation and springs only from the contract of bailment. It cannot arise independently of a contract. In this case the ornaments were not made over to the Government under any contract whatsoever.... The Government, therefore, never occupied the position of bailee and is not liable as such to indemnify the plaintiffs."[11]

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6. *Bank of Chittor* v *Narasimbulu*, AIR 1966 AP 163.
7. *Per* VENKATASWAMI J at p 166, *ibid.*
8. (1928) 120 IC 421. Goods which cannot be delivered, like a film not yet produced, cannot be pledged. *G.C. Rev Authority* v *Sudarsanam Pictures*, AIR 1968 Mad 319.
9. *N.R. Srinivasa Iyer* v *New India Ins Co*, (1983) 3 SCC 458, 466, 469 : AIR 1983 SC 899 : (1983) 54 Comp Cas 711.
10. AIR 1950 All 206. *See* also *Om Prasad* v *Secy of State*, (1937) 172 IC 567 ; *Surendra Nath* v *Kali Kumar*, AIR 1956 Ass 55, hiring of elephants is not bailment unless so agreed. *Annamali Timber Trust Ltd* v *Trippunitchura*, AIR 1954 TC 305.
11. To the *same effect* is *Mohd Murad* v *Govt of UP*, AIR 1956 All 75, property deposited in court under orders, no bailment because there was no contract.

In Pollock and Mulla the above assumption has been described as unjustifiable.[12]

Non-contractual Bailments

English law recognises bailment without contract. In the words of Cheshire and Fifoot:

> "At the present day, no doubt, in most instances where goods are lent or hired or deposited for safe custody, or as security for a debt, the delivery will be the result of a contract. But this ingredient, though usual, is not essential."[13]

The Bombay High Court in its decision in *Lasalgaon Merchants Co-operative Bank Ltd* v *Prabhudas Hathibhai*[14] has taken the lead in imposing the obligation of a bailee without a contract. In the opinion of the court, as expressed through NAIK J, where certain goods belonging to an individual are seized by the Government the latter becomes the bailee thereof even if there is no suggestion of a contract between the Government and the individual. The facts stated briefly were as follows:

> Certain packages of tobacco lying in the godown of a partnership firm were pledged to the plaintiff bank. Some of the partners, having failed to clear their income tax dues, the Income Tax Officer ordered seizure of the goods. The officials of the Collectorate accordingly locked the godown and handed over the key to the police. Then came heavy rains. The roof of the godown leaked and the tobacco was damaged.

The Court said: "Heavy rains do not (necessarily) amount to an act of God. It was the duty of Government officers to take such care as every prudent manager would take of his own goods. The Government stood in the position of bailees and it was for them to prove that they had taken as much care as was (reasonably) possible for them and that the damage was due to reasons beyond their control."[15]

This view was accepted by the Supreme Court in *State of Gujarat* v *Memon Mahomed*.[16]

> Certain motor vehicles and other goods belonging to the plaintiffs were seized by the State in exercise of its powers under a Sea Customs Act. The goods while in the custody of the State remained totally uncared for.

It was contended on behalf of the State that as the State were not bailees, there was no obligation to take care. Referring to this SHELAT J observed as follows:[17]

> "That contention is not sustainable. Bailment is dealt with by the Contract Act only in cases where it arises from a contract, but it is not correct to say that

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12. INDIAN CONTRACT AND SPECIFIC RELIEF ACTS, 562 (8th edn, by Setalvad & Goodersen, 1957).
13. The LAW OF CONTRACT, 73 (6th edn, 1964). *See also* the speech of Lord COLERIDGE CJ in *The Queen* v *Macdonald*, (1885) 15 QBD 323, 326 and CAVE J at p 327. For an illustration of non-contractual bailment see *Gilchrist Watt & Sanderson Property Ltd* v *York Products Property Ltd*, (1970) 3 All ER 825 : (1970) 1 WLR 1262, PC, where a party who unloaded goods became bailee for their safe custody.
14. AIR 1966 Bom 134.
15. *Ibid.* NAIK J at p 140.
16. AIR 1967 SC 1885.
17. *Ibid.* at p 1888.

there cannot be a bailment without an enforceable contract. . . .[18] Nor is consent indispensible for such a relationship to arise. A finder of goods of another has been held to be a bailee in certain circumstances."

The court also cited the following passage from POLLOCK and WRIGHT:[19]

> "Bailment is a relationship *sui generis* and unless it is sought to increase or diminish the burdens imposed upon the bailee by the very act of bailment, it is not necessary to incorporate it into the law of contract and to prove a consideration."[20]

The trend set by these cases has been affirmed by the Supreme Court though without reference to them.[21] The facts involved a repetition of the *Ram Gulam*[22] story, namely, theft, recovery of the ornaments by the police and their final disappearance from police custody. The State was held liable to pay the value of the ornaments to the victim of the theft.

When the Port Trust is required to store imported goods, the relationship of bailor and bailee comes into existence. Under Section 42(6) of the Major Port Trusts Act, 1963, the Port Trust of a Major Port would be regarded as the bailee of the goods coming into its possession. The provisions of Sections 151, 152 and 161 of the Contract Act become applicable (duty of care and duty to return).[23]

Contract, Express or Implied

The contract may be express or implied. Thus, where with the consent of the station-master goods were stored on a railway company's platform, wagons being not available, the company was held liable when they were damaged by fire caused by a spark emitted by a passing engine.[24]

3. Delivery should be upon some purpose

Bailment of goods is always made for some purpose and is subject to the condition that when the purpose is accomplished the goods will be returned to the bailor or disposed of according to his mandate.[25] If the person to whom the goods are delivered is not bound to restore them to the person delivering them or to deal with them according to his directions, their relationship will not be that of bailor and bailee.

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18. Here the learned Judge quoted a passage from POSSESSION IN THE COMMON LAW, by Pollock and Wright, at p 163.
19. POSSESSION IN THE COMMON LAW, 143.
20. *State of Gujarat* v *Memom Mahomed*, (1967) 3 SCR 938, 943 : AIR 1967 SC 1885, 1888.
21. *Basavva K.D. Patil* v *State of Mysore*, (1977) 4 SCC 358. B.B. Pandey welcomes this decision in his article, *Government Liability for the Goods Lost in Custody: A Step in the Direction of Reasonable Accountability*, (1977) 4 SCC 13 (Journal section).
22. *Ram Gulam* v *Govt of UP*, AIR 1950 All 206.
23. *Board of Trustees of the Port of Bombay* v *Sriyanesh Knitters*, (1999) 7 SCC 359: AIR 1999 SC 2947: (1999) 112 ELT 373.
24. *G.-G. of India in Council* v *Jubilee Mills Ltd*, AIR 1953 Bom 46. Where, however, the goods were left after they were marked by the loading clerk and neither any railway receipt was obtained, nor the railway company made incharge of the goods, no bailment arose. *Luchmi Narain* v *Bombay, Baroda & Central India Rly*, (1923) 45 All 235 ; *Dhanraj* v *Union of India*, AIR 1958 Ass 5.
25. *See* SMITH J in *Queen* v *Ashweli*, (1885) 16 QBD 190, 198 ; *Streeter* v *Harlock*, (1822) 1 Bing 34, bailee's right to deal with the goods as directed. *Gangaram* v *Crown*, AIR 1943 Nag 436, no bailment where the thing is not to be specifically accounted for.

> The plaintiff delivered to the Treasury Officer at Meerut nine Government promissory notes for cancellation and consolidation into a single note of Rs 48,000. The defendant's servants misappropriated the notes. The plaintiff sued the State to hold them responsible as bailees.[26]

But his action failed. There can be no bailment unless there is a delivery of goods and a promise to return. The Government was not bound to return the same notes, nor was it bound to dispose of the surrendered notes in accordance with the plaintiff's directions.

Bailment Compared with other Similar Relations

It is this feature of bailment which distinguishes it from many other transactions of the same kind. A deposit of money with a banker is not a bailment as he is not bound to return the same notes and coins.[27] Accordingly, a bank was not allowed to exercise the right of lien as a bailee on money held under a fixed deposit.[28] An agent who has collected money on his principal's behalf is not a bailee of the money for the same reason.[29] In the words of SHETTY J of the Supreme Court:[30]

> "One important distinguishing feature between agency and bailment is that the bailee does not represent the bailor. He merely exercises, with the leave of the bailor (under contract or otherwise), certain power of the bailor in respect of his property. Secondly, the bailee has no power to make contracts on bailor's behalf, nor can he make the bailor liable, simply as bailee, for any acts he does."[31]

Applying this principle to the position of a banker who was holding the goods on behalf of its account-holder for the purpose of delivering them to his customers against payment, the court held that the bank was not thereby constituted into an agent and remained a baliee only.

A bailment is also distinguishable from sale, exchange or barter. In these transactions what is transferred is not mere possession, but also ownership and, therefore, the person buying is under no obligation to return. In a sale of beer bottles, one of the terms was that the price of the bottles would be refunded on the buyer returning the bottles. The transaction was held to be a sale of the bottles and not a bailment.[32] But hire-purchase contract is a bailment, though of

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26. *Secretary of State* v *Sheo Singh Rai*, (1880) 2 All 756.
27. *Ichha Dhanji* v *Natha*, (1888) 13 Bom 338 ; *Devendra Kumar* v *Gulab Singh*, AIR 1946 Nag 114 : ILR 1946 Nag 210.
28. *Union Bank of India* v *K.V. Venugopalan*, AIR 1990 Ker 223.
29. *Shanker Lal* v *Bhura Lal*, AIR 1951 Ajm 24 ; *Bridges* v *Garrett*, (1870) LR 5 CP 451.
30. *United Commercial Bank* v *Hem Chandra Sarkar*, (1990) 3 SCC 389, 395 : AIR 1990 SC 1329.
31. *Citing* Friedman's LAW OF AGENCY, 23 (5th edn).
32. *Kalyani Breweries Ltd* v *State of WB*, AIR 1998 SC 70, under the WB Sales Tax Act, 1954; *distinguishing* it from *United Breweries Ltd* v *State of AP*, (1997) 3 SCC 530: (1997) AIR SCW 1414, where recovery of bottles was under a well-laid out system. *Raj Steel* v *State of AP*, (1989) 3 SCC 262: AIR 1989 SC 1696. *State of Maharashtra* v *Britannia Biscuit Co*, 1995 Supp (2) SCC 72: (1995) 96 STC 642, deposit taken for tins, refundable on return of tins. The court held that the tins would be deemed to be sold on the expiry of the time for return.

course, not merely a bailment. It has two aspects, bailment *plus* an element of sale.[33]

Post Office, Bailee

Post Office is a bailee of the articles of the sender.[34]

DUTY OF BAILOR

According to Section 150 which deals with the duty of bailor, bailors are of two kinds, namely:

(1) gratuitous bailor, and

(2) bailor for reward.

A person who lends his articles or goods without any charge, is called a "gratuitous bailor". His duty is naturally much less than that of a bailor for hire or consideration.

Duty of gratuitous bailor

Speaking of the duty of a gratuitous bailor, Section 150 says:

150. Bailor's duty to disclose faults in goods bailed.—The bailor is bound to disclose to the bailee faults in the goods bailed, of which the bailor is aware, and which materially interfere with the use of them, or expose the bailee to extraordinary risks; and if he does not make such disclosure, he is responsible for damage arising to the bailee directly from such faults.

If the goods are bailed for hire, the bailor is responsible for such damage, whether he was or was not aware of the existence of such faults in the goods bailed.

Illustrations

(a) *A* lends a horse, which he knows to be vicious, to *B*. He does not disclose the fact that the horse is vicious. The horse runs away. *B* is thrown and injured. *A* is responsible to *B* for damage sustained.

(b) *A* hires a carriage of *B*. The carriage is unsafe, though *B* is not aware of it, and *A* is injured. *B* is responsible to *A* for the injury.

A person, for example, who lends his cycle or horse to a friend, and if he knows that the cycle is without brakes or that the horse is unsound, he should disclose this fact and his duty ends there. "Would it not be monstrous to hold that if the owner of a horse, knowing it to be vicious and unmanageable, should lend it to one who is ignorant of its bad qualities and conceal them from him, and the rider, using ordinary care and skill, is thrown from it and injured, he should not be responsible? By the necessarily implied purpose of the loan a duty is

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33. So held by the Supreme Court in a number of cases: *Instalment Supply (P) Ltd* v *Union of India*, (1962) 2 SCR 644 : AIR 1962 SC 53 ; *K.L. Johar & Co* v *Dy Commercial Tax Officer*, (1965) 2 SCR 112 : AIR 1965 SC 1082 ; *Damodar Valley Corpn* v *State of Bihar*, (1961) 2 SCR 522 : AIR 1961 SC 440 ; *Sundaram Finance Ltd* v *State of Kerala*, (1966) 2 SCR 828 : AIR 1966 SC 1178 ; *South Australian Ins Co* v *Randell*, (1869) LR 3 PC 101, delivery of goods with a right to claim equivalent value in some other goods.

34. *Income Tax Commissioner* v *P.M. Rathod*, (1960) 1 SCR 401 : AIR 1959 SC 1394. The position of post office in reference to VPP articles.

contracted towards the borrower not to conceal from him those defects known to the lender which may make the loan perilous or unprofitable to him."[35] The conditions of his liability are:

(1) He should have knowledge of the defect and the bailee should not be aware.[36]

(2) The defect in the goods must be such as exposes the bailee to extraordinary risks or materially interferes in the use of the goods.

Duty of bailor for reward

The duty of a bailor for consideration is much greater. He is making profit from his profession and, therefore, it is his duty to see that the goods which he delivers are reasonably safe for the purpose of the bailment. It is no defence for him to say that he was not aware of the defect. Section 150 clearly says that "if the goods are bailed for hire, the bailor is responsible for such damage, whether he was or was not aware of such faults in the goods bailed". He has to examine the goods and remove such defects as reasonable examination would have disclosed. In *Hyman & Wife* v *Nye & Sons*:[37]

> The plaintiff hired from the defendant for a specific journey a carriage, a pair of horses and a driver. During the journey a bolt in the underpart of the carriage broke, the splinter bar became displaced, the carriage was upset and the plaintiff injured.

Holding the defendant liable Justice LINDLEY said: "A person who lets out carriages is not responsible for all defects discoverable or not; he is not an insurer against all defects. But he is an insurer against all the defects which care and skill can guard against. His duty is to supply a carriage as fit for the purpose for which it is hired as care and skill can render it." Similarly in *Reed* v *Dean*:[38]

> The plaintiffs hired a motor launch from the defendant for a holiday on the river Thames. The launch caught fire, and the plaintiffs were unable to extinguish it, the fire-fighting equipment being out of order. They were injured and suffered loss.

The court held that there was an implied undertaking that the launch was as fit for the purpose for which it was hired as reasonable care and skill could make it. The defendant was accordingly held liable.

Where a bailor delivers goods to another for carriage or for some other purpose, and if the goods are of dangerous nature, the fact should be disclosed to the bailee.[39]

DUTIES OF BAILEE

The following are the duties of every bailee:

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35. *Blakemore* v *Bristol and Exeter Rly Co*, (1858) 8 E&B 1035, 1051.
36. *MacCarthy* v *Younge*, (1861) 6 H&N 329, gratuitous bailor not liable for defects not known to him.
37. (1881) 6 QBD 685.
38. (1949) 1 KB 188.
39. *Lyell* v *Ganga Das*, ILR (1875) 1 All 60, goods consigned without disclosing that they were combustible ; *Bamfield* v *Goole & Sheffield Transport Co Ltd*, (1910) 2 KB 94; *Great Northern Rly* v *L.E.P. Transport Ltd*, (1923) 2 KB 742; *Dwarkanath* v *River Steam Navigation Co Ltd*, AIR 1917 PC 173 : 20 Bom LR 735.

1. **Duty of reasonable care [Ss. 151-152]**

Section 151 lays down this duty in the following terms:

151. Care to be taken by bailee.—In all cases of bailment the bailee is bound to take as much care of the goods bailed to him as a man of ordinary prudence would, under similar circumstances take, of his own goods of the same bulk, quality and value as the goods bailed.

Uniform Standard of Care

The section lays down a uniform standard of care for "all cases of bailment".[40] Originally in English law "liability in bailment was absolute. It was no excuse for the bailee to say that the damage or failure to return was due to no fault of his own; he was liable in any case".[41] Thus, where goods were delivered to a bailee for safe custody and he was robbed of them, the court held him liable, saying, "it is a delivery which chargeth him to keep at his peril".[42] The first concession was given to a gratuitous bailee. It was laid down in *King* v *Viscount Hertford*[43] that "if money be given to one to keep generally without consideration and if the person be robbed, he is discharged". Lord HOLT in *Coggs* v *Bernard*[44] further reduced the scope of absolute liability by confining it only to bailees "who exercised a public calling", namely, public carriers and innkeepers.[45] Subsequently still by a judgment of Lord MANSFIELD absolute liability was confined to carriers only.[46] The rest of the bailees owe only the duty of reasonable care.[47]

For the purpose of duty of care modern English law divides bailees into two kinds only, namely, gratuitous bailee and bailee for reward. A gratuitous bailee is liable for loss of, or damage to, goods only if he is guilty of gross negligence. "There is a certain degree of negligence to which everyone attaches great blame", and that may be called "gross negligence".[48] But the modern trend is towards a

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40. Thus even a gratuitous or involuntary bailee is bound to bring into his duty the same amount of care as is prescribed by the section. *Wilson* v *Brett*, (1843) 11 M&W 113.
41. *See* C.V. Davidge, *Bailment*, (1925) 41 LQR 433, 436.
42. *Southcot* v *Bennet*, (1601) 78 ER 1041.
43. (1681) Shower 172 : 39 ER 870.
44. (1704) 2 Ld Raym 909.
45. About innkeepers (hotels, lodges and guest-houses) the general trend of decisions is that they are bailees liable only if the requisite standard of care is not observed. See *Rampal Singh* v *Murray & Co*, (1899) 22 All 164 ; before the Contract Act there were some decisions to the contrary effect. See *Whateley* v *Palanji*, (1866) 3 BHC (OC) 137. But now the opinion is different. *Jam and Son* v *Cameron*, (1922) 44 All 735.
46. *Forward* v *Pittard*, (1785) 1 TR 27 : 1 RR 142.
47. A carrier is permitted by the Carriers Act, 1865 to reduce his liability from an insurer to that of a bailee by a special contract with each consignee, but he cannot exclude his liability for negligence. *Irrawaddy Flotilla & Co* v *Bugwandas*, 18 IA 121 (1891) : 18 Cal 620 ; S. 93 of the Railways Act, 1989 charges the Railways with the responsibility of an insurer subject only to some defences and variations permitted by the Act. Carriers by Sea and Air are under similar responsibility. *See*, for further details, Avtar Singh, LAW OF CARRIAGE, (3rd edn, 1993) ; *Parasram* v *Air-India Ltd*, 56 Bom LR 944 ; *National Tobacco Co* v *I.A.C.*, AIR 1961 Cal 383 ; *Rukmanand* v *Airways India Ltd*, AIR 1961 Ass 71 ; *I.A.C.* v *Madhuri Choudhri*, AIR 1965 Cal 252 ; *Bombay Steam Navigation Co* v *Vasudev*, 29 Bom LR 1551, CARRIAGE OF GOODS BY SEA ACT, 1925.
48. *Giblin* v *McMullen*, (1869) 2 PC 317.

simple principle of liability for negligence in all cases.[49] *Blount* v *The War Office*[50] shows this trend.

> A house belonging to the plaintiff was requisitioned by the War Office. The plaintiff was allowed to store certain articles in a strong-room in the house, which he locked. Of the troops stationed there, who were not kept under proper control, some broke into the room and stole a quantity of silver plates.

The War Office was held liable. The court said: "There was a voluntary bailment of the goods to the defendants in the way of deposit and the standard of care required of them was reasonable care which a man would take of his own property. It is hard to believe that any reasonable man, who had valuable property of his own stored in those circumstances, would leave it to the tender mercies of seventy or eighty displaced persons of that type without taking any precaution. The Ministry was negligent."

This trend has been further confirmed by the Court of Appeal in *Houghland* v *R.R. Low (Luxury Coaches) Ltd.*[51]

> The plaintiff was a passenger in one of the defendant's coaches. She had her suitcase put in the boot of the coach from where it was lost. The trial Judge found that this was technically a gratuitous bailment.

Even so it was held that the standard of care was that of reasonable care and was the same whether the bailment was gratuitous or for reward. ORMEROD LJ said:

> "The question that we have to consider in a case of this kind, if it is necessary to consider negligence, is whether in the circumstances of this particular case a sufficient standard of care has been observed by the defendants or their servants."

The standard of care expected of a paid bailee has been expressed in almost similar terms. This appears from *Martin* v *London County Council*.[52]

> The plaintiff was brought to a paid hospital as a patient. On her entry, the hospital officials took charge of two pieces of jewellery and a gold cigarette-case. They were subsequently stolen by a thief who broke into the room in which they were kept.

It was held that the defendants were bailees for reward and were liable for the loss as they had failed to exercise care which the nature and quality of the articles required.

In India, however, Section 151 prescribes a uniform standard of care in all cases of bailment, that is, a degree of care which a man of ordinary prudence would take of his own goods of the same type and under similar circumstances. If the care devoted by the bailee falls below this standard, he will be liable for loss of or damage to the goods:

152. Bailee when not liable for loss, etc, of thing bailed.—The bailee, in the absence of any special contract, is not responsible for

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49. The Supreme Court of India has also pointed out that liability under Ss. 151-152 is one for negligence only. *Union of India* v *Amar Singh*, (1960) 2 SCR 75 : AIR 1960 SC 233.
50. (1953) 1 All ER 1071.
51. (1962) 1 QB 694, CA : (1962) 2 All ER 159.
52. (1947) KB 628.

the loss, destruction or deterioration of the thing bailed, if he has taken the amount of care of it described in Section 151.

"No cast-iron standard can be laid down for the measure of care due from a bailee and the nature and amount of care must vary with the posture of each case."[53] Nature, quality and bulk of the goods bailed, the purpose of bailment, facilities reasonably available for safe custody and the like, will be taken into account for determining whether proper care has been taken. Thus, where a part of the foodgrains stored at a bailee's godown were damaged by floods unprecedented in the history of the place;[54] where a man hired a wooden shop and it was burnt by mobs during communal riots in the city,[55] the bailee in each case was held not liable as the loss was due to events beyond his control. Where on account of partition of the country a bank had to flee along with mass exodus from Pakistan to India, the bank was held to be not liable for goods bailed to it in Pakistan and which were thus lost there.[56]

Loss by Theft

Where the bailor's goods are stolen from the custody of the bailee, he will be liable if there has been negligence on his part. Where the plaintiff stayed at a hotel and his articles were stolen while he was away, the hotelier was held liable as the room was, to his knowledge, in an insecure condition.[57] Similarly, in another case, a bailee kept the bailor's ornaments locked in a safe and kept the key in a cash-box in the same room. The room was situated on the ground floor and, being locked from outside, was easily accessible to burglars by removing the latch. The ornaments having been stolen, the bailee was held liable.[58] Where a banker was rendering the service of receiving goods on behalf of its account-holder and to hold them for the purpose of delivering them to the customers of the account-holder against payment, it was held by the Supreme Court that the position of the banker was that of the bailee and he was liable for the account-holder's loss inasmuch as the banker did not deliver goods to the customers from whom payment had been received.

The Court said:[59]

> "The banker-bailee, gratuitous or for reward, is bound to take the same care of the property entrusted to him as a reasonably prudent person and careful man may fairly be expected to take of his own property of the like description. In fact, a paid bailee must use the greatest possible care and is expected to employ all precautions in respect of the goods deposited with him. If the property is not

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53. *Shanti Lal* v *Tara Chand*, AIR 1933 All 158. As to the effect of circumstances see *Shiv Nath Rai* v *Union of India*, AIR 1965 SC 1666 and *Union of India* v *Udha Ram & Sons*, (1963) 2 SCR 702 : AIR 1963 SC 422.
54. *Ibid.*
55. *Sunder* v *Ram Swarup*, 1952 All 205.
56. *Gopal Singh* v *P.N.B.*, AIR 1976 Del 115.
57. *Jain & Son* v *Comeron*, 1922 All 735.
58. *Rampal* v *Gouri Shanker*, AIR 1952 Nag 8. See *Lakhaji* v *Mahadeo*, AIR 1938 Bom 101 : 41 Bom LR 6. Failure to insure would not have made the bailee liable because ordinarily an owner also does not insure. *Bosech & Co* v *Maudlestan*, 1906 Punj Rec No 70.
59. *United Commercial Bank* v *Hem Chandra Sarkar*, (1990) 3 SCC 389, 396 : AIR 1990 SC 1329.

delivered to the true owner, the banker cannot avoid his liability in conversion."[60]

Applying these principles the court held that "the bank could not avoid the liability to return the goods as agreed upon or to pay an equivalent amount to the plaintiff. Even if we assume that the goods were delivered to a wrong person, the bank had to own up the liability to the plaintiff. The liability of banker to a customer in such a case is absolute even if no negligence is proved". In HALSBURY'S LAWS OF ENGLAND it is stated: "Where the bank delivers the goods to the wrong person, whereby they are lost to the owner, the liability of the bank is absolute, though there is no element of negligence, as where delivery is obtained by means of an artfully forged order. In law the banker could contract out of this liability, but he would be unlikely to do so in practice."[61]

Burden of Proof

The burden of proof is on the bailee to show that he was exercising reasonable care and if he can prove this he will not be liable. If the bailee places before the court evidence to show that he had taken reasonable care to avoid damage which was reasonably foreseeable or had taken all reasonable precautions to obviate risks which were reasonably apprehended, he would be absolved of his liability.[62] Thus, where the railway administration was not able to explain how the barge carrying the plaintiff's goods sank and was lost, negligence was presumed making the railway liable.[63] Where a jewellery box with declared contents was handed over to a bank under the clause which provided, "The articles in safe custody will be kept in the strong-room under joint custody of the manager or an officer duly authorised by the Head Office and the cashier", it was held that the bank was liable to account for the

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60. *Citing* HALSBURY'S LAWS OF ENGLAND, para 23, Vol 3, 4th edn, and T.G. Reeday, THE LAW RELATING TO BANKING, 81 (4th edn) ; F.E. Ferry, THE LAW AND PRACTICE RELATING TO BANKING, 21 (5th edn).

61. HALSBURY'S LAWS OF ENGLAND, para 94, Vol 3, 4th edn *Lakshmi Narain* v *Secy of State for India*, (1923) 27 Cal WN 1017, carrying goods in a boat with holes, obvious negligence.

62. *Chellapan Pillai* v *Canara Bank*, (1988) 2 Ker LT 54. A Port Authority was held liable in the absence of proof that they took as much care of the goods landed at their port as satisfied the requirement of Section 151. They neither informed the consignee of the arrival of the goods nor made any serious effort to find out what had happened to the goods. *Chittagong Port Authority* v *Mohd Ishaque*, (1983) 35 DLR (AD) 1983 SC (Bangladesh). *Milap Carriers* v *National Insurance Co Ltd*, AIR 1994 24, loss due to circumstances beyond control of carrier, there was also special contract exempting certain risks, the insurer who had to pay the claim was not allowed to recover indemnity from the carrier.

63. *Union of India* v *Sugauli Sugar Works*, (1976) 3 SCC 32. *See* also *Orient Paper Mills Ltd* v *Union of India*, AIR 1984 Ori 157 for responsibility of railways as bailees and the question of burden of proof. Loading was done in the private siding of the plaintiff and so burden upon him to prove the fact of loading; *Cochin Port Trust* v *Associated Cotton Traders*, AIR 1983 Ker 154, Port Trust not able to explain how fire commenced and destroyed bailor's goods, held, presumption of negligence. *State Bank of India* v *Quality Bread Factory*, AIR 1983 P&H 244, goods lost from hypothecated godown on account of the negligence of bank officials, held, borrower's liability reduced to that extent. *Raman & Co* v *Union of India*, AIR 1985 Bom 37, since the liability of the Railways is that of bailee u/Ss. 151-152, burden was on them to show how loss occurred and that it occurred after the first 7 days after the completion of the transit ; *M. Veerabhadra Rao* v *Union of India*, (1985) 1 ATC 207 AP, goods lost after seven days, the plaintiff came to receive the goods 4 months after their arrival, no liability. *Shields* v *Wilkinson*, (1887) 9 All 398, horse dying in the bailee's custody, burden on him to account for circumstances. *Trustees of Harbour, Madras* v *Best & Co*, (1899) 22 Mad 524, goods lost from safe-custody, accountability.

missing articles of jewellery and became liable because it failed to give any sufficient explanation for the loss. The depositor having died the recovery was sought by legal heirs through open delivery in court.[64] Where the bank took over possession of the hypothecated truck because of the borrower's default in repayment and neither disposed it of in accordance with the terms of the agreement nor took proper care of it leaving it in an open place, the extent to which the truck suffered loss of value because of the passage of time, the loan amount had to be reduced to that extent.[65] Where the plaintiff's car was lost in a fire occurring in a garage where it was delivered for repairs and the bailees did not lead any evidence to show as to how the incident took place, the Supreme Court held the bailees liable.[66] Where the goods were removed by the carrier's driver and attendant, it was held that the onus was on the carriers, as bailee, to prove that the loss was not caused by any fault of his or his agents. In the case before the court the carrier had failed to discharge the onus of proof and as such the court found as a fact that the carrier was negligent in appointing a particular driver in the circumstances.[67] As against it, where certain engraving plates were gratuitously left with a bailee and they were lost and though he was not able to account for the manner of loss, he proved that the plates were kept in a proper place under the care of proper persons and in a proper arrangement. He was accordingly held not liable.[68]

Loss due to act of Bailee's Servant

Where the loss has been due to the act of the bailee's servant, he would be liable if the servant's act is within the scope of his employment. Explaining the principle in *Cheshire* v *Bailey*[69] COLLINS MR said:

> "The bailee is bound to bring reasonable care to the execution of every part of the duty accepted. He may perform that duty by servant or personally, and if he employs servants he is as much responsible for all acts done by them within the scope of their employment."

Thus in, *Sanderson* v *Collins*:[70]

> The defendant sent his carriage to the plaintiff for repairs and the latter lent his own carriage to the defendant while the repairs were going on. The defendant's coachman, without his knowledge, took away the carriage for his own purpose and damaged it.

The defendant was held not liable as the coachman at the time when the injury was done to the carriage was not acting within the course of his employment. "If a burglar broke into the coach house and took away the carriage and caused damage

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64. *Jagdish Chandra Trikha* v *Punjab National Bank*, AIR 1998 Delhi 266. The suit filed within three years after obtaining letters of administration was held to be within time. Recovery of the value of the missing articles was allowed at the market price on the date of the suit with 12% simple interest.
65. *Central Bank of India* v *Abdul Mujeeb Khan*, (1997) AIHC 299 MP.
66. *N.R. Srinivasa Iyer* v *New India Ins Co Ltd*, (1983) 3 SCC 458, 469 : AIR 1983 SC 899 : (1983) 54 Comp Cas 711.
67. *Rothmans of Pall Mall* v *Neo Kim*, (1989) 1 Current LJ 59 HC Kuala Lumpur.
68. *Bullen* v *Swan Electric Graving Co*, (1907) 23 TLR 258.
69. (1905) 1 KB 237.
70. (1904) 1 KB 628. *See* also *Bilaspur Central Co-op Bank Ltd* v *State of MP*, AIR 1959 MP 77.

to it and brought it back, no liability would attach to the bailee. The act of the servant was not different."[71]

Where, on the other hand, the bailee's driver left the vehicle in which he was carrying the plaintiff's goods unattended and half the goods were stolen, the bailee was held liable. The court also rejected the argument that the bailee had contracted with a forwarding agent and not with the plaintiffs, as the bailee knew that the goods belonged to the plaintiff.[72] The same result followed where the goods were stolen by the driver and attendant of the carrier's motor lorry.[73]

When the goods have been stolen from the bailee's custody, he should take reasonable steps to recover them.

> A farmer accepted certain cattle for ajistment. Some of them were stolen without his default, but he made no efforts whether by informing the owner or the police to recover them.[74]

He was held liable. He should have used reasonable diligence to recover them and he could discharge himself only by showing that such diligence would have been unavailing.

Bailee's own Goods lost with those of Bailor

Where the bailee's own goods are lost along with those of the bailor, the bailee would naturally contend that he was taking as much care of the bailor's goods as he did of his own.[75] But this would not be the deciding factor. The fact that the bailee is generally negligent with his own goods is no justification for his negligence towards the bailor's goods,[76] unless the bailor is aware of his habits and, therefore, knew what to expect. Even in such cases the proper inquiry is whether reasonable care has been taken. Thus, where a general merchant going to consign his parcel for export, took, out of voluntary courtesy, his friend's parcel for similar consignment and entered both the parcels under a wrong heading, and, consequently, both were seized and lost. He was held not liable as he had in good faith taken equal care of both the parcels.[77]

Involuntary bailee

"A person who has come into possession of a chattel through no act of his own and without his consent" is called an involuntary bailee. An early illustration is to be found in the facts of *Haward* v *Harris*:[78]

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71. *See* also *Cheshire* v *Bailey*, (1905) 1 KB 237 ; *Giblin* v *McMullen*, (1869) 2 PC 317 ; *Searl* v *Liverick*, (1874) QB 122, damage caused by collapse of a roof owing to high winds, bailee not liable. *South Eastern Carriers P Ltd* v *Mohd Sarvar*, (1996) AIHC 2988 AP, the driver of the lorry along with his employer held liable for short delivery for which the driver was responsible.
72. *Lee Cooper Ltd* v *C.H. Jeakins & Sons Ltd*, (1965) 3 WLR 753.
73. *Rothmans of Pall Mall* v *Neo Kim*, (1989) 1 Current LJ 59.
74. *Coldman* v *Hill*, (1919) 1 KB 443.
75. *Calcutta Credit Corpn* v *Prince Peter*, AIR 1964 Cal 374.
76. See *Lakshmidas* v *Megh Raj*, (1900) Punj Rec No 90, p 371 and *Doorman* v *Jenkins*, 2 A & E 256.
77. *Sheills* v *Blackburne*, (1789) 1 HBL 158.
78. (1884) C&E 253, any such report being not available, the facts have been collected from CHITTY ON CONTRACTS, 22nd edn (1961), Vol 2, p 161.

The author of a play, without being asked, sent his manuscript to a theatre operator, who lost it.

The court held "that no duty of any kind was cast on the defendant by receipt of something he had not asked for". Subsequent decisions, however, do not support this view of the situation. And this is amply shown by *Newman* v *Bourne & Hollingsworth*[79].

The plaintiff went to the defendant's shop to buy a coat. She was wearing a coat fastened with a diamond brooch, and she took the coat off, and put it on a glass case with the brooch by the side of it. When leaving she forgot the brooch and it was handed by an assistant to the shopwalker who put it in his desk, from where it was lost.

The defendant was held liable. "He had not exercised that degree of care which was due from one who had found an article and had assumed possession of it. The degree of negligence must be measured by the apparent value of the article."

But if an involuntary bailee, without negligence, does something which results in the loss of the property, he will not be liable for conversion. This has been laid down in *Elvin & Powell Ltd* v *Plummer Raddis Ltd.*[80]

A man came to the plaintiff's warehouse, and ordered to buy £350 worth of coats. He said he wanted them to be sent to the Brighton Branch of P.&E. Ltd, which was done. Subsequently he sent a telegram to P.&.E. saying: "Goods sent to your branch by error. Sending van to collect." The defendants, believing in good faith in the error theory, allowed him to have the goods.

The plaintiff's action against them for conversion failed.

Contract to the contrary

It is still debatable whether a bailee can contract himself out of the duty prescribed by Section 151, or whether a contract of bailment can exempt the bailee from his liability for negligence? The argument is built chiefly on the ground that Section 152 opens with the remark: "in the absence of any special contract". This may show that the legislative intent was to permit him to reduce the scope of his liability. Judicial thinking on this line is in evidence in a Punjab and Haryana decision.[81] The court said that the words "in the absence of special contract" as used in Section 152 show that a bailee can contract himself out of the obligation under Section 151.[82] The court cited the following observation from a Bombay decision:

"This court in *Bombay Steam Navigation Co* v *Vasudev Baburao*[83] held that it was open to a bailee to contract himself out of the obligation imposed by Section 151. The Act does not expressly prohibit contracting out of Section 151 and it could be a startling thing to say that persons *sui juris* are not at liberty to enter into such a contract of bailment as they may think fit. Contracts of bailment

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79. (1951) 31 TLR 209.
80. (1933) 50 TLR 158. *See* Burnett, H.W., *Conversion by Involuntary Bailee*, (1960) 75 LQR 364.
81. *State Bank of India* v *Quality Bread Factory*, AIR 1983 P&H 244.
82. The court *cited* the observations of Beaumont CJ in *Lakhaji Dadaji & Co* v *B.M. Rajanna*, 41 Bom LR 6 : AIR 1939 Bom 101.
83. (1928) ILR 52 Bom 37 : AIR 1928 Bom 5.

are very common although they are not always called by their technical name. There is no reason why a man should not be at liberty to agree to keep property belonging to a friend on the terms that such property is to be entirely at the risk of the consumer and that the man who keeps it is to be under no liability for the negligence of his servants in failing to look after it."[84]

It is submitted with respect that this seems to be an unnatural reading of the two sections. Section 151 prescribes the minimum standard of care expected of a bailee and Section 152 has the effect of saying that unless the standard of care is enhanced by special contract, the bailee will be liable only when he fails to observe the requirement of Section 151. The words in Section 152 "in the absence of any special contract" would permit the standard of duty to be revised upwards and not to be diluted. Apart from this, it has always been held that it is unfair and unreasonable for any person to say that he would not be liable for negligence. No one can get a licence to be negligent. Thus in a Gujarat case bales of cloth were lost from bank custody under circumstances showing negligence. The banker was held liable irrespective of a clause which absolved him of all liability.[85] The clause in question was that the bank will be absolved from all liability for shortage of goods by way of pilferage, stealth or removal from the godown in any manner. Even this could not protect the bank because it was against the meaning and intent of the minimum standard prescribed by Section 151. The Kerala High Court has also adopted this line of reasoning.[86] The court held:[87]

"Where the goods are entrusted with the Port Trust, their duty is certainly in the nature of a bailee's duty and they are expected to take reasonable care. [They] cannot claim a total exemption from the standard of care to be taken by a bailee by taking recourse to the provision contained in Section 121 of the Major Ports Trust Act, 1963 (protection from liability for acts done in good faith). A Division Bench of this court had occasion to consider in *Cochin Port Trust* v *Associated Cotton Traders Ltd*[88] the nature of the duty of the Cochin Port Trust towards the owner of the goods. In this case also the goods were destroyed in a fire which broke out in the godown of the Port Trust. The court held that the Port Trust which is in the position of a bailee has a duty to take all proper measures for protection of the goods. When goods entrusted to a bailee are lost or damaged, there is initial presumption of negligence (failure to take care) on the part of the bailee. Onus of proof is on the bailee to show that he had taken necessary precautions and care required under law. The bailee alone will be in a position to explain the cause of fire. It is a fact specially within his

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84. This case was *followed* by a Division Bench of Gujarat High Court in *Chittarmal Anandi Lal* v *P.N.B.*, ILR (1969) 10 Guj 480.

85. *Mahendra Kumar Chandulal* v *C.B.I.*, AIR 1984 Guj (NOC) 53 : (1984) 1 Guj LR 237. *See* further *Chittagong Port Authority* v *Mohd Ishaque*, (1983) 35 DLR (AD) 364, where the Chittagong Port Act was under consideration and that Act had dropped the words "in the special contract" and retained only the rest of the contents of Section 152. It was held that the goods delivered by a ship to the port constitutes the port into a bailee of the consignee ; *Sheikh Mahamed* v *British Indian Steam Navigation Co.* (1908) 32 Mad 95 ; *Raipur Transport Co* v *Ghanshyam*, AIR 1956 Nag 145.

86. *United India Insurance Co Ltd* v *Pooppally Coir Mills*, (1994) 2 Ker LT 473.

87. *Per* USHA J at p 474, *ibid.*

88. 1983 Ker LT 562.

knowledge and, therefore, under Section 106 of the Evidence Act, 1872, the burden of proving that fact will be upon him."[89]

Delivery of goods to Railways for purpose of carriage is under a special contract because, in addition to it being an ordinary contract of bailment, the provisions of the Railways Act[90] also apply. The Bombay High Court faced a problem on this point in a case[91] involving consignment of certain bales of cloth to be carried in brake van and on arrival at the destination one of the bales being tampered with resulting in short delivery to the extent of 33 kg. The Railways escaped liability because the value of the goods was not declared as required by the relevant section of the Railways Act.[92]

As ordinary bailees Railways too are bound by the duty imposed by Section 151. The Railways were held liable where, instead of keeping the goods in their own godown, they left them at the jetty of a port and they were destroyed by fire.[93]

A contract of bailment provided that the bailee would not be liable for loss or damage due to causes beyond his control. It was held that this would not include shortage in the weight of the goods.[94] The court said that the words "any other cause whatsoever" would also not cover shortage of which no cause is shown. The bank officers were negligent in taking count and weight of the handles and cotton strips. Such irresponsibility could not be described as a cause. The word "cause" had to be interpreted as other causes akin to those mentioned in the clause.[95]

2. Duty not to make unauthorised use [S. 154]

154. Liability of bailee making unauthorised use of goods bailed.—If the bailee makes any use of the goods bailed which is not according to the conditions of the bailment, he is liable to make compensation to the bailor for any damage arising to the goods from or during such use of them.

Illustrations

(a) *A* lends a horse to *B* for his own riding only. *B* allows *C*, a member of his family, to ride the horse, *C* rides with care, but the horse accidentally falls and is injured. *B* is liable to make compensation to *A* for the injury done to the horse.

(b) *A* hires a horse in Calcutta from *B* expressly to march to Benares. *A* rides with due care, but marches to Cuttack instead. The horse accidentally falls and is injured. *A* is liable to make compensation to *B* for the injury to the horse.

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89. *See* also *R.S. Deboo* v *M.V. Hindlekar*, AIR 1995 Bom 68, laundry receipt carried printed term of liability up to 20% of charges or half the value of the garment, whichever was less, held, unreasonable. The court said that liability under S. 151 could not be diluted.
90. No. 1 of 1890, S. 77-B(1) in this case. Now Section 93 of the new Railways Act of 1989.
91. *Jugalkishore* v *Union of India*, AIR 1988 Bom 377.
92. S. 77-B(1) of the old Railways Act. The new Act of 1989 does not carry any list of articles of special value.
93. *Union of India* v *Hafiz Bashir Ad*, 1987 Supp SCC 174. The liability of a carrier is regulated by the Carriers Act, 1865 and that of the Railways by the Railways Act, 1989. There are similar provisions in these Acts and, therefore, barring a few exceptions stated therein, the liability is absolute, see *Shah Jugaldas Amritlal* v *Shah Hira Lal*, AIR 1986 Guj 88.
94. *Balwantlal Chhabildas Mehta* v *State Bank of Saurashtra*, (1998) 4 Guj CD 3112 (Guj).
95. *Ibid.* at p 3115.

Goods must be used by the bailee strictly for the purpose for which they have been bailed to him. Any unauthorised use of the goods would make the bailee absolutely liable for any loss of or damage to the goods. Even an act of God or inevitable accident would be no defence. A horse lent for riding should not be used for any other purpose and if it is used outside the scope of the bailment, the bailee would be liable for any damage to the horse howsoever happening. Apart from this, the bailor may terminate the contract at once and insist on the goods being returned to him. This is so provided in Section 153.[96]

153. Termination of bailment by bailee's act inconsistent with conditions.—A contract of bailment is avoidable at the option of the bailor, if the bailee does any act with regard to the goods bailed, inconsistent with the conditions of the bailment.

Illustration

A lets to *B*, for hire, a horse for his own riding. *B* drives the horse in his carriage. This is, at the option of *A*, a termination of the bailment.

3. Duty not to mix [Ss. 155-157]

The bailee should maintain the separate identity of the bailor's goods. He should not mix his own goods with those of the bailor and without his consent. If the goods are mixed with the consent of the bailor, both will have a proportionate interest in the mixture thus produced.[97] If the mixture is made without bailor's consent, and if the goods can be separated, or divided, the bailee is bound to bear the expenses of separation as well as any damage arising from the mixture.[98] But if the mixture is beyond separation, the bailee must compensate the bailor for his loss. Sections 155 to 157 run as follows:

155. Effect of mixture, with bailor's consent, of his goods with bailee's.—If the bailee, with the consent of the bailor, mixes the goods of the bailor with his own goods, the bailor and the bailee shall have an interest, in proportion to their respective shares, in the mixture thus produced.

156. Effect of mixture, without bailor's consent when the goods can be separated.—If the bailee, without the consent of the bailor, mixes the goods of the bailor with his own goods, and the goods can be separated or divided, the property in the goods remains in the parties respectively; but the bailee is bound to bear the expense of separation or division, and any damage arising from the mixture.

Illustration

A bails 100 bales of cotton marked with a particular mark to *B*. *B* without *A*'s consent, mixes the 100 bales with other bales of his own, bearing a different mark; *A* is entitled to have his 100 bales returned, and *B* is bound to bear all the expenses incurred in the separation of the bales, and any other incidental damage.

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96. *See* also *Hafizullah* v *Montague*, (1935) 156 IC 354. See *Perdana Properties* v *United Orient Leasing Co*, (1981) 1 WLR 1496, PC on termination of bailment.
97. Section 155.
98. Section 156.

157. Effect of mixture, without bailor's consent, when the goods cannot be separated.—If the bailee, without the consent of the bailor, mixes the goods of the bailor with his own goods, in such a manner that it is impossible to separate the goods bailed from the other goods, and deliver them back, the bailor is entitled to be compensated by the bailee for the loss of the goods.

Illustration

A bails a barrel of Cape flour worth Rs 45 to *B*. *B*, without *A's* consent, mixes the flour with country flour of his own, worth only Rs 25 a barrel. *B* must compensate *A* for the loss of his flour.

4. **Duty to return [Ss. 160 and 161]**

Section 160 provides for the duty to return.

160. Return of goods bailed, on expiration of time or accomplishment of purpose.—It is the duty of the bailee to return, or deliver according to the bailor's directions, the goods bailed, without demand, as soon as the time for which they were bailed has expired, or the purpose for which they were bailed has been accomplished.

161. Bailee's responsibility when goods are not duly returned.—If, by the default of the bailee, the goods are not returned, delivered or tendered at the proper time, he is responsible to the bailor for any loss, destruction or deterioration of the goods from that time.

When the purpose of bailment is accomplished or the time for which the goods were bailed has expired, the bailee should return the goods to the bailor without demand.[1] If he fails to do so, he will keep the goods at his risk and will be responsible for any loss of or damage to the goods arising howsoever. For example, in *Shaw & Co* v *Symmons & Sons*:[2]

> The plaintiff entrusted books to the defendant, a bookbinder, to be bound, the latter promising to return them within a reasonable time. The plaintiff having required the defendant to deliver the whole of the books then bound, the defendant failed to deliver them within a reasonable time and they were subsequently burnt in an accidental fire on his premises.

The defendant was held liable in damages for the loss of the books. When the loss takes place while the bailee's wrongful act is in operation, there is no question of any defence like "act of God" or "inevitable accident" being set up. He is liable in any case.[3]

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1. He can be sued for detinue. *Dhian Singh Sobha Singh* v *Union of India*, 1958 SCR 781: AIR 1958 SC 274.
2. (1917) 1 KB 799.
3. But see *Prakash Road Lines P Ltd* v *Oriental Fire and Gen Ins Co*, (1988) 1 TAC 263: (1988) 1 Kant LJ 118, failure to perform the obligation of a bailee makes the bailee liable except when the loss is due to act of God or *force majeure*. Where the goods are not fit for the purposes of bailment, the bailee has only to inform the bailor and not actually to return them. *Isuffli* v *Ibrahim*, 29 Bom LR 403.

Similarly, where a pawnee refused to return the goods even after the tender of the debt by the pawner, and the goods, having been subsequently stolen, he was held liable.[4]

Termination of Gratuitous Bailment

Where the lending of the goods is gratuitous, the bailor may at any time require return of the goods even though he lent them for a specified time or purpose. But if the bailee has acted on the faith of the loan made for a specified time or purpose in such manner that if the goods are demanded back before the agreed time, the bailee's loss would be greater than the benefits derived, the bailor must, if he compels the return, indemnify the bailee for the amount in which the loss occasioned exceeds the benefits derived.[5] Section 159 is as follows:

159. Restoration of goods lent gratuitously.—The lender of a thing for use may at any time require its return, if the loan was gratuitous, even though he lent it for a specified time or purpose. But, if, on the faith of such loan made for a specified time or purpose, the borrower has acted in such a manner that the return of the thing lent before the time agreed upon would cause him loss exceeding the benefit actually derived by him from the loan, the lender must, if he compels the return, indemnify the borrower for the amount in which the loss so occasioned exceeds the benefit so derived.

A gratuitous bailment is also terminated by the death either of the bailor or of the bailee.[6] Section 162 is as follows:

162. Termination of gratuitous bailment by death.—A gratuitous bailment is terminated by the death either of the bailor or of the bailee.

Bailment by Joint Owners [S. 165]

165. Bailment by several joint owners.—If several joint owners of goods bail them the bailee may deliver them back to, or according to the directions of, one joint owner without the consent of all, in the absence of any agreement to the contrary.

5. **Duty not to set up *jus tertii***

A bailee is not entitled to set up, as against the bailor's demand, the defence of *jus tertii*, that is to say, that the goods belong to a third person.[7] The bailee is estopped from denying the right of the bailor to bail the goods and to receive them

4. *Rampal* v *Gourishankar*, AIR 1952 Nag 8. *See* also *Dhian Singh Sobha Singh* v *Union of India*, 1958 SCR 781: AIR 1958 SC 274. Failure to account for the goods amounts to failure to deliver and, therefore, attracts the absolute liability of the section. *Chittagong Port Authority* v *Mohd Ishaque*, (1983) 35 DLR (AD) 364 Bangladesh Supreme Court.
5. Section 159.
6. Section 162.
7. This is called the estoppel of bailee. He can return the goods to the person bailing them even against the demands of the true owner unless he is under legal pressure. *Rodgers Sons & Co* v *Lambert & Co*, (1891) 1 QB 318, 325.

back.[8] Where the goods were returned to the warehousekeeper who had pledged them without the authority of the owner and the pledgee did not know this fact, the pledgee was held to be not liable to the true owner.[9] Even if there is a person who has a better title to the goods than that of the bailor or who claims ownership of the goods, the bailee may safely return the goods to the bailor and he will not be liable to the owner for conversion.

166. Bailee not responsible on re-delivery to bailor without title.—If the bailor has no title to the goods, and the bailee, in good faith, delivers them back to, or according to the directions of the bailor, the bailee is not responsible to the owner in respect of such delivery.

But the person who claims the ownership may apply to the court to prevent the bailee from returning the goods to the bailor and to have the question of title decided.[10]

167. Right of third person claiming goods bailed.—If a person, other than the bailor, claims goods bailed, he may apply to the Court to stop the delivery of the goods to the bailor, and to decide the title to the goods.

Further, if the bailee has already delivered the goods to the person having a better title, and yet the bailor sues him, he may prove that such person had a better right to receive the goods as against the bailor.[11] In a case before the Supreme Court:[12]

> Oil was consigned with the Railways from Kanpur to Calcutta. It reached Calcutta intact. The sender, however, instructed the Railways to bring it back to Kanpur. Before the formalities for the same could be complied with, the oil was seized by a food inspector, who found it adulterated and had it destroyed under the order of the High Court.

Holding the Railways not liable, the Court said that a bailee is excused from returning the subject-matter of the bailment to the bailor where it was taken away from him by an authority of law.

Where goods have been bailed by several joint owners, the bailee may deliver them back to one joint owner without the consent of all, in the absence of any agreement to the contrary. [Section 165]

6. Duty to return increase [S. 163]

In the absence of any agreement to the contrary, the bailee is bound to return to the bailor natural increases or profits accruing to the goods during the period of bailment.[13] This is so provided in Section 163, which is as follows:

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8. Section 117 of the Indian Evidence Act (Act 1 of 1872). Where the goods have been seized by the Government, liability under this section does not arise. *Juggilal Kamlapat Oil Mills* v *Union of India*, (1976) 1 SCC 893.
9. *Bank of Bombay* v *Nandlal Thakersey Das*, (1912) ILR 37 Bom 122: 40 IA 1.
10. *Rodgers Sons & Co* v *Lambert & Co*, (1891) 1 QB 318.
11. Explanation (2) to Section 117 of the Indian Evidence Act, 1872.
12. *Juggilal Kamlapat Oil Mills* v *Union of India*, (1976) 1 SCC 893.
13. Where, for example, bonus shares are allotted in respect of the shares during the period of

163. Bailor entitled to increase or profit from goods bailed.—In the absence of any contract to the contrary, the bailee is bound to deliver to the bailor, or according to his directions, any increase or profit which may have accrued from the goods bailed.

Illustration

A leaves a cow in the custody of *B* to be taken care of. The cow has a calf. *B* is bound to deliver the calf as well as the cow to *A*.

Where shares and securities were pledged with a bank and the bank received bonus shares and dividends and interest in respect thereof, it was held that the bank could not be compelled to handover such increment unless the pledged securities were redeemed.[14]

FINDER [Ss. 168 and 169]

168. Right of finder of goods: May sue for specific reward offered.—The finder of goods has no right to sue the owner for compensation for trouble and expense voluntarily incurred by him to preserve the goods and to find out the owner; but he may retain the goods against the owner until he receives such compensation; and where the owner has offered a specific reward for the return of goods lost, the finder may sue for such reward, and may retain the goods until he receives it.

169. When finder of thing commonly on sale may sell it.—When a thing which is commonly the subject of sale is lost, if the owner cannot with reasonable diligence be found, or if he refuses, upon demand, to pay the lawful charges of the finder, the finder may sell it—

(1) when the thing is in danger of perishing or of losing the greater part of its value, or

(2) when the lawful charges of the finder, in respect of the thing found, amount to two-thirds of its value.

Finders are bailees

A finder of goods is a bailee thereof and as such bound by the duty of reasonable care.[15] He does not have the right to sue the owner for compensation for trouble and expense voluntarily incurred by him to preserve the goods and to find out the owner.[16] Early English cases disallowed not only any compensation, but also right to lien for expenses. Thus where:

A finder fed a dog for 20 weeks and claimed 20s. for the same.[17]

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their pledge, the increment has to be returned on the redemption of the pledge. *Motilal Hirabhai* v *Bai Mani*, (1924) 52 IA 137: 27 Bom LR 455.

14. *Standard Chartered Bank* v *Custodian*, AIR 2000 SC 1488.
15. He is under no higher duty than that. *Isaack* v *Clark*, (1615) 2 Bulstr 306.
16. Section 168.
17. *Binstead* v *Buck*, 2 Black W 1117: 96 ER 660.

The court said he would be guilty of trover if he refused to deliver unless paid for his keeping. Similarly, in another case:[18]

> A quantity of timber, placed in a dock on the bank of a navigable river, being accidentally loosened, was carried by the tide to a considerable distance.The defendant, finding it in that situation, voluntarily conveyed it to a place of safety.

He was held not entitled to lien on the timber for the trouble or expense, but was liable in trover for refusing to deliver.

Finder's rights

Sections 168 and 169, however, protect the interest of a finder in two ways. Section 168 allows the finder to retain the goods against the owner until he receives compensation for trouble and expense. Further, where the owner has offered a specific reward for the return of the goods lost, the finder may sue for such reward, and may retain the goods until he receives it.

Section 169 allows the finder to sell the goods in certain circumstances. Where the thing found is commonly the subject of sale and if the owner cannot be found with reasonable diligence, or if he refuses to pay the lawful charges of the finder, the finder may sell the goods in the following cases:

(1) when the thing is in danger of perishing or of losing greater part of its value, or

(2) when the lawful charges of the finder, in respect of the thing found, amount to two-thirds of its value.

RIGHTS OF BAILEE

1. Right to compensation [S. 164]

164. Bailor's responsibility to bailee.—The bailor is responsible to the bailee for any loss which the bailee may sustain by reason that the bailor was not entitled to make the bailment, or to receive back the goods, or to give directions respecting them.

If the bailor has no right to bail the goods, or to receive them back or to give directions respecting them and consequently the bailee is exposed to some loss, the bailor is responsible for the same.

2. Right to expenses or remuneration [S. 158]

158. Repayment, by bailor, of necessary expenses.—Where, by the conditions of the bailment, the goods are to be kept or to be carried, or to have work done upon them by the bailee for the bailor, and the bailee is to receive no remuneration, the bailor shall repay to the bailee the necessary expenses incurred by him for the purpose of the bailment.

A bailee is entitled to recover his agreed charges. But where there is no such agreement at all, Section 158 comes into play. The section says that where the bailee is required by the terms of bailment to keep or carry the goods or to do some work upon them for the benefit of the bailor, and the contract provides for no reward, the bailee

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18. *Nicholson* v *Chapman*, (1793) 3 RR 374.

has a right to ask the bailor for payment of necessary expenses incurred by him for the purpose of the bailment. The American law is also the same.

> Where the bailment is gratuitous and the bailee is in no way benefited, the bailor has to bear the expenses, if any, of the bailee for keeping the chattel. It is akin to the lien of a warehouseman for claiming charges for the preservation of the goods.[19]

The Calcutta High Court has laid down that this right is not linked with the right of lien. Lien can be exercised only as long as possession is retained whereas the right to charges remains alive even when possession has been parted with. In this case the State Trading Corporation had hired the plaintiff's storage tank for storing its oil. On account of a dispute, the STC appointed a special officer who took charge of the tank and delivered its contents to others as directed. The plaintiff thus lost possession of the oil and with it his lien, but his right to charges for protection and storage of the oil survived. The court said that the bailor had enjoyed the benefit of the bailee's services.[20]

Where the bailment is for the benefit of the bailee, there, in reference to expenses, the following two propositions apply:

> If in using the thing, the borrower is put to any expense, this must be borne by himself. Thus, for example, if a horse is lent to a friend for a journey, he must bear expenses of his food during that journey, and to getting him shod, if he should chance to require it, for it is a burden which is naturally attendant upon the use of the horse.
>
> "The borrower is compellable to bear the ordinary expenses; for the loan being for his benefit he must be presumed to engage to bear the burden as an incident to the use."[21]

3. Right of lien [Ss. 170-171]

If the bailee's lawful charges are not paid he may retain the goods. The right to retain any property until the charges due in respect of the property are paid, is called the right of lien. The Supreme Court[22] cited the following passage from HALSBURY'S LAWS OF ENGLAND[23] as to the nature of this right:

> "Lien is in its primary sense a right in one man to retain that which is in his possession belonging to another until certain demands of the person in possession are satisfied. In this primary sense it is given by law and not by contract."

Liens are of two kinds, namely:

(1) particular Lien, and

(2) general Lien.

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19. WILLINGTON ON CONTRACTS as cited in Ramachandran, THE LAW OF CONTRACT IN INDIA, 2266 (Vol III).
20. *Surya Investment Co* v *S.T.C. of India*, AIR 1987 Cal 46.
21. STORY ON BAILMENTS, Ss. 256 and 273.
22. *Syndicate Bank* v *Vijay Kumar*, (1992) 2 SCC 330: AIR 1992 SC 1066, 1068. *See* also *V.S. Prabhu (Dr)* v *R.D. Mujumdar*, (1993) 2 Kar LJ 1, the bailee cannot be deprived of his possession for any superior claim. He has to be paid first. Where goods were taken away from bailee under court order, his lien survived and applied to the sale proceeds of the goods for his payment.
23. 552, para 695, Vol 20, 2nd edn.

Particular lien [S. 170]

As a general rule a bailee is entitled only to particular lien, which means the right to retain only that particular property in respect of which the charge is due. This right is provided for in Section 170 of the Act.

170. Bailee's particular lien.—Where the bailee has, in accordance with the purpose of the bailment, rendered any service involving the exercise of labour or skill in respect of the goods bailed, he has, in the absence of a contract to the contrary, a right to retain such goods until he receives due remuneration for the services he has rendered in respect of them.

Illustrations

(a) *A* delivers a rough diamond to *B*, a jeweller, to be cut and polished, which is accordingly done. *B* is entitled to retain the stone till he is paid for the services he has rendered.

(b) *A* gives cloth to *B*, a tailor, to make into a coat. *B* promises *A* to deliver the coat as soon as it is finished, and to give a three months' credit for the price. *B* is not entitled to retain the coat until he is paid.

Exercise of Labour or Skill

Thus the right is available subject to certain important conditions. The foremost among them is that the bailee must have rendered some service involving the exercise of labour or skill in respect of the goods bailed.[24] Further, it has been frequently pointed out that the labour or skill exercised by the bailee must be such as improves the goods.

> "There is no authority for the proposition that if what the contractor does is not to improve the article, but merely to maintain it in its former condition, he gets a lien for the amount spent upon it for that maintenance. A job master has no lien at all for the amount of his bill in respect of feeding and keeping a horse at his stable, whereas a trainer does get a lien upon a horse for the improvements which he effects to the horse."[25]

Similarly, it has been observed in another case that "where a bailee has expended his labour and skill in the improvement of a chattel delivered to him, he has lien for his charge in that respect. Thus, the artificer to whom the goods are delivered for the purpose of being worked up into form, or the farrier by whose skill the animal is cured of a disease, or the horse-breaker by whose skill he is rendered manageable, have liens on the chattels in respect of 'their charges".[26] In *Hutton* v *Car Maintenance Co*:[27]

> The owner of a motor car gave it to a company to maintain it for three years on a fixed annual payment. An amount having become due for maintenance charges, the company claimed lien on the car.

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24. It was observed by BEST CJ in *Bevan* v *Waters*, (1828) 3 Car & P 520 that if a man has an article delivered to him, on the improvement of which he has to bestow trouble and expense, he has a right to detain it until his demand is paid.
25. *Hutton* v *Car Maintenance Co*, (1915) 1 Ch 621.
26. PARKE B in *Scarfe* v *Morgan*, (1838) 4 M&W 270, 283: 51 RR 568, 578.
27. (1915) 1 Ch 621.

It was held that inasmuch as what the company did was not to improve the car, but only to maintain it in its former condition, the company had no lien on the car. Similarly, where a bailee claimed lien for storage of sugar, it was held that such custody, not being a service involving the exercise of labour or skill within the meaning of Section 170, the bailee was not entitled to lien.[28] On the same reasoning, a person to whom cattle are given for grazing does not have the right of lien on them for his charges.[29]

In Accordance with Contract

Secondly, the labour or skill must have been exercised in accordance with the purpose of the bailment and the terms of the contract.[30]

Goods on which Labour or Skill Bestowed

Thirdly, only such goods can be retained on which the bailee has bestowed trouble and expense. He cannot retain any other goods belonging to the bailor which are in his custody.[31] It is this element of "particular lien" which distinguishes it from "general lien".

POSSESSORY RIGHT.—Lastly, the right depends on possession and is lost as soon as possession of the goods is lost. In a case before the Nagpur High Court:[32]

> The plaintiff purchased an old refrigerator, the vendor agreeing to repair it for a fixed charge. When the repair was over and the condition of the machine was found satisfactory, it was delivered to the plaintiff but a part of the repair money was still unpaid. The machine broke down again and the vendor carried its engine and another part for further repairs and claimed lien on these parts until the outstanding charges of repair were paid.

The court held that delivery of possession after repairs are effected puts an end to the lien which the repairer has for the charges of repairs and cannot be revived because the repairer undertakes further repairs merely out of grace and not as a matter of fresh contract. The court cited Lord ELLENBOROUGH as saying:[33]

> "...the defendant, after the repairs were completed, relinquished his possession, and could not afterwards detain for the amount of the repairs."

Thus, "lien is a possessory right which continues only so long as the possessor holds the goods".[34]

The right of lien may also be defeated or excluded by an agreement to the contrary. By an agreement to that effect, a particular lien may be converted into

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28. *Chand Mal* v *Ganda Singh*, (1885) Rec No. 60, p 126. *Kalloomal Tapeshwari Prasad & Co* v *R.C.&F. Ltd*, AIR 1990 All 214, lien not allowed for mere storage of fertilizers.
29. *Vithoba Laxman Kalar* v *Maroti Ukandsa Kalar*, AIR 1940 Nag 273.
30. *Skinner* v *Jager*, (1883) 6 All 1894.
31. *Chase* v *Westmore*, (1816) 15 M&S 180, piecemeal delivery of goods under one contract, lien on the whole lot arises; *Miller* v *Nasmyth's Patent Press Co Ltd*, (1882) 8 Cal 312, jute delivered from time to time for pressing.
32. *Eduljee* v *Cafe John Bros*, ILR 1944 Nag 37.
33. In *Hartley* v *Hitchcock*, (1816) 171 ER 512.
34. See *Legg* v *Evans*, (1840) 151 ER 311; *Jacobs* v *Latour*, (1828) 130 ER 1010, *cited* in the above-cited Nagpur decision. *See* also *Surya Investment Co* v *S.T.C.*, AIR 1987 Cal 46, where the bailee lost his lien because the goods in his cold store were claimed by a special officer, the bailee was allowed by personal action to recover under Section 158 his expenses of storage; *Pennington* v *Reliance Motor Works*, (1923) 1 KB 127, non-transferable right.

a general lien. For, Section 171 says in the end that no other persons have the right to general lien unless there is an express contract to that effect.

General lien [S. 171]

The right of "general lien", as provided for in Section 171, means the right to hold the goods bailed as security for a general balance of account. The right of particular lien entitles a bailee to detain only that particular property in respect of which charges are due. But general lien entitled the bailee to detain any goods bailed to him for any amount due to him whether in respect of those goods or any other goods. If, for example, two securities are given to a banker but a loan has been taken only against one of them, the banker may detain both securities until his dues are paid. Where a quantity of imported meat was stored with a warehousekeeper who by a general term of the trade had a general lien, it was held that he could retain the meat for his charges due in respect of other goods.[35]

171. General lien of bankers, factors, wharfingers, attorneys and policy brokers.—Bankers, factors, wharfingers, attorneys of a High Court and policy brokers may, in the absence of a contract to the contrary, retain as a security for a general balance of account, any goods bailed to them; but no other persons have a right to retain, as a security for such balance, goods bailed to them, unless there is an express contract to that effect.

Parties entitled to general lien

The right of general lien is a privilege and is specially conferred by Section 171 on certain kinds of bailees only.[36] They are:

(1) Bankers,
(2) Factors,
(3) Wharfingers,
(4) Attorneys of a High Court, and
(5) Policy-brokers.

1. Bankers

"The general lien of bankers, as judicially recognised and dealt with in Section 171, attaches to all goods and securities deposited with them as bankers by a customer or by a third person on a customer's account, provided there is no contract, express or implied, inconsistent with such lien."[37] The Supreme Court[38] cited the following passage from CHALMERS ON BILLS OF EXCHANGE[39] as to the concept of banker's lien:

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35. *Jowitt & Sons* v *Union Cold Storage Co*, (1913) 3 KB 1.
36. See *Brandao* v *Barnett*, (1846) 12 Cl & Fin 787: 60 RR 204. There is no lien where there is no claim. *R.K. Agencies Ltd* v *Central Bank of India*, AIR 1992 Cal 193.
37. *Mercantile Bank* v *Rochaldas*, AIR 1926 Sind 225; *Misa* v *Currie*, (1876) 1 AC 554: *London Chartered Bank* v *White*, (1879) 4 AC 413; *Roxburghe* v *Cox*, (1881) 17 Ch D 520. *State Bank of India* v *Deepak Malviya*, AIR 1996 All 165, banker entitled to retain goods bailed for satisfaction of any other debt or promise.
38. *Syndicate Bank* v *Vijay Kumar*, (1992) 2 SCC 330: AIR 1992 SC 1066, 1069.
39. 91 (13th edn).

> "A banker's lien on negotiable securities has been judicially defined as an 'implied pledge'. A banker has, in the absence of agreement to the contrary, a lien on all bills received from a customer in the ordinary course of banking business in respect of any balance that may be due from such customer."

The court also cited the following passage from CHITTY ON CONTRACTS:[40]

> "By mercantile custom the banker has a general lien over all forms of commercial paper deposited by or on behalf of a customer in the ordinary course of banking business. The custom does not extend to valuables lodged for the purpose of safe custody and may in any event be displaced by an express agreement or circumstances which show an implied agreement inconsistent with the lien.
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> . . . .The lien is applicable to negotiable instruments which are remitted to a banker from the customer for the purpose of collection. When collection has been made, the proceeds may be used by the banker in reduction of the customer's debt balance unless otherwise earmarked."[41]

Acting on these authorities the court came to the conclusion that fixed deposit receipts deposited by way of security for cash-credit facility were usable as security against the customer's other debts also.

Certain gold ornaments were pledged with a bank for raising a loan. The borrower paid back the loan. The bank retained the security because of another loan subsequently taken by the borrower. The bank was held to be entitled to do so till the satisfaction of the other loan also.[42]

It is necessary that the goods should have been given to the banker as a bailee, because the lien extends only to goods which have been bailed to the banker.[43] "And there is a distinction between bailment and deposit. It has been held,[44] that money paid into a bank to be credited into the current account of the person making the payment does not constitute a bailment."[45] Following these authorities, it has been held that Section 171 does not apply to cases of deposit of money in a bank. The bank cannot claim lien on such money.[46] The court said: "Section 171 of the Contract Act in terms does not apply to cases of deposit of money. In such cases, the relationship of bailor and bailee is not established within the meaning of Section 148. Money deposited with a bank does not maintain its identity unless set apart or earmarked for some special purpose. Since the relationship of creditor and debtor is

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40. 389 (para 3032, 26th edn).
41. The court also *cited* similar passages from Paget's LAW OF BANKING, 408 (8th edn) and *Brandao* v *Barnett*, (1846) 12 Cl & Fin 787; *Barnett* v *Brandao*, (1843) 6 Man & G 630: 7 LT(OS) 525.
42. *K. Sita* v *Corporation Bank*, (1999) 3 An WR 393 (AP).
43. Little deeds casually left at a banker's table after refusal by him to advance a loan were not within the spell of banker's general lien. *Lucas* v *Dorrein*, (1817) 7 Taunt 278. Things deposited with him in his character as a banker are within the spell. *London Chartered Bank* v *White*, (1879) 4 App Cas 413; *Misa* v *Currie*, (1876) 1 App Cas 554.
44. *Foley* v *Hill*, (1840) 9 ER 1002; *Official Assignee of Madras* v *Smith*, ILR (1908) Mad 68 and *Ichha Dhanji* v *Natha*, ILR (1888) 13 Bom 338.
45. PURANIK J in *Devendra Kumar* v *Chaudhary Gulab Singh*, ILR 1946 Nag 210, 212.
46. *State Bank of India* v *M P Iron & Steel Works Ltd*, AIR 1998 MP 93. To the same effect is the decision of the Bombay High Court in *State Bank of India* v *Javed Akhtar Hussain*, (1993) 1 Bom CR 421.

established, the money in customers' accounts legitimately belongs to the bank. The bank has the right of ownership over the money. The bank cannot claim lien on money which belongs to it. Therefore, the application of Section 171 should be properly confined to cases where the papers, securities and other goods of the debtor are lying with the bank under bailment. Similarly, where goods are deposited for safe custody or some other special purpose, they will not be under the spell of general lien as the acceptance of the goods for a special purpose impliedly excludes general lien.[47] Thus where securities were given to a bank to get them exchanged for fresh bills, the banker could not exercise lien on the new securities which, as Lord CAMPBELL said, "were delivered to them for a special purpose inconsistent with the existence of the lien claimed".[48] The securities were brought to the bank by a customer but they belonged to another person. The customer instructed the bank to have them renewed and to transfer the interest to his personal account. On the interest so credited the bank was allowed to exercise lien.

Another illustration of a deposit for a special purpose is the case of *Mercantile Bank of India Ltd* v *Rochaldas Gidumal & Co.*[49]

> A customer gave his banker a sum of money for transmission by telegraphic transfer to his own firm at another place. The bank purported to hold the money for their balance of account against the firm.

The first question raised was whether "money" would be covered by the words "goods bailed" as used in Section 171. The word "goods" is not defined in the Indian Contract Act. The Indian Sale of Goods Act defines "goods" as excluding money.[50] Thus the matter was open and following English authorities it was held that "money is a species of goods which may be the subject-matter of bailment and over which lien may be exercised".[51] But the court held that money given for telegraphic transfer is given for a special purpose inconsistent with the exercise of the right of lien. "It would be most unbusinesslike and unreasonable for a banker to expect that a remitter who is in urgent need of money at the place of payment would agree to transmit money through the banker if he is told or has reason to

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47. *Cuthbert* v *Robarts Lubboch & Co*, (1909) 2 Ch 226 CA. Where the goods were seized by a banker under a particular hypothecation, the terms of which did not permit such seizure, the loanee paid the amount, the banker was not permitted to detain the goods for its other claims. *C.R. Narasimha Setty* v *Canara Bank*, (1990) 1 Kar LJ 81. Citing, *George Henry Chambers* v *Patrick Davidson*, LR 1 PC 296 where it was observed that "if a consignee takes an express security, such security, being the stipulation and agreement of the parties, it excludes his general lien. Acceptance on special purpose impliedly excludes the right of general lien. *Kingston and Gross, ex. p.*, (1817) 6 Ch App 632; *Loyds Bank Ltd* v *Administrator-General of Burma*, (1934) 12 Rang 25: AIR 1934 Rang 66, the right does not extend to a trust account unless it is the property of the customer. *Agra Bank's Claim Re*, (1872) LR 8 HL 41; *Official Assignee of Madras* v *Ramaswamy Chetty*, (1920) 43 Mad 747, the special purpose must be clearly inconsistent with general lien. *State Bank of India* v *Javed Akhtar Hussain*, AIR 1993 Bom 67, money deposited in fixed deposit by the debtor in joint account with his wife in another branch than the lending branch, not allowed to be held under lien.

48. *Brandao* v *Barnett*, (1846) 12 Cl & Fin 787: 136 ER 207, *cited* by TAYABJI AJC in *Mercantile Bank* v *Rochaldas*, AIR 1926 Sind 225, 229.

49. AIR 1926 Sind 225.

50. Section 2(7) of the Sale of Goods Act, 1930. See *Devendra Kumar* v *Chaudhary Gulab Singh*, ILR 1946 Nag 210, 212.

51. *Misa* v *Currie*, (1876) 1 AC 554; *Union Bank of Australia* v *Murray Ansley*, (1898) AC 693; *Nagalinga* v *Kayarohana*, AIR 1915 Mad 80.

believe that the money is likely to be withheld in the exercise of this alleged lien."[52]

Where a customer has two accounts, a deposit account and a loan account, the banker may in the exercise of its lien, transfer the money in the deposit account to the loan account without any specific instructions of the depositor to that effect.[53] The Karnataka High Court has held that the right would extend to the fixed deposits of the customer including those of his/her spouse. The bank was entitled to adjust the amounts towards the loan account.[54] The court relied upon the decision of the Supreme Court in *Syndicate Bank* v *Vijay Kumar*,[55] which was to the effect that the banker's lien could be exercised in respect of a joint account also[56] and also fixed deposits. "The banker's lien is not prejudiced by any defect in the title of the customer or equities of third parties, provided the banker acts honestly and without notice of any defect of title."[57] Thus where a banker knows that the securities deposited by a customer belong to some other person he cannot hold them in the exercise of his lien against the customer.[58] But where two firms have separate accounts in a bank and agree to give the bank a general lien over all monies of the two firms, the bank may hold the money in one account against a loan on the other account. This has been so held by the Punjab High Court in *Kishan Das* v *Central Bank of India*.[59]

> One of the above two firms gave a sum of money to the bank to remit the same to a sugar mill. The mill refused to accept the amount when offered. The amount thus came back to the bank and it claimed lien on it for a balance due against the other firm.

The court held that the specific object for which the money was given having failed, the money was no longer bound by any incident of trust and, therefore, the bank had a good lien in the terms of the firms' agreement.[60]

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52. *Per* RUPCHAND BILARAM AJC, *Mercantile Bank of India Ltd* v *Rochaldas Gidumal & Co*, AIR 1926 Sind 225, 227. See *Krishna Kishore Kar* v *United Commercial Bank*, AIR 1982 Cal 62, where there was special arrangement for reimbursement between the parties and that excluded particular lien. In reference to the contents of an account the court held that they could be withheld for debit balance in another account of the same customer. *Board of Trustees of Port of Bombay* v *Sriyanesh Knitters*, AIR 1983 Bom 88, special statutory rights excluding general lien; *Trustees of the Port of Bombay* v *Premier Automobiles*. The Supreme Court did not allow a bank to detain goods belonging to the firm against partners' individual accounts. *Gurbax Rai* v *P.N.B.*, (1984) 3 SCC 96: AIR 1984 SC 1012.
53. *Devendra Kumar* v *Chaudhary Gulab Singh*, ILR 1946 Nag 210. However, money held under a fixed deposit scheme has been held to be not a subject-matter of general lien. *Union Bank of India* v *Venugopalan*, (1990) 1 Ker LT 262. Such money does not create the relationship of bailor and bailee. It creates the relationship of creditor and debtor.
54. *K.S. Nagalambika* v *Corporation Bank*, AIR 2000 Kant 201.
55. AIR 1992 SC 1066: 1992 AIR SCW 945.
56. To this extent the decision of the Lahore High Court in *Simla Banking & Industrial Co Ltd* v *Bhagwan Kaur*, AIR 1928 Lah 316 because in that the opinion expressed was that a joint account would not come within the coverage of the right of lien.
57. *Jai Kishan Das* v *Central Bank of India*, AIR 1955 Punj 250. *Bank of New South Wales* v *Goulburn Butter Factory*, (1902) AC 543. Lien would be defeated if there was notice. *Locke* v *Prescot*, (1863) 32 Beau 261; *Jeffreys* v *Agra Bank*, (1866) LR 2 Eq 674.
58. *Cuthbert* v *Robarts, Lubbock & Co*, (1909) 2 Ch 226; *Punjab National Bank Ltd* v *Satyapal Virmani*, AIR 1956 Punj 118.
59. AIR 1955 Punj 250.
60. *See* the Judgment of KAPUR J at p 252, where the learned Judge considered *Farley* v *Turner*,

Where an equitable mortgage is created by deposit of title deeds for a particular loan, whether the same can be withheld for a subsequent debt is a question to be answered on facts. The Karnataka High Court has held that they would not be the subject-matter of a general lien unless there was intention on the part of the depositor to that effect.[61]

> The property mortgaged by the customer for the loan in question was attached and sold in execution of a decree. The purchaser paid back the loan and asked for return of the title deeds. The bank sought to retain the deeds as against another loan for which the customer was a surety. The purchaser paid the surety money also under protest, got the title deeds released, and then sued the bank for refund of the surety money as having been paid under coercion.

He was allowed refund. The bank was not entitled to general lien. Its withholding was wrongful and wrongful withholding of property is coercion.[62] The deeds were deposited to secure one particular loan and no more. The court cited Lord KINDERSLEY remark that conveyance of land was not subject to general lien.[63] The court also cited a remark from PAGET'S LAW OF BANKING[64] to the effect that "it must be assumed that the general lien extends only to the customer's own securities".

Similarly, where a person obtained a loan on a pledge of gold ornaments to the lending bank and subsequently became a guarantor for another person's loan, he was allowed to claim his ornaments on paying off his personal loan though the loan of another person guaranteed by him still subsisted.[65] The principle of general lien does not extend to a loan taken by the customer from another branch of the bank.[66]

2. *Factors*

The word 'factor' in India, as in England, means an agent entrusted with possession of goods for the purpose of selling them for his principal.[67] He is given the possession of the goods in the ordinary course of his business for the purpose of sale. He has a general lien on the goods of his principal for his balance of account against the principal. Thus where a motor car was delivered to an agent for sale, he was held entitled to retain the car until his charges were paid.[68] It is necessary for

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(1857) 112 RR 442 and *W.P. Greenhalf & Sons* v *Union Bank of Manchester*, (1924) 2 KB 153. *See* also *United Commercial Bank* v *Okara Grain Buyers Syndicate Ltd*, AIR 1968 SC 1115.

61. *Mangalore Catholic Co-op Bank Ltd* v *M. Sundara Shetty*, (1987) 3 Kant LJ 21.
62. The court *referred* to *Walts* v *Christie*, (1849) 11 Beav 546, where a customer's lease-deed was not allowed to be retained for dues against the firm of which he was a partner. Lord ESHER MR remarked that a general lien-holder has no right to take a security given for one purpose and apply it to another. *Wolstenholm* v *Sheffied Bank*, (1886) 54 LT 746, lease-deed deposited to secure a particular advance not allowed to be used for other dues.
63. *Wylde* v *Radford*, (1863) 33 LJ Ch 51, 53.
64. 500 (8th edn).
65. *Jagdishwar Reddy* v *Manager, Andhra Bank*, (1988) 1 Andh LT 605.
66. *Syndicate Bank* v *Devendra Karkera*, AIR 1994 Kant 1. The court *referred* to *Sree Yellamma Cotton Mills Co Ltd*, *Re: Bank of Maharashtra Ltd* v *Official Liquidator*, AIR 1969 Mys 280, where the court said hypothecation is only an extended idea of pledge. *Indian Bank* v *Sri Annapoorna Finance Aid*, AIR 2002 Mad 180, banker's lien upon the proceeds of a customer's cheque.
67. STUART CJ in *E.H. Parakh* v *King Emperor*, AIR 1926 Oudh 202. For other similar remarks see *Stevens* v *Biller*, (1883) 25 Ch D 31.
68. *E.H. Parakh* v *King Emperor*, AIR 1926 Oudh 202.

the lien to arise that the goods should have been delivered to the factor in the course of business and in his capacity as a "factor".

> A factor who used to have various dealings with his principal was instructed by the principal to effect a policy of insurance on a ship. The principal sent the premium and the policy remained in the possession of the agent, who claimed lien for the money which was owing to him in his capacity as a factor.

His claim was not allowed, as the policy of insurance had not come to his possession in his capacity as a factor.[69]

A factor, like a banker, will not have the right of lien on such goods as have come to his possession for a specific purpose which impliedly excludes the right to lien.[70]

3. *Wharfingers*

"Wharf means a place contiguous to water, used for the purpose of loading and unloading goods, and over which the goods pass in loading and unloading. It is essential to a wharf that goods should be in transit over it. The primary idea is that, it is a place used, not for storing goods, but in the process of their transit to or from water."[71] Wharfinger "is he that owns or keeps a wharf, or hath the oversight or the management of it".[72] A wharfinger has general lien on the goods bailed to him until his wharfage, which means, charges due for the use of his wharf, are paid.

"The fact that a manufacturer has a wharf upon which he receives goods brought to him by customers, does not entitle him to claim lien as a wharfinger upon such goods."[73] He is not a wharfinger in the real sense of the word.

4. *Attorney of High Court*

An attorney or a solicitor who is engaged by a client is entitled to general lien until the fee for his professional service and other costs[74] incurred by him are paid.[75] The right extends to the proceeds of the action that come to the hands of the attorney.[76] He has a right of lien over funds which are deposited with the court.[77] The Bombay High Court held in a case that a solicitor who is discharged by his

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69. *Dixon* v *Stansfield*, (1850) 10 CB 398: 16 LT 150.
70. See *Spalding* v *Ruding*, (1843) 63 RR 120; *Frith* v *Forbes*, (1862) 135 RR 217.
71. *Per* COLLINS LJ in *Haddock* v *Humphrey*, (1900) 1 QB 609.
72. *Chittock* v *Bellomy*, 64 LJ QB 250; *Tredgor Iron Co* v *S.S. Colliope*, (1891) AC 11.
73. *Miller* v *Nasmyths Patent Press Co*, (1882) 8 Cal 312.
74. Costs of engaging a counsel, for example *Taylor Stileman and Underwood, Re*, (1891) 1 Ch 590.
75. *General Share Trust Co* v *Chapman*, (1876) 1 CPD 771, lien on client's cheques. It is necessary that documents should come into his prossession as an attorney. *Sheffield* v *Eden*, (1878) 10 Ch D 291.
76. *Devkabai* v *Jefferson, Bhaishankar and Dinshaw*, (1886) 10 Bom 248; *Mangal Chand* v *Purna Chandra*, AIR 1949 Cal 505: (1945) 1 Cal 430.
77. He can have the fund released through him. His right is not defeated by any assignment of the decree or attachment. *Ghulam Moideen* v *Mohd Oomer*, AIR 1931 Mad 183: (1931) 60 Mad LJ 133; *Tyabji Dayabhai & Co* v *Jetha Devji & Co*, AIR 1927 Bom 542; *Ved and Sopher* v *R.P. Wagle & Co*, AIR 1925 Bom 351.

client, has the right to hold the papers entrusted to him subject to his lien for costs.[78] The court cited the following passage from a judgment of Lord Justice JAMES:[79]

> A man has a right to change his solicitor if he likes; but then the law imposes certain terms in favour of the solicitor, that is to say, that the papers in the suit cannot be taken out of his hands without his having his costs paid.

But if the attorney himself decides not to act for the client, he forfeits his lien and, therefore, must hand over the papers to the client, whether his costs are paid or not. Thus where an attorney refused to act unless his previous costs were paid[80], and where a firm of attorneys was dissolved and, therefore, they ceased to act for their client[81], it was held in either case that the lien was lost.

The law on this point has been summarised by the Andhra Pradesh High Court in terms of the following propositions:[82]

> (1) The common law right of passive and retaining lien available to a solicitor in England is accepted by courts in India as part of the law of this country.
>
> (2) The said common law right is not abrogated by Section 171, Contract Act.
>
> (3) Section 171, Contract Act, enacts a special rule of lien applicable exclusively to attorneys who are also known as solicitors.
>
> (4) The other practitioners, who discharge the functions of solicitors, are entitled to invoke the common law rights applicable to solicitors though Section 171 is inapplicable to them.
>
> (5) The practitioner forfeits the right of retaining lien the moment he discharges himself or by his client for misconduct.

Advocates.—The Supreme Court has laid down in *R.D. Saxena* v *Balram Prasad Sharma*[83] that advocates have no right of lien over clients' papers for their unpaid fee. The Court said that files containing copies of the records (perhaps some original documents also) could not be equated with the word "goods" referred in Section 171. It could not be said that files and papers of a client lying with the advocate were in the category of "goods bailed". In the case of litigation papers in the hands of the advocate there is neither delivery of goods nor any contract that they shall be returned or otherwise disposed of. That apart, the word "goods"

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78. *Balkesserbai* v *Naranji Walji*, ILR (1880) 4 Bom 352.
79. *Ex p Yelden*, 4 Ch D 131, 355, *ibid.*
80. *Basanta Kumar Mitter* v *Kusum Kumar Mitter*, (1900) 4 CWN 767. It is not a professional misconduct for a lawyer to retain the papers until payment of his fee. *Damodardas Agarwal* v *R. Badrilal*, AIR 1987 AP 254; *Bijili Sahib* v *Dadhamia Bhalambai*, AIR 1936 Mad 48; *An Advocate, Re, Tuticorin*, AIR 1943 Mad 493. Section 171 is not exhaustive of the relationship of a lawyer with his client. These decisions should now be taken in the light of the Supreme Court decision in *R.D. Saxena* v *Balram Prasad Sharma*, AIR 2000 SC 2912 because the Supreme Court has held that refusal of an advocate to return files to his client amounts to professional misconduct irrespective of the fact whether his fee has been paid or not.
81. *McCorkindale, Re*, (1880) 6 Cal 1. The court followed *Moss, Re*, (1866) 2 Eq 345; *see* also *Atool Chandra Mukerjee* v *Shoshee Bhusan Mookerjee*, (1902) 6 Cal WN 215, a vakil may be changed if he is not proceeding with due diligence in prosecuting the case; *Rajah V. Muthu Krishna* v *W.H. Nurse*, AIR 1921 Mad 320, a vakil cannot refuse to work in the case accepted by him because his fee has not been paid; *Basanta Kumar Mitter* v *Kusum Kumar Mitter*, (1900) 4 Cal WN 767. There is no lien when the removal is for misconduct. *'M' Re*, AIR 1957 SC 149, the courts can examine professional conduct, *An Advocate, Re*, AIR 1943 Mad 493.
82. *Damodardas Agarwal* v *R. Badrilal*, AIR 1987 AP 264-265.
83. (2000) 7 SCC 264: AIR 2000 SC 2912 at p 2914: (2000) 163 CTR 32.

mentioned in Section 171 is to be understood in the sense in which that word is defined in the Sale of Goods Act. Thus they have to be saleable goods. There is no scope for converting the case-files into money, nor they can be sold to any buyer. Hence, an advocate cannot place reliance upon Section 171.

5. Policy Brokers

An insurance agent who is employed to effect a policy of marine insurance is called a policy broker.[84] His lien extends to any balance on any insurance account due to him from the person who employed him to effect the policy.

Lien against Time-Barred Debt

One of the great advantages of the right of lien is that it can be exercised for the realisation of a debt even when an action for recovery of the debt would be time barred.[85]

Maritime Lien

The Supreme Court explained the concept in *MV Al Quamar* v *Tsavitris Salvage (International) Ltd*:[86] "Be it noted that there are two attributes to maritime lien: (*a*) a right to a part of the property in the *res*; and (*b*) a privileged claim upon a ship, aircraft or other maritime property in respect of services rendered to or injury caused by that property. Maritime lien thus attaches to the property in the event of the cause of action arising and remains attached. It is, however, inchoate and very little positive in value unless it is enforced by an action. It is a right which stems from general maritime law and is based on the concept as if the ship itself caused the harm, loss or damage to others or to their property and the ship itself must make good that loss."[87]

Carrier's Lien

A carrier has the right to retain goods until his dues are paid. A carrier cannot be forced to deliver goods without payment of demurrage even if the detention order was issued by the Customs Authorities. The detention order turned out to be illegal. Therefore, the Customs Authorities became liable to pay the demurrage.[88]

Lien of Port Trust

The general lien contained in Section 171 of the Contract Act is not covered by the provisions of Chapter VI of the Major Ports Trust (MPT) Act. This Act no doubt deals with lien in respect of, inter alia, the goods imported but it does not deal with the general lien in respect of amount due on earlier consignments for which payment has not been made. The contract to the contrary as envisaged in Section 171 of the Contract Act has to be specific. The MPT Act nowhere provides that the general lien under Section 171 of the Contract Act would not be available to wharfingers in a case where the MPT Act is applicable.[89]

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84. See *Universo Insurance Co* v *Merchants' Marine Ins Co*, (1897) 2 QB 90 and *Power* v *Butcher*, (1830) 10 B&C 339.
85. *Bombay Dyeing & Mfg Co Ltd* v *State of Bombay*, AIR 1958 SC 328: 1958 SCR 1122, 1135.
86. AIR 2000 SC 2826 at p 2848.
87. *Citing* MARITIME LAW by Chrisopher Hill (2nd Edn).
88. *Shipping Corpn of India Ltd* v *C.L. Jain Woollen Mills*, AIR 2001 SC 1806.
89. *Board of Trustees of the Port of Bombay* v *Sriyanesh Knitters*, (1999) 7 SCC 359; *Om Shankar Biyani* v *Board of Trustees of Port of Calcutta*, (2002) 3 SCC 168: AIR 2002 SC 1217.

"General Balance of Account"

Services which are undertaken under Section 42 of the Major Ports Trust Act, 1963 have to be paid for and any amount so due would be regarded as a part of the "general balance of account". There is no reason to give a restricted meaning to the expression to include only the wharfage charges and exclude demurrage. A comparison of the provisions of Section 171 of the Contract Act and Sections 59 and 61 of the MPT Act shows that while Section 171 enables the retention of the goods only as a trustee, Section 59 of the MPT. Act gives the right of lien, while Section 61 gives the power to sell the goods and realise its dues.[90]

Lien of Chit Fund Company

The nature of the transaction in a chit has been held to be not that of a creditor and debtor, but contractual. The chit fund company can exercise lien over the chit amounts. The company was entitled to seek the relief of attachment before judgment against the prize amount of the surety in another chit.[91]

Types of lien covered by the Act

The Act provides for the following types of lien:

1. Lien of finder of goods [S. 168];
2. Bailee's lien:
   (*a*) Particular [S. 170];
   (*b*) General [S. 171];
3. Lien of pledgee or pawnee [Ss. 173-174];
4. Lien of agents [S. 221].

4. Right to Sue

180. Suit by bailor or bailee against wrongdoer.—If a third person wrongfully deprives the bailee of the use or possession of the goods bailed, or does them any injury, the bailee is entitled to use such remedies as the owner might have used in the like case if no bailment had been made; and either the bailor or the bailee may bring a suit against a third person for such deprivation or injury.

Section 180 enables a bailee to sue any person who has wrongfully deprived him of the use or possession of the goods bailed or has done them any injury.[92] The bailee's rights and remedies against the wrongdoer are just the same as those of the owner. An action may, therefore, be brought by the bailee or the bailor. "Whatever is obtained by way of relief or compensation in any such suit shall, as between the bailor and the bailee, be dealt with according to their respective interests."[93] For example, where the railway company was induced on production of forged railway

90. *Board of Trustees of the Port of Bombay* v *Sriyanesh Knitters* (1999) 7 SCC 359.
91. *Margadarsi Chit Fund Co Ltd* v *Sd Fayazuddin*, (2001) 1 Andh LT 541.
92. *Karnataka Electricity Board* v *Halappa*, (1987) 1 TAC 451, suit by bailee against carrier.
93. Section 181 and see *Morvi Mercantile Bank* v *Union of India*, AIR 1965 SC 1954, where a pledgee of the goods was held entitled to recover the same amount for the loss of the goods as the pledger could have recovered. *See* the judgment of SUBBA RAO J (afterwards CJ) at pp 1960-61.

receipts to deliver certain goods, the company was held entitled as a bailee to sue to recover the goods from a person with whom they were subsequently pledged.[94]

"Although sub-bailment is a sub-bailment, the law has been slow to define the critical aspects of the parties' relationship."[95] *Morris v C.W. Martin and Sons Ltd*[96] has been considered to be an important starting-point of the legal development.

The plaintiff delivered a mink stole to a furrier to be cleaned. With his consent the stole was given to the defendant, a reputed cleaner. The furrier was aware of the terms and conditions of the trade which applied to sub-bailment. One of those conditions purported to exclude liability for loss of or damage to goods. The fur was stolen by an employee of the cleaner. The owner sued him.

Lord DENNING MR spoke thus:[97]

> "Here it was not the owner, the plaintiff, who entrusted the fur to the cleaner. She handed it to Beder, who, in turn, with her authority, handed it to the cleaners who were sub-bailees for reward. Mr Beder could clearly himself sue the cleaners. But can the plaintiff sue the cleaners direct for the misappropriation by their servant."

The plaintiff's action was accordingly allowed. The sub-bailee owed a duty to her to take care. The Court of Appeal noted with emphasis that the legal relationship of bailor and bailee of a chattel can exist independently of any contract. An exemption clause in a sub-bailment contract could be enforced against the owner only if he had expressly or impliedly consented to the bailee making a sub-bailment containing those conditions, but not otherwise.

The decision in *Johnson Mathey and Co Ltd* v *Constantine Terminals Ltd*[98] laid emphasis upon this that if the original bailor decides to sue the sub-bailee directly, he would be bound by the terms of the contract between the bailee and sub-bailee, whether there was consent or not. He could not claim to be put in a better position than that of the bailee if the latter had sued his sub-bailee.

In this case silver bullion was taken by one carrier for a part of the way and then handed over to another for completing the last leg of the journey. This latter carrier's contract with the original carrier had this clause that he would not be liable for any loss unless it was due to his wilful neglect or default. The bullion was stolen from the end carrier's possession. The clause was held to be effective against the owner.

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94. *Purshottamdas* v *Union of India*, AIR 1967 All 549. *See* also *Pledge by Unauthorised Persons*, below Chapter 14, under the heading "who can pledge". A partnership firm which was bailee of goods was allowed to sue the third person who damaged the goods. *Umarani Sen* v *Sudhir Kumar*, AIR 1984 Cal 230; *Kavita Trehan* v *Balsara Hygiene Products Ltd*, AIR 1992 Del 92.

95. Peter Devonshire, *Sub-bailment on Terms and the Efficacy of Contractual Defences against a Non-contractual Bailor*, (1966) JBL 329.

96. (1996) 1 QB 716.

97. At p 728, *ibid*. The consent theory was approved in *Compania Portorafti Commerciale SA* v *Ultramar Panama Inc*, (1990) 2 Lloyd's Rep 395 *see* at p 405 and the need for it was not negatived in a subsequent contrary decision in *Dresser U.K. Ltd* v *Falcongate Freight Management Ltd*, (1992) 1 QB 502.

98. (1976) 2 Lloyd's Rep 215.

The Privy Council examined the doctrinal basis of the concept of sub-bailment in *Pioneer Container, The*,:[99]

> The plaintiffs contracted with freight carriers for carriage of their goods by container. The Bills of Lading provided that the carriers would be entitled to sub-contract on any terms, the whole or any part of the handling, storage or carriage of the goods. The carriers sub-contracted the carriage from Taiwan to Hong Kong with the defendant shipowners. The defendants issued feeder bills of lading containing the clause that the Bills of Lading would be governed by Chinese law and that any dispute would be determined in Taiwan. The vessel sank with the cargo as the result of a collision.

The plaintiffs commenced proceedings in Hong Kong by issuing a writ *in rem* for arresting a sister ship. The proceedings in Hong Kong suited them because if they had sued in Taiwan they would have been obliged to pay advance costs and a counter-security for the claim if the vessel was arrested. The defendants moved for stay of proceedings in Hong Kong. By the time the matter was heard the limitation period in Taiwan had expired. In reference to the contention of sub-bailment and lack of privity of contract their Lordships of the Privy Council specifically acknowledged that rights and obligations under bailment were independent of contractual doctrines. The law of bailment does not depend for its efficacy upon the doctrine of consideration and privity of contract. Their Lordships emphasised that the relationship of bailment arises automatically when a party voluntarily takes possession of another's goods. An integral element of the relationship is the assumption of a duty to the owner and direct accountability for any breach. An action would be maintained by the owner without reference to the contract of sub-bailment. It would be sufficient that the claim is founded on bailment alone. Thus, the principal bailor was not bound by the exclusive jurisdiction clause.

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99. (1994) 3 WLR 1. *See* also *Makhutai, The*, (1996) 3 All ER 502, on the same point.

14
Pledge

DEFINITION

Section 172 defines pledge:

172. "Pledge", "pawnor" and "pawnee" defined.—The bailment of goods as security for payment of a debt or performance of a promise is called ''pledge''. The bailor is in this case called the ''pawnor''. The bailee is called the ''pawnee''.

Thus a pledge is only a special kind of bailment, and the chief basis of distinction is the object of the contract. Where the object of the delivery of goods is to provide a security for a loan or for the fulfilment of an obligation, that kind of bailment is called pledge. "Pawn or pledge is a bailment of personal property as a security for some debt or engagement. A pawner is one who being liable to an engagement gives to the person to whom he is liable a thing to be held as security for payment of his debt or the fulfilment of his liability."[1]

Following are the essential characteristics or ingredients of a pledge:

1. Delivery of possession

"Delivery of the chattel pawned is a necessary element in the making of a pawn."[2] The property pledged should be delivered to the pawnee.[3] Thus, where the producer of a film borrowed a sum of money from a financier-distributor, and agreed to deliver the final prints of the film when ready, the agreement was held not to amount to a pledge, there being no actual transfer of possession.[4] Delivery of possession may be actual or constructive.[5] Delivery of the key of the godown where the goods are stored, is an illustration of constructive delivery. Where the goods are in the possession of a third person, who, on the direction of the pledger, consents to hold them on pledgee's behalf, that is enough delivery. It is sometimes called delivery by attornment.[6] Delivery of documents of title which would enable the pledgee to obtain possession is equally effective to create a pledge. This was clearly recognised by the Supreme Court in *Morvi Mercantile Bank* v *Union of India*.[7]

> Certain goods were consigned with the Railways to "self" from Bombay for transit to Okhla. The consigner endorsed the railway receipts to the appellant bank against an advance of Rs 20,000. The goods having been lost in

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1. *Per* SHELAT J of the Supreme Court in *Lallan Prasad* v *Rahmat Ali*, AIR 1967 SC 1322, 1325. Any kind of personal property which is movable and saleable can be the subject-matter of pledge. *Official Assignee, Bombay* v *Madholal*, 48 Bom LR 828; *Arjun Pd* v *Central Bank of India*, AIR 1956 Pat 32.
2. *See* SHELAT J at p 1325, *ibid.*
3. Things delivered would include the increments, if any, on the goods. Where shares and securities were pledged, it was held that bonus shares, dividends and interest income in respect of the securities received by the pledgee became a pledged property, *Standard Chartered Bank* v *Custodian*, AIR 2000 SC 1488: (2000) 6 SCC 427.
4. *Revenue Authority* v *Sudarsanam Pictures*, AIR 1968 Mad 319.
5. *See* Section 149, which provides about the mode of delivery.
6. *Madras Official Assignee* v *Mercantile Bank of India Ltd*, (1935) AC 53, 58-59.
7. AIR 1965 SC 1954.

transit, the bank as an endorsee of the railway receipts and pledgee of the goods sued the Railways for the loss of the goods which were worth Rs 35,500. The trial court rejected the action. The Bombay High Court allowed recovery up to Rs 20,000 only. There were cross-appeals against this decision.

The Supreme Court was called upon to decide whether a railway receipt could be equated with the goods covered by the word "goods" for the purpose of constituting delivery of goods. SUBBA RAO J (afterwards CJ), who delivered the majority opinion, held, that delivery of railway receipts was the same thing as delivery of goods, the pledge was, therefore, valid and the pledgee was entitled to sue for the loss. "In this vast country where goods are carried by Railways over long distances and remain in transit for long periods of time, the railway receipt is regarded as the symbol of the goods for all purposes for which a bill of lading is so regarded in England."[8] The Court also held that the pledgee was entitled to recover the full value of the goods lost and not merely the amount of his advance. "A pledge being a bailment of goods as security for payment of a debt, the pledgee will have the same remedies as the owner of the goods would have against third person for deprivation of the said goods or injury to them."[9]

RAMASWAMI and MUDHOLKAR JJ dissented. They were of the view that in all cases of pledge an effective change of possession is absolutely necessary. The only exception could be in favour of a bill of lading. If the pledger has goods in his physical possession he could effect the pledge by actual delivery. If, however, the goods are in the physical possession of a third person, pledge should be effected by a notification to the custodian who should acknowledge to hold the goods for the bailee. There would thus be a change of possession and constructive delivery.

It has been held by the Mysore High Court that way bills issued by a public carrier have not yet acquired the character of being documents of title and, therefore, their delivery cannot be regarded as pledge of the goods.[10]

Pledge by hypothecation

Sometimes the goods are allowed to remain in the custody of the pledger for a special purpose. But that does not militate against the effectiveness of the pledge. *Reeves* v *Capper*[11] is an early illustration.

The captain of a ship pledged his chronometer with the shipowner who allowed him to use the instrument for the purpose of a voyage. The captain pledged it over again with another person.

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8. *Marvi Mercantile Bank* v *Union of India*, AIR 1965 SC 1954 at pp. 1960-61. Way bills issued by a truck operator, being not documents of title, their delivery as against an advance did not amount to pledge of the goods. *C.I.&B. Syndicate* v *Ram Chandra*, AIR 1968 Mys 133.
9. *Per* SUBBA RAO J (afterwards CJ) in AIR 1968 Mys 133.
10. *C.I.&B. Syndicate* v *Ram Chandra*, AIR 1968 Mys 133. Share certificates are not documents of title to goods, they are goods in themselves, *Lalit Mohan* v *Haridas*, (1916) 24 Cal LJ 335; *L.I.C.* v *Escorts Ltd*, (1986) 1 SCC 264: 59 Comp Cas 548; *Remp* v *Falk*, (1882) 7 App Cas 573, cash receipts in place of delivery orders, not documents of title.
11. (1838) 5 Bing NC 136: 132 ER 1057: 8 LJCP 44: 50 RR 634. *See* also *Martin* v *Reid*, (1862) 11 CB (NS) 730: LJCP 126: 5 LT 727; *United Bank of India* v *New Glencoe Tea Co*, AIR 1987 Cal 143, valid mortgage of movables without delivery of possession. Though pledge by way of hypothecation is not dealt with under the Act, hypothecation is a valid security creating similar rights and duties as those created by a pledge. *Haripada* v *Anath Nath De*, (1918) 22 Cal WN 758.

The question was whether the first pledge was valid. The court held that it was. In the same way a constructive pledge comes into existence as soon as the pawner, without actually delivering the goods, agrees to hold them for the pawnee and promises to deliver them on demand. An illustration is the decision of Andhra Pradesh High Court in *Bank of Chittoor* v *Narasimbulu*.[12]

> A cinema projector and accessories were pledged with a bank. The bank allowed the property to remain with the pledgers, since they formed the equipment of a running cinema. Subsequently the pledgers sold the machinery.

The court held that the sale was subject to the pledge. "There was a constructive delivery or delivery by attornment to the bank."[13]

Similarly, where a firm of merchants, having pledged certain railway receipts with a bank, took them back under the pretence of clearing the goods and repledged them with another bank, the Privy Council held that the first pledge was not thereby defeated.[14] Likewise, where certain motor vehicles pledged by a motor dealer were allowed to remain in his possession for demonstration purposes, the pledge was held to be valid.[15]

In such cases the other creditors cannot claim anything from such goods unless the claim of the pledgee is first satisfied.[16]

2. In pursuance of contract

"Pledge is a conveyance pursuant to a contract, and it is essential to a valid pledge that delivery of the chattel shall be made by the pledger to the pledgee in pursuance of the contract of pledge."[17] But it is not necessary that delivery of possession and the loan should be contemporaneous. "Delivery and advance need not be simultaneous and a pledge may be perfected by delivery after the advance is made."[18] Delivery may be made before or in contemplation of an advance, which ripens into a pledge as soon as the advance is made. For instance, in *Blundell Leigh* v *Attenborough*:[19]

> On November 1, 1919, the plaintiff handed her jewellery to one Miller to value it and let her know what offer he could make as to lending her money; he was to keep the jewellery as security if he made the advance. On the same day

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12. AIR 1966 AP 163.
13. VENKATASAMI J at p 166.
14. *Mercantile Bank of India* v *Central Bank of India*, (1938) AC 287: (1938) 1 All ER 52 (PC).
15. *Appa Rao* v *Salem Motors*, AIR 1955 Mad 505. In this respect a pledge becomes closer to a hypothecation because in a transaction of hypothecation, the material remains with the borrower, the lender getting only the right to seize on default and to realise the value. He is not liable for any accident caused by the motor vehicle which is under his hypothecation; *Bank of Baroda* v *Rabari Bachubhai Hirabhai*, AIR 1987 Guj 1. A surety cannot claim the benefit of Section 141 when the security is in the shape of hypothecated goods. *Bank of India* v *Yogeshwar Kant Wadhera*, AIR 1987 P&H 176.
16. *Bank of India* v *Binod Steel Ltd*, AIR 1977 MP 188.
17. *See* BANKES LJ in *Blundell Leigh* v *Attenborough*, (1921) 3 KB 233, 239, *citing* from the judgment of the trial Court whose statement was approved in principle, though not his decision.
18. SHELAT J in *Lallan Prasad* v *Rahmat Ali*, AIR 1967 SC 1322, 1325. Thus possession may be delivered within reasonable time after the advance. *Jyoti Prakash Nandi* v *Mukte Prakash Nandi*, 33 IC 891: (1917) 22 Cal WN 297, pledge of Government promissory notes; *Hilton* v *Tucker*, (1888) 39 Ch D 669.
19. (1921) 3 KB 233.

Miller pledged the jewellery with the defendants, a pawnbroker, who in good faith advanced £1000 on it. On November 5, Miller advanced £500 to the plaintiff on the security of the ring. Miller died. The plaintiff came to know the facts. She paid the amount she had borrowed and sued the defendant for return of her jewellery.

The contention on her part was that when she gave the jewellery to Miller for examination, he only became a gratuitous bailee having no right to deal with it. There was no valid pledge then. Subsequently, when he advanced the money, no valid pledge could arise as he had already parted with the possession of the goods. But the court held that the pledge was valid. Delivery made on November 1 was a good delivery for the purpose of creating a pledge, whenever that pledge was created. "It is clear that the plaintiff intended, when she handed over the jewellery to Miller, to create a valid pledge as between him and her from the moment when he handed her the money by way of loan which she was prepared to accept."[20]

RIGHTS OF PAWNEE

1. Right of Retainer [Ss. 173 and 174]

173. Pawnee's right of retainer.—The pawnee may retain the goods pledged, not only for a payment of the debt or the performance of the promise, but for the interest of the debt, and all necessary expenses incurred by him in respect of the possession or for the preservation of the goods pledged.

174. Pawnee not to retain for debt or promise other than that for which goods pledged: Presumption in case of subsequent advances.—The pawnee shall not, in the absence of a contract to that effect, retain the goods pledged for any debt or promise other than the debt or promise for which they are pledged; but such contract, in the absence of anything to the contrary, shall be presumed in regard to subsequent advances made by the pawnee.

The first important right of a pawnee is the right to retain the goods pledged until his dues are paid. He has a right to retain the goods not only for payment of the debt or performance of the promise, but for the interest due on the debt, and all necessary expenses incurred by him in respect of the possession or for the preservation of the goods pledged.[21]

The pledgee can retain the goods only for the payment of that particular debt for which the goods were pledged and not for any other debt or promise, unless

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20. *See* BANKES LJ in *Blundell Leigh* v *Attenborough*, (1921) 3 KB 233, 240.

21. This right of the pledgee has to be distinguished from bailee's lien. A pledge creates a special interest in the property pledged in favour of the pledgee giving him the right to sell, but a lien is only a right to retain. *Alliance Bank of Simla* v *Ghamandi Lal*, AIR 1925 Lah 408; (1927) 8 Lah 373. A mortgage is different from pledge in this sense that the legal interest in the property becomes vested in the mortgagee subject only to the mortgagor's right of redemption, whereas a pledge gives to the pledgee only a special interest. *Metonic India P Ltd* v *Krishna Behl*, AIR 1997 P&H 297, the pledgee bank took over possession of the goods in the pledgor's godown and locked it, that did not amount to sub-letting of the premises for the purposes of evicting the lessee under the East Punjab Urban Rent Restriction Act, 1949.

there is a contract to the contrary. Where, however, after a pledge is created, a subsequent advance is made without any other security, a contract to burden the same goods shall be presumed.[22] The right of retainer ends on proper tender of payment. If the pledgee refuses a proper tender, he opens himself up for pledger's remedies of seeking return and absolute liability of bailee under Sections 160 and 161 for failure to return in time.[23]

Special and Paramount Interest of Pledgee

The right of retainer is thus in the nature of a particular lien.[24] Yet lien is different from pledge. "A pawn or pledge is an intermediate between a simple lien and a mortgage."[25] "The pawnee gets a special property in the goods pledged. The general property remains in the pawner and wholly reverts to him on discharge of the debt. The right to property vests in the pledgee only so far as is necessary to secure the debt."[26]

Explaining the nature of the special property in the goods which is acquired by the pledgee in *Bank of Bihar* v *State of Bihar*[27] the Supreme Court observed:

> "This special property or interest is to be distinguished from the mere right of detention which the holder of a lien possesses, in that it is transferable in the sense that a pawnee may assign or pledge his special property or interest in the goods. Where judgment has been obtained against the pawner of goods and execution has issued thereon, the sheriff cannot seize the goods pawned unless he satisfies the claim of the pawnee. On the bankruptcy of the pawner the pawnee is a secured creditor with respect to things pledged."[28]

Thus, so long as the pawnee's claim is not satisfied no other creditor of the pawner has any right to take away the goods or their price. In that case, the goods which were under the pledge of a bank were seized by the State of Bihar. It was held that the seizure could not deprive the pledgee of his right to realise the amount for which the goods were pledged and, therefore, the State was bound to indemnify him up to the amount which would have been realised from the goods. The court also pointed out that the Indian law in this respect was not different from the English law.[29]

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22. *Cowasji* v *Official Assignee*, AIR 1928 Bom 507: (1928) 30 Bom LR 1310.
23. *Bank of New South Wales* v *O'Connor*, (1880) 14 App Cas 273. *See* also *Branch Manager, State Bank of Hyderabad* v *Godirajee Rama Bhaskara*, AIR 1993 AP 337, the pledgor by a will transferred his interest in gold articles lying with the bank to his legal representative, who paid off the whole claim of the bank. It was held that the bank was bound to return the security without demanding succession certificate. The pledgee should exercise his power in a fair manner and not maliciously, *Bank of India* v *Lakshimani Das*, AIR 2000 SC 1172: (2000) 3 SCC 640.
24. For the meaning of "particular lien", see *supra*, S. 170.
25. SHELAT J. in *Lallan Prasad* v *Rahmat Ali*, AIR 1967 SC 1325. *Citing* from *Halliday* v *Holygate*, (1868) 3 Ex 299.
26. *Ibid.*, at p 1325. *See* also *Jyoti Prakash Nandi* v *Mukte Prakash Nandi*, 33 IC 891; *Carter* v *Wake*, (1877) 4 Ch D 605; *Bookhouse* v *Charlton*, (1878) 8 Ch D 444.
27. (1972) 3 SCC 196: AIR 1971 SC 1210.
28. At pp. 197-200.
29. *Bank of Bihar* v *State of Bihar*, (1972) 3 SCC 196, 200. Another example, *State Bank of Hyderabad* v *Susheela*, AIR 1980 AP 1. To the same effect, *State of AP* v *Andhra Bank Ltd*, AIR 1988 AP 18, the court pointing out that English law is no different in this respect; *Central Bank of India* v *Grains and Gunny Agencies*, AIR 1989 MP 28, the bank not being able to deliver goods, nor account for their loss, was held entitled to no relief; *State Bank of India* v *N. Sathiah*, AIR 1989 Mad 279, the pledgee is entitled to a clean decree and not one

Hypothecatee has no Direct Right of Seizure

Where the pledge is by way of hypothecation, the creditor cannot directly seize the goods by entering premises or otherwise. He has to do so either with the consent of the borrower or through a court order. The creditor does not have the right to enter the premises, lock and seal the same. In *Union of India* v *Shenthilnathan*[30] the most conspicuous feature of the agreement was that in case the borrower committed default in payment of the debt as stipulated, the lender was at liberty to seize the goods. The court held that this power was not directly exercisable. No possession was delivered on the date when the hypothecation deed was entered into. What was contemplated was a future *overt act* on the part of the creditor to sequester the goods, if so desired and that too by a process known to law. At best the right which the plaintiff had under the agreement was to file a suit on the debt and after obtaining a decree to proceed against the property specified in realisation of the decree.[31]

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linked with the genuineness or spuriousness of the pledged artfcles; workers' claims not given precedence over that of the pledgee's right, *Central Bank of India* v *Authority under the Payment of Wages Act*, (1987) 1 Mad LJ 349; *Bank of India* v *Bind Steel Ltd*, AIR 1977 MP 188.

S.Y.C.W. and S. Mills, Re, AIR 1969 Mys 280. A. NARAYANA PAI J. observed as follows:—"In the case of hypothecation or pledge of movable goods, there in no doubt about the creditor's right to take possession, to retain possession and to sell the goods directly without the intervention of court for the purpose of recovering his dues. The position in the case of regular pledge completed by possession is undoubted and set out in the relevant sections of the Contract Act. Hypothecation is only extended idea of pledge, the creditor permitting the debtor to retain possession either on behalf of or in trust for himself (the creditor). *State Bank of India* v *State of Rajasthan*, (1995) AIHC 4314 Raj, here the bank had lien over the goods in question. The attachment of such goods for payment of State Taxes was held to be illegal. *Bank of Baroda* v *Collector, Indore*, (1993) Cri LJ 3503 MP, attachment of goods under bank's pledge not lawful even if the trader who pledged them was violating the limits of the Essential Commodities Act, 1955.

30. (1977) 2 Mad LJ 499.

31. *Followed* in *Sukra Shoe Fabric* v *UCO Bank*, (1991) 1 Mad LJ 27. The court also pointed out that such claims cannot be raised through writ jurisdiction even when the claim is against Government agencies, such as nationalised banks, because the subject-matter of the litigation is purely contractual. Citing, *Bareilly Development Authority* v *A.P. Singh*, (1989) 2 SCC 116: AIR 1989 SC 1076 and *Sri Anadi Mukta Sadguru* v *R. Rudani*, (1989) 2 SCC 691: AIR 1989 SC 1607. Where the financier who is hypothecatee of the material financed by him takes possession on default in lawful manner and in accordance with the terms of the agreement, he cannot be charged with theft under S. 379 of the Indian Penal Code, 1860, *Shriram Transport Finance Co Ltd* v *R. Khaishiulla Khan*, (1993) 1 Kar LJ 62 DB. Such right has also been *upheld* in *State Bank of India* v *S.B. Shah Ali*, AIR 1995 AP 134, including the right of sale without intervention of court. *Haripada* v *Anatha Nath*, AIR 1918 Cal 165, hypothecation is not a creation of statute, security is created by the intention of the parties. *Nanhuji* v *Chimna*, (1911) 10 Ind Cas 869, hypothecation without delivery of possession, valid security. To the same effect *Co-operative Hindustan Bank* v *Surendra Nath*, AIR 1932 Cal 524. *Venkatchalam* v *Venkatram*, AIR 1940 Mad 929, under S. 3, Transfer of Property Act, 1882, there can be valid mortgage of movable property, mortgage of crop in this case, *Simla Banking Co* v *Pritams*, AIR 1960 Punj 42, validity and points of difference with pledge emphasised. *Nadar Bank Ltd* v *Canara Bank Ltd*, AIR 1961 Mad 326, pledging of godown with certain powers of control in favour of the bank, pledge, not hypothecation. *Followed* in *Jayant T. Shah* v *Andhra Bank Ltd*, (1977) 2 Andh WR (HC) 129. *Gopal Singh* v *Punjab National Bank*, AIR 1976 Delhi 115, hypothecatee is deemed to be in possession of the goods. *Syndicate Bank* v *Official Liquidator*, AIR 1985 Delhi 256, pledge or hypothecation does not involve transfer of any interest in the goods. *State* v *Andhra Bank Ltd*, AIR 1988 AP 18 at p 22, validity of hypothecation recognised. *Builders*

2. Right to Extraordinary Expenses [S. 175]

The pawnee is entitled to receive from the pawner extraordinary expenses incurred by him for the preservation of the goods pledged. For such expenses, however, he does not have the right to retain the goods. He can only sue to recover them. This right is provided for in Section 175 which is as follows:

175. Pawnee's right as to extraordinary expenses incurred.—The pawnee is entitled to receive from the pawnor extraordinary expenses incurred by him for the preservation of the goods pledged.

3. Right to Sell [S. 176]

Section 176 which provides for this important right is as follows:

176. Pawnee's right where pawnor makes default.—If the pawnor makes default in payment of the debt, or performance, at the stipulated time, of the promise, in respect of which the goods were pledged, the pawnee may bring a suit against the pawnor upon the debt or promise, and retain the goods pledged as a collateral security; or he may sell the thing pledged, on giving the pawnor reasonable notice of the sale.

If the proceeds of such sale are less than the amount due in respect of the debt or promise, the pawnor is still liable to pay the balance. If the proceeds of the sale are greater than the amount so due, the pawnee shall pay over the surplus to the pawnor.

Upon a default being made by the pawner in the payment of the debt or performance of the promise, the pledgee gets two distinct rights under Section 176 of the Act. Firstly, the pledgee may sue upon the debt and retain the goods as a collateral security.[32] Secondly, he may sell the goods after reasonable notice of the intended sale to the pawner.[33]

Supply Corpn v *Union of India*, AIR 1965 SC 1061, consideration of the concept of "law in force". *Tehilram* v *Dimello*, AIR 1916 Bom 77, hypothecation has become a part of law. *Union of India* v *C.T. Shentilanathan*, (1978) 48 Comp Cas 640, hypothecation accepted in law merchant by long usage and practice. *Ahmad Alim Mohamad Khoja, Re*, AIR 1932 Bom 613, rights of hypothecatee not inferior to those of mortgagee. *Watkins* v *Evans*, (1887) 18 QBD 386, agreement to insure chattels covered by the deed and to deliver the receipt to the lender who had the power to seize in case of need. Another case of the same kind, *Morritt, Re, Ex. P. Official Receiver*, (1886) 18 QBD 222. The provision for the mortgagor to retain possession until default is not inconsistent with a provision for taking possession on the happening of an event, *Francis, Re*, (1878) 10 Ch D 408 CA. Hypothecation is a species of pledge which creates a charge in favour of the hypothecatee, *Hindustan Machine Tools Ltd* v *Nedungardi Bank Ltd*, AIR 1995 Kant 185. *S.Y.C.W.&S. Mills, Re*, AIR 1969 Mys 280, hypothecation provides a security which the bank can use by making private sale in accordance with the terms of the hypothecation deed.

32. *S.K. Engg Works* v *New Bank of India*, (1986-2) 90 Punj LR 546; *Chandradhar* v *Gauhati*, AIR 1967 SC 1058; *State Bank of India* v *Kashmir Art Printing Press*, (1981) 83 Punj LR 300; *Shri Bharat Laxmi Wood Store* v *Punjab National Bank*, (1982) 84 Punj LR 472; *State Bank of India* v *Quality Bread Factory*, AIR 1983 P&H 244; *Central Bank of India* v *P.R.C. Industries*, AIR 1986 Guj 113. A pledgee cannot be non-suited only because instead of realising the security, he is proceeding against the pledger personally. *Kamla Prasad Jadawal* v *Punjab National Bank*, AIR 1992 MP 45.

33. The right of personal action does not take away the right of realising the security. *Mahalinga* v *Ganapathi*, (1902) 27 Mad 528; *Nim Chand* v *Jogabandhu*, (1894) 22 Cal 21.

The right to sue is a personal action and rests upon the contract of loan quite apart from the pledge. But until the money due is recovered, the pledged goods may be retained, though they would have to be surrendered when the loan is realised. If by reason of his own act, the pledgee is unable to return the goods, he cannot have judgment for the debt. This was laid down by the Supreme Court in *Lallan Prasad* v *Rahmat Ali*.[34]

> The defendant borrowed Rs 20,000 from the plaintiff on a promissory note and gave him aeroscrapes worth about Rs 35,000 as security for the loan. The plaintiff sued for repayment of the loan, but was unable to produce the security, having sold it, and, therefore, his action for the loan was rejected.

SHELAT J after examining the rights of the parties to a pledge, cited the following passage from the decision of the House of Lords in *Trustees of the Property of Ellis & Co* v *Dixon Johnson*:[35]

> "If a creditor holding security sues for the debt, he is under an obligation on payment of the debt to hand over the security, and that if, having improperly made away with the security he is unable to return it to the debtor he cannot have judgment for the debt."

"If it were otherwise," SHELAT J added, "the result would be that he would recover the debt and also retain the goods pledged and the pawner in such a case would be placed in a position where he incurs a greater liability than he bargained for under the contract of pledge."[36]

The Orissa High Court followed this decision so as to hold that a bank holding gold by way of collateral security and suing the borrower on the promissory note would get a decree conditional upon return of the gold to the

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Where the amount was fully recovered personally from the borrower, a claim of penal interest after full recovery was not allowed. *S.N. Choubey* v *Central Coalfields Ltd*, AIR 2001 Jhar 13.

34. AIR 1967 SC 1322: (1967) 2 SCR 233. The goods are retained in such a case as a collateral security. See *S.K. Engineering Works* v *New Bank of India*, AIR 1987 P&H 90, the right of the bank to sue, while retaining the goods as a collateral security subject, of course, to the precondition of being able to return the things pledged allowed. *Bank of Baroda* v *B.B. Hirabhai*, AIR 1987 Guj 1, the bank does not become the owner of the hypothecated goods, it has only the right to sell. *T.S. Kotagi* v *Tahsildar*, AIR 1985 Kant 265, the right to sue can be exercised without notice, but not right of sale: *Tapanga Light Foundry* v *State Bank of India*, AIR 1987 Ori 174. *Followed* in *Khusiram* v *Swaroop Narain*, (1989) 2 Raj LR 181, no right to repayment unless securities produced where the pledgee was in possession; *Union Bank of India* v *Debendra Nath Roy Choudhury*, AIR 1992 Gau 88.

35. (1925) AC 489. At p 1325, *ibid.*

36. AIR 1967 SC 1326. The right of sale arises only by reason of the pledge. It has been held by the Supreme Court that giving a loan and keeping goods in stock does not amount to pledge for the purposes of Section 176. *P.S.N.S.A. Chettiar* v *Express Newspapers Ltd*, (1968) 2 SCR 239: AIR 1968 SC 741. Where the goods were delivered by a godown-keeper under the order of the Controller of Foodgrains, he not pointing out that he was only a pledgee, he was not afterwards permitted to raise the plea of pledge. *Ram Prasad* v *State of MP*, (1969) 3 SCC 24: (1970) 2 SCR 677: AIR 1970 SC 1818. The court does not restrain a pledgee from exercising his right of sale. *State Bank of Bikaner* v *Ballabh Das*, AIR 1984 Raj 107. The Kerala High Court in its decision in *Dena Bank* v *Glorphis James*, (1993) 2 Ker LT 105 *distinguished* this case from the decision in *Lallan Pd* v *Rahmat Ali*, AIR 1967 SC 1322 and held that even where the security is lost on account of the negligence of the bank, it would not lose its right to recover back the loan amount if there is clause in the agreement exempting the bank from liability for loss caused by negligence.

borrower[37] and a decree for sale of the articles if the borrower does not satisfy the decree.[38] Where certain fixed deposit receipts were pledged with a bank as a collateral security, they being in the nature of goods, it was held that the bank could exercise the option of retaining them and file a suit for recovery of the loan. It was also held that the bank was not obliged to adjust the monthly instalments of FDR refunds towards the loan amount.[39] Thus the creditor has two rights which are concurrent and the right to proceed against the property is not merely accessory to the right to proceed against the debtor personally. The same principles have been held to be applicable to cases of hypothecation or mortgage of movable property.[40] Section 176 has been held to be mandatory.[41] Where the bank took over possession of the hypothecated truck but thereafter neither sold it according to the agreed terms nor took care of it, leaving it in open place, the bank was liable for the extraordinary depreciation in the value of the vehicle.[42]

Where the bank provided money for purchase of a lorry and also paid insurance premium and subsequently the owner reported loss by theft, it was held that the insurance company was liable to pay the insurance money to the bank irrespective of the fact that the insurance was not in the name of the bank. The bank was the hypothecatee and both the insurance company and the borrower were joint debtors, the insurance company to the extent of insured value and the borrower for the balance.[43]

The Two Rights are Disjunctive

The pawnee's two rights, namely the right to sue the pawnor for personal recovery or resort to sell the security after reasonable notice, are disjunctive, being independent of each other. The fact that a period is prescribed for filing suit would not mean that the prescribed period would also apply to the alternative remedy of selling the goods.[44]

Requirement of notice

Alternatively, the pledgee may sell the goods. Before making the sale he is required to give to the pawner, a reasonable notice of his intention to sell.[45] The requirement of "reasonable notice" is a statutory obligation and, therefore,

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37. *Dodla Bhaskar Rao* v *State Bank of India*, AIR 1992 Ori 161. The court *distinguished* the case from the decision of the Madras High Court in *State Bank of India* v *N. Sathiah*, AIR 1989 Mad 279, where the requirement of precondition was described to be against the Act.
38. *Haridas Mundra* v *National and Grindlays Bank*, AIR 1963 Cal 132.
39. *State Bank of India* v *Neela Ashok Naik*, AIR 2000 Bom 151: (2000) 1 Mh LJ 801.
40. *Gulam Hussain Lalji Sajan* v *Clare D'Souza*, AIR 1929 Bom 471.
41. *Official Assignee* v *Madholal Sindhu*, AIR 1947 Bom 217 DB.
42. *Central Bank of India* v *Abdul Mujeeb Khan*, (1997) AIHC 299. *See* also *Punjab and Sind Bank* v *Nagrath Industries P Ltd*, AIR 1996 MP 32, goods handed over to the bank by the judgment-debtor, the bank should have sold them immediately and not retained them. Interest not allowed from the date on which the goods were made available for realising sale proceeds.
43. *State Bank of India* v *Suresh Kumar*, (1995) AIHC 3889.
44. *K.M. Hidayathulla* v *Bank of India*, AIR 2000 Mad 251, the period for sale was not extended so as to make it commensurate with the right of personal action.
45. *Kersarimal* v *Gundabathula Suryanarayanmurthy*, AIR 1928 Mad 1022, once proper notice is given, no further authorisation or permission of the pawner to effect the actual sale is needed, nor he is bound to dispose of within reasonable time thereafter; *Motilal* v *Lukhmichand*, AIR 1943 Nag 234.

cannot be excluded by a contact to the contrary.[46] Thus, for example, in a case before the Allahabad High Court:

> One of the terms of an agreement of loan enabled the lending banker to sell the securities without any notice to the pawner. The pawner defaulted in payment. The bank sent a reminder, but the pawner asked for more time. The bank thereupon disposed of the securities.

The sale was held to be bad in law. "What is contemplated by Section 176," the Court said, "is not merely a notice but a 'reasonable' notice, meaning thereby a notice of intended sale of the security by the creditor within a certain date so as to afford an opportunity to the debtor to pay up the amount within the time mentioned in the notice."[47] The court refused to agree with the bank's contention that the sale notice should be inferred from the pawner's request for time. "A notice of the character contemplated by Section 176 cannot be implied. Such notice has to be clear and specific in language...."[48]

If the proceeds of sale are less than the amount due in respect of the debt or promise, the pawner is still liable to pay the balance. If the proceeds of sale are greater than the amount so due, the pawnee shall pay over the surplus to the pawner.[49]

In a case before the Patna High Court,[50] a banker, with whom some jute bales were pledged, sold them in the exercise of his right of resale, but refunded the price to the buyer when the latter rejected the goods on the ground that they contained "gudri" and not merely jute. The banker resold the goods to another buyer at a lower figure and then sued the pawner for the balance still due after adjusting the sale proceeds. The court rejected his action. He should have referred to the pawner before refunding the price. UNTWALLA J said:[51]

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46. Pledger's right to redeem cannot be taken away, nor he can be foreclosed from redeeming the pledge. *Carter* v *Wake*, (1877) 4 Ch D 605. Where the pledgee acquiesces in the sale, it amounts to ratification of sale without notice. *Madholal* v *Official Assignee of Bombay*, AIR 1950 FC 21: 51 Bom LR 906.

47. *Prabhat Bank* v *Babu Ram*, AIR 1966 All 134; *Sri Raja Kakral Puni Venkatasudarasana Sundara etc.* v *Andhra Bank Ltd*, (1960) 1 Andh WR 234. It is enough if the notice carries an intimation of the proposed sale, whether it is signed or not, or whether it specifies the amount due or not have been held to be immaterial. *A. Srinivasulu Naidu* v *Gajraj Mehta*, (1990) 1 Mad LJ 188; *Motilal* v *Lakshmichand*, AIR 1943 Nag 162; *Sankaranarayana Iyer Saraswathy Ammal* v *Kottayam Bank Ltd*, AIR 1950 Trav-Co 66, no advance arrangement for sale necessary; *Hulas Kunwar* v *Allahabad Bank Ltd*, AIR 1958 Cal 644. Sale without notice is void as between the parties. *Official Assignee of Bombay* v *Madholal*, 48 Bom LR 830; *Sankaranarayana* v *Kottayam Bank*, AIR 1950 Trav Co 66, notice to the surety for the pledger not needed, but it would be better to inform him too so as to give him the opportunity to pay and save the security.

48. Sale of items by a cold store after giving proper notice and advertisement, depositor not turning up, sale proper and binding on him. *H.F.G. Co-op M.&P. Society* v *U.I.F.P.*, AIR 1984 HP 18; *Sri Rama Finance Corpn, Bobbeli* v *Chajla Yellaiah Reddi*, (1976) 1 Andh WR 107. The pledgee is not bound to sell immediately after the date on which notice period expires; *Kesarimal* v *Gandabathula Suryanarayanamurthy*, AIR 1928 Mad 1022; *Kunj Behari Lal* v *Bhargav Commercial Bank*, (1918) 40 All 522.

49. Section 176 (2nd para). *See* also *Dhani Ram & Sons* v *Frontier Bank*, AIR 1962 Punj 321, 322-323.

50. *L.N. Arjundas* v *State Bank of India*, AIR 1969 Pat 385.

51. At p 393.

"I find no principle or authority to support the contention that all that was done by the bank in regard to the dispute was incidental to the power of sale of the bank under Section 176. It would be disastrous for the commercial world to accept and uphold it to be good."

The right of sale can be exercised even against a time-barred debt. In lieu of sale, the court can order the pawner to pay off the time-barred debt but such an order must inevitably be accompanied with an order to the pawnee to return the pledged articles.[52]

Supposing that a due notice of sale has been given so that the pledgee gets the right to sell, may he buy the goods himself? The Punjab High Court held,[53] following a Privy Council decision[54] that a sale to the pledgee himself is not void. It does not terminate the contract of pledge so as to entitle the pledger to have back the goods without payment of loan. But the pledger may hold the pledgee liable for any loss he may have suffered by reason of that fact, for example, that the goods have been given a value less than their market price.

Loss of Security due to Pledgee's Negligence

Where goods are lost due to the negligence of the pledgee, the liability of the pledger is reduced to the extent of the value of such goods. In a case before the Supreme Court:

> Certain goods in the godown of a firm were under the pledge of a bank. The godown was insured against fire. A part of them was damaged by fire. The bank received insurance money to the extent of the fire.

The bank was obliged by the court to give credit to the firm in its cash-credit account for the amount so received. The court also pointed out that bank was not entitled to hold it under lien against partners' personal accounts. The goods were of the firm. They were not the goods of the partners. They were not offered as security for the individual debts of the partners. The goods were pledged against the cash-credit facility allowed to the firm.[55]

Pawner's right to redeem [S. 177]

Section 177 which provides for the most valuable right of the pawner is as follows:

177. Defaulting pawnor's right to redeem.—If a time is stipulated for the payment of the debt, or performance of the promise, for which the pledge is made, and the pawnor makes default in payment of the debt or performance of the promise at the stipulated time, he may redeem the goods pledged at any subsequent time before the actual sale of them; but he must, in that case, pay, in addition, any expenses which have arisen from his default.

"Satisfaction of the debt or engagement extinguishes the pawn and the pawnee on such satisfaction is bound to redeliver the property. The pawner has an

52. *T.A. Kotagi* v *Tahsildar*, AIR 1985 Kant 265.
53. *Dhani Ram & Sons* v *Frontier Bank*, AIR 1962 Punj 321, 322-323.
54. *Neckram Dobey* v *Bank of Bengal*, ILR 19 Cal 322, 323.
55. *Gurbax Rai* v *Punjab National Bank*, (1984) 3 SCC 96: AIR 1984 SC 1012, 1013.

absolute right to redeem the property pledged upon tender of the amount advanced."[56] It has been pointed out by the Supreme Court[57] that "the special interest of the pledgee comes to an end as soon as the debt for which the goods were pledged is discharged. It is open to the pledger to redeem the pledge by full payment of the amount for which the pledge had been made at any time if there is no period fixed for redemption, or at any time after the fixed date and the right continues until the thing pledged is lawfully sold". The right to redeem clearly continues up to the time on the expiry of which the pawnee has notified that the goods would be sold. But the right continues even longer, for Section 177 clearly provides that the pawner may redeem the goods at any subsequent time before the actual sale of them. "So long as the sale does not take place the pawner is entitled to redeem the goods on payment of the debt." In other words, the right to redeem is extinguished not by the expiry of time specified in the notice of sale, but by the actual sale of the goods.

Where the pawner redeems after the expiry of the specified time, he is bound to pay to the pawnee such expenses as have arisen on account of his default.[58]

The pawner has the right to take back with the goods the increase, if any, that the goods have undergone during the period of pledge. In a case before Delhi High Court,[59] the pledge was that of certain shares of a company and during the period of pledge the company issued bonus and rights shares. It was held that these increases belonged to the pawner.

Redemption means the enforcement of the right to have the title to corpus of the pledged property restored to the pledgor free and clear of the pledge. A suit for redemption has to be filed for exercising this specific remedy and not just for a declaration of the right of redemption.[60]

WHO CAN PLEDGE

Ordinarily goods may be pledged by the owner or by any person with the owner's authority. A pledge made by any other person may not be valid. Thus, for example, where goods were left in the possession of a servant, while the owner was temporarily absent, a pledge made by the servant was held to be invalid.[61] Similarly, where certain goods are left in the care of a person for some special purpose, he cannot pledge them.[62] In a case before the Allahabad High Court,[63] the railway company delivered goods on a forged railway receipt. The goods were then pledged with the defendants. In a suit by the Railways to recover the goods, the defendants contended that the Railways were too negligent in delivering the goods to a wrong

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56. *Per* SHELAT J in *Lallan Prasad* v *Rahmat Ali*, AIR 1967 SC 1122, 1125. *Vasant Deorao Deshpande* v *State Bank of India*, (1996) Mh LJ 914, the pledgor giving notice to the bank that he was willing to pay off the loan provided the bank would return his gold securities, bank making no reply, interest did not cease to run from the date of such notice.
57. *Jaswantrai Manilal Akhaney* v *State of Bombay*, 1956 SCR 483, 498: AIR 1956 SC 575.
58. Section 177.
59. *M.R. Dhawan* v *Madan Mohan*, AIR 1969 Del 313.
60. *Nabha Investment P Ltd* v *Harkishan Das Lakhmidas*, (1995) 58 Delhi LT 285. The pledgor cannot seek any relief without tendering the amount due against him.
61. *Biddomoy Dabee* v *Sittaram*, ILR 4 Cal 497.
62. *Shankar Murlidhar* v *Mohanlal Jaduram*, ILR 11 Bom 704; *Seager* v *Hukma Kesa*, ILR 24 Bom 458; *Naganda Davay* v *Bappu Chettiar*, ILR 27 Mad 424.
63. *Purshottam Das* v *Union of India*, AIR 1967 All 549.

person. But the court held that this would not constitute an estoppel against the company and that pledge was not valid.[64] The principle is necessary to protect the individual interest in the ownership of property. But interest acquired in the course of lawful commercial transactions equally deserves to be protected. Accordingly, Sections 178 and 179 provide for certain circumstances in which a person, being left in possession with the consent of the owner, may make a valid pledge though without the owner's authority.

1. Pledge by mercantile agent [S. 178]

178. Pledge by mercantile agent.—Where a mercantile agent is, with the consent of the owner, in possession of goods or the documents of title to goods, any pledge made by him, when acting in the ordinary course of business of a mercantile agent, shall be as valid as if he were expressly authorised by the owner of the goods to make the same: Provided that the pawnee acts in good faith and has not at the time of the pledge notice that the pawnor has no authority to pledge.

Explanation.—In this section, the expressions "mercantile agent" and "documents of title" shall have the meanings assigned to them in the Indian Sale of Goods Act, 1930 (III of 1930).

The first exception is in favour of a pledge created by a mercantile agent. Section 178 provides that where a mercantile agent is, with the consent of the owner, in possession of goods or documents of title to goods, any pledge made by him while acting in the ordinary course of business shall be valid, provided that the pawnee acts in good faith and has no notice of the fact that the agent has no authority to pledge.[65] The necessary conditions of validity under the section are as follows:

1. Mercantile Agent

There should be a mercantile agent. The explanation to the section says that the expression "mercantile agent" has the same meaning as is assigned to it by Indian Sale of Goods Act, 1930.[66] In this Act, "mercantile agent means an agent having in the customary course of business as such agent authority either to sell goods, or to consign goods for the purpose of sale, or to buy goods or to raise money on the security of goods".[67]

2. Possession with Owner's Consent

The mercantile agent should be in possession of the goods or documents of title with the consent of the owner. The Supreme Court has laid down that the word "consent" for this purpose means agreeing on the same thing in the same sense as

64. *See* the judgment of R. PRASAD J at pp. 555-556, where the learned Judge considers the case-law.
65. Ordinary examples are: pledge of customer's jewellery by a jewellery broker, *Sesappier* v *Subramania*, (1917) 40 Mad 678; pledge of customer's shares by sharebroker, *Fuller* v *Glyn*, (1914) 2 KB 168.
66. No. III of 1930.
67. Section 2(9) *ibid.*

defined in Section 13 of the Contract Act.[68] If the consent is real, it is immaterial that it was obtained by fraud or misrepresentation or with dishonest intention.[69] All these things may make the person receiving possession liable for some offence, but the consent of the owner actually given is not annulled thereby.[70] Thus, where a goldsmith obtained possession of certain jewellery under the pretence that he had a customer, and instead pledged the jewellery, the pledgee was held to have obtained a good title.[71] Similarly, where a French Company sent to their London agents certain pictures, some being for exhibition only, but the agent pledged them, the pledge was held to be valid, the court saying that the principle applies to all goods in the custody of the mercantile agent whether for sale or not.[72]

3. *In the Course of Business*

Goods should have been entrusted to the agent in his capacity as a mercantile agent and he should be in possession in that capacity. If the goods are entrusted to him in a different capacity, it is not open to a third party who takes a pledge from him to say that they were in his possession as a mercantile agent and therefore, he had the power to create a pledge.[73] In Chalmer's SALE OF GOODS,[74] the principle is explained by this illustration:

> Suppose a house were let furnished to a man who happened to be an auctioneer. Could he sell the furniture by auction and give a good title to the buyer ? Surely not ?[75]

It is further necessary that he should make the pledge in the ordinary course of his business as such agent.

> The plaintiff, a dealer in diamonds at Amsterdam, sent some diamonds to a diamond broker in London for sale. The broker asked a friend of his to pledge the diamonds for him. The friend pledged them with the defendants, who were pawnbrokers.[76]

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68. B.K. MUKHERJEA J of the Supreme Court in *Central National Bank* v *United Industrial Bank*, AIR 1954 SC 181, 184.
69. *Ibid.*, at p 185.
70. *Ibid.* The learned Judge *cited* from *Cahn* v *Pockett's Bristol Channel Steam Packet Co*, (1899) 1 QB 643, 659 and *Folkes* v *King*, (1923) 1 KB 282; *Pearson* v *Rose*, (1950) 2 All ER 1027.
71. *U. Sulaiman* v *Ma Ywet*, (1934) 151 IC 413; *Ah San* v *Maung Ba Thi*, (1937) 169 IC 221.
72. *Moody* v *Pall Mall Deposit & Forwarding Co*, (1917) 33 TLR 306. *See* also *Oppenheimer* v *Attenborough & Sons*, (1908) 1 KB 221. The Supreme Court has held in *Central National Bank* v *United Industrial Bank*, 1954 SCR 391, 402: AIR 1954 SC 181, that when an agent to whom goods were given for repairs sells them, the owner's consent is not thereby affected.
73. *See* MACKINNON J in *Staffs Motor Guarantee Ltd* v *Br. Wagon Co Ltd*, (1934) 2 KB 304.
74. Page 202 (1957), (13th edn) by Steighart.
75. The illustration is given in comment on Section 2 of the (English) Factors Act, 1889 dealing with the power of a mercantile agent to dispose of goods; Section 10 of the Indian Sale of Goods Act and Section 178 of the Contract Act are in corresponding terms.
76. *De Gorier* v *George Attenborough & Sons*, (1904) 21 TLR 19. Similarly it is not in the ordinary course of business to pledge outside the agent's business premises or out of business hours. *Oppenheimer* v *Attenborough & Sons*, (1908) 1 KB 221; sale of a motor car without registration book is also not in the ordinary course of business. *Pearson* v *Rose & Young*, (1951) 1 KB 275. The common law meaning of the expression "good faith" was explained by the House of Lords in *Jones* v *Gordon*, (1877) 2 App Cas 616. The expression was explained under Indian Factors Act, 1842 in *Gobind Chunder Sein* v *Rayan*, (1861) 9 MIA 140; *Jonmenjoy* v *Watson*, (1884) 10 Cal 901: 11 IA 94.

In the owner's action against the defendants for the diamonds, the pledge was held to be invalid. "It was not the ordinary course of business of a mercantile agent to ask a friend to pledge goods entrusted to him, but to pledge them himself."

4. Good faith

The last essential requirement is that the pawnee should act in good faith and should not have at the time of the pledge notice that the pawner has no authority to pledge. The expressions "good faith" and "notice" are not defined in the Act. The definition of "good faith" as given in the General Clauses Act, 1895 is, therefore, applicable. According to that Act a thing is said to be done in good faith when it is done honestly, whether negligently or not. "Notice" will mean actual as well as constructive notice.[77]

Pledge by documents of title[78]

Where a mercantile agent is in possession of the documents of title relating to his principal's goods, and if he pledges the same, the pledgee gets a good title if he acts in good faith and without notice. An explanation to Section 178 says that the expression "documents of title" shall have the same meaning as is assigned to it in the Sale of Goods Act, 1930. Section 2(4) of this Act provides that "documents of title to goods" includes a bill of lading, dock warrant, warehousekeeper's certificate, wharfinger's certificate, railway receipt, warrant or order for the delivery of goods and any other documents used in the ordinary course of business as proof of the possession or control of goods, or authorising or purporting to authorise, either by endorsement or by delivery, the possessor of the document to transfer or receive goods hereby represented.

Before the Sale of Goods Act was separated from the Contract Act in 1930, "railway receipts" were not included in the meaning of the expression "documents of title". But the Privy Council had held that "railway receipts" were also documents of title as they are treated as a symbol of possession and control of goods covered by them.[79] In 1930 when the Sale of Goods Act was enacted "railway receipt" was expressly included in the definition of "documents of title to goods". "This indicates the legislative intention to accept the mercantile usage found by the Judicial Committee in *Ramdas Vithaldas* v *S. Amer Chand & Co*".[80]

May the owner himself pledge the goods by transferring documents of title? It has been held both by the Privy Council and the Supreme Court that it is impossible to justify a restriction on the owner's power to pledge which was not imposed on the powers of the mercantile agent.[81]

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77. Burden lies upon the person who disputes the pledge to prove that the pledgee had notice or that he did not act in good faith. *Stadium Finance* v *Robbins*, (1962) 2 QB 664. A pledge after termination of authority would be equally valid unless the pledgee had notice of it. *Moody* v *Pall Mall Deposit & Forwarding Co*, (1917) 33 TLR 306.

78. Section 178.

79. *Ramdas Vithaldas* v *S. AmerChand & Co*, LR 43 IA 164; *Official Assignee of Madras* v *Mercantile Bank of India Ltd*, (1934) 61 IA 416, *considered* and *followed* by SUBBA RAO J (afterwards C.J.) in *Morvi Mercantile Bank* v *Union of India*, AIR 1965 SC 1954; (1965) SCA 191-192.

80. *Ibid.*, at p 191.

81. *Morvi Mercantile Bank* v *Union of India*, AIR 1965 SC 1954; (1965) SCA 191 at p 193. *See also* the decision of the Mysore High Court in *C.I.&B. Syndicate* v *Ram Chandra*, AIR 1968 Mys 133, where it has been held that way bills issued by a public carrier have not yet

2. Person in possession under voidable contract [S. 178-A]

178-A. Pledge by person in possession under voidable contract.—When the pawnor has obtained possession of the goods pledged by him under a contract voidable under Section 19 or Section 19-A, but the contract has not been rescinded at the time of the pledge, the pawnee acquires a good title to the goods, provided he acts in good faith and without notice of the pawnor's defect of title.

Where goods are pledged by a person who has obtained possession under a voidable contract, the pledge is valid, provided that the contract has not been rescinded at the time of the pledge and the pledgee has acted in good faith and without notice of the pledger's defect of title. *Phillips* v *Brooks Ltd*[82] is a well-known authority.

> A fraudulent person, pretending to be a man of credit, induced the plaintiff to give him a valuable ring in return for his cheque which proved worthless. Before the fraud could be discovered, the ring was pledged with the defendants.

The pledge was held to be valid, it being made by a person in possession under a voidable contract. The effect of fraud is to render the transaction voidable and not void and if, therefore, an innocent person has taken the goods under a pledge before the transaction is avoided, the true owner cannot claim them back. Explaining the principle, DENNING LJ observed in *Pearson* v *Rose*:[83]

> "For instance, if a mercantile agent should induce the owner to pass the property to him by some false pretence as by giving him a worthless cheque, or should induce the owner to entrust property to him for display purposes, by falsely pretending that he was in a large way of business when he was not, then the owner cannot claim the goods back from an innocent purchaser (or pledgee)...."[84]

But if the contract under which possession is obtained is void, the person in possession cannot create a valid pledge. The following passage in the judgment of B.K. MUKHERJEA J in *Central National Bank* v *United Industrial Bank*[85] explains the principle:

> "The position, however, is entirely different if the fraud committed is of such a character as would prevent there being consent at all on the part of the owner to give possession of the goods to a particular person. Thus *A* might obtain possession of the goods from the owner by falsely representing himself to be *B*. In such cases the owner can never have consented to the possession of goods by *A*; the so-called consent being not a real consent is a totally void thing in law. . . .[86]

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acquired the character of being "documents of title". Share certificates and cash receipts have been held to be not documents of title, *Lalit Mohan* v *Haridas*, (1916) 24 Cal LJ 335; *LIC* v *Escorts Ltd*, (1986) 1 SCC 264; *Kemp* v *Falk*, (1882) 7 App Cas 573.

82. (1919) 2 KB 243.

83. (1950) 2 All ER 1027, 1032. Possession under a contract made without intention to perform is voidable possession, *Clough* v *London & N.W. Rly Co*, (1871) LR 7 Ex 26; *Croft* v *Lumley*, (1858) 6 HLC 672.

84. *Cited* by B.K. MUKHERJEA J in *Central National Bank* v *United Industrial Bank*, AIR 1954 SC 181, 184.

85. *Ibid.*, at p 184. *Hardman* v *Booth*, (1863) 1 H&C 803; 32 LJ Ex 105, where also no contract existed. For facts *see* under "mistake of identity" in the chapter on mistake.

86. The learned Judge *quoted* here Lord HALDANE in *Lake* v *Simmons*, (1927) AC 487, 500.

The position, therefore, is that when the transaction of possession is voidable merely by reason of its being induced by fraud, which can be rescinded at the option of the owner, the consent which follows false representation is a sufficient consent. But where the fraud induced an error regarding the identity of the person to whom or the property in respect of which possession was given, the whole thing is void and there is no consent in the sense of an agreement between two persons on the same thing in the same sense."[87]

The contract must not have been rescinded at the time of the pledge. The usual method of rescinding a contract is by giving notice to the other party of the intention to rescind. If he pledges the goods after receiving such notice, the pledge will not be valid. Where the person who has taken away the goods keeps out of the way so that he cannot be contacted, the contract can be rescinded by doing whatever the owner can do to regain possession. Thus, informing the police and requesting the Automobile Association to trace the car which has been taken away by a swindler by giving a fake cheque has been held to be a sufficient demonstration of the intent to rescind and any dealing with the goods after this will not bind the owner.[88]

3. Pledge by pledgee [S. 179]

179. Pledge where pawnor has only a limited interest.—Where a person pledges goods in which he has only a limited interest, the pledge is valid to the extent of that interest.

Section 179, which is the relevant provision says that where a person pledges goods in which he has only a limited interest, the pledge is valid to the extent of that interest. Thus, when a pledgee further pledges the goods the pledge will be valid only to the extent of his interest and his interest is the amount for which the goods have been given to him as a security. If he pledges for a larger amount, the original pledger will still be entitled to his goods on paying the amount for which he himself pledged the goods.[89]

Where, on the other hand, an effective pledge in favour of the pledgee has not taken place, any repledge made by him will be equally ineffective. The Supreme Court decision *Jaswantrai Manilal Akhaney* v *State of Bombay*[90] is an instructive, though a bit complicated, illustration.

A Co-operative Bank had an overdraft account with the Exchange Bank, which was secured by the deposit of certain securities. After many dealings and adjustments the last position of the account was that the overdraft limit was set at Rs 66,150 and the securities under the pledge of the bank were worth Rs 75,000. The Co-operative Bank did not, however, make use of this overdraft

87. *See* also *Cundy* v *Lindsey*, (1877) 2 QBD 96 CA: (1878) 3 App Cas 459 *and Ingram* v *Little*, (1961) 1 QB 31.

88. *Car & Universal Finance Co Ltd* v *Caldwell*, (1964) 1 All ER 290. The method of avoiding a contract as prescribed by Section 66 is giving notice to the other party of the intention to avoid.

89. *Thakurdas* v *Mathura Prasad*, AIR 1958 All 66; *Belgrum Urban Pioneer Co-operative Bank* v *Satyopromoda*, AIR 1962 Mys 48. *See also* Comments on the section by SCOTT C.J. in *Lakhmsey Ladha & Co* v *Lakmi Chand*, (1918) 42 Bom 205 and remarks of the Privy Council in *Haji Rahim Bux* v *Central Bank of India Ltd*, (1928) 56 Cal 367, 387-388: 119 IC 23: (1929) AC 497 PC. It would not matter that the pledgee had no knowledge of the pledger's limited interest, *Hoare* v *Parker*, (1788) 2 TR 376.

90. 1956 SCR 483: AIR 1956 SC 575.

facility for a very long time and when it attempted to sue the Exchange Bank it was itself in financial straits and had pledged the securities first with the Canara Bank and then having redeemed them, pledged them again with a private financier.

The Supreme Court held that the pledge was not valid. If the Co-operative Bank had in fact operated the overdraft account and drawn sums within the limit, the Exchange Bank would have had *pro tanto* an interest in these securities and might then have been entitled to pledge the securities with a third party. But so long as there was no overdraft by the pledger, the pledgee had no such interest as would have enabled it to sub-pledge to a third party.

Additional exceptions under the Sale of Goods Act

In addition to these exceptions, a pledge by a seller remaining in possession after sale and by a buyer obtaining possession before sale is valid.[91] Where one of several joint-owners is in possession with the permission of all, a pledge by him would be valid, if the buyer had no notice of the situation.[92]

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91. *See* S. 30(1) and (2) of the Sale of Goods Act, 1930 and *City Fur Mfg Co* v *Fureenbond (Brokers) London Ltd*, (1937) 1 All ER 199, goods left in the broker's warehouse after purchase; *Haji Rahim Bux* v *Central Bank of India*, AIR 1929 Cal 447, goods remaining in the seller's godown; *Belsize Motor Supply Co* v *Cox*, (1914) 1 KB 244, buyer obtaining possession before sale.

92. *Shadi Ram* v *Mahtab Chand*, (1895) Punj Rec 1.