

Punjab National Bank Ltd.

Vs

Shri Vikram Cotton Mills and Another

Civil Appeals No. 1957 and 1958 of 1966

(J.C. Shah, A.N. Grover JJ)

17.09.1969

JUDGMENT

SHAH, J. -

1. Ranjit Singh was a director of Ranjit Singh & Sons Ltd. - Which acted as a Managing Agent of Shri Vikram Cotton Mills Ltd., Shri Vikram Cotton Mills Ltd. - hereinafter called the Company, opened a cash credit account with the Punjab National Bank, and to secure repayment of the balance due at the foot of the account on June 27, 1953, four documents were executed - three by the Managing Agents on behalf of the Company and one by Ranjit Singh. The three documents executed by the Managing Agents were : (i) promissory note for Rs. 13,00,000/- payable with interest at the rate of 2 1/2% over the Reserve Bank of India rate with a minimum rate of 6% per annum until payment; (ii) a deed of hypothecation of goods described in the Schedule annexed to the document; (iii) a letter to the Bank agreeing that during the continuance of the agreement evidenced by the letter of hypothecation, the Company will remain solely responsible for all loss, damage or rain, robbery, dacoity or by any other cause whatsoever. Ranjit Singh executed a deed called an "agreement of guarantee" agreeing to pay on demand all monies which may be due as "ultimate balance" from the Company to the Bank.

2. In December 1953, The Company closed its business. The stocks pledged were disposed of by the Bank and the amount realised was credited in the account of the Company. The Bank claimed that an amount of Rs. 2,56,877/12/6 remained due at the foot of the account.

3. Some creditors of the Company had in the meantime filed a petition in the High Court of Allahabad for an order winding up the Company. On February 22, 1956, a scheme of composition was settled among the creditors that the total liability of the Company was Rs. 34,45,197-11-2 and the total assets of the Company were Rs. 5,00,000/- that the Company was desirous of confirming "a lease agreement" and that in order to safeguard the rights and interests of the Company and its unsecured creditors the Company had entered into an agreement which the lessee. The scheme was sanctioned by order of the High Court of Allahabad, dated May 21, 1956, under Section 391 of the Indian Companies Act, 1956, after rejecting the opposition of the Bank.

4. The Bank then Filed a suit in the Court of the Civil Judge, Malihabad, Lucknow, against the Company and Ranjit Singh for a declaration that on the date of the suit a sum of Rs. 2,56,877/12/6 was due against the Company and for a decree for payment of that amount against Ranjit Singh with costs and interest pendente lite. In a joint written statement it was contended, inter alia, that Ranjit Singh, was "only a guarantor and not a co-debtor" and that he could be made liable only in case of default by the Company, and since the Company had made no default the suit against Ranjit Singh

was not maintainable.

5. Certain preliminary issues were raised by the Trial Judge at the hereing of the suit out of which the following are relevant :

"(1) Whether the plaintiff (Bank) is not entitled to file this suit as against the defendant No. 1 (the Company without obtaining the leave of the Company Judge as alleged ? If so, effect ?

(2) Whether the court has no jurisdiction to decide on the merits of the plaintiff's claim in view of the facts as alleged in Para 12 (A) of the written statement ? If so, its effect ?

(3) Whether the suit against defendant No. 2 (Ranjit Singh) is not maintainable as pleaded under Paras 7, 13 and 14 of the written statement ?"

The trial Court held that the suit was not maintainable against the Company without obtaining leave of the Company Judge, and also that the Court had no jurisdiction to adjudicate upon the merits of the Bank's claim for under the scheme the Board of Trustees were to scrutinise the claim against Ranjit singh the Court held that he had not made any default in payment of the dues and under the terms of guarantee the suit was premature against him as well. The Court accordingly dismissed the suit.

6. Two appeals were preferred to the High Court of Allahabad against the judgments in the suit. The High Court held that a scheme of composition between the Company and its creditors confirmed by the Court had statutory operation and was binding on all creditor regardless of the fact whether any of them agreed or not; that according to the scheme the Bank became an unseoured creditor for the amount remaining due after sale of the pledged goods, that under Clause 12 of the Scheme the Scheme the amount payable to the unsecured creditors shall be the principal amount due to them determined by the Board of Trustees, that it was for the Board of Trustees to determine the amount that remained payable to the Bank, that though under Clause 16 of the scheme a creditor may file suits and take appropriate steps, for the limited purpose of establishing their claim the suit had to be filed with the leave of the Court, and that the suit of the Company without obtaining leave of the Court was not maintainable. The High Court further held that Ranjit Singh had executed an indemnity bond, and that even assuming that Ranjit Singh was a surety it was expressly provided by the terms of the bond executed by him that the guarantee was only for ensuring payment of the "ultimate balance" remaining due to the Bank on such cash-credit account up to the specified limit, and therefore Ranjit Singh was only to pay "the ultimate balance" which might be found due against the Company after "taking into account all dividends, compositions and payments etc., as payments in gross towards the debt", that the Bank's dues could be recovered from Ranjit Singh upon default in payment by the company of the ultimate balance after scrutiny by the Board of Trustees, and that the "proper stage for commencing a suit against Ranjit Singh was after the ultimate liability of the Company was determined by the Board of trustees and the Company committed default in payment". The High Court accordingly Confirmed the decree of the Trial Court even in favour of Ranjit Singh. With special leave granted by this Court, these two appeals have been preferred by the Bank.

7. The Bank claimed a mere declaration against the Company and not a decree for payment of the amount due. Section 391 of the Companies Act, 1956, in so far as it is material provides :

"(1) Where a compromise or arrangement is proposed -

(a) between a company and its creditors or any class of them; or

(b) between a company and its members or any class of them :

the Court may, on the application of the Company or of any creditor or member of the Company, or, in the case of a company which is being creditors, or of the members or class of members, as the case may be, to be called, held and conducted in such manner as the Court directs.

(2) If a majority in number representing three-fourths in value of creditors, or class of creditors, or members, or class of members, as the case may be, present and voting either in person or, where proxies the allowed by proxy, at the meeting, agree to any compromise or arrangement, the compromise or arrangement shall, if sanctioned by the Court, be binding on all the creditors, all the creditors of the class, as the case may be, and also on the company, or, in the case of a company which is being wound up, on the liquidator and contributories of the company.

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Section 392(1) provides :

"Where a High Court makes an order under Section 391 sanctioning a compromise or an arrangement in respect of a company, it -

(a) shall have power to supervise the carrying out of the compromise or arrangement; and

(b) may, at the time of making such order or at any time there-after, give such directions in regard to any matter or make such modification in the compromise or arrangement as it may consider necessary for the proper working of the promise or arrangement."

In the present case a meeting of creditors of the Company was held in which a majority in number representing three-fourths in value of the creditors agreed to the scheme of composition and the court rejected objection raised by the Bank and Sanctioned the scheme. the scheme was binding upon the Bank and the rights and obligations of the Bank had to be worked out under the scheme.

8. In reaching its conclusion that the bond executed by Ranjit Singh in favour of the Bank was of the nature of a contract of indemnity and not a contract of guarantee, the High Court was impressed by the circumstances that the company was not a party to the bond, and that the bond was only a bilateral agreement between the bank and Ranjit Singh.

9. Section 124 of the Indian Contract Act defines a "contract of indemnity". A contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person, is called a "contract of indemnity". Section 126 defines a "contract of guarantee". It states :

"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."

10. A promise to be primarily and independently liable for another person's conduct may amount to a contract of indemnity. A contract of guarantee requires concurrence of three persons - the Principal debtor, the surety and creditor - the surety undertaking an obligation at the request express or implied of the principal debtor. The obligation of the surety depends substantially on the principal debtor's default; under a contract of indemnity liability arises from loss caused to the promisee by the conduct of the promisor himself or by the conduct of another person.

11. In the present case the Company did not execute the bond. But the bond executed by Ranjit Singh was one of four documents executed on June 27, 1953. It was part of the scheme to ensure payment of the amount due at the foot of the cash-credit account in favour of the Bank. The Company executed by its managing agents - (i) a promissory note; (ii) a deed of hypothecation; and (iii) a letter assuring the Bank that the Company shall remain solely responsible for all loss, damage or deterioration to the stocks hypothecated with the Bank. The Bank also insisted upon a promise by some other person to pay the debt, and as a part of the same arrangement Ranjit Singh executed the bond on which the suit is filed. The bond was expressly called an "agreement of guarantee" : it was also recited therein that Ranjit Singh guaranteed to the Bank, payment on demand of all monies which may at any time be due to the Bank from the Company on the general balance of that account with the Bank, that the guarantee was to be a continuing guarantee for the ultimate balance which shall remain due to the Bank on such cash-credit account. In the written statement it was admitted that Ranjit Singh was a guarantor. The bond, it is true, did not expressly recite that the Company was the principal debtor; it is also true and the Company did not execute the bond. But a contract of guarantee may be wholly written, may be wholly oral, or may be partly written and partly oral. The documents which secured repayment of the Bank's claim at the foot of the cash-credit account were executed simultaneously : the bond executed by Ranjit Singh was one of them and the conduct of Ranjit Singh and the Company indicates that Ranjit Singh agreed to guarantee payment of the debt due by the Company. We hold therefore, that the Bank, the Company and Ranjit Singh were parties to the agreement under which the dues of the Company, Ranjit Singh became a surety.

12. The extent of the liability of Ranjit Singh the terms of the bond must, therefore, be determined. Section 123 of the Indian Contract Act provides that the liability of the surety is co-extensive with that of the principal debtor. Certain clauses of the bond are relevant :

"(1) In consideration of your Bank at my request allowing an accommodation by way of cash, credit and D/D limits to M/s. S. V. Cotton Mills Ltd., at Lucknow Branch, I, in my personal capacity hereby guarantee to you the payment on demand of all monies which may at any time be due to you from M/s. S. V. Cotton Mills Ltd., on the general balance of the account with your Bank.

(2) I declare that this guarantee shall be continuing guarantee and shall not be considered as cancelled or in any way affected by the fact that at any time the said cash-credit and D/D account may show no liability against the borrower, or may even show a credit in favour of the borrower, but shall continue in operation in respect of subsequent transactions."

"(4) I further declare that all dividends, compositions, payments received by you from the said borrower or any other person or persons liable or his or their representatives shall be taken and applied as payment in gross without right on the part of myself or representative to stand in your place in respect of or to claim the benefit of any such dividends, compositions or payments until full amount of all your claims against the said borrower or his/their representatives which are covered by this gurantee shall have been paid and that this gurantee shall apply to and secure ultimate balance which shall remain due to you on such cash-credit account up to the extent of Rs. 13,00,000/-.

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"(8) I also agree that the Bank shall be entitled to recover its entire dues under the said cash-credit account from my person or property upon default in payment by the said borrower."

By Clause 4 it is expressly stipulated that the bond secured "the ultimate balance" remaining due to the Bank. Therefore, unless and until the ultimate balance is determined no liability on Ranjit Singh to pay the amount arises, and it is common ground that the ultimate balance due is not determined. The suit was for a decree for Rs. 2,56,877/12/6, but the claim against Ranjit Singh could be decreed only for the amount remaining due as the ultimate balance under Clauses 4 and 5 of the bond.

13. We are, however, unable to agree with the High Court that the suit filed was premature. The Bank was under the terms of the bond executed by Ranjit Singh entitled to claim at any time the money due from the Company as well as Ranjit Singh under the Promissory note and the bond. The suit could not, therefore, be said to be premature. The High Court instead of dismissing the suit should have stayed it till "ultimate balance" due to the Bank from the Company was determined. We deem it necessary to observe that a binding obligation created under a composition under Section 391 of the Companies Act, 1956, between the Company and its creditors does not affect the liability of the surety unless the contract of suretyship otherwise provides. As observed in Halsbury's Laws of England, Vol. 6, 3rd Edn., Article 1555 at p. 771 :

"A scheme need not expressly reserve the rights of any creditors against sureties for debts of the company, as such rights are unaffected by a scheme."

It was held in *Re Garner's Motors Ltd.* ((1967) ch 594) that the scheme] when sanctioned by the Court has a statutory operation and the scheme does not release other persons not parties to the scheme from their obligations.

14. The High Court, in our judgment, should have stayed the suit and after "the ultimate balance" due by the Company was determined the Court should have proceeded to decree the claim according to the provisions of Clause 4 of the bond.

15. We accordingly modify the decree passed by the Trial Court and declare that the rights of the against the Company are governed by the scheme sanctioned by the High Court of Allahabad in Company case No. 16 of 1956 by their judgment, dated May 21, 1956. Liability of Ranjit Singh being only for payment of "the ultimate balance" which remains due on the cash-credit account with the Bank in favour of the company. The Court will, when such ultimate balance is determined, proceed to, pass a decree in favour of the Bank.

16. Ranjit Singh has filed an affidavit in this Court that in accordance with the scheme the total amount due to the Bank was determined at Rs. 41,536/7/3 as the ultimate balance and a cheque for Rs. 35,721/- was sent to the Bank on October 6, 1956, being 25% plus the other Pro rate payments allowed by the Trustees to creditors but the bank did not cash the cheque. Thereafter by letter, dated October 28, 1966, the Bank requested that a fresh was issued to the Bank on November 5, 1966, comprising Rs. 35,721/- on the basis of the old cheque plus Rs. 2,326-46 sanctioned for pro rare payment to the Bank by the Trustees on November 3, 1966, at the rate of 50% of then balance due. Thereafter another cheque for Rs. 1,744-50 being 50% of the amount then due to the Bank was also forwarded to the Bank on January 29, 1968, in pursuance of another pro rate payment resolution passed by the Trustees and the balance now due to the Bank out of the original amount is Rs. 1,744.09 only. We are unable to investigate the correctness of these averments.

17. The decree passed by the High Court is set aside and the suit be remanded to the Trial Court to be disposed of in the light of the observations made in this judgment. There will be no order as to costs in the High court and in this Court. Costs in the Trial Court will be costs in the suit.

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