Dr.M.I.Itty vs Kerala Financial Corporation on 5 April, 2010

Bench: K.Balakrishnan Nair, P.N.Ravindran

IN THE HIGH COURT OF KERALA AT ERNAKULAM

WA.No. 2002 of 2006(A)

1. DR.M.I.ITTY,
... Petitioner

Vs

1. KERALA FINANCIAL CORPORATION,
... Respondent

2. DEPUTY TAHSILDAR,

3. VILLAGE OFFICER,

4. VILLAGE OFFICER,

For Petitioner :SRI.ANTONY DOMINIC

For Respondent :SRI.M.PATHROSE MATTHAI (SR.)

The Hon'ble MR. Justice K.BALAKRISHNAN NAIR
The Hon'ble MR. Justice P.N.RAVINDRAN

Dated :05/04/2010

O R D E R

"C.R"

K.BALAKRISHNAN NAIR & P.N.RAVINDRAN, JJ.

W.A.No.2002 of 2006

Dated this the 5th day of April, 2010

JUDGMENT

Ravindran,J.

The appellant in this Writ Appeal is the first petitioner in O.P.No.666 of 1996 and the respondents are the respondents therein. By judgment delivered on 15-2-2006, the learned single Judge dismissed the writ petition. Aggrieved thereby the first petitioner therein has filed this writ appeal. The brief facts of the case are as follows.

2. The appellant was the Managing Director of Southern Organics Private Limited, a company incorporated under the Companies Act, 1956. The said company had availed a loan of Rs.8,30,000/- from the Kerala Financial Corporation, the first respondent herein. The loan was secured by a mortgage of the immovable assets of the company as per mortgage deed registered as document No.2790 of 1978 of the Sub Registrar's Office, Edappally and by hypothecation of the plant and machinery. The company and its Directors, including the appellant, had executed Ext.R1(a) agreement dated 28.8.1978 undertaking to repay the loan in seventeen half yearly instalments commencing from 10-7-1981 and ending with 10-7-1989. Thereafter, an additional loan of Rs.3,40,000/- was availed in the year 1980. Thereupon the appellant in his capacity as the Managing Director of the company, executed Ext.R1

(b) agreement dated 15-9-1980 undertaking to repay the said loan in seventeen half yearly instalments commencing from 10-7-1981 and ending with 10.7.1989. Besides the aforesaid two agreements the appellant and the other Directors of the company had executed Ext.R1(c) deed of guarantee dated 17-9-1980 personally guaranteeing repayment of the money payable by the company to the Corporation.

3. The company did not repay the loan in time and was in default. The Kerala Financial Corporation, (hereinafter referred to as the Corporation" for short) thereupon initiated proceedings under the Kerala Revenue Recovery Act, 1968 against the company, its Directors and their assets. The Directors thereupon forwarded a proposal for rehabilitation. The repayment of loan was thereafter rescheduled and the revenue recovery proceedings were withdrawn. Even thereafter, the loan was not repaid in time. While matters stood thus, by order passed on 27-8-1990 in C.P.No.6 of 1990 this Court ordered winding up of the company. Pursuant to the order of winding up passed by this Court, possession of the assets of the company was taken over by the Official Liquidator attached to this Court. The Corporation did not choose to stand outside the winding up. The Official Liquidator attached to this Court brought the properties of the company, that were offered as security for the loan, for sale. The Corporation thereafter moved the Official Liquidator claiming payment of the sum of Rs.47,02,769.40 being the amount then outstanding in the loan account. The Official Liquidator admitted the claim only to the extent of Rs.38,32,219.80. Aggrieved thereby the Corporation filed M.C.A.No.19 of 1993 in C.P.No.6 of 1990. By Ext.P2 order passed on 18-8-1993 the learned company Judge of this Court held that the adjudication made by the Official Liquidator does not call for any interference. It was held that the Corporation can claim payment of interest after the date of winding up only if there is a surplus in the hands of the Official Liquidator, after payment in full of all the claims admitted to proof. The Corporation challenged Ext.P2 by filing M.F.A.No.1311 of 1993 in this Court.

4. It appears the Official Liquidator did not disburse even the admitted amount to the Corporation. The Corporation therefore initiated fresh proceedings under the Kerala Revenue Recovery Act, 1968 for realisation of the sum of Rs.71,78,000/- with future interest thereon at the rate of 19.75% per annum. Ext.P4 demand notice dated 18-11-1995 was thereupon issued to the appellant and the other Directors. They filed O.P.No.18767 of 1995 in this Court contending that they are liable only for the amount that may be found due from the principal debtor and not for the entire amount. While matters stood thus, the Official Liquidator paid over the sum of R.38,32,219.80 to the Corporation. In view of the said development, O.P.No.18767 of 1995 was disposed of by Ext.P5 judgment delivered on 11-12-1995 recording the undertaking given by the Corporation that the then existing demand notices will be withdrawn and a revised demand notice issued after giving credit to the amount received from the Official Liquidator. The Corporation thereafter issued Ext.P6 demand notices under Sections 7 and 34 of the Kerala Revenue Recovery Act, 1968 demanding payment of the sum of Rs.33,45,780.20 together with interest thereon @ 19.75% from 1.6.1995. The petitioner, Sri.K.R.Vijayan, another Director and the legal heirs of yet another Director (late E.M.Varkey) thereupon filed O.P.No.666 of 1996 in this Court challenging Ext.P6 demand notices and seeking the following reliefs:-

> (i) to issue a writ of certiorari or other appropriate writ, order or direction quashing Ext.P6 notice.
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> (ii) to issue a writ in the nature of mandamus directing the respondents to forbear from taking any action pursuant to Ext.P6 notice in default of payment of the amount claimed under the impugned notice.
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> (iii) to issue a writ in the nature of prohibition restraining respondents from taking any action invoking RR proceedings under the Kerala Revenue Recovery Act to recover if any of the amounts due from the petitioners.
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> (iv) to issue appropriate writ, order or direction including stay of operation of Ext.P6 notice, till the disposal of the Original Petition.

5. They contended, inter alia, that the provisions of the Kerala Revenue Recovery Act, 1968 cannot be invoked to recover the amounts due under the loan agreements/deed of guarantee, that the demand made in Ext.P6 is excessive and exorbitant and that as the Corporation had participated in the winding up and their claim was admitted only to the tune of Rs.38,32,219.80 by the Official Liquidator appointed by this Court in the winding up proceedings, they are not liable to pay any further amount to the Corporation. It was contended that the rights of the creditor (Kerala Financial Corporation) stand concluded by the order passed by the learned company Judge upholding the decision of the Official Liquidator and therefore the Corporation is not entitled to recover any further amount from the company or its Directors/guarantors. It was contended that as the adjudication made by the Official Liquidator as regards the amount which the Corporation is entitled to get was upheld by this Court in another jurisdiction, the Corporation is not entitled to recover any amount besides the amount admitted by the Official Liquidator, from the company or its Directors/guarantors.

6. While O.P.No.666 of 1996 and M.F.A.No.1311 of 1993 were was pending, the Official Liquidator made a further payment of Rs.7,79,218.80 by way of interest to the Corporation on 23-6-1998. Upon that payment being made, the appellant herein filed C.A.No.273 of 1999 in C.P.No.6 of 1990 praying for an order directing the Official Liquidator to return the capital to the contributories. He contended that the Official Liquidator had declared 100% dividend to all the creditors who were included in the final list of creditors before the initial payment of Rs.38,32,219.80, that thereafter, after obtaining the orders of this Court, the Official Liquidator has paid a further sum of Rs.7,79,218.80 to the Corporation by way of interest calculated at the rate of 4% per annum for the period from the date of winding up till the date of declaration of the dividend, that after payment to the creditors, the Official Liquidator is in possession of sufficient funds for payment to the contributories and therefore, the Official Liquidator may be directed to return the capital to the contributories. M.F.A.No.1311 of 1993 and C.A.No.273 of 1999 in C.P.No.6 of 1990 were heard and disposed of by a Division Bench of this Court by Ext.P7 judgment delivered on 20-9-2002. The Division Bench held that with the payment of the sum of Rs.7,79,218.80 by way of interest calculated at the rate of 4% per annum, the amount due to the Corporation has already been paid. The Division Bench accordingly declined to interfere with Ext.P2 order passed by the learned company Judge and dismissed the appeal. Relying on the decision of the Division Bench of this Court in M.F.A.No.1186 of 1997 (Federal Bank v. Official Liquidator, 2002 (3) KLT 663), it was held that it is only if there is any surplus amount left in the hands of the Official Liquidator after paying off all the secured creditors including those covered by Section 529A of the Companies Act that even a secured creditor who has obtained a decree can realise interest in excess of 4%. Relying on Ext.P7 judgment, the petitioners contended that as the amounts due to the Corporation have already been paid as noticed therein, the liability of the principal debtor does not survive and therefore, the sureties cannot be proceeded against.

7. The first respondent/Corporation resisted the writ petition contending, inter alia, that the liability of the guarantors subsists even after the winding up of the company and that under the loan agreements/deed of guarantee they are entitled to proceed against the appellant and the other Guarantors for realisation of the balance amount due from the principal debtor. The learned single Judge dismissed the writ petition holding that the liability of the surety is not extinguished with the winding up order passed by this Court and that on the terms of the loan agreements/deed of guarantee, the sureties are liable for the entire amount due from the principal debtor after giving credit to the payments made by the Official Liquidator. The first petitioner, aggrieved thereby, has filed this writ appeal.

8. We heard Sri.P.Gopinath Menon, the learned counsel appearing for the appellant, Sri.M.M.Sayed Muhammed, the learned Standing Counsel appearing for the Corporation and Smt.R.Bindu, the learned Government Pleader appearing for respondents 2 to 4. The learned counsel for the appellant contended that the liability of the guarantors stood extinguished, when, in the winding up proceedings, the Corporation, a secured creditor, chose to prove its debt before the Official Liquidator and the Official Liquidator admitted the claim only to the extent of Rs.38,32,219.80. The learned counsel for the appellant further contended that as Ext.P2 order passed by the learned company Judge affirming the decision of the Official Liquidator was upheld by the Division Bench of this Court by Ext.P7 judgment in M.F.A.No.1311 of 1993, the Corporation cannot have any further

claim against the company and therefore, as the principal debtor is not liable to pay any further amount to the Corporation, the appellant, a guarantor, cannot be held liable. Reliance was placed on Sections 128, 134 and 141 of the Indian Contract Act, 1872 in support of the said contention. The learned counsel for the appellant also referred to and relied on the decision of the Division Bench of this Court in Federal Bank v. Official Liquidator, 2002 (3) KLT 663 to contend for the position that with the payments made by the Official Liquidator the claim of the Corporation stood satisfied and that in the absence of any surplus in the hands of the Official Liquidator the claim of the Corporation for interest in excess of 4% cannot be considered. He also relied on the decision of the Apex Court in Syndicate Bank v. Channaveerappa Beleri and others, (2006) 11 SCC 506 to contend that as the Corporation never made a demand on the guarantors while the claim was alive as against the principal debtor, no demand can thereafter be made against the guarantors since the claim against the principal debtor is no longer alive.

9. Per contra, the learned standing counsel appearing for the Corporation contended that the adjudication made by the Official Liquidator in the winding up proceedings does not relieve the guarantors of their obligations under the loan agreements/deed of guarantee and that on the terms of the loan agreements/deed of guarantee, the Corporation is entitled to proceed against the guarantors as if they are the principal debtors. The learned standing counsel for the Corporation also referred to and relied on the decision of a Division Bench of this Court in Radha Thiagarajan v. South Indian Bank Ltd., ILR 1986 (1) Kerala 370 and of the Apex Court in Industrial Finance Corporation of India Ltd. v. Cannanore Spinning and Weaving Mills Ltd. and others, (2002) 5 SCC 54, to contend that the order winding up the company, does not discharge the sureties.

10. We have considered the rival submissions made at the Bar by the learned counsel appearing on either side. We have also gone through the pleadings and the materials on record. It is not in dispute that when the company was ordered to be wound up, the sum of Rs.47,02,769.40 was payable to the Corporation. The winding up order was passed on 27-8-1990. The Corporation did not choose to stand outside the winding up. Instead, it participated in the winding up proceedings and submitted proof of its claim with the Official Liquidator. The claim of the Corporation before the Official Liquidator was for the sum of Rs.47,02,769.40, which included interest after the winding up to the tune of Rs.8,65,549.60 and Rs.873.96 being the T.A. and D.A. paid to the nominee Directors. The Official Liquidator rejected the claim for interest after the winding up and the claim for TA and DA. The Official Liquidator admitted the claim of the Corporation only to the tune of Rs.38,32,219.80, which included interest at the contract rate upto the date of the winding up. The claim for the balance sum of Rs.8,70,549.60 was not admitted. Though the Corporation questioned the decision of the Official Liquidator before the learned company Judge, by filing M.C.A.No.19 of 1993, under Rule 164 of the Companies (Court) Rules, 1959, the said application was dismissed by Ext.P2 order passed on 18.8.1993. The learned company Judge rejected the claim of the Corporation for interest after the winding up on the short ground that the question of payment of interest after winding up would arise only if there is any surplus amount left in the hands of the Official Liquidator after payment in full of all the claims admitted to proof. The Corporation challenged Ext.P2 order by filing M.F.A.No.1311 of 1993. In that appeal they claimed payment of the interest that was declined by the Official Liquidator. While the said appeal was pending, on 23-6-1998 the Official Liquidator paid a further sum of Rs.7,79,218.80 by way of interest to the Corporation calculated at the rate of

4% per annum. M.F.A.No.1311 of 1993 was finally heard and dismissed by Ext.P7 judgment on 20-9-2002, wherein the Division Bench of this Court held that the Corporation can claim interest in excess of 4% only if there is any surplus left in the hands of the Official Liquidator after satisfying the claims of all the secured creditors including those covered by Section 529A of the Companies Act, 1956. It was held that the amounts due have already been paid. Ext.P2 order passed by the learned company Judge was accordingly affirmed.

11. The main contention raised by the learned counsel for the appellant is that as the company, which is the principal debtor, is no longer liable after its winding up and dissolution, the appellant, one among the guarantors, cannot be held liable for the debt of the company. Reliance is placed on Section 128 of the Indian Contract Act, 1872 in support of the said contention. It is also contended that as the company, which is the principal debtor, has been wound up and is no longer in existence and its assets have been sold, the right of the surety to proceed against the principal debtor recognised under sections 140 and 141 of the Indian Contract Act, 1872 has been lost. In such circumstances, it cannot be said that the sureties are liable to be proceeded against, it is contended. Ext.R1(a) loan agreement entered into between the company and the Corporation on 28-8-1978 is one executed by the appellant herein in his capacity as the Director of the company. The appellant and other Directors have executed the said loan agreement in their capacity as Guarantors also. Sub-clauses (1), (2) and (5) of Clause 27 of Ext.R1(a) loan agreement read as follows:-

> "27. In consideration of the Corporation having agreed to lend and advance the loan hereinbefore mentioned to the Borrower Company as aforesaid, the Guarantors hereby agree and covenant with the Corporation as follows:-
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> 1) If at any time default shall be made by the Borrower company in the payment to the Corporation of the principal, interest and other moneys due to the Corporation upon the security of othis hypothecation, the Guarantors on demand will pay to the Corporation the whole of such principal interest and other moneys which shall then be due to the Corporation as aforesaid And in the event of their failure to pay the same the Corporation shall be entitled to recover the same with interest from the Guarantors jointly and severally, personally and from their properties, And the Guarantors will indemnify and keep indemnified the Corporation against all loss of principal or interest or other moneys secured by this Hypothecation and all costs charges and expenses whatsoever which the Corporation may incur by reason of any default on the part of the Borrower company.
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> 2) The Corporation shall have the fullest liberty without the further assent and knowledge of the Guarantors and without affecting the guarantee herein contained to allow at its discretion any variation of the terms and conditions for utilisation of the loan amount of the Borrower company or any other terms and conditions hereinbefore contained or to postpone for any time or from time to time the exercise of the power of sale or any other power or powers conferred on it by these presents and in any manner and either to enforce or forbear to enforce the covenants for payment to the Corporation of principal or interest or other moneys or any other

covenants contained or implied in the Hypothecation or any other remedies available to the Corporation And the Guarantors shall not be released by any exercise by the Corporation of its liberty with reference to the matters aforesaid or any of them or by reason of time being given to the Borrower company or any other person liable with or for it or any other forbearance act or omission on the part of the Corporation or any other indulgence granted or shown by the Corporation to the Borrower company or any other person liable with or for it or by any other matter or thing whatsoever which under the law relating to sureties would but for this provision have the effect of so releasing the guarantors.

xx xx xx

5) In order to give effect to the guarantee herein

contained the Corporation shall be entitled to act as if the Guarantors were the principal debtors to the Corporation for all the payments and covenants guaranteed by them as aforesaid to the Corporation."

(emphasis supplied)

12. In Ext.R1(c) deed of guarantee executed by the appellant and other Directors as guarantors, they had undertaken to personally guarantee repayment of all moneys at any time payable by the borrower company to the Corporation in respect of the additional loan and also guaranteed payment and discharge of all the liabilities of the borrower company to the Corporation. It is also stipulated that the guarantee is one for all the amounts advanced by the Corporation to the borrower company. The relevant provisions of Ext.R1(c) deed of guarantee read as follows:-

"NOW THIS DEED WITNESSETH and it is hereby covenanted agreed and declared (the Guarantors contracting jointly and severally) as follows:-

(1) That in consideration of the Corporation agreeing at the request of the Guarantors to grant the said loan to the Borrower company the Guarantors personally guarantee to the Corporation the repayment of all moneys at any time payable by the Borrower company to the Corporation in respect of the said loan and also the payments and discharge of all the indebtedness and liabilities of the Borrower company to the Corporation for all the expenses payable to or incurred by the Corporation in relation thereto.

(2) That the Guarantors agree that the Guarantee herein contained is independent and distinct from the security that the Corporation has taken or may take by way of Equitable Mortgage and/or hypothecation of movables or in any other manner over any other property from the Borrower company and that the Guarantors will not claim to be discharged to any extent because of the Corporation's failure to secure or obtain the necessary security aforesaid or requiring, acquiring or obtaining any other

security or losing for any other reason whatsoever including reasons attributable to its default and negligence any other security that has been or could have been taken.

(3) That the Guarantors further agree that if the Borrower company shall become insolvent, bankrupt, enter into liquidation (compulsory or voluntary) or make any arrangement or composition with creditors, the Corporation may (notwithstanding payment to the Corporation by the Guarantors or any other person of the whole or any part of the amount hereby secured) rank as creditor and prove against the estate of the Borrower company for the full amount of all the Corporation's claim against the Borrower company or agree to and accept any composition in respect thereof and the Corporation may receive and retain the whole of the dividends, composition or other payments thereon to the exclusion of all rights of the guarantors for the Borrower company, in competition with the Corporation until all the Corporation's claims are fully satisfied and the Guarantors will not be paying off the amount payable by the Borrower company or any part thereof or otherwise prove or claim against the estate of the Borrower company until the whole of the Corporation's claims against the Borrower company have been satisfied and the Corporation may enforce and recover payment from the Borrower company of the full amount payable by the Borrower company notwithstanding any such proof of composition as aforesaid.

(4) The Corporation shall have the fullest liberty without in any way affecting this guarantee and discharging the Guarantors from their liability hereunder, to postpone for any time or from time to time the exercise of the power of sale or any other powers conferred by the said equitable mortgage and/or hypothecation and to exercise the same at any time and in any manner and either to enforce or forbear to enforce the covenants for payment of principal or interest or any other covenants contained in or implied by the said securities or any other remedies or securities available to the Corporation or to grant any indulgence or facility to the Borrower company and the Guarantors shall not be released by any exercise by the Corporation of its liberty with reference to the matters aforesaid or any of them or by reason of time being given to the Borrower company or any other forbearance act or omission on the part of the Corporation or any other indulgence by the Corporation to the Borrower company or by any other matters or things whatsoever which under the law relating to sureties would but for this provision have the effect of so releasing the Guarantors and the Guarantors hereby waive all suretyship and other rights which they might otherwise be entitled to enforce.

xx xx xx (6) In order to give effect to the Guarantee herein contained the Corporation shall be entitled to act as if the Guarantors were the principal debtors to the Corporation for all payments and covenants guaranteed by them as aforesaid to the Corporation.

xx xx xx (8) The Guarantee herein contained is one for all amounts advanced by the Corporation to the Borrower company under the said loan Agreement and also for all interest costs and other moneys which may from time to time become due and remain unpaid to the Corporation hereunder and shall remain in force until all such moneys shall be paid off in full with interest and other charges.

xx xx xx (13) The Guarantee shall remain in full force and effect so long as the last pie due to the Corporation under the loan Agreement with the Borrower Company remains unpaid."

13. Interpreting the above stipulations in the loan agreement/deed of guarantee, the learned single Judge has, in paragraph 11 of the judgment under challenge in this appeal, held as follows:-

"11. Ext.P7 judgment would, no doubt, show that the proceedings related to the refusal on the part of the Liquidator to allow interest claimed by the respondent Corporation. Interest due to the Corporation has already been paid by the Official Liquidator which was found at the rate of four per cent in accordance with rule 179, and the Corporation is not entitled to get interest in excess of four per cent. Thus, the Corporation was found entitled to only four per cent interest in terms of rule 179. The Guarantors have agreed by Exts.R1(a) to pay the amount due to the Corporation by way of principal, interest and other amounts due to the Corporation on the strength of the hypothecation in case of default, no doubt, by the company. Further, the Guarantors agreed to indemnify and keep indemnified the Corporation against all loss of principal or interest or other moneys secured by the hypothecation by reason of any default by the company. By Ext.R1(c), the guarantors personally guaranteed the Corporation the repayment of all moneys at any time payable by the Borrower company to the Corporation in respect of the said loan and also the payments and discharge of all the indebtedness and liabilities of the Borrower company to the Corporation for all the expenses payable to or incurred by the Corporation in relation thereto. Therefore, it is clear that even though the company was liable to pay interest only at four per cent by virtue of rule 179 of the Company (Court) Rules, it cannot be in dispute that the liability which was undertaken by the Guarantors was the liability in terms of the agreements. In such circumstances, it is difficult to accept the position that by virtue of the order of the Official Liquidator as confirmed in Ext.P7, the Guarantors would be absolved of their liability under the agreements to pay to the Corporation the amounts due from the company in terms of the hypothecation. According to me, the fixing of the amount under the Companies Act in respect of a company which is wound up, cannot detract from the liability of the sureties under Exts.R1(a) and R1(c) Agreements, which I find, bind the petitioners to pay the entire amounts due, dehors the amounts arrived at in terms of the Companies Act and Rules. While, no amount in excess of the amount fixed under the Companies Act and the Rules can be realised from the company under law, that is not the same thing as saying that there is an extinguishment of the liability of the sureties under Exts.R1(a) and R1(c) Agreements. Therefore, I find no merit in the writ petition and the writ

petition is dismissed."

14. A Division Bench of this Court has in Aypunni Mani v. Devassy Kochouseph, 1965 KLT 1266, interpreting Section 128 of the Indian Contract Act, 1872 in the light of the stipulations contained in the Kerala Agriculturists Debt Relief Act, 1958, held as follows:-

> "7. ... It appears to us, that S.128 of the Indian Contract Act, sketches the ambit of liability of the surety when it enacts that the liability is co- extensive with that of the principal debtor. It has nothing to do with the consequences of recovery of the debt. Such being the scope and intendment of the section, we feel that a statutory reduction or extinguishment of the principal debtor's liability will operate as a pro tanto reduction, or extinguishment of the surety's debt. A reduction or extinguishment of the debt, is quite different from its unenforceability against the principal debtor by operation of the law of Bankruptcy or the statute of Limitation."

15. In Maharashtra State Electricity Board, Bombay v. The Official Liquidator, High Court, Ernakulam and another, AIR 1982 SC 1497, the Apex Court, while considering the terms of a bank guarantee executed by the Canara Bank Limited on behalf of a company that was being wound up, in favour of Maharashtra State Electricity Board, held that the mere fact that the company is in liquidation would not have any effect on the liability of the Bank, that is the guarantor. The Apex Court in paragraph 7 of the aforesaid decision held as follows:-

> 7. ... "The fact that the company in liquidation i.e. The principal debtor has gone into liquidation also would not have any effect on the liability of the Bank i.e., the guarantor. Under Section 128 of the Indian Contract Act, the liability of the surety is co-extensive with that of the principal debtor unless it is otherwise provided by the contract. A surety is no doubt discharged under S.134 of the Indian Contract Act 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, but a discharge which the principal debtor may secure by operation of law in bankruptcy (or in liquidation proceedings in the case of a company) does not absolve the surety of his liability.

(See Jagannath Ganeshram Agarwala v. Shivnarayan Bhagirath, AIR 1940 Bom 247. See also In re Fitzgeorge Ex parte Robson, (1905) 1 KB 462). In view of the unequivocal language of the letter of guarantee, no reliance can be placed by the company in liquidation on the decision of this Court in Punjab National Bank Limited v. Sri.Bikram Cotton Mills, (1970) 2 SCR 462: (AIR 1970 SC 1973) in which the surety's liability was limited to the 'ultimate balance' found due from the principal debtor and the said balance had not been ascertained before the institution of the suit." (emphasis supplied)

16. In Radha Thiagarajan v. South Indian Bank Ltd.,ILR 1986 (1) Kerala 370, Kochu Thommen, J. (as His Lordship then was), speaking for the Division Bench of this Court, held as follows:-

> "10. The discharge of the principal debtor will not discharge the surety where it is not brought about by the voluntary act of the creditor, but by the operation of law, such as the bar under the statute of limitations or by reason of bankruptcy or liquidation of the principal debtor (see Cartger v. White, (1884) 25 Ch.D.666). In re London Chartered Bank of Australia (1893 3 Ch.540), Ex Parte Jacobs, In re Jacobs [(1875) 10 Ch.App. Cas. 211], Fitz George In re Robson, Ex parte [(1905) 1 K.B. 462], Re Garnar Motors, Ltd. [(1937) 1 All E.R. 671] and, Bank of India Ltd. v. R.F.Cowasjee (AIR 1955 Bom.419, 431). See also "Rowlatt on Principal and Surety", 4th Edn., p.177; William W.Story, "A Treaties on the Law of Contracts:, Vol.II, para 869. As stated by Mc Kay, J:
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> "The discharge of the principal which discharges a surety must be a discharge by some act or neglect of the creditor, and a discharge by operation of law being, as it is, against the consent and beyond the power of the creditor, does not discharge the surety."

Phillipps v. Solomon (42 Gre. 192) (quoted by Brandt op. cit para 168). But if the contract under which the debt became due is not enforceable by reason of the substantive law (as opposed to some procedural regulation) and is therefore void ab initio -void from its very inception - (Section 2(g) of the Contract Act), as for example, a contract with an alien enemy, or has become illegal in the course of its performance [Section 2(j) of the Contract Act], as, for example, a contract with one who had been an alien friend, but later became an alien enemy, the debt in such cases of voidness or nullity is extinguished and not merely barred, and so is the obligation of the surety. The "nullity of the principal obligation necessarily induces the nullity of the accessory": Ferry v. Burchard (21 Cenn.597), per Storrs, J. (quoted by Brandt op.cit, Vol.I, para 379); see also Mahanth Singh v. U.Ba Yi (AIR 1939 P.C. 110 at 113). While the bar of limitation or the law of insolvency or liquidation or othe requirements of procedural law making the contract unenforceable, but without extinguishing rights and remedies, will leave the obligation of the surety unimpaired, the intervention of substantive law destroying rights and obligations wholly or partly will to the extent of such extinguishment release the surety. One striking illustration of the latter is where the law itself, as in the case of the Madras Agriculturists' Relief Act, 1938 (Act IV of 1938) [considered in Subramania v. Narayanaswami, AIR 1951 Mad. 48 (F.B)], or the Agriculturists Debt Relief Act (Kerala), 1958 (Act 31 of 1958) considered in Mani v. Kochuouseph (1965 KLT 1266), is found to provide that the debt due from the principal debtor is partly or wholly extinguished, and not merely barred. In such a case the liability of the surety is pro tanto extinguished."

25. Significantly section 45 of the Insolvency Act specifically provides that an order of discharge of the insolvent does not have the effect of releasing a surety. This was a well recognised principle of the common law even before it was adopted by the statute: English v. Darley [(1800) 2 Box & P.61, 62 cited in (1947) 63 L.Q.R.355] Ex parte Jacobs, In re Jacobs [(1875) Law Rep.10 Ch.App. 211]. See Rowlatt, op. cit. p.173. The same is the position in liquidation proceedings. The dissolution of a company does not release the surety: See the principle stated in Ex parte Jacobs In re Jacobs [(1875) Law Rep.10 Ch.App.211]. In re London Chartered Bank of Australia [(1893) 3 Ch.540, 546-547], Fitz George In re Robson, Ex parte [(1905) 1 K.B. 462], Re Garner Motors Ltd. [(1937) 1 All.E.R. 671]

and, Jaganath v.

Shivnarayan (AIR 1940 Bom 247). In both these events the principal debtor is released personally. The creditor's right to sue is converted to a right to prove and he thus retains his nexus, though of a different character, with the principal debtor which can be enforced (see Stramit Industries Ltd. v. Gardner (1970) 92 N (NSW) 433, 436-437). The insolvency of an individual (or the liquidation of a company) thus results in a release of the principal debtor, and the creditor's right against him are transformed into rights against his assets: see (1947) 63 L.Q.R.355, 365.

> "The debtor's possible inability to perform the principal obligation is the creditor's motivation for asking for a guarantee and the guarantor's for giving it. The law could, therefore, never countenance that a creditor should 'lose the benefit of the guarantee at the very moment he most needs it'. "Moschi v. Lep Air Services Ltd. (1973) A.C. 331, 356 H.H.L. See Johan Steyn (1974) 90 L.Q.R. 246, 264. As stated by Jordan, C.J.:
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> "There is no reason to attribute to the Legislature, when it releases or provides for the release of a bankrupt debtor, an intention to deprive a creditor, who will otherwise go unpaid to some extent or perhaps entirely, of recourse against the guarantor whose obligation he has been prudent enough to obtain."

Insurance Office of Australia, Ltd. v. T.M.Burke Ply. Ltd. (1935) 35 S.R. (N.S.W.) 436, 442-443 quoted in (1947) 63 L.Q.R. 355, 366. This principle applies with equal, if not greater, force to a case such as the present, where the principal debtor is released under the Nationalisation Act only to the extent to which the claims against him are admitted, and his liability for the undischarged debts remain unaffected. To that extent the liability of the surety remains unimpaired."

(emphasis supplied) The Division Bench held that the Sick Textile Undertakings (Nationalisation) Act, 1974 does not extinguish the liability of the principal debtor, although he is discharged to the extent to which the claims against him are admitted and credited or paid under the Act and is therefore no longer liable to be proceeded against to the extent of such accord and satisfaction. The Division Bench also held that the liability of the nationalised company in respect of the balance amount remains unimpaired and to the extent of such undischarged liability, the surety is liable to be proceeded against even before the creditor has exhausted his remedies against the principal debtor.

17. In Punjab National Bank v. State of U.P. (2002) 5 SCC 80, the Apex Court considered a similar question arising under the Sick Textile Undertakings (Nationalisation) Act, 1974 and held as follows:-

> 5. "We have gone through the provisions of the said Act and in our opinion the decision of the courts below is not correct. Section 5 of the said Act provides for the owner to be liable for certain prior liabilities and Section 29 states that the said Act will have an overriding effect over all other enactments. This Act only deals with the

> liabilities of a company which is nationalized and there is no provision therein which in any way affects the liability of a guarantor who is bound by the deed of guarantee executed by it. The High Court has referred to a decision of this Court in Maharashtra SEB v. Official Liquidator, High Court, Ernakulam where the liability of the guarantor in a case where liability of the principal debtor was discharged under the insolvency law or the company law, was considered. It was held in this case that in view of the unequivocal guarantee such liability of the guarantor continues and the creditor can realise the same from the guarantor in view of the language of Section 128 of the Contract Act as there is no discharge under Section 134 of that Act.
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> 6. In our opinion, the principle of the aforesaid decision of this Court is equally applicable in the present case. The right of the appellant to recover money from respondents 1, 2 and 3 who stood guarantors arises out of the terms of the deed of guarantee which are not in any way superseded or brought to a naught merely because the appellant may not be able to recover money from the principal borrower. It may here be added that even as a result of the Nationalisation Act the liability of the principal borrower does not come to an end. It is only the mode of recovery which is referred to in the said Act."

The very same view was reiterated by the Apex Court in Industrial Finance Corporation of India Ltd. v. Cannanore Spinning and Weaving Mills Ltd. and others, (supra).

18. It is thus evident from the decisions cited above that the winding up of the company of which the appellant was the Director, does not discharge the surety. As noticed by Kochu Thommen,J.(as His Lordship then was) in Radha Thiagarajan's case (supra) if such a view is adopted, a creditor would lose the benefit of the guarantee at the very moment he most needs it. All that could be stated is that the liability of the surety is scaled down to the extent of the amounts realised by the Corporation from the Official Liquidator. We accordingly hold that the liability of the surety will be to that extent of the balance amount payable by the company to the Corporation. Further, the appellant and the other creditors had in Ext.R1(a) loan agreement agreed and undertaken that in the event of default being made by the company, the guarantors will pay the Corporation such principal, interest and other moneys which is due to the Corporation and in the event of their failure to pay the same the Corporation will be entitled to recover the same with interest from them jointly and severally, personally and from their assets. They had also agreed that the Corporation will be entitled to treat them as the principal debtors to the Corporation for all payments and covenants guaranteed by them to the Corporation. In Ext.R1(c) deed of guarantee the appellant and the other guarantors had also undertaken to repay all moneys at any time payable by the borrower company to the Corporation. Ext.R1(c) deed of guarantee stipulates in express terms that the guarantee is one for all amounts advanced by the Corporation to the borrower company and also for interests, costs and other moneys which may, from time to time become due and remain unpaid to the Corporation and shall remain in force until all such moneys are paid off in full with interest and other charges. It was expressly stipulated that the guarantee shall remain in force and in effect so long as the last paise due to the Corporation under the loan agreement with the borrower company remains unpaid. On the terms of the loan agreements/deed of guarantee the appellant and the other Directors cannot be

heard to contend that with the winding up of the company and the payments effected by the Official Liquidator in such winding up, they stand discharged.

19. We shall now refer to the decision Division Bench of this Court in Federal Bank's case (supra), which was referred to and relied on by the learned counsel for the appellant and also consider the effect of the decision of this Court in M.F.A.No.1311 of 1993. As noticed by the learned single Judge in the judgment under challenge, the Division Bench of this Court in Federal Bank's case (supra), had only held that in winding up proceedings, a secured creditor, who has obtained a decree with interest at a rate of more than 4% would be entitled to realise the said interest, only if there is surplus amount left in the hands of the Official Liquidator after satisfying the claims of all secured creditors including secured creditors who stood outside the winding up. It was held that a secured creditor can claim interest in excess of 4% only in such an event. M.F.A.No.1311 of 1993 filed by the Corporation was dismissed following the decision in Federal Bank's case (supra). As noticed earlier, the Official Liquidator had initially paid over the sum of Rs.38,32,219.80, which included interest at the contract rate till the date of winding up. The claim for interest after the winding up (the winding up order was passed on 27-8-1990) was declined. The Corporation challenged the said order by filing an application under Rule 164 of the Companies (Court) Rules. That application was rejected on the ground that interest after the date of winding up can be claimed only if there is any surplus left in the hands of the Official Liquidator after payment in full of all the claims admitted to proof. After the learned company Judge dismissed the said application and while M.F.A.No.1311 of 1993 was pending, the Official Liquidator paid the sum of Rs.7,79,218.80 to the Corporation, being the amount of interest calculated at the rate of 4% per annum from the date of winding up. Under the terms of the loan agreement, the Corporation was entitled to interest, even after the winding up, in excess of 4%. To recover the said amount revenue recovery proceedings were initiated by Ext.P4 demand notice dated 18-11-1995. At that time, the appellant and the other guarantors filed O.P.No.18767 of 1995 in this Court. In that writ petition the only contention raised was that they are not liable for the entire amount of Rs.71,78,000/- and that they are liable only for the amount that may be found due from the principal debtor. It was while that writ petition was pending that the Official Liquidator paid over the sum of Rs.38,32,219.80 to the Corporation. In view of the said payment, the Corporation undertook that they will withdraw the then existing demand notice and issue a revised demand notice after giving credit to the amount received from the Official Liquidator. O.P.No.18767 of 1995 was thereupon disposed of by Ext.P5 judgment delivered on 11-12-1995 recording the said undertaking. It was thereafter that the present demand notices were issued, which were challenged in O.P.No.666 of 1996 from which this writ appeal arises. In our opinion, in view of the stand taken by the appellant and other Directors in O.P.No.18767 of 1995 they cannot be heard to contend that they are not liable to pay any further amount to the Corporation. The appellant is, in our opinion, bound by Ext.P5 judgment in O.P.No.18767 of 1995 and cannot take advantage of the payments made by the Official Liquidator and the dissolution of the company to contend that the guarantors are discharged of their obligations under the loan agreement/deed of guarantee. We agree with the learned single Judge that the adjudication made by the Official Liquidator attached to this Court in the winding up proceedings does not absolve the sureties of their obligations arising under the loan agreements/deed of guarantee. The appellant and the other sureties can in our opinion, at best only contend that they are liable only for the balance amount payable by the company after giving credit to the payments made by the Official Liquidator

in the winding up proceedings.

20. We shall now deal with the contention raised by the learned counsel for the appellant that as the assets of the company have been sold in the winding up proceedings, the right of the surety to proceed against the principal debtor recognised in sections 140 and 141 of the Indian Contract Act, 1872 has been impaired or lost and therefore, the sureties are not liable to be proceeded against. Clause 27(5) of Ext.R1

(a) loan agreement, and clause (6) of Ext.R1(c) deed of guarantee, which we have quoted above, entitles the Corporation to proceed against the guarantors as if they are the principal debtors for all the payments and covenants guaranteed by them to the Corporation. Clause (4) of Ext.R1(c) deed of guarantee, which we have quoted above, expressly stipulates that the guarantors have waived all suretyship and other rights which they might otherwise be entitled to enforce. Thus it is evident from the stipulations in the loan agreements/deed of guarantee that the guarantors shall be liable as if they are the principal debtors and that they have waived all their rights as sureties which they are otherwise entitled to enforce under sections 140 and 141 of the Indian Contract Act, 1872. Therefore, the guarantors cannot contend that upon payment of the balance amount due from the company they will be vested with all the rights which the creditor had against the principal debtor. The guarantors have by agreeing to the stipulations in the loan agreements/deed of guarantee quoted above, waived their rights under Section 140 of the Indian Contract Act, 1872 to step into the shoes of the creditor and to proceed against the principal debtor. Therefore, in our opinion no reliance can be placed on Section 140 of the Indian Contract Act, 1872 to contend that as the right of the surety to proceed against the principal debtor has been impaired, the surety cannot be proceeded against.

21. Section 141 of the Indian Contract Act, 1872 stipulates that 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. The Apex Court has in Industrial Finance Corporation of India Ltd. v. Cannanore Spinning and Weaving Mills Ltd. and others, (supra) interpreting Section 141 of the Indian Contract Act held that where there was no deliberate act on the part of the principal debtor which led to the loss of the security and the security was lost not by any definite act of the creditor or the debtor, but by the operation of law over which none of the parties had any control, it cannot be said that the surety is discharged. The Apex Court also negatived the contention that by reason of the non-availability of the security in terms of Section 141 of the Indian Contract Act, 1872, the contract of guarantee stood frustrated. Therefore, the guarantors cannot be heard to contend that as the security offered by the company, the principal debtor, has been lost, they are discharged to the extent of the value of the security. In the light of the authoritative pronouncement of the Apex Court, the contention based on Sections 140 and 141 of the Indian Contract Act, 1872 cannot be sustained.

For the reasons stated above we hold that there is no merit in the writ appeal. The writ appeal fails and it is accordingly dismissed. The parties shall bear their respective costs.

K.BALAKRISHNAN NAIR, Judge P.N.RAVINDRAN, Judge.

ahg.

K.BALAKRISHNAN NAIR & P.N.RAVINDRAN, JJ.

JUDGMENT 5th March, 2010