

(2016) 11 DEL CK 0153
In the Delhi High Court
Case No : CS(OS) No. 2557 of 2000

Canbank Financial Services Ltd.

APPELLANT

Vs

SFL Industries Ltd.

RESPONDENT

Date of Decision : 09-11-2016

Acts Referred:

Companies Act, 1956 — Section 137, Section 141, Section 446
Sick Industrial Companies (Special Provisions) Act, 1985 — Section 22(1)

Citation : (2017) 237 DLT 165

Hon'ble Judges : Mr. Rajiv Sahai Endlaw, J.

Bench : Single Bench

Advocate : Mr. Ravi Krishan Chandna, Advocate, for the Plaintiff; Mr. Jagjit Singh, Advocate, for the Defendant No. 2

Final Decision : Disposed Off

Judgement

Mr. Rajiv Sahai Endlaw, J.—The counsel for the plaintiff and the counsel for the defendant no.2 Shri Harbhajan Singh have been heard.

2. The plaintiff instituted this suit for recovery of Rs. 1,20,49,597.24p with interest, jointly and severally from the two defendants, pleading (i) that the plaintiff, vide its letter dated 12th December, 1990 sanctioned and agreed to provide the defendant no.1 lease finance to the extent of Rs. 50,00,000/- for installing the plant, machinery and equipment at Village & P.O. Rail Majra, Tehsil Balachaur, District Nawanshahr, Punjab; (ii) on 12th December, 1990 itself an agreement of lease of the said plant and machinery was executed at New Delhi; (iii) as per the said lease agreement the lease rentals were to be paid in eight years w.e.f. the handing over of the plant and machinery; (iv) that on 21st August, 1991 a supplementary agreement was entered into between the parties where under the equipment worth Rs. 29,64,018/- was leased to the defendant and lease rentals were to commence w.e.f. 21st August, 1991, for a period of eight years i.e. up to 20th August, 1999; (v) the said plant and machinery were installed at the factory aforesaid of the defendant no.1; (vi) the said lease

expired on 20th August, 1999 and the defendant became liable to pay the entire lease rentals along with interest as per the terms of the agreement; (vii) that on 27th September, 1991 another supplementary agreement was executed between the parties where under equipment worth Rs. 39,59,370/- was leased to the defendant and the leased rentals were to commence from 27th September, 1991 and till 26th September, 1999; (viii) the plant and equipment under the said agreement also was installed at the factory of the defendant no.1; (ix) the said lease has also expired on 26th September, 1999 and the defendant became liable to pay the entire lease rentals along with interest; (x) that both the supplementary agreements dated 21st August, 1991 and 27th September, 1991 were to form part and parcel of the Agreement dated 12th December, 1990; (xi) that the defendant no.2 Shri Harbhajan Singh stood as guarantor, to the said transaction, to secure the re-payment of the amounts and executed Guarantee Deed dated 15th March, 1996 in favour of the plaintiff; (xii) that the defendant no.2 is thus jointly and severally liable with the defendant no.1 to pay the outstanding amount; (xiii) that the defendants failed to maintain financial discipline and were never regular in making payments of lease rentals in spite of repeated requests and reminders of the plaintiff and acknowledgement of the defendants; (xiv) on 6th December, 1996, the defendants admitted and acknowledged liability of Rs. 61,34,897.45p as on 31st August, 1996; (xv) however till the date of institution of the suit, payment had not been made in spite of legal notice; (xvi) the defendant no.1 on 6th May, 1999 approached the Board for Industrial & Financial Reconstruction (BIFR) under the provisions of Sick Industrial Companies (Special Provisions) Act, 1985 (SICA) and the said reference was registered; (xvii) the plaintiff approached BIFR for permission under Section 22 of the SICA; (xviii) BIFR vide order dated 3rd January, 2000 rejected the application of the plaintiff; (xix) the plaintiff filed an appeal to Appellate Authority for Industrial and Financial Re-construction (AAIFR); (xx) AAIFR vide order dated 12th September, 2000 allowed the application of the plaintiff under Section 22 of SICA; (xxi) that as per the books of accounts of the plaintiff maintained in the regular course of business, the defendants at the time of institution of the suit were liable to pay a total sum of Rs. 1,20,49,597.24p to the plaintiff; and, (xxii) the defendants are also liable to pay pendent lite and future interest as per the agreement at the rate of 2% per month compounded with monthly rests till the date of realisation.

3. The suit was entertained and summons thereof issued.

4. None appeared for the defendant no.1 which was vide order dated 11th December, 2002 proceeded against ex parte. The defendant no.2 filed an application under Section 8 of the Arbitration and Conciliation Act, 1996 and which application was allowed and vide order dated 12th May, 2004 the parties were referred to arbitration.

5. The plaintiff filed FAO(OS) No.156/2004. The counsel for the defendant no.2, on 9th April, 2012, withdrew the application aforesaid under Section 8 and as a

result whereof the order dated 12th May, 2004 of disposal of the suit was set aside and the suit restored to its original position.

6. On 8th May, 2012 it was informed that the defendant no.1 had been wound up pursuant to the order of Punjab & Haryana High Court. The plaintiff was accordingly directed to take steps to bring the Official Liquidator (OL) on record.

7. Notice thereof was issued to the OL who appeared through counsel before this court on 23rd April, 2013 and for few dates thereafter but then stopped appearing.

8. The defendant no.2 filed a written statement pleading (i) that the suit against the defendant no.2 as guarantor is not maintainable since the defendant no.1 as principal borrower had died a legal death and ordered to be wound up pursuant to the recommendations of the BIFR; (ii) that the OL attached to the High Court of Punjab & Haryana had sold all assets comprising of land, building, plant, machinery and equipment of the defendant no.1 for a sum of Rs. 4.91 crores and the sale stood confirmed; that the defendant no.2 even otherwise stood discharged as a guarantor because (a) the plaintiff had given up its right to enforce its charge as against all the securities ? plant and machinery ? equipment financed under the alleged Lease Agreement; (b) of the conduct of the plaintiff in not taking appropriate steps for preservation of securities/plant/machinery/leased equipment governed by the contract in spite of the defendant no.1 failing to adhere to financial discipline; and, (c) the plaintiff having not taken any remedial or legal steps against the securities and the same amounting to novation/modification of the terms of contract; (iii) that the liability of a guarantor is subject to existing securities of the principal borrower and which securities are to be made available to the guarantor when the guarantee is put to enforcement; (iv) the plaintiff has not pleaded the details of securities or nature of securities; (v) the plaintiff has therefore failed to enforce its rights as against securities of principal borrower and resultantly the defendant no.2 stood discharged; (vi) that the OL attached to Punjab & Haryana High Court had invited claims from all class of creditors of the defendant no.1 and till such time as the said claims are investigated and adjudicated upon, no recovery from the defendant no.2 can be made; and, (vii) the plaintiff should have taken steps to save and protect its securities/leased equipment in its capacity as a secured creditor or having charge over the equipment/machinery; (viii) generally denying the contents of the plaint.

9. The suit though pending for the last sixteen years, has stood so.

10. On 26th October, 2016, the counsel for the defendant no.2 though initially stated that no issue of fact arises but subsequently, when the order was being dictated, stated that an issue may arise with respect to the plea of Section 141 of the Indian Contract Act, 1872 and also whether the suit could be proceeded with as the plaintiff was required to take permission under Section 446 of the Companies Act, 1956.

11. On 26th October, 2016 I prima facie observed that once permission under Section 22(1) of SICA had been granted and the order of winding up is in pursuance to the orders of BIFR, SICA being a special statute would prevail and need may not arise for permission under Section 446 of the Act. On perusal of file on that date it was also found that the OL had appeared not only in the suit as aforesaid recorded but also in FAO(OS) No.156/2004 supra. On 26th October, 2016 it was further enquired from the counsel for the plaintiff whether a plea under Section 141 of the Contract Act was to be taken in execution or in suit. On a perusal of the Deed of Guarantee admittedly executed by the defendant no.2 in favour of the plaintiff it was found that the defendant no.2 had agreed that his liability would be joint and several with the defendant no.1 and it was thus enquired from the counsel for the defendant no.2 on 26th October, 2016 as to how defendant no.2 could oppose the claim in the suit.

12. Faced therewith, the counsel for the defendant no.2 on 26th October, 2016 had stated that the plaintiff had already recovered part of its claim. He was however unable to show any document to the said effect. The counsel for the plaintiff, on that day stated that no amount had been recovered and it was so evident from the report filed by the OL also.

13. The counsel for the defendant no.2 had then sought adjournment to place on record the latest report of the OL.

14. The defendant no.2 has filed an affidavit dated 3rd November, 2016 to the effect (i) that the OL in his report filed in these proceedings had disclosed as many as five secured creditors of the defendant no.1 Company; (ii) that in the said report the plaintiff was shown as debenture holder secured by floating charge of Rs. 10,00,000/-; (iii) that no charge had however been registered over plant, machinery and equipment in favour of the plaintiff in terms of Sections 125/126 of the Companies Act; (iv) that the amount of Rs. 4.91 crores realised by the OL from sale of assets of defendant no.1 was payable first to the secured creditors and thereafter to the unsecured creditors; (v) that the plaintiff is an unsecured creditor; (vi) that the plaintiff consented to the sale by the OL without securing its rights; and, (vii) that the said action of the plaintiff is detrimental to the interest of the defendant no.2 warranting discharge of the defendant no.2 from liabilities.

15. It would thus be seen that the only defence of the defendant no.2 to the claim of the plaintiff is that though the plaintiff, on default by the defendant no.1, was entitled to possess the leased plant, machinery and equipment and to sell the same to realize its dues from the defendant no.1 but did not do so and such failure of the plaintiff discharges the defendant no.2 as guarantor.

16. The counsel for the defendant No.2 has during the hearing handed over copies of (i) State of Madhya Pradesh v. Kaluram 1967 (1) SCR 266 ? in this case Kaluram stood surety for Jagatram whose bid for purchase of felled trees had been accepted; the State of Madhya Pradesh had a right to stop removal of felled

trees exceeding the amount paid by Jagatram; the State was found to have a first charge over the felled trees; the claim of the State against Kaluram on the basis of surety was defeated holding that the State having allowed Jagatram to remove the felled trees in excess of the price paid, Kaluram stood discharged to the extent of the value of the excess felled trees permitted to be taken; (ii) *Amrit Lal Goverdhan Lalan v. State Bank of Travancore* 1968 (3) SCR 724; (iii) *The State Bank of Saurashtra v. Chitranjan Rangnath Raja* AIR 1980 SC 1528; and, (iv) *Morgan Signatures Towers Private Limited v. M.P. Nagar* (2015) 12 SCC 519 ? but which are not found to be of any relevance.

17. I have perused the documents about which there is no dispute.

18. As per the Agreement of Lease dated 12th December, 1990 between the plaintiff and the defendant no.1 (i) though the defendant no.1 as lessee had a right to have and retain possession and use of the equipment for the full term of the lease, the equipment was to remain the property of the plaintiff; (ii) the defendant no.1 agreed not to sell, sublet, pledge or hypothecate or otherwise encumber or create any rights with respect to the said equipment; (iii) defendant no.1 agreed to provide "Collateral Security" to the plaintiff for full lease rental; (iv) the plaintiff was allowed, on occurrence of a default, to demand the entire amount due and to terminate the agreement and to demand return of the equipment and to take possession thereof at the cost and risk of the defendant no.1 and to sell the same and to demand the balance of its dues from the defendant no.1 or to avail any other remedy which may be available to it in law with neither of the two remedies being exclusive; and, (v) as per the Deed of Guarantee executed by the defendant no.2, the defendant no.2, in consideration of the plaintiff having agreed to grant lease to the defendant no.1, had agreed (a) to indemnify the plaintiff against all losses and to pay to the plaintiff on demand the balance due to the plaintiff not exceeding a sum of Rs. 109.75 lacs; (b) that his liability to the plaintiff shall be construed as joint and several with the plaintiff; (c) that he as guarantor shall not be discharged from his liability by the plaintiff releasing the defendant No.1 or by any act or omission of the plaintiff; (d) that if the defendant no.1 became insolvent, his liability shall continue; and, (e) that his guarantee shall be in addition to and shall not in any manner be prejudiced or affected by any collateral or other security or guarantee which the plaintiff may have.

19. It would thus be seen that the entire argument made by the counsel for the defendant no.2 is de hors the facts. For this reason only perhaps, the counsel for the defendant no.2 instead of referring to the documents chose to refer to the judgments and argue therefrom. The question of the proposition of law emerging from the said judgments applying would depend upon the facts of the case and the judgments cited are not relevant at all to the present case. Here, not only is the guarantee furnished by the defendant no.2 the only security under the Lease Agreement dated 12th December, 1990 available to the plaintiff but the counsel for the defendant no.2 himself as aforesaid agrees that no charge in favour of

the plaintiff was recorded. In the absence thereof, invocation by the counsel for the defendant no.2 of Section 141 of the Contract Act is meaningless as without such charge being recorded with the Registrar of Companies there can be no security. Moreover no clause from the Lease Agreement has been shown to canvass that the leased equipment was security. A creditor is not bound to insist upon any particular kind of security from the principal debtor and it is only when the creditor takes security from the principal debtor that the surety can claim a right to the benefit of that security. In the present case no security came in existence owing to non-registration of charge with the Registrar of Companies.

20. Though undoubtedly the leased equipment continued to be in the ownership of the plaintiff but it cannot be lost sight of that the defendant no.1 was in use such leased equipment which is embedded in the factory and incorporated in the plant and which independently is of no value and in most cases the cost of removal thereof is more than the value thereof. The defendant no.2 has also not pleaded any specific value of the same. It thus cannot be said that the plaintiff, by not asserting its rights to take back possession of the leased equipment has lost a chance to recover any part of its dues from the defendant no.1 or has acted detrimentally to the defendant no.2.

21. Moreover, under the Lease Agreement as aforesaid, the plaintiff was not even obliged, in the event of default by the defendant no.1 to take possession of the leased equipment and had a choice either to take possession thereof or to take any other remedies against the defendant no.1. Similarly the defendant no.2 had in the Deed of Guarantee agreed that he shall not stand discharged by any such thing. The defendant no.2 is now estopped from raising pleas as have been raised.

22. Section 141 of the Contract Act as under:

"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."

Is to be read along with Section 137 thereof which is as under:

"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."

23. The plaintiff, for removing the leased equipment incorporated in the plant and machinery at the factory of the defendant No.1, would have been required to take legal proceedings. The question which arises is, whether the choice exercised by the plaintiff of not taking such action would be "mere forbearance"

within the meaning of Section 137 or an act on the part of the plaintiff of "losing or parting with such security" within the meaning of Section 141.

24. In my view, considering the facts and circumstances of the present case i.e. the agreement between the parties, the practicality of removing the leased equipment from the factory premises of the defendant No.1 and the value of such leased equipment even if had been taken into custody/possession, the same would fall within the meaning of "mere forbearance" in Section 137 and not of "losing or parting with the security" within the meaning of Section 141.

25. A Division Bench of the High Court of Karnataka in *Karnataka Bank Ltd. v. Gajanan Shankararao Kulkarni* AIR 1977 Kant 14 held that mere passive inactivity 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, because the surety can himself avoid consequences of such passivity by himself paying the debt and becoming subrogated to the rights of the creditor and because in the absence of a contract to the contrary, the creditor is under no obligation of active diligence for the protection of the security, so long as the surety himself remains inactive. The said view was agreed to by a Division Bench of the High Court of Orissa in *Babani Shankar Patra v. State Bank of India* AIR 1986 Ori 247 and followed in *Ibrahim Abdul Latif Shaikh v. Corporation Bank* AIR 2003 Kant 98. I respectfully concur therewith.

26. Inkling can also be had from the "illustrations" to the two sections. The illustration to Section 137 is as under:

"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."

and the illustrations to Section 141 are as under:

"Illustrations: (a) C, advances to B, his tenant, 2,000 rupees on the guarantee of A. C has also a further security for the 2,000 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.

(c) 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."

27. The matter is put beyond any pale of controversy by the Supreme Court in *Industrial Finance Corporation of India Ltd. v. Cannanore Spinning and Weaving*

Mills Ltd. (2002) 5 SCC 54. It was held that the intent of the law makers is apparent from use in Section 141 of the words "or without the consent of the surety" and "parts with such security" and that a definite violation is required to come within the ambit of Section 141.

28. No merit is thus found in the plea of the defendant No.2 on the basis of Section 141 of the Contract Act. The action/inaction of the plaintiff on account of which the defendant No.2 claims to have been discharged do not fall within the ambit of Section 141 of the Contract Act and are within the ambit of Section 137 of the Contract Act.

29. As far as the contention of the counsel for the defendant No.2, of Section 446 of the Companies Act is concerned, I have on 26th October, 2016 already prima facie observed that once permission under Section 22(1) of SICA has been granted and the order of winding up is in pursuance to the order of BIFR, Section 446 of the Companies Act would not be applicable. I find support for the said view from the dicta of Justice R.M. Lodha, as a Judge of the Bombay High Court in Industrial Development Bank of India v. Moradabad Syntex Ltd. AIR 1997 Bom 306. It was held that the condition precedent to the applicability of Section 446 is the passing of the winding up order and/or appointment of official liquidator as provisional liquidator by the Court; any recommendation of winding up made by BIFR under SICA is not covered under the expression "winding up order has been made" by the Court and Section 446 is thus not applicable. Moreover, it is the case of the defendant No.2 itself that the winding up process is over. Once it is so the question of applicability of Section 446 does not arise. There is thus no merit in the said plea either.

30. The counsel for the defendant no.2, faced therewith has argued that the claim of the plaintiff in the plaint verified on 28th September, 2000 for Rs. 1,20,49,597.24p is unbelievable in the light of the said claim as on 28th February, 1998 being pleaded to be Rs. 66,97,514.51p.

31. I have enquired from the counsel for the defendant no.2 whether he has computed the amounts as per the rates of interest stipulated in the agreements.

32. The counsel states that he has not.

33. The same again demonstrates the arbitrary manner in which the argument is being raised.

34. I thus do not find any plea in the written statement of the defendant no.2 to be raising an issue of fact or law requiring determination. There is no need for the plaintiff to lead ex parte evidence against the defendant no.1 which has chosen not to contest in spite of service of notice including on the OL.

35. The plaintiff is thus entitled to a decree against the defendants as sought. However, having found the Deed of Guarantee executed by the defendant no.2 to be limiting the amount to be recovered thereunder to Rs. 109.75 lacs, the decree insofar as against the defendant no.2 has to be limited to the said amount.

36. Accordingly, a decree is passed in favour of the plaintiff and against the defendant no.1 for recovery of Rs. 1,20,49,597.24p with pendente lite and future interest at the rate of 2% per annum compounded with monthly rests.

37. A decree is also passed in favour of the plaintiff and against the defendant No.2 for recovery of Rs. 109.75 lacs.

38. The plaintiff shall also be entitled to costs of the suit jointly and