

(1984) 12 KL CK 0002
In the High Court Of Kerala
Case No : A.S. No. 14 of 1978

Radha Thiagarajan

APPELLANT

Vs

South Indian Bank Ltd. and Others

RESPONDENT

Date of Decision : 12-12-1984

Acts Referred:

Contract Act, 1872 — Section 128, 134, 135, 137, 139
Industries (Development and Regulation) Act, 1951 — Section 18A
Sick Textile Undertakings (Nationalisation) Act, 1974 — Section 17, 19, 20, 21, 22

Citation : (1984) 12 KL CK 0002

Hon'ble Judges : T. Kochu Thommen, J; M. Fathima Beevi, J

Bench : Division Bench

Advocate : T.R.G. Warriar, M.K. Ananthakrishnan and R. Bhaskaran, for the Appellant; S. Narayanan Potti, S. Sankara Subban and K. George Mathew and T.L. Viswanatha Iyer, P.S. Narayanan, K.S. Menon and S. Ramachandran and M. Vijaya Kumar, for respondents Nos. 6 to 15, for the Respondent

Final Decision : Dismissed

Judgement

Kochu Thommen, J.—The second defendant in a suit for recovery of money is the appellant. The plaintiff is the South Indian Bank Ltd. (also referred to herein as "the bank " or the " creditor " as the context may require). The first defendant (also referred to herein as " the owner " or the " principal debtor ") is a limited company which owned a textile mill, the management of which had been taken over by the Central Government under the Industries-(Development and Regulation) Act, 1951 (the "1951 Act"), and which has been subsequently nationalised under the Sick Textile Undertakings (Nationalisation) Act, 1974 (Act No. 57 of 1974) (the "Nationalisation Act"). Defendants Nos. 2 and 3 (also referred to as " the sureties") executed in favour of the bank a continuing guarantee in respect of the overdraft account which the first defendant had with the bank and under which the plaint amount is alleged to be still outstanding from the first defendant as the principal debtor and defendants Nos. 2 and 3 as the sureties. The third defendant died during the pendency of the suit and

additional defendants Nos. 4 to 16 were impleaded as the legal representatives of the third defendant. The second defendant is also one of his legal representatives. The suit against the first defendant was dismissed in view of the alternative remedy available to the plaintiff under the Nationalisation Act, but it was decreed against defendants Nos. 2 and 3 in the sum of Rs. 84,514.32 together with interest, subject to the direction that the liability of the legal representatives of the third defendant should be decided at the stage of execution.

2. The management of the textile mill (hereinafter referred to as "the undertaking ") was assumed by the Central Government u/s 18A of the 1951 Act with effect from July 14, 1972. Subsequently, as from August 18, 1972, it was declared as a relief undertaking in terms of the Kerala Relief Undertakings (Special Provisions) Act, 1961 (Act 6 of 1962) ("the 1961 Act"). During the pendency of the suit, the Nationalisation Act which received the assent of the President of India on December 21, 1974, came into force as from April 1, 1974. The First Schedule to that Act contains the names of the undertakings and their owners as well as the amounts awarded to them in compensation. The undertaking of the first defendant is mentioned as item No. 78 and the compensation awarded to it is Rs. 26,05,000.

3. The suit has been instituted by the bank for realisation of the amount due to it from the first defendant under the overdraft account which was granted on the strength of the guarantees executed by defendants Nos. 2 and 3. Exhibits A-1 and A-2, respectively, are the demand promissory note and the overdraft agreement for a sum of Rs. 1,00,000 executed by the first defendant on October 11, 1969. Exhibits A-3 and A-4 are the guarantees dated October 11, 1969, and April 18, 1970, executed by defendants Nos. 2 and 3 in favour of the bank in respect of the said overdraft account. It is specifically provided in exhibit A-3 that it is a continuing guarantee up to a maximum of Rs. 4,25,000 with interest thereon at the rate of 11% per annum. It contains the necessary reservation of remedies against the sureties. Clauses 3 to 5 provide that the liability of the sureties will remain unaffected, notwithstanding any time, indulgence or other release granted by the bank to the principal debtor or the bankruptcy or insolvency of the principal debtor or any arrangement or composition made between them. These provisions have been reaffirmed in exhibit A-4.

4. Counsel for the appellant, Sri Govinda Warriar, submits that the liability of the principal debtor was extinguished by virtue of the provisions of the Nationalisation Act and consequently the liability of the sureties which is accessory or secondary in character was also extinguished and the suit was, therefore, on the coming into force of the Nationalisation Act, no longer maintainable and accordingly the learned judge ought to have dismissed the suit against all the defendants. He further points out that, in so far as the suit was dismissed against the first defendant, there is *res judicata* as regards that claim as the plaintiff has not challenged that part of the decree. On that ground alone,

whatever right the plaintiff had against the first defendant, he says, became extinct and to that extent defendants Nos. 2 and 3, being sureties, were fully exonerated. Counsel submits that the only remedy which the bank has is to prove its claims under the Nationalisation Act and it has no remedy by means of a suit as against the principal debtor or the sureties.

5. Sri Ramesh Babu, appearing for the bank, submits with much learning and skill that the Nationalisation Act does not extinguish the obligations of the principal debtor or the sureties or affects the rights of the creditor, but provides for a mode of payment to the various creditors from out of the compensation awarded to the former owner of the nationalised undertaking. That remedy, under the Act, is without prejudice to the contractual rights and obligations of the parties. He says that the discharge granted to the owner under the Nationalisation Act is only to the extent to which the claims of the creditors are admitted and for the balance amount, the owner remains fully liable in terms of the contract. He further submits that in so far as the sureties are concerned, they remain liable under the guarantee and are bound to pay the amount due to the bank in the event of default by the principal debtor. Since the first defendant did not pay the amount demanded by notice dated September 25, 1972, the sureties became liable to pay the same. The dismissal of the suit against the first defendant, he says, does not affect the liability of the sureties.

These are the only contentions urged at the Bar on either side.

6. A contract of guarantee (or suretyship) is a contract to answer for the debt, default or miscarriage of another person : (see " Anson's Principles of the English Law of Contract", 22nd edition, page 69). Section 126 of the Indian Contract Act says: " A " contract of guarantee " is a contract to perform the promise, or discharge the liability, of a third person in case of his default". In such a contract, there must always be three persons in contemplation: the principal debtor, the creditor and the surety (also called the guarantor). The liability of a surety is accessory or secondary or collateral. In a contract of indemnity, on the other hand, the promisor makes himself primarily liable and undertakes to discharge the liability in any event (see Anson, op. cit).

7. The liability of the surety is co-extensive with that of the principal debtor, unless it is otherwise provided by the contract (section 128 of the Contract Act). Where there is no principal, there can be no surety. "As a general rule, a voluntary discharge of the principal discharges the surety also, yet the surety may, by express stipulation in the guarantee, agree to remain liable, even after the discharge of the principal debtor " : De Colyar's Law of Guarantees and of Principal and Surely, 3rd edition, page 417.

8. Where there is an absolute release of the principal debtor, the remedy against the surety is gone, because the debt itself is extinguished. It would be a fraud on the principal debtor to profess to release him and then to sue the surety who in turn might sue the principal debtor. On the other hand, if the creditor, at the time

he releases the principal debtor, reserves his remedies against the surety, such release merely amounts to a covenant not to sue, but does not discharge the surety (see George W. Brandt "The Law of Suretyship and Guarantee", Chicago, 1905, volume I, para 165). As stated by Lord Hatherley:

"...such a release (which is subject to a reservation) is not to be construed as absolute, but only as a covenant not to sue. That being so, the remedy is gone as between the debtor and creditor, inasmuch as the creditor cannot sue the debtor; but as against all other persons the rights of the creditor are reserved..."

9. Green v. Wynn [1869] LR 4 Ch App Cas 204. The law on this aspect is stated by the Privy Council in AIR 1939 110 (Privy Council) , at pages 111, 112, 113 as follows:

" A surety is discharged if the creditor, without his consent, either releases the principal debtor or enters into a binding arrangement with him to give him time. In each case, the ground of the discharge is that the surety's right to pay the debt at any time and after paying it, to sue the principal in the name of the creditor is interfered with. To hold that in such cases the creditor still retained his right against the surety, and that the surety on his part could still sue the principal debtor, would mean that the release or grant of time was of no effect inasmuch as the debtor would still be liable at any moment to an action at the suit of the surety.

Where an absolute release is given, there is no room for any reservation of remedies against the surety: see Webb v. Hewitt [1857] 3 K&J 438 and Commercial Bank of Tasmania v. Jones [1893] AC 313. Where, however, the debt has not been actually released, the creditor may reserve his rights by notifying the debtor that he does so, and this reservation is effective not only where the time of payment is postponed but even where the creditor has entered into an agreement not to sue the debtor. In neither case is there any deception of the debtor since he knows that he is still exposed to a suit at the will of the surety....

The appellant's act in continuing to sue the surety though he withdrew his action against the principal debtors was in their view a clear reservation of his rights. Indian authority illustrating this proposition is to be found in Murugappa v. Munusami AIR [1920] Mad 216; 54 IC 758; 38 MLJ 131 and Nur Din v. Allah Ditta [AIR 1932 Lah 419; 138 IC 305; 13 Lah 817."

10. The conduct of the creditor discharging a surety may, unless otherwise stipulated, arise from such circumstances as the creditor varying the terms of the original contract between himself and the principal debtor, or between himself and the surety, or where he takes a new security from the principal debtor in lieu of the original security, or where he releases or discharges the principal debtor or a co-surety, or where he compounds with or gives time to the principal debtor or agrees with him to give time to the surety or where loss occurs through his negligence or fault (see Sections 133, 134, 135 and 139 of the Contract Act). However, mere forbearance on the part of the creditor to sue the principal debtor

or to enforce any other remedy against him does not, unless otherwise provided in the guarantee, discharge the surety (see Section 137 of the Contract Act). Mere neglect to sue (as distinguished from a positive agreement or an act or omission within the meaning of Sections 134, 136 and 139 of the Contract Act, the legal consequence of which is to discharge the principal debtor and not merely to bar the remedy) will not affect the right of the creditor against the surety. These provisions, as stated by the Privy Council, are declaratory of the principles adopted in English law on the matter: see AIR 1939 110 (Privy Council) see also *Carter v. White* [1884] 26 Ch D 666 ; *Sankara Kalana v. Virupakshapa Ganeshapa* ILR [1883] Bom 146, *Krishto Kishori Chowdhrair v. Radha Romun Munshi* ILR [1886] Cal 330, *Subramania Aiyar v. Gopala Aiyar* ILR [1909] Mad 308 and *Dil Mohammad v. Sain Das* AIR 1927 Lah 396. Referring to the rule laid down by Lord Eldon in *Satmtell v. Howdrth* [1817] 3 Mer 272 Lord Diplock says in *Moschi v. Lep Air Services Ltd.* [1972] 2 WLR 1175:

"that where the creditor, after the guarantee has been entered into, gives a contractual promise to the debtor to allow him time to pay the guaranteed debt, the guarantor is discharged from his obligation to the creditor. This is because the creditor by altering the debtor's obligation to him has deprived the guarantor of his equitable right to compel the debtor to perform his original obligation to the creditor, which was all that the guarantor had guaranteed. In contrast, the guarantor is not discharged by the mere voluntary forbearance of the creditor to take steps to obtain timeous performance by the debtor of the obligation which is the subject of the guarantee ; for this does not affect the guarantor's equitable right to compel the debtor to perform it."

11. 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 *Carler v. White* [1881] All ER Rep 921 *London Chartered Bank of Australia, In re* [1893] 3 Ch 540; *Jacobs, In re : Ex parte Jacobs* [1875] 10 Ch App Cas 211, *Fitzgeorge, In re: Ex parte Robson* [1905] 1 KB 462 *Garner Motors Ltd., In re* [1937] 1 All ER 671 and *The Bank of India, Ltd. Vs. Rustom Fakirji Cowasjee*, , See also " *Rowlatt on Principal and Surety* ", 4th edition, page 177 and *William W. Story, " A Treaties on the Law of Contracts "*, Volume II, para. 869). As stated by McKay J.:

"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."

12. *Phillips v. Solomon*, (42 Go. 192) (quoted by Brandt op. cit, para. 168). But if the contract under which the debt becomes 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 Conn 597) per Storra J. (quoted by Brandt op. cit, Volume I, para. 379); see also AIR 1939 110 (Privy Council) at page 113. While the bar of limitation or the law of insolvency or liquidation or the 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 *A.L.S.P.Pl. Subramania Chettiar (decd.) and Another Vs. Moniam P. Narayanaswami Gounder, 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.

13. The question, therefore, is whether in the present case, on account of the Nationalisation Act, there was an extinguishment of the whole or part of the principal debt due from the first defendant and whether defendants Nos. 2 and 3 were pro tanto released from their liability. We shall presently consider the relevant provisions of the Nationalisation Act, but before we do so, we shall briefly consider the effect of the two earlier statutes.

14. Section 18A of the 1951 Act enables the Central Government to take over by notified order the management of the whole or any part of the undertaking and exercise such functions of control as specified in the order. The object of such take-over is to conserve a sick industry by preventing further deterioration in its capacity for production and by developing and regulating the industry. With this object in view, the Kerala Legislature enacted the 1961 Act declaring any notified industry as a relief undertaking and suspending the enforcement of all remedies and staying all proceedings against such industry during the period of the relief undertaking. As a result of the operation of these two enactments, the undertaking in question has been already in the care and management of the Government ever since July 14, 1972.

15. The Nationalisation Act is in effect a continuation and culmination of the process of take over initiated under the earlier enactments. With effect from April 1, 1974, the undertaking stood nationalised. Consequently, the undertaking and the right, title, and interest of the owner in relation to it stood transferred to and vested absolutely in the Central Government and thereupon in the National Textile Corporation (Section 3).

16. As a result of such vesting, all the assets of the undertaking were freed and

discharged from any trust, obligation, mortgage, charge, lien or other incumbrances or restraints affecting them (Section 4). Every liability, other than a liability arising from loans advanced by the Central or State Government or by the National or State Textile Corporation to the undertaking after the management of the same had been taken over under the 1951 Act, is, subject to the provisions of Section 27 concerning category I of the Second Schedule to the Act, stated to be the exclusive liability of the owner himself and enforceable against him only (Section 5). In respect of such posterior period as is referred to in Section 5(2), Section 4(6) provides that if any suit, appeal or other proceeding instituted by or against the textile company in respect of such undertaking is pending, the same will not abate or be prejudicially affected by reason of such transfer, but can be continued and enforced by or against the National Textile Corporation.

17. Sections 8 and 9 provide for payment of amounts to the owners as compensation for the nationalisation of the undertakings. While Section 8 provides for payment of an amount equal to the amount specified in the corresponding entry in column (4) of the First Schedule, Section 9 provides, in consideration of the retrospective operation of Sections 3, 4 and 5, for payment of a further amount at the rate specified in Section 6 of the Sick Textile Undertakings (Taking Over of Management) Act, 1972, and also for payment of interest. Section 8 says that the amount shall be paid in cash and in the manner specified in Chapter VI which contains Sections 17 - 26.

18. Section 17 provides for the appointment of Commissioners of Payments in respect of different areas. Section 18 says that the Central Government shall, within 30 days from the date specified, pay in cash to the concerned Commissioner, for payment to the owner, such amount as is specified in the First Schedule and also the amount payable in terms of Section 9. Section 19 says that the National Textile Corporation is entitled to receive, up to the specified date, to the exclusion of all other persons, any amount due to the undertaking realised after the appointed day, i.e., April 1, 1974, even if such realisations pertain to a period prior to that day. As a result of this and the earlier provisions, the owner is deprived of all the assets of the undertaking, including the amounts realised subsequent to April 1, 1974, even if they pertain to the anterior period. All that the owner is entitled to receive as compensation for the loss of all this is what sections 8 and 9 provide for payment through the Commissioner, but subject to the disbursement in satisfaction of the admitted claims of the creditors in accordance with the mode prescribed under Sections 20 - 24.

19. Section 20 says that every person having a claim against the owner should prefer his claim before the Commissioner within the time prescribed in that section. The priority of claims is specified in Section 21. It reads;

"21. Priority of claims.--The claims arising out of the matters specified in the Second Schedule shall have priorities in accordance with the following principles, namely :--

(a) category I will have precedence over all other categories and category II will have precedence over category III and so on ;

(b) the claims specified in each of the categories except category IV shall rank equally and be paid in full, but if the amount is insufficient to meet such claims in full, they shall abate in equal proportions and be paid accordingly ;

(c) the liabilities specified in category IV shall be discharged, subject to the priorities specified in this section, in accordance with the terms of the secured loans and the priority inter se of such loans, and

(d) the question of payment of a liability with regard to a matter specified in a lower category shall arise only if a surplus is left after meeting all the liabilities specified in the immediately higher category."

20. The Second Schedule referred to in the section contains two parts : Part A deals with categories I and II while Part B deals with categories III to VI, among which category IV concerns secured loans. The priority of claims mentioned in Section 21 provides that category I will be preferred to all other categories, category II will be preferred to the remaining categories, and so on. In respect of each category, with the exception of category IV, the claims will rank equally and will be paid in full, but if the amount is insufficient to meet them in full, the claims will abate in equal proportions and will be paid accordingly. In regard to category IV, the liability will be discharged, subject to the priorities mentioned in the section, in accordance with the terms of the secured loans and the priority inter se of such loans. Section 21(d) specifically provides that no lower category will be paid unless there is a surplus left after meeting all the demands of the immediately higher category.

21. Section 22 deals with the examination of claims. It says that the Commissioner must, on receipt of the claims, arrange them in the order of priority specified in the Second Schedule and examine them in accordance with that order. If, on an examination of the claims, the Commissioner comes to the conclusion that the amount paid to him is not sufficient "to meet the liabilities specified in any lower category, it will not be necessary for him to examine the liabilities in respect of such lower category.

22. Sub-section (1) of Section 23 refers to the admission or rejection of claims. Sub-section (3) says that every claimant should file proof of his claim within the date specified by the Commissioner, failing which such claimant would be excluded from the benefit of the disbursement made by the Commissioner. Such date has to be notified in the manner provided under Sub-section (2). Sub-section (4) says :

"(4) The Commissioner shall, after such investigation as may, in his opinion, be necessary and after giving the sick textile undertaking an opportunity of refuting the claim and after giving the claimants a reasonable opportunity of being heard, in writing, admit or reject the claim in whole or in part."

23. Before a claim is so admitted or rejected, the sick textile undertaking has to be afforded an opportunity of refuting the claim and the claimants have to be given a reasonable opportunity of being heard. Sub-sections (5) to (7) prescribe the procedure for investigation by the Commissioner and appeal to a civil court from his decision. It would appear from Sub-section (4) and other provisions that the admission or rejection of a claim is based on two factors; (1) the merits of the claim, and (2) the availability of money. If, upon hearing the parties, the claim is found to be valid, and the amount provided as compensation is sufficient to meet it wholly or in part in accordance with the priorities specified in Section 21, such claim will be admitted to the extent to which the amount permits. On the other hand, if the claim is found to be not admissible at all for want of merit or for want of money, it will be rejected. In other words, the admission or rejection of a claim in whole or in part may be for either of the two reasons. To the extent to which a claim is admitted, the amount due in respect of such admitted claim has to be credited or paid in the manner provided u/s 24. This section reads:

" 24. Disbursement of money by the Commissioner to claimants.---After admitting a claim under this Act, the amount due in respect of such claim shall be credited by the Commissioner to the relevant fund or be paid to the person or persons to whom such sums are due and on such credit or payment the liability of the owner in respect of such claim shall stand discharged. "

24. The section deals only with the admitted claim and not the claim as originally lodged by the claimant. It is to the extent to which a claim is admitted, that the amount falls due pro tanto under that claim and it is that amount which is credited to the relevant fund or paid to the claimant. On such credit or payment, the liability of the owner will, in respect of the admitted claim, stand discharged pro tanto. This, in our view, is the meaning of this provision. The words " the liability of the owner in respect of such claim " mean the liability in respect of the claim admitted in terms of Section 23(4), and it is only to that extent the liability stands discharged and not any further. The discharge under the section has, therefore, no effect upon any claim which has been rejected in part or whole, and, in regard to any such claim, the remedy against the owner has to be pursued outside the statute. Section 25 says that any balance left with the Commissioner out of the moneys paid to him in relation to the undertaking, after meeting the liabilities specified in the Second Schedule, must be disbursed by him to the owner, provided the Commissioner is satisfied as to the right of such person to receive the whole or any part of the amount. In the event of any doubt or dispute as to his right, the matter has to be referred by the Commissioner to the competent court and the Commissioner shall make the disbursement in accordance with the decision of that court.

25. Section 27 refers to assumption by the Central Government and discharge by the National Textile Corporation of the liability of the owner arising in the post-take-over management period out of any items specified in category I of the

Second Schedule which refers to loans advanced by a bank or any other institution, or any other loan or credit availed of for the purpose of trade or manufacturing operations.

26. It is significant that the only liability of the owner which is assumed by the Central Government and discharged by the National Textile Corporation is the liability which arose subsequent to the take-over of the management under the 1951 Act (which in the present case was on July 14, 1972) as provided u/s 27 in respect of the loans and credits of category I, and also in respect of the loans and amounts advanced by the Central or State Government or the National or State Textile Corporation mentioned in Section 5(2) read with Section 4(6). (We are told that the present claim includes a sum of Rs. 2,000 which pertains to the post-take-over management period). Every other liability of the owner, to the extent to which it is not admitted for disbursement under Chapter VI, remains undischarged under the Nationalisation Act, and in respect of the same, the owner is liable to be proceeded against by the claimant in accordance with the general law.

27. Section 35 is apparently meant to protect the interest of the creditors whose claims are not admitted in terms of the Act. It provides that a textile company specified as the owner in the First Schedule shall not be wound up except with the consent of the Central Government.

28. These and other provisions of the Nationalisation Act indicate that, apart from nationalising, reorganising and rehabilitating a sick textile undertaking, the object of the Act is to equitably distribute the compensation due to the owner among the various claimants in accordance with the prescribed priorities and pay only the balance, if any, to the owner. In this respect, these provisions, though not identical, are in some ways akin to the provisions of the Insolvency Act, 1956 (Act 2 of 1956). We must, however, hasten to add that while the insolvent is, with certain specified exceptions, released fully from all debts provable under the Insolvency Act, the discharge of the owner under the Nationalisation Act is only to the extent to which claims against him are admitted and he continues to remain liable under the contract for the rejected claims, and can, therefore, be sued for the undischarged debts.

29. 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 Bos & P 61, 62 (cited in [1947] 63 LQR 355; *Ex parte Jacobs*, *In re Jacobs* [1875] LR 10 Ch App 211; See Rowlatt, *op ctt.* p. 173. The same is the position in liquidation proceedings. The dissolution of a company does not release the surety : See the principles stated in *Ex parte Jacobs*: *Jacobs*, *In re* [1875] LR 10 Ch App 211; *London Chartered Bank of Australia*, *In re* [1893] 3 Ch 540, 546-547; *Fitzgeorge*, *In re*: *Ex parte Robson* [1905] 1 KB 462; *Garner Motors Ltd.*, *In re* [1937] 1 All ER 671 and *Jagannath Ganeshram Agarwala Vs. Shivnarayan Bhagirath*, . In both these

events, the principal debtor is released personally. The creditor's right to sue is converted into a right to prove and he thus retains his nexus, though of a different character, with the principal debtor which can be enforced (see *Stremitt Industries Ltd. v. Gardner* [1970] 92 WN (NSW) 435. The insolvency of an individual (or the liquidation of a company) thus results in a release of the principal debtor, and the creditor's rights against him are transformed into rights against his assets: see [1947] 63 LQR 355 "The debtor's possible inability to perform the principal obligation is the creditor's motivation for asking for a guarantee and the guarantor 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." (*Moscki v. Lep Air Services Ltd.* [1973] AC 331 356 H (HL): See *Johan Steyn* [1974] 90 LQR 246, 264. As stated by Jordon C. J.:

" 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."

30. *Insurance Office of Australia Ltd. v. T.M. Burke P. Ltd.* [1935] 35 SR 438 442-443 (quoted in [1947] 63 LQR 355. 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 remains unaffected. To that extent, the liability of the surety remains unimpaired.

31. There is no merit in the contention that the Nationalisation Act has extinguished 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. His liability in respect of the balance amounts remains unimpaired: See *Anand Kumar v. Dhani Ram* ILR (1978) P&H 329.

32. 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: *Bank of Bihar Ltd. Vs. Dr. Damodar Prasad and Another*, ; and *Jagannath Ganeshram Agarwala Vs. Shivnarayan Bhagirath*, , 249. On payment, the surety will be subrogated to the rights of the creditor as against the principal debtor, and he will also be entitled to enforce the implied promise of the principal debtor to indemnify him and thus recover from the principal debtor whatever sum the surety has rightfully paid under the guarantees (see Sections 140, 141 and 145 of the Contract Act). Furthermore, when there is an actual accrued debt and the surety is liable and admits liability for the amount guaranteed, he has a right to compel the principal debtor to relieve him from his liability by paying off the debt: *Ascherson v. Tredegar Dry Dock and Wharf Co. Ltd.* [1909] 2 Ch 401.

33. It is true that the plaintiff has not appealed against that part of the decree

rejecting its claim against the first defendant. But the claim was not rejected on merits, but on the sole ground of the alternative remedy available under the Nationalisation Act. Consequently, as pointed out by the Supreme Court in *Daryao and Others Vs. The State of U.P. and Others*, 1466, a rejection solely on the ground of alternative remedy does not constitute a bar. In any event, such rejection does not debar the plaintiff's right of enforcing its claim against the sureties. Mere forbearance on the part of the plaintiff to sue the principal debtor, or to enforce its remedies against it by way of appeal, in the absence of any provision in the guarantee to the contrary, does not discharge the sureties (see Section 137 of the Contract Act: *P. Murugappa Mudaliar (dead) and Others Vs. Munusami Mudali and Others*, *Hata v. Smail* AIR 1932 Lah 414, *L. Khushal Chand v. Gattri Shankar* AIR 1935 Lah 906, *Bombay Dyeing and Manufacturing Co. Ltd. Vs. The State of Bombay and Others*, AIR 1939 110 (Privy Council)). In any view of the matter, the contract of guarantee, as we have noticed above, contains the necessary reservation of remedies against the sureties so as to keep them bound under the guarantee, notwithstanding the plaintiff's forbearance or omission to challenge the decree by an appeal or cross-objection. Furthermore, the sureties can themselves "set the law in operation against the debtor": per Lindley LJ. *Carter v. White* [1883] 25 ChD 666, 672. Accordingly, we see no merit in the contention that the plaintiff is debarred from enforcing its claim against defendants Nos. 2 and 3 in terms of the contract.

34. Story points out in his *Commentaries on Equity Jurisprudence*, 2nd edition", 1892, page 215:

"...The contract of suretyship imports entire good faith and confidence between the parties in regard to the whole transaction..., the creditor is, in all subsequent transactions with the debtor, bound to equal good faith to the surety;...

.....if a creditor does any act injurious to the surety or inconsistent with his rights, or if he omits to do any act, when required by the surety, which his duty enjoins him to do, and the omission proves injurious to the surety, in all such cases the latter will be discharged, and he may set up such conduct as a defence to any suit brought against him in equity."

35. This principle of justice and equity, in our view, must necessarily guide the subsequent conduct of the creditor. We are told by the plaintiff's counsel that the claim filed by the bank under the Nationalisation Act is still pending disposal. Accordingly, we are of the view that, in executing the decree appealed against, credit shall be given to the sureties of any amount which the plaintiff might realise in terms of the Sick Textile Undertakings (Nationalisation) Act, 1974. The decree is accordingly modified and its execution shall stand postponed to the final disposal of the plaintiff's claim pending before the authority under the said Act. Subject to this modification, we confirm the decree and dismiss the appeal. We do not, however, make any order as to costs.