

MAHARASHTRA STATE ELECTRICITY BOARD,
BOMBAY,

v.

OFFICIAL LIQUIDATOR, HIGH COURT,
ERNAKULAM, ANR.

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October 13, 1982

[E.S. VENKATARAMIAH AND V. BALAKRISHNA ERADI, JJ.]

Companies Act, 1956—Company gave bank guarantee for supply of goods on tenders—Company ordered to be wound up—Appellant restrained from realising the amount of guarantee—Liability of bank—Nature of.

C

Contract Act—Bank gave guarantee for a company for supply of goods against tenders—Company ordered to be wound up—Liability of surety—Nature of.

D

The appellant Board invites tenders for the supply of goods. One of the terms of the tenders required the intending supplier of goods to pay earnest money and/or security to the Board along with the tender a sum approximately equivalent to 10% of the estimated price of goods tendered. But where an intending tenderer deposited a sum of Rs. 50,000 either in cash or in any form approved by the Board such as a Bank guarantee he could offer to supply goods of any value either under one or more tenders without complying with the above condition.

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In accordance with the terms of tender the company in liquidation offered a bank guarantee for a sum of Rs. 50,000 for supply of goods to the Board. As security for the guarantee, the Bank took from the company in liquidation a fixed deposit receipt and some quantity of imported zinc ingots and the Bank had certain rights in respect of these securities.

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In August, 1973 the Board called upon the Bank to pay to it the guarantee amount. In the meanwhile, however, the High Court ordered the winding up of the company in liquidation. The Bank then wrote to the Official Liquidator that the company in liquidation was liable to the Bank a large sum of money one of which was the sum of Rs. 50,000 demanded by the Board.

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On application by the Official Liquidator the company Judge issued an order restraining the Board from realising the amount from the Bank on the ground that since the Bank would have recourse to the securities given by the company in liquidation for realising the amount paid by it in accordance with the bank guarantee and that since such action of the Bank would affect the assets of the company in liquidation, it was not open to the Board to claim the amount of guarantee from the Bank except as a creditor in the winding up proceedings. A Division Bench of the High Court dismissed the Board's appeal.

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On the question whether the Board could recover from the Bank the sum of Rs. 50,000 according to the terms of the bank guarantee and what its effect would be on liquidation proceedings,

Allowing the Appeal,

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HELD : It was not open to the company Judge to make any order under the Companies Act 1956 prohibiting the Board from realising the amount guaranteed by the Bank as this had nothing to do with the assets of the company in liquidation. [568-D]

The terms of the document on the basis of which the Board has claimed the amount from the Bank constituted a contract of guarantee and not a contract of indemnity. [566-F]

C

The three transactions, namely (1) the bank guarantee, (2) the contract of supply between the Board and the Company in liquidation and (3) the document under which the Company in liquidation gave a fixed deposit receipt and some quantity of zinc ingots as security are independent of each other in so far as their legal incidents are concerned. [566-H; 567-A]

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In order to realise the guarantee amount of Rs. 50,000 all that the Board had to do was to make a demand, within 48 hours of which the Bank had to pay the sum to the Board. The Board was not required to prove any default on the part of the Company in liquidation. Nor could the Bank raise the plea that it was liable only to the extent of any loss sustained by the Board. The Bank's liability to pay the sum demanded by the Board was absolute and unconditional.

[567-C-D]

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The fact that the principal debtor had gone into liquidation would not have any effect on the Bank's liability as 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 section 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.

[567-D-F]

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Jagannath Ganeshram Aggarwala v. Shivnarayan Bhagirath & Ors., A.I.R. 1940 Bom. 247, approved.

In re Fitzegeorge Ex parte Robson, [1905] 1 K.B. 462, referred to.

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Punjab National Bank Limited v. Bikram Cotton Mills & Anr., [1970] 2 S.C.R. 462, held inapplicable.

On payment of the sum demanded by the Board it was open to the Bank to have recourse to the securities given by the Company in liquidation. The

Board was not concerned with what the Bank did to reimburse itself. It was the Bank's responsibility to deal with the securities held by it in accordance with law. [568 C]

CIVIL APPELLATE JURISDICTION: Civil Appeal No. 3182 of 1982.

Appeal by special leave from the Judgment and Order dated the 13th November, 1978 of the Kerala High Court in M.F.A. No. 145 of 1976.

B.S. Bhasme and *H.S. Parihar* for the Appellant.

K.N. Bhatt for Respondent No. 2.

A.S. Nambiar for the intervener.

The Judgment of the Court was delivered by

VENKATARAMIAH, J. This is an appeal by special leave under Article 136 of the Constitution against the judgment and order dated November 13, 1978 of the High Court of Kerala in M.F.A. No. 145 of 1976.

The facts leading to this appeal may be briefly stated thus: The appellant is the Maharashtra State Electricity Board (hereinafter referred to as 'the Electricity Board'). Cochin Malleables (P) Ltd. (in liquidation) (hereinafter referred to as 'the Company in liquidation') used to enter into contracts with the Electricity Board before it was ordered to be wound up by the High Court of Kerala to supply goods to the Electricity Board pursuant to tenders which were being issued from time to time. One of the terms usually found in such tenders was that the intending supplier of goods should pay as earnest money and/or security to the Electricity Board alongwith every tender a sum approximately equivalent to 10% of the estimated price of the goods in question. There was, however, a provision for exempting payment of such earnest money or security deposit in the case of those tenderers who would keep a permanent deposit of Rs. 50,000 either in cash or in any form approved by the Electricity Board and one such approved form was a bank guarantee to the tune of Rs. 50,000. The effect of such deposit of Rs. 50,000 made by an intending tenderer with the Electricity Board under this condition was that he acquired the privilege of offering his tender for the supply of goods of any value to the Electricity Board and of such tender being considered along-

A with other tenders made by others who had in the ordinary course paid 10% of the estimated cost of goods as security deposit as per the usual condition. Such privilege was available to him in the case of any tender that he might make as long as the deposit remained intact with the Electricity Board. In other words, on depositing a sum of Rs. 50,000 an intending tenderer could offer to supply goods of any value either under one or more tenders without complying with the condition which required him to deposit along with tender a sum equivalent to 10% of the estimated value of goods which he intended to supply. The security of Rs. 50,000 thus given did not relate to any specific tender but it was open to the Electricity Board to appropriate the whole or any part of it towards any amount due from the tenderer under any supply contract entered into during the relevant period. Any balance which remained unadjusted became refundable to the person who had made it on demand provided that there was no other subsisting liability towards which the said balance could be adjusted and on such refund being made the person ceased to enjoy the exemption from the requirement of making an earnest deposit in respect of any future tender. Any bank guarantee given by any such intending tenderer in lieu of the cash deposit of Rs. 50,000 was deemed to be equivalent to the cash deposit made on date of the guarantee and the Electricity Board could realise the bank guarantee amount or any part of it at its will on any day irrespective of whether any tender had been made by the person concerned during the period or not. On such realisation of the bank guarantee amount, the Electricity Board could deal with it in accordance with the terms of the contract as if the said amount had been deposited with it in cash on the date of bank guarantee. The liability of the bank which gave the bank guarantee under these terms was unconditional and did not vary according to the number of tenders offered, the value of the goods offered for sale under those tenders, and the defaults, if any, committed by the tenderer in the supply of goods.

G Pursuant to the above term, the Company in liquidation offered on September 1, 1966 a bank guarantee for a sum not exceeding Rs. 50,000 given by the Canara Bank Ltd. (now known as Canara Bank and hereinafter referred to as 'the Bank'). The relevant part of the said guarantee was as follows

H "THE CANARA BANK LTD.", hereby agrees unequivocally and unconditionally to pay, within 48 (Forty eight) hours, on demand in writing from the Maharashtra

State Electricity Board or any officer authorised by it in this behalf, of any amount upto and not exceeding Rs. 50,000/- (Rupees Fifty thousand only) to the said Maharashtra State Electricity Board, Bombay on behalf of M/s Cochin Malleables (Private) Ltd., Trichur, who have tendered and/or contracted or may tender or contract hereafter for supply of materials equipment or service to the Maharashtra State Electricity Board and have been exempted from payment of earnest money and/or security deposit against such tenders or contracts."

The original period of guarantee was one year. It was, however, extended from time to time and the guarantee was in force in the year 1973. On August 27, 1973, the Electricity Board called upon the Bank to pay the guarantee amount of Rs. 50,000. Thereafter reminders were sent and a final demand was made on May 23, 1974. In the meanwhile Company Petition No. 14 of 1973 was filed on July 30, 1973 on the file of the High Court of Kerala for the winding up of the Company in liquidation. By an order dated September 16, 1974 the High Court ordered the winding up of the Company in liquidation and directed the Official Liquidator to take charge of its affairs. In view of these proceedings the Bank wrote to the Official Liquidator on November 4, 1974 stating that the Company in Liquidation was liable to the Bank to the extent of Rs. 1,64,353.12 on two heads one of which was the sum of Rs. 50,000 demanded by the Electricity Board as per the terms of the bank guarantee referred to above. Thereupon, the Official Liquidator filed an application under section 456(2) of the Companies Act, 1956 read with Rule 9 of the Companies (Court) Rules, 1959 before the Company Judge praying for an order restraining the Electricity Board from realising the amount covered by the guarantee on the ground that since the Company in liquidation had been ordered to be wound up the Electricity Board could not claim the amount of guarantee from the Bank. The Electricity Board contended that the amount of Rs. 50,000 was not being claimed as a creditor of the Company in liquidation but on the basis of the bank guarantee, the liability under which was not affected by the liquidation proceedings. The learned Company Judge upheld the plea of the Official Liquidator and issued an order restraining the Electricity Board from realising the amount from the Bank on the ground that since the Bank would have recourse to the securities given by the Company in liquidation to the Bank for realising the amount paid by it in accordance with the bank guarantee and such

A action of the Bank would affect the assets of the Company in liquidation, it was not open to the Electricity Board to claim the amount of guarantee from the Bank except as a creditor in the winding up proceedings. An appeal filed by the Electricity Board before the Division Bench of the High Court was dismissed. This appeal is filed by the Electricity Board against the order of the Division Bench.

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After the petition for special leave was filed in this Court in July 1979, notice was issued to the Official Liquidator. He has written a letter to this Court stating that the High Court of Kerala has since sanctioned a scheme for reconstruction of the Company in liquidation by an order dated November 6, 1979, subject to certain conditions and that the winding up proceedings are directed to be kept in abeyance till December 31, 1982. He has further stated that he has handed over all the assets of the Company in liquidation to the new management as per directions of the High Court and that he has no funds to participate in these proceedings. The Managing Director of the Company in liquidation has entered appearance as an intervener and is represented by a counsel. The learned counsel for the intervener has been heard in this appeal. He has also filed his submissions in writing.

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The principal question which arises for determination in this appeal relates to the effect of the liquidation proceedings on the right of the Electricity Board to recover from the Bank the sum of Rs. 50,000 as per the terms of the bank guarantee. It cannot be disputed that the terms of the document on the basis of which the Electricity Board has claimed the amount from the Bank constitute a contract of guarantee and not a contract of indemnity. Under that document the Bank has undertaken to pay any amount not exceeding Rs. 50,000 to the Electricity Board within forty eight hours of the demand. The payment of the amount guaranteed by the Bank is not made dependent upon the proof of any default on the part of the Company in liquidation. It may be that in order to give the said guarantee, the Bank had in its turn taken as security from the Company in liquidation certain fixed deposit receipt and a certain quantity of imported zinc ingots and that the Bank had certain rights in respect of those securities. There may also be some claims or counter-claims arising out of the contracts of supply entered into between the Electricity Board and the Company in liquidation. But the transactions viz. (1) the bank guarantee executed by the Bank in favour of the Electricity Board, (2) the

contracts of supply entered into between the Electricity Board and the Company in liquidation and (3) the document under which the Company in liquidation had given a fixed deposit receipt and certain quantity of zinc ingots as security to the Bank for executing the letter of guarantee in favour of the Electricity Board are independent of each other in so far as their legal incidents are concerned.

Under the bank guarantee in question the Bank has undertaken to pay the Electricity Board any sum upto Rs. 50,000 and in order to realise it all that the Electricity Board has to do is to make a demand. Within forty eight hours of such demand the Bank has to pay the amount to the Electricity Board which is not under any obligation to prove any default on the part of the Company in liquidation before the amount demanded is paid. The Bank cannot raise the plea that it is liable only to the extent of any loss that may have been sustained by the Electricity Board owing to any default on the part of the supplier of goods i.e. the company in liquidation. The liability is absolute and unconditional. 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 section 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 Aggarwala v. Shivnarayan Bhagirath & Ors.*⁽¹⁾) See also *In re Fitzgeorge Ex parte Robson*⁽²⁾. 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. Bikram Cotton Mills & Anr.*⁽³⁾ 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.

(1) A.I.R. 1940 Bom. 247.

(2) [1905] 1 K.B. 462.

(3) [1970] 2 S.C.R. 462.

- A** The facts of this case are distinguishable from the facts in the case before us. As mentioned earlier the liability of the Bank to pay the amount as per the letter of guarantee did not depend upon prior proof of any default on the part of the Company in liquidation. Whether the whole of Rs. 50,000 should be demanded or any lesser sum should be demanded from the Bank was entirely within the choice of the Electricity Board. The Bank has, therefore, to pay the amount due under the letter of guarantee given by it to the Electricity Board. On such payment it is open to the Bank to have recourse to the securities given by the Company in liquidation for the purpose of the issue of the letter of guarantee. The Electricity Board is not concerned with what the Bank does in order to reimburse itself after making payment of the amount guaranteed by it. It is the responsibility of the Bank to deal with the securities held by it in accordance with law. It was not, however, open to the Company Judge to make any order under the Companies Act prohibiting the Electricity Board from realising the amount guaranteed by the Bank as this had nothing to do with the assets of the Company in liquidation. The order of the Company Judge and the Judgment of the Division Bench in appeal are, therefore, liable to be set aside and they are accordingly set aside.
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- E** Before concluding this judgment, we place on record the submission made on behalf of the Electricity Board that it is open to the Company in liquidation to prefer any claim arising out of the supply contracts as against the Electricity Board. It is also open to the Electricity Board to claim any sum that may be due to it under such contracts. In considering the above mutual rights and liabilities of the Electricity Board and the Company in liquidation the sum to be received by the Electricity Board from the Bank under the letter of guarantee will have to be taken into consideration and dealt with in accordance with the terms of the supply contracts.
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The appeal is accordingly allowed. No costs.

P.B.R.

Appeal allowed.