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Case Comment: Bank of Bihar v Damodar Prasad & Anr - Surety moving along with the Principal Debtor to Step into the Creditor's Shoes

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INTRODUCTION

The case *Bank of Bihar Ltd v Damodar Prasad & Anrs*¹ is a landmark judgment related to the contract of guarantee under the Indian Contract Act, of 1872 and liability of the surety and principal debtor against the creditor. As there was a contract of guarantee it was a tripartite agreement between the principal debtor, surety, and the creditor. Here the main question was of co-extensiveness of surety's liability in a contract of guarantee. Co-extensive means that, unless they previously agreed to it, the surety who has committed to cover the principal debtor's obligations in the case of default is only and only accountable for the amount for which the principal debtor is due.

This case also dealt with how the creditor can proceed in case of default by the principal debtor and the right, which the surety enjoys against the principal debtor when the surety has paid for the default of the principal debtor also known as the right of subrogation, which in simple

¹ *Bank of Bihar Ltd. v DR. Damodar Prasad & Anrs* AIR (1969) SC 297

language means surety stepping into the shoes of creditor. It gives all the powers available to the creditor which he/she can use against the principal debtor if he would have defaulted.

There are three separate agreements that have significant ties to one another in the guarantee contract. A 'Bond of Guarantee' binds the surety and creditor together. Subrogation is a right that the creditor has in the current situation that can be used to enforce the validity of the parties' agreement and the guarantee bond. Since all three parties are bound by the creditor's obligation, it is the responsibility of the surety to ensure that the principal debtor complies with the agreement; otherwise, the agreement is deemed to have been defaulted, and the surety's subrogation right becomes active.

PROCEDURAL HISTORY

- As per the procedure, the plaintiff (Bank) first approached the trial court with the contention that the creditor can ask for payment from the surety to pay the amount guaranteed even before the principal debtor in case of default. Here the contention of the plaintiff was dismissed by the learned trial court.
- Then the plaintiff against the above decision approached the Patna high court with the same contention but again the court dismissed the appeal without looking into the merits.²
- Again, the plaintiff filed an appeal against the decision of the Patna high court in front of the Honorable Supreme Court of India where three judges' bench of Justice S.M Sikri, R.S Bachwat, and K.S Hegde, gave the final verdict in this case on August 8, 1968.

FACTUAL MATRIX

- In this case, there was a contract of guarantee between the Bank of Bihar (plaintiff) the creditor, Dr. Damodar Prasad (Respondent No.1) the principal debtor, and the surety Paras Nath Sinha (Respondent No.2).

² Nilakhi Barman et al., 'Case- Commentary on Bank of Bihar Limited v Dharmdas Ghosh' (2019) 5 South Asian Law Review Journal <https://thelawbrigade.com/wp-content/uploads/2019/06/Nilakhi-Aradhya-Ashutosh.pdf?_gl=1*1by5vq1*_ga*MTE2MzE0ODQ1OS4xNjg1ODAyNTU5*_ga_77Y54C8SBH*MTY4NTgwMjU1OC4xLjEuMTY4NTgwMjU4MC4wLjAuMA..> accessed 26 April 2023

- The plaintiff bank lent a sum of Rs.12,000 to Damador Prasad (respondent 1) on a guarantee of Paras Nath (respondent 2) that he will pay in case respondent 1 defaulted with interest.
- The respondent no.1 defaults and the (plaintiff) bank asks for payment of debt but both parties deny it.
- On this, both the trial court and Patna high court held that the creditor should exhaust all his remedies against the principal debtor before going to the surety.
- Against the above decree, the plaintiff approached the Supreme Court where the final verdict was delivered.

RATIONALE: LEGAL PROVISIONS RELIED UPON BY THE COURT

The main contention in this case was of the Indian Contracts Act,1872 and the section which was in question or which was part of the court's judgment were as follows: -

Section 126 the contract of guarantee: is a contract where one party (surety/guarantor) promises the other party (creditor) to perform or discharge the liability in case of default by the third person (principal debtor).³

Section 128 Surety's liability: the liability of the surety is co-extensive with that of a principal debtor unless anything contrary appears to the contract.⁴

Section 140 Rights of Surety or Right of subrogation: When the principal debtor defaults in performance and the surety makes the repayment or performs for all that he was liable for, surety enters in the shoes of the creditor and has all rights which the creditor had against the principal debtor.⁵

Section 151 of the Civil Procedure Code, 1908 "saving of inherent powers of the court": "Nothing in this Code shall be deemed to limit or otherwise affect the inherent power of the

³ Indian Contract Act 1872, s 126

⁴ Indian Contract Act 1872, s 128

⁵ Indian Contract Act 1872, s 140

Court to make such orders as may be necessary for the ends of justice or to prevent abuse of the process of the Court”.⁶

ISSUE OF THE CASE

Issue 1: Whether there is a breach of contract that has caused loss to the plaintiff?

Issue 2: Whether the creditor can ask for payment from the surety in case of default even before exhausting rights against the principal debtor?

ARGUMENTS

Plaintiff Side

For Issue No.1 - In this, the petitioner argued that there was a breach by the defendants because the contract was to repay the loan and on the failure of defendant No.1, defendant No.2 have to pay as he gave the guarantee for repayment. And this has caused him injury.

For Issue No.2 - Here, it was contended that if the surety asks to go to the debtor first the reason for the guarantee would be defeated if the surety can be easily dissolved of liability.

Defendants Side

For Issue No. 1 - According to the defendants there is no breach of contract and the case is silent on this part.

For Issue No. 2 - In this surety (defendant No.2) has contended that since the principal debtor's estate is capable to repay the loan in case of default so the first thing the creditor should focus on the liquidation of the debtor's asset as surety's liability is secondary. And creditor should first try to recover from the debtor (defendant No.1).

JUDGEMENT OF THE CASE

As a result, the appeal was allowed, and the direction of the lower court was set aside where the creditor was first asked to exhaust his remedies against the debtor (defendant 1). And following observations were made for the respective issues.

⁶ Civil Procedure Code 1908, s 151

For Issue No. 1 - Yes, there was a breach of contract by the principal debtor when on demand of repayment he refused to repay the amount lent to him, and when surety also declined to repay on non-performance/default of the principal debtor as the whole essence of the contract of guarantee was finished as the guarantee is a promise given by surety to perform the contract when principal debtor defaults or there is non-performance and the contract would be redundant if surety can be easily cut off. On this, the plaintiff here suffered the loss of money lent to the defendant.

For Issue No. 2 - Yes, as per the court judgment creditor can ask for payment from surety before the principal debtor and surety has no right to dictate his terms to the creditor.

Dicta - Here, the court also stated that after the surety has been paid or performed on behalf of a principal debtor when he/she defaults he always has a remedy to recover from the debtor, as per section 140 of the Indian Contracts Act, 1872 on payment the surety comes in shoes of creditor and he can seek all remedies which a creditor has against the debtor.

ANALYSIS OF THE CASE

In this case, finally, the Hon'ble Supreme Court allowed the appeal of the petitioner that is Bank of Bihar and overruled the decision of lower courts wherein they held that the Bank should first exhaust their remedies against the principal debtor in case of default and then approach the surety. The trial court did not properly consider the ramifications of the decision it made and the subsequent direction, as a result of which the objective of the guarantee contract and the right of subrogation provided in Section 140 of the Indian Contract Act, 1872 have been violated. If the creditor first exhausts his or her remedies against the principal debtor, the objective to preserve the creditor's amount is futile and the surety becomes passive towards liability. The high court showed no interest in the decision and merely supported the trial court's position and arguments; it didn't even consider the case's merits. This demonstrates how unconcerned the judiciary is with the provisions, laws, and decisions of the lower court should be interpreted as well as with the interests of the litigant and the other parties involved. I observed that courts in India are a little sluggish in their interpretation of the case's provisions, especially the lower

courts, who showed little interest in taking a thorough look at the precedent and the requirements.

The Supreme Court rightly held that it is wrong that the surety dictates the term of surety as the sole purpose of the contract of guarantee formed was to give security to the creditor from any default from the debtor's side and when it is time to secure the creditor from any losses which he may incur in case of default he is simply cutting off his liability towards him by saying his liability is secondary and the creditor should recover from debtor's estate when he is solvent. By this, the surety is defeating the purpose of the contract of guarantee itself.

In the judgment, there were more cases cited like *Wright v Simpson*⁷ and *Lachman Joharimal v Bapu Khandu and Surety Tukaram Khandoji*⁸ where it was held 'that a creditor is not bound to exhaust his remedy against the principal debtor before suing the surety and that when a decree is obtained against a surety, it may be enforced in the same manner as a decree for any other debt'.

Court also mentioned about 'right of subrogation' which also protected the interest of surety (defendant No.2) by giving him the rights of the creditor.

This case was again cited in a case *V. Velayudhan v State Bank of India*⁹ of Kerala high court, where one of the respondents took a loan from the bank and another respondent gave surety for the same, on the death of the first respondent's bank asked the surety to pay on which he asked the bank to first recover it from his estate or legal heirs in which the hon'ble court reiterated thus judgment and said the bank can proceed in any way he likes and surety has no right to dictate. One more case based on almost the same facts again appeared in the court *State Bank of India v G.J. Herman and Ors.*¹⁰ Again the stand taken in the case of *Bank of Bihar v Damodar Prasad* was reaffirmed.

⁷ *Wright v Simpson* [1902] 200 Ill 56

⁸ *Lachman Joharimal V Bapu Khandu* (1869) 6 Bom 241

⁹ *V Velayudhan v State Bank of India* (1988) Ker 38

¹⁰ *State Bank of India v G J Herman and Ors* (1998) Ker 161

CONCLUSION

With this I conclude that this was a landmark judgment as far as I have analyzed the case, it cleared the question of what are the rights of creditors to claim compensation from surety as in section 128 of the Indian Contracts Act also the word used is 'co-extensive' which means that liability of surety and principal debtor must go hand in hand it is not that liability of debtor is not of surety, and surety has no right to direct creditor how to proceed.

It also stated what are the rights of surety against the debtor once he has paid or performed on his behalf. It doesn't leave the surety at a loss as he then gets the right that creditors can exercise against a debtor and get it enforced.

Though initially the trial court and Patna High court took a very vague stand regarding the right of the creditor plaintiff they didn't consider the real question of law instead simply upheld the decision of the trial court, just considering the sections in which creditor i.e., plaintiff has to first exhaust all his remedies against debtor then move to surety as it contradicted Section-128 of the Indian contract act itself.

All these drawbacks were rectified by the Hon'ble Supreme Court, because in their judgment it considered the interpretation of the sections and also gave remedy so that no party is at loss with Section-151 of the Civil Procedure Code, 1908¹¹. But here the court could also have applied Section-145 of the Indian Contracts Act, 1872¹² which states that it is an implied promise by the principal debtor to indemnify the surety in case he pays/act for his default along with Section-140¹³ of the same act.

¹¹ Civil Procedure Code 1908, s 151

¹² Indian Contracts Act 1872, s 145

¹³ Indian Contracts Act 1872, s 140