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CASE ANALYSIS: STATE BANK OF INDIA V. PREMCO SAW MILL 1983

~ K Chakra Pani

INTRODUCTION

A contract of guarantee is one of the special types of contracts mentioned in the Indian Contract Act 1872 (hereinafter referred to as 'the Act'). This is different from a contract of indemnity and a contract of loan. While in the contract of indemnity, there are only two parties which are Principal Debtor and Surety, the contract of guarantee is a tripartite agreement i.e., there are three parties to the contract: Principal Debtor, Creditor, and Surety. The surety guarantees the repayment of the liability to the creditor in case of default on part of the debtor.

There is an implied agreement between the principal debtor and surety. The surety guarantees on behalf of the principal debtor, and there must be a consideration for the same. This consideration can be seen in two ways: consideration by the principal debtor, or consideration by the creditor. Consideration by the principal debtor is covered under section 145¹ of the Act, which indemnifies the surety for any rightful charges paid on behalf of the principal debtor. Although this is implied, it can be said that the principal debtor is bound to compensate the surety for the guarantee of payment, and subsequent payment, to the creditor. Consideration by the creditor is provided under section 127² of the Act. This section provides that the creditor's promise to fulfil their contractual obligation is sufficient consideration for the surety to give a guarantee on behalf of the principal debtor. As a consideration for the surety's guarantee, the creditor promises their performance of the contract.

¹ Indian Contract Act, 1872, Sec 145, No. 9, Acts of Parliament, 1872 (India).

² Indian Contract Act, 1872, Sec 127, No. 9, Acts of Parliament, 1872 (India).

The case of **State Bank of India V. Premco Saw Mill**³ being analysed is about consideration for the guarantee, and critically analysing the court's ruling along with the law applied.

FACTS OF THE CASE

In the present case, Defendant i.e., the business firm through its proprietor had availed credit from Plaintiff i.e., State Bank of India, for purposes of factory pledged machinery and book debts. The credit was due in October 1975. Plaintiff had sent notice to Defendant calling upon them to pay, or else Plaintiff would proceed with the properties pledged against the credit. The defendant had got her husband i.e., the second Defendant, as surety, and he had guaranteed the payment of the credit in case of default by the first Defendant. Promissory notes were issued in favour of Plaintiff, and a guaranteed bond was signed by the second Defendant i.e., the guarantor. When the notice was sent to pay the loan amount, the second Defendant contended that he was not liable to pay for the amount as he had entered as a surety after the loan amount had been taken and that his signatures on the guaranteed bonds were taken by fraud by the Plaintiff.

A case was filed before the City Civil Court by the Defendants. The lower court ordered in favour of the Defendants that he was not liable to pay for the loan amount and would be liable only for amounts subsequent to the guaranteed bond. The Bank appealed before the Gujarat High Court challenging this order.

ISSUES RAISED

Whether the second Defendant was liable to pay for the loan availed by the first Respondent as a surety and guarantor?

LAWS APPLICABLE

Sections 126 and 127 of the Indian Contract Act. Other provisions regarding the contract of guarantee.

ANALYSIS OF THE COURT

The High Court focused on issues and contentions that the guarantor was fraudulently made to sign blank papers in the name of a guarantee bond by the Plaintiff. The Court rejected this

³ SBI v Premco Saw Mills, AIR 1940 Oudh 346.

contention and held that the surety is liable to pay for the loan amount. It was also contended that Plaintiff would forbear from taking action against the Respondents. The notice of such forbearance was also issued. The Court noted that forbearance from proceeding with legal action is a valid consideration for a surety's guarantee. The consideration for a contract cannot be one of the terms of the contract. The Court thus held that the surety is liable for the loan amount even though he was had a party to the contract after taking the loan amount.

CRITICAL ANALYSIS OF THE JUDGEMENT

The fundamental principle covering such cases is that a contract needs offer and acceptance along with consideration i.e., consideration is a necessity in any contract, although there are exceptions to it. But in a contract of guarantee, under Section 127, there must be some consideration for the providing of guarantee by the surety. Section 127 reads as follows:

“Anything done, or any promise made, for the benefit of the principal debtor, may be a sufficient consideration to the surety for giving the guarantee.”⁴

The emphasis is placed on ‘anything done’ and ‘any promise made’. This signifies that an act which is a past or a future event (done or promised) is sufficient consideration for the surety to give a guarantee. Although it is considered that an act must be done in the future to be considered as consideration, past consideration is a concept which has limited scope and applicability. In the present case, the consideration can be seen in two ways: the loan given by the Plaintiff i.e., the past consideration, or the forbearance from pursuing the legal route for repayment of the loan i.e., future consideration. The doctrine of past consideration is criticized by the renowned commentaries on Contract Law by Pollock and Mulla, and this judgement gives a very distinct and significantly different interpretation to the phrase ‘anything done’ in the provision. This interpretation does not align with the basic doctrine of past consideration and present acts. It is found more suitable and easier to understand that the forbearance from filing a legal case is a better and easier way to understand consideration for the surety's guarantee.

The consideration is usually in the future or present. In this case, Plaintiff had threatened the First Respondent with legal action if there is a default. On the entry of the surety i.e., the Second Respondent, there was a guarantee bond signed, and that the plaintiff would not initiate legal proceedings against the respondents provided that the amount is paid in the case of behalf. For

⁴ Indian Contract Act, 1872, Sec 127, No. 9, Acts of Parliament, 1872 (India).

the surety's guarantee, the subsequent act of the Plaintiff to forbear from legal action is a sufficient consideration.

It also meets the condition 'for the benefit of the principal debtor'. The forbearance gives time for the debtor to repay the amount and prevent and avoid the worst circumstance of default in repayment. The delay in repayment allowed by the Plaintiff shows a sign of patience and gives a chance for the defendants to take suitable measures in repaying the debt. It gives extended chance and lifeline to the respondents and there is no threat to their property which is attached as security to the debt amount. The property would not be acquired or invoked by a pledge given to Plaintiff. This gives relief to the Respondents, and no stress and mental agony in repaying the debt amount. It also gives increased confidence and trusts in the parties involved. The Debtor has confidence that they can pay the amount on their own, the surety is confident that they are ready as a backup in case of default, and the Creditor is confident that the extended time gives leverage for the parties to take measures to fulfil their liability.

Although there may not be separate considerations for each agreement or clause in the contract, there can be past considerations for a surety's guarantee. The Court thus held that the plaintiff's act of not pursuing the compromised activity of taking over security and treating it as default is acceptable and sufficient consideration for the surety's guarantee. The act of issuing a promissory note in favour of the Plaintiff signifies the willingness of the surety to repay the amount in case of default. And as sufficient consideration, Plaintiff does not initiate legal proceedings.

CONCLUSION

The Court thus rightly held that while past consideration is acceptable, the future consideration to a surety's guarantee for the benefit of the principal debtor is sufficient. But it was enforced that there must be a consideration for the surety, whether it is past or future.

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