CRITICAL ANALYSIS OF SURETY'S RIGHT OF SUBROGATION WITH RESPECT TO AMRIT LAL VS STATE BANK OF TRANVANCORE

AUTHOR

Alena Singh

B.B.A LLB 2nd Year

BURNISHED LAW JOURNAL

INDEX

1. Abstract………………………………………………… 03
2. Introduction…………………………………………… 04
3. Literature Review………………………………………….. 06
4. Statement of Problem ………………………………………. 08
5. Rationale of Study …………………………………………. 09
6. Research Objective …………………………………………. 09
7. Research Questions …………………………………………. 09
8. Research Methodology……………………………………. 09
9. Main Content………………………………………………. 10
10. Legislative Framework, Committee Reports, Amendments etc… 13
11. Judicial Precedent. …………………………………… 14
12. Critical Analysis……………………………………….. 16
13. Suggestions…………………………………………… 17
14. Conclusion……………………………………………. 18
15. Bibliography……………………………………….. 19

BURNISHED LAW JOURNAL

Abstract

This research includes the aspects related to the subrogation and its uses in the contract of guarantee. This research widens the topic form its origin to its uses in the contract of guarantee and contract of indemnity. Subrogation is the right of the surety to get back his money from the principal debtor. Subrogation is a circumstance where an entity (Surety) is substituted into the place of another entity (the Principal) with regard to a claim or legal right of the Surety's Principal. As a result, the Surety will "step into the shoes" of its Principal and assume the Principal's claims, legal rights, and remedies.

The Surety promises the Project Owner that it will fulfil the contractual obligations of its Principal in the event the Principal defaults on a bonded contract.

Keywords: Subrogation, Guarantee, Surety

Introduction

To properly comprehend the Surety's right of subrogation, it is necessary to be familiar with the other features that it encompasses.

Subrogation is a legal notion in which one person assumes the rights or remedies of a creditor against his or her debtor. Subrogation rights can arise in two ways: automatically as a matter of law, or by consent as a component of the contract. Subrogation by contract is most typically found in insurance contracts. Subrogation is a legal notion that is part of a larger body of law known as unjust enrichment.

It is necessary to understand the Surety's right of subrogation. Insurance and sureties are the two most common areas where subrogation is used. The basic premise in each case is that when one person makes a payment on an obligation that is, in law, the primary responsibility of another party, the person making the payment is subrogated to the claims of the person to whom the payment was made with respect to any claims or remedies exercisable against the primarily responsible party.

For example, if a car owner has collision insurance on their car and the car is damaged by a negligent third party, if the car owner chooses to make a claim under his insurance policy, any claims made by the car owner against the negligent party will be transferred to the insurance company in jurisdictions that recognise the doctrine. Similarly, if a father guarantees his son's obligations to a bank and the bank chooses to call on the guarantee rather than directly claim against the son, then if the father pays out on the guarantee, he becomes subrogated to the bank's claims against the son. Subrogation can also be used to transfer property rights, such as a security interest or claim to ownership.

BURNISHED LAW JOURNAL

If a guarantor pays out a guarantee but the bank also has a mortgage on the debtor's house, the guarantor will be subrogated to the bank's rights as a mortgagee over the debtor's house. Subrogation is typically controlled in the terms of the applicable contract in the most prevalent areas where it occurs as a matter of law. Subrogation is sometimes misinterpreted and criticised by lay people on the grounds that payment under an insurance claim is merely a right based on their payment of insurance premiums and a notion that they should also maintain the ability to exercise any claims emanating from the insured occurrence.

The term subrogation is derived from the Latin words sub (neath) and rogare (to claim) (to ask). The denotative sense has been transformed from an asking, under the substitution or succession with regard to the right of payment. The origin and nature of the right of subrogation were established in Morgan v Seymore, which held that a surety who has performed the obligations of the principal that are the subject of his guarantee is entitled to stand in the shoes of the creditor and enjoy all the rights that the creditor had against the principal. This is what is considered to be a fair right. It is a right derived from the surety-creditor relationship.

Literature Review

- **ARTICLES**

Nishi Bhandari, International Journal of Advance Research and Development, Doctrine of subrogation and its uses in contract of guarantee, 2018[1]

This research includes the aspects related to the subrogation and its uses in the contract of guarantee. This research widens the topic form its origin to its uses in the contract of guarantee and contract of indemnity. Subrogation is the right of the surety to get back his money from the principal debtor. When a debt is paid off, the person who paid it off can take the place of the creditor. When subrogation is used, the surety usually goes after the main debtor. This can be a problem if the person the surety wants to subrogate against is not the main debtor of the suretyship contract but a third party who is not part of the contract.

Gregory R. Veal, Tort & Insurance Law Journal, Subrogation: The Duties and Obligations of The Insured and Rights of the Insured Revisited, 1992[2]

This article revisits subrogation by reviewing the number of the more recent decisions shaping the right. Subrogation is an equitable remedy that seeks to impose ultimate responsibility for a wrong or less on the party who, in equity, ought to bear it. Most of these decisions do not deal with insurance, but the cases that are on point demonstrate that the courts adopt determinative principles from numerous contexts, all of which are instructive.

Michael A. Stover, The Surety's Equitable Subrogation Rights and the UCC,2022[3]

The doctrine of equitable subrogation is based on the fairness principle that when someone who is secondarily liable pays the debt of someone who is primarily liable, the secondarily liable party gets all the rights and remedies of the creditor against the primarily obligated party whose share of the joint liability the secondarily liable party was forced to pay. The doctrine is not based on whether or not the parties have a contract or know each other. Instead, it comes from fairness and is based on natural justice principles.

- **BOOKS**

Avtar Singh, 2019, Contract & Specific Relief Act[4]

:

[4] Avtar Singh, Contract & Specific Relief Act, Pg. 657, (EBC,2019)

BURNISHED LAW JOURNAL

A surety has certain rights against the debtor, creditor and co-sureties. When the surety has paid all that, he is liable for he is invested with all the rights which the creditor had against the principal debtor. The surety steps into the shoes of the creditor. The creditor had the right to sue the principal debtor. The language of Section 140 which employs the words "is invested with all the rights which the creditor had against the principal debtor" makes it plain that even.

P C Markanda, 2018, The Law of Contract[5]

The surety bond contained a term that the surety shall abide by the terms thereof and that in the event of the creditor closing the account of the debtor and the debtor making the accounts payable by him under the accounts of the creditor did not mean that by the clause the surety had undertaken to guarantee the liability even in the event of the creditor adjusting or compromising its claim with the principal debtor without reference to him.

Moitra's, 2016, Law of Contract and Specific Relief[6]

The right of the surety to the benefit of the security held by the creditor is derived from the obligation of the principal debtor to indemnify the surety but a surety is not entitled to the securities which the creditor holds until he pays the entirety of the debt though not so in cases where the surety guaranteed part of the debt. A surety after the performance of his liability or making the payment, enters into shoes of the creditors and gets all the rights which he had against the principal debtor. This right of surety does not depend upon any contract. It is founded on equitable principle that he should be indemnified.

H.K. Saharay, 2018, Dutt on Contract[7]

Under the section a surety who pays off a debt guaranteed by him must be entitled to all the equities which the creditor could have enforced, not merely against the principal debtor but also against persons claiming under him. The section makes it perfectly clear that these rights accrue when the surety has done all that he is liable to do. If the surety does not pay the whole

<u>Statement of problem</u>

Even though a Surety might be entitled to the legal notion of equitable subrogation, there are a lot of situations in which the amount of money that is still owed on the contract won't cover

[5] Vol.2, P C Markanda, The Law of Contract, Pg. 1570, (LexisNexis, 2018)

[6] Vol.2, Moitra's, Law of Contract and Specific Relief, Pg. 1059, (Universal Law Publishing, 2016)

[7] H.K. Saharay, Dutt on Contract, Pg. 813, (Eastern Law House, 2018)

the expenses involved in finishing it. The overwhelming majority of judicial authorities agree that the UCC does not govern the surety's rights of equitable subrogation. This is due to the fact that the theory of equitable subrogation serves a function that is in line with its fundamental characteristics. The insurance company has the right to file a claim for compensation against the party who was responsible for the accident in order to recoup the money that was paid out to you as benefits. Another sort of subrogation is known as surety's subrogation rights, and it allows a person who has paid off the debts of another individual to be eligible for reimbursement of that money. The right to subrogation is typically stipulated in the insurance policy contract that is drawn up between the insurance provider and the insured party. There may be special clauses in the contracts that provide the insurance company the authority to begin the process of obtaining the person who injured the insured party to pay for the insurance claim. If there is such a clause, the insurance company has the right to do so.

BURNISHED LAW JOURNAL

Rationale of study

Though a Surety may be entitled to the legal theory of equitable subrogation, there are many cases where the amount of remaining contract balance will not cover the cost to complete. In light of the nature and the purpose of the doctrine of the equitable subrogation, the great weight of decisional authority holds that the surety's rights of equitable subrogation are not subject to the UCC. The insurance company can sue the person who caused the accident to get back the money it paid you in benefits. Another type of subrogation is surety's subrogation rights, which means that a person who paid off someone else's debts can get the money back. Most of the time, the subrogation right is written into the contract between the insurance company and the insured party. There may be special clauses in the contracts that give the insurance company the right to start the process of getting the person who hurt the insured party to pay for the insurance claim.

Research Objectives

The purpose of this research is

- To understand what is "Subrogation".
- To discern what is surety's right of subrogation.
- To analyse the Amrit Lal v. Bank of Travancore 1968 case in relation to subrogation.
- To study about the Surety's right of Subrogation

Research Questions

- What are the rights of the surety?
- How does the surety's subrogation work?
- Validity of Amrit Lal v. Bank of Travancore 1968 case with respect to surety's right of subrogation

Research Methodology

The methodology applied to carry out this research is doctrinal and analytical. In this research the primary source of information is the case study of Amrit Lal v. Bank of Travancore 1968 case, Section 141 of the Indian Contract Act,1872. The secondary sources comprises of articles, legal journals, websites, scholarly articles, print media, online journals, case comments and others were used in the research.

BURNISHED LAW JOURNAL

Main Content

Subrogation is derived from the Latin words *'sub'* (beneath) and *'rogare'* (to assert) (to ask). The denotative sense of a request has been modified as a result of the substitution or succession with respect to the entitlement to payment. Morgan v. Seymore established the genesis and nature of the right of subrogation, holding that a surety who has discharged the obligations of the principle that are the subject of his guarantee is entitled to stand in the creditor's shoes and enjoy all of the creditor's rights against the principal. This is an equity-based right. It is a right derived from the relationship between the surety and creditor.

The international dictionary defines subrogation as "the replacement of one person for another, especially a creditor for another; one person is entitled to enforce another's rights against the defendant." The disagreement arose as a result of the subrogation plaintiff's payment of a debt owed by the defendant for legitimate reasons.

Subrogation as defined under Marine Insurance Act, 1963 [8]

> *Where the insurer pays for a total loss, either of the whole, or in the case of goods of any apportion able part, of the subject- matter insured, he thereupon becomes entitled to take over the interest of the assured in whatever may remain of the subject- matter so paid for, and he is thereby subrogated to all the rights and remedies of the assured in and in respect of that subject- matter as from the time of the casualty causing the loss.*

BURNISHED LAW JOURNAL

How this right of subrogation arises

The following situations give rise to the subrogation right:

1. **Under tort**

   This is a violation of the rights of another. A person cannot commit a wrong by damaging another's property or by inflicting bodily harm on that person. If this happens, a cause of action accrues in favour of the victim and against the offender.

2. **Under Contract**

[8] Subrogation as defined under Marine Insurance Act, 1963

A violation of contract may be accompanied with a contractual responsibility to pay the aggrieved party. Obligation under the contract of affreightment and the contract of bailment, etc.

3. **Under statue**

Statues may also create liability, for making compensation, arising out of a breach thereof. For Examples: Factories Act, Occupies Liability Act, Carriage of goods by Sea Act, etc.

Surety's subrogation rights

To recover the money paid, the surety is subrogated to the creditor's prior claims and remedies against the debtor. This is a bill of exchange's endorsement. Regarding subrogation rights, the surety will likewise benefit from any security interest held by the original creditor. Even if the subrogee was uninformed of the subrogor's security rights, the subrogate will obtain them automatically. Therefore, it is improbable, at least in this field of law, that the right of subrogation is grounded on an implicit word.

Surety's right of subrogation can be better understood with respect to the case of Amrit Lal v. Bank of Travancore 1968. [9]The facts of the case are as follows:

On February 27, 1956, a partnership entered into a guarantee agreement with the former Travancore Forward Bank Ltd. Both sides agreed to open a Rs 1,000,000 cash credit account. This account was to exist until the bank liquidated it, and the bank secured the pledged property. In addition, the respondents agreed that the bank could legally sell or dispose of all of the firm's securities, either publicly through an auction or privately through a contract, and apply the proceeds to liquidating the firm's debt if the firm failed to repay the bank any debts owed to the bank upon demand.

In addition, it was agreed that if there was an outstanding sum on the debt, the bank would be authorised to apply any funds held to the respondents' credit to the repayment of the obligation. A clause in the agreement stipulated that the bank could at any time test the value of the commodities pledged by the respondent by weighing them, and that the respondent would bear the cost of such a test. When the respondents failed to repay the amount owed to

[9] Amrit Lal Goverdhan Lalan v. State Bank of Travancore and ors , 1968

the bank, the pledged goods were liquidated and the proceeds allocated to the respondents' debt.

The central contention in the case was that the pledged stock was initially valued at around 99,991 INR, but verification revealed a deficit of 35,690 INR. The respondents were given time to make up the gap, but they were unable to do so; after modifications, the total amount they owed the bank was 40,933 INR. As a result of the respondent's failure to pay, the bank filed litigation against the respondent and the appellant.

The appellant then argued that there had been a change in the terms of the contract regarding the value of the limit from 1,00,000 to 50,000 to 1,00,000 between the principal debtor and creditor; the only evidence supporting this contention was a handful of entries in the pages of the Bank's accounts referring to the "limit" as 50,000 INR. In addition, the appellant argued that he was uninformed of such a revision and, as a result, asked for release under Section 133 of the Indian Contract Act. In addition, the appellant asserted that the bank relieved him from liability by allowing the respondents time to make up the difference. Last but not least, the appellant asserted that since a portion of the security was disposed of without the consent of the surety, the appellant's duty was discharged to the extent of the value of the security so lost.

In India, the right of subrogation has been enunciated in Sections 140 and 141 of the Indian Contract Act, 1872. [11][12]

BURNISHED LAW JOURNAL

In Amrit Lai Goverdhan Lalan v. State Bank of Travancore, the Supreme Court ruled that the surety is entitled to every remedy the creditor had against the principal debtor; to enforce every security and every means of payment; to stand in the creditor's place; to have the securities transferred to him, even though there was no agreement to that effect; and to use all of those securities against the debtor. This right of assurance is established not only in the contract, but also in natural justice principles. Section 140's phrase "is invested with all the rights the creditor had against the principal debtor" makes it apparent that "the law vests these rights in the surety without the need for a transfer.

[11] Indian Contract Act 1872, Section 140
[12] Indian Contract Act 1872, Section 141

In Amrit Lai Goverdhan Lalan v. State Bank of Travancore, the Supreme Court made the following distinction between English law and Section 141:

"True, Section 141 restricts the surety's right to securities held by the creditor when he becomes his surety and modifies the English rule that the surety is entitled to securities given to the creditor both before and after the contract of guarantee. Section 141 includes the English law norm on the discharge of a guarantor when the creditor disposes of or loses the security held by him, subject to this alteration."

Legislative framework , Committee reports , amendment etc.

SECTION 140 OF THE INDIAN CONTRACT ACT, 1872 [13]

When a guaranteed debt becomes due or when the principle debtor fails to perform a guaranteed duty, the surety is vested with all of the creditor's rights against the principal debtor upon payment or performance of all that he is liable for**.**

SECTION 141 OF THE INDIAN CONTRACT ACT, 1872[14]

The Indian Contract Act of 1872, section 141, addresses claims against debtors. The surety has several rights against the creditor, such as the right to security, share reduction, and setoff. It states *"A surety is entitled to the benefit of every security the creditor held against the principal debtor at the time the contract of suretyship was executed, regardless of whether the surety was aware of the existence of such security or not; and if the creditor loses or disposes of such security without the surety's consent, the surety is discharged to the equities."*

SECTION 145 OF THE INDIAN CONTRACT ACT, 1872[15]

In every guarantee contract, the principal debtor implicitly agrees to indemnify the surety, and the surety is entitled to recover from the principal debtor any sum legitimately paid under the guarantee, but not any amount paid in error.

BURNISHED LAW JOURNAL

[13] The Indian contract Act, 1872 Section 140
[14] The Indian contract 1872, Section 141
[15] The Indian Contract Act 1872, Section 145

Judicial Precedent

CASE 1

State of Madhya Pradesh v. Kaluram 1967[16]

The Supreme Court's decision was based on Section 141 of the Indian Contract Act, which indicates that the department should not have enabled the Jagatram to destroy the forest without completing the necessary loan payment. Since the creditor was at fault, the surety cannot be held responsible for repaying the loan, as this action relieved him from his duty.

CASE 2

Rajappan v. Associated Industries Private Ltd. (1990)[17]

The Kerala High Court noted that the plaintiff had offered proof of the second defendant's adherence to the arrangement. The court concluded that the second defendant cannot be released from his obligations only on the basis that he did not sign the contract. Therefore, the contract of guarantee has three parties: the creditor, the major debtor, and the surety. It should not be necessary that only the signature establishes the formation of a contract; implicit behaviours may also be interpreted as permission.

CASE 3

Radha Kanta Pal v. United Bank of India Ltd. (1954)[18]

The case was in respect to the agreement. Rajnikant Pal (Deceased) came under a bond dated 8 August 1944 with Comilia Banking Corporation Limited (at the time of executing the bond) now known as United Bank of India after amalgamation in respect to appointing Nishikanta Pal as a cashier in the bank. The consideration of the bond was Rs 10,000.

CASE 4

M/S. Water Management India PVT. LTD. And Another V Suman Lata Saxena 2018[19]

---

[16] State of Madhya Pradesh v. Kaluram 1967 SCR (1) 266 (1966)
[17] Rajappan v. Associated Industries Private Ltd. (1990)
[18] Radha Kanta Pal v. United Bank of India Ltd. (1954)
[19] M/S. Water Management India PVT. LTD. And Another V Suman Lata Saxena 2018

This Regular First Appeal under Section 96 of the Code of Civil Procedure, 1908 (CPC) has been filed by two defendants in the suit against the judgement dated 22.11.2017 by which the Trial Court decreed the suit filed by the respondent/plaintiff and dismissed the counterclaim filed by the appellants/defendants. The respondent/plaintiff in the litigation has been awarded Rs. 18,10 lacs plus interest at a rate of 5% per annum simple. According to Section 140 of the Indian Contract Act of 1872, if the guarantor pays the creditor the amount owing by the principal borrower, the guarantor may seek reimbursement from the principal borrower. The appeal was denied because it lacked merit.

CASE 5

Sumitra Devi Shah V Tata Steel BSL Ltd. 2021[20]

The applicant cannot be declared as a secured creditor, and therefore, the Official Liquidator cannot be directed to disburse the funds to the applicant from the realized amount from the sale of the company in liquidation to the extent of the amount paid by the applicant to respondent No.2. Accordingly, this application fails, and it is dismissed accordingly.

[20] Sumitra Devi Shah V Tata Steel BSL Ltd. 2021

Critical Analysis

Subrogation is the act of substituting one entity (the Surety) for another (the Principal) in relation to a claim or legal right belonging to the Surety's Principal. As a result, the Surety will assume all of the principal's claims, legal rights, and remedies. When a contractor secures a performance bond, the surety can pursue the contractor for damages for the first time on the date the bond is signed. The surety must assume the performance contract in order to assert fair subrogation. The Surety has the right under contractual subrogation to recover monies from the Owner to cover the cost of making debt payments on behalf of its principal. Subrogation is still possible even if there is no clear agreement between the Surety and its Principal. The Surety provides the Project Owner with an additional guarantee in the form of the Performance Bond. A surety has the right to use any security the creditor has for the principal obligation at the time the contract for suretyship was executed. Subrogation is not a legal right in equitable courts, but doing the right thing is. For instance,

Your car was damaged one fine day after a careless driver collided with it. Now, the third party who hit your automobile is refusing to accept responsibility. You didn't have time to dispute, so you drove away in your wrecked car.

This is precisely where the subrogation procedure begins. You file a claim for the cost of damage to your covered vehicle while also transferring the legal right to reclaim the compensation amount from the third party who caused the harm. Following the settlement of your claim, your insurance will hold him/her liable for the harm and recover the cost of the damage.

BURNISHED LAW JOURNAL

Suggestions

- The subrogation right is often defined in the contracts that are negotiated between the insurance company and the party that is insured, as was discovered by the findings of the research that I completed for the assignment.
- There is a possibility that the contracts will include specific clauses that grant the insurance company the authority to initiate the process of recouping the payment of an insurance claim from the party that was responsible for the damages sustained by the insured party.
- This would be the case in the event that the contracts include such clauses.

Conclusion

The guarantee contract is distinct from other types of contracts. In the contract of guarantee, there are three parties instead of two, and this contract is formed particularly to safeguard the creditor from the default of the major debtor, which is not typical of other contracts. In typical types of contracts, there must be a consideration in exchange for performance of the act, but here there is no significant consideration; it is a promise to recover the loss caused to the creditor by the principal debtor's default.

BURNISHED LAW JOURNAL

Bibliography

- **ARTICLES**

- Samriddhi Tripathi – Right of a surety , 2022
- Khushboo Garg – Analysis of Section 144 of the Indian contract Act 1872 , 2021
- TSIB Team – What is Surety's Right of Subrogation ? , 2020
- Nishi Bhandari - Doctrine of subrogation and its uses in contract of guarantee,
- Aishwarya Sandeep – Case Brief : Amrit Lal v. State Bank of Travancore

- **BOOKS**

- Avtar Singh , Contract and Specific Relief Act , 13th Edition , ISBN : 9839388206044, 2019
- PC Makarchand , The Law of contract , 4th Edition , ISBN : 8131253945, 2018
- AC Moitra , Law of contract and specific relief , ISBN : 9789350357651 , 2016
- HK Saharay , Dutt on Contract , ISBN : 9788171773428 , 2018

- **CASES**

- State of Madhya Pradesh v. Kaluram 1967
- Rajappan v. Associated Industries Private Ltd. (1990)
- Radha Kanta Pal v. United Bank of India Ltd. (1954)
- M/S. Water Management India PVT. LTD. And Another V Suman Lata Saxena 2018
- Sumitra Devi Shah V Tata Steel BSL Ltd. 2021

BURNISHED LAW JOURNAL

BURNISHED LAW JOURNAL