ORIGINAL CIVIL.

Before Sir John Beaumont, Chief Justice, and Mr. Justice Kania.

1940 *March* 11

RAMCHANDRA B. LOYALKA (ORIGINAL DEFENDANT), APPELLANT *v.* SHAPOORJI N. BHOWNAGREE (ORIGINAL PLAINTIFF), RESPONDENT.*

Indian Contract Act (IX of 1872), ss. 124, 126, 125, 145—Contract between sub-broker and broker, whether one of guarantee or indemnity—Default of constituent—Right of broker to compromise suits against sub-broker.

The plaintiff (a sub-broker) introduced clients to the defendant (a broker) under an agreement of March 12, 1935, made between them in the following terms:—

"That I (the sub-broker) shall be answerable and responsible to you for all business secured by me from my constituents and to be answerable and responsible for the due payments by the constituents for all moneys due in respect of such business as you may from time to time transact at my request and I agree on demand to make good any default on part of my said constituents and also to pay all damages, costs .....that may be incurred by you or due to you by reason of such default.

It is agreed that I shall be entitled to get 50 per cent. return of brokerage for business secured by me."

On six of the constitutents having failed to pay the defendants the plaintiff wrote to the defendant on June 29, 1935, Exhibit B as follows:—

"At the foot of the account of clients introduced by me a total balance of Rs. 16,176-3-9 is due and payable to you from some clients.....

It is hereby agreed between us today that I should pay you the above said balance in the following way.

Please debit this amount to my account and in future credit whatever amount or amounts you realise from the above named gentlemen to my account towards the payment of the balance due to you."

Subsequently the broker (defendant) had without reference to the sub-broker compromised suits filed by him against three of his defaulting constituents and received smaller sums than was due from them.

In a suit by the sub-broker against the broker for accounts the question having arisen whether the sub-broker was not discharged from his obligation to the broker in respect of his defaulting constituent by reason of the suits against them being compromised without the knowledge and consent of the sub-broker:

Held (reversing Somjee J.), that the contract was a contract of indemnity within s. 124 of the Indian Contract Act and not one of guarantee within s. 126; that both under s. 135 of the Indian Contract Act and also under the express terms of the letter of June 29, 1935 (Exhibit B) the defendant was entitled to compromise the claims

* O. C. J. Appeal No. 25 of 1939: Suit No. 712 of 1938.

and that in the absence of any suggestion of any collusion or imprudent conduct on the part of the broker he was entitled to claim from the sub-broker the balance of the sums due from the defaulting constituents.

APPEAL from the decision of Somjee J. Suit for accounts.

The facts material for the purpose of this report are fully stated in the Judgment of the Chief Justice.

On the construction of the two arguments set out in the head note Somjee J. observed as follows :—

"I hold that by the agreement of June 29, 1935, the plaintiff was not constituted a debtor to the defendant in the sum of Rs. 16,186-3-9 irrespective of the claims against the six constituents of the defendant and irrespective of the provisions of the agreement of March 12, 1935.....

"The defendant having settled his claims against H. E. P.; S. N. D.; and M. N. B.—(the three debtors) for smaller sums and having given up the remainder of his claims against them, I hold that the plaintiff as a guarantor is discharged from his liability to the defendant."

and in referring the matter to the Commissioner to take accounts declared :—

"That the defendant is not entitled to recover from the plaintiff anything in respect of his claims against H. E. Patel, S. N. Dubash and M. N. Billimoria."

The defendant appealed.

N. P. Engineer, with *F. J. Coltman*, for the appellant.

J. S. Khergamwalla, with *Sir Jamshedji Kanga*, for the respondent.

BEAUMONT C. J. This is an appeal from a decision of Mr. Justice Somjee. The plaintiff is a sub-broker and was employed as such by the defendant, who is a broker, on the terms of a contract, exhibit A, which was subsequently modified by exhibit B, to which documents I will refer in a moment. The plaintiff sues for an account of the commission payable to him under the agreements. The only substantial point, which appears to have been argued before the learned Judge and which has been argued on this appeal,

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is as to the liability of the plaintiff in respect of default made by the clients introduced by him. The learned Judge held that the plaintiff had been discharged from liability under circumstances which I will narrate in a moment, and the real question is whether that order is right. The learned Judge referred the matter to the Commissioner for taking accounts, and no doubt the matter will have to be referred to the Commissioner, and the only question before us is as to the basis on which these disputed items should be dealt with.

The contract, exhibit A, is in the form of a letter dated March 12, 1935; it is addressed by the plaintiff to the defendant and says:

"With reference to the business in shares, securities and other commodities which I have agreed to canvass from my constituents approved by you, and to introduce and place with or procure to you I hereby agree with you as follows:—

"That I shall be answerable and responsible to you for all business secured by me from my constituents and to be answerable and responsible for the due payments by the said constituents for all moneys due in respect of such business as you may from time to time transact at my request and I agree on demand to make good any default on part of my said constituents and also to pay all damages, costs, charges and expenses that may be incurred by you or due to you by reason of such default.

"It is agreed that I shall be entitled to get 50 per cent. return of brokerage for business secured by me."

That is a common form of sub-brokerage contract, under which the sub-broker gets fifty per cent. broker's commission, introduces constituents to the broker and is answerable to the broker for the performance by the constituents introduced of their obligations. Subsequent to the date of that contract certain constituents introduced by the plaintiff to the defendant made default, and on June 29, 1935, the plaintiff wrote another letter to the defendant, which is exhibit B. He says:—

"At the foot of the account of clients introduced by me a total balance of Rs. 16,176-3-9 (Rupees sixteen thousand one hundred and seventy-six annas

three nine pies) is due and payable to you from some clients the details of which are as follows:"

Then the letter sets out the names of six clients and the amounts due from them, making the total referred to. Then the letter goes on:

"It is hereby agreed between us today that I should pay you the above said balance in the following way: Please debit this amount to my account and in future credit whatever amount or amounts you realise from the above named gentlemen to my account towards the payment of the balance due to you."

Then, there is a provision for making good this liability out of half the fifty per cent. brokerage payable to the plaintiff. It appears that in the case of three of the constituents the defendant compromised the amount due for something less than the full figure, and we are told that the compromises were embodied in decrees of the Court. The compromises were arrived at without the consent of the plaintiff, and his contention is that as a guarantor he is thereby discharged from his obligations to pay the debts of those constituents.

The first question argued and decided by the learned Judge is whether the first document, exhibit A, is a contract of guarantee or a contract of indemnity. If it is a contract of guarantee, no doubt making a settlement with the principal debtor behind the back of the surety would discharge the surety. The learned Judge held that the contract was a contract of guarantee, but I am unable to agree with that view. We were referred to two English cases. *Harburg India Rubber Comb Company* v. *Martin*[1] and *Montagu Stanley & Co.*, v. *J. C. Solomon, Ltd.*[2] in which a very similar contract fell to be considered by the Court, and in both those cases the Court held that the contract was a contract of indemnity, and not a contract of guarantee, within the meaning of s. 4 of the Statute of Frauds which requires

[1] [1902] 1 K. B. 778.

[2] [1932] 1 K. B. 611.

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that a contract to answer for the debt, default or miscarriage of another shall be in writing. The ground on which the English Courts based their decisions was that under a contract of this nature the guarantor is not interested solely in the guarantee, he is interested in the subject-matter of the contract, because he is getting substantial payments under the contract, and therefore the contract is one of indemnity and not of guarantee.

Apart from that, I think that the contract is a contract of indemnity within the meaning of the Indian Contract Act. Section 124 defines a contract of indemnity as being a contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person. This contract seems to me clearly to fall within the terms of that definition. The promisor is agreeing to save the promisee from loss occasioned by the conduct of the constituents introduced. On the other hand, a contract of guarantee is defined in s. 126 in these terms :

> "A 'contract of guarantee' is a contract to perform the promise, or discharge the liability, of a third person in case of his default. The person who gives the guarantee is called the 'surety'; the person in respect of whose default the guarantee is given is called the 'principal debtor', and the person to whom the guarantee is given is called the 'creditor'."

It is I think true that a contract might fall within both those definitions, but it is clear from s. 126 that a contract of guarantee involves three parties,—the creditor, the surety and the principal debtor—, and I agree with the view taken by the Madras High Court in *Periamanna Marakkayar* v. *Banians & Co.*[1] that a contract of guarantee involves a contract to which those parties are privy. Of course, the contract need not be embodied in a single document, but I think there must be a contract or contracts to which the three parties referred to in s. 126 are privy. There

[1] (1925) 49 Mad. 156.

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must be a contract, first of all, between the principal debtor and the creditor. That lays the foundation for the whole transaction. Then there must be a contract between the surety and the creditor, by which the surety guarantees the debt, and no doubt the consideration for that contract may move either from the creditor or from the principal debtor or both. But if those are the only contracts, in my opinion, the case is one of indemnity. In order to constitute a contract of guarantee there must be a third contract, by which the principal debtor expressly or impliedly requests the surety to act as surety. Unless that element is present, it is impossible in my view to work out the rights and liabilities of the surety under the Indian Contract Act. Section 145 provides that in every contract of guarantee there is an implied promise by the principal debtor to indemnify the surety. It is impossible to imply a promise by the principal debt or to indemnify the surety, unless the principal debtor is privy to the contract of suretyship. A promise cannot be implied against a stranger to the transaction of guarantee. Again, the right of a surety to call upon the principal debtor to discharge the debt of the creditor which has become due,—a right which is referred to in Mulla's note to s. 145 of the Contract Act, and is illustrated by the English case there referred to, *Ascherson* v. *Tredegor Dry Cock and Wharf Company, Limited*,[1] cannot be worked out, unless the principal debtor has authorised the contract of suretyship. Unless he has done that, the surety is not in a position to compel the principal debtor to pay the debt. In my view, therefore, exhibit A is a contract of indemnity and not a contract of guarantee; the principal debtors, namely the constituents introduced by the plaintiff not only knew nothing of the alleged guarantee, but were unascertained when the contract was made.

[1] [1909] 2 Ch. 401.

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But even if I am wrong on that point, I feel no doubt whatever that under exhibit B the plaintiff is liable to pay the whole amount of Rs. 16,176 therein referred to. Exhibit B is, I should say, neither a contract of guarantee nor a contract of indemnity. It is a contract to pay an agreed sum ascertained, I will assume, as the amount due on a contract of guarantee. I can see no answer on the part of the plaintiff to a suit against him for payment of the agreed amount. No doubt, had such a claim been made against him, he would have been entitled to require the defendant to assign to him the debts covered by his contract, and if the creditor had compromised some of those debts without consulting the plaintiff, the plaintiff might have challenged the compromise. But he would then have to show that he had suffered loss by reason of the compromise, and that he has not done. *Prima facie* under s. 135 of the Indian Contract Act and also under the express terms of exhibit B, I am of opinion that the defendant was entitled to compromise the claim. Exhibit B refers to his giving credit to the plaintiff for whatever amount or amounts the defendant realized from the named clients. I think that implies a right to realize the amount in the ordinary course of business. There is no suggestion here of any collusion or imprudent conduct in arranging the compromise.

In my opinion, therefore, the defendant is entitled to claim as against the plaintiff the amount due under exhibit B, less the sums which he has actually received in respect of the debtors named in that document, and that amount will have to be set off against anything due to the plaintiff for sub-brokerage.

KANIA J. The relevant facts and documents have been summarised in the judgment just delivered by the learned Chief Justice. The question for consideration is whether the document of March 12, 1935, is a letter of guarantee

or of indemnity. Sections 124 and 126 of the Indian Contract Act state when a contract amounts to one of indemnity and when of guarantee. Section 126 in terms states that the contract of guarantee is a contract to perform the promise, or discharge the liability, of a third person in case of his default. That presupposes the existence of a named promisee, or the existence of the liability of a third party when the guarantee is offered. It does not contemplate an arrangement between two parties under which, in consideration of an amount to be paid by the promisee, the promisor agrees to indemnify him in respect of the promise of someone or the action of someone else as mentioned in s. 124.

Exhibit A in this case is the general arrangement made between the plaintiff and the defendant and shows that the plaintiff agreed to save the defendant from any loss which he would suffer by reason of the defendant effecting transactions at the request of the plaintiff. The general scheme is that the plaintiff agreed to be responsible for due payments in respect of transactions which were to be effected at his request, to make good any default and to pay the damages, costs and expenses that may be incurred due to such default. I, therefore, think that the very first element required to make it a contract of guarantee, when the letter of March 12, 1935, was passed, is wanting in this case. *Sutton & Co.* v. *Grey*[1] and *Montagu Stanley & Co.* v. *J. C. Solomon, Ltd.*,[2] where the contracts between the broker and a person who stood in the position of a sub-broker were in almost similar terms, decided that the contract was one of indemnity and not of guarantee. The test there laid down is where the sub-broker is interested in the transaction to be effected, apart from the fact that he had agreed to be liable, the contract is one of indemnity. There is nothing

[1] [1894] 1 Q. B. 285.

[2] [1932] 1 K. B. 611.

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to show that ss. 124 and 126 give a go-by to this distinction which has been so well recognized in England.

Periamanna Marakkayar v. *Banians & Co.*[1] was also relied upon by the appellant. It seems to me that in the absence of three parties, in which one is a principal debtor and another a creditor, unless the third party, who is the surety, agrees to make good the loss, the transaction is not complete. Individual contracts between the principal debtor and creditor, and between the creditor and surety, are not sufficient to spell out a contract of guarantee. There must be a third contract either expressly made or arising by the conduct of the parties by which the principal debtor agrees to satisfy the claim of the surety. If the surety satisfies the claim of the creditor without such contract, the action of the surety would be voluntary, and the debtor may repudiate all liability for the payment made by the surety, on the ground that he had never requested the surety to make any payment.

The second agreement in this case, moreover, completely defeats the plaintiff's claim. By that agreement the plaintiff agreed to be liable that day for the amounts mentioned in the document. He stipulated that the amount should be debited to his account that day. If that was done, the defendant was not obliged to do anything more nor take any steps against the six constituents whose names were mentioned in the letter. The only argument urged on behalf of the plaintiff is that by the compromise made by the defendant, with three out of the six constituents, his remedies against those three parties are lost. In the first place, this is no argument. His rights, if any, come into existence only when he makes the payment and not before. If he chooses not to make a payment for an indefinite time, there is nothing to prevent the defendant

[1] (1925) 49 Mad. 156.

from attempting to recover, as best as he could, the amount which the constituents had to pay. The writing, exhibit B, does not in terms deprive the defendant of that right. Indeed it contemplates the recovery of those amounts from the constituents by the defendant. If the plaintiff takes no steps and permits the claims to be time-barred, he could not blame the defendant. If, therefore, the defendant proceeded and got what he could, as a prudent man, it was not open to the plaintiff to challenge those transactions without showing that the compromise was not *bona fide* or was one which a prudent man would not enter into. The plaint in this case does not suggest that the compromise was imprudent in any way. The only ground on which the compromises were challenged was that the plaintiff did not consent to the same. But in law that does not appear to be necessary under the circumstances of the case.

I, therefore, think that the plaintiff's contention fails. I agree that the decree suggested in the judgment just delivered be passed.

PER CURIAM. We vary the Judge's order by striking out the first declaration, and in lieu thereof declare that the defendant is entitled to recover from the plaintiff the amounts shown in exhibit B against the names of H. E. Patel, S. N. Dubash and M. N. Billimoria, less the amount or amounts actually realized by the defendant from any of those persons. In other respects the order made by the Judge to stand.

The respondent to pay the costs of the appeal.

Attorneys for appellant: Messrs. *Madhavji & Co.*

Attorneys for respondent: Messrs. *Unwalla & Co.*

Appeal allowed: Order varied.

N. K. A.