



BANKING AND FINANCE

Discharge or Liability? The Supreme Court Clarifies the Extent of a Surety's Obligations Where the Principal Debtor Overdraws a Sanctioned Credit Facility

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I. Introduction

The law of guarantee, as codified under Chapter VIII of the Indian Contract Act, 1872, has long grappled with the tension between the legitimate recovery interests of creditors and the equitable protection owed to sureties who undertake obligations in good faith and within defined contractual limits. The judgment of the Supreme Court of India in *Bhagyalaxmi Co-operative Bank Ltd. v. Babaldas Amtharam Patel (D) Through Legal Representatives & Others*¹, constitutes a seminal contribution to this jurisprudential landscape. The decision conclusively resolves a long-standing interpretive dispute regarding the nature and extent of a surety's discharge when the terms of the principal contract are varied without the surety's knowledge or consent, and in doing so, firmly establishes that the discharge of a surety under Section 133 of the Act is neither absolute nor all-encompassing, but is strictly confined to transactions arising subsequent to the variance.

Prior to this ruling, there existed a degree of judicial ambiguity most acutely illustrated by the impugned judgment of the High Court of Gujarat as to whether a surety who has been exposed to a variation of the underlying contract could claim to be wholly absolved from all liability, including liability for obligations that were clearly within the contemplated scope of the original guarantee. The Supreme Court's unequivocal rejection of this *'all or nothing'* approach, and its affirmation of a principled, statute-mandated bifurcation of the surety's liability, renders this decision of considerable practical and doctrinal significance to banks, financial institutions, borrowers, guarantors, and legal practitioners alike.

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II. Factual Background and Procedural History

The genesis of the dispute lies in a cash-credit facility sanctioned by Bhagyalaxmi Co-operative Bank Ltd. (the appellant-Bank) on 30th October, 1993 in favour of M/s Darshak Trading Company (Respondent No. 6 the principal borrower), permitting a withdrawal of Rs. 4,00,000/- (Rupees Four Lakhs Only). As security for the facility, the mercantile goods belonging to the principal borrower were hypothecated to the Bank. Critically, Respondent Nos. 1 and 2 the respondent sureties executed formal contracts of guarantee in favour of the Bank, thereby undertaking personal liability for the repayment of the said loan in the event of default by the principal borrower. The ambit of their guarantee was, on the face of the contract, coextensive with the sanctioned facility of Rs. 4,00,000/-.

It was the Bank's case that Respondent No. 6, acting in connivance with certain employees of the Bank, proceeded to withdraw sums vastly exceeding the sanctioned limit of Rs. 4,00,000/-, without obtaining the consent of the sureties or otherwise amending the terms of the guarantee to reflect this expanded exposure. Upon default by the principal borrower, the Bank instituted Lavad Suit No. 181/1995 before the Board of Nominees, seeking to recover the sum of Rs. 26,95,196.75/- a figure representing the total outstanding dues inclusive of the overdrawn amounts together with interest, from both the principal borrower and the sureties jointly.

The Board of Nominees, by its judgment dated 9th July 2001, adopted a selective approach to the claim. It decreed the suit in its entirety against the principal borrower, directing recovery of Rs. 26,95,196.75/- along with interest at 21% per annum from 1st October 1994. However, it dismissed the suit as against Respondent Nos. 1 and 2 in their capacity as sureties, thereby vacating the restraint order that had been issued against their properties. Aggrieved by this partial relief, the Bank preferred an appeal before the Gujarat State Co-operative Tribunal in Appeal No. 552/2001.

The Tribunal, by order dated 31st January 2007, allowed the Bank's appeal to the extent of directing recovery of Rs. 4,00,000/- with applicable interest from the sureties, and simultaneously issued an injunction restraining them from alienating their immovable properties. This represented a jurisprudentially sound middle path holding the sureties liable for the amount originally guaranteed, while not extending their obligation to the overdrawn amounts. The respondent-sureties, dissatisfied with this outcome, challenged the Tribunal's order by filing Special Civil Application No. 17125/2007 before the High Court of Gujarat at Ahmedabad.

By the impugned judgment dated 25th June 2008, the High Court allowed the writ petition and set aside the Tribunal's order. The High Court reasoned that since the Bank had permitted Respondent No. 6 to overdraw amounts beyond the sanctioned limit a circumstance amounting to a variation of the contract made without the sureties' consent the sureties stood fully discharged. It further held that no bifurcation of the sureties' liability was legally permissible: the sureties were either liable for the entire amount deemed payable by the principal borrower, or they were not liable at all. This sweeping proposition, grounded in an interpretation of Section 139 of the Indian Contract Act, formed the basis of the Bank's civil appeal to the Supreme Court.

III. Issues for Determination

The Supreme Court identified the central issue for determination as follows: whether, on the facts of the present case, the respondent-sureties were entitled to complete discharge from their obligations under Section 139 of the Indian Contract Act, 1872, as contended by the respondents, or whether their liability continued to subsist albeit in a limited form in accordance with Section 133 of the Act, as contended by the appellant-Bank. Ancillary to this principal question was the issue of whether the High Court was correct in holding that a bifurcation of the sureties' liability between the originally sanctioned amount and the subsequently overdrawn amounts was legally impermissible, and that the sureties' liability, if any, had to be assessed on an all-or-nothing basis.

IV. Submissions of the Parties

A. Submissions on Behalf of the Appellant-Bank

Senior Counsel appearing for the appellant-Bank placed primary reliance on Section 133 of the Indian Contract Act, 1872, contending that the High Court had fundamentally mischaracterized the applicable legal framework. It was submitted that Section 133 expressly contemplates a scenario wherein the terms of the contract between the principal debtor and the creditor are varied without the surety's consent, and provides that in such circumstances, the surety is discharged but only as to transactions subsequent to the variance. Counsel emphasized that the statutory language admits of no ambiguity: the discharge of the surety under Section 133 is prospective in nature and does not affect the surety's liability in respect of obligations arising prior to the point of contractual variance.

In the context of the present case, Counsel argued that the sureties had clearly and knowingly contracted to guarantee the repayment of the originally sanctioned sum of Rs. 4,00,000/-. The act of permitting the principal borrower to overdraw amounts in excess of this limit constituted a variation of the contract made without the sureties consent. By operation of Section 133, the sureties were accordingly discharged from liability only in respect of the overdrawn amounts being transactions subsequent to the variance but remained fully bound by their contractual obligations with respect to the originally sanctioned sum. The High Court's *'all or nothing'* interpretation was characterized as legally untenable and contrary to the plain text of the statute.

B. Submissions on Behalf of the Respondent-Sureties

Counsel for the respondent-sureties relied upon Section 139 of the Indian Contract Act, 1872, in support of the High Court's conclusion. It was submitted that the Bank, as the creditor, had acted in a manner wholly inconsistent with the rights of the sureties by permitting the principal debtor to overdraw the cash-credit account to an extent far beyond the sanctioned limit, and had done so entirely without the knowledge or consent of the guarantors. This conduct, it was argued, fell squarely within the ambit of Section 139, which provides for the complete discharge of the surety where the creditor does any act inconsistent with the surety's rights or omits to perform a duty owed to the surety, thereby impairing the surety's eventual remedy against the principal debtor.

Counsel further contended that had the sureties been duly informed of the overdrawals, they would have been in a position to exercise their rights including the right to make timely payment and step into the shoes of the creditor against the principal debtor and to take stock of their potential financial exposure. In the absence of such disclosure, the Bank had effectively deprived the

sureties of the ability to protect their interests, thereby impairing their eventual remedy. On this basis, Counsel submitted that the sureties stood entirely discharged from their obligations and that the appeal deserved to be dismissed.

V. Case Laws Relied Upon

The Supreme Court undertook a comprehensive survey of the relevant judicial authorities to arrive at its conclusions. The decision in *Radha Kanta Pal v. United Bank of India Ltd.*², was examined for its elucidation of the conditions necessary to attract Section 139. The Calcutta High Court had observed therein that for Section 139 to operate, there must not only be an act or omission inconsistent with the rights of the surety, but it is equally essential that the surety's eventual remedy against the principal debtor is thereby impaired. The absence of such impairment, the court held, was fatal to the claim of discharge under that Section.

The factual parallel in *Bishwanath Agarwala v. State Bank of India*³, was particularly instructive. In that case, involving a comparable situation of overdrafts from a cash-credit facility beyond a guaranteed limit, the Jharkhand High Court held that the surety remained liable for the amount originally guaranteed Rs. 2,50,000/- in that case but was not bound by the overdrawn amounts, as the surety's discharge under Section 133 operated only prospectively from the point of variance.

The three-Judge Bench decision of the Supreme Court in *State Bank of India v. M/s Indexport Registered*⁴, affirmed the foundational principle that the liability of a surety is co-extensive with that of the principal debtor and that a creditor is not obligated to exhaust his remedies against the principal debtor before proceeding against the surety. In *Syndicate Bank v. Channaveerappa Beleri*⁵, it was observed that the nature and extent of a guarantor's liability is ultimately a function of the terms of the guarantee instrument, and that even a time-barred claim against the principal debtor may remain enforceable against the guarantor.

The Court also drew upon academic authority, including Chitty on Contracts (28th Edition, Volume 2) and Pollock and Mulla on the Indian Contract & Specific Relief Acts (16th Edition), to illuminate the scope and application of Sections 133 and 139. The classical English authority in *Bonar v. Macdonald*⁶, was cited for the proposition that any variance in the agreement executed by the surety, made without his knowledge or consent and which may prejudice him or amount to the substitution of a new agreement, will discharge the surety. The cardinal principle enunciated in *State of Maharashtra v. Dr. M.N. Kaul (D) by his LRs*⁷, that a guarantor must not be held liable beyond the terms of his engagement was also reaffirmed.

VI. The Court's Legal Analysis

The Supreme Court commenced its analysis with an authoritative exposition of the statutory framework governing suretyship under the Indian Contract Act, 1872. Chapter VIII of the Act, dealing with contracts of indemnity and guarantee, was examined in detail. The Court noted that Section 126 defines a contract of guarantee as a contract to perform the promise or discharge the liability of a third person in the event of his default, and identifies the three parties to such a transaction: the surety, the principal debtor, and the creditor. Section 128 establishes the foundational principle that the liability of the surety is co-extensive with that of the principal debtor, unless otherwise stipulated in the contract of guarantee. The Court then turned to Sections 133 to 139, which collectively govern the circumstances in which a surety may be discharged from his obligations.

With respect to Section 133, the Court articulated the principle that a surety cannot be bound by obligations which he did not originally undertake. Where the contract between the principal debtor and the creditor is varied without the surety's consent, the surety is effectively exposed to a risk which was never within the contemplation of the parties at the time the guarantee was executed. The legislature's response to this situation, as embodied in Section 133, is to discharge the surety but the discharge is carefully calibrated to operate only prospectively: the surety is relieved of liability in respect of transactions that arise subsequent to the variation of the contract. Transactions that preceded the variance remain within the compass of the original guarantee, and the surety's obligations in that regard are unaffected. The Court was emphatic that this statutory design reflects a considered legislative judgment that a bifurcation of the surety's liability between pre-variance and post-variance transactions is not merely permissible, but is expressly mandated.

Turning to Section 139, the Court explained that this provision is residuary in character and operates on altogether different principles. The Section provides for the discharge of the surety where the creditor either performs an act inconsistent with the surety's rights, or omits to perform an act which his duty to the surety requires, provided that such act or omission impairs the surety's eventual remedy against the principal debtor. The Court emphasised that both limbs of the condition must be concurrently satisfied. A mere showing that the creditor's conduct was inconsistent with the surety's rights is insufficient; it must

also be established that the surety's ability to seek recourse against the principal debtor upon discharging the guaranteed debt has been materially impaired as a result of the creditor's act or omission. Section 139, the Court observed, is designed to protect the structural integrity of the surety's subrogation rights, and not merely to penalise a creditor for any deviation from ideal conduct.

Applying these principles to the facts, the Court found that Section 139 had no application to the present case. While the Bank's act of permitting overdrawals beyond the sanctioned limit could, with some latitude, be characterised as inconsistent with the sureties' rights, the Court found no evidence that the sureties' eventual remedy against the principal debtor had been thereby impaired. The principal debtor M/s Darshak Trading Company, Respondent No. 6 remained identifiable and subject to legal process; the sureties, upon discharging their guaranteed obligations, retained their full right of subrogation against the principal debtor. There was no act by the Bank such as the release of securities, the granting of time without consent, or the improper relinquishment of assets that had diminished the surety's ability to recover from the principal debtor. The Court accordingly rejected the respondents' invocation of Section 139 as without merit.

The Court also robustly repudiated the High Court's 'all or nothing' reasoning. The proposition that sureties must either be liable for the entirety of the amount payable by the principal borrower or discharged from all liability was found to be directly contrary to the express terms of Section 133. The Section draws an unambiguous distinction between pre-variance and post-variance transactions, and to hold that a surety's discharge on account of a variance necessarily extends to obligations arising before the variance would be to read into the provision a meaning it plainly does not bear. Such an interpretation would, moreover, create perverse incentives enabling a principal debtor to unilaterally liberate guarantors from valid obligations by engineering a variation of the contract, to the manifest prejudice of creditors acting in good faith.

VII. Final Decision and Directions

The Supreme Court allowed the civil appeal and set aside the impugned judgment of the High Court of Gujarat dated 25th June 2008, passed in Special Civil Application No. 17125 of 2007. The Court held that the liability of the respondent-sureties, Respondent Nos. 1 and 2, was governed by Section 133 of the Indian Contract Act, 1872, and not by Section 139 thereof. Accordingly, the sureties were held liable to the extent of the originally sanctioned cash-credit facility of Rs. 4,00,000/- (Rupees Four Lakhs Only) together with applicable interest being the amount for which they had expressly undertaken liability under the contracts of guarantee executed in favour of the Bank. However, the sureties were held to be entirely discharged from liability in respect of the amounts overdrawn from the cash-credit facility in excess of the sanctioned limit, the same constituting transactions arising subsequent to the variation of the contract made without their consent. The parties were directed to bear their respective costs.

VIII. Concluding Observations

The decision in Bhagyalaxmi Co-operative Bank Ltd. v. Babaldas Amtharam Patel merits recognition as a jurisprudentially sound and practically significant contribution to the Indian law of suretyship. By firmly anchoring the discharge of a surety to the precise language and legislative intent of Section 133 of the Indian Contract Act, 1872, the Supreme Court has provided a principled and workable framework for adjudicating disputes that arise at the intersection of contractual variation and guarantee liability. The ruling offers clear and predictable guidance to all stakeholders: a creditor who permits overdrawals or otherwise varies the principal contract without the surety's consent does not thereby forfeit the right to enforce the guarantee in respect of the originally contemplated obligations, while the surety is afforded meaningful protection from exposure to liabilities he never agreed to underwrite.

The Court's careful delineation of the distinct spheres of operation of Sections 133 and 139 is equally commendable. By clarifying that Section 139 requires both an inconsistent act and a demonstrated impairment of the surety's eventual remedy and is not triggered by mere irregularity on the part of the creditor the Court has preserved the utility of the guarantee as a commercial instrument while ensuring that sureties are not left without recourse where their subrogation rights have been materially compromised. Taken together, these holdings reaffirm the abiding relevance of the principle that a guarantor's liability must be assessed strictly by reference to the terms of his engagement, and that the law will neither expand that liability beyond its contracted limits nor permit its wholesale extinguishment on grounds that do not satisfy the requisite statutory conditions.

For more details, write to us at: contact@indialaw.in

1. CIVIL APPEAL NO.3200 OF 2016 (Reported as 2026 INSC 205) ??

2. AIR 1955 Cal 217 [??](#)
3. AIR 2005 Jhar 69 [??](#)
4. (1992) 3 SCC 159 [??](#)
5. (2006) 11 SCC 506 [??](#)
6. (1850) 3 HLC 226 [??](#)
7. AIR 1967 SC 1634 [??](#)

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