State Bank of Hyderabad Vs Nagabhushanam and Another

Court: Andhra Pradesh High Court

Date of Decision: Dec. 7, 1984

Acts Referred: Contract Act, 1872 â€" Section 126
Negotiable Instruments Act, 1881 (NI) â€" Section 36

Citation: (1985) 2 APLJ 3 : (1986) 60 CompCas 740

Hon'ble Judges: A. Seetharam Reddy, J

Bench: Single Bench

Advocate: M.L. Ramakrishna Rao, for the Appellant; B. Prakasa Rao, for the Respondent

Judgement

A. Seetharam Reddy, J.
The short, but a fairly substantial question that falls for determination in this second appeal is, whether a

promissory note executed in favour of a guarantor, who endorsed it in favour of the bank, which lent the amount to the original executant of the

promissory note, will enable the banker to successfully lay a claim against the guarantor, while giving up the original executant ?

2. The plaintiff, which is the bank, filed the suit against defendants Nos. 1 and 2. The first defendant, who is the first respondent herein, was having

a hotel business and he was given credit facility to the extent of Rs. 2,000 against the personal guarantee of the second defendant, who is the

second respondent herein. In respect of the above loan facility, a demand promissory note for Rs. 2,000 was executed by the first defendant in

favour of the second defendant and later it was endorsed by the second defendant in favour of the appellant bank. Also an agreement of cash

credit executed by the first defendant along with the second defendant were taken in favour of the appellant bank. Though the first defendant

availed of the entire credit facility, nothing was paid. Hence the suit.

3. It may, however, be stated here, that inasmuch as the suit was not pressed against the first defendant, the same was dismissed as against the first

defendant and the trial court thereafter held that the second defendant cannot be termed as co-obligant and, therefore, the suit cannot be decreed

as the first defendant was given up. The decree of the trial court was confirmed on appeal.

4. The learned counsel for the appellant argues that even if the first defendant is given up, it is quite apparent from the pronote, exhibit A-1, that it

was executed by the first defendant in favour of the second defendant and the second defendant in his turn had endorsed it in favour of the bank

and, therefore, he is the co-obligant. Apart from that, it is equally apparent from section 36 of the Negotiable instruments Act, 1881, that every

prior party to a Negotiable instrument is liable thereon to a holder in due course, and, therefore, though the first respondent was given up, the

second respondent was nevertheless liable to discharge the debt.

5. It is not in dispute that the pronote was executed by the first defendant promising to pay on demand on the second defendant and also it reads

further :

or order at the State Bank of Hyderabad, the sum of Rs. 2,000 only.

6. On the reverse of the said pronote, an endorsement has been made by the second defendant as under :

Endorsed in favour of the bank"". Exhibit A-2 is an agreement for hypothecation and guarantees hypothecation of goods, machinery, book debts

and other assets, wherein the first defendant was styled as borrower and the second defendant was styled as guarantor.

7. Now, the question, therefore, is whether these two documents will have to be read together and assessed as to whether the second respondent-

defendant is a co-obligant or a mere surety. In circumstances, which are stronger then those before us, the Supreme Court in S. Chattanatha

Karayalar Vs. The Central Bank of India and Others, discussed a case, wherein a loan was secured by three defendants, - a company, A and B -

from the plaintiff bank on a promissory note which was sent to the bank along with a letter and a deed of hypothecation. All the defendants have

signed the promissory note and the letter. The letter contained the words :

We beg to enclose an on demand pronote ..... signed by us which is given to you as security for the repayment ..... the promissory note is to

be a security for any repayment of any overdraft ..... and the relevant words of the promissory note were "On demand we ..... jointly and

severally promise to pay ..... the sum".According to the hypothecation agreements, it operated as a security for the balance due to the bank on

the cash credit account.

8. The bank instituted the suit for recovery of the balance from all the three defendants. The plea of A and B that they executed the promissory

note as surety and that they are not co-obligants, did not find favour with the High Court, but, on appeal to the Supreme Court, it held (AIR 1965

SC 1857 headnote) :

that in interpreting the language of the promissory note in the context of the other two documents, it was manifest that the status of B with regard

to the transaction was that of a surety and not of co-obligant, that the blank was a party to the contract of guarantee, namely, the letter, which was

contemporaneous with the promissory note, that the bank was also a party to the contract of hypothecation executed by the company, in which it

which it was stated that the bank had agreed to open a cash credit account in favour of the company and that, therefore, the requirements of

section 126 of the Contract Act were satisfied and B had the status of a surety and not of a co-obligant in the transaction of overdraft account

opened in the name of the company by the bank.

9. In this case, precisely for the same reason the second defendant cannot be termed as co-obligant, when the promissory note is read along with

the hypothecation agreement, wherein the second defendant has been styled as guarantor, since the bank has given up the claim against the first

defendant who is in a position of borrower and also the executant of the promissory note, though later it was endorsed in favour of the bank by the

second defendant. Therefore, the cumulative effect of the reading of the documents will undoubtedly demonstrate that the second defendant is the

guarantor and if the default on the part of the original borrower is not either proved or established, the question of its enforcement against the surety

does not arise. Consequently, section 36 of the Negotiable Instruments Act, 1881, which reads, that every prior party to a negotiable instrument is

liable thereon to a holder in due course until the instrument is duly satisfied lays down a principle, with which there can be hardly any quarrel, and

the stress which was laid on that point by the learned counsel for the appellant, is of little or no consequence in the adjudication of the case before

me, inasmuch as here, the construction will have to be with reference to the joint executant of a particular document accompanied by another

document or documents. In which case it is to be seen whether even if the promissory note is executed by more than one person and in the

accompanying document of guarantee there is a recital that the rest of the persons were merely guarantors, then, in which case, the sureties will not

be make liable, if the promissor himself defaults. So, judged from this angle also, the appellant has no case, having given up the first defendant, to

have any decree from the court on the basis of the promissory note and on the plea that the second defendant is the co-executant, when he is

merely a surety. The question of law, therefore, has to be answered against the appellant.

10. In view of the above discussion, this second appeal has to be dismissed and it is accordingly dismissed with costs.