

**(2016) 03 KAR CK 0173**

**In the Karnataka High Court**

**Case No :** Misc. First Appeal No. 2272 of 2010 (SFC)

Karnataka State Financial Corporation

APPELLANT

Vs

M/s. Madhu Paper Mills Private Ltd.

RESPONDENT

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**Date of Decision :** 11-03-2016

**Acts Referred:**

State Financial Corporations Act, 1951 — Section 31(1)

**Citation :** (2016) 3 AirKarR 744

**Hon'ble Judges :** N.K. Patil and Mrs. Rathnakala, JJ.

**Bench :** Division Bench

**Advocate :** Gururaj Joshi, Advocate, for the Appellant; V. Jayaram, Advocate, for the Respondent No. 1; G. Krishnamurthy, Senior Advocate for Rakesh Bhat, Advocate, for the Respondent No. 2; K.V. Satish, Advocate, for the Respondent No. 3

**Final Decision :** Allowed

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## Judgement

Mrs. Rathnakala, J.—This Appeal is preferred by the Karnataka State Financial Corporation ("the Corporation" for short) impugning the order dated 25.1.2010 in Miscellaneous Petition No. 28/2001 passed by the I Additional District Judge at Mysore, whereby the petition filed by the Corporation under Sections 31(1)(aa) and 32 of the State Financial Corporations Act, 1951 ("the Act" for short) came to be dismissed.

2. Briefly stated, the Corporation filed a petition before the court below under Sections 31(1)(aa) and 32 of the Act against the respondents seeking direction for enforcement of the liability of respondent Nos. 2 and 3 jointly and severally to pay a sum of Rs.4,00,19,992.70 paise as on 10.6.2000 with future interest thereon at 16.5% per annum compounded quarterly with effect from 11.6.2000 till payment.

3. It was the case of Corporation that the first respondent is the Company, now wound up by the order of the High Court. Respondent Nos. 2 and 3 are its Directors, who stood guarantors for the loan due from the first respondent. Rs.30

lakhs was sanctioned in favour of the first respondent for the purpose of establishing a mini paper mill in accordance with the terms and conditions of the sanction letter dated 28.7.1976; on the request of the first respondent, additional term loan of Ks.22.55 lakhs was sanctioned subject to terms and conditions set out in the sanction letter dated 23.3.1987. As security for repayment of the loan amount, first respondent created an equitable mortgage in respect of land, building, plant and machinery of the Company in favour of the Corporation vide mortgage deed dated 3.10.1977 and supplemental agreement dated 1.3.1978. Modification deed of mortgage dated 26.3.1988 in respect of the terms of loan is executed by the guarantors. First respondent hypothecated its movables under hypothecation deed dated 26.3.1988. The respondents-2 and 3 have given personal guarantee for repayment of the amount due from the first respondent. First respondent defaulted in repayment of the loan, made reference under Section 15(1) of Sick Industrial Companies (Special Provisions) Act, 1985 before the BIFR for rehabilitation of the Company. The BIFR by its order dated 10.10.1996 held that the Company should be wound up under Section 20(1) of Sick Industrial Companies (Special Provisions) Act. The assets of the company were taken over by M/s. Karnataka State Industrial Investment and Development Corporation (for short "the KSIIDC") in exercise of its power under Section 29 of the Act on 29.6.1998; efforts were made to sell the assets of the Company; since no good offer was received, the assets of the Company could not be sold. The Corporation invoked the personal guarantee of the respondents-2 and 3 by issuing a notice on 17.8.2000 calling upon them to jointly and severally pay the Corporation a sum of Rs.4,00,19,992.70 paise with future interest within ten days from the date of receipt of the notice.

4. Respondent No. 1/Company is placed ex parte. Respondents-2 and 3 contested the petition. The pith of contention is, the claim is barred by limitation. The guarantee deeds relied by the Corporation do not constitute continuing guarantee. The liability of the Company having already been merged with its assets by the act of the parties, as well as by operation of law and the assets already have been taken over by KSIIDC under Section 29 of the Act, the KSIIDC after obtaining permission from the Court has sold the assets of the Company and the confirmation of the said sale is pending before the Company Court. The personal guarantee, if any, is already extinguished, as per Sections 134 and 135 of the Indian Contract Act. Due to the negligence of the Corporation, the hypothecated and pledged assets have deteriorated, damaged and become rusted resulting in heavy loss to the Corporation, thereby the eventual remedy available against the Company already lost and the personal guarantees are extinguished under Section 139 of the Indian Contract Act; there is no liability for the guarantor to pay the amount claimed and the interest thereon.

5. On consideration of rival contentions and evidentiary material, the concerned Court has dismissed the petition.

6. Sri. Gururaj Joshi, learned Counsel appearing for the appellant submits, the

District Court lost sight of the fact that the first charge on the assets of the Company was that of KSIIDC and the second charge was of the appellant and only action sought was against the guarantor. The guarantee deeds executed by the respondents-2 and 3 is a continuing guarantee, which binds them for the loan amount unpaid. The Court under wrong notion has held that the Article 137 of the Limitation Act is applicable to the present facts of the case by assuming that the petitioner had issued demand notices to respondents-1 to 3 which were not responded by the guarantors. The learned District Judge has ignored the fact that if such notice was in possession of the respondents, necessarily they would have produced the same. Stray admission during cross-examination of PW-1 to the effect that notice under Section 29 was issued to the first respondent with copy to the guarantor will not enure any benefit for the guarantors since such admission is not supported by corroborative material. No document is produced to counter the Ex.P8/legal notice dated 21.8.2000. As per the law laid down by the Apex Court in the matter of Deepak Bhandari v. H.P. State Industrial Development Corporation Limited, reported in AIR 2014 SC 961, right to sue on a contract of indemnity/guarantee would arise when the contract is broken. Since the guarantors did not comply the demand, as called for in Ex.P8, time begins to run from 21.8.2000 only and petition filed on 2.3.2001 is well within time.

7. As per the judgment of the Apex Court in the matter of Syndicate Bank v. Channaveerappa Beleri and others, reported in AIR 2006 SC 1874, the continuing guarantee is different from the ordinary guarantee. Even if the claim is barred against the principal debtor, but still is enforceable against a guarantor. In that view of the matter, the Court was not justified in dismissing the claim as time barred.

8. It is a fact that the KSIIDC, which had the first charge on the assets of the Company, sold the assets and after adjusting its claims, released Rs.18 lakhs to the Corporation towards the second charge it had over the assets of the Company.

9. Sri. G. Krishnamurthy, learned Senior Counsel appearing for the second respondent draws our attention to para-14 of the petition whereby it is pleaded that the appellant had called upon the principal debtor and the guarantors to pay the loan amount vide pre-instalment notice and post-instalment demands. The Company had paid only one instalment and after sanction, the additional term loan of Rs.22.5 lakhs was sanctioned for acquisition of additional plan and machinery, however, only a sum of Rs.55,000/- was released in favour of the Company and the remaining Rs.22 lakhs was adjusted against the overdue that has been admitted by PW-1 during his cross-examination. The deed of mortgage and the deed of guarantee in respect of the additional loan were executed on 26.3.1988. After executing the guarantee deed, since the Company did not pay any instalment, demand notice was issued to respondent Nos. 1 to 3, every three months. It has come in the cross-examination of PW-9 that the Corporation issued notice under Section 29 of the Act, but did not take any action. KSIIDC

was also having pari passu agreement with the Corporation. On 2.12.1989, the appellant/Corporation addressed a letter to BIFR that they have issued notice on 15.11.1989 under Section 29 of the Act to the Company and also to the promoters. Since no repayment was forthcoming, they sought permission to BIFR to take possession and dispose of the assets of the Company. Similar letter was addressed on 12.1.1990, till the year 1996, there was no action.

10. In respect of a petition under Section 31(1)(aa) of the Act to enforce the surety, the petition ought to have been filed within three years from the date of first demand and the relevant provision applicable is Article 137 of the Limitation Act. Having allowed the taking over of the Company and its assets being sold out, right against the guarantors is allowed to be lost. Hence, the surety stands discharged under Section 139 of the Contract Act. Rightly the District Judge has dismissed the petition.

11. The judgments of the Apex Court relied by the appellant/Corporation are not applicable in the present facts and circumstances of the case. In the former case, it was an original suit for recovery of loan amount from the Managing Director and Directors of the Company. In the said judgment, the respondents had contested the claim. Their contention was, when the operation ceased and the accounts became dormant, it should be treated as a refusal to pay by the principal debtor and also by the guarantors and the limitation would begin to run not when there is refusal to meet the demand but when the accounts became dormant and the said contention was not appreciated by the Apex Court, but the contention of the respondents in the present case was otherwise. The appellant having made demand against the guarantors as early as in the year 1986 slept over the matter. By taking possession of the plant, machinery and immovable properties did not dispose of the property, thereby value of assets is depreciated and without making a specific case for how much amount was due from the Company, filed the claim petition. PW-1 having admitted during his cross-examination that demand notices were issued after release of the second term loan in the year 1986, no burden would lay on the respondents to produce the said demand letters to facilitate as to from which date the limitation would run. In the second judgment of Deepak Bhandari (supra), the Corporation had made claim against the indemnifiers but not against the guarantors. The contract of guaranty and indemnifiers stands on different pedestal, as per the judgment of the Apex Court in Maharashtra State Financial Corporation v. Ashok K. Agarwal and others reported in AIR 2006 SC 1584. In a petition under Section 31(1) and 32 of the Act in respect of the liability of the surety, Article 137 of the Limitation Act would apply and the application filed beyond three years from the date of the demand is barred. In that view of the matter, the order of the court below is well reasoned not calling for interference in this appeal.

12. In the light of the rival submissions made at the Bar and on careful consideration of the impugned order, the following points gain our attention:

(1) When does the period of limitation starts running for invoking a continuous

guarantee?

(2) Whether the omission and commission of the appellant/Corporation has impaired the rights of the guarantors, consequently discharging them from their liability?

13. The Corporation is non-suited on two counts:

(1) The Corporation had issued notice to the respondents in the year 1988 for proceeding against the assets of the Company since the loan amount was not repaid, that amounts to breach of contract between the Corporation and the guarantors. Hence, the petition filed in the year 2001 is hit by Article 137 of the Limitation Act, which contemplates three years of limitation period from when the right to apply accrues;

(2) The properties mortgaged to the Corporation having already been sold, the particulars of tire sale proceeds not being made available and not shown in the Ledger extract of the Corporation, the guarantors have lost their rights over the said property. Consequently, the guarantors lost their right over the properly due to the above omission of the Corporation and they are entitled to be discharged of their liability in accordance with Section 139 of the Contract Act, 1872.

14. Coming to the question of limitation, strong reliance is placed on two judgments of the Apex Court pronounced by the same Bench within a time gap of 10 days. In Maharashtra State Financial Corporation's case (supra) (D/D.30.3.2006), it was held that the Article 137 of the Limitation Act is applicable to enforce the liability of the surety. In Syndicate Bank's case (supra) (10.4.2006), on reference to the earlier judgments, it was held that " the extent of liability under a guarantee as also the question as to when the liability of a guarantor will arise, would depend purely on the terms of the contract A claim may even be time barred against the principal debtor but still enforceable against the guarantor." However, the Apex Court further proceeded to hold that "if the debt had already become time barred against the principal debtor, the question of creditor demanding payment thereafter, for the first time, against the guarantor would not arise. When the demand is made against the guarantor if the claim is a live claim (that is, a claim is not barred) against the principal debtor, limitation in respect of guarantor will run from the date of such demand and refusal/non-compliance."

15. PW-1 during the course of his cross-examination had admitted that, the demand notices were issued to the respondents, but loan was not repaid. For non-repayment of the loan amount, action was taken in the year 1988, that prompted the District Judge to hold that, the petition filed for the first time in the year 2001 is time barred. It cannot be lost sight of, that PW-1 was not the person, who had filed the petition. He had never worked in the Branch Office of the Corporation at Mysore. He had no personal information about the loan transaction. That being so, without perusing the notice, which is alleged to have been issued to the respondents in the year 1988, the Court could not have held

that, the limitation to enforce the liability commences from the year 1988. Public money is involved in the loan transaction. The petition could not have been disposed of on a superficial assessment of the evidence. Under Section 32(1A) of the Act, when it is an application under Section 31 sub-section (1) clause (aa) of the Act, the District Judge shall issue notice calling upon the surety to show-cause on a date to be specified in the notice why his liability should not be enforced. He shall proceed under sub-section (4A) if no cause is shown on or before the date specified in the notice and order the enforcement of the liability of the surety. That being the rigour of a petition seeking relief under Section 31 of the Act, the District Judge could not have non-suited the Corporation only on a cross-examination admission without verifying the nature of the notice, which is claimed to have been served on the guarantors. The burden was on the guarantors to place on record the notice so served on them or the Court could have called upon the entire records of the action taken against the respondents pursuant to non-payment of the instalment. That prompts us to hold that the District Court has proceeded on the insufficient and sketchy evidence to hold that the claim is barred by limitation. Further, learned District Judge finds fault with the Corporation in allowing KSIIDC to proceed against the debtors and guarantors by invoking Section 29 of the Act in respect of the properties given as security to the loan amount. According to the District Judge, there was no explanation by the Corporation about not selling the movables hypothecated in favour of the appellant/Corporation. Admittedly, the matter was before the BIFR and it was declared "sick industry" and the Corporation was entitled to invoke the personal guarantee of the guarantors dehors their claim against the principal debtor. The KSIIDC having its first charge over the assets of the Company is said to have released Rs. 18 lakhs from the sale proceeds. When the action was being taken by the KSIIDC, which had pari passu rights along with the appellant without the benefit of positive evidence, the Court could not have held the Corporation guilty of omission and commission, which would discharge the guarantors from their liability.

16. For the discussion made supra, we are of the considered opinion that the matter requires re-consideration by affording opportunity to both parties to place on record the best possible evidence at their hands before the concerned Court.

17. The appeal is allowed. The order dated 25.1.2010 in Miscellaneous Petition No. 28/2001 passed by the I Additional District Judge at Mysore, is hereby set aside.

18. The matter is remanded to the District Court with a direction to permit both parties to adduce further evidence/rebuttal evidence, if any application is filed by them to that effect.

19. The District Court is directed to dispose of the matter within a time frame of four months from the date of receipt of case records, in accordance with law.

20. Without waiting for any notice from the Court, the parties are directed to

appear before the concerned Court on 6th April, 2016 at 11.00 a.m. either personally or through their Counsel and collect further date of hearing.

21. It is made clear that this order shall not have any bearing while final adjudication of the case on merits.

22. Office is directed to transmit the records to the District Court forthwith.