

(1982) 09 AP CK 0001

In the Andhra Pradesh High Court

Case No : Second Appeal No. 361 of 1979

Mehrunnisa Begum and Others

APPELLANT

Vs

Shaik Chand Bi and Others

RESPONDENT

Date of Decision : 23-09-1982

Acts Referred:

Negotiable Instruments Act, 1881 (NI) — Section 118, 9

Citation : (1985) 58 CompCas 197

Hon'ble Judges : A. Seetharam Reddy, J

Bench : Single Bench

Advocate : T. Veerabhadrayya, for the Appellant; T.S. Haranath, for the Respondent

Judgement

Seetharam Reddy, J.

1. The substantial questions of law which are to be answered in this second appeal are :

"(1) Whether Ex. A-1 is a promissory note which is negotiable or is only a collateral security.

(2) Whether the endorsement of transfer, Ex. A-2, is valid and confers any right on the plaintiff ?

(3) Whether the plaintiff is a holder in due course ?

(4) Whether Ex. A-1 can be enforced de hors the liability of the chit fund company to run the chit for the full period ?

2. The brief facts which give rise to this second appeal may be set out. The defendants are the appellants and the plaintiff is the respondent. On December 3, 1969, the defendants executed a promissory note in favour of M/s. Safire Trading Co. ("chit fund company", for short) and received consideration undertaking to repay the same with interest at 12 percent. per annum. The said promissory note was transferred for consideration to the plaintiff on September

30, 1972, who filed a suit against the defendants as they committed default in payment of the instalments to the chit fund company; he is a holder in due course and he is not aware of any defects in the promissory note.

3. The defence was that the suit promissory note was never intended to be a negotiable instrument. It was executed to serve as a collateral security for the due payment of the instalments payable by the first defendant as per the rules of the chit fund company in a chit fund transaction of 40 months, that the first defendant happened to be a prized subscriber, that defendants Nos. 2 and 3 signed the document only as sureties, that the rules of the company do not provide for transfer of the security provided in the shape of the promissory note, that dividends were not deducted till July 29, 1970, and that, therefore, the first defendant is not bound to pay the amount covered by the promissory note. Further, after September 29, 1970, the company ceased to hold auction and, consequently, there was no determination and collection of the monthly instalments, that the company is not entitled to transfer the promissory note which is intended to be a collateral security, the alleged signature under the endorsement of transfer on the back of the suit promissory note of D. B. Prasad, said to be of the chairman of the chit fund company, is a forgery and the plaintiff does not acquire any right by the said endorsement of transfer as she is not a holder in due course. The person who is said to have endorsed the transfer has no authority to do so and, therefore, it is invalid which does not bind the first defendant. Also averred is the case that the endorsement of transfer is only an assignment to the amount payable under the promissory note which is not enforceable under law. For all these reasons the plaintiff is not a holder in due course. As the company stopped its business after July 29, 1970, and no collection was made, it cannot collect the promissory note amount.

4. The trial court held that the suit promissory note was not intended to be a collateral security, that the plaintiff is a holder in due course and the endorsement of transfer is valid and was binding on the defendants and that the suit promissory note is enforceable as the plaintiff is a holder in due course. The appellate court confirmed the same and dismissed the appeal resulting in decreeing the suit with costs. Hence, this second appeal.

5. Sri T. Veerabhadrayya, the learned counsel for the appellants, contended that :

(1) the suit promissory note is not a negotiable instrument as it was executed only as a collateral security;

(2) the plaintiff also was a subscriber to the said chit fund company and, therefore, she knew the defect in title and yet obtained the transfer and so the suit cannot be laid;

(3) even after executing the promissory note, the defendants were paying the future instalments thereafter, but the company stopped paying dividends and hence the promissory note cannot be enforced;

(4) The purported transfer of the promissory note was made by a person, namely, the chairman of the company, who had no authority to do so and, therefore, the same is not binding and is unenforceable.

6. The important point which has at first to be decided in the aforesaid format of the case is whether the plaintiff is a holder in due course of the suit promissory note. In order to determine the same, the provisions enacted under s. 9 of the Negotiable Instruments Act, 1881, will have to be noticed.

Section 9 reads :

"Holder in due course" means any person who for consideration became the possessor of a promissory note, bill of exchange or cheque if payable to bearer

or the payee or indorsee thereof, if payable to order,

before the amount mentioned in it became payable, and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title."

7. It is manifest from the provisions that the payee or indorsee of the promissory note in order to be successful in the suit filed for the recovery of the amount covered by the promissory note transferred in his favour, has to establish that he had no sufficient cause to believe that there existed any defect in the title of the person from whom he derived the same. The cases cited across the Bar may now be looked into.

8. In *N. Chellaperumal Chetty Vs. N.M. Jayarathnam Chettiar*, , the defendant, a subscriber to a chit fund conducted by C company, after paying some instalments purchased the chit and executed a promissory note in respect of the remaining amount due towards future instalments. It was orally agreed that the promissory note would be deemed to be discharged in the event of the payment of Rs. 150 every month during the next 35 months. After payment of some more instalments, the company endorsed the promissory note in favour of the plaintiff, another subscriber, by way of settlement of his claim. The plaintiff brought a suit against the defendant for recovery and the High Court held that the promissory note was not by way of security for payment of remaining instalments. So long as the defendant did not plead that the promissory note was nominal or that no liability was intended to be incurred under it, he could not be allowed to plead that the promissory note was mere security for some other liability, or that it was not enforceable. Evidence seeking to prove any such plea would be barred under s. 92 of the Evidence Act. Hence, the plaintiff, as the endorsee of the promissory note, had obtained the right to enforce the promissory note. It was also held that the sums paid by the defendant into the chit account subsequent to the execution of the promissory note had to be credited towards the liability on the promissory note. Therefore, the payment of Rs. 150 made by the defendant being a payment in reduction of his liability under the promissory note saved limitation under s. 20 of the Limitation Act.

9. Hegde J., as he then was, held in a case, Paschal Nazereth v. Denis Lobo AIR 1958 Mys 126, and observed (headnote) :

"In order to become a holder in due course, the holder should have taken the assignment without having sufficient cause to believe that any defect existed in the title of the person from whom he got the assignment.

Where in a suit based on a pronote executed in favour of a proprietor of a chit fund and on his insolvency assigned to the plaintiff, the assignee knew at the time he got the assignment that the insolvent was running the "fund" and the defendant was having dealings with the insolvent; and he also knew the circumstances under which the said pronote was executed :

Held, that he was not a holder in due course."

10. A Division Bench of this court in Company Application No. 295 of 1976, decided on April 20, 1978 (Voluntary Liquidator, Linsen Finance and Trading Co. (P.) Ltd. Vs. Aknar Dawood Ali Kassam Nathoo and Others, held (at p. 510) :

"It is no doubt true that the promissory note which is obtained from the successful prize bidder is for a sum of Rs. 5,000. But his liability to pay the amount thereunder is by way of subscription to the chit fund and he is to pay the monthly chit of Rs. 125 per month less the discount earned every month during the remaining period of 40 months The liability to repay the prize amount which a subscriber has purchased by offering the highest bid is thus a liability incurred by the subscriber on account of becoming the successful prize bidder. It is for securing repayment of this amount that the promissory note and the surety bonds are taken from the prize bidder by way of collateral security."

11. The Bench then referred to a decision of the Madras High Court in P. N. Raghavan v. S. Arumugham AIR 1935, wherein the Division Bench held (headnote) :

"A chit fund transaction is different from a loan transaction. It is not a case of borrowing. At the auction the person bidding the highest discount is regarded as the purchaser of the subject of the auction, i.e., a present sum of money. The contract is one of sale, the auction purchaser purchasing the subject-matter of the chit immediately by offering, (1) the highest discount, and (2) a bond for the future payments of instalments. These two things together constitute the consideration for the purchase."

and eventually held (at p. 511 of 52 Comp Cas) :

"The question really is whether that liability could be enforced without conducting the chit for the full period of 40 months as envisaged under the particular chit fund scheme or whether it would be enforced on the strength of the promissory note and the surety bond without conducting the chit for the full period is the real question. One thing, however, is clear that the subscriber by offering the highest discount and becoming the prize bidder is liable to pay the

amount to the chit fund and this liability could be enforced. This liability, however, is enforceable not on the ground that he is a subscriber of a chit, for, no subscriber is bound to pay the entire 40 instalments and he has the option to stop payment at any stage of the chit without incurring any further liability except that of forfeiting certain amount from out of the instalments already paid by him as per the conditions of the particular chit. The liability of the successful prize subscriber becomes enforceable on account of the terms subject to which he had offered the bid. One of the principal terms thereof was that he would subscribe for the remaining period of the chit. The liability of the successful prize bidder cannot be determined solely on the basis of the promissory note, the guarantee and surety bond. The amount paid there-under is not a lending by the company. It is not lent to any and every person; it is paid only to the subscribers of the chit The liability of the subscriber also is not to repay the full amount of Rs. 5,000 mentioned in the promissory note but is to pay the said amount less the discount earned by each subscriber of the chit The mutual obligations arising between the company and the successful prize bidders have to be determined treating the entire chit fund scheme, promissory note and the surety bonds as constituting part of single scheme. The rights and obligations of each of the parties thereto being interdependent, in our view, the liability under promissory note and the guarantee and surety bonds cannot be enforced by the company, and now by the liquidator, without conducting the chit for the full period. In a sense, the successful prize bidder is a debtor; but as discussed above, his liability to repay the amount cannot be enforced independently of the liability to conduct the chit for its full period."

12. In *Maruda Konar v. Veerammal* adverting to the argument that a security bond must be construed only in the light of the chit rules and not as if there was an independent debt payable by instalments, that, according to the true construction of the chit rules, subscriptions have to be paid only on the date when the chit is to be drawn and that if the chits are no longer to be drawn because the chit has collapsed, the obligation to pay the subscriptions as per the terms of the rules also comes to an end, whatever other liability might exist under the general law on the part of the benefited subscriber, the learned judge held (p. 987) :

"It seems to me only reasonable to hold that in case like the present, the security bond must be interpreted in the light of the rules and the obligation undertaken by it is not repayment of the benefit already received as if it were a debt but the payment of future subscriptions whether the continuance of the chit was a condition precedent or not, will not depend merely on the terms of the bond but must be decided with reference to the surrounding circumstances, including the rules of the chit fund. For this purpose, a distinction may well have to be drawn between cases in which benefited subscribers cease to have any share in the profits arising out of future drawings and cases in which they continue to share in such profits. The present case belongs to the latter category."

13. On the above conspectus. I am of the view that the respondent herein is not the holder in due course as it cannot be said that he had no sufficient cause to believe that there was defect existing in the title of the chit fund company from which he derived his title. This is undoubtedly so because, firstly, she was herself one of the subscribers to the chit fund company and, secondly, which is not in dispute, the appellant also is one of the subscribers and he executed the promissory note as a collateral security for the chit amount and, therefore, the endorsement of transfer made by the chit fund company in favour of the respondent does not pass any title in favour of the respondent.

14. The learned counsel for the respondents contended that under s. 118(g) of the Negotiable Instruments Act (Act 26 of 1881), which reads :

"that the holder of a negotiable instrument is a holder in due course :

Provided that, where the instrument has been obtained from its lawful owner, or from any person in lawful custody thereof, by means of an offence or fraud, or has been obtained from the maker or acceptor thereof by means of an offence or fraud, or for unlawful consideration, the burden of proving that the holder is a holder in due course lies upon him."

15. Until the contrary is proved, the above presumption shall be made, and contends further that once it is established that the respondent is the holder of a negotiable instrument, it is not for him to establish that he is the holder in due course. I apprehend the contention is not well-founded. Section 9 of the Act has to be read independent of and de hors s. 118. The presumptions laid down in s. 118 are conditional and so they do not ipso facto follow. If s. 118 has to be read as is sought to be done by the learned counsel for the respondent, then it would not only do violence to the language employed in s. 9 but also would render otiose the entire provision enacted in s. 9, and so it is inescapable that in order to be a "holder in due course", one must establish, before successfully enforcing the claim under a promissory note by endorsement of transfer, that he had no sufficient cause to believe that there existed any defect in the title of the person from whom he derived it.

16. The presumption contemplated under s. 118(g) of the Act would not come to his rescue. In fact s. 9 must be read as an explanation to the said presumption postulated by s. 118(g). This, in my judgment, is the harmonious construction, which the language employed in ss. 9 and 118 has to be subjected to.

17. For reasons aforementioned, I am of the undoubted view that the respondent herein cannot be held to be a holder in due course and the pro note endorsed by the chit fund company in her favour was only for collateral security given by the appellant herein and if that be so, the same is unenforceable.

18. The second contention is that the plaintiff being himself a subscriber must be presumed to know the law and the knowledge of such pronote being taken must be attributable to him and, therefore, he cannot be said to be a holder in due

course as he is expected to know the defects inherent in the said pronote. Justice Desai of the Bombay High Court had an occasion to deal with a case in *Sunderdas Sobhraj (Firm) v. Liberty Pictures (Firm)* [1956] 26 Comp Cas 455 (Bom), arising under s. 9 of the Negotiable Instruments Act. The case was concerning a partnership firm wherein a partner drew a cheque in his own favour and endorsed it in favour of a third party to secure repayment of his separate debt. The learned judge held at pp. 462 and 463 of 26 Comp Cas) :

"The implied authority of a partner to bind the firm is, therefore, restricted to acts usually done in the business of the kind carried on by the firm. But if all that can be said of an act is that it was convenient or that it facilitated the transaction of the business of the firm or that it was done because it was in the interest of the firm to contract with an individual partner, that is not sufficient to bind the firm in the absence of evidence of sanction by the other partners.

The same principle applies and with the same certainty where a partner purporting to act on behalf of the firm draws a cheque in his own favour and then endorses it in favour of a third party to secure repayment of his own separate debt. In any such case, if the third party is aware of the fact that the negotiable instrument was made or endorsed by a partner in his own favour and then negotiated with the third party, that would be a circumstance and a reasonable ground which should put the third party upon further inquiry.

It would be on the third party in such case to show that there were circumstances attending the transaction which afforded him reasonable ground for belief that the transaction was sanctioned by the other partners or to show by fair implication that the other partners had in fact authorised or confirmed the transaction. These results must indeed flow from the known limitation of the law of agency and the law of partnership is a branch of the law of agency. A bona fide holder for value without notice would, of course, be in a different position The rule as laid down in section 9 of the Negotiable Instruments Act which defines "holder in due course" is stricter than the rule of English law on the subject and a payee or endorsee of a negotiable instrument can, under our law, prefer a claim to be a holder in due course of the instrument only if he obtained the same without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title. A bona fide holder for value without notice is, of course, as I have already observed, in a different position. But a third party who knowingly accepts any negotiable instrument from a partner in a firm drawn or endorsed by the partner in his own favour although he parts with consideration for the same must take the instrument with the knowledge of the principles of justice and equity applied to every contract involving the element of agency and the natural result of the limitations inherent in such an agency. In any such case, he takes the instrument with notice that there is something about it which cannot be ignored or overlooked. As I have already pointed out, he is put upon further inquiry and it is upon him to show that there was no failure by him to avail himself of all reasonable means of

inquiry into the title of the partner who endorsed the instrument in his favour and that there was sufficient cause for him to believe that no defect existed in the title of that partner."

19. Dealing with a case arising under s. 9 of the Negotiable Instruments Act, 1881, Hegde J. of the Mysore High Court in *Paschal Nazereth v. Denis Lobo* AIR 1958 Mys 126, held thus (p. 128) :

"It is clear from the facts of the case that the plaintiff even on the date of assignment knew that the said pronote has been executed by the defendant as a security for the due payment of future instalments. He was aware that the pronote was supported by the consideration only to the extent of the arrears of payment. That was the reason as to why he claimed only Rs. 440 in his registered notice.

In fact he filed the suit for a much lesser sum. So he knew that the negotiable instrument was not what it looked. He got the assignment from the official receiver. He is likely to have known the circumstances under which the insolvency proceedings had started. Hence, it was his duty to make the necessary enquiries and find out the real state of affairs.

He was put on notice of the defect in the instrument. In order to become a holder in due course, the holder should have taken the assignment without having sufficient cause to believe that any defect existed in the title of the person from whom he got the assignment. It is contended for the respondent that the petitioner had sufficient information to put him on enquiry.

The learned counsel for the petitioner contends that his client's duty was to investigate only about the defect in so far as it related to the transaction on the basis of which the suit instrument had been executed, and he had no duty to enquire into all the dealings between the insolvent and his creditor. I am unable to accept this contention. As stated by Lord Blackburn in *Jones v. Gordon* [1877] 2 AC 616, 628 (HL) :

"that in order to make such a defence ... it is necessary to show that the person ... was affected with notice that there was something wrong about it when he took it. I do not think it is necessary that he should have notice of what the particular wrong was".

In this case the plaintiff knew at the time he got the assignment that the insolvent was running the "fund" and the defendant was having dealings with the insolvent. He also knew the circumstances under which the said pronote was executed. He was taking the assignment from the official receiver and it is proper to presume that he was acquainted with the circumstances relating to the insolvency.

He had a duty to find out the nature of the defect in the suit instrument. Hence, it is not possible to come to the conclusion that the plaintiff is a holder in due course."

20. It is, therefore, quite manifest from the above decision that the respondent, who being a subscriber himself, and having got the promissory note endorsed in his favour, executed by another subscriber, must, firstly, be presumed to know the law that the pronote in those circumstances is executed as only collateral security for failure of compliance in future of the terms and conditions of the chit. The knowledge about the nature of the pronote is positively attributed to the respondent as he knew that the promissory note had defects of title and he had sufficient cause to believe that there existed a defective title and hence he cannot be held to be holder in due course to enforce the claim under the promissory note.

21. The third point pertains to the authority of the person who is said to have endorsed the pronote on behalf of the chit fund company in favour of the respondents. The contention is that the transfer by the chairman of the chit fund company of the pronote had no legal or valid sanction, firstly, because the articles of association have not been filed, though P.W. 1, who is the superintendent of the said chit fund company, stated in his deposition that the articles of association are with him and yet the same were not filed. Therefore, in the absence of any provision enabling the chairman concerned to transfer the said pronote, being invalid and illegal, cannot be enforced.

22. The chairman of the chit fund company, one D. Purushothama Prasad, has figured himself as a witness for the plaintiff (P.W. 3). He stated that in the articles, there existed a provision empowering the company, to transfer pronotes. He further stated that he was not the chairman by the date of Ex. A-2. (Ex. A-2 is the endorsement of transfer on the pronote). He again says that by the date of Ex. A-2, the group in which the plaintiff was a member, was closed. Ex. A-1 is the pronote. P.W. 1, as stated earlier, is the superintendent of the said chit fund company. He stated that Ex. A-2 transfer was made on September 30, 1972. The chairman signed before him. The deposition of P.W. 1 relating to the execution of the pronote is as follows :

"for future instalments pronote was taken. For the payments due, pronote was taken. Security has to be furnished by auction bidder. D. 2 and D. 3 are sureties ... Plaintiff has not paid any instalments after July, 1970 I, the chairman, and the plaintiff were present when transfer was effected. I have not failed to show that chairman has got power to transfer pronote ... I brought the auction minutes. 28 auctions were held. Afterwards no one attended the auction."

23. The appellate court in para. 10 of its judgment has observed as under :

"In order to establish that P.W. 3 was not the chairman on the date of the transfer, Ex. B-4 marked in this appeal is sought to be relied upon by the appellants. It is not mentioned in Ex. B-4 that P.W. 3 is the chairman of the chit fund company. The learned counsel for the plaintiff-respondent has pointed out that u/s 47 of the Companies Act any person acting under the authority of the company, either express or implied, can draw, accept, endorse a bill of exchange,

hundi or a pronote. No doubt, the learned counsel for the defendants-appellants contend that inasmuch as the endorsement of transfer (Ex. A-2) was made as if P.W. 3 was the chairman of the plaintiff-company, it has to be established by the defendant. It was also pointed out by him that there was an admission by P.W. 3 that he was not the chairman by the date of Ex. A-2. The trial court in para. (7) of its judgment has pointed out that the above evidence might have been mistakenly recorded inasmuch as the very purpose of summoning P.W. 3 was to establish that he was the chairman on the date of the endorsement of transfer. Sitting in appeal I cannot determine whether there was a mistake in recording evidence of P.W. 3. It may be so that the appellants are trying to take advantage of the same. Nevertheless the defendants have not taken any steps to produce the records of Messers Safire Trading Co. to disprove the version of P.W. 3. No doubt they have filed I.A. No. 400 of 1978 in this court to summon M/s. Safire Chit Funds Company to produce the minutes book and the resolution book of the general body during the period 1969-72. Even in the said application, it is not specifically averred that the deponent (first appellant herein) was quite aware that P.W. 3 was not the chairman by the date of the transfer. In my opinion, it is not necessary to probe into the affairs of the chit fund company in as much as the real point in controversy is whether P.W. 3 who has executed the endorsement of transfer was competent to do so "may be as a chairman or as a director".

24. It is quite evident from the aforesaid material that the respondent has failed to establish that the chit fund company, much less the chairman, P.W. 3, was competent or authorised to effect the transfer of the pronote. It is quite incomprehensible as to why the plaintiff-respondent herein failed to implead the chit fund company. At any rate he ought to have got the relevant material, like the articles of association, rules or by-laws framed by the company, marked, in order to substantiate that the chairman had necessary sanction or authority to endorse the pronote in favour of third party.

25. In *Sunderdas Sobhraj (Firm) Vs. Liberty Pictures (Firm)*, Desai J. held (at p. 462) :

"The implied authority of a partner to bind the firm is, therefore, restricted to acts usually done in the business of the kind carried on by the firm. But if all that can be said of an act is that it was convenient or that it facilitated the transaction of the business of the firm or that it was done because it was in the interest of the firm to contract with an individual partner, that is not sufficient to bind the firm in the absence of evidence of sanction by the other partners."

26. A fortiori, in this case, there is a miserable failure to establish that the chit fund company had authority to transfer pronotes. They are invariably taken as collateral securities, and, therefore, it is for the party, who asserts that endorsement of transfer on the negotiable instrument, like the pronote, was made with some authority and it is for him to trace the source of the authority and not for the party, who controverts that the endorsement was contrary to the

authority. Hence, I have no hesitation to hold that the plaintiff had failed to establish that the person, viz., P.W. 3, who is said to have made the endorsement of transfer on the pronote, had any authority to do so and in the absence of such sanction, the transfer cannot be held to be valid and, therefore, the same cannot be enforceable.

27. The next contention is that even after the pronote was executed on December 3, 1969, the first defendant paid a few instalments up to September 29, 1970, and the chit fund company came to a close on April 1, 1971, before cover of the entire chit, which was for 40 instalments, i.e., to run till September 6, 1972. In fact the chit fund company had issued a notice to the first defendant on August 26, 1972, demanding payment of the necessary amount and the transfer of the pronote was effected on September 13, 1972. The original transfer was for Rs. 4,250, and the suit was for Rs. 4,600. If that be so, the instalments that were paid up to September 29, 1970, have to be given due credit and the claim for Rs. 4,600 cannot be a valid one, even assuming that the pronote is enforceable. For this reason also the plaintiffs' claim does not sustain.

28. I see sufficient force in this contention. The consideration of the pronote could not be actually one for which the pronote was executed, because it was only given as collateral security for the failure of payment of future instalments that will be due by the first defendant to the chit fund company. Certain instalments have been made on September 29, 1970, and yet the transfer is said to have been made on September 13, 1972, for the amount of Rs. 4,600, which cannot reasonably be conceived of, as the chit fund company itself having received some amounts, can not enforce the claim for the entire amount of Rs. 4,600. If that be so, much less the endorsee of the said pronote can enforce the claim for the entire amount mentioned in the pronote. It is, however, needless to adjudicate on this aspect of the case as to whether the chit fund company itself can enforce the claim against the respondent herein and if so in what sum and so forth. As has been held earlier, the respondent not being a holder in due course cannot enforce the claim under the suit pronote, which has been furnished only as a collateral security.

29. Consequently, all the four points framed at the outset are answered in the negative.

30. In the result, the judgment under appeal is set aside and the appeal is allowed with costs throughout.