1954 *Present :* **Gratiaen J. and Gunasekara J.**

G. E. MISSO, Appellant, *and* B. MOHAMEDALLY *et al.*, Respondents

S. C. 282—D. C. Colombo, 11,594 (Summary)

Promissory note—Subsequent additional security—Does not amount to discharge by novation— Negotiability—Bills of Exchange Ordinance, s. 36 (1).

The maker of a promissory note who subsequently creates a mortgage to secure the repayment of his debt is nevertheless liable to an indorsee for value without notice unless he shows that the mortgage bond was not merely an additional security but had superseded the obligation founded on the promissory note.

APPEAL from a judgment of the District Court, Colombo.

Colvin R. de Silva, with *S. J. Kadirgamar* and *L. Mututantri*, for the plaintiff appellant.

H. V. Perera, Q.C., with *H. W. Tambiah* and *C. Shanmuganayagam*, for the defendants respondents.

Cur. adv. vult.

February 11, 1954. GRATIAEN J.—

This was an action for the recovery of a sum of Rs. 34,450 and interest alleged to be due on a promissory note dated 16th October, 1947, from the 1st defendant (as maker of the note) and the 2nd defendant (as payee who had subsequently indorsed it to the plaintiff).

The defendants filed separate answers, denying liability on the note. For the purposes of this appeal, the following facts as held by the learned trial Judge will form the basis of my judgment :

> The " on demand " promissory note sued on had been granted by the 1st defendant to the 2nd defendant for valuable consideration. On 15th January, 1948, a total sum of Rs. 94,150 was found to be due by the 1st defendant to the 2nd defendant on this and certain other transactions, and the 1st defendant executed a notarially attested mortgage bond whereby he hypothecated certain immovable property as security for the repayment of the aggregate amount (which was specifically stated to include the sum of Rs. 35,450, and interest borrowed on the promissory note sued on). The 2nd defendant continued, however, to retain the promissory note in its original condition except that it now bore an endorsement signed by both defendants and by the attesting notary to the following effect :
>
> > " The amount due on this promissory note together with interest from the date hereof has been secured by mortgage bond No. 44 dated 15th January 1948 . . . . "
>
> The endorsement was undated, but it was in fact made at the attesting notary's office immediately after the execution of the bond. Several months later, the 2nd defendant endorsed and delivered the note to the plaintiff for valuable consideration. It had never come back into the maker's hands during the intervening period.

Upon these facts, and upon the evidence of the attesting notary who explained his version of the circumstances which led to the execution of the bond and to the endorsement made on the note, the learned Judge held (1) that the note had been discharged on 15th January, 1948 by the 2nd defendant's acceptance of the " higher security " of the mortgage bond, and that therefore (2) only the 2nd defendant (but not the 1st defendant) was liable on the note to the plaintiff who subsequently became its holder for value. Judgment was accordingly entered as prayed for against the 2nd defendant, but the plaintiff's action against the 1st defendant was dismissed with costs. This appeal is against the latter part of the decree.

The learned Judge has rejected as unproved the allegation that the plaintiff was aware, at the time of the endorsement in his favour, that the note had been previously (as alleged) " discharged ". Nevertheless, he held, on the authority of *Jayawardena v. Rahaiman Lebbe* [1] and *Tenna v. Balaya* [2] that, when the bond had been granted to secure the liability

[1] *(1919) 21 N. L. R. 178.*

[2] *(1908) 11 N. L. R. 27.*

on the promissory note, the note itself was automatically discharged and became " a mere waste-paper "—with the result that its subsequent indorsement by the original payee could not vest the indorsee with any rights on the document against the original maker.

Section 36 (1) of the Bills of Exchange Ordinance provides, *inter alia*, that a promissory note loses its character of negotiability when it has been " discharged by payment or otherwise ", and it is clear law that the rights of a holder of a note can be satisfied, extinguished or released in a number of ways besides payment—*Byles on Bills (20th Ed.) p. 237.* As an illustration of a discharge " otherwise than by payment ", the textbook mentions, *at p. 238*, a case where " the taking of a security of a higher nature for a bill or note merges the remedy on the inferior instrument ". It is by the application of this rule that the learned Judge decided the present case.

There is no absolute proposition of law which declares that the taking of a " higher security " necessarily operates in every case as a discharge of the earlier " inferior instrument ". As I understand the true principle, the issue invariably calls for a decision on a question of fact, and the onus of proving the discharge in an action between an indorsee for value and a maker is on the maker. In *Twopenny v. Young* [1], for instance, the plea of " discharge " was rejected because the latter security recognized the earlier note as still existing. In other words, the maker had failed to prove that the transaction was intended to operate as an extinguishment of the payee's claims on the original security.

If the maker of a promissory note subsequently creates a mortgage to secure the repayment of his debt, the Court would not be justified in holding that the note was thereby discharged unless an intention to provide a substituted (as opposed to an additional) security was established. " It is often a nice question whether an obligation arising from a bond novates an earlier obligation founded on . . . . a promissory note or other *causa debendi*. If the facts show that the bond was granted as an additional security, there is no novation ; but if it is manifest that the parties intended the bond to supersede the original obligation and take its place, then there is a novation "—*Wessels' Law of Contract, Vol. 1, p. 723, para. 2409.*

In the present case, the language of the indorsement made on the note (and signed by both defendants) by no means makes it " manifest " that the liability on the note had been extinguished. On the contrary, it is calculated to give the impression that the repayment of the " amount due " on the note was *also* secured by the mortgage bond dated 15th January 1948. Besides, at the time when the note was subsequently indorsed to the plaintiff for value, it still remained in the payee's hands and bore all the appearances of an undischarged note. In *Glasscock v. Balls* [2] Lord Esher said :

> " If a negotiable instrument remains current, even though it has been paid, there is nothing to prevent a person to whom it has been indorsed for value without knowledge that it has been paid from suing ".

It is not easy to reconcile this *dictum* with the proposition laid down in far more general terms by a Bench of three Judges of this Court (wrongly

[1] *(1824) 3 B. and C. 208.* [2] *(1889) 24 Q. B. D. 13 at 15.*

described in the Report as a " Full Bench ") in *Jayawardena v. Rahaiman Lebbe* (supra), and I respectfully agree with the view of Jayawardena J. that the question calls for an authoritative decision, after reconsideration of the problem, when a suitable occasion arises.—*Muttu Carpen Chetty v. Samaratunge* [1]. Be that as it may, it is certainly permissible to regard the fact that a promissory note remained in the payee's hands (without any indication of " discharge " or " cancellation " on the face of it) as a relevant circumstance to be taken into account in deciding the question of fact whether the liability had been extinguished by novation. Moreover, the 1st defendant (as maker of the note), is, in my opinion, precluded *as against an indorsee for value without notice* from alleging that the execution of the mortgage bond was intended by him to have more serious implications than those which were actually indicated in the indorsement which he signed. The language of his indorsement is quite insufficient to support the plea of discharge by novation, and is especially binding on the maker of a note who allows it thereafter to remain in circulation with all the appearances of a valid promissory note. Besides, to my mind the language of the bond itself is equivocal.

It would seriously impair the principle of negotiability attaching to instruments governed by the Bills of Exchange Ordinance if an indorsee for value without notice could be confronted with defences which are inconsistent with the terms of a memorandum or indorsement made on the face of the instrument by both the maker and the payee. Even, therefore, if as between the defendants *inter se*, the true position (unknown to the plaintiff) was that the note sued on ought to be regarded as having been discharged on 15th January 1948, that defence is not in my opinion available as against the plaintiff. The present case is, in the special circumstances described by me, distinguishable from those with which the earlier decisions were concerned.

It was suggested to us during the argument that the learned Judge had wrongly applied in favour of the plaintiff the statutory presumption that he was a holder for value, because the plaintiff had not discharged the initial onus of proving (as against the 1st defendant) that the note had in fact been indorsed and delivered to him by the 2nd defendant. I agree that generally an indorsee must establish that he is the *holder* of a note before he can rely on the presumption that he is a holder *for value*. But this, in any particular case, depends on whether the fact of indorsement and delivery has been challenged by the maker. I do not doubt that, at the preliminary discussion which took place under section 146 of the Civil Procedure Code when the trial commenced, the learned Judge was made to understand that the 1st defendant, while not disputing that the note had in fact been indorsed and delivered to the plaintiff, denied only that he was a *holder for value without notice*. Indeed, the 1st defendant's position (as indicated in his pleadings) seems to have been that the note had been indorsed to the plaintiff *but collusively and without consideration*. When the stage for determining the issues

[1] *(1924) 26 N. L. R. 381 at 384.*

arrived, no issue was suggested by the 1st defendant's counsel with specific reference to the bare fact of endorsement and delivery (as distinct from the connected issues of " consideration " and " notice "). On the contrary, the issues, as finally determined at the trial, emphasised that the dispute on this aspect of the litigation was confined to the alleged absence of consideration for the indorsement, and to the further allegation that the plaintiff was well aware that the note had been discharged before indorsement. It could only have been for this reason that the learned Judge ruled that the onus was on the defendants to rebut the statutory presumptions in favour of the plaintiff. I cannot imagine that the experienced judge who tried the case could have entertained the view that a person purporting to sue on a promissory note as its indorsee must be presumed to be its indorsee even though the bare fact of indorsement has been put in issue.

I would allow the appeal and enter judgment in favour of the plaintiff as prayed for with costs in both Courts.

GUNASEKARA J.—I agree.

Appeal allowed.