SUPREME COURT OF INDIA

Kerala State Co-operative Marketing Federation

Vs.

State of Bank of India

C.A.No.151 of 1998

(S.N.Variava and H.K.Sema JJ.)

30.01.2004

JUDGMENT

S.N. Variava, J.

1. This Appeal is against a Judgment dated 5th October, 1995.

2. Briefly stated the facts are as follows:

> "The Appellant received a cheque for Rs. 1,00,000/- from the 3rd Respondent. The cheque was drawn on the 2nd Respondent . The Appellant sent the cheque by post along with some other cheques. However, the cheque in question was stolen in post and was altered to read as if it was payable to Shri K. Narayhanan. A person calling himself K. Narayhanan opened a bank account with the 1st Respondent Bank on 24th December, 1982. The account was opened with a sum of Rs. 20/-. The customer then asked for a cheque book and was informed that the minimum balance had to be Rs. 100/- to obtain a cheque book. He therefore put in Rs. 80/- into the account. He was then issued a cheque book. Thereafter on 29th December, 1982 the cheque for Rs. 1,00,000/- was deposited into the account and the same was collected by the 1st Respondent on behalf of its client. On 30th December, 1982 a sum of Rs. 50,000/- was withdrawn from the accountant just prior to stop instructions being received."

3. The said K. Narayhanan turned out to be fictitious person. He was never traced again. The remaining balance of Rs. 50,000/- was ultimately returned to the Appellant. When the Appellants claimed the sum of Rs. 50,000/- from the 1st Respondent they claimed protection of Section 131 of the Negotiable Instruments Act.

4. The Appellant thus filed a Suit for recovery of the sum of Rs. 50,000/-. The Suit was decreed by the trial Court. However, the High Court has allowed the Appeal of the 1st Respondent, set aside the decree of the trial Court and dismissed the Suit. Hence this Appeal.

Section 131 of the Negotiable Instruments Act reads as follows:

> "131. Non-liability of banker receiving payment of cheque- A banker who has in good faith and without negligence received payment for a customer of a cheque crossed generally or specially to himself shall not, in case the title to the cheque proves defective, incur any liability to the true owner of the cheque by reason only of having received such payment."
>
> It is thus to be seen that a banker, who encashes a cheque, in respect of which his client had no title, would become liable in conversion or for money had and received. However Section 131 of the Negotiable Instruments Act protects the banker, provided he has received payment in good faith and without negligence of a cheque crossed generally or specially.

5. In the case of *Indian Overseas bank vs. Bank of Madura Ltd reported in*[1] the receiving banker was held guilty of negligence and lack of good faith in as much as it had allowed the opening of an account with a small amount and shortly thereafter, i.e. within 90 days allowed withdrawal of a sum of Rs.9,500/-. It was held that the opening of the account, the presentation of the draft and withdrawal of the amount were part of one integral scheme. The fact that the person who introduced the account holder had not been examined in the suit was held against the bank.

6. In the case of *Syndicate Bank vs. United Commercial Bank reported in*[2] it was held that the Appellant bank had a to prove that it had acted in good faith and without negligence. It was held that the fact that the customer had just opened the account and had only one transaction with the bank, namely the encashment of the cheque, showed that the bank had not acted in good faith and without negligence.

7. In case the *Brahma vs. Chartered Bank reported in*[3] it has been held that the onus of proving "good faith" and "absence of negligence" is on the banker claiming protection under Section 131 of the Negotiable Instruments Act. It is held that in deciding whether a collecting banker has or has not been negligent it becomes necessary to take into consideration many factors such as the customer, the account and the surrounding circumstances. It is held that if the cheque is of a large amount, then the bank has to be more careful unless the customer was a customer of long standing, good repute and with great personal credit and was one who regularly deposited and withdrew cheques of large amounts.

8. The same principles are reiterated in the cases of *Central Bank of India Ltd. vs. Gopinathan Nair reported in*[4] *and Indian Bank vs. Catholic Syrian Bank Ltd. reported in*[5].

9. This Court has also considered this question in the case of Indian Overseas Bank vs. Industrial Chain Concern reported in. In this case, on the basis of evidence lead by the Bank (evidence of the Manager and the accountant of the bank) the bank was exonerated. However, principles which governed such cases were noted from various decisions. The relevant portion reads as follows:

"9. What is the standard of care to be taken by a bank in opening an account? In the Practice and Law of Banking by H.P. Sheldon, 11th edn. in chapter 5 at page 64 it is said:

"Before opening an account for a customer who is not already known to him, a banker should make proper preliminary inquiries. In particular, he should obtain references from responsible persons with regard to the identity, integrity and reliability of the proposed customer.

If a banker does not act prudently and in accordance with current banking practice when obtaining references concerning a proposed customer, he may later have cause for regret."

10. M.L. Tannan in Banking Law and Practice, in India, 18th edn. at page 198 says:

"Before opening a new account, a banker should take certain precautions and must ascertain by inquiring from the person wishing to open the account, if such person is unknown to the banker, as to his profession or trade as well as the nature of the account he proposes to open. By making necessary inquiries from the references furnished by the new customer, the banker can easily verify such information and judge whether or not the person wishing to open an account is a desirable customer. It is necessary for a bank to inquire, from responsible parties, given as references by the customer, as to the latter's integrity and respectability, an omission of which may result in serious consequences not only for the banker concerned, but also for other bankers and the general public."

11. One of the tests of deciding whether the bank was negligent, though not always conclusive, is to see whether the Rules or instructions of the banks were followed or not. We may accordingly consult those instructions. Ex. B-6 contains the general instructions regarding constituent accounts for bank. Mark II deals with opening with opening of accounts. It says:

"Except at large branches where the sub-agent or accountant may be authorised to open Current Accounts, no new Current Account shall be opened without the authority of the agent manager who is solely responsible for all Current. Accounts being opened in the proper manner. A written application on the appropriate from must be submitted and will be initiated by the agent at the top left corner after he has satisfied himself of the respectability of the applicant (s). It is important that every party must be introduced to the Bank by a respectable person known to the Bank, who must normally call at the Bank and sign in the column specially provided for the purpose in the account opening form. In all cases his signature must be verified with the specimen lodged and attested. The agent or accountant may introduce constituents to the Bank provided they are known to him personally and in such cases he should sign the application from at the appropriate place in his personal capacity. When the

introduction of any other member of the staff is accepted, the agent must invariably make independent inquiry and record his findings on the account opening form for future reference if the need arises..."

12. Mark IV deals with accounts of proprietary concerns. It says:

> "An individual trading in the name of concern should fill in Form F.S. 5 and sign it in his personal Name and also affix his signature on behalf of he concern as proprietor in the space provided."
>
> If the banker was negligent in following up the references given at opening of account and subsequently cheques etc. are collected for the customer paid into that account and those happened to be of someone else the Bank may be liable to conversion, unless protected by law. In the instant case, Sethuraman having been known to the Manager who gave the introduction, there was no violation of any instruction or rules.

13. It was held in *Commissioners of Taxation vs. English, Scottish and Australian Bank*[6]) that a negligence in collection is not a question of negligence in opening an account, though the circumstances connected with the opening of an account may shed light on the question whether there was negligence in collecting a cheque.

14. In *Ladbroke and Co. vs. Todd*[7], the plaintiff drew a cheque and sent it to the payee by post. The letter was stolen and the thief book it to the defendant, a banker, and used it for the purpose of opening an account for the purpose of which he forged the payee's endorsement. The defendant accepted believing him to be the payee. He was not introduced to the bank and no references were obtained. The defendant opened to the account and the cheque was specially cleared at the request of the thief, and he drew out the proceeds on the next day. On the discovery of the fraud the plaintiff brought an action against the defendant for conversion. One of the main questions raised was whether the account having been opened by payment in all the cheques to be collected the defendant could be properly regarded as having received payment for a customer. It was held that as account was already opened when the cheque was collected, payment had been received for a customer. The drawer thereupon sent another cheque to the real payee and took an assignment of his rights in the stolen cheque and, as holders of the cheque or alternatively as assignees, brought an action against the bank to recover the proceeds collected by the bank as money had and received to their use. Evidence was given that it was the general practice of bankers to obtain a satisfactory introduction or reference. It was held that the banker had acted in good faith, but was guilty of negligence in not taking reasonable precautions to safeguard the interests of the true owner of the cheque and that therefore he had put himself outside the protection of Section 82 of the *Bills of Exchange Act, 1882*. Bailhache, J. also said that the banker would have been entitled to the protection of the section as having received payment for a customer, but had lost it owing to his want of due care. It was also held that the relation of banker and customer began as

soon as the first cheque was handed in to the banker for collection, and not when it was paid.

15. In *Turner vs. London and Provincial Bank*[8] evidence was admitted as proof of negligence, that the customer had given a reference on opening the account and that this was not followed up."

10. The principles governing the liability of a collecting banker have also been extracted in the impugned judgment. They read as follows:

"(1) As a general rule the collecting banker shall be exposed to his usual liability under common law for conversation or for money had and received, as against the 'true owner' of a cheque or a draft, in the event the customer from whom he collects the cheque or draft has not title or a defective title.

(2) The banker, however, may claim protection from such normal liability provided he fulfils strictly, the conditions laid down in S. 131 or S.131A of the Act and one of those conditions is that he must have received the payment in good faith and without negligence.

(3) It is the banker seeking protection who has on his shoulders the onus or proving that he acted in good faith and without negligence.

(4) The standard of care to be exercised by the collecting banker to escape the charge of negligence depends upon the general practice of bankers which may go on changing from time to time with the enormous spread of banking activities and cases decided a few decades ago may not probably offer an unfailing guidance in determining the question about negligence today.

(5) Negligence is a question of fact and what is relevant in determining the liability of a collecting banker is not his negligence in opening the account of the customer but negligence in the collection of the relevant cheque unless, of course, the opening of the account and depositing of the cheque in question therein from part and parcel of one scheme as where the account is opened with the cheque in question or deposited therein so soon after the opening of the account as to lead to an inference that the depositing the cheque and opening the account are interconnected moves in a integrated plan.

(6) Negligence in opening the account such as failure to fulfill the procedure for opening an account which is prescribed by the bank itself or opening an account of an unknown person or non-existing person or with dubious introduction may lead to a cogent, though not conclusive, proof of negligence particularly if the cheque in question has been deposited in the account soon after the opening thereof.

(7) The standard of care expected from a banker in collecting the cheque does not

require him to subject the cheque to a minute and microscopic examination but disregarding the circumstances about the cheque which on the face of it give rise to a suspicion may amount to negligence on the part of the collecting banker.

(8) The question of good faith and negligence is to be judged from the stand point of the true owner towards whom the banker owes no contractual duty but the statutory duty which is created by this section and it is a price which the banker pays for seeking protection, under the statute, from the otherwise larger liability he would be exposed to under common law.

(9) Allegation of contributory negligence against the paying banker could provide no defence for a collecting banker who has not collected the amount in good faith and without negligence".

11. On the basis of the above law, let us now see whether the 1st Respondent bank has discharged the burden which lay upon it to show that it had acted in good faith and without negligence.

12. The facts narrated hereinabove indicate that the transaction of opening of the account, depositing the exact amount for being entitled to receive a cheque book, depositing of the cheque of Rs. 1,00,000/- and the withdrawal of the sum of Rs. 50,000/- were all part of the same transaction. All these took place in close proximity to each other.

13. The 1st Respondent's Branch Manager gave evidence. From his evidence it is clear that the person who called himself K. Narayhanan opened an account on the introduction of an account holder by name Dharman Panicker. In the Account Opening Form the address is given only as 'Kaniyarath P.O. Kallisseri". Thus an absolutely vague address was given. The Bank made no enquiries as to the credit worthiness of the said K. Narayhanan or as to his full address or even about his telephone number. Thereafter even though initially the account was opened with only Rs. 20/- the exact amount of Rs. 80/- was deposited for purposes of receipt of a cheque book. The 1st Respondent bank does not seem to have put on its guard, even when a cheque for a very large amount i.e. Rs. 1,00,000/- was deposited soon thereafter. In cross-examination the Branch Manager admits that in the Account opening form neither the name nor the occupation of the person introducing had been filled up. He admits that no enquiry was made regarding the nature of business of K. Narayhanan or where the place of business was. Even after it was found out that that a cheque had been forged and stop payment notice had been issued, no enquiry was made by the Bank with the introducer. When asked why no enquiries were made, the answer given was that the bank has no responsibility to look into it. Another factor which mitigates against the 1st Respondent Bank is that it made no attempt to lead the evidence of the person who had introduced the account holder.

14. It appears to us that the above mentioned facts discloses that the 1st Respondent bank has not discharged the burden which lay upon it to show that it had acted in good faith and without negligence.

15. In this view of the matter, we are unable to sustain the impugned judgment. It is accordingly set aside. The decree of the trial Court is restored. This Appeal stands disposed of accordingly. There will be no order as to costs.

[1] *(1962) vol. 75 Company Cases 481*
[2] *(1991) 70 Company Cases 748*
[3] *1956 AIR (Calcutta) 399*
[4] *1972 Kerala Law Times 518*
[5] *1981 AIR (Madras) 129*
[6] *1920 AC 683*
[7] *1914 (30) TLR 433)*
[8] *(1903) 2 Legal Decisions Affecting Bankers 33*