

(1993) 04 KAR CK 0024
In the Karnataka High Court
Case No : First Appeal No. 184 of 1989

M/s. Praveen Metal Agencies, Bangalore and others	APPELLANT
Vs	
M. Balasubramanyam and another	RESPONDENT

Date of Decision : 01-04-1993

Acts Referred:

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

Citation : AIR 1993 Kar 334 : (1993) ILR (Kar) 1538 : (1993) 2 KarLJ 123

Hon'ble Judges : M.M. Mirdhe, J;K. Shivashankar Bhat, J

Bench : Division Bench

Advocate : S.P. Shankar, for the Appellant; H.B. Datar and H.N. Narayan, for the Respondent

Judgement

Shivashankar Bhat, J.—The appeal is by the plaintiffs. According to the plaint the plaintiffs are dealing in metal scraps among other goods and the two plaintiffs are having common partners. The transactions in question are common as against the defendants-1 and 2 and consequently the suit is filed invoking Order I, Rule 1 of Code of Civil Procedure.

2. The first defendant started a metal rolling mill at Bangalore. The second defendant is a trader in metal scraps. The plaintiffs and second defendant had several business transactions. Financial accommodation was also being provided between them in the matter of providing stock and arranging finances. According to the plaintiffs, the first defendant issued two cheques dated 16-4-1981, one for Rs.20,000/- and another for Rs.52,041/- in favour of the second defendant. These cheques were endorsed by the second defendant in favour of the plaintiffs for valuable consideration, the consideration being the adjustment of the amounts due from the second defendant to the plaintiffs under the respective accounts. However, when the plaintiffs presented these cheques, they were returned by the Bank. According to the plaintiffs they are the holders in due course and therefore entitled to claim the amounts payable under the two cheques. One cheque for Rs. 52,041/-was endorsed in favour of the first plaintiff

and the other cheque for Rs. 20,000/- was endorsed in favour of the second plaintiff. The plaint also states that the second defendant had sold brass sheet cutting scrap to the first defendant, value of which was Rs. 72,041/-. The two cheques were issued by the first defendant towards this amount representing the value of the scrap purchased by the first defendant from the second defendant. It is unnecessary to refer to other statements in the plaint for the purpose of this appeal. The suit claim is Rs. 1,00,000/- inclusive of the interest up to the date of the suit. The plaintiffs claim current and future interest also at 18% per annum.

3. The first defendant stated that he was not aware of the status of the plaintiffs as trading firms. The plaintiffs were called upon to prove strictly the averments regarding the alleged financial accommodation between the plaintiffs and the second defendant. According to the first defendant the first defendant never purchased anything from the second defendant valued at Rs. 72,041/- and no cheques were issued by the first defendant. The first defendant had a manager by name Shanmugam. He was in possession of cheque leaves left with him by the first defendant duly signed by the first defendant. These cheques were left with the manager "for the purposes of office establishment". However, the said Shanmugam misused the cheques. There were series of fraudulent transactions carried out by the said manager; since the cheques were not genuine and were not issued by a competent person, the first defendant denied any liability thereunder. The first defendant also did not admit that the plaintiffs are the purchasers for valuable consideration of the alleged cheques. The alleged adjustment between the plaintiffs and the second defendant were also denied. The first defendant asserts that the suit was filed in collusion with the second defendant.

4. The second defendant asserted that he obtained the two cheques from the first defendant in consideration of the supply of metal scraps. The second defendant pointed out that there were other sale transactions under which the first defendant purchased another quantity of metal scraps and issued a cheque for Rs. 66,821 /- dated 25-2-1981. The suit cheques were with reference to invoice No. 229 while the cheque dated 25-2-1981 for another sum of Rs.66,821/- was with reference to invoice No. 230. The second defendant endorsed the two cheques connected with invoice No. 229 in favour of the plaintiffs for valuable consideration and consequently the plaintiffs were the holders in due course. However, the second defendant denied any liability to meet the claim of the plaintiffs since the accounts have been settled between them.

5. The trial Court framed the following issues:

"1. Whether the plaintiffs prove that they having purchased the cheques in question for valuable consideration become holders in due course of the said two negotiable instruments?

2. If so, whether defendant 1 proves that because of the misuse of the cheques

signed and kept by him by his manager Shanmugam (as contended in para 2 of his written statement) he is not liable to pay the suit claim?

3. Whether the proceeding initiated in IC. No. 10 of 1981 is a bar to the present suit?

4. Whether the suit is bad for misjoinder of parties and causes of action.?

5. What decree or order?"

It was held by the trial Court that the plaintiffs have proved that they were holders of two cheques Exs. P4 and P5 on payment of consideration. However the trial Court held that the plaintiffs failed to find out whether the said cheques were issued by the first defendant in consideration of the goods allegedly supplied by the second defendant to the first defendant. Though the cheques were signed by the first defendant, the name of the payee and the amount in the cheques were found in different writings. This should have created suspicion in the mind of the plaintiffs and the plaintiffs should have held an appropriate enquiry; this having been not done by the plaintiffs, it cannot be held that they were holders in due course falling within Section 9 of the Negotiable Instruments Act. The trial Court held that Shanmugam, employed by the first defendant had no authority to issue the cheques and blank cheque leaves were entrusted to him to meet the electricity and other office establishment bills, including the demands of the Commercial Tax Department. According to the trial Court, the plaintiffs should have called upon the second defendant to produce the invoice books to prove that goods were supplied by the second defendant to the first defendant. The substance of the reasoning of the trial Court was that the first defendant was the victim of the fraud played upon by his employee and therefore there was no consideration for the cheques Exs. P4 and P5.

6. The question to be considered by us in this appeal is whether the plaintiffs were the holders in due course.

7. So long as there is nothing to evoke suspicion in the mind of an indorsee about the genuineness of a cheque, he will be its holder in due course, provided there was a consideration for the indorsement. Section 9 of the Negotiable Instruments Act reads thus:

"Holder in due course. -- "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."

If, in the instant case, the plaintiffs became the possessors of the cheques for consideration, before the amount mentioned in the cheques became payable, the plaintiffs could be considered as holders in due course provided they became the

possessors of the cheques without having sufficient cause to believe that any defect existed in the title of the second defendant. Therefore the first question is to find out whether there was any consideration went to the 2nd defendant from the plaintiffs for the cheques endorsed in their favour and the second question is whether there was any sufficient cause which should have made the plaintiffs to verify as to the genuineness of the title of the second defendant to the cheques.

8. On the first question even the trial Court has held in favour of the plaintiffs. The relevant accounts maintained by the plaintiffs in due course of their business were marked in evidence and spoken to by P.W. 1. It is clear from Ex. P6 that there were prior dealings between the plaintiffs and the second defendant. Amounts were being adjusted in the accounts either by receipt of cash or cheques. When Exs. P4 and P5 were indorsed in favour of the plaintiffs by the second defendant, in the accounts of the plaintiffs some amounts were due to them by the second defendant. The cheques indorsed in favour of the plaintiffs were accordingly adjusted towards this amount. However, subsequently the cheques were not honoured by the Bank. The fact remains that there were dealings between the plaintiffs and the second defendant and the outstanding due to the plaintiffs by the second defendant were adjusted by virtue of the cheques being indorsed in favour of the plaintiffs. Therefore it cannot be denied that there was a valid consideration for the endorsement; in other words the plaintiffs became the holders in due course of the cheques because they came to possess the cheques for valid consideration.

9. The trial Court negated the claim of the plaintiffs on the ground that the plaintiffs ought to have enquired about the binding nature of the cheques since the cheques were not in the handwriting of the signatory, in the sense the name of the payee and the amounts were written by someone else. Further, the trial Court obviously sympathised with the plight of the first defendant having regard to the fraud played upon by his employee Shanmugam.

10. It is undisputed that the first defendant is carrying on business operations in Bangalore, though he is a resident of Madras. According to the plaintiffs the first defendant was a reputed concern. It is usual for an employee to fill up the cheques though the cheques ought to be signed by the proprietor. Only because some part of the cheque is written by someone else it cannot be held that a third party should be on guard against accepting the cheque provided the third party has no reason to suspect the genuineness of the signature. Admittedly the first defendant left signed cheque leaves with Shanmugam. Shanmugam was the manager in charge of the establishment at Bangalore. In such a situation, if the manager issues the cheques the burden will be entirely on the first defendant to show that the person who came into possession of cheque received the cheque with knowledge of the suspicious circumstances warranting an enquiry by the said persons to the title of the payee. When blank cheques were entrusted to Shanmugam the first defendant invited considerable risk on himself. He cannot blame a third party who received the cheque for consideration and assert that

the third party should have enquired with the first defendant as to whether the cheque was properly issued.

11. The trial Court is not right in holding that the plaintiff should have enquired with the first defendant before receiving the cheque from second defendant. u/s 9 a person becomes a holder in due course if he gets the cheque for consideration without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title. In other words it shall have to be established here that the plaintiff had sufficient cause to believe that some defect existed in the title of the second defendant to the cheque.

12. There is a presumption u/s 118 of the Negotiable Instruments Act that every such instrument was made or drawn for consideration and that a holder of negotiable instrument is a holder in due course, subject to the proviso stated in clause (g) Section 118. The first defendant has not proved that there was any collusion between the plaintiffs and the second defendant. The first defendant has been asserting that the second defendant did not supply any material to the first defendant. The burden was on the first defendant to have the books of the second defendant summoned. The report of the chartered accountant, appointed as commissioner, who examined the books of the first defendant shows that several materials were available with the first defendant. It is not a case where the first defendant's shop did not possess any material similar to the one supplied by the second defendant. A perusal of the evidence of D.W. 1 shows that his allegation against the plaintiff and the second defendant is quite vague. His entire evidence is concentrated to show that he was the victim of p. fraud played by Shanmugam. However, he has not been able to show any link between Shanmugam and the plaintiffs or between the second defendant and the plaintiffs.

13. The learned authors, Bhashyam and Adiga on the Negotiable Instruments Act, (15th Edition), states at page 172 thus:

"The expression "without having sufficient cause to believe" has been interpreted as more favourable to the person who claims to have become a holder in due course than the words, "acting bona fide". The claim of a holder of an instrument will be defeated only by proving the existence of positive circumstances to put him on inquiry. Mere failure to prove bona fide or absence of negligence on his part would not negative his claim."

In M/s. U. Ponnappa Moothan Sons, Palghat Vs. Catholic Syrian Bank Ltd. and others, the scope of Section 9 of the Negotiable Instruments Act came up for consideration. At page 449 it was held thus:

"However, with regard to the legal importance of negligence in appreciating the principle of "sufficient cause to believe" a passage from Chalmers' book "The Law Relating to Negotiable Instruments in British India" 4th Edn. may usefully be noted:

"All the circumstances of the transactions whereby the holder became possessed of the instrument have a bearing on the question whether he had "sufficient cause to believe" that any defect existed.

It is left to the Court to decide, in any case where the holder has been negligent in taking the instrument without close enquiry as to the title of his transferor, whether such negligence is so extraordinary as to lead to the presumption that the holder had cause to believe that such title was defective."

This view is more sound and logical. The legal position as explained by Chitty may be noted in this context which reads as under:

"While the doctrine of constructive notice does not apply in the law of negotiable instruments the holder is not entitled to disregard a "red flag" which has raised his suspicions."

We, therefore, modify the view taken by the Allahabad High Court in *Durga Shah Mohan Lal Bankers Vs. Governor General in Council and Others*, , to the extent that though the failure to prove bona fide or absence of negligence would not negative the claim of the holder to be a holder in due course yet in the circumstances of a given case, if there is patent gross negligence on his part which by itself indicates lack of due diligence, it can negative his claim, for he cannot negligently disregard a "red flag".

There is also an indication in the above decision of the Supreme Court that it is not for the indorsee of the cheque to enquire about the transactions between the drawer of the cheque and the person in whose favour it was drawn. At page 451 the Supreme Court stated on the facts, thus:

".....It should therefore necessarily be inferred that there is also an implied contract to credit the proceeds of the cheques in favour of defendant No. 1 to his account before actually receiving them. As a question of fact this aspect is established by the evidence on record. In such a situation the plaintiff need not make enquiries about the transactions of supply of goods etc. that were going on between defendants Nos. 1 and 6. Even if defendant No. 1 has not supplied the goods in respect of which the cheque in question were issued by defendant No. 6 there was no cause at any rate sufficient cause for the plaintiff to doubt the title of defendant No. 1 nor can it be said that the plaintiff acted negligently disregarding "red flag" raising suspicion. Viewed from this background it cannot be said that there was sufficient cause to doubt the title nor there is scope to infer gross negligence on the part of the plaintiff."

We have already pointed out that requisite "red flag" is not forthcoming in the instant case so far as the plaintiffs are concerned. It is entirely unnecessary for us to examine the genuineness of the transaction between the first defendant and the second defendant and therefore it is unnecessary to go into the question whether Ex. P3 was properly proved. The trial Court committed a gross error in going into the genuineness of the transaction between defendants-1 and 2 and

then attribute it to the transaction between the plaintiffs and the second defendant.

14. For the reasons stated above we disagree with the decree of the trial Court so far as the trial Court dismissed the suit against the first defendant. Accordingly this appeal is allowed. There shall be a decree against the first defendant also. The defendants-1 and 2 are jointly and severally liable to meet the claim of the plaintiffs in respect of the amount decreed by the trial Court. The first defendant shall pay the costs of this appeal to the plaintiffs-appellants.

15. Appeal allowed.