

Virgo Steels Vs Bank of Rajasthan Ltd. and others

Court: Bombay High Court

Date of Decision: July 29, 1997

Acts Referred: Civil Procedure Code, 1908 (CPC) â€” Order 37 Rule 2
Negotiable Instruments Act, 1881 (NI) â€” Section 30, 52
Uniform Customs and Practice for Documentary Credits, 1993 â€” Article 10

Citation: AIR 1998 Bom 82 : (1997) 4 ALLMR 729 : (1998) 3 BomCR 773

Hon'ble Judges: M.B. Shah, C.J; Smt. R.P. Desai, J

Bench: Division Bench

Advocate: Janak Dwarkadas, D.V. Merchant and Leena Mirasee instructed by M/s. Shah and Sanghiv, for the Appellant; Virendra Tulzapurkar and Virag Tulzapurkar, instructed by y M/s. Kanga and Co. and S.H. Doctor, K.L. Desai and A. Hirani Advs. instructed by y M/s. Majumdar and Co. and C.R. Patel, instructed by y M/s. C.R. Patel and Co., for the Respondent

Judgement

@JUDGMENTTAG-ORDER

M.B. Shah, C.J.

These nine Appeals are filed by defendants against orders passed by the learned Single Judge granting conditional leave

to defend in the summonses for Judgment in three summary suits.

2. (a) Summons for Judgments No. 425 of 1994 in Summary Suit No. 4510 of 1993:

The suit is filed by the Bank of Rajasthan Limited against UCO Bank (defendant No. 1), Virgo Steel (defendant No. 2) and Krishna Steel Udyog

(defendant No. 3). Virgo Steel opened an Irrevocable letter of credit dated 22nd August, 1991. The letter of credit was for the benefit of Krishna

Steel Udyog (defendant No. 3) Defendant No.3 drew a Bill of Exchange dated 22nd August, 1991 for a sum of Rs. 49,50,000/- and presented all

the relevant documents to the Bank of Rajasthan Limited (plaintiffs). The Bank of Rajasthan Limited forwarded the original documents, together

with the Letter of Credit, to UCO Bank and sought a confirmation whether the documents were in order. UCO Bank, by their reply dated 27th

August, 1991 confirmed that the documents were in order, and that they would make payment on due date. After receiving the said confirmation,

the Bank of Rajasthan Limited paid the amount to Krishna Steel Udyog. As the amount was not received by the Bank of Rajasthan Limited, the

suit is filed against the UCO Bank on the basis of Letter of Credit, against Virgo Steel, as the Acceptors of the Bill of Exchange and against

Krishna Steel Udyog, as the Drawers of the Bill of Exchange.

The suit claim is for recovery of Rupees 63,90,257/- with interest on the principal sum of Rs. 49,50,000/- at the rate of 18% per annum from the

due date till payment. Leave to defend is granted on depositing Rs. 32 lacs.

(b) Summons for Judgment No. 426 of 1997 in Summary Suit No. 4513 of 1993 :

The parties in the aforesaid suit are the same, except change of dates with regard to Bills of Exchange and Letters of Credit.

Leave to defend is granted on the condition of depositing Rs. one crore by the defendants. The claim in the suit is Rs. 2,57,19,511.64 with interest

on the principal sum of Rs. 1,96,95,000/- at the rate of 17.5% per annum.

(c) Summons for Judgment No. 427 of 1994 in Summary Suit No. 226 of 1994 ;

The Bank of Rajasthan Limited has filed suit against defendant No. 1, the UCO Bank, defendant No. 2, Virgo Steel, and defendant No. 3,

Western Ministeel Limited.

It is the contention of the plaintiffs, Bank of Rajasthan Ltd., that UCO Bank (defendant No. 1) had issued Letters of Credit at the request of

defendant No. 2, Virgo Steel. Western Ministeel Limited (defendant No. 3) delivered Letters of Credit and other documents, including Bills of

Exchange to the Bank of Rajasthan Limited for negotiation. The Bank of Rajasthan Limited sought a confirmation from the UCO Bank as to

whether the documents drawn under the Letters of Credit were in order and whether they were acceptable to the UCO Bank. The UCO Bank,

upon physical examination of the documents, by their letter dated 9th August, 1991, confirmed that the documents were in order and that they

would release payment on due date by their Pay Order to Bank of Rajasthan Limited. Upon receiving such confirmations, the plaintiff, Bank of

Rajasthan Limited, made payment to defendant No. 3, Western Ministeel Limited.

Bills of Exchange are drawn by Western Ministeel Limited (defendant No. 3), Drawers, on Virgo Steel (defendant No. 2). Virgo Steel (defendant

No. 2) had unconditionally accepted the same. This suit is filed by the Bank of Rajasthan Limited against the UCO Bank, Virgo Steel and Western

Ministeel Limited, as the plaintiff did not receive the payment from neither the UCO Bank, nor from the acceptors, on the due dates, by contending

that all the three parties were jointly and severally liable for payment to the Bank of Rajasthan Limited.

The suit claim is Rs. 4,65,31,858.40 with interest on the principal sum of Rs. 3,63,63,752.60 at the rate of 18% per annum from the due date till

payment. Leave to defend is granted on the condition of depositing Rs. 2.43 crores by the defendants.

3. Against these three orders dated 22nd January, 1997 passed in summonses for Judgment No. 425 of 1994, 426 of 1994 and 427 of 1994, all

the defendants have filed the aforesaid 9 appeals separately. As the contentions raised in all these appeals are similar, these appeals are disposed

of by this common judgment and order.

4. We would first examine the liability of the drawer and the drawee of the Bill of Exchange in case of dishonour of the Bill of Exchange under the

Negotiable Instruments Act, 1881. Section 30 reads as under:-

30. Liability of drawer.---The drawer of a Bill of Exchange or cheque is bound in case of dishonour by the drawee or accept or thereof, to

compensate the holder, provided due notice of dishonour has been given to, or received by, the drawer as hereinafter provided.

5. In view of the aforesaid section, the drawers of the Bill of Exchange are bound, in case of dishonour by the drawees or acceptors, to

compensate the holders, that is to say, Western Ministeel Limited (defendant No. 3) in summons for Judgement No. 427 of 1994 or Krishna Steel

Udyog (defendant No. 3) in summons for Judgment No. 425 of 1994, would be liable to compensate the Bank of Rajasthan Ltd., as the Bill of

Exchange has been dishonoured by the Drawers and Acceptors, Virgo Steel (defendant No. 2).

It is not disputed that, in all the three suits, the drawees have accepted the Bill of Exchange in writing on the Bills of Exchange. Section 32 provide

as under :-

32. Liability of maker of note and acceptor of bill.---In the absence of a contract to the contrary, the maker of a promissory note and the

acceptor before maturity of a bill of exchange are bound to pay the amount thereof at maturity, according to the apparent tenor of the note or

acceptance respectively, and the acceptor of a bill of exchange at or after maturity is bound to pay the amount thereof to the holder on demand.

In view of the aforesaid section, the acceptor of the Bill of Exchange is bound to pay the amount at or after maturity to the holder on demand.

6. Section 52 provides for endorsement of the negotiable instrument by excluding endorser's liability. One illustration to the said section is that the

endorser of a negotiable instrument can sign his name, adding the words without recourse. Upon this endorsement, he incurs no liability, in case of

dishonour of the instrument. In the present case, there is no endorsement to the effect ""without recourse"" to the drawer.

In view of these facts, prima facie, for defendant Nos. 2 and 3 there appears to be no defence.

7. However, Mr. Chagla, learned Counsel appearing for the appellants, drawers of the Bills of Exchange, vehemently submitted that defendant No.

3 is not liable under the suit Bills of Exchange, because the said Bills of Exchange are drawn under the Letters of Credit, and that Letters of Credit

provided available by your drafts drawn payable on 180th day from the date of acceptance by UCO Bank, Mandvi Br. Bombay-400 003 without

recourse to drawers. ...

8. In our view, this submission is without any substance qua the plaintiffs. Liability of the drawers of the Bill of Exchange is not governed by the

Letters of Credit. Conditions in the Letters of Credit by using the expression ""without recourse to the drawers"" are between UCO Bank and the

drawers, but, with regard to the liability of the drawers of the Bills of Exchange to make payment in case of not making payment by the UCO

Bank, which have issued Letters of Credit, the holders of the Bills of Exchange are entitled to recover it from the drawers of the Bills of Exchange.

This is absolutely clear in view of section 30 of the Negotiable Instruments Act. This is also Clear from Article, 10A(o)(iv) of the Uniform Customs

and Contract for Documentary Credit UCP, under which Article, UCO Bank is required to make payment without recourse to the drawers and/or

bona fide holders of the drafts drawn by the beneficiary under the Letters of Credit. It would mean that, if the UCO Bank makes payment under

the Letters of Credit, UCO Bank cannot demand such payment from the drawers, for whose benefit, Letters of Credit were issued, or from the

bona fide holders of the drafts. It has to recover it from the drawees, but this would not mean that the liability of the drawers in case of failure on

the part of the UCO Bank to make payment under the Letters of Credit, for one or the other reason, would absolve the drawers of their liability to

make payment.

9. Learned Counsel, Mr. Chagla, for the appellants (Drawers) referred to the Law of Banker's Commercial Credits by Gut ridge and Megrah,

particularly to the passage captioned ""Recourse"" at page 84, wherein it is stated as under :-

Recourse.---The reference in the Uniform Customs to recourse is to be found in Article 3(b)(iii), whereby a continuing bank undertakes:

(iii) To purchase, negotiate, without recourse to drawers and on bona fide holders, drafts drawn by the beneficiary, at sight or at a tenor, on the

issuing Bank, or on the applicant for the credit or on any other drawee specified in the credit, if the credit provides for purchase/negotiation.

Provided that the terms and conditions of the credit are complied with. It is to be noted that nothing is said as to negotiation of documents

unaccompanied by a draft; the question of payment might be difficult in that case. The 1983 Article 10 covers the same ground except that in sub-

article (a.ii) it covers deferred payment and in (b.iv) (confirmation) there is no recourse on drafts drawn on the issuing Bank or the applicant the

credit or on any other drawee stipulated in the credit other than the confirming Bank itself. The reason for this explicit addition is not obvious. In

terms the Article prohibits recourse by an issuing or confirming bank against the drawer-beneficiary of a credit or the bona fide holder of his draft.

If the credit is open to negotiation by any bank an intermediary bank purchasing or negotiating drafts may make whatever terms it likes as a

condition and may retain recourse to the drawer-beneficiary in case the issuing Bank fails for whatever reason to meet its obligation. That

obligation is dependent upon the seller-beneficiary's compliance with the terms and conditions of the credit, which include the tender of the proper

documents.

It has been suggested that there should not be any right of recourse because the negotiating Bank-purchaser of the draft looks solely to the credit

of the drawee Bank and impliedly releases the drawer. There seems, however, to be no foundation for this view; it is a question of fact. No doubt

the purchaser of the draft places his chief reliance on the credit of the Bank but, except for Article 3 of the Uniform Customs, this will not of itself

suffice to release the seller. If the seller desires to escape liability he can sign his draft without recourse, and if he fails to do so or is prohibited by

the terms of the credit from doing so he must (again, apart from Article 3) be taken to have accepted the usual liabilities of the drawer of a Bill of

Exchange,

10. In the present case, admittedly there is no endorsement on the Bill of Exchange to the effect "'without recourse'" to the drawer. Even the learned

Authors have observed, as quoted above, that there is no foundation for the view that there should not be any right of recourse to the drawer

because the negotiating Bank-purchaser of the draft looks solely to the credit of the drawee bank and impliedly releases the drawer. The learned

Authors have further stated that the right of recourse to the beneficiary is of value and renders purchase or negotiation more likely. If a Bank buys

or negotiates the drawer's draft it would normally have a right of recourse to the drawer in the event of dishonour, such right deriving from the law

relating to negotiable instruments. Under the Negotiable Instruments Act, as discussed above, section 30 specifically provides that a drawer of a

Bill of Exchange is bound, in case of dishonour by the drawee or acceptor thereof, to compensate the holder. Hence the drawer and drawee in the

present case are jointly and severally liable to make payment to the Bank of Rajasthan Ltd.

11. The learned Counsel further referred to the decision rendered by the Supreme Court in the case of AIR 1990 2218 (SC) wherein, with regard

to granting of leave to defend in a suit which was brought under Order XXXVII, Rule 2 of the Code of Civil Procedure, the Court has held that

leave to defend is declined where the Court is of the opinion that grant of leave would merely enable the defendant to prolong the litigation by

raising untenable and frivolous defenses; the test is to see whether the defence raises a real issue and not a sham one, in the sense that if the facts

alleged by the defendant are established there would be a good or even a plausible defence on those facts. The Court has held that summary

judgments under Order XXXVII should not be granted where serious conflict as to matter of fact or where any difficulty on issues as to law arises.

As discussed above, in the present suits, there is no dispute with regard to Bill of Exchange or drawer's acceptance. Hence there appears no

plausible defence to the drawer and the drawee of the Bill of Exchange.

12. Now we would deal with the appeals filed by UCO Bank.

Admittedly, UCO Bank had issued Letter of Credit at the request of M/s. Virgo Steel, original defendant No. 2. As per the said Letter of Credit,

the Bank has issued irrevocable Letter of Credit at the request of M/s. Virgo Steel (defendant No. 2) in favour of defendant No. 3, Western

Ministeel Limited for the sum mentioned in the said Letter of Credit (L/C). It specifically provides that drafts drawn were payable on the 180th day

from the date of acceptance by UCO Bank, Mahim Branch, Bombay, without recourse to drawers. It specifically provides that all drafts drawn

under this credit must be marked "'Drawn under Letter of Credit No.and carry charges and interest at NIL from (he date of negotiation to the

date of acceptance'". It also provides that "'documents under this credit are to be negotiated through any Bank'".

13. On the basis of the said L/C, complying with the said conditions, the drawer has drawn the Bills of Exchange which were negotiated by the

Bank of Rajasthan. On receipt of the said drafts, the Bank of Rajasthan wrote letters to UCO Bank, Mahim Branch, along with documents for

reference. Thereafter UCO Bank replied as under :-

We confirm as under:

The documents are acceptable to us under L/C.

2. The signature of the acceptance of Mr. Narendra Goshar (Partner) is as per our records.

3. We will release the payment directly to you by our Pay Order on due date.....

14. It appears that subsequently on October 21, 1991 the Deputy General Manager of UCO Bank wrote to the Senior Manager, Bank of

Rajasthan, Nariman Point, Bombay, to the effect that "our enquiry reveals that M/s. Virgo Steels, the drawee of the bills, in connivance with some

of the officials of the Branch got the L/Cs opened much in excess of the limit for which they were not authorised by the Bank, Necessary steps

against the erring officials as well as the drawee of the bills are being taken by us. Under the circumstances, we hereby disown our liability for

payment of the bills on due dates". There is on record a further letter dated November 14, 1991 written by Deputy General Manager of UCO

Bank to the Assistant General Manager of Bank of Rajasthan wherein it is stated as under:-

You must have observed that all bills were drawn on the basis of Proforma Invoice, drawn by M/s. Western Ministeel Ltd. on M/s. Virgo Steel

which shows that there was no genuine transaction on the basis of which bills were drawn. The modus operandi of the transaction confirms that

both the parties entered into an agreement to accommodate the drawer of the bills for reasons best known to them and we have been informed

that no actual delivery of goods was made under the bills negotiated by you. You must agree that this type of accommodative transaction arising

out of genuine documents cannot bind the Bank in any way whatsoever.

We agree that said L/Cs were opened by some of our officials but the same was done by them beyond their authority and as such their actions of

opening such L/Cs are not binding on the bank.

15. Learned Counsel for UCO Bank submitted that--

(a) UCO Bank ought to have been given unconditional leave to defend the suit;

(b) the documents are not in accordance with the Letters of Credit inasmuch as the documents were required to be accepted by UCO Bank and

that the Bill of Exchange were not accepted by UCO Bank and that, therefore, UCO Bank cannot be held liable;

(c) there is a fraud or conspiracy amongst the drawers and acceptors of the Bills of Exchange and the Bank of Rajasthan Limited and that

therefore, UCO Bank is not liable to make payment under the Letters of Credit;

(d) the allegations in the plaint regarding estoppel require evidence and therefore it is a triable issue.

16. In our view, the defence raised by UCO Bank qua the plaintiffs, Bank of Rajasthan Ltd. is totally misconceived. UCO Bank has issued

irrecoverable L/C. On the basis of the said L/C, Bank of Rajasthan negotiated the Bills of Exchange drawn by defendant No. 1 Bank and

accepted by defendant No. 2. After receipt of the Bills of Exchange with documents, the Bank of Rajasthan sought confirmation from UCO Bank

and UCO Bank has confirmed the same. In this set of circumstances, whether the drawer or the acceptor or some officers of UCO Bank

committed fraud would hardly be defence for non-payment of the amount due to the Bills of Exchange negotiated by the Bank of Rajasthan a third

party. The dispute between UCO Bank and defendant No. 2 would be of no consequence qua UCO Bank's responsibility to pay the amount to

Bank of Rajasthan.

17. With regard to the liability arising out of irrevocable Letters of Credit, the Supreme Court in the case of U.P. Cooperative Federation Ltd. Vs.

Singh Consultants and Engineers (P) Ltd., , has succinctly set out the nature and ambit of the transaction evidenced by a Letter of Credit. The

Court has held as under:---

45. The Letter of Credit has been developed over hundreds of years of international trade. It was most commonly used in conjunction with the

sale of goods between geographically distant parties. It was intended to facilitate the transfer of goods between distant and unfamiliar buyer and

seller. It was found difficult for the seller to rely upon the credit of an unknown customer. It was also found difficult for a buyer to pay for goods

prior to their delivery. The Bank's Letter of Credit came into existence to bridge this gap. In such transactions, the seller (beneficiary) receives

payment from issuing Bank when he presents a demand as per terms of the documents. The Bank must pay if the documents are in order and the

terms of credit are satisfied, The Bank, however, was not allowed to determine whether the seller had actually shipped the goods or whether the

goods conformed to the requirements of the contract. Any dispute between the buyer and the seller must be settled between themselves. The

courts, however carved out an exception to this rule of absolute independence. The courts held that if there has been fraud in the transaction the

Bank could dishonour beneficiary's demand for payment. The courts have generally permitted dishonour only on the fraud of the beneficiary, not

the fraud of somebody else.

46. It was perhaps for the first time the said exception of fraud to the rule of absolute independence of the Letter of Credit has been applied by

Shientag, J. in the American case of *Sztejn v. J. Henry Schroder Banking Corporation*, 31 N.Y.S 2d 631. Mr. Sztejn wanted to buy some bristles

from India and so he entered into a deal with an Indian seller to sell him a quantity. The issuing bank issued a letter of credit to the Indian seller that

provided that, upon receipt of appropriate documents, the Bank would pay for the shipment. Somehow Mr. Sztejn discovered that the shipment

made was not crates of bristles but crates of worthless material and rubbish. He went to his Bank which probably informed him that the letter of

credit was an independent undertaking of the bank and it must pay.

After discussing various cases the Court has finally observed as under:--

Whether it is a traditional Letter of Credit or a new device like performance bond or performance guarantee, the obligation of banks appears to

be the same. If documentary credits are irrevocable and independent, the bank must pay when demand is made. Since the bank pledges its own

credit involving its reputation, it has no defence except in the case of fraud. The Bank's obligations of course should not be extended to protect the

unscrupulous seller, that is, the seller who is responsible for the fraud. But, the Banker must be sure of his ground before declining to pay. The

nature of the fraud that the courts talk about is fraud of an egregious nature as to vitiate the entire underlying transaction. It is fraud of the

beneficiary, not the fraud of somebody else. If the Bank defects with a minimal investigation the fraudulent action of the seller, the payment could

be refused. The Bank cannot be compelled to honour the credit in such cases. But it may be very difficult for the bank to take a decision on the

alleged fraudulent action. In such cases, it would be proper for the bank to ask the buyer to approach the Court for an injunction.

18. As discussed above, in the present case, irrevocable Letter of Credit was issued by UCO Bank, UCO Bank has confirmed it and after receipt

of the confirmation the plaintiff Bank has paid the amount to defendant No. 2. Till the affidavit-in-reply was filed UCO Bank has never raised any

contention that some Officers of Bank of Rajasthan, which is altogether a third party, was involved in any alleged fraud or conspiracy. Prima facie,

this plea appears to be an afterthought and is absolutely vague. In these sets of circumstances, qua the plaintiff Bank, defendant No. 1 UCO

Bank's plea that some fraud has been committed by the drawer and the drawee and, therefore UCO Bank is not responsible to reimburse Bank of

Rajasthan cannot be accepted.

19. Even if there is some allegation of fraud, the liability of UCO Bank qua the plaintiff cannot be denied on the basis of the circular issued by the

Reserve Bank of India (R.B.I.). For this purpose, learned Counsel for the plaintiff rightly relied upon the circular dated 1st April, 1992 issued by

R.B.I. in such type of cases, which is as under:---

Recently we have come across few instances where letters of credit (L/Cs) were opened by officials of Banks in an unauthorized manner. In

certain cases the L/C transactions were not recorded in the books of the branch by officials issuing them, while in some other cases the amounts of

L/ Cs were much in excess of the powers vested in them for the purpose. Subsequently, the Banks having come to know about the fraudulent issue

of L/Cs have disclaimed liability on the ground that these were transactions involving a conspiracy/collusion between the beneficiary and the

constituent. You will appreciate that if the bills drawn under L/Cs are not honoured, it will adversely affect the character of L/Cs and the relative

bills as an accepted means of payment. This could also affect credibility of the entire payment mechanism through banks and affect the image of the

Banks. In view of this, we advise that banks should honour their commitments/letters of credit and make payments promptly leaving the

opportunity for any complaints in this regard. Needless to say that Banks will take action against the concerned officials as well as constituents on

whose behalf the L/Cs were opened and the beneficiaries of L/Cs as a criminal conspiracy is involved.

From this Circular it is apparent that bills drawn under the L/Cs are required to be honoured. If on such plea bills are not honoured, it would

adversely affect the character of L/Cs and, as stated by R.B.I. this plea also affects the credibility of the entire payment mechanism through Banks

and affect the image of the Banks. In any set of circumstances, in the present case, UCO Bank is bound by its own confirmation that the

documents were in order and that payment is to be made on the due date. Therefore, the learned Judge was right in not granting unconditional

leave to defend to UCO Bank.

20. It is clarified that the observations made in this order and the order passed by the learned Single Judge are only at prima facie stage for

considering whether unconditional leave to defend is required to be granted or not.

21. In the result, all these appeals are dismissed.

22. Operation of this order is stayed for a period of 8 weeks from today.

23. Issuance of certified copy of this order is expedited.

24. Appeals dismissed.