

Privy Council Appeal No. 113 of 1918.

S. N. Sen and another - - - - - *Appellants*

v.

The Bank of Bengal - - - - - *Respondent*

FROM

THE CHIEF COURT OF LOWER BURMA.

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE
PRIVY COUNCIL, DELIVERED THE 18TH DECEMBER, 1919.

Present at the Hearing :

LORD SHAW.

LORD PHILLIMORE.

SIR JOHN EDGE.

MR. AMEER ALL.

SIR LAWRENCE JENKINS.

[*Delivered by* LORD PHILLIMORE.]

One Gnanamutu Stephen was khazanchee at the Rangoon branch of the Bank of Bengal, which Bank is the defendant in the suit and respondent in the present appeal.

Gnanamutu Stephen was also a moneylender carrying on business on his own account. He ceased to be khazanchee on the 27th January, 1903, on which event his son Edward was appointed in his stead.

The bank required Edward to find security, and this security was found by his father for him upon the terms of a tripartite agreement dated the 5th February, 1903, to which the father, the son and the bank were parties.

On the 1st December, 1907, the father took his son Edward and another son, Andrew, into partnership, and the three traded for a short time under the name of G. Stephen & Sons. This did not last long, and the father died on the 27th January, 1908, leaving a will by which, subject to certain provisions for his wife and certain legacies, the residue of his property was bequeathed to his two sons in equal shares.

David Rajh was one of the executors named in the will, and probate was granted to him. He is the second plaintiff in the suit, and the second appellant before the Board.

After the death of the father the partnership was continued between the sons, and an indenture of partnership was executed between them on the 27th April, 1908; but Andrew Stephen on the 1st June, exercised the power given to him by the partnership indenture of giving three months' notice to retire from the partnership, and did so on the 1st September. In March, 1909, Edward tendered to the Bank his resignation of the office, and ceased to be khazanchee on the 18th June, 1909. On the 1st March, 1910, he was adjudicated insolvent, and S. N. Sen, an Official Receiver, is now the representative of his estate. Sen is the first plaintiff and the first appellant.

When the accounts between the Bank and Edward Stephen in his capacity of a customer came to be settled, he was found to be largely indebted to the Bank. The figure as ultimately worked out is Rs. 184,548. The appellants, however, contend that this figure is wiped out because the Bank holds certain promissory notes to the value of Rs. 195,000.

On the 3rd February, 1913, this action was brought for the purpose of recovering from the Bank the security which the father had lodged for the son's faithful discharge of his duties as khazanchee, security, which being at the beginning of the value of Rs. 75,000, had been augmented by interest to Rs. 82,437. The case put forward by the plaintiffs was that all accounts between Edward in his capacity of khazanchee and the Bank had been long since settled, that nothing was due from him in that capacity, that it was immaterial to a claim by the father's representative that money was due from Edward in his capacity as a customer, and that even if that were to be inquired into, the block of securities held by the Bank was more than enough to wipe out the debit. The logical consequence of this would be that Rajh, as representing the father's estate, would be entitled to recover the securities which the father had deposited.

Sen's interest was a derivative one only as representing the son's share as legatee under his father's will, and he seems to have been an unnecessary party. However, no objection was taken. No doubt ultimately, success by the father's executor would inure to the benefit of the creditors of the legatee son, and it is not without some importance, in view of what happened, that Sen and Rajh should be found thus acting together.

The position taken by the Bank was that Edward in his capacity as khazanchee had not been faithful, and that he had committed distinct breaches of the agreement of security by being fraudulent as a customer, and concealing these frauds from the Bank though he was as an official bound to report upon the frauds of a customer or upon anything likely to affect the solvency of a customer, and that, therefore, the loss which the Bank had sustained by reason of his account being in debit was properly attributable to his misconduct as khazanchee. The Bank further

said that, for reasons to be hereinafter mentioned, the block of securities though of the apparent nominal value of Rs. 195,000, either was of no value or was not such as the Bank was bound to realise, while it had, in fact transferred the block for what it was worth to Sen acting on behalf of himself and Rajh.

Part of the security deposited was a sum of Rs. 25,000 cash. During the course of the proceedings, and by arrangement, the other effects were realised, and it was agreed that the total sum thereby obtained amounted to Rs. 82,437.

When the case came on trial in the Chief Court of Lower Burmah, Young, J., decided in favour of the plaintiffs, being of opinion that the Bank was not entitled to retain the security, and ordered it to re-pay to the plaintiffs the sum of Rs. 82,347 with costs.

On appeal, the Court, in its appellate jurisdiction, consisting of Ormond, O.C.J., and Parlett, J., reversed this decision and dismissed the suit with costs in both Courts, hence the present appeal.

The first point made on behalf of the appellants was that the instrument of security was a continuing guarantee within the meaning of the Indian Contract Act, Section 129, and as such was revoked by the death of the surety according to Section 131.

It is to be gathered from the terms of the agreement of the 5th February, 1903, that the natural person to deposit security was Edward Stephen, the new khazanchee, and that by special arrangement the father was let in to deposit security in lieu of the son. There is no binding of the father in the agreement, but merely a pledging of the deposited security. In these circumstances it might be questioned whether there was any contract of guarantee within the meaning of Section 124 of the same Act. But this view does not appear to have been presented to the Courts in India, and their Lordships find it unnecessary to express an opinion upon it.

Both Courts treating the transaction as one of guarantee held that it was not a continuing guarantee, and their Lordships think rightly.

The words of the section are "A guarantee which extends to a series of transactions is called a continuing guarantee." There was no series of transactions here. It was one transaction, the appointment of Edward Stephen to a place of trust in the Bank. So long as he continued in that place the guarantee remained and would not be revoked by the death of the guarantor. Any other view would have consequences very injurious to business. It would put the Bank in the position of having either to get rid of an official forthwith upon the death of his guarantor, which might be most inconvenient, or to keep him without security for his good behaviour. Moreover, as the Judges in the Appeal Court observe, Edward Stephen was entitled to three months' notice, and the Bank could not get rid of him forthwith, and must take a risk for three months if the guarantee was revoked by the father's death.

Their Lordships deem it unnecessary to elaborate the argument on this point.

This point being disposed of, two other questions arise for their Lordships' determination; whether the loss, if any, which the Bank has sustained by reason of the debit on Edward Stephen's account as a customer can be attributed to some misfeasance on the part of Edward Stephen as khazanchee, that is some misfeasance falling within the terms of the instrument of security, and secondly, whether having regard to the block of securities already mentioned as at one time in the possession of the Bank, it is to be held that there is a true debit balance on the account of Edward Stephen as a customer which the Bank cannot, or is not bound to, wipe out by the realisation of this block of securities.

It is now necessary to turn to the terms of the instrument of security. As already stated, it is a tripartite agreement, and it begins with the following recitals:—

“ *Whereas* the said Edward Dawson Stephen (hereinafter called the khazanchee) has been appointed to and now holds the office of khazanchee for the Rangoon Branch of the Bank, and upon the said appointment being made it was agreed that he should furnish security to the Bank to the extent of Rs. 75,000 for the due and faithful performance of the duties of his office. *And whereas* the said Gnanamathu Stephen has at the request of the khazanchee and with the concurrence of the Bank agreed to furnish the said security for the khazanchee in the manner hereinafter stated; namely by depositing with the Bank the sum of Rs. 25,000 in cash, bearing interest at the rate of 5 per cent. per annum, payable at the Bank of Bengal Rangoon half-yearly, and a demand promissory note dated the 1st October, 1902, for Rs. 25,000, signed by S. N. Ramanathen Chetty and V. V. R. Chockalingum Chetty jointly and severally, in favour of the said Gnanamathu Stephen, and by him endorsed to the Bank the said demand promissory note to be a continuing security for so long as the khazanchee shall be liable under this agreement to the Bank and by the mortgage hereinafter recited to the Bank to secure the further sum of Rs. 25,000. *And whereas* in part performance of the said agreement the said Gnanamathu Stephen has deposited with the Bank the said sum of Rs. 25,000, and also the said Promissory Note, particulars whereof are specified in the first schedule hereto *And whereas* by an Indenture bearing or intended to bear even date with these presents and made between the said Gnanamathu Stephen of the first part the khazanchee of the second part and the Bank of the third part, all that dwelling house and premises known as No. 11, Mission Road, Rangoon, more particularly specified in the second schedule hereto are in further pursuance of the said agreement mortgaged and charged to the Bank as security to the extent of the further sum of Rs. 25,000, for the due and faithful performance by the khazanchee of the duties of his said office *And whereas* these presents are entered into for the purpose of defining generally, the duties, liabilities and responsibilities of the said office of khazanchee.”

The material clauses of the agreement are the following:—

“ 1. That the khazanchee shall be and continue the khazanchee of the Rangoon Branch of the Bank from the date of these presents at a monthly salary of Rs. 350 only such service being determinable on either side by three calendar months' notice to that effect.

“ 2. That the duties liabilities and responsibilities devolving upon the khazanchee as such khazanchee as aforesaid, shall be such as either by custom or contract usually devolve upon a khazanchee in the employ

of the Bank including the duties liabilities and responsibilities hereinafter mentioned.

* * * * *

“5. That the khazanchee shall enquire into and as far as possible ascertain and, if required to do so, truly and faithfully report in writing upon the identity, credit, solvency and circumstances of all persons being Asiatic residents in India or Burma, who shall after the date hereof have dealings of any kind with the Bank through the Agency of the khazanchee in the course of his employment as khazanchee, and shall make good to the Bank all losses and expenses by reason of any carelessness, or default or misrepresentation in any such enquiry or report made by the khazanchee during the course of his employment as khazanchee.

“8. That the said cash deposit and promissory note so deposited as aforesaid shall remain in the hands of the Secretary and Treasurer for the time being of the Bank as security for the faithful discharge by the khazanchee of the duties of his office, and also for the protection and security of the Bank, their successors or assigns against any such damages, losses, costs, charges and expenses as are hereinbefore set forth, and that the said securities shall not be claimed by or returned to the said Gnanamathu Stephen until all accounts between the khazanchee and the Bank, their successors or assigns have been finally closed and settled, and all balances if any, due by the khazanchee shall have been paid and discharged. . . .

“9. Until any such loss or damage shall happen, interest on the said cash deposit of Rs. 25,000, at the rate of 5 per cent. per annum, shall be paid by the Bank. . . .”

It is admitted that the firm of which Edward Stephen was either a partner or sole member comes within the description of Asiatic residents in Burmah.

The account of Edward Stephen being generally overdrawn he was expected to furnish, and did furnish, security which varied from time to time. This security generally took the form of promissory notes by Chetties engaged in financial transactions. These notes were indorsed and handed to the Bank. From time to time the makers would pay off the notes, and then Edward Stephen would fetch them away from the Bank and deposit, if the state of the account required it, some other promissory notes as security. Apparently he was to this extent trusted by the makers that they would pay him the money without requiring the immediate production of the notes, and would leave it to Stephen to hand them back later.

The block of securities to which reference has been made consisted of six notes for large sums, three made in 1907 and three in 1908. At different dates in 1908 and 1909, all while Edward Stephen was khazanchee, the sum due on these notes was paid, in some cases by one payment, in some by instalments, to Edward Stephen by the makers. Edward Stephen did not inform the makers that the notes had been indorsed over, and were in the possession of the Bank so that he could not give a good discharge without getting them from the Bank; he did not inform the Bank that they had been paid; and, though the sums paid by the makers found their way to Edward Stephen's account with the Bank, and to that extent reduced his debit balance, the manager of the Bank was left in the belief that he still had these notes as good security, and consequently allowed from time

to time larger overdrafts than he otherwise would have done. It was due to this circumstance that Edward Stephen was allowed to overdraw to so large an extent, and to be upon the final winding up so heavily indebted.

That these transactions were frauds upon the makers of the promissory notes there can be no question, nor can it, in their Lordships' opinion, be doubted that they were frauds upon the Bank. It is true that the notes being negotiable instruments, and having been transferred to the Bank for value, payment to Edward Stephen did not operate as a discharge to the several makers, and that the Bank as holders in due course might possibly still sue upon them and compel the makers to pay over again. But in the first place the Bank was entitled to hold these documents as unquestionable securities, and not securities which would almost necessarily involve litigation if they were to be realised. Secondly, the Bank was entitled not to be put into the odious position which such litigation would put it in, a position extremely likely to injure its popularity and its custom, and thirdly, inasmuch as Edward Stephen filled a dual capacity it would be quite possible that a plausible case might be set up by each maker to the effect that he must be deemed to have paid to Edward Stephen in the capacity of an officer of the Bank; that the Bank had, in fact, through Edward, got the money, and therefore that it was inequitable to sue him to recover it over again.

Thus while to the belief of the Bank manager the paper remained as good a security as it was at the first, its value had at least seriously diminished; it was no longer an absolute, but at the best a questionable security.

Now was this fraud committed by Edward as a customer, and not revealed nor provided against by Edward as khazanchee, one of those acts or defaults for which the security deposited by his father could be made responsible?

Clause 2 of the agreement defines the duties of a khazanchee as those which either by custom or contract usually devolve upon such an officer including, but not confined to, the duties, liabilities and responsibilities afterwards set out in detail. That an officer of the Bank who has heard some rumour that a customer is or may be doing something fraudulent may be absolved from communicating his information to his superior is quite possible. This argument was forcibly brought before their Lordships by Counsel for the appellants. But when it is no longer a question of rumour or probability, but the officer knows, and as he was himself the fraudulent person he knew, and when the fraud was of the kind which it was, it seems pretty plain that it would be a breach of duty not to communicate it.

If evidence were wanted to prove that this was one of the duties which by custom or contract would devolve upon a khazanchee the evidence of Mr. William Mackintosh, acting Agent of the Bank of Bengal, evidence unchallenged by cross-examination and uncontradicted, would be sufficient to prove this.

But the Bank also relies upon Clause 5 which makes it the

duty of the khazanchee to enquire into and, so far as possible, ascertain the credit, solvency and circumstances of Asiatic residents who have dealings with the Bank through his agency and in the course of his employment.

It is true that in the same clause occurs the phrase that he is to report in writing when required, and that he was not required. But if it is his duty to enquire and ascertain, and the result of the ascertainment is such as would lead the manager of the Bank to close the customer's account there needs no requirement to make a report necessary; the ascertainment would be idle if it was not followed by the proper result, that is a report.

In their Lordships' opinion the Court of Appeal put the right construction upon these clauses, and therefore the effects deposited as security for the faithful discharge of the duties of his office and for the protection and security of the Bank against such losses as are set forth in the instrument may be retained by the Bank until all such losses have been discharged.

There remains the question whether the Bank has sustained any loss, in other words, whether the Bank was bound to realise the promissory notes, obtain payment of them over again, and apply the sums received to wipe out the debit balance. As to this it appears that the Bank did make application to each of the makers, and received for answer in each case that the makers had, as in fact they had, paid the money to Edward Stephen in the belief that he was the holder of the notes.

Afterwards, and during the course of much discussion and correspondence, the Bank, as already stated, passed the notes to Sen. It may well be that in his hands they were valueless because he represents Edward, but if there were any value to be got out of them at all it could be just as well got by his co-plaintiff, Rajh, as by the Bank.

In their Lordships' opinion the Bank was not bound to sue these makers and compel them to pay over again. It may be doubted whether, in any event, the Bank would be bound to sue upon the notes, but in the particular circumstances it would put an intolerable burden upon the Bank.

The Bank was probably bound (if so required) to hand the notes over to the father's representative, so that he might make what he could out of them, at any rate to the extent of the value of the security which he had deposited. But in substance that is what was done when the notes were transferred to Sen. If the Bank either could not realise or was not bound to realise the notes, the debit balance remains; and it is larger than the total amount of the security deposited. There was, therefore, misfeasance by the khazanchee within the terms of the agreement, and by reason of such misfeasance there was a loss incurred by the Bank to the full extent of the security.

Their Lordships will humbly advise His Majesty that this appeal should be dismissed with costs.

In the Privy Council.

S. N. SEN AND ANOTHER

v.

THE BANK OF BENGAL.

DELIVERED BY LORD PHILLIMORE.