

An Analysis Of Banker's Liability For Fraud Of Its Employees On The Basis Of Doctrine-Vicarious Liability; Maxim -Qui Facit Per Alium Facit Per Se ¹

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ABSTRACT: It is the need of the hour to peruse on whom the liability can be thrust, for the frauds that is constantly on raise in banks, which is the repercussion of act of outsiders or employees. Sometimes this is inflicted by the outsiders with the connivance of bank employees. Can law clutch banker with liability for the fraud perpetrated by the employees? Section 238 of Indian contract Act, 1872 enunciates that, when there is fraud or misrepresentation by an agent while making an agreement on behalf of the principle, apart from affecting the validity of the contract, an agent's fraud or wrongful act makes the principle liable if he is acting within the scope of his employment.

The answer to the question, can banker be endorsed with liability for the fraud of its employees? Can be scrutinized in two aspects.

- Liability of bank to its customers in case of fraud of its employees, if committed in the course of his employment

This can be examined by referring landmark cases like Shyama Devi v Union of India, in Leesh River Tea Co Ltd v British India Steam Navigation Co. Ltd, United Africa Co Ltd v Saka Owoade, United Bank of India Ltd v Muhammad Shamsuddin and ors. National Bank of Lahore v Sohaila.

- Liability of bank to another bank when its employees collude with defaulters -for the fraudulent issue of letter of undertaking

The general principle is that banker is bound to issue a letter of undertaking based on the sanctioned credit limit, cash margin as collateral for bank guarantees. Exceptions emerge only when it is perpetrated with fraudulent intention, as happened in Nirav Modi's case, Punjab National Bank, second largest public sector bank, the biggest ever scam in Indian banking history as a result of fraudulent issue of letter of undertaking through SWIFT without making entries in the banking system. Can the bank be clutched with liability to another bank in this case? What is the move taken by RBI about LOU after this case? This can be anatomize in the following article on the premise of Doctrine of Vicarious liability and maxim -qui facit per alium facit perse.

KEY WORDS: Banker, Employee, Fraud, vicariously liability.

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I. INTRODUCTION:

Bank, the custodian of people's money, savior for business circles, imbibing within itself much more features are subjected to constant agitation in recent times, due to tremendous fraud been perpetrated on it, by repercussion of fraud of outsiders or its own employees or by connivance of both. This article throws light on how banker's hand can be clutched by law for the wrongful acts perpetrated by its employees on the premise of Doctrine of Vicarious liability and maxim -qui facit per alium facit perse, analysis of precedents, RBI guidelines, section 238 of Indian Contract act.

LIABILITY OF THE BANKER TO ITS CUSTOMERS -FOR THE FRAUDULENT ACTION OF ITS EMPLOYEES:

Statutory definition of fraud as enunciated by Indian Contract Act, 1872 are, Fraud means and includes any of the following acts committed by the party to a contract or with his connivance, or by his agent, with the intend to deceive another party or his agent or to induce him to enter into contract:

- Suggestion, as to fact, of that which is not true by one who doesn't believe it to be true
- The active concealment of a fact by one having knowledge or belief of the fact
- A promise made without any intention of performing it
- Any other act fitted to deceive

- Any such act or omission as the law specially declares to be fraudulent¹

PRINCIPLE OF VICARIOUS LIABILITY:

General principles of law- a person is not clutched or made liable for the wrongful acts committed by another person, rather he incurs liability only for his own acts. Exceptional situations arise by which, a person is determined liable for the acts of another person. This is endorsed by the doctrine of 'vicarious liability'. Thus for law to clutch an innocent person on the basis of doctrine the following kind of relationship should exist between two parties.

- principle and agent
- Employer and employee
- Partners
- Master and servant.

It is based on the maxim "qui facit per alium facit per se"². The liability of master arises not only to the acts which he expressly authorizes but also to those done by servant in the course of his employment. Thus in order to make the master liable, it has to be analyzed whether the act done by the servant is an unauthorized act and is outside the scope of employment, or is merely an unauthorized way of doing an authorized act which is within the scope of his employment, in the latter case the master is liable for the acts of his servant. For determining an act, whether done in the course of one's employment, it has to be analyzed if the act is incidental to or within the class of acts that the servant was normally employed or authorized to do. In *Lloyd v Grace, Smith & Co*³ House of Lords held that, the master is liable for the act of his servant despite the fact, the servant is acting not for the benefit of his master rather for his own benefit. Thus for upholding the master's liability, the only obligation imposed on the plaintiff is to prove the agent was working within the scope of his authority, it is not necessary to prove the impugned act was for the benefit of the master.⁴

BANKER VICARIOUSLY LIABLE FOR THE ACTS OF ITS EMPLOYEES, IN COURSE OF HIS EMPLOYMENT:

Section 238 of Indian Contract Act, 1872 states that, when there is fraud or misrepresentation by an agent while making an agreement on behalf of the principle, apart from affecting the validity of the contract, an agent's fraud or wrongful act makes the principle liable if he is acting within the scope of his business.

In *State Bank of India v Shyama Devi*⁵, two cheques one for rupees 4,000 and another for rupees 8,000 were handed over by Shyama Devi to Kapil Deo Shukla, based on the arrangement between them that the latter will deposit the amount in the account of the former with the State Bank of India, Allahabad branch, who is her neighbor and also an employee of the bank. Suspicion aroused to the respondents on the entries made in the pass book. When asked about the account details, the bank denied the alleged deposits which have been deposited through KD Shukla. The respondents sued the bank contending that the bank is liable for the fraud of its employees. Apex court relying upon the House of Lords decision in *Leesh River Tea Co Ltd v British India Steam Navigation Co Ltd* and the Privy Council decision in *United Africa Co Ltd v Saka Owoade*, held that the settled legal principle which governs the vicarious liability of an employer for the loss caused to a customer through the misdemeanor or negligence of an employee, if it is done in the course of employment and this remains to be determined as a question of fact⁶. The employer is absolved of the liability if the loss or damages arose without the employer's actual fault or privity and without the fault or neglect of his agents or servants in the course of employment. Thus master is liable for his servant's fraud, whether the fraud was for his benefit or not, if it is perpetrated by the servant in the course of his employment. Thus, in this case the court was of the view that false and fictitious entries to cover up a fraud were made by employee of the bank in the passbook of the client, hence, his act could not be deemed to be an act committed in the course of employment with the bank. Hence the bank is not liable to make good the loss caused to the client by the act of the employee because the latter in such case would be deemed to have acted as an agent of the client for delivering the sums to the bank which was not within the scope of employment of the bank. The liability would have been there if the customer deposited the money personally on the counter and the same was defalcated by an employee⁷. Thus the principle

¹ Indian Contract Act, 1872, section 17.

² Act of the agent is the act of the principle, Dr. R.K. Bangia, Contract -II, 2009 edition, Allahabad law agency.

³ (1912) A.C. 716

⁴ DR. R. K. Bangia, Law of Torts, 3rd edition, Allahabad law agency.

⁵ 1979(49) comp.cas.130

⁶ State bank of India v shyama devi, <https://indiankanoon.org/doc/1228981/>

⁷ D.C. Pandey, law of torts, The Indian law Institute

is settled that the banker can be held vicariously liable for the fraud committed by its employees if it is perpetrated in the course of his employment.

Let us examine the principle laid down by House of Lords in *Leesh River Tea Co Ltd v British India Steam Navigation Co .Ltd*⁸

Facts are as follows: A cargo ship during its voyage stopped at an intermediate port and a stevedore company was engaged in loading and unloading of the items in the ship .A servant of the company stole the steel brass, its removal rendered the ship unseaworthy, thus causing damage to the cargo as watered entered the ship, the owner of the damaged cargo brought an action against the ship-owner.

The observation of Lord Danckwerts L.J are as; It seems that the vital points in the case is whether the theft of the brass plate was made by the stevedore at port sudan ,in the course of employment .He was to be regarded as the agent of the ship-owners for the purpose of unloading and loading cargo. There can be no doubt that this gave him the opportunity to effect the theft of the plate .But stevedore was concerned with cargo and not with the ship or parts of the ship. If in case the stevedore either caused damage or stolen the cargo directly which they are to handle, then the master could be held vicariously liable. Since he deliberately stole the plate he was acting in a way which was completely outside the scope of his employment .Thus the ship owners are not held vicariously liable for the act of the servant as the loss arose neither with his fault nor with the fraud of the agent in the due course of his employment.

Privy Council in *United Africa Co Ltd v Saka Owoade*, held that bank was not liable to make good the loss to respondent, because the respondent failed to discharge the onus on her to show that she paid the amount to an employee of the bank which was received by the said employee in the course of his employment, and the false entry in the pass book of the bank does not shift the onus to the bank to prove the contrary. Hence the bank is not liable because the employee acted as the agent of the respondent and not of the bank within the course of employment, nor could the false entry in the pass book and the ledger to cover up the fraud made the embezzlement committed by him within the course of employment⁹.

In *United Bank of India Ltd v Muhammad shamsuddin and ors.*¹⁰, the allegation put forth by Muhammad shamsuddin was that, he was induced to part with his money and enter into partnership with B in his business, by the banks accountant C, who by making false and fraudulent representations about B's status in business and on the false assurance that money and goods deposited in B account would be operated upon only in the joint names of B and A. B gave a written instructions to C to the effect that his overdraft account with the bank will be operated upon both of them jointly but neither of them pursued the prescribed procedure of opening a new overdraft account in joint names in place of old one. Hence the instructions were not followed by the bank, resulting in withdrawal of all amount by B.

The court absolved the bank of its liability and laid the following observations: The action of the bank or its employees, in allowing B to withdraw the money and goods from his account on his own signature, disregarding the instructions given, was perfectly justified as they didn't proceed with the authorized way of opening a new Over-draft account. Since it is devoid of any wrongful Act, there is no question of arising any liability, hence no vicarious liability of banker

Further the banker would also not be held liable, on the account of assurance which the bank accountant had given to A, about the joint operation of B's account in the bank because he was only in charge of maintaining the overdraft account and not anything else .such an assurance was outside the scope of business or authority as an employee of the bank. Hence the bank not vicariously liable for any consequences arising from such assurances.

In *Bank of Bihar Ltd v Mahabir Lal and ors*¹¹, the facts are as follows: The Mahabir lal and ors, was running the business under the name Messrs.Jogilal Prabhu chand, for promotion of which they availed cash credit facility with the bank of Bihar by entering into an agreement. The cash credit facilities were sanctioned up to a limit of 50,000Rs against cloth bales on certain terms .A promissory note in favor of the Bank for Rs 50,000 was executed by the firm on august 28,1947 and approached the manager for immediate advance of 35,000, to purchase certain bales of cotton, from the wholesale dealer at Patna. The firm was allowed to draw on the security of the promissory note on its agreeing to pledge the bales of cloth as further security .The manager passed the cheque, but the amount was not paid to the partner of the firm rather the bank approached the potdar to hand over the money to the wholesale dealer directly and take the delivery of goods back to the premises of the bank .potdar flew up with the amount and never turned up.

⁸(1966) 3 ALL E.L.R. 593

⁹State bank of India v shyama devi ,<https://indiankanoon.org/doc/1228981/>

¹⁰AIR 1961 Patna 488

¹¹1964 AIR 377

The court upheld the liability of bank as the bank intend to constitute potdar the agent of the bank for paying the money to the wholesale dealer, who committed fraud on the company's money and no money had in fact actually passed on to the firm, thus the firm cannot be made jointly liable .¹²

In another case ,National Bank of Lahore v Sohanlal¹³,the bank maintained a safe deposit vault in its Jullundur city branch, the locker were rented to the customers for the deposit of jewelry and other valuables .one key for the vault is handed to the customer and the master key for the lockers is with the bank .As a matter of precaution, the vault has to be under the joint control of the cashier and the manager .Further the master keys and the keys for unleased lockers have also to remain under the joint control of two bank officers .Contrary to all this the keys were personally held by Baldev Chand ,the manager of the alleged bank . The Jewelry and the other valuables kept by the customer in his safe vault is found missing, it came to light the theft occurred due to the fraud committed by its employee, the bank manager as he tampers with the lever of the lock before the lockers were rented to the plaintiffs .the bank held vicariously liable for the fraud committed by its servants, notwithstanding the fact that the bankers are not liable for loss or theft of the valuables if proper precaution is taken in its side.

Thus all the above-said legal decisions enunciates that , banker's liability for the misdemeanor or fraud of its employees arises, provided the fraud is perpetrated by the employees in the course of his employment ,notwithstanding the fact , the act is for the benefit of the employees. However if the employee goes beyond the scope of his business or authority and does something for his own benefit and if the act done by him is independent of the scope of his authorized business ,it may be treated as 'frolic of his own' and would not bring the master within the liability of the third party .

LIABILITY OF THE BANK TO OTHER BANK –WHEN ITS EMPLOYEES COLLUDE WITH DEFAULTERS: FRAUDELENT ISSUE OF UNDERTAKING ----PUNJAB NATIONAL BANK

LETTER OF UNDERTAKING¹⁴:

As a precaution for averting the frauds committed on bank, RBI in its master circular on guarantees and co-acceptances, from July 2014 stated "Banks should refrain from issuing guarantees on behalf of customers who do not enjoy credit facilities with them." In addition the banks can also ask for collateral or guarantee, which could be in the form of fixed deposits or other assets ¹⁵.Exceptions arisesonly if their intention is to perpetrate fraud.

NIRAV MODI: IS PUNJAB NATIONAL BANK LIABLE FOR FRAUDULENT LOU ISSUED BY ITS EMPLOYEES:

Brief Facts are as follows: on 29th Jan Punjab National Bank lodged a complaint with CBI , stating some fraudulent and unauthorized transactions took place in one of its branches in Mumbai ,against the billionaire diamantaire Nirav Modi and jewellery company,transaction to the worth 11,400 crores .

How did it come into light?On 16th Jan , a set of partnership firms –Diamond R US, Solar exports and stellar Diamonds knocked the doors of the bank with a set of import documents and requested for Buyer's credit to make payments to overseas suppliers .The firms have Nirav modi ,Nishal modi ,Mr.Nirav's wife Ami nirav Modi and Mehul Chokshi as partners . The branch officials requested the firms to furnish 110% cash margin as collateral for issuing LOU, as there is no sanctioned credit limit in the name of the firms .The firms contested that they have been availing this facility for the pastyears. Yet, there is no official records to corroborate this. On digging the truth, bank officials brought to light the fact that two of its employees at Mumbai branch had fraudulently issued LOUs on the SWIFT interbank messaging system in the past, with neither having a sanctioned credit limit nor maintaining funds on margin .further such transactions were not recorded in the bank's core banking system, which made the entire modus operanti suspicious.¹⁶

NOW THE QUESTION THAT ARISES IS, WHO ASSUMES THE LIABILITY OF SCAM THAT TOOK PLACE IN INDIA'S SECOND BIGGEST STATE –RUN LENDER? WHO WILL REIMBURSE THE

¹² www.google.co.in/amp/s/www.legalcrystal.com/case/amp/639060/bank-bihar-ltd-v-mahabir-lal-ors

¹³ A.I.R 1962 Punjab 534

¹⁴ LOU is a provision of bank guarantee ,under which a bank allows its customer to raise money from another Indian bank's foreign branch in the form of short term credit for imports , All u want to know about LOU-The Hindu Business Line , <http://www.thehindubusinessline.com>>..

¹⁵ DE-jargoned: Letter of undertaking, <https://www.livemint.com>>deja...

¹⁶ Explainer : How Punjab national bank fell victim to India 's biggest bank fraud ... www.google.co.in/amp/www.newindianexpress.com/business/2018explainer-how-punjab-national-bank-fell-victim-to-indias-biggest-bank-fraud-1773876.amp

BANKS WHO HAVE ISSUED CREDIT BASED ON THE ASSURANCES GIVEN BY PUNJAB NATIONAL BANK?

PNB has said that, the transactions are contingent in nature and it will decide the liability based on law and the genuineness of the transactions. Report says that RBI has directed PNB to reimburse other banks for the loans disbursed by them, who by acknowledging the fraudulent Letter of Undertaking issued by the former granted the loan. In Accordance with it the said bank has decided to settle claims worth 65 billion against LOUs issued to seven banks¹⁷. In the wake of massive PNB scam, RBI scrapped the practice of issuing LOU, a form of credit guarantee, for trade credits for imports, as LOU lead receiving bank to completely depend upon the issuing bank for the creditworthiness, thus raises the risks.¹⁸

RBI, in its master circular on customer service in banks, says that,

- If the branch is convinced that an irregularity /fraud has been committed by its staff towards any constituent, branch should at once acknowledge its liability and pay the just claim
- In cases where the banks are at fault, the banks should compensate customers without demur
- In cases where neither the bank is at fault nor the customer is at fault but the fault lies elsewhere in the system, then also bank should compensate the customers (up to a limit) as part of a board approved customer relations policy¹⁹

Further section 409 of Indian Penal Code inflicts criminal liability on the banker for the criminal breach of trust and imposes punishment which may extend to imprisonment for life or imprisonment of either description for a term which may extend to 10 years and fine.

II. CONCLUSION:

Thus deriving conclusion from the above analysis, banker's liability is vindicated to the customer and to the fellow banker for the damage or loss incurred by them, on account of the fraud perpetrated by its employees, provided it is within the course of their employment, or it is incidental to their employment notwithstanding the fact, the act is for the private benefit of its employees, on the basis of the maxim *qui facit per alium facit per se*. On the other side, if the act done is, outside the course of his employment, the liability cannot be imposed on the banker.

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¹⁷www.google.co.in/amp/s/qz.com/1208266/the-1-8-billion-punjab-national-bank-nirav-modi-fraud -explained.

¹⁸RBI's Ban on Letters of Undertaking Explained –NDTV.com, <http://www.ndtv.com/business...>

¹⁹<http://www.hindustan times.com...>