

IN THE SPECIAL COURT CONSTITUTED UNDER THE SPECIAL COURT
(TRIAL OF OFFENCES RELATING TO TRANSACTIONS IN SECURITIES)
ACT, 1992 AT BOMBAY

CHAMBER SUMMONS NO. 11 OF 2002
IN
SUIT NO. 35 OF 1995

State Bank of India ...Plaintiffs.

Versus

National Housing Bank & Ors. ...Defendants.

Mr. Janak Dwarkadas, senior counsel with T.K. Cooper and D.J. Khambatta i/b M/s. Little & Co. for the Plaintiffs.

Mr. Aspi Chinoy with Amit Thambe i/b Desai & Diwanji for Defendant No.1

Mr. J. Chandran i/b. M/s. P.M. Mithi & Co. for the Defendant No.3.

CORAM: S.H. KAPADIA, J.
JUDGE, SPECIAL COURT.
DATE : 4TH JUNE, 2002

P.C.:

1. By this Chamber Summons, the Plaintiff-State Bank of India (for short "SBI") seeks discovery by interrogatories. By this Chamber Summons, SBI seeks leave of this Court to deliver the interrogatories for examination of Defendant No.1 - National Housing Bank (for short "NHB") and for the purpose of uncovering the true facts in the matter. Therefore, this Application is made under Order XI Rule 1 and Rule 2 of the Civil Procedure Code.



2. SBI instituted the above suit on 8th June, 1995. They are seeking to recover Rs 707 crores from NHB. During the period October, 1991 to March, 1992 the deceased Harshad Mehta (original Defendant No.2) in the suit brought 13 cheques to SBI and requested SBI to collect the proceeds thereof on his behalf and credit the same to his account with SBI. According to the unamended Plaint, SBI has alleged that at the relevant time, there was a practice, followed by Banks dealing in securities and money market under which, cheques which were intended for the benefit of private parties were drawn not in the name of a private party as payee but they were drawn in favour of the Bank as a payee, although such a Bank was not a beneficiary to the proceeds of the cheque. This practice came to be evolved so that credit could be availed of against the cheque on the same day. Generally, these cheques were of high denomination. That, this practice was known to NHB. In the original suit, the Plaintiff has alleged that there were no transactions between SBI and NHB relating to the suit cheques. According to Written Statement dated 2nd March, 1996 filed by NHB, the Plaintiff-SBI was negligent in crediting the proceeds of the cheques to the account of Harshad Mehta. That, payments were made in favour of SBI on account of the fraud purported on NHB by its own

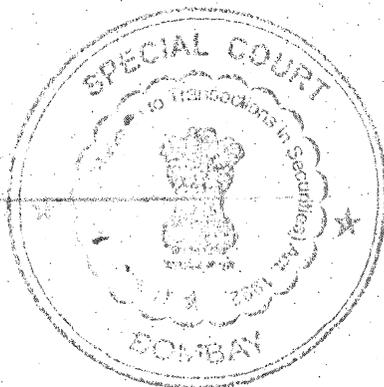


employees and, therefore, these payments were not on account of any security transactions with SBI but they were made on account of fraud by the Officers of NHB who had entered into fictitious security transactions as recorded in the books of NHB. In the said suit, an Amendment Application was made by SBI vide Chamber Summons No.35 of 1999. By this Amendment Application, SBI claimed that after the filing of the above suit they had discovered that NHB used to enter into security transactions with private parties other than Banks and Financial Institutions on regular basis at the relevant time. That, these security transactions were shown as if they were entered into with the payee Banks, although, in fact, they were with the private parties and, therefore, there were no contract notes, sale memos, delivery orders etc. That, NHB used to enter into Ready Forward transactions on back to back basis and earned huge profits without deploying its own funds as alleged. That, it recorded security transactions in its records as if they were with the payee Banks and in this manner they suppressed the identity of the real counterparty. It is also alleged in the Amendment Application that NHB was aware of the identity of the real counterparty and that if the records were produced before the Court the plaintiff were in a position to prove as to who was the real counterparty. According to SBI, the real counterparty was the late Harshad Mehta. This Chamber Summons No. 35 of 1999 which was an Amendment Application was heavily contested. By Order dated 17th February, 2000 this Court came to the conclusion that



the amendment sought needs to be granted. This Court opined that, in this suit, the main controversy which is required to be decided is: who was the real counterparty? The Court found merit in the Amendment Application. The Amendment Application was granted by this Court because, in the original Written Statement, NHB had contended that there were no transactions between SBI and NHB and that 13 cheques were drawn by NHB in favour of SBI pursuant to the fraud played by its own employees. However, SBI sought amendment on the footing that subsequently they have discovered that NHB had numerous transactions with Harshad Mehta. That, some of them were Ready Forward transactions on back to back basis and that the real counterparty was Harshad Mehta and that the cheques were not drawn by NHB pursuant to any alleged fictitious transactions or fraud played by its employees. That, NHB was deliberately keeping back the records. This aspect SBI wants to prove. Therefore, vide Order dated 17th February, 2000 this Court granted the Amendment Application.

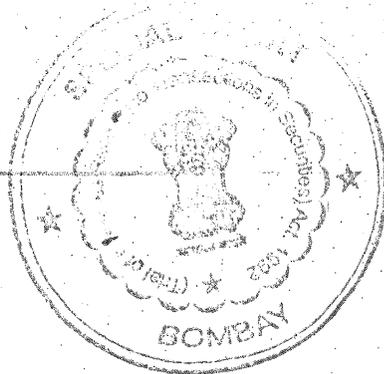
I have extensively referred to my Order dated 17th February, 2000 in Chamber Summons No. 35 of 1999 as it indicates the scope of the Suit No.35 of 1995 filed by SBI vs NHB. I have also extensively referred to the said Order dated 17th February, 2000 as it indicates the reasons for this Court allowing the Amendment Application filed by SBI-Plaintiff. Ultimately, this Court is set up under a special enactment of 1992 and, therefore, this Court is required to



ascertain in all these alleged tainted transactions as to who was the real counterparty in these transactions. At this stage, it may also be mentioned that ordinarily NHB was required to file a suit. But in the present case, the suit was filed by SBI as RBI had intervened in the dispute and RBI had directed SBI to pay Rs 707 crores to NHB pending Resolution of the dispute. Ultimately, SBI is a Bank and NHB is subsidiary of RBI.

ARGUMENTS:

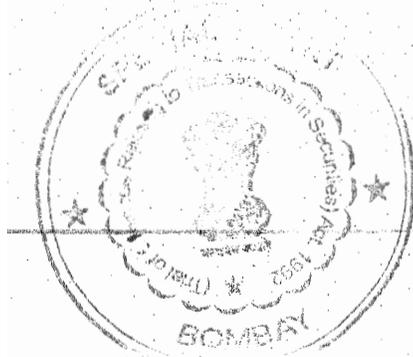
3. Mr. Harish Salve, the learned Solicitor General of India appearing in support of the Chamber Summons No. 11 of 2002 contended that the suit, as amended, proceeds on the basis that SBI had no transactions with NHB. That, the suit cheques, according to SBI, were in respect of transactions between NHB and late Harshad Mehta. That, in the present suit, the main controversy is : who were the parties to the transactions; with whom were the transactions. That, at that time, there was a tripartite arrangement. It was called as Waste Book Arrangement. That, NHB, SBI and Harshad Mehta were all parties to this arrangement. That, at the relevant time, NHB followed what is also called as same day payment system. He submitted that, in the present suit, as amended, the Court is required to ascertain as to who was the real counterparty and was the amount payable on transactions of cheques? That, according to SBI, the proceeds of 13 cheques were collected



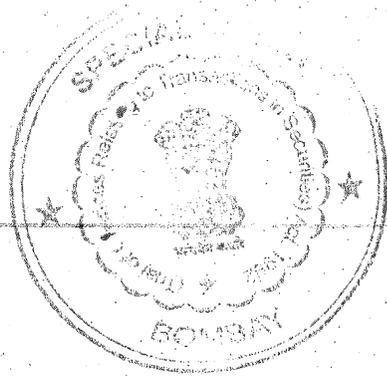
by SBI. That, these cheques were drawn by NHB in favour of SBI. That, under the Waste Book Management Arrangement, SBI was required to collect the proceeds in order to make the funds available to the broker. That, under that arrangement, SBI made the proceeds available to the broker. That, those proceeds were kept at the disposal of the broker. That, the suit is not confined to section 131 of the Negotiable Instruments Act. That, the suit is sui generis. That, there were various indications which indicated the practice prevailing in the Banks at the relevant time. He contended that if one looks at page 18G of the amended Plaint it is clear that SBI was not only a collecting Bank. In particular Mr Salve placed reliance on the amended Plaint - paragraphs 5D and 5F. He contended that suit cheques were issued for consideration which flowed from third party and not from the payee Bank. That, prior to, during and even subsequent to the issuance of the suit cheques, NHB had issued large number of cheques in favour of SBI, the proceeds whereof were made available to late Harshad Mehta and that, similarly, NHB had also received large number of cheques from SBI at the behest of Harshad Mehta, although there were no transactions between SBI and NHB. In this connection, he relied upon the particulars given in Exhibits "J" and Exhibit "K" which contain a list of cheques issued by the Plaintiff-SBI to NHB and, similarly, cheques issued by NHB to SBI. That, SBI intended to prove that NHB had dealings with private parties and they were being shown as if those dealings were with



Banks in order to conceal the identity of the counterparty. He contended that in respect of two cheques the amount claimed was in excess of the amount of the cheques which demonstrated that payments were made on the basis of underlying transaction with Harshad Mehta. That they were not based on the cheques. He further pointed out that a Banker's cheque dated 14th March, 1992 for Rs. 44.97 crores drawn by State Bank of Patiala in favour of SBI was a cheque in respect of which NHB had no cause of action against SBI as NHB was neither a payee nor an endorsee and yet recovery of the said amount was sought by NHB from the Plaintiff through RBI. Similarly, a cheque dated 30th March, 1992 for Rs 90.45 crores was drawn by NHB favouring SBI representing consideration for sale of securities viz. 17% NTPC bonds sold by SBI Cap to NHB on March 30, 1992. According to SBI, the record of SBI Cap shows that this transaction was a transaction with NHB and proceeds of the said cheques of Rs 90.45 crores were on instructions of Harshad Mehta credited to the account of SBI Cap as alleged in the amended Plaint and yet, this amount forms part of Rs 707 crores which NHB sought to recover through RBI from SBI. These are some of the instances which were pointed out by the learned Counsel in support of his contention that this case was not centered only around section 131 of the Negotiable Instruments Act. That, the suit revolved around a certain irregular practice which prevailed at that time which was more of funding the brokers. That public funds were diverted into the account of

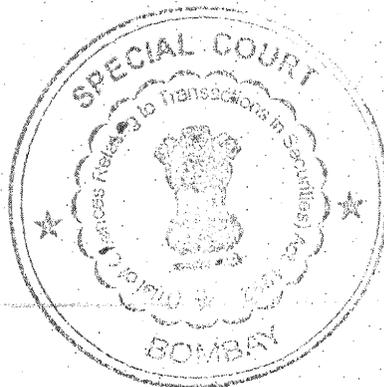


these brokers through such practices and one such practice was Waste Book Arrangement which facilitated same day payment to the broker particularly in respect of high value denomination cheques. He further contended that the suit cheques stood on the same footing as those cheques referred to in Exhibit "J" and Exhibit "K". He contended that according to SBI, NHB at that time, dealt with Harshad Mehta, Fairgrowth and other private parties on principal to principal basis. That, in the reply to some of the interrogatories NHB has admitted of having dealt with private parties other than Banks and Financial Institutions. They have admitted that instead of name of such private parties being shown in record, the name of the payee Bank was being shown. In the circumstances, the learned Counsel submitted that in the original Written Statement a false defence has been taken by NHB that the suit cheques were drawn pursuant to the fictitious transactions. He contended that, according to SBI, consideration has been received by NHB from those private parties and that the cheques were issued for consideration received from Harshad Mehta and they were not issued on account of bogus alleged transactions. He contended that, in this case, by virtue of the interrogatories, SBI wanted to know whether in cases where cheques were received by NHB from SBI, the counterparty was Harshad Mehta. Similarly, he contended that page 86 of the Written Statement filed by NHB dated 2nd March, 1996 shows that 8 were outright transactions. He pointed out that SBI wanted to



know as to from where did NHB get the date of maturity. He further submitted that on the same page there are two reversals and, therefore, SBI wanted to know the new date of reversal. Accordingly, it was submitted that the present Chamber Summons seeks leave to deliver these interrogatories so that expedition of the trial takes place.

4. In reply, Mr Chinoy, learned Counsel appearing for NHB, contended that by the present Chamber Summons No. 11 of 2002, in effect, about 500 interrogatories have been served on NHB. That, this Chamber Summons No. 11 of 2002 has been preferred after almost 7 years down the line. He contended that, in the present suit, the claim of SBI is solely based on cheques and not on transactions. He conceded that the NHB was bound to answer the interrogatories pertaining to the suit cheques. However, he contended that these 500 interrogatories do not only pertain to the suit cheques but a roving inquiry into the affairs of NHB is sought to be made. He contended that the tenor of these interrogatories shows that most of these interrogatories are in the nature of cross examination which is not permitted under Order XI of Civil Procedure Code. He contended that, in this case, SBI claims no title to the suit cheques and, therefore, consideration did not come in. He submitted that NHB was the drawer of suit cheque and SBI was the payee. That, SBI has disclaimed the title to the suit cheques and, therefore, instruments were without consideration as the payee has disclaimed the title. He



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contends that SBI was only a collecting Bank according to the plea raised in the Plaint. That, according to SBI, they were not the payee Bank. But the collecting Bank has only one defence to the action on conversion. That, SBI was not claiming title in the suit. Therefore, the defence of SBI could fall only under section 131 of the Negotiable Instruments Act. Therefore, SBI was only required to establish good faith and absence of negligence. He, therefore, contended that in adversarial litigation one has to go by the provisions of the Act. He contended that if one reads the Plaint filed by SBI the case comes clearly under section 131 of the Negotiable Instruments Act only. He contended that SBI, in the present suit, was therefore required to establish good faith and absence of negligence as they have submitted that they have acted only as a collecting Bank for Harshad Mehta and, therefore, SBI cannot resort to a roving inquiry. He contended that the burden was always on collecting Bank to show absence of negligence and good faith. He contended that this burden could be discharged only with reference to the fact on the basis of which cheques were cleared by SBI during the relevant period. He contended that each of the 13 cheques constituted a separate cause of action. He heavily relied upon the Judgment of the Special Court in the case of NHB vs. ANZ Grindlays Bank PLC reported in 1998 Vol 2 Learned Judgment, page 153. In particular, he relied upon the observations of Special Court at page 254. He contended that the burden was on SBI to show that they



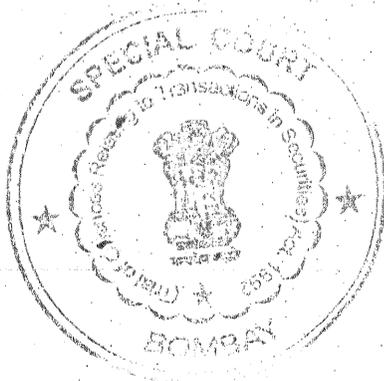
acted in good faith and without negligence and that SBI cannot succeed in this case on the basis that the burden was on NHB to show who the real beneficiary was. He contended that all the interrogatories constituted a roving inquiry. He contended that the burden was on SBI to prove absence of negligence and good faith and, therefore, there was no question of delivering the interrogatories to NHB. He contended that, in the present matter, SBI acted contrary to the mandate given in the instrument and now SBI says that NHB should answer the interrogatories to show that there was a transaction between NHB and Harshad Mehta. He contended that in this case SBI was only the collecting Bank according to its own plea. He contended that the purpose of delivering interrogatories was only to particularise the issue and to know the nature of the case. He contended that the purpose of interrogatories is not to cross examine NHB. He contended that by these interrogatories SBI is seeking access to transactions to which the suit is not even related. He contended that this is a valid legal defence open to NHB which defence cannot be jettisoned by resorting to the garb of the Court being set up under the provisions of the Special Court Act. He contended that according to NHB, the suit cheques were drawn in favour of SBI and if SBI had wrongly credited the proceeds to Harshad Mehta on account of negligence then SBI cannot get over such negligence by resorting to discovery under Order XI of the Civil Procedure Code. He contended that without a letter of authority from

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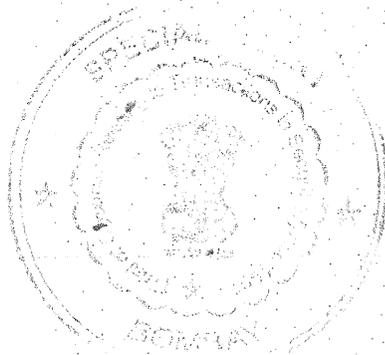
NHB directing proceeds to be credited to Harshad Mehta, SBI could not have given credit to Harshad Mehta vis-a-vis the proceeds of such cheques. That, SBI was fully aware as a Banker that without such authorisation the proceeds of the cheques could not have been credited to the account of Harshad Mehta. Therefore, SBI was negligent in crediting the proceeds to the account of Harshad Mehta. That, in the pleadings, SBI has not stated that they did not know about such letter of authority being issued as a practice by the drawer at the relevant time. Therefore, SBI was aware of that practice and, therefore, SBI negligently credited the proceeds to the account of Harshad Mehta. He contended that but for the intervention of RBI, NHB would not have been able to recover Rs 707 crores from SBI. He contended that according to the original Plaintiff, Harshad Mehta handed over suit cheques to SBI for collection. That, these cheques were drawn on RBI by NHB. Therefore, according to the original Plaintiff, SBI was only a collecting Banker. That, the original suit was filed on section 131 of the Negotiable Instruments Act only. It is for this reason that in para 6 of the Plaintiff it is alleged by SBI that the suit cheques were drawn by NHB in favour of SBI at the behest of Harshad Mehta and as per the practice prevalent at that time for immediate clearance. Therefore, it was contended that the suit is based only on section 131 of the Negotiable Instruments Act. That, according to SBI also, there was no conversion because cheques were cleared on same day as per prevalent practice



and it is for this reason that SBI is not claiming title to the cheques. He contended that, in the present case, it is not open for SBI to say that they were justified in giving credit to Harshad Mehta by relying on facts which they discovered subsequently. That, this argument of SBI shows that on the date of clearance SBI was not aware of the fact that NHB had transactions with Harshad Mehta and if they were not aware of these facts which they alleged to have come to know subsequently then for the purposes of suit under section 131, SBI was not justified in relying on facts which they discovered subsequently in 1997 vide Arbitration Petition No. 1 of 1997. He contended that the basic touchstone was as to on what basis SBI credited the proceeds of the suit cheques to the account of Harshad Mehta at the relevant time. He contended that interrogatories cannot be delivered to shift the burden. That, what NHB did was irrelevant. That what NHB did, which SBI did not know, was irrelevant. He contended that only good faith and absence of negligence were required to be proved by SBI in this case under section 131 of the Negotiable Instruments Act and, therefore, all other interrogatories besides those concerning section 131 were irrelevant.

FINDINGS:

5. At the outset, it may be mentioned that I have not granted permission to deliver all 500 interrogatories as



claimed by SBI. Partly, I agree with the learned Counsel for NHB that some of the interrogatories are in the nature of cross-examination. I have, therefore, culled out the interrogatories which, according to me, are relevant. They are annexed to this order.

6. As sated hereinabove, in the present case, ordinarily, NHB would have been the Plaintiff. However, RBI had intervened in the dispute and had directed SBI to pay Rs 707 crores to NHB.

Suit No. 35 of 1995 was filed on 8th June, 1995. In the original Plaintiff, it was alleged that during the relevant years 1991-1992, there was a practice in existence followed by Banks dealing in securities and money market under which cheques which were intended for the benefit of private parties were drawn not in the name of private party as a payee but in favour of the Bank as a payee. This practice was evolved so that credit could be secured against the cheque on the same day. Some of the brokers like Harshad Mehta had a turn over of Rs 300 crores per day. Their transactions required immediate clearance of high value cheques. At that time, immediate clearance of high value cheques on the same day was not available in all Banks. Therefore, this practice referred to above came to be evolved. This practice has been specifically referred to in the original Plaintiff. According to original Plaintiff, this practice was also known to NHB.



Therefore, it would not be correct to say that the original suit was filed only on the basis of section 131 of the Negotiable Instruments Act. As stated above, Chamber Summons No.35 of 1999 was preferred by SBI - Plaintiff to amend the Plaint. The Plaint was sought to be amended as the Plaintiff wanted to prove that the suit cheques were drawn by NHB pursuant to the consideration which they received from the counterparty and that the cheques were not drawn on account of fictitious transactions as alleged by NHB. While allowing the amendment, this Court specifically observed that the facts which came to the notice of SBI after filing of the present suit were required to be gone into as, in the present matter, this Court will have to ascertain whether payments were made on account of fictitious transactions or whether they were made pursuant to alleged transactions between NHB and Harshad Mehta. It is for this reason that the amendment was granted. In fact, in the Order allowing the Amendment Application dated 17th February, 2000 the Court has noted the contention of SBI that if the Amendment Application is granted then SBI would be calling upon NHB to produce the relevant documents and records which would show that NHB had security transactions with private parties like Harshad Mehta and that payments were made pursuant to such transactions which were not fictitious as alleged by NHB. Therefore, the present matter is a sequel to this Court's Order dated 17th February, 2000 in Chamber Summons No.35 of 1999. I therefore do not find any merit in the argument advanced on behalf of



NHB that the present suit is confined to section 131 only. Moreover, the interrogatories delivered by the present Chamber Summons are based on the particulars given in Exhibits "J" and "K". These particulars indicate a pointer. It appears from Exhibit "J", Exhibit "K" and page 86 of the Written Statement filed by NHB that there were different types of transactions between NHB and Harshad Mehta. That, just as the suit cheques were drawn in favour of SBI, similarly, the cheques were vice versa drawn in favour of NHB by SBI. That, similarly, the particulars sought by SBI like date of reversals, date of maturity, particulars of outright transactions etc. would reveal as to for what purpose the suit cheques were drawn by NHB in favour of SBI. I find prima facie merit in the argument advanced on behalf of SBI that an amount of Rs 707 crores under 13 suit cheques could not have been paid to SBI purely on account of fictitious transactions particularly when these cheques were required to be signed by at least two Officers. NHB is a subsidiary of RBI. As a public body, NHB was required to disclose to this Court the relevant documents particularly when Exhibit "J", Exhibit "K" and the Statement at page 86 reveals transactions with the broker. This Court is certainly aware of the legal defences available to NHB. However, the primary function of this Court is to ascertain also whether public funds have been diverted through the above Waste Book Arrangement into the account of the brokers. For that purpose, NHB is duty bound to disclose the relevant documents



and in order to expedite the trial they were duty bound to answer the interrogatories. According to SBI, this arrangement was known to NHB. That, it was a tripartite arrangement. Prima facie, I find merit in the argument of SBI that the suit cheques covering Rs 707 crores were situated similar to the cheques numbering 200 as appearing in Exhibit "J" and Exhibit "K". These 200 cheques in Exhibits "J" and "K" are pointer to one fact viz. that the suit cheques were a part of Waste Book Arrangement/Mechanism. Similarly, the particulars given at page 86 of the Written Statement of NHB also indicate that there were transactions between NHB and Harshad Mehta. These are, of course, prima facie observations. Similarly, the controversy regarding cheques drawn in favour of SBI by State Bank of Patiala also shows that the suit cheques came within the purview of this arrangement. All these are only indicia relied upon by SBI to show that the suit cheques were not drawn on account of fictitious transactions as alleged, but they were drawn by NHB which had received consideration from private parties like FFSL and Harshad Mehta. Therefore, I ^{partly} am allowing the Chamber Summons No.11 of 2002 only to the extent of the interrogatories which I have culled out from the said Chamber Summons which are annexed to this Order. NHB is directed to answer the interrogatories as per annexure hereto within 12 weeks.

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7. The above reasons are prima facie in nature. They are given only in support of this order. They are not to be



treated as conclusive. They will not bind either parties in the final hearing of this suit.

CONCLUSION:

8. Before concluding this Court would like to make an observation. The present suit is filed for recovery of Rs 707 crores. It is filed by State Bank of India against National Housing Bank and against the heirs of late Harshad Mehta. The original suit was filed against NHB and Harshad Mehta. It is the duty of this Court to point out to the Finance Ministry that the cost of litigation running into lacs of rupees could be substantially curtailed if inter se disputes between Banks and Financial Institutions could be settled and steps be taken by these Banks and Financial Institutions to jointly claim recovery of the public funds. In this case, State Bank of India has preferred a Chamber Summons. The matter has been argued on number of days. The matter has been argued by Senior Advocates from Delhi and Mumbai. That, matters are being argued on interlocutory applications for days together for which, ultimately, the cost is borne by the Government. NHB is a subsidiary of RBI. SBI is also coming within the purview of the Finance Ministry. The present Chamber Summons is being fought by SBI versus NHB. No relief is claimed against the broker. In the circumstances, by this Order, this Court recommends to the Finance Ministry to look into this aspect of the matter and to evolve a Scheme and examine all



pending cases whereby lacs of rupees spent on litigation between Banks and Financial Institutions could be saved. I directing the Office to forward a copy of this Order to the Custodian who, in turn, is requested to forward the same to the Finance Ministry so that immediate steps could be taken not only confined to this case but also to cases pending in the Special Court.

~~Sd/- XXX~~
JUDGE, SPECIAL COURT.

Applied on 5/7/2014
Pages ①
Examined by H.P. Kadum
Compared with M.S. Kamli
Ready on 7/7/2014
Delivered on 14.11.2014



Certified to be a true copy
[Signature]
OFFICER ON SPECIAL DUTY
Officer of the Special Court
Bombay.

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7/7/2014