

Payment & Collection of Cheques

A Legal & Procedural Dossier
for the Paying Banker



The Customer (Drawer)

The Creditor who deposits
money.
Issues the unconditional
order (cheque).

The Paying Banker (Drawee)

The Drawee of a cheque. A
banker with whom the customer
holds an account, and to whom the
cheque is addressed for payment.

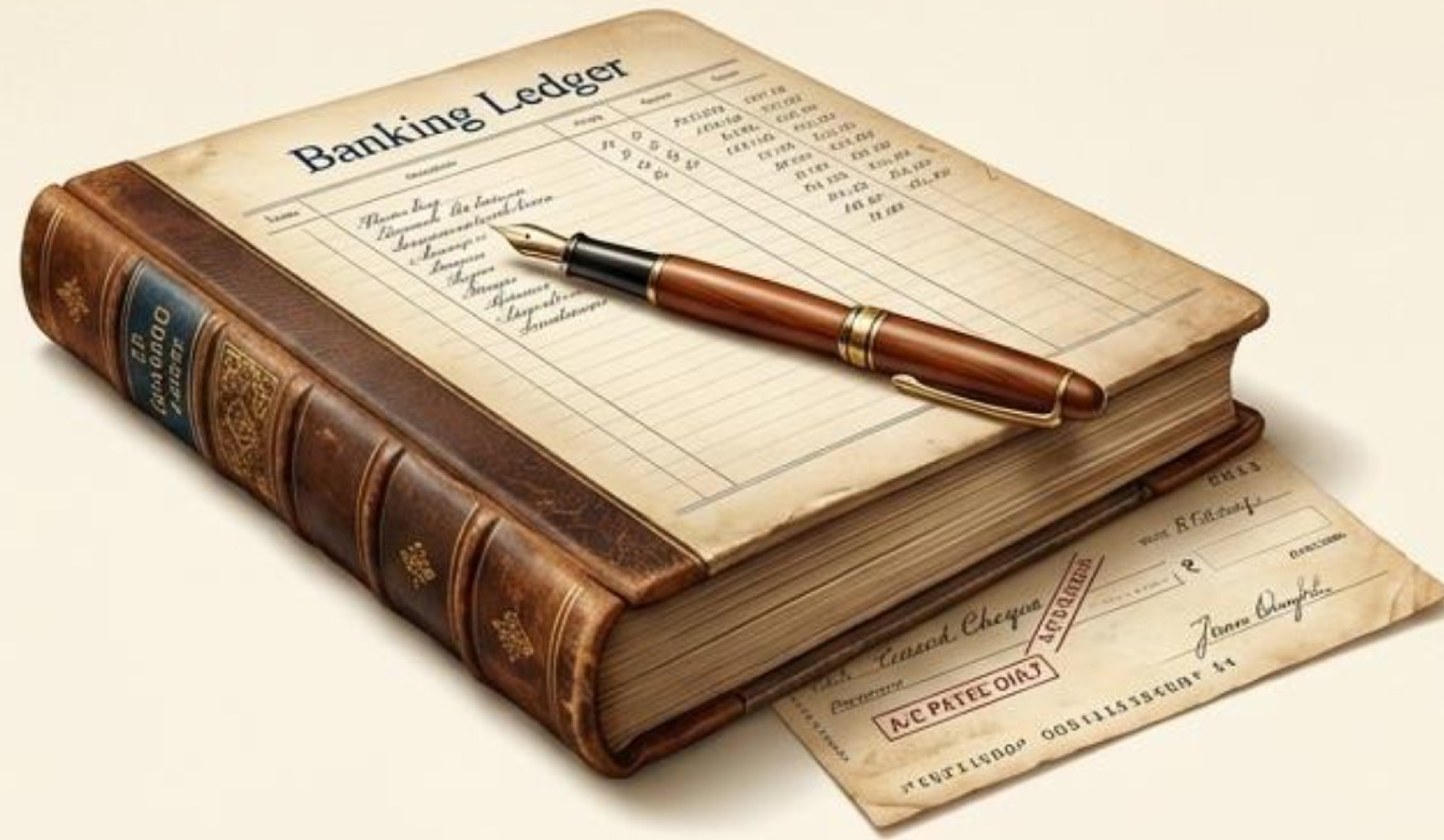
Role: The Executor of the
mandate. The Debtor holding
the customer's funds.

Payment

The legal discharge of a banker's
obligation. Settling the debtor-creditor
relationship by executing the drawer's
mandate to transfer funds.

The Payee

The individual entitled to
receive the funds.



Precautions which are to be taken by a banker before making the payment of cheque

Payment of Cheques



Amuf



Signature

The drawee of a cheque having sufficient funds of the drawer in his hands, properly applicable to the payment of such cheque, must pay the cheque when duly required to do so and in default, such payment must compensate the drawer for any loss or damage caused by such default.

Section 31 of the negotiable instrument act, 1881

Section (1)



(1) Precautions regarding cheques' genuineness

Ensure the cheque is regular and legal in all respects and on proper forms defined by the bank.



Byf.

Section (2)



(2) Precautions regarding customer's account and the balance

Check sufficient funds, proper application of funds, and customer's specimen signature.



Signature

Section (3)



(3) Precautions regarding legal restrictions.

Adhere to court orders, garnishments, or other legal prohibitions affecting payment.



Signature

2.1 Precautions regarding genuineness of a cheque (Part 1)

(i) Proper form of the cheque

There is no prescribed form of a cheque as defined by the negotiable instrument act. Further there is no clarification about whether it is printed one or it is simply a written piece of paper.

But it has been accepted by all the banks that **the cheque must be drawn on the bank's printed forms and the bank reserves its right to refuse payment of any cheques drawn otherwise.**

Signal

The image shows a sample bank cheque form. It has a decorative border and several fields for information: 'Payee' with a line for writing, 'Date' with a line, 'Amount in Words' with a line, 'Amount in Figures' with a box, and 'Signature' with a line. There is a circular seal on the left and a rectangular stamp that says 'OFFICIAL BANKING DOCUMENT' in the center. Three lines with dots at the end point from the text boxes to specific parts of the form: one points to the 'Payee' line, another points to the 'Date' line, and a third points to the 'Signature' line.

(ii) Date of the cheque

A cheque must bear a date because the mandate of the customer to the banker given in the cheque becomes legally effective on the date mentioned there in. Hence it is necessary that the drawer of a cheque fill in the date before the cheque is issued.

Note that if a drawer has not filled in the date then the cheque does not become invalid. The holder or the payee can fill the date and present it for payment.

But if a cheque is presented undated then the banker must refuse its payment.

Signal

2.1 Precautions regarding genuineness of a cheque (Part 2)



(iii) Proper place for presentation

- The cheque should be presented at a specific branch of a bank on whom it is drawn.
- Sometimes there is given a facility to present cheque at nearby branch of the bank to the customer for payment of a cheque but in this case it is necessary that the new branch of the bank must have the specimen signature of the drawer.



(iv) Presentation at proper time

- The cheque for payment must be presented on working date and during working hours.
- Working hours of bank are determined as per the feasibility of a place and traditions.



2.1 Precautions regarding genuineness of a cheque (Part 3)



(v) Amount of the cheque

The amount shown in the cheque must be certain. i.e. The amount shown in words and figures should tally each other. Under such discrepancy the Section-18 provides that the amount in words shall be the amount undertaken or ordered to be paid. So when the banker pays the amount written in words there is no liability. If the amount is written in figures only then it is sent back to the drawer for necessary entry.



(vi) Crossing of the cheque

(vi) Crossing of the cheque: The paying banker is under an obligation to make payment of the crossed cheques in accordance with the instruction of the drawer conveyed through the crossing. (Section 128)



2.1 Precautions regarding genuineness of a cheque (Part 4)

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(vii) Material Alteration: An alteration can be made by the drawer which is duly countersigned or initialled. But an alteration on a material part of a negotiable instrument which is not signed makes it invalid.

Protection (Section - 89)

A banker, however is protected if he pays a cheque with alterations under the following circumstances:

- ✓ (i) if the alteration is not apparent, and
- ✓ (ii) if the payment is according to the apparent tenor of the instrument.

2.1 Precautions regarding genuineness of a cheque (Part 5)



STRICT
COMPLIANCE

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Rules & Statutory Protection

(viii) Signature of a customer on a cheque: The paying banker should carefully ascertain that the cheque bears the genuine signature of the drawer after comparing the same with his specimen signature. If the signature on the cheque differs from the specimen signature... the banker must refuse payment. Payment of a cheque with the forged signature of the drawer is deemed as payment without the authority.

(ix) The name of a payee endorsement: Section 85(1) provides statutory protection to the paying banker as follows: "Where a cheque payable to order has a meaning to be endorsed by or on behalf of the payee, the drawee is discharged by payment in due course."

STRICT
COMPLIANCE

Case Law Focus

Ref. : Lala Pirbhu Dayal Vs. Jwala Bank Ltd.
AIR 1938, Allahabad 374.

The banker is not absolved of his liability on forged cheque, even if the customer was negligent in keeping the cheque-book under lock and key.

2.1 Precautions regarding genuineness of a cheque (Part 6)



STRICT COMPLIANCE

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(x) The cheques should not be void or torn or multilitiated: The bank should check that the cheque presented for payment should not be void, torn or multilitiated.

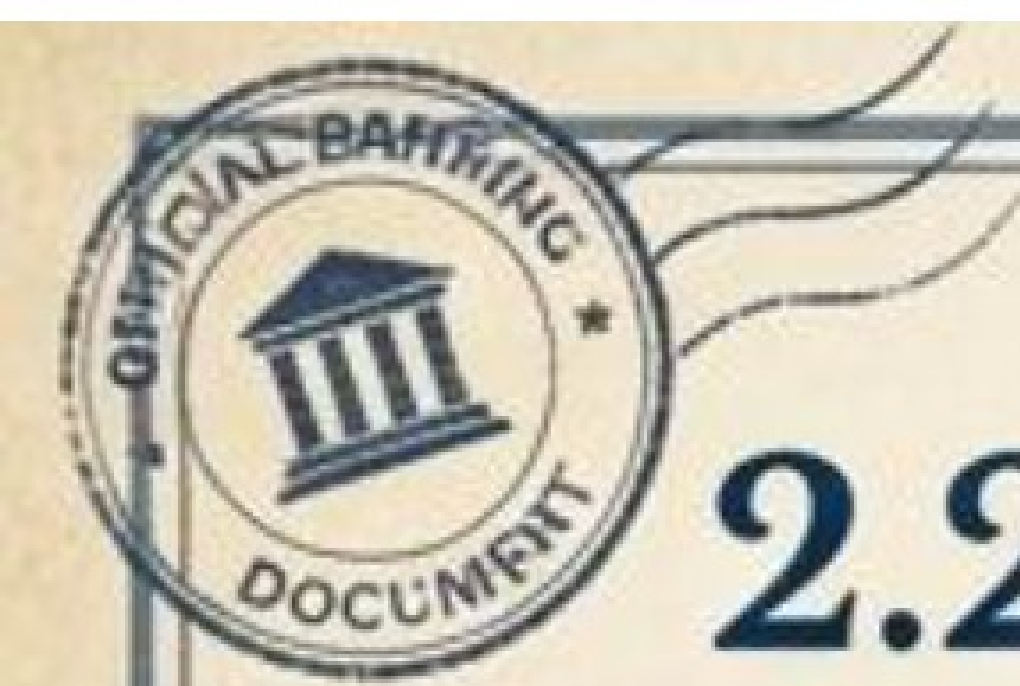


Endorsement must be regular: Note that the regularity of endorsement signifying to be that of the payee or his authorised agent.

Ref : Central Bank of India Vs. Bombay Vs. Gopinathan Nair and others - AIR 1979, Kerala 74.

The cheque torn at the corner may be accepted but if the crossing at the corner be torn out then the cheque should be returned.

(Ref. : Schale Vs Rambottom case) in which banker was made responsible for payment of the multilitiated cheque.



2.2 Precautions regarding customer's account and the balance

**STRICT
COMPLIANCE**



(1) While paying cheque's money to a customer or honouring a cheque of the customer, the banker has to check carefully the balance in his account and then only he should make payment.



**STRICT
COMPLIANCE**

(2) If a customer has more than one accounts in a branch of a bank, it is not necessary for a banker to collect all balances of different accounts but he is required to check only the account for which a customer has drawn the cheque. If the other accounts bear sufficient balance and the account for which the cheque is drawn has insufficient balance then the cheque must be returned with a note "Insufficient Fund".



(3) If there is no adequate credit balance in the account of a customer, then there is no part payment.



(4) If a cheque of large sum has been dishonoured by a banker and afterwards he receives a cheque of small amount than the second cheque can be paid by the banker if fund is available in the customer's account.

2.3 Precautions Regarding Legal Restrictions (Part 1)

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STRICT
COMPLIANCE

(1) Stop payment by a customer: (or countermand order of a customer)

A cheque is an unconditional order of the drawer to the banker. The drawer is competent to cancel or withdraw such order at any time before its payment is made.

The drawer need not explain the reason for stopping payment... It is necessary to give a written instruction to the banker for stop-payment of a cheque by the customer, wherein he has to give the details of the cheque and also it is required to be signed by the customer.

Note that the stop-payment instruction can be given by the customer only and not by holder (payee) or endorsee.

(2) Death of the drawer:

On receipt of authentic information about the death of the customer, the banker must stop payment of the cheques signed by him because the order of the customer to the banker ceased to operate on the occurrence of his death.



2.3 Precautions Regarding Legal Restrictions (Part 2)

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Legal Citation

Case Law



(3) Insanity of the customer :



The banker is not bound to honour his customer's cheques on **receipt of notice** that the customer has become absolutely insane or of unsound mind.

But so long as the customer acts - **rationally and understands properly**, his cheques should not be refused.

STRICT
COMPLIANCE

(4) Insolvency of the drawer :



If a debtor commits an **act of insolvency** as defined in the insolvency law either he or any of his creditors may present a petition in the Court of Law for an order of adjudication.

When the Court issues an **order of adjudication**  banker must **stop payment**. The customer's drawn cheques **should not be honoured after his insolvency declaration**.

Legal Citation

Case Law

2.3 Precautions Regarding Legal Restrictions (Part 3)

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STRICT COMPLIANCE

(5) Garnishee order :

customer's cheques is demolished on receipt of an order of the court (known as Garnishee order), issued under **order 21, Rule 46 of the code of civil procedure - 1908**.

COURT
ORDER

A garnishee order may attach either the entire amount of the judgment-debtor... or a *specified amount only*. If it has been mentioned specifically about the amount to be attached... and then payment of cheque can be done from the rest of the amount.

COURT ORDER

(6) Notice of assignment of credit balance :

The credit balance in the account of a customer may be assigned (or transferred) by him to another person under **section 130 of the Transfer of Property Act, 1882**.

Bank-Customer Relationship

On receipt of a notice of such assignment, the bankers must **stop payment** of the cheques drawn by the assignor.

NOTICE OF
ASSIGNMENT

The legal restrictions imposed on cheque



(7) Breach of Trust :

If the banker comes to know that the customer, who is operating a Trust account, contemplates to use the funds of the Trust Account in breach of trust, the banker must stop payment of the cheques drawn on such account.



(8) Defective title of the party :

If any person presenting a cheque has defective title to the cheque and the banker is aware of this fact, he can refuse to honour such a cheque without any risk, because if he makes payment of the cheque to such person, it will not be made in good faith and the payment will not be deemed as payment-in-due-course.

Concept Integration: Payment-in-due-course



1

(a) Payment is in accordance with the apparent tenor of the instrument.

Legal citation 1; 31

5

(e) Payment must be made in money only.

Legal cita. 2; 1

2

(b) Payment must be made in good faith and without negligence.

Legal 5

4

(d) Payment must be made under circumstances which do not afford a reasonable ground for believing that he is not entitled to receive payment.

Legal citation 17,1-7

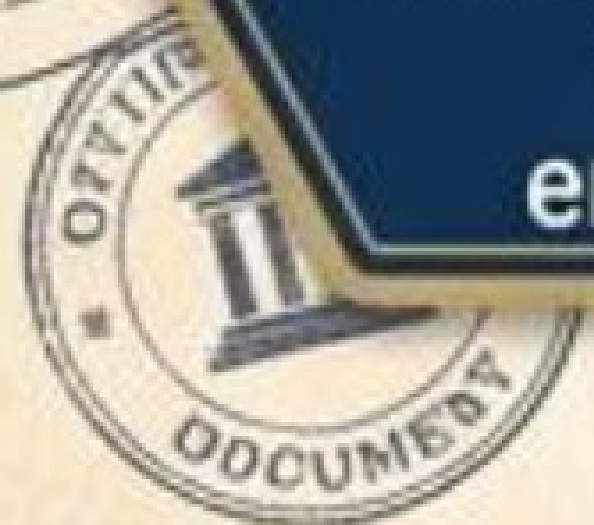
Legal 7

3

(c) Payment must be made to the person in possession of the instrument.

Section-10 of the negotiable instrument act explains the meaning of payment-in-due-course as follows :
“Payment in due course” means

Payment-in-due-course



Practical Examples of Payment-in-due-course Failures

Note that:



(1) Payment of a crossed cheque in cash is not a payment in accordance with the apparent tenor and hence it is not a payment-in-due-course.



(2) Payment made after stop payment is not a payment-in-due-course.



(3) Payment made after banking hours is not a payment-in-due-course.



(4) Payment of a forged cheque is also not a payment-in-due-course.



(5) Payment of a bearer cheque of Rs. 2 lac demanded by a rickshaw-puller must prompt the bank to verify the genuineness of the payment, even by speaking to the drawer, as otherwise it may not meet the requirement of (d) above.



5. When a banker is justified in refusing payment ?

A banker will be justified in refusing payment of the cheques in the following circumstances :



When a banker is justified in refusing payment ?



(i) If the cheque is a post-dated cheque or a stale cheque then a banker can refuse to pay it.



(ii) If the cheque is drawn on another branch of the same bank then a banker can refuse to pay it.



(iii) If the cheque contains an apparent material alteration which is not properly authenticated by the drawer then a banker can refuse to pay it.

When a banker is justified in refusing payment ?



(iv) If the signature of the drawer does not tally with his specimen signature or if it is a forged one then a banker can refuse to pay it.



(v) If the funds of the customer in his relative account are not sufficient then a banker can refuse to pay it.



(vi) If the endorsement on the back of a cheque is found defective then a banker can refuse to pay it.

The legal restrictions imposed on cheque

If there is any constitutional or legal restriction on cheque, the banker should not make payment of such cheque. The legal restrictions imposed on cheque are cited as follows :



The legal restrictions imposed on cheque

(1) Stop payment by a customer : (or countermand order of a customer) :

A cheque is an unconditional order of the drawer to the banker. The drawer is competent to cancel or withdraw such order at any time before its payment is made.



(2) Death of the drawer :

On receipt of authentic information about the death of the customer, the banker must stop payment of the cheques signed by him because the order of the customer to the banker ceased to operate on the occurrence of his death.



The legal restrictions imposed on cheque



(3) Insanity of the customer :

The banker is not bound to honour his customer's cheques on receipt of notice that the customer has become absolutely insane or of unsound mind.



(4) Insolvency of the drawer :

If a debtor commits an act of insolvency as defined in the insolvency law either he or any of his creditors may present a petition in the Court of Law for an order of adjudication. When the Court issues an order of adjudication, the whole property of insolvent person vests in the Court or an official receiver and becomes available for distribution among the creditors. The official receiver is empowered and the banker should act as per receiver's instruction after customer's insolvency.



The legal restrictions imposed on cheque



(5) Garnishee order :

In chapter-1 we have seen that the **obligation of a banker to honour his customer's cheques is demolished on receipt of an order of the court (known as Garnishee order)**, issued under order 21. Rule 46 of the code of civil procedure – 1908. Under the execution of this order the **banker cannot honour the cheque** of his customer.



(6) Notice of assignment of credit balance :

The **credit balance** in the account of a customer may be assigned (or transferred) by him to **another person** under section 130 of the Transfer of Property Act, 1882. On receipt of a notice of such assignment, the bankers must **stop payment** of the cheques drawn by the assignor, as the assignor ceases to be the owner of such funds.

The legal restrictions imposed on cheque



(7) Breach of Trust :

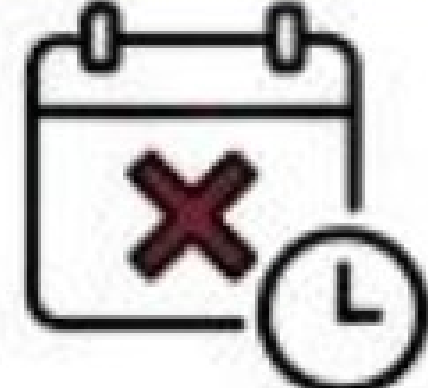
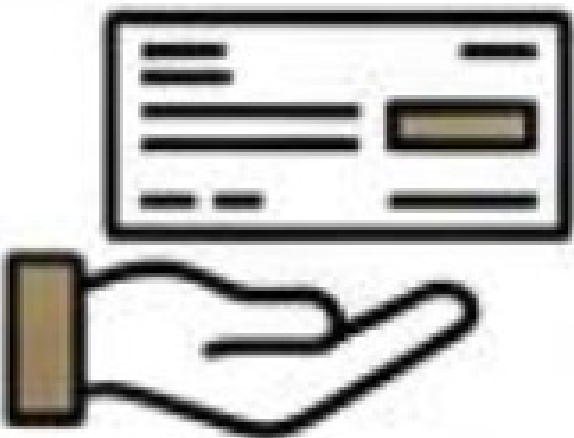
If the banker comes to know that the customer, who is operating a Trust account, contemplates to use the funds of the Trust Account in breach of trust, the banker must stop payment of the cheques drawn on such account.



(8) Defective title of the party :

If any person presenting a cheque has defective title to the cheque and the banker is aware of this fact, he can refuse to honour such a cheque without any risk, because if he makes payment of the cheque to such person, it will not be made in good faith and the payment will not be deemed as payment-in-due-course.

Payment of Cheques

conditions of payment-in-due-course :	When a banker is justified in refusing payment ?
 (a) Payment is in accordance with the apparent tenor	 (i) Post-dated cheque or stale cheque
 (b) Payment must be made in good faith and without negligence	 (ii) Drawn on another branche
 (c) Payment must be made to the person in possession	 (iii) Apparent material alteration
 (d) Circumstances which do not afford a reasonable ground	 (iv) Signature does not tally / forged
 (e) Payment must be made in money only	 (v) Funds are not sufficient
	 (vi) Endorsement is found defective
	The legal restrictions imposed on cheque : Stop payment, Death, Insanity, Insolvency, Garnishee order, Notice of assignment, Breach of Trust, Defective title.

Wrongful Dishonour

Under section 31 of Indian
Negotiable Instrument Act
(1881)

If the cheques are correctly written and presented in time at the proper place for collection to a banker by the customer and the same is dishonoured by the banker by mistake then it will be a wrongful dishonour of the cheques and bank will be declared defaulter for such sort of action and the customer has to be compensated for the loss on account of economic losses or loss of credit in the business world.



The compensation may be of two types :

- (i) Nominal compensation and
- (ii) Special or substantial compensation.

Nominal Compensation

(i) Nominal Compensation :

This type of compensation is given to customer who is not a businessman and the dishonour of the cheque by a banker does not affect his credit in the business world. In such a case court ordinarily orders for nominal compensation.



e.g. The case of **Gibans Vs. West Minister Bank of 1939** is an important example under which court ordered the banker to pay nominal compensation to the customer. Mrs. Gibans had given a cheque of 9£ and 16s to her landlord for the monthly payment on the bank. The bank wrongly dishonoured the cheque. Mrs. Gibans approached the court against this dishonour and the court ordered the banker to pay the compensation of 40 s. to Mrs. Gibans. The basis of this compensation was that she was not a business woman. Hence, she is entitled to get nominal compensation.

Special or substantial compensation



(ii) **Special or substantial compensation** : When a cheque of a businessman is wrongly dishonoured by a banker the customer is entitled to get exemplary compensation. This sort of compensation is given on the following conditions :

(a) There is possibility of damaging the business of the customer.

(b) Creditors of the customer loss in the confidence of the customer.

(c) Damage to the special credit of the customer.

(d) If an important contract of the customer is damaged.

The special compensation can only be given to a customer who is a businessman. Other conditions are secondary.

Special or substantial compensation

In the suite of **New Central Hall Vs United Commercial Bank Ltd.**, it was held that a trader could get special damage as the dishonour of a cheque would affect his major asset, namely his credit.

In the suite of **Davidson Vs Barclay's Bank Ltd.** the banker of a book maker had dishonoured oninqu a cheque of a small sum of £ 2-15 s. by mistake. Taking into account his business and the amount of the cheque, he was awarded a special damage of £ 250.

In **Canara Bank V/s. I. V. Rajgopal**, the banker had dishonoured by mistake a cheque for Rs. 294-40 ps. drawn by a non-trader customer Mr. I. V. Rajgopal. It was proved in the court that this erroneous dishonour led to the termination of employment. The court found that the customer had suffered much damage and so a special damage of Rs. 14000/- was awarded to the customer.

Hence in assessing damages, the courts of law give due weightage to factor like the financial position, business reputation and the custom of trade. In exceptional cases a non-trade customer can also be entitled to claim the special compensation against the damages which he has suffered, is alleged and proved.

Wrongful Dishonour

Grounds for proceeding	Meaning of Loss
In case of dishonour of cheque the customer can proceed against the banker for wrongful dishonour on the following grounds :  (a) Breach of contract  (b) Negligence  (c) Defamation (or Libel)	Hence the words "Loss or damage" as appearing in Section 31 of the Negotiable Instrument Act (1881) means the following :  (i) Damage for the breach of the contract to pay cheques.  (ii) Damage to the drawer's general business.  (iii) Damage to his general reputations and credit  (iv) Damage for the negligence of the banker.

Countermanding Payments of Cheques and Drafts

A cheque is a bill of exchange, drawn on a specified banker and not expressed to be payable otherwise than on demand. ... A cheque is an unconditional order of the customer to the banker. The customer has the right to cancel his mandate before the payment is made by the bank. Hence he has the right to countermand the payment of the cheque issued by him before it is actually paid.

(1) For that a customer (drawer) has to give instruction to the banker (drawee) and he cannot be questioned to provide reasons for the instruction. A banker has to accept such instructions from the drawer and not from the payee or endorsee i.e. Stop payment instruction is issued only by the drawer.

(2) If a payee or endorsee reports loss of the instrument to the bank then the bank should advise them to set stop payment instruction issued from drawer.

(3) Stop payment instruction can be given after business hours even and should preferably in writing but oral instructions or telephonic or telegraphic requests are accepted if followed by written confirmation.

(4) If there are more than one persons authorised to operate the account, stop payment instruction, given by any one of them shall be treated as valid.

Countermanding Payments of Cheques and Drafts

(5) Customer must provide certain minimum information while requesting for stop payment which includes cheque number, date of cheque, name of the payee and the amount.

(7) Stop payment instruction is valid till the time the cheque is returned by the bank marked payment countermanded. In practice, the validity continues for six months since by that time the instrument becomes stale and payment is otherwise not made.

(6) When the banker fails to take proper precautions and pays a countermanded cheque, even by mistake, the payment will not be considered to be in due course. He cannot debit customer's account in such circumstances nor claim the money from the holder whose right to the amount of cheque is unaffected.

(8) Banks are required to send acknowledgment of receipt of instructions for stop payment.

Countermanding Payments of Cheques and Drafts

(9) The draft is purchased by non-customer also. It is payable on demand. It cannot be made payable to bearer. The purchaser of the draft can countermand payment held by it agent, thus terminating the relationship of principal and agent.

(10) The purchaser of a draft can direct the bank who has issued the draft to cancel the same and refund the money to him at any time before the draft has been delivered to the payee.

[Ref. : *Malik Barkat Ali Vs. Imperial Bank of India* (1945 A.I.R. Lahore 213)
The Court held the banker was under no obligation to comply with 'stop payment' order of the purchaser.]

Legal Significance of (stop-order) notice

The stop-order (notice) given by the drawer of the cheque may be considered legal if the notice contains all the necessary details relative to the cheque, then and then only it has legal significance. The necessary details are :

- ✓ (i) Cheque number
- ✓ (ii) Date (of the cheque)
- ✓ (iii) Amount
- ✓ (iv) Name of the payee
- ✓ (v) Name of the drawer (i.e. Account number of the drawer)

The banker then verifies the signature with the specimen signature from his account number. If there be any miss the banker can try to clarify with the customer. If that is not possible then the banker can interpret as per his own discretion and acts accordingly. Similarly the stop-order (notice) given by the purchaser of the draft may be considered legal if the notice contains all the necessary details relative to the draft. Further it is necessary that the draft should have not been reached to the payee (or holder). Because the **Lahore Court** held that “**the banker** was under no obligation to comply with ‘Stop-payment’ order of the purchaser.”

Cheque & draft has a validity only for 3 months

Cheque & draft used for financial transactions have a validity only for 3 months. R.B.I. has passed a regulation regarding this. This regulation has come into force with effect from 1st April 2012.



This regulation has come into force with effect from 1st April 2012.

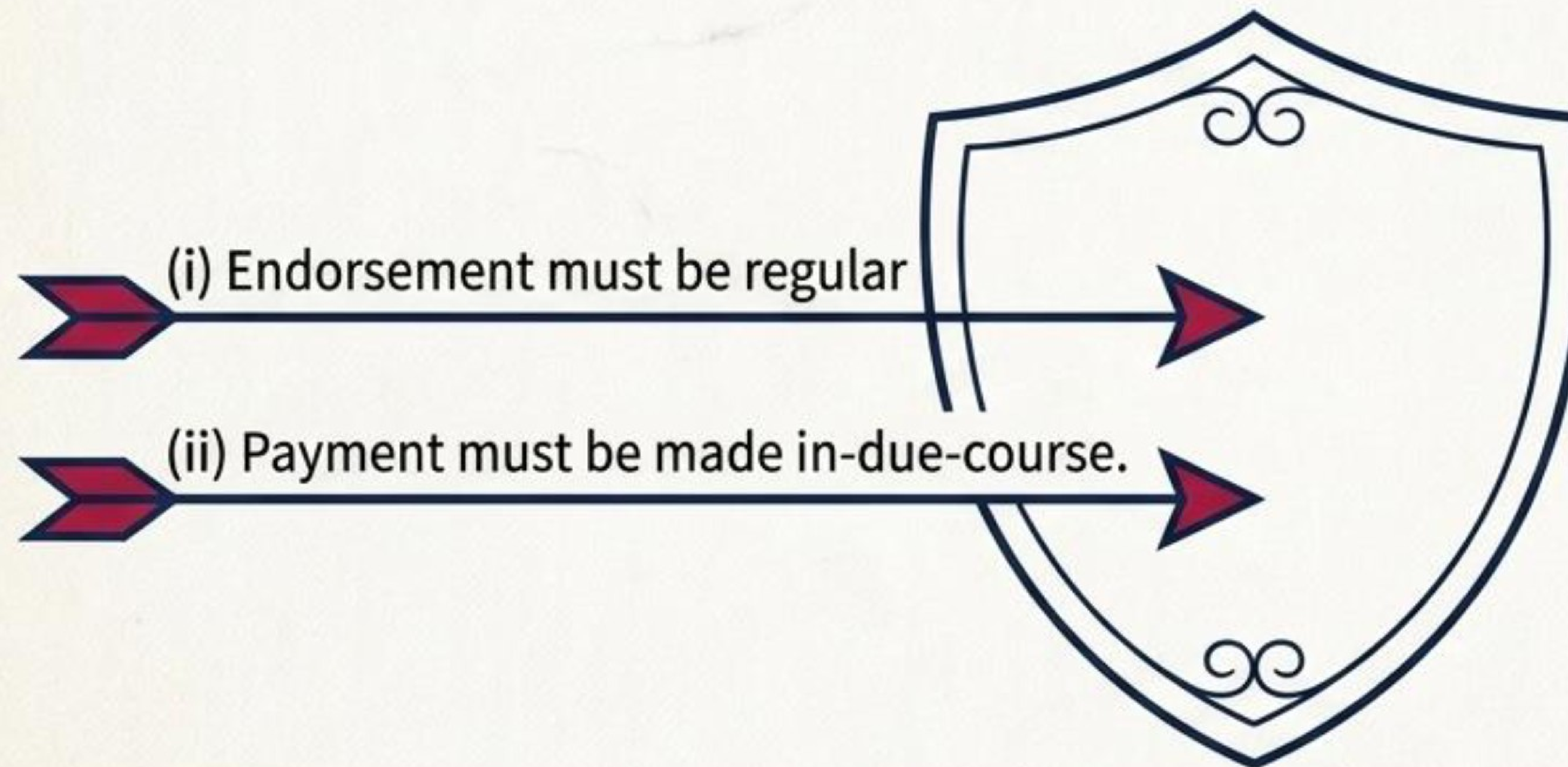
Because of this, Banks would honour the cheques upto 3 months after written date on the cheques. Previously this period was of 6 months.

R.B.I. Rationale

R.B.I. was forced to reduce the time limit to 3 months for validity to reduce malpractices.

Protection given to a Paying Banker in case of Order Cheques

In case of an order cheque, Section 85(1) provides legal protection to the paying banker as follows : “Where a cheque payable to order purports to be endorsed by or on behalf of the payee, the drawee is discharged by payment-in-due-course.”



This section grants protection to the paying banker if he makes payment of an order cheque with forged endorsement on behalf of the payee. ... The main object of this section is “to make the banker free of all responsibilities in respect of the genuineness or the validity of the each and every endorser.”

Signature of a customer on a cheque

If the signature on the cheque differs from the specimen signature of the drawer or the former is a **forged** one, the banker must **refuse payment** of the cheque because a **cheque with forged signature of the drawer is a nullity and gives no mandate to the banker to make any payment.**



Payment of a cheque with the forged signature of the **drawer is deemed as payment without the authority of the customer and hence a breach of the implied contract between a banker and his customer.**



The paying banker is, therefore not given any protection under the law, if he pays a cheque with the forged signature of the drawer.



The banker is not absolved of his liability on forged cheque, even if the customer was negligent in keeping the cheque-book under lock and key as required by the rules of the bank. (Ref. : Lala Pirbhu Dayal Vs. Jwala Bank Ltd. AIR 1938, Allahabad 374).

Protection given to a paying banker in case of bearer cheques

Section 85(2) of the negotiable instrument act provides protection to the paying banker in respect of bearer cheques as follows :

“Where a cheque is originally expressed to be payable to bearer, the drawee is discharged by payment in-due-course to the bearer thereof, notwithstanding any endorsement whoether in full or in blank appearing thereon, and notwithstanding that any such endorsement purports to restrict or exclude further negotiation.”

This Section 85(2) implies that a cheque originally issued as a bearer cheque always retains its bearer character, irrespective of the fact that it bears endorsement in full or in blank or whether any endorsement restricts further negotiation or not. Thus the banker is not required to verify the regularity of the endorsement on the bearer cheques, even in case of endorsements in full. If such a cheque is stolen and the banker makes its payment without the knowledge of such theft, then he will be discharged of his obligation and will be protected under this Section 85(2) of the act.

Protection Given to a Paying Banker in cases of Crossed Cheques

The paying banker is under an obligation to make the payment of the crossed cheques in accordance with the instruction of the drawer conveyed through the crossing. If he does so, he is protected by Section 128 of the negotiable instrument act as follows :

“Where the banker on whom a crossed cheque is drawn has paid the same in-due-course, the banker paying the cheque, and in case such cheque has come to the hands of the payee) the drawer thereof shall respectively be entitled to the same rights, and be placed in the same position in all respects, as they would respectively be entitled to and placed in if the amount of the cheque had been paid to and received by the true owner thereof.”

i.e. The banker making payment of a crossed cheque is given protection under section-128 of the act, if he makes the payment after fulfilling the following two requirements :

(a) He has made payment in-due-course (under section 10) i.e. in good faith and without negligence and according to the apparent tenor of the cheque,

(b) The payment has been made in accordance with the requirement of the crossing (under section 126).

Limitations and Legal Protection

Limitations

There is however one limitation to the protection granted under this Section-128. If the banker cannot avail of the protection granted by other sections of the act, protection under section-128 shall not be available to him. For example, if the paying banker makes payment of a crossed cheque with (i) irregular endorsement or (ii) a material alteration or (iii) forged signature of the drawer, he loses statutory protection granted to him under the act for these lapses on his part...

Material Alteration

Legal Protection in case of Material Alteration :
When materials by the customer are found in a cheque or a document and if such alterations are not clearly visible and crossing in such a cheque is rubbed out to such an extent that it may not be seen at first sight and if the bank has made payment in-due-course as per desire of the parties the banker is free from the responsibility.

Protection Against Payment in-due-course : In case of payment of cheque in-due-course, the paying banker gets legal protection.

Note : Under no circumstances, a banker is given legal protection in the payment for the forged signature.

Collection of Cheques

1. Introduction : Collection of Cheques

When a person receives a cheque drawn on any other banker he has two options before him :

(i) Either to receive the payment personally or through his agent at the counter of the drawee bank

(ii) To sent it to his banker for the purpose of collection from the drawee bank.

In option (ii), the banker, deputed to collect the amount of the cheque from another (drawee) banker, is called the **‘Collecting banker’**.

While collecting cheques on behalf of the customer, a banker acts either as a holder for value or as an agent of the customer.

2. Collecting Banker as Holder for Value :

(i) If he allows his customers to withdraw money before cheques paid in for collection are actually collected and credited.

[Ref. : Underwood Vs. Barclays Bank (1924).]

(ii) If any open cheque is accepted and the value is paid before collection and / or

(iii) If there is a reduction in the overdraft account of the customer before the cheque is collected and credited in the respective account.

(iv) If he gives its value to the customer by lending further on the strength of the cheques.

(v) If he gives its value to the customer by paying over the amount of the cheque or part of it in cash or in account before it is cleared.

(vi) If he gives cash over the counter for the cheque at the time it is paid in for collection.

2.1 The Rights of a Banker as a Holder for Value :



(1) If the banker acts as a holder, his rights will be the same as those of a holder in due course. Hence the collecting banker enjoys all the rights and liabilities of a holder and hence a holder in due course. Note that the title of a holder in due course is superior to the title of the true-owner.



(2) If there is a forged endorsement on the back of a cheque then the paying banker is liable to compensate the damage caused to the true-owner. And the collecting banker possesses the right to recover this damage from the last endorser. Hence in the case of instrument containing forgery the title of true owner is superior. If the last endorser i.e. the customer is unable to meet the liability then the banker will have to bear the burden.



(3) If the cheque sent for collection is returned dishonoured then the collecting banker can sue all previous parties after giving them notice of dishonour. It is, however, essential that the amount of the cheque is paid to the customer in good faith.

3. Collecting Banker as an Agent of the Customer :



The bank is acting as an agent of the customer and charges him the commission for collecting the amount... If the cheque collected by the bank does not belong to his customer, he will be held liable for “conversion of money”.

4. Conversion : & 4.1 A banker's Liability :



conversion is a wrongful interference or meddling with goods of another. Here ‘**goods**’ includes bill of exchange, cheque or promissory note.

This conversion may be committed innocently.

Hence, if a collecting banker, however innocent he may be, has converted the goods of another, he will be held personally liable.

4.2 Legal Protection to the Collecting Banker :

‘A banker who has in good faith and without negligence received payment for a customer of a cheque, crossed generally or specially to himself, shall not, in case the title to the cheque proves defective, incur any liability to the true owner of the cheque, by reason only of having received such payment.’

- Section 131 of Negotiable Instruments Act of 1881.

(i) The cheque must be a crossed cheque.

(ii) The payment must be received for a customer.

(iii) Payment must be received in good faith and without negligence.

5. Precautions to be Taken by a Collecting Banker :

(i) Crossed cheques only :

- Statutory protection can be claimed only for crossed cheques.
- If collecting an open cheque, in which his customer has no title, the banker becomes liable for conversion.
- Further the crossing must be made prior to its presentation to the banker. If the crossing has been made afterwards then as per Section 131 it cannot be considered as a crossed cheque.

(ii) Money collected must be for a customer :

- The collecting banker should act as an agent of the customer, not as a holder.
- Protection applies to an "account holder of the bank".
- The collection must be collected only for the customer and not for the stranger.

5. Precautions... (iii) In good faith and without negligence :

The payment procedure has been done honestly and without any negligence. This depends upon the circumstances of each case. Generally speaking, negligence indicates lack of care.



Central Bank of India Ltd. Bombay Vs. Gopinath Nair and others (Kerala High Court)

The test of negligence under sec. 131 is whether the payment considered in the light of the circumstances, antecedent and present, was so much out of ordinary course that it ought to have aroused doubt in the banker's mind and caused him to make enquiries.

6. Negligence : & Grounds of Negligence :

It is flexible and is ever expanding in its scope as new circumstances arise.

“The assumption of this duty to a stranger must be regarded as a part of the price paid by bankers for protection.”

– Sir John Paget

Grounds of Negligence :

- (i) Opening of accounts without proper introduction
- (ii) Irregularity of endorsements
- (iii) No enquiry being made in doubtful cases.
- (iv) Failure to take note of 'Not Negotiable' crossing.
- (v) Collection of 'Account Payee' cheque for any other person (or stranger).

Instances of negligence of a banker

(i) Lord Terrington

Collecting a cheque drawn against the Principal's A/c of the agent without enquiry. Agent paid them into his private account on Beckett's account.

(ii) Bavan Vs. The National Bank Ltd

Collecting a cheque payable to the firm to the private account of the partner without enquiry.

(iii) Underwood Vs. Bank of Liverpool and Martins

Collecting a cheque payable to the company to the private account of a director or any other officer without enquiry.

(iv) Employee to Employer

Collecting a cheque payable to the employer to the private account of the employee.

(v) Trust Accounts

Collecting a cheque payable to the trustee to the private account of the person operating the trust account.

7. Duties of a Collecting Banker :

The collecting banker acts as an agent of his customer and responsible to him for his acts of omission or mistakes. The following are the duties...

- (1) The banker should collect the cheques, sent by his customers with due care and should present the cheques to the drawee bank within a reasonable time.
- (2) If the paying and collecting bankers are located in the same place, the collecting banker should present the cheque the next day after he receives it.
- (3) In the case of outstation cheques the collecting banker should dispatch such cheques to the drawee banker on the day after it is received by him.
- (4) It is the duty of the collecting banker to exercise the same care and precaution in the interests of the true owner of a cheque as a reasonable businessman would exercise in his own interests.

Collection of Cheques (Duties Continued)

5

verify endorsements on an order cheque.

6

proper investigation of 'Per Pro' endorsements.

7

If the cheque sent for collection has been dishonoured, the collecting banker should inform his customer without any delay.

8

ask for introductory references if the account of the customer was opened without introduction.

9

If an open cheque is submitted... the banker owes a duty towards himself to get cheque crossed.

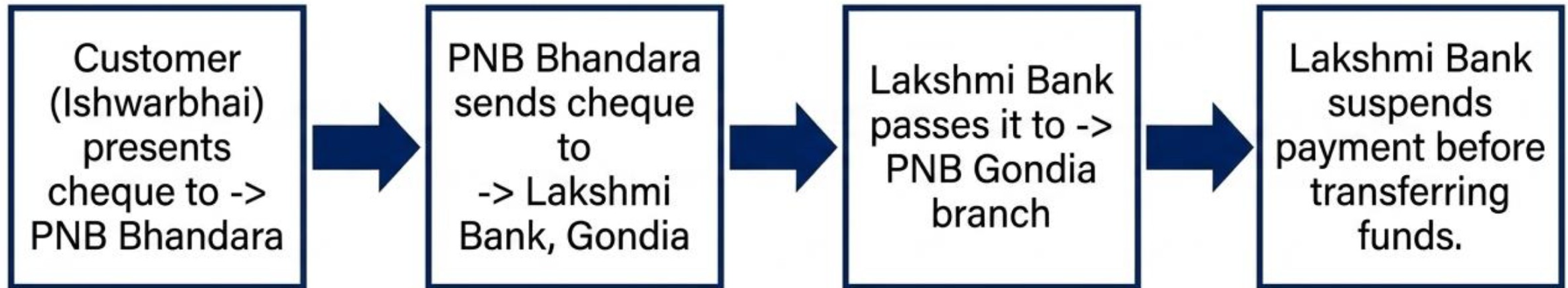
10

verify in detail the correct position if at any time the banker entertain a doubt regarding the ownership.

11

accept the cheque from his customer for collection.

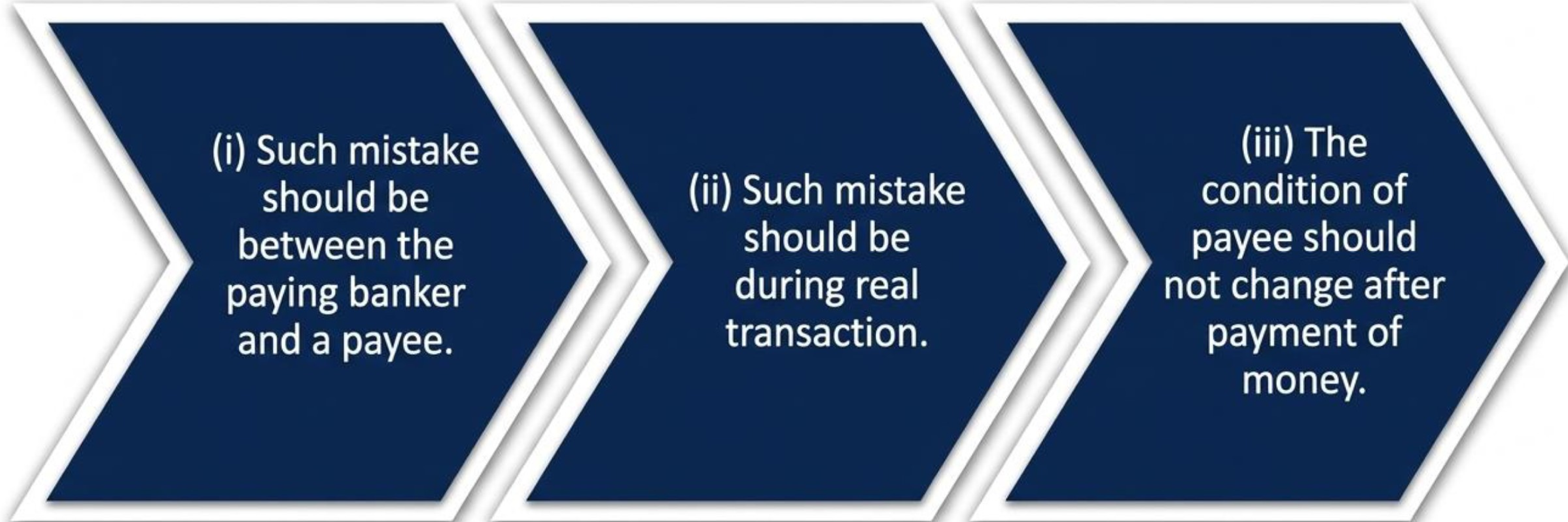
7.1 Liability of the Collecting Banker in Respect of its Agent Appointed for Collection :



Legal Finding: The Bombay High Court ruled Lakshmi Bank was a substituted agent, not a sub-agent. Punjab National Bank would not be responsible to the customer unless it had received the amount in its hands and credited the same to the account of the customer.

7.2 Recovery of Money Paid by Mistake :

If the banker has paid the money of a cheque due to mistake of fact he is entitled to recover the money but following conditions should be fulfilled :



(i) Such mistake should be between the paying banker and a payee.

(ii) Such mistake should be during real transaction.

(iii) The condition of payee should not change after payment of money.

8. Paying Banker Vs Collecting Banker :

The banker renders two types of services to the customers :

- (1) To make payments of the cheque drawn by a customer.
- (2) To collect money of the cheque deposited into the account by the customer.

Paying Banker

Should pay money of cheque drawn by customers.

The banker whose payment is proper gets protection.

Collecting Banker

If collecting banker makes proper payment he gets protection.

The instrument for which the collecting banker acts as an agent should be studied by him properly.

These two services are compulsory for every banker. If any banker is a paying banker for one customer, he may be a collecting banker for another customer.