

LAW OF BANKING

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Class-room live lectures edited, enlarged
and updated**

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CHAPTER 1

BANKING REGULATION ACT 1949

1.1 : Reserve Bank of India

The Reserve Bank of India, which is the central bank of our nation, was established in 1935 under R.B.I. Act 1934. It took over the currency issue authority and credit control from the then Imperial Bank of India. The Bank was nationalised in 1948.

Composition:

Central Board of Directors : 20 Members; Headquarters : Bombay.

This consists of:

- (i) A Governor and not more than 4 Deputy Governors appointed by the Central Government. The Governor is the Chief Executive Authority or Chairman of the Bank.
- (ii) 4 Directors nominated by Central Government from local Boards of Bombay, Calcutta, Madras, New Delhi.
- (iii) 10 Directors nominated by Central Government as per Sn.8(i)(c).
- (iv) One Government official nominated by Central Government.

Functions :

Many important functions are saddled on R.B.I.

Briefly they are :

- (i) It issues and regulates "Currency" in India (Issue Department).
- (ii) It acts as a banker to the Central Government and also to State Governments, and also manages the public debts.
- (iii) It acts as bankers bank i.e., as banker to all commercial Banks. All commercial Banks keep and maintain their accounts with R.B.I, i.e., they keep deposits with R.B.I, and borrow when necessary.
- (iv) It controls credits to ensure price stability.
- (v) It maintains the "internal value" of the " Indian Rupee" in India and also its "external value" i.e., against foreign currencies.
- (vi) Promotional activities or functions: It promotes sound economic growth by issuing guidelines to all Banking Institutions in India. In this regard it has (a) established a "Bill Market Scheme", (b) helped in establishing financial corporations in the field of agriculture, Industry, etc, also extending Banking facilities to rural areas.(c) has helped the commercial Banks to open branches -in foreign countries and also in promoting exports and imports by opening EXIM Bank etc.
- (vii) It controls the activities of all commercial Banks under the Banking Regulations Act 1949. It has the power of issuing Licences, to open branches.to inspect the banks : It has wide powers leading to over-all control of the banks... It has the power of "Select Credit Control" i.e., Advancing Policies, Rates of interest etc
- (viii) It controls the volume of total credit given by the Banks by resorting to (a)

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fixation of rate of interest; (b) by open market operation and (c) by specifying reserve requirements.

(ix) It may require commercial banks to maintain Statutory Liquidity Ratio (SLR), Cash Reserve Ratio (CRR) etc. (x) It may issue directions and orders to the Banks and these are final and binding.

Conclusion:

An assessment of the working of the RBI shows that though there are both achievements and failure largely it has been a success. It is rightly claimed that the inauguration of the RBI has "inaugurated a new era of financial stability. Banking reform, and extension and re-orientation of the money market".

The recent scam scandal has shown how the RBI is still in the process of becoming perfect, and, it is now working with alertness to peg up loop-holes and to make the system fool-proof to gain the confidence of the people.

1.2 : Banking Companies :

The Banking Regulations Act 1949 regulates the functions of the various banking companies and corporations in India and also provides for the social control over banks. The act applies to (1) all nationalised Banks (2) non-nationalized Banks and (3) co-operative Banks.

Functions and services

Banking means accepting of deposits of money from the public for the purpose of investment, repayable on demand or otherwise (sn.5 (b) Banking Regulations Act.

Banking company means any company which transacts the business of banking in India Sn 5(c). It further clarifies that if a company is formed for trade or manufacture and accepts "deposit from the public", it is **not a banking company**.

Functions Sn .6

- i) Business of banking is the major business of the Banking company.
- ii) Borrowing of money, lending of money, with or without security, dealing with Bill of Exchange, hundis, Bill of Lading [B/L] or other such instruments.
- iii) Issuing of LC (letter of credit) and travellers cheques, Credit cards.
- (iv) Buying and selling of Foreign Exchange.
- (v) Purchasing or selling of debentures, shares etc
- (vi) Providing safe-deposit vaults,
- (vii) Acting as agent of Government or local authority, clearing of goods.
- (viii.) Participating in issuing of public or private issues or other shares, stocks etc. of Corporations.
- (ix) Carrying on every kind of guarantee and indemnity business
- (x) Undertaking and executing trusts
- (xi) undertaking the administration of estates as executor, trustee, etc.;
- (xii) Making payments towards pensions, insurances, electric Bills, water Bills of customers, etc.

(xiii) The Banking company may acquire construct and maintain buildings in running its business.

(xiv) Sell, lease, mortgage or exchange the property of the Company.

General :

The Banking company is empowered to do all things incidental or conducive to the promotion or advancement of the business of the company.

Prohibition :

The Banking company is prohibited from engaging itself in any activity other than what is stated in the Banking Regulations Act.

1.3 Nationalization of Banks : 1969—Concept of Social Control :

"Social Control" with reference to Banks and Banking companies came into vogue in 1967, with the Government at the centre proposing to impose social controls over Banks by (i) establishing the N.C.C. (National Credit Council) and (ii) introducing legislative measures and controls in "Banking Regulation Act".

After India became independent, the Government at the centre enunciated its policy of "Socialistic Pattern of Society"—meaning equitable distribution of wealth, through democratic means. It introduced the mixed economy : (i) public sector controlled by Government and (ii) private sector to function on its own. The private sector was controlled by M.R.T.P. Act (Monopolies & Restricted Trade Practices Act 1969). The public sector could grow by nationalisation of Industries and Institutions.

The banking system in India in the private sector had many basic weaknesses :

(i) There were complaints that the commercial banks were giving priority to large and medium scale industries and had neglected small scale industries.

(ii) Exports from India, to earn valuable foreign exchange had not been given top priority by Banks.

(iii) Small scale industries and imports were also neglected.

(iv) Banks' top officials who were framing the policies were directing the funds to big and established business houses.

(v) Banks were under the control of mostly industrialists. They were influencing in advancing to companies, firms or institutions where the Bank directors were *substantially interested*. There were cases of credit given to hoarders, speculators-etc.

(vi) In some banks there were cases of mismanagement calling for immediate intervention by Government.

(vii) Agricultural and rural sectors had been much ignored by the commercial banks.

(viii) The Management of banks lacked professional expertise in many Banks.

Nationalisation :

The panacea, to cure the ills of the commercial banks, was nationalisation of these banks. This was done at two stages.

(i) By the Parliament passing the Banking Companies (Acquisition and Transfer of Undertaking Act 1970) which came into force from 19-7-1969.

14 Major commercial banks each having deposits of 50 crores and above were nationalised. The aggregate deposits were 2632 crores with 4130 branches.

(ii) 6 more banks were nationalised on 15-4-1980.

Process of Nationalisation :

Prior to nationalisation, the central government announced in 1967 its decision to impose "social control" over banks. For this two steps were taken,

(i) Establishment of National Credit Council (N.C.C.)

(ii) Amending Banking Regulation Act to introduce legislative controls.

The N.C.C. did a commendable job in

(a) assessing the credit demands from various sectors;

(b) identifying the priority sectors and their requirements;

(c) finding out ways and means to guarantee the optimum and effective use of the overall resources.

Controls : The Banking Regulations Act was amended. It provided for

(a) Board of Directors having special qualifications in Banking in addition to industrialists;

(b) Appointment of whole time Chairman;

(c) Restrictions on loans and advances to relatives of Directors etc.

Social Revolution : By an ordinance issued by the President on 19th July 1969, 14 Banks were nationalised and taken over and this was called "Social Revolution" in the Banking system. The reason for this sudden step was that public ownership of Banks would help mobilisation and development of national resources. These could be used on the basis of plans and priorities. Further, in many banks, the influence of the retired chairman and others was patent. They were hardly obeying the government's directions in implementing social control measures. Direct control was the solution. As the Government stated "the country cannot afford a trial and error" method, and hence, "an element of dynamism and new vigour" was needed in Banks. The Government further justified its stand stating that credits would be properly channelised on priority basis, banks could expand to rural areas.

Legal Mode :

The Nationalisation was effected by an ordinance issued on 19-7-69. This was challenged before the Supreme Court (Rustom Cowarji Cooper V. Union of India)

The court held that:

(i) Art 14 : There was discrimination as foreign and other Indian Banks were permitted but only 14 Banks were nationalised.

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(ii) **Art 19(i)(g)** : Though the 14 Banks were allowed to do business, their assets, premises, staff and names are taken away and hence it was impossible to do business. The restriction was unreasonable.

(iii) Compensation provided were illusory.

These constitutional loopholes were suitably plugged by making amendments and providing for :

- (a) mode of transfer of 14 banks;
- (b) payment of compensation;
- (c) management of the 14 banks.

Effect of Nationalisation :

The result of nationalisation is very significant and impressive.

(a) There is a rapid expansion and dispersal of branches of banks in cities, urban towns, and semi urban and rural areas.

(b) There is a significant mobilisation of deposits.

(c) Banking facilities have been extended to the length and breadth of the country. There is banking habit growing in the people.

(d) Banking advances and loans are being given on priority basis.

(e) The infra-structure in management is capable of taking quick decisions and implement them down the line etc.

Conclusion :

There is complete re-orientation in banking system after nationalisation. There is a shift from "class" banking to "mass" banking, "asset-based" lending to "production-based" lending and from "elite" banking to "social banking".

Criticism:

Many eminent persons and economists have opposed nationalisation :

(i) The commercial banks were significantly responding to the social control concept, in a spirit of cooperation.-

(ii) There could be some evils in the private sectors, but nationalisation was not a solution. **This has only substituted one evil for another.**

(iii) There is no dynamism in public sector. There is room for corruption and favoritism. There is delay, there is lethargy in work. Service is poor. Evils in banks are rampant.

(iv) Lack of competition in Banking has resulted in employees becoming public sector minded, quality of service has dropped down.

(v) Due to government restraints, bank officials are afraid of taking decisions. This has badly hit the customers.

The pros and cons of nationalisation have been recently studied by the Narasimhan Committee and many suggestions have been made. The latest trend is towards privatisation.

1.4 Bankers Books Evidence Act:

Banker's Books' Evidence Act 1891, is a very important law made exclusively for Bankers in India. This Act was amended in 1983. The Act has provided for special privileges to bankers as regards the mode of proving bank entries in their books and their production in Courts, **and no further**.

According to the Evidence Act, the contents of a document are to be proved before a court by producing the Original. The Bankers Evidence Act provides for a privilege and a Certified copy may be produced.

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(i) **Banker's Books** mean ledgers, day books, cash books, account books and all other books used in the ordinary business of the Bank.

(ii) **Certified Copy** means a copy of any entry in the books of the bank together with a certificate at the foot that it is a true copy duly signed by the manager or chief accountant of the branch.

Further, there must be a certification that the entry is made in the ordinary course of banking business etc.

Such a certificate is admissible in evidence in the court. It is a prima facie evidence of the existence of such entries as they are in the originals. The presumption is that these entries are genuine.

But this is a rebuttable presumption. In *C, Goswami V. Gauhati Bank Ltd.*, the bank had produced a certificate copy from its branch that Rs. 10,000 had been advanced to plaintiff. Petitioners challenged the entries. **The Supreme Court held, that the 'certified copy was admissible, but when challenged the entries are to be proved by the Bank with the originals.**

The provisions contained in the Bankers Books Evidence Act have been upheld by the courts (**Punjab National Bank V.Vmod Kumar**).

Restrictions:

When the Bank is not a party to a suit, no officer of the Bank shall be compelled to give evidence ,to appear or produce documents except under court orders.

Investigation by police officer : Police, not be below the rank of Superintendent of Police may compel the bank to produce the books for investigation purposes, under the Cr.P.C.

A party to a legal proceedings may apply to the Judge requesting him to issue an order to the other party to produce the certified copies as required by law.

CHAPTER 2 CUSTOMER AND BANKER

2.1 Relationship :

"The relation of banker and customer is primarily that of debtor and creditor" says Sir John Paget. The money deposited by the customer is absolutely at his disposal. But so far as the bank is concerned it is a debtor, with an obligation that it should honour the customer's cheques drawn on it upon his balance as is available and sufficient.

The bank becomes the owner of money on deposit. It is not a lien, it is not a bailee. The money is used by the Bank to earn profits and to pay interest. The bank need not pay with the same currency notes and coins as deposited by the customer (*Hanuman Bank Ltd. V.K.P.T.*)

There is no debtor-creditor relationship when the bank is entrusted with money to pay certain amounts to specified persons under an agreement, as then the bank will be a trustee. The bank is not a bailee* not an agent but only a debtor, when a customer deposits money. It was so held in **Foley V. Hill. In Shanti Prasad V. Director of Enforcement**, the Supreme Court held that the relation in case of deposits by a customer with the bank is **that of a creditor and debtor and not of a trustee and beneficiary.**

Bank is sometimes called a *dignified debtor* as the bank borrows as a borrower but is called in a dignified way as "deposit"; customer goes to the "bank" and not the bank to the customer; repayment by bank is done when customer demands, the place is the bank's branch office, not any other place. Further, bank *does not* give any security to customer for the deposits made.

Bank is to repay only when a *demand* is made by the customer. **In Jokinson V. Swiss Banking Corpn.**, Lord Atkin (Privy Council) pointed out that there was "one and indivisible" contract created between the bank and the customer. The bank undertakes to receive money, collect bills, repay at the branch during office hours and honour cheques (pr bills) issued by the customer.

The customer undertakes to take reasonable care in issuing cheques and not to mislead the bank. It was held in **Clare and Co. V. Dresdner Bank**, that the payment by bank is confined to the, particular branch where account is kept.

The reasons are one of convenience and of verification of signature and state of affairs of the customer's account. However, special arrangements may be made for payment in other branches by agreement. Though the primary relationship of debtor-creditor is created by the customer opening an account in the Bank, there may be other subsidiary relationships created by agreement such as : bailor-bailee, trustee beneficiary, principal-agent etc.

Points of difference between, bank-customer relationship and commercial creditor-debtor are :

Creditor - Debtor

- 1 The borrower is a debtor.
- 2 The amount is a "debt".
- 3 Debtor goes to Creditor, borrows as per general rules or custom.
- 4 The loan may be secured or unsecured.
- 5 The loan may be paid back at any time or place, by mutual arrangements.
- 6 The period of limitation is 3 years from the date of the loan.

Bank - Customer

- Bank, though a borrower is a dignified debtor.
It is styled "deposit".
Customer (Creditor) goes to the Bank, deposits and gets challans for such deposits.
The Deposit is always unsecured.
The bank will pay only on demand, at a particular branch. The demand should be in writing as in cheque etc.
There is no period of limitation for deposits. Period starts when demand is made by the customer. Not otherwise.

2.2 Salient Features of Banker's Relationship :

1. Honouring customer's cheques

When a customer opens an account there is an undertaking by the Bank to honour the cheques of the customer. The cheque should be presented, within 6 months [now 3 months] from the date of issue to the branch concerned.

If there is any order of court or any competent tax authority etc. the amount need not be paid. There are other legal grounds for the bank to dishonour its customers' cheques.

Otherwise dishonor becomes wrong and the bank becomes liable to pay damages, for loss of credit or injury to reputation of customer.

Leading cases : (i) **Marzette V. Williams**; (ii) **Canara Bank V. Rajagopal**. P issued the cheque for Rs.294/- to telephone department. This was wrongly dishonoured and the department disconnected the phone and P lost his job. The court awarded Rs. 10,000 for loss of salary and Rs,4,000 for loss of reputation and mental agony

2. Lien of Banker : The general rule is that the banker has a "general lien" on securities etc. of the customer and can draw on them to liquidate the balance of account due by the customer. This rule applies unless there is a contract to the contrary between the customer and the banker. Banker has no lien over "Safe Custody Deposit" of customer or on the deposit made for special purpose.

3. Maintenance of Secrecy of Accounts : In **Tousier's Case** (1924), it was declared that there was an implied legal condition that the account of the customer must not be disclosed. This obligation to maintain secrecy continues even if the account is closed by the customer.

However, to guarantor introduced by the customer the state of the account may be disclosed to the extent necessary; to the court, as per its order, the bank may disclose, and no further.

4. Levying Incidental Charges : The banker has a right to claim incidental charges from the customer especially when the account is not remunerative. In recent years,

the banks are closing the account when the balance is less than minimum for years in customer's accounts.

5. **Duration** : Formerly there must have been some recognisable course of habit in dealing between the person and banker. Hence a single banking transaction or by merely opening an account the account holder would not become a "customer". This was so held in *Mathews V. William Brown & Co.* But this is discarded and today, as per *Ledbrooke V. Todd*, the relationship begins as soon as a cheque is paid in and accepted for collection.

In **Central Bank V. Gopinathan Nair**, the court held that so far as banking business is concerned the customer is a person whose money has been accepted by the bank on the condition that the bank will honour the customer's cheques to the extent of credit available, irrespective of his connection being of short or long standing.

Hence, the general relationship commences, from the time the customer opens his account.

6. **Demand essential for payment**: There should be a demand by the customer for payment. The period of limitation of 3 years starts from the date of demand. Hence, for Fixed Deposit, the period starts when ED. receipt is produced and demand made. Similarly in case of current account, savings bank accounts etc.

2.3 : Banker's General Lien

It is an established fact that the relationship between a banker and its customer is one of debtor and creditor. The salient features of this relationship are ;

- (i) The bank undertakes to honour the cheques etc, of its customer for the money deposited by the customer in his accounts.
- (ii) Banker has a lien on securities etc. of the customer.
- (iii) Banker should maintain secrecy of the Customers accounts.
- (iv) Banker may levy incidental charges, and
- (v) Customer's demand is necessary for payment.

Banker's lien is one such feature. "Lien" is a right to hold or retain goods, securities etc. and the banker's lien is called General lien, i.e., to hold or retain all securities for a general accounts of the customer. Hence, the bank may adjust or draw on them towards payment due by the customer. This right extends to all securities, including goods etc., unless there is an agreement to the contrary (*Brandae V. Barneit*). This lien is an implied pledge. The banker has a right to sell the securities on default of payment. In regard to immovable property, the banker has a right to retain the deeds.

Banker's lien extends to all funds, securities and amounts that come to banker's hands, e

According to Sir John. Paget,, "General lien extends only to customer's own securities."

Creation of Lien : As per Sn.171 of Contract Act, the banker's lien is implied. However,

- (i) the banker should get the property of customer as a banker;
- (ii) The possession should be obtained lawfully;

iii) The property should not be for a particular purpose and there should be no agreement against the General lien.

2.4 Safety Vaults

The banks are providing in their own premises specially built safety vaults for use by the customers, on payment of a special fee. This is a special service available. The Bank in such a case is a bailee in respect of articles deposited by the customers. Though as per Sn.171 of Contract Act, there is a general lien of the banker, this rule will not apply to safety vaults. The reason is, *this is not banking*, but a special, service for a particular purpose, i.e., safe custody. Hence, the banks will have no lien. It was held in **Lease V. Martin** that the banker (in London) who had advanced loans on security of share certificates could not exercise lien on a safety box deposited by customer for custody.

No Lien on B/E or document: For specific purposes, a customer may deposit in the bank B/E or other documents. In such cases, the banker cannot exercise a general lien.

Trust Account: There is no right of lien over trust account as the trust is for a particular purpose.

Firms : For loans due from a firm, the bank cannot exercise a lien over partner's unless there is acceptance by the partner.

If money is deposited for a particular specified purpose, there is no general lien.

Problem : Can a bank exercise general lien on the following :

(i) Sealed box or a bar of gold deposited in safety vault.

Ans : No general lien can be exercised. The bank acts as a bailee; the purpose of deposit is specific and hence no general lien.

(ii) Documents of title to goods, fixed deposit receipts, life insurance policy, cheques and bills deposited for collection.

•Ans: The bank has a general lien as these have come to his hands as a banker. In the case of cheques and bills, they are deposited for collection. The banker has received in his capacity as a banker. Hence, there is general lien.

(iii) Dividend and interest warrants or coupons deposited for collection.

Ans /There is general lien as these are received by the bank in its capacity as banker.

(iv) Money deposited for a particular purpose.

Ans : There is no general lien, as the purpose is specified and accepted.

(v) Securities left by customer by mistake.

Ans : There is no general lien as the bank has not received lawfully.

(vi) Fixed deposits by X and Y jointly.

Ans: X is due certain amount to the Bank. Hence, X and Y are not having debit and credit account in the same right. Hence, bank cannot have general lien for arrears from X.

2 5 : Secrecy of Customer's Account:

In the relation of the banker and customer as a debtor and creditor, there is an obligation on the banker to maintain the secrecy of the customer's financial position as the

disclosure may harm his creditworthiness. From **Tousier's** case, this secrecy is considered as an "implied condition" of the relationship. This obligation continues even when the accounts are closed by the customers.

Exceptions :

To the general rule of secrecy, there are exceptions.

(i) The status or condition of the account of a customer may be disclosed when there are proper and reasonable circumstances.

(a) Court Order: When there is a court order to the bank summoning the bank to disclose the state of affairs of the customer's standing, the bank is justified in testifying to the accounts of the customer. The Civil Procedure Code has made provisions for productions of evidence before the court as for eg. discovery and inspection, examination of bank officials under oath, production of books of accounts or documents or under commission. Similar provisions are in the Income Tax Act, the Wealth Tax Act etc.

Under Criminal Procedure Code, the police and under the Customs Act, the officials may call for any information from any person including a banker.

(b) Enemy Character : In case of war, if the bank comes across its customer's transactions dealing with a country having Enemy Status, it may disclose the status to the government in public interest.

(c) Recovery by Civil Action : When the bank, for recovery of loans, sues the customer in a civil court, it may disclose to the court the status of the account of the dependent customer.

(d) Guarantor : When the customer brings in a guarantor to stand as surety, and if the guarantor makes enquiry about the state of affairs of the customer's credit status, the bank may disclose the information as may be necessary for the purpose. Normally, the bank takes permission of the customer in such circumstances.

(ii) **Limited Disclosures :**

(a) Status or Credit Information : This gives general information regarding the status of the customer. This is based on courtesy between banks as when a person stands as guarantor or surety. The bank of such guarantor may by courtesy give information but it must be given very cautiously and to the extent necessary. It must be general otherwise the bank may be liable, in damages for libel to its customer.

(b) Disclosure under direct use of I., T. Dept.: **Shankar Lai V SBI**

The customer remitted 261 currency notes of 1000 Rs, denomination to a SBI branch. The branch reported to the I & T department which issued a notice to the customer and attached. Question was whether this was a proper or legal disclosure. The High Court held that de-monetization was made by law and directives had been duly issued by the department. Hence, disclosure was proper, (i.e., the amounts were released later as per I.T.Act)

(c) Foreign Exchange Regulations Act authorises the R.B.I, to inspect the books of accounts of the banks.

(d) The Companies Act empowers Inspector of Central Government to inspect the

books of accounts for investigation purposes.

(e) Customer himself authorising a reference in which case the bank may disclose as may be necessary. Consent by the customer may be express or implied.

Cases : (1) **Sutherland V. Barclay's Bank**. A cheque issued by wife W was dishonoured by the bank. At the instance of the husband H, W phoned to the bank to know the reason and when conversation was in progress, H took the phone and expressed his displeasure for dishonouring but the manager told H about W's cheques being issued to betting in horse race etc. W sued the bank. Held, W by giving phone to H, had given her implied consent and hence *not liable to the bank*.

(2) **Hadley Byrne & Co. V. Heller & Partner Ltd.** (3) **Banbery V. Bank of Montreal**

Hence, the general rule is that secrecy of the customer's financial status should be maintained by the Bank as an implied condition of its relation with the customer. However, only in exceptional and defined circumstances disclosure is allowed. The bank becomes liable for damages for the tort of libel if disclosure is beyond these limits.

2.6 : Honouring Customer's Cheques :

(i) **Obligation** : When a customer opens an account there is a super head obligation or an undertaking by the bank to honour the cheque of the customer. The cheque should be presented within 6 months from the date of issue to the branch concerned.

There are certain legal grounds on which the bank may refuse to honour the cheque of its customers. These are :

1. Insufficient funds of the drawer.
2. Post dated cheques.
3. When the form of cheque is of doubtful legality.
4. Cheque not presented during banking hours.
5. When the funds cannot be applied to the cheque.
6. Material alterations, signature irregular etc.
7. Death of drawer, bank having notice.
8. insolvency of drawer, bank getting notice.
9. Countermanding of cheque.
10. Cheque drawn on different branch.
11. On receipt of Court order, prohibiting payment.
12. When the customer's account is held under general lien by the bank.

(ii) **Nature of the obligation to honour:**

There is a 'Contractual obligation' on the part of the bank to honour its customer's cheque, and hence, the bank is bound by this obligation. As per Sn.31 of Negotiable Instruments Act, there is also a statutory obligation in as much as this section imposes an obligation to pay if there are sufficient funds properly applicable and 'in default of such payment, must compensate drawer for any loss or damage caused by such default';

(a). **Sufficiency of funds** : The funds available in customer's account (i.e., Current Account) must be sufficient. Having credit balance in another branch of the bank is of no

consequence. Overdraft given, if any, must be taken into consideration.

(b) **Proper application** : The funds must be available for payment in Customer's accounts and should be capable of being appropriated. Credit balance in other accounts as for eg., Trust account, specific amounts deposited for a purpose etc. are not funds properly available.

(c) **Within 6 months** : The cheque should be presented in 6 months from the date of issue.

(d) **No legal bar** : If a court has issued a 'general order' attaching the funds of the customer, the bank may dishonour the cheque of its customer.

(iii) **Consequences of Wrongful dishonour** : If a bank refuses to pay or dishonour a cheque without justifiable reason, there is wrongful dishonour (*Hopkinson V. Forester*). The bank will become liable to compensate the customer for 'injury to his credit'. The leading case is **Marzette V. Williams** (1830). Marzette, a wine merchant had opened an account in Williams (Bank). On a particular day, the balance was £ 69 and on the same day £ 40 was remitted. A cheque of Marzette drawn in favour of Mr. Sampson came up for collection, and, was dishonoured. Marzette sued the bank. Held, Bank liable, even though there was no financial loss to Marzette. There was injury to his credit or reputation.

In **Sterling V, Barclay's Bank**, Mrs. Sterling sued the bank for dishonouring her cheque. Her cheques had been dishonoured twice for insufficient funds. Only nominal damages were granted. For non-traders special loss or injury should be proved.

In **Gibbon V. Westminster Bank**, nominal damages of £ 2 were awarded. Held, special damage should be proved to recover substantial damages.

However, in case of a trader or businessman, substantial damages will be awarded, without proof of special loss or injury.

Leading cases : (a) **New Central Hall V. U. C. Bank** .-The cheque was dishonoured

by mistake but the bank wrote letters explaining the mistake. The court held 'First unjustly spitting on a person, and then washing it with a bucket of water' will not in any way reduce the liability. Substantial damages were awarded.

(b) **Canara Bank V. Rajgopal** : R, a non-trader had issued a cheque for Rs.294/- to telephone department which was wrongly dishonoured by the bank. The telephone was disconnected and R lost his job. The court awarded Rs.14,000 towards loss of salary, prestige and for mental agony.

(c) **In Davidson V. Barclay's Bank**, a trader was awarded £250 for wrongful dishonour of his cheque of £ 2.15.,

Is wrongful dishonour defamatory ? According to leading cases 'Yes'. Hence, when a cheque is wrongfully dishonoured with the reason 'No Account', 'Not sufficient funds', 'Refer to drawer', 'Present again' are held by the courts to be a libel and hence, substantial damages, will be awarded by the courts. ^ /;

In *Wilson y Midland Bank*, endorsement by Bank 'no account' was held libelous. In *Davidson V. Barclays Bank*, 'not sufficient funds' was held as defamatory. In *Sterling V. Bare lays Bank*, 'refer to drawer' was held libelous. Of course in all these cases, the dishonour

was wrongful.

Conclusion :

The bank is under a contractual and statutory obligation to honour the customer's cheques. The legal grounds for dishonoring are well defined, However, for wrongful dishonour, the bank, is made liable and, substantial damages are awarded as detailed above, to the traders, but to others, only nominal damages are awarded. The law on this is well defined.

CHAPTER 3

OPENING OF ACCOUNTS

3.1: Precautions to be taken by the Bank before opening an account:

(i) Proper introduction of the customer is essential. The manager should verify whether the new customer is a person with integrity and reputation to be a "desirable customer", to open the Account. This is to prevent any fraud,

(ii) The bank manager may make enquiries from references given by the customer or banks about the status of the customer. He should make 'reasonable enquiry' as is necessary in the circumstances, to convince himself that the person is a bona fide customer. He need not act like a master detective and put the new customer to serious cross examination.

(iii) The manager should not act negligently in making enquiries; if proper enquiries are made, he gets protection under Sn.131 of the Negotiable Instruments Act.

3.2: Minor's Account:

(i) **General** : As a minor has legal incapacity (**incapax**) to enter into contracts, generally he cannot open a Bank account. This rule is made only to give protection and to safeguard the interests of the minor. Hence, there should be a guardian according to law to deal with minor's property. The father is the natural guardian, and after his demise, the mother. The court in suitable cases may appoint a court guardian, Hence, the general rule is that the Guardian may open and operate the Bank Account on behalf of the minor. He ceases to act, on the minor attaining majority.

(ii) **Practice**: In practice, the banks allow a minor above 12 years, to open an account in his own name and to issue cheques as per Sn.26(a) of the Negotiable Instruments Act. This is valid and the minor may continue his account on attaining majority at 18 (or if under Court of Wards, age 21).

No overdraft can be given to a minor, as overdraft involves a contract which would be void **ab initio**

A minor may be admitted to the benefits of a partnership firm, as per Sn.30 of the Partnership Act, but he will not be liable for the debts of the firm.

3.3 : Joint Account:

While opening the joint account, all the concerned persons should sign the application form. The necessary forms are filled up and signed to specify how the account is to be operated and also who is authorised on all matters including cheques, bills, securities, advances etc. Operation of the account may be by one or more persons but clear instructions are essential to draw cheques etc. Instructions regarding survivorship are also a part of the process of opening of accounts. Generally the account is made payable to either or survivor and the survivor is entitled to the amounts standing to the credit. The joint holders may nominate a person, if they so desire.

Example of Joint Account is Husband and Wife.

In a case of an account with instructions payable to either or survivor it is held that on the demise of the husband, the wife would be entitled to the amount if the husband had such an intention to benefit her, but, if there is no intention, it becomes part of the estate of the husband and hence heirs will be entitled as per law. Death of the husband, will not constitute a gift to the wife. The burden of proving the intention is on the wife (*Marshall V. Crulwell; Foley V. Foley; Panikar V. TWQ Bank Ltd.*)

3.4: Partnership Account

A banker may open a Current Account in the name of the Partnership, Firm on application made and duly signed by all the Partners along with the partnership deed (original or certified copy). The banker should make enquiries as usual and also about the nature of the business, names' and addresses, of partners etc. He should get an authority letter signed by all partners authorising a partner or two or more partners to draw cheques and other documents, to endorse bills or to accept bills etc., to mortgage, and sell property of the firm.

The partnership deed is an important document to know the nature of the authority of the partners including implied authority of a partner. The number of partners is limited to 10 in Banking business and 20 in other businesses. From the provisions of the Partnership Act:

(i) A partner's act will bind the firm if such an act is done in usual business of the firm or on *behalf of* (the firm, with an intention to bind the firm. This authority is implied.

(ii) Registration under Sn.69 of the Partnership Act is optional. However, if the firm is not registered, it gets no *locus standi* to sue an outsider. Partner cannot sue the firm or other partners. But, third parties may sue the firm.

To maintain a suit, (a) the firm should be registered; (b) names of Partners are to be on records of Register of Firm.

(iii) Implied Authority *does not* enable a partner to open an account **on behalf of the firm in his own name.**

Hence, the manager should ensure that the acts of the partner bind the firm, and that a partner does not act on his own behalf. According to Sn.4 of Partnership Act, "a partnership is the relation between persons who have agreed to share the profits of a business, carried on by/all or any of them acting for all."

In *Abbas Bros. V, Chetandas*, the signatures on two pronotes were (1) for M. M. Abbas & Bros., Mohsin Bhai, Partner; (2) Mohsin Bhai, Partner, M. M. Abbas & Bros.

The second was held as one that does not bind the firm or the partners, as it is not done on behalf of the firm. The first was held to bind the firm and the partners.

Partners' Private Accounts: Transfer of funds from the private account of a partner to the firm may be done by the bank, but not *vice versa*.

On retirement of a partner, the liability of such partner continues up to the date of retirement and notice thereof. The Bank may close the account and open a new account with the reconstituted firm, but to avoid the operation of *Clayton's ease*, a continuing guarantee by the retiring partner becomes essential.

3.5 : Joint Stock Companies : Public Limited Companies and Private Limited Companies :

The manager should take the usual precautions while opening a Current Account. Application for opening the current account should be filled up and signed by the duly authorised director or officer of the company.

The following documents are essential:

- (i) Certified copy of the latest Memorandum of Association;
- (ii) Certified copy of the latest Articles of Association;
- (iii) Certificate of incorporation of a private company, as that itself is the certificate of commencement in case of Private Companies;
- (iv) Certificate of Authority, to commence business, issued by the Registrar of Joint Stock Companies, for Public Limited Companies;
- (v) Copy of the extract of the Resolutions passed by the Board of Directors, authorising the opening in the Bank, a current account (and such other accounts) in the name of the company mentioning the names of directors authorised to operate the account, to draw or endorse cheque, bill of exchange etc.;
- / (vi) A complete list of current directors (with addresses) of the company duly signed by the Chairman of the Company;
- (vii) Balance Sheet of 3 years (if not a new company) of the company. On a perusal of the M/a & A/A, the manager will get a picture of the objects, Capital (authorised and paid-up) nature and functions of Board of Directors, the borrowing powers of the company etc. with the other documents he will be in a position to ascertain whether the company has already commenced its business, if so with what results, its financial status, profits and losses etc.* The certified copy of resolution enables the manager to restrict the operations of the accounts of the company strictly according to the resolutions. As was observed by the learned judges in *Royal British Bank V. Turquand*, all those who have dealings with the company are expected to know the contents of its M/A and A/A.

When the company puts up a proposal for a loan or overdraft, the bank should follow a number of formalities.

The company should have the powers to borrow; it should submit a certified copy of resolution of the Board, authorising the borrowing and the amount, terms, and conditions etc. (within the limits allowed). Balance sheets for 3 years should be submitted. This would give a clear picture of the financial status of the company. When there is a charge on the assets of the company, the charge should be registered within 30 days of its creation etc. with the Registrar of Joint Stock Companies.

In case of a Private company, the manager should enquire the antecedents to ascertain whether there was any conversion from a partnership firm or proprietor concern to private company. This will help to prevent any fraud or misrepresentation.

3.6 Married Woman :

"/ A married woman (Hindu) has the contractual capacity (if about 18 years of age) and has the right to acquire or dispose of her personal property called "Stridhana" in Hindu Law.

The manager should make the usual essential enquiries in opening the account of a married woman. In the application (account opening form), she should fill up in addition to her name, address etc., the name of her husband,, his address (and the address of the employer of the husband). Proper introduction is necessary.

As a competent person, she can draw and endorse cheques and other documents and these can be debited to her account. As long as credit balance is there in her account, there will be no risks, but, if loan or overdraft is to be given the Bank should ascertain her credit worthiness, her personal properties (*Stridhana*) the nature of the properties held by her etc.

The Husband is not liable for her debts, except for those loans incurred for "necessaries of life" for her and her family. Precautions in granting loans or overdraft are necessary as (i) she may have no property *as stridhana* (ii) Her Husband's property is not liable except for necessaries,(iii) she may plead undue influence or ignorance of the nature of loan transaction, (iv) she cannot be committed to civil prison.

3.7 Purdanashin Woman:

She is one who wears a veil (Purdah), as per her customs, and is secluded except the members of her family. Some Muslim women observe this as custom in their community.

The Manager should of course follow the preliminary enquiries as usual and may allow such a woman to open an account .Her identity and that she is opening the account out of her free-will are essential. To be on the safer side the manager may require a responsible person known to the bank attest her signature. Better if he insists such attestation in respect of her withdrawals also.

3.8 Trust Account The Manager of the Bank should make his usual enquiries in regard to the trust, the nature of the trust, its objectives, the trustee, his status etc. The application for opening the trust account should be filled up and signed by the trustees duly authorized. The Manager should get the original Trust Deed ,examine it and

collect a copy along with the application. The trust deed gives-an idea about the nature the trust, whether registered or not, who is the author (or settler) of the trust, who is appointed as the trustee, what are his powers, functions etc, who is the beneficiary, what is the trust property etc. He must examine the Registration Certificate and satisfy himself about registration. All the trustees should sign the account opening form and subscribe to a declaration that they will operate the account as per the terms of the Trust deed in the interests of the beneficiary. If there are more than two trustees, the manager should get a resolution passed as to who is the chairman and by whom the accounts are to be operated, (whether Jointly or otherwise) as per the Trust deed, and get their specimen signature.

If the trustees desire to borrow there should be specific powers mentioned in the Trust Deed to borrow and to charge the trust property. If care is not taken, the manager becomes liable to the beneficiary. In case of retirement, insanity or death of a trustee the manager should refer to the Trust deed and proceed accordingly.

3.9 H.U.F.:

The Hindu Undivided Family, is governed by the Hindu Mithakshara school, and consists of the propositus, his sons, grandsons, and great grandsons (up to 3 degrees) their wives, unmarried daughters, widows, etc. The coparceners, are all male descendants and get their status by birth, not by contract. The Kartha is the head of the family. He is entitled to foil possession of the H.U.F. property and is absolute in its management. He is a sui generis. He has a legal right to represent the H.U.F. and to bind the H.U.F. He has absolute discretion to spend the family income for the purposes of the family and for "legal necessity".

The Bank Manager should get all the details of the H.U.F. before opening the Account. In the account opening form, the names and addresses of the Kartha and all coparceners should be filled up and they should give their mandate in the declaration, by putting their signatures. On behalf of minors, the signature of the guardian should be taken. The date of birth of minors should be noted and when they attain majority their signatures should be taken to cover their earlier transactions.

When a charge is created on the property by the H.U.F. the coparceners should execute the Bank documents. The Kartha no doubt has the capacity to sign, but his powers to alienate the H.U.F. property is limited to legal necessity and hence to be on the safer side, all should sign. Further, the burden of proving that the overdraft or loan was for legal necessity or for family business would be on the manager. The loan should not be for speculative, business or for immoral purposes. The leading case is **Ramdayal V. Bhanwarlal**.¹ It was held that the alienation should be for the benefit of the estate or for legal-necessity. However, the burden is on the transferee. He should have made reasonable inquiries and be satisfied with the purpose of the loan as for H.U.F. business. The liability of minors is limited to the extent of their interest; but adult male coparceners are personally liable with the Kartha, if they sign the documents. This was so held in *Jivan Das V. Peoples Bank*,

The Manager should therefore take maximum care in getting the loan documents duly executed in the light of the above position of H.U.F. in Law.

CHAPTER 4 TYPES OF ACCOUNTS

4.1 : Current Account (Current Deposit) :

The Current Account facilitates commercial and industrial undertakings (Companies, Firms etc.) and public bodies and authorities in attending to their numerous and frequent transactions. Deposits and issue of cheques are continuous processes and bank's role is appreciable. No interest is payable by the Bank under this account, as per R.B.I. regulations, but Banks may levy incidental charges.

The obligations on the bank is onerous in respect of current accounts as customers cheques are to be answered as long as there are funds to their credit. Further the bank should keep sufficient funds to meet such cheques

. In Fixed Deposit, the Bank may be aware of the maximum the customer may demand, but in respect of Current Account, the bank should make available large funds to meet all emergent demands.

4.2 : Fixed Deposit:

The bank is a debtor to the depositor in fixed deposits. This is so even after the expiry of the date of maturity. The legal relations of depositor-bank is that of creditor-debtor in fixed deposits. The relations continue even after the F.D. receipt matures and until it is paid up or discharged. The bank in order to accommodate the depositor may allow withdrawal subject to R.B.I. directives (regarding interests) but F.D.R. is to be discharged by the depositor. This affects the cash-reserves of the Bank. After due date, interest is payable as per R.B.I. directives, if the F.D.R. is renewed.

The F.D.R. issued by the Bank is not negotiable. But it can be assigned. The F.D.R. is not a negotiable instrument. This was so held in **Abdul Rahaman V, Central Bank**. An assignment may be made with due notice to the Bank. The Bank should obtain a letter of authority from the depositor for making payment, in such cases.

The F.D.R. is a debt or an actionable claim and hence a gift of it may be made by making an instrument of transfer..

If an F.D.R. is lost the Bank may issue a duplicate or make the payment on maturity to the depositor by obtaining an indemnity bond in either case.

Under a garnishee order the F.D.R. may be attached if there was a real "debt" of the judgment-debtor.

The Income-tax Assessment officer (or T.R.O.) may issue a notice to the Bank demanding payment or attachment of F.D.R. If the notice is received before maturity of F.D., the bank is bound to make payment to the Department on date of maturity of the F.D.

The F.D.s may be made payable to "either or survivor" or Former or survivor. In such a case the appointment of a nominee is not necessary,

4.3 : S. B. Accounts :

The Banks had not evinced much interest in S.B. Accounts earlier, but when banking

services became extensive and savings started becoming a movement among people, banks found this to be a paying **business**. **Of the total bank deposits of 56 lakh crores, nearly 14 lakh crores were in savings bank deposits. (2011 March)** This is not a small amount to be ignored ! Further it fosters savings habit. The S.B. account holder, should leave a fixed minimum as balance in his account and may withdraw by cheques or withdrawal forms. Cheques payable to the customer are sent for collection. These deposits earn interest as per Bank regulations. Banks provide special services and also privileges of safety vaults etc. to such account holders, to have good customer-bank relations. ; • From the Banker's stand point maintenance of these accounts does not involve much expenditure and hence less expensive.

4.4 : Closing of Account or Stoppage of Operation :

The customer - banker relation is not only that of a creditor - debtor and hence contractual, but it is also statutory in view of the Negotiable Instruments Act and other statutes. As such there are well-defined principles in regard to closing of Accounts or 'stoppage of operation by the Bank.

The Bank may close or stop operation of an account on the following grounds : (i) customer's notice to close the account; (ii) customer's death; (iii) customer's insanity; (iv) customer's insolvency; (v) Garnishee order from Court; (vi) Assignment of Credit balance and notice thereof by customer.

Every customer has a right to close his Account and the reasons may be varied. It may be in respect of Bank's services, rate of interest, incidental charges, lack of facilities, and lack of confidence in the Bank etc. Similarly the bank may close the account if the customer is "undesirable" or is convicted of forgery etc.

(i) **Notice necessary** : The customer may give notice to close his account, but he is not bound to do so. But so far as the Bank is concerned adequate notice should be given. It was held in the "snowball" scheme case i.e. *Prosperity Lid, V Lloyd Bank Lid.*, that as the scheme had spread world-wide and bank had full knowledge of the wide spectrum of operations, a month's notice given to the company was inadequate and amounted to violation of contract by the Bank. Closing an account by the Bank without notice is invalid and against the Banking Code. Generally, one month's notice suffices.

(ii) **Customer's death** : The death of a customer and notice or knowledge thereof is sufficient for the Bank to close the account, in *UBI V Devi*, the Supreme Court held that notice to one branch is not a constructive notice to all other branches.

(iii) **Customer's insanity**: The general presumption by the Bank is that the customer is sane unless there is conclusive proof of his insanity and based on this if there is notice of Insanity the Bank may stop operation of the account (*Young V Toynbee*).

(iv) **Insolvency**: In the case of individual customer, on notice of insolvency the Bank should stop the operation of the Account and should not honour cheques etc. In the case of a company (private and public) when the winding-up proceedings start and the Liquidator is appointed, the Bank should transfer the balance in the account to the Liquidator.

(v) **Gurnishee Order :**

On receipt of the order of the civil court, the Bank should take steps, as per the order. If an amount is specified, such amount is to be earmarked for the purpose and the balance may be subject to honour customer's cheque.

If the entire account is to be garnished the Bank may do so and stop all further payments.

(vi) Assignments : The **assignee gets a right and** hence, when the Bank receives notice of the assignment (transfer), the assignor (customer) will have no right to the balance in his account, and the Bank is justified in closing the account.

CHAPTER 5

PASSBOOK

5.1 : Meaning and Scope :

"Pass Book's proper function is to constitute a conclusive or unquestionable record of the transactions between banker and customer and it should be recognised as such"—Sir John Paget.

This view of the learned author is based on Chancery Court decision in **Devaynes V Noble**; it was held that if a customer after getting the entries made finds omissions or errors he should report to the Bank, otherwise his silence would mean acceptance. This is no longer the law today in view of a large number of decisions in England and in India.

The Pass Book is a book that keeps record of the customer's account for his use and it is called as 'Pass' book as it passes periodically between the bank and customer. Actually, it is a copy of the bank's book : 'the ledger'. With the **introduction of computer**, the banks are sending loose leaves of copy of ledger to the customer. The Pass book contains the ledger entries as:

Date	Particulars	Debit	Credit	Dr or Cr	Balance
------	-------------	-------	--------	----------------	---------

5.2 Mistakes in Pass-book

The questions that arise as regards Pass Book are :

- (i) According to Sir John Paget, is pass book a conclusive proof of its correctness ?
- (ii) If mistakes of omissions or commissions are found either in favour of a Bank OR of the customer what is the legal position ?
- (iii) Is confirmation slip, signed by the customer and returned to Bank, conclusive? or can mistake or commission (e.g. forgery) still be questioned?

(i) **Entries not conclusive;** In the United States, the courts have held that there was a duty on the customer to examine his pass book and confirm its correctness. However, in England, and in India, the courts have not accepted *such a duty*. On the contrary, the return of the pass book by the business organisation after ticking of the day to day entries is *prima*

facie evidence of validity, but it is not conclusive. If there is a mistake or omission or payment of forged cheque remedy is always open (*Canara Bank V Canara Sales Corporation*). There is- trust between the customer and the bank. Hence in India, **Paget's theory is not approved.**

(ii) Mistake in favour of customer:

If the customer has acted in good faith and has withdrawn the moneys the bank is prevented from recovering, In **Styring V Greenwood**, a military officer had drawn from the Bank, in good faith certain moneys. The bank sought to recover but the court rejected the claim. This is the case of individuals.

In respect of business organisations, the statement and pass book entries are checked regularly by them and hence, it will be difficult to establish bona fides that the mistake was not known to them. In *Oaklay Bowden V. Indian Bank* the customer company had maintained regular accounts and hence could not plead and establish its bona fides, when there was a wrong entry in the pass book.

If a customer draws from the Bank on the basis of pass book entry, and a cheque is dishonoured by the bank, it amounts to wrongful dishonour and the bank becomes liable. In *Holland VM&L District Banking* the credit balance was £ 70, in which there was a wrong credit of £ 60 to its account. A cheque for £ 67 issued was dishonoured. Held : bank was liable, as the customer had acted on the entry in his pass book.

Mistake in favour of Bank :

Though the law is not very clear, in general, it is the customer's responsibility to examine the entries. However, he is not bound to do so and the Bank cannot draw; any inference against him.

Though it is the customer who should check the entries in the pass book from time to time, there is no duty cast on him to do so. Hence as was observed in *Vagliano V Bank of England* even though there was a course of conduct developed between the customer and the bank, it could not be inferred that the customer had a duty to the bank.

In fact, mere debit entry is not conclusive evidence of payment. In **UBI V. STO** the bank had issued a token to P the bearer of the cheque to draw cash. Before P collected cash, he was arrested by the police at the instance of STO. The bank kept the amounts in suspense account. Ultimately the bank contended that debit entry is made duly, but the Bombay High Court held that debit entry in pass book did not constitute payment. Hence, the bank is not discharged from its liability.

(iii) Confirmation slips :

The courts are in favour of the view that if a confirmation slip is signed by the customer and returned to bank, an inference could be drawn that the customer could not object. (*Essma Ismail V Indian Bank*).

However if payment is made on a forged cheque or if there is fraud by the bank, the confirmation slips will not prevent him from questioning the forgery or fraud.

CHAPTER 6 GENERAL MANAGER

6.1 Definition:

There is no definition of 'G.M.' or Manager in the Banking Regulation Act. According to the Companies Act, he is a person who is subject to the control and direction of the directors and who has the management of the whole or substantially the whole of the banking business or affairs of the bank (The Branch Manager is different and is only the Head of the Branch).

6.2 Qualifications :

Tannan has consolidated the various qualifications of the G.M. in his *Banking Law and Practice*. The G.M. Should be an intellectual, a man of Wisdom, talent and moral rectitude. He need not be a poet, statesman or orator, but a man of profound commonsense, skill and experience.

He should have good qualities of head and heart. His technical knowledge, ability to take quick decisions, his mastery of legal principles involved and his ability to judge persons and to delegate the work, go a long way in the administrative efficiency in the bank.

He should infuse confidence in his subordinates and make them serve with a spirit of service. In public contact he should remind them of "Smile" and "be pleasant", "Smile" and "sell" are good business catchwords.

«

6.3 Powers and Functions :

He is a general agent and hence he can act within the scope of his banking authority and can bind the bank. Even when he exceeds his authority, the bank is responsible when the third party has no knowledge of the restrictions on him,

For his mistakes and in some cases for fraud the bank is liable. Similarly the bank is liable for theft, deceit or for criminal acts, in some **circumstances Lloyd V Grace, Smith & Co.**

Rights and Liabilities :

Under the Banking Regulation Act the G.M. called the 'Principal Officer' is saddled with statutory responsibilities, powers and functions and he should act within these limits. He should not make any secret profit or commissions.

'CHAPTER 7 NEGOTIABLE INSTRUMENTS

7.1 Definition (Sn. 13):

A Negotiable Instrument means (i) a Promissory Note P/N, (ii) Bill of Exchange B/E or (111) Cheque payable to bearer or to order. Negotiation is defined by Negotiable - Instruments Act Sn.14. It means that the P/N or B/B of cheque hi to be transferred to any person as to make him the holder of the instrument.

(a) If the instrument is to be negotiable the form may be as follows •

Payable to X; X or order; order of X, 'to bearer' or to X or bearer'. When the instrument is payable to X, it means to X or order and hence, it is negotiable. If it says payable to P only, it is not negotiable.

(b) If the negotiable instrument is endorsed in blank or is payable to bearer, it may be negotiated. A bill is payable to Mr. Smith or order. Smith endorses it in blank-and negotiates it. It is payable to bearer.

(c) If a negotiable instrument is payable to the order of a specified person it is nevertheless payable to the specified person or to his order.

(d) The negotiable instrument may be payable to two or more payees jointly or to one of two or more payees.

(1) A share of a limited company is transferable but *not negotiable* as a negotiable instrument. A share can be transferred only as per Companies Act and then only the transferee becomes the owner of the share. But a negotiable instrument is negotiable by delivery, or by endorsement and delivery and the transferee gets rights of ownership.

(2) The transferee of negotiable instrument who takes as holder in due course is cured of the defects and gets a better title. A bearer cheque if stolen and transferred by A to B, B is a holder in due course though the cheque is stolen.

7.2 Transfer:

A negotiable instrument may be transferred by two methods. One according to Sn.130 of Transfer of Property Act and the other according to the provisions of Negotiable . Instruments Act. Sn,130 Transfer of Property Act provides for transfer of an 'actionable claim' by means of executing as assignment deed.

This method requires that notice must be given to the debtor by the assignee.

Under Negotiable Instruments Act transfer by negotiation may be made either by delivery or by endorsement and delivery.

An instrument which is payable to the bearer containing a blank endorsement may be transferred by mere delivery. An instrument payable on the order of the payee or the payee's order, requires to be negotiated only by indorsement and delivery.

7.3 Assignability and Negotiability distinguished :

ASSIGNABILITY

1. The instrument P/N, B/E or cheque is a chose in action and may be transferred under an assignment according to the Transfer of Property Act.
2. Consideration must be proved.
3. Notice of assignment must be given by the assignee to the debtor.
4. The assignee (even if he has taken in good faith and for value) is subject to the equities and defences between the assignor and the original debtor, i.e., he cannot get a better title.

NEGOTIABILITY

The instrument P/N, B/E or cheque may be transferred by negotiation to the holder. This may be done by delivery or by indorsement and delivery.
 Consideration is presumed under Sn.118 N/I Act (Rebuttable).
 Notice of transfer is not necessary.
 The holder in due course gets a good title, and all defects are cured in his favour.

7.4 Cheque—Definition (Sn, S) i

A cheque is a Bill of Exchange, drawn on a specified banker and not expressed to be payable otherwise than on demand. Generally, cheques are drawn on forms supplied by the banker.

	No.....
Bank	
	Date
<i>Pay</i> > bearer
<i>Rupees</i>	<i>Rs</i> (Signature)

7.5 Characteristics of a cheque

(i) Writing ; A cheque is an instrument in writing and hence writing is essential.

Cheque books or leaves are provided by the banks. Pencil not allowed but other modes of writing by pen, ink or ball pen etc. or printed or typewritten allowed.

(ii) **Unconditional Order to pay** : The drawer should order the Bank to 'Pay' to the Payee (named). The cheque is drawn on the specified bank only (with branch address) and the drawer should make an order to the Bank to 'Pay to' the named payee (or bearer or order) No conditions are to be attached. If attached, it will not be a cheque and hence invalid Extreme politeness like 'Please pay and oblige' will also make the cheque invalid

n.) **Specified Bank** : The cheque should be drawn on a specified Bank (and branch) only with address of branch (The Government Treasury Bills are not cheques)

(iv) Specified sum only . It is essential that the order for payment should be for a certain sum only^ The amount should be certain and stated in words and figures to avoid mistakes. Care should be taken, not to allow space before or after writing figures to avoid bud. e-g, Rs 800G/. (Rupees Eight Thousand only) may be easily changed to Rs 80000 (Rupees Eighty Thousand only). If this fraud is not noticeable with *reasonable care*, the bank will be justified in debiting drawer's account.

(v) Payee should be certain : The cheque should specify the name of the payee, it should be made payable to, or, to the order of a certain person, or the bearer. Person includes individuals, corporate bodies, firm, society, club, association, institution etc.

vi Demand :The cheque is always payable **on demand** "; otherwise the cheque is invalid.

Other Features of Cheque

(i) Date : The drawer may date the cheque as is usually done or he may allow the holder to insert the date. The holder must date within a reasonable time. The Banks (though they can fill the date) generally dishonour such cheques. A drawer is allowed to issue a post-dated or ante-dated cheque.

(ii) Crossing : To prevent cheques going to wrong hands or to prevent fraud the drawer may cross the cheque. This is a speciality with cheques. And the crossing may be special or general as per Negotiable Instruments Act.

(iii) Countermanding The drawer of a cheque has a right to countermand (to stop) payment by writing or instructing the concerned bank (and branch) to stop payment. This should be done before payment of the cheque,

7,6 Cheques and Bills of Exchange Distinguished :

CHEQUE

1. Drawn on the Bank
2. Cheque is always payable on demand. No acceptance is required.

BILL OF EXCHANGE

- May be drawn on any person.
- If not payable on demand, requires acceptance.

::

Cheque (Contd.)

3. Presumption that the cheque is drawn by the drawer against his funds in the hands of the Drawee (Bank).
4. Cheque is payable on demand.
5. Notice of dishonour not necessary.
6. Drawer may countermand the cheque before payment.

Bill of Exchange (Contd.)

- There is no such presumption.
 3 days of grace allowed for payment.
 Notice of dishonour is absolutely necessary.
 After acceptance there can be no countermand by drawer.

7.7 Bill of Exchange:

Definition : The Bill of Exchange is an instrument in writing drawn by a person known as Drawer (Seller) containing an unconditional order directing another person known as; Drawee (Buyer), to pay a certain sum of money only, to or to the order of a certain person or to the bearer.

The person who accepts is the acceptor (Drawee). Hence, Drawee becomes acceptor. As such it requires the presence of the minimum of three parties. If the acceptor accepts, he incurs the responsibility of the principal debtor

BILL OF EXCHANGE

Rs. 6,000/-

Date:

Thirty days after sight, please pay to Karnataka Bank or order Rs.6,000/- [Rupees Six Thousand only] on receipt of goods received.

(Sd.) Seller
Mysore To

•., M/s. D&Co.,
Bombay (Buyer)

This is a Bill of Exchange and stamps not necessary. Here, seller is the drawer, buyer is the drawee and Karnataka Bank is the payee.

Essentials:

(i) Writing : The Bill of Exchange must be in writing. Oral agreements are not valid. The writings may be in ink, or printed or in other modes. Though no proforma is prescribed,

the instrument must have all the essentials of a Bill of Exchange

(ii) Order to Pay : The essential feature of the bill of exchange is that the drawer should order the drawee to pay to the payee. However the words 'Please Pay' may be used. But excessive politeness makes the Bill invalid, e.g. "Mr. M., please oblige the bearer Rs.10,000 and place it on my account and you will kindly oblige." This is not a demand and hence, not a Bill.

(iii) Unconditional order : It is essential that the order to pay should not be subject to any contingency. However, conditions like (a) to pay after a lapse of time, (b) to pay installments; (c) to pay on the happening of an event which in the ordinary expectations of life is certain to happen are valid.

E.g. "90 days after sight".

But, the following conditions are invalid:

"When I marry ..."

"When I am in prosperous condition"

"Pay on the sale of 3 bales of cotton ..."

(iv) Drawee and the Payee must be certain : The name of the drawee must be named or indicated with certainty. The payee should be in a position to know to whom he must present the bill for acceptance or payment. The payee must be named. If there is a misnamed person or a person is designated by description only, even then the person is ascertainable with certainty and hence valid.

(v) Sum must be certain : It is essential that "Certain sum" must be stated definitely on the face of the Bill. If after stating the amount reference is made to interest or exchange rate of foreign currency, it is certain and valid.

7.8 Promissory Note—P/N :

Definition

: Section 4 of the Negotiable Instruments Act defines a Pro-note. A promissory note is an instrument in writing with an undertaking to pay a certain sum of money and money only unconditionally, to the payee or his order or the bearer of the instrument.

A pro-note requires the presence of two parties, i.e., Maker and payee. There may be two or more makers or two or more payees. The parties should be legally competent to create contractual obligations. The maker is the debtor and the payee the creditor.

E.g.: (1) I owe you Rs.1,000/-. This is a Pro-note.

(2) A agrees to pay to C Rs.1000, unconditionally on demand made by C, the creditor. This is a Pro-Note.

(3) I have received Rs.1,000/- from C. This is *not* a pro-note.

(4) I have taken Rs.1,000/- as loan today from C. I agree to Rs.2000/- and handover my cow for the balance of money and interest thereof. This is *not* a pro-note.

Essentials :

(i) **Writing** : The Promissory Note must be in writing. This means oral agreements

PRO-NOTE

Mysore

Dated ..

On demand, I Promise to pay Sri.....or order Rs.500/- (Rupees Five Hundred) only with interest at 18% per annum for value received.

Witness :

(Sd.) Maker

A(Address)

Stamps

B (Address)

are not acceptable. The writings may be in ink or printed or in other modes. No proforma is prescribed by the Act, but the instrument must have all the essentials.

(ii) **Undertaking:** There must be an express promise to pay the amounts as specified in the Promissory Note.

"Deposited with me Rs.10,000/- to be returned on demand"*—This is not a P/N.

A mere receipt of money is not a P/N.

"Rs.1,000 balance still due to you. I am indebted and do promise to pay." This *is* a promissory note.

(iii) **Unconditional Promise** : There must be a promise to pay without any conditions. It is not a P/N if the promise to pay is based on the happening of an event, which may or may not happen.

E.g. : "I promise to pay Rs.1,000/- when P my debtor returns it.";

"I promise to pay according to my convenience."

These are not Pro-Notes. Any condition to prevent negotiation makes the P/N invalid.

(vi) **Maker's Signature** : Signature or thumb impression is essential and must be on the instrument.

(v) **Maker must be certain:** There must be certainty of the maker of the P/N. There may be one person or jointly two or more persons. These persons may be jointly or severally liable. A, B & C may sign, making themselves jointly and severally liable.

(vi) **Pay money and money only** : It is essential that the sum must be definitely stated on the face of the instrument. "I promise to pay Rs.5,000/- and all other money due" is not a P/N.

The undertaking to pay must be for a sum of money only. E.g.: "I promise to pay Rs.1,500/- and deliver my cycle towards interest", is *not a* P/N.

(vii) **Payee must be certain** : The P/N should specify the name of the payee who is entitled to the payment. If it is uncertain or doubtful, it is not a P/N,

"I promise to pay to any person who may be partner of the firm X & Co. for the time being" is *not a* P/N as it leads to uncertainty. But a reference to "Son of A" as payee is valid if the son is known definitely.

(viii) **Consideration** : The words "for value received" refer to the consideration. The presumption is that the consideration is valid and legal.

7.9 Material alteration (of Cheques):

A material alteration is one which substantially changes the operation of the cheque (or bill of exchange). The business effect is changed, or is one which changes the "legal identity" or "character" of the cheque (or bill of exchange) in its terms or the relations of the parties. The rights and liabilities of the parties are affected or changed.

Examples :

(i) Alteration of date; (ii) Alteration of place of payment; (iii) Alteration of Sum payable; (iv) Alteration of changing priority number in endorsement in the relation of parties or their legal character; (v) Cancelling the crossing on cheque; (vi) Changing special crossing to general crossing; (vii) "Not Negotiable" or "Account Payee" is changed or struck off.

Altering change of date, change from "Order" to "bearer" in the cheque requires the signature of drawer. If there are two or more, all should sign. Signature should be by the drawer himself or his authorised power of attorney holder, or authority. Rubber Stamp signatures are invalid. Illiterate person's cheques require thumb impressions duly witnessed by a person known to the Bank.

Minor apparent mistakes will not make the cheque invalid. For example, "One Hundred Rupee only" instead of "One Hundred Rupees only".

Cases :

(i) **Lisby V. Westminster Bank Ltd.** C had drawn a cheque in favour of "Pay to John Prust & Co., or order", but it was signed by his executors as drawers. In the space before "or Order" in the cheques, C added "per Cumberbirch & Potts". The cheque was in C's handwriting except signatures of executors. The Bank paid the cheque. The Executor sued. Held, Bank not liable, as it was an invalid cheque.

(ii) **Ladies Beauty V, S.B.I.** C issued two cheques a/c. payee. Stranger tampered the cheques and removed a/c. payee and order and changed to bearer, with special chemical. Bank paid to¹ bearer. C sued the bank.

The bank contended that special chemical erasures were not visible when paid but visible now. The court rejected and held bank liable as the erasures were visible on careful scrutiny, the bank was negligent, and hence liable.

No alteration : (i) Changing an open cheque into a crossed cheque;
 (ii) Changing bearer to order;
 (iii) Changing general crossing to special crossing;
 (iv) Filling blanks of incomplete cheque etc. are some instances where the change will not make the cheque invalid as the change is not material.

CHAPTER 8 CHEQUES—CROSSING, ENDORSEMENT

8.1 Crossing of Cheque :

"Crossing a cheque generally" means drawing across the cheque two parallel transverse lines with or without the words "& Co.". This may be stamped or handwritten. Crossing was invented to give protection and safety. In 1856, English statute recognised this. In India, Negotiable Instruments Act has defined Crossing in Sns. 123 and 124.

General Crossing :

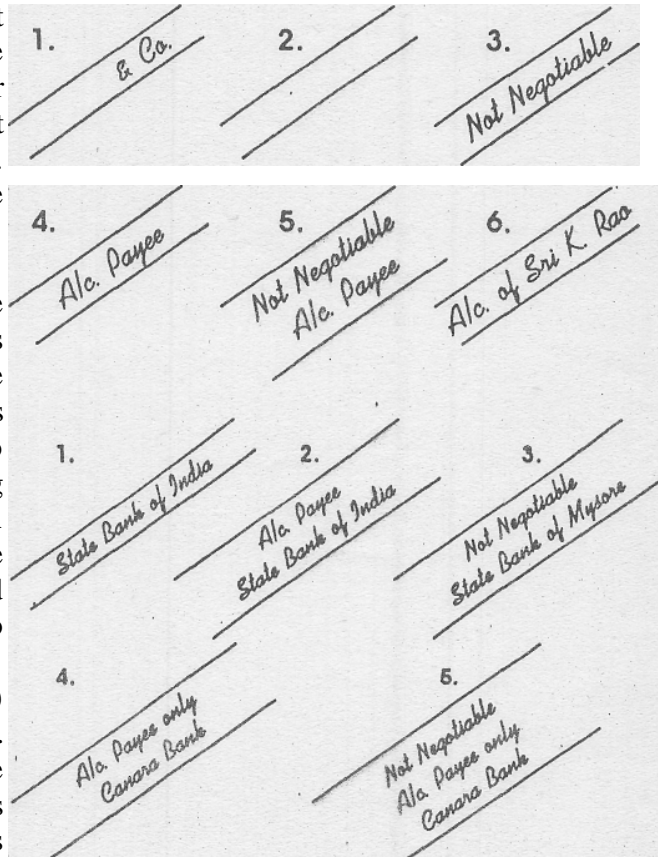
The objective is to direct the banker, not to make the payment except through another banker and thus the cheque cannot be encashed at the counter. "A/c. Payee" Crossing will not affect the negotiability of a cheque.

Special Crossing:

In special crossing, the name of the collecting banker is written on the face of the cheque as shown above. Such a cheque is paid by the paying banker only to the banker named in the Crossing or his agent for collection. A generally crossed cheque may be converted into specially crossed cheque. This will not amount to material alteration.

Effect of Crossing : (a) "A/c. Payee" or "A/c. of Mr. K. Rao"—these words are like directions to the receiving bank, as to how the collection of money is to be paid after receipt of it. Hence, it does not affect negotiability nor its transferability. The paying banker's liability ends, when he pays to the collecting banker.

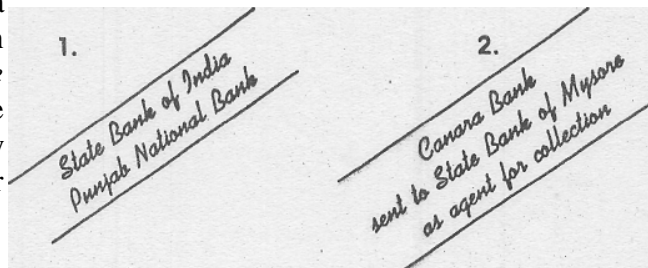
(b) "Not Negotiable": According to Sn.130 of Negotiable Instruments Act, a person -who takes a cheque with "Not Negotiable" Crossing, takes it with no better title than the person from whom he got it; in consequence, he cannot pass a better title. The cheque may



he transferred. It is like a stolen watch, the receiver of which gets no better title (*G. W. Rly Co. V. L & C Banking Co.*) What is barred is its negotiability, that is it *cannot be transferred free from defects* (Negotiability means, transfer by endorsement AND transfer free from defects; transferability means mere transfer of cheque, and hence holder takes it subject to its, defects etc.)

Payment of Crossed cheques by paying banker :

According to Negotiable instruments Act, (i) when cheque is crossed generally, paying banker (on whom it is drawn) shall pay only to a banker; (ii) when a cheque is crossed specially, the banker on whom it is drawn, shall pay only to the banker to whom it is crossed (or his agent); (iii) When a cheque is drawn on more than one banker (i.e., *Double Crossing*) the banker shall refuse payment (e.g. 1 in Fig.), He may pay if it is crossing to agent for collection (e.g.- 2 in Fig-)



8.2 "Bearer Cheque" :

The general rule is "Once a bearer cheque, always a bearer cheque". The "Holder" of a cheque is one who is entitled to possession and payment. In bearer cheque, the possession or bearer of the cheque is the holder. In case of order cheque, "Pay Mr. Sindhu or order", endorsement by Mr. Sindhu is required. If the cheque is "Pay Mr. Sindhu" it is an "order cheque" and hence by endorsement it can be transferred.

Bearer Cheque is payable to the bearer or possessor. No endorsement is necessary for transfer by one to another. (Bearer's signature taken by paying bank, serves as a receipt of payment.) The identity of the bearer (presenter) is not material, but in practice, banks may enquire for identity of person. "Pay to Mr. Raghu or bearer or order" is a bearer cheque. Hence, the general rule is once a bearer cheque always a bearer cheque.

Amendment:

In Forbes Campbell's case, the court expressed doubts about this rule. Hence, the amendment was made to clarify and confirm the correct position in Law (Sn.85(2) of Negotiable Instruments Act]. According to it when a cheque is originally drawn payable to bearer, notwithstanding any endorsement in full or blank or with restrictions, the *Bank is discharged by payment indue course to the bearer.*

Hence the rule is good. But, it does not apply to a crossed cheque, or a cheque which is made bearer by means of endorsement, subsequently.

8.3 Marking of a Cheque (Marked Cheque) :

A "Marked Cheque" is a cheque on which the paying banker puts his initials or writes "Marked good for payment" and puts his initials. This means the cheque is drawn in good

faith and is having sufficient funds to meet the cheque when presented. This is only to facilitate the drawer or the parties, and the banker is under no obligation to 'Mark' the cheque. When a drawer draws the cheque in favour of a payee against payment or supply of goods etc., the payee may not be sure that it would be honoured. In such a case the marking by the banker will be useful.

The marking may be done at the instance of the drawer, or the payee or the collecting banker.

The leading case is **Punjab National Bank V. Bank of Baroda Ltd.**

It was held that such marking on the cheque does not create any *legal obligation* on the paying banker. The facts of the case briefly were as follows : Mr. Amin was the Manager of Bank of Baroda Ltd., Calcutta Branch. Mr. Chose had his account in that branch, Mr. B. Das was the Manager of PNB Ltd., Calcutta, where Mr. Mitter had his account, Mr. Ghose drew a cheque for Rs.2,75,000/- in favour of Mr. Mitter or order, and on the face of it was marked 'marked good for payment on 20-6-1939', and this was signed by Mr. Amin, manager. On the security of it PNB advanced Rs.2.4 lakhs to Mr. Mitter. The cheque was dishonoured on presentation. Thereupon PNB sued Bank of Baroda. The question was whether the manager's marking created a legal obligation. The Privy Council held that the marking was not legally binding and created no legal obligation.

in actual practice, the Banks have stopped marking of cheques. Instead they issue a draft or pay order.

8.4 Ante dated and post dated cheques :

According to the Negotiable Instruments Act, if a cheque is to be valid it should bear a date. But, the date may be the date of issue or Ante Dated or Post Dated. If undated, paying bank may dishonour.

(i) **Ante dated** : The cheque is valid but it should be presented within 6 months from the date of issue for payment, otherwise it would be barred, as stale.

(ii) **Post dated** : The cheque is valid and negotiable. If presented before due date the paying banker may refuse payment and return as post dated. If the bank pays the post dated cheque it runs the risk of countermanding by drawer, or drawer's insolvency, death or garnishee order etc. The Bank does not get the protection under Sn.85 of the Negotiable Instruments Act available for payment in due course.

8.5 Endorsement:

This comes from the Latin term "*in dorsum*" meaning "on the back". Hence, it means signing on the back of the N/I or cheque, with a view to transferring the property or right therein

. According to N/I Act, Sn.1.5, when a maker or holder of a N/I signs for purposes of negotiation on the back (or face or on a slip of paper thereon), he is said to have endorsed the same and he is called the endorser and the person to whom it is **endorsed** is called the **endorsee.**; w

Allonged Crossing : If the endorsement is on a piece of paper attached, it is called

Allonged Crossing.

Essentials :

Endorsement should be in writing and as per practice on the back of the cheque. It should be made by the drawer, payee or endorsee (not by a stranger). Putting date of endorsement is not necessary. Mere signature will suffice. Endorsement is complete when there is actual or constructive delivery thereof.

Legal Effect :

The endorser by endorsement, transfers his title or right in the cheque to the endorsee. This speaks to genuineness, good title and he should compensate every holder, in case of dishonour. "He who has no title, cannot pass a title" applies and hence, no endorsee will get a better title than the previous endorser. Only holder in due course is cured of the defects, if any, in the title to the instrument or cheque,

Forgery : In case of a forged endorsement, the court has held in *Sullivan's case*, that payment to a bearer instrument-holder *in due course*.

Kinds of Endorsement :

(i) **Endorsement in blank :**

Mere signature without naming the endorsee, is endorsement in blank and can be negotiated by mere delivery.

(ii) **Endorsement in full :**

Here endorser adds a direction to pay to a certain person or order e.g., Pay to Mr. M or order, Pay to order of Mr. M, etc.

(iii) **Conditional Endorsement :**

Here there is a condition precedent or condition subsequent in addition to endorsement.

(a) Pay M/s. K & Go. on arrival of vessel S.S. Maruti at Madras;

(b) Pay Mr. X if he returns from London in 3 months;

(c) Pay Mr. X on his attaining majority;

Until the condition is fulfilled, the instrument **will not be payable**.

(iv) **Restrictive endorsement :**

Here there is a specific restriction or exclusion by express words, e.g., 'Pay contents to Mr. S.M.K. only' or 'Pay to Mr. SMK for my use'

(v) **Endorsement sans recourse :** Here by adding these words Sans Recourse (without recourse to me) the endorser may exclude his liability as in "Pay Mr. G or order sans recourse. Sd./-....."

CHAPTER 9

PAYINGBANKER

The Bank on whom a cheque is drawn by the customer or the Bank required to pay is called the "Paying Banker" (or Drawee Bank). There is a legal obligation on the Bank to pay as per Sn.31, N/i Act. According to it, the Bank (drawee) having sufficient funds of the

drawer, properly applicable to payment, should pay; the cheque when duly presented. If he does not do so, he must compensate the drawer for any loss or damage caused thereof.

The legal position of the paying bank is like a person caught between the devil and the deep sea. Hence the bank should take precautions while paying the cheques.

Precautions (Risk Avoidance):

(i) The cheque should be in the usual form; otherwise, the bank may return, with remarks, "cheque not drawn in proper form".

(ii) The cheque should be properly dated. If undated, or post dated, the bank may return. If date is impossible as 30th Feb 93, he should return.

(iii) Amount should be certain. Amount in figures and words should tally. If words are clear, but figures differ, the bank may honour as per words, but generally it is returned with remarks "words and figures differ".

(iv) No part payment should be made. If amounts in the account are insufficient, the Bank should return with a remark "Not sufficient" or "Refer to Drawer". If two or more cheques are presented or received for clearing, it is better to pay as many cheques as funds permit. The bank may pay cheque with bigger amounts, but cheques in favour of tax or insurance authorities are generally given preference. But, to reject all the cheques received together, saying insufficient funds, is not a good policy and bears the risk as well.

(v) Cheque should be received within banking hours. Belated cheque received and paid beyond banking hours carries risks. Risk of garnishee order, or death of customer etc.

(vi) Drawer's signature to be verified. If it does not tally, the bank should return with remark "Drawer's Signature differs".

(vii) Cheque should be on the same branch.

(viii) Cheque should be "Open Cheque" if presented at the counter, for payment. Crossed cheques should not be paid at the counter.

(ix).If bearer cheque, it can be paid to the presenter. If it is an "Order Cheque", the bank should see whether the payee is certain and the endorsement is in order, and regular. If there are many endorsements, the bank should check up whether there are restrictive or conditional endorsements and if so, to act accordingly.

(x) If there are material alterations, the bank may pay after confirmation by drawer. Similarly mutilated or torn or pasted cheque should be rejected or may be paid after confirmation by the drawer.

[Net Banking and other modes doing banking have changed these rules]

Protection :

The N/I Act has made provisions to give protection to a paying or drawee bank in Sns. 85(i) and (ii), 85A, 89, 128 and Sns. 10 & 16.

(i) **Payee forged** signature—Sn.85(1): As per Sn, 85(1) where a cheque payable to order purports to be endorsed by or on behalf of the payee, the drawee (bank) is discharged *by payment in due course*,

Here, the endorsement should be regular or correct, and the payment should be *in due course*, The protection is given as the Bank has no specimen signature of payee to verify.

Forged Endorsement—Sn.16(2) : The bank is protected if the endorsement is regular and correct, and, the payment **is in-due course**,

(ii) **Ikurer Cheque**—Sn.85(2): "**Once a bearer cheque, always a bearer cheque**" is followed and, hence, the Bank is discharged, if paid *in due course*, even if the endorsement is in full or conditional or restricted.

(iii) **Forged Draft**: If a draft is drawn by a bank, payable *to order on demand*, the bank is discharged if the endorsement is regular or correct and payment is *in due course*.

(iv) **Material Alteration**—Sn.89 : If the material alteration is not visible or noticeable with reasonable care, the Bank is discharged for payment *in due course*. Acheque may be presented with crossing erased which is not noticeable *with reasonable care*; the bank is discharged for payment *in due course*.

(v) **Payment in due course—Sn.10 :**

It means—

- (1) Payment as per tenor of the instrument: cheque or B/E;
- (2) In good faith and without negligence;
- (3) Paid to person in possession of the cheque, who is entitled to receive.
- (4) payment made in money only, (not in any other form as P/N or B/E etc).

CHAPTER 10

COLLECTING BANKER

1. Definition A collecting banker is one who collects cheques (crossed or uncrossed) drawn upon bankers, on behalf of his customers. There is no legal obligation, but this is part of the practice of Banks in modern banking system. In fact every paying banks also functions as a collecting Bank.

2. Functions : The Bank acts as

3. (i) holder for value of the cheque
and (ii) as agent of customer.

(i) **Bank as holder for value** : When the bank pays the value of the cheque (i.e. by discounting the cheque and crediting to the account of its customer), it becomes a holder for value. The Bank in such a case is collecting for itself, the cheque. The Rights of the Bank are that if the cheque is dishonoured, it can recover from all or any of the endorsers, If the crossed cheque is with defective title of its customer, or if any of the endorsement is forged, the Bank can recover the amount from all or any of the endorsers subsequent to the forgery. However, if it is an open cheque (uncrossed cheque) with customer's defective title, or if any endorsement is forged, the Bank becomes liable to the true owner.

(ii) **Bank as Agent of customer**: When the Bank sends the cheque for collection on behalf of its customer, it is acting as Agent of the customer. The Bank's rights or title to the cheque are the same as its customer, i.e., it cannot get a better title than the customer. But, the problem is : what would be the position if the customer had no title or defective title, or the endorsement was forged ? The Bank could be held liable for conversion, to the true owner of the cheque. Hence, protection is given under Sn.131 of N/I Act.

3. Statutory Protection : (i) Crossed cheques : Sn. 131 [N I Act] says : 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 is defective *incur any liability* to the true owner, by reason only of having received payment. Hence, the protection to collecting Bank is for crossed cheques only,

(ii) **Sn. 131.A.** In regard to crossed drafts, (drawn by one branch of a Bank on its another branch) the same protection is given in respect payment received by the collecting Bank in good faith. This is because even drafts are considered as cheques in India.

(iii) In the leading *Gordon's case* in England, the court held that if the amounts are credited to customer's account on a crossed cheque, it amounted to taking the cheques for value by the Bank. Hence to meet such problems in India explanation to Sn.131-A was added:

A banker is said to receive payment of a crossed cheque for a customer within the meaning of Sn.131, notwithstanding that he credits his customers account with the amount of the cheque *before receiving* the payment thereof.

(i v) Good **faith** Vs **Conversion**: The important condition is that the collecting banker can avail this protection, if the bank has received payment in "good faith and without negligence". This is a "trap" according to Sir John Paget. Bank generally acts in

good-faith, but the second condition "without negligence" should be examined in the light of cases. •

(a) **Negligence** may stem from opening of an account without satisfactory references. The leading cases are *Union of India V. National Overseas and Grindlay's Bank Ltd.* (1978), *Bapulal Premchand V. Nath Bank Ltd.* In **Bharath Bank V. Chellaram**, a crossed cheque issued by Chellaram was lost in transit. D, who got it, opened an account at Bharath Bank, Madras Branch, deposited the cheque for collection. He withdrew the amounts, when credits were made to his account. Held Bank liable for conversion. Bank had not enquired properly about *bona fides* of the account holder. Hence, Bank was not entitled to protection.

(b) **Irregular endorsement**: The collecting Bank should check up the endorsement. If they are irregular the Bank will be liable for negligence.

(c) **Disregarding clear warning** on the face of the cheque amounts to negligence. *Savory and Co V. Lloyd Bank*: P & S were two clerks in Savory & Co, which had issued a number of cheques on its bank to its customers. P & S stole these cheques & deposited in Lloyd Bank for collection. Lloyd Bank collected and credited amounts to accounts of P & S who withdrew the amounts. Fraud was discovered. Savory & Co sued Lloyd Bank. Held negligence of Lloyd Bank and hence liable to pay. To this category belong cases where a cheque is endorsed under a power of attorney and cheque paid to customer's own account (*Rechitt's Case*). ;,,'

;, ;, (d) **Third parties' cheques** : The banker should be cautious in accepting them for collection (*Motor Traders case*). Hence,, what is required by the collecting Bank is, *due care and diligence*, otherwise it will be liable for conversion,

In *Central Bank of India V. Gopinath Nair* (1970) : P Purchased a D.D. payable to "Haridas Auddy", a proprietary concern and sent it to the concern. It was stolen in transit. The endorsement was forged, as follows : Please pay to Smitter & Co., "Haridas Auddy".

The Court held that the collecting Bank was negligent and hence liable. The Bank should have suspected how Das Auddy got the rubber stamp of Smitter & Co as the endorsement had this rubber stamp. The other leading cases are; **Canara Bank V. Govindan, Brahma V. Chartered Bank.**

10.2 Recovery of money paid by mistake :

(i) Bank and Legal position :

A collecting banker is one who collects cheques (crossed or uncrossed), drawn upon bankers on behalf of his customers. This is *not a legal obligation*, but a service in modern banking system. The question is what is the legal position, if money is paid by mistake, by the collecting banker? Can he recover it as a mistake of fact? What is the position if payment is both a mistake of law and a mistake of fact ?

The protection given to the collecting Bank under Sn.131, 131 A (explanation) of N/I regarding the problem of payment by mistake of law. Hence, the legal position is to be gathered from general law of Contract and decisions of courts.

(ii) Quasi-contract (Sn.72 Contract Act) :

According to Sn.72, Contract Act. "A person to whom money is paid or anything delivered by MISTAKE or under coercion, must repay or return it". This is the "doctrine of unjust enrichment". Though this is the rule the courts have held that *not under* all

circumstances of mistake of fact, money is recoverable. Hence under estoppels and other circumstances, the money cannot be recovered. This rule applies to Bills also.

When recoverable :

A person who receives payment, should have *received with mala fides*. That is, he is aware that he is not entitled to the amount. It must be mistake of fact: if a Bank has paid to the a/c of A, instead of to B, it is recoverable by the Bank as B is not entitled to it. But if the payee is innocent, the amount is not recoverable, if the bank is under a duty to inform the true statement. In *Skyring V. Greenwood*, S. an army paymaster had spent the money, believing that he was entitled. The court held that money was not recoverable, as D had believed *bona fide* he was entitled.

(iii) Mistake between payer and receiver :

(a) The mistake of fact should be between party paying and the party receiving the money. If a Bank by mistake of the balance in account pays a cheque drawn by its customer, to payee P, it cannot recover from P (*Chamber V Miller*)

(b) The courts have held (*Kelley V. Solari*), that even if plaintiff is negligent, he can recover when if he has paid under a mistake but there should be "no duty to payee not to make mistake".

When not recoverable :

As per the decision of *Cocks V. Maslerman*, *if a bill is honoured and amount received, and allowed to be kept with him, the payer cannot recover the reason is that the holder of the bill has a right to know the fate of his bill especially when it has been endorsed and gone to several parties. A collecting Banker cannot recover, if he has "not paid in good faith and without negligence".

Leading cases : (i) Savory & Co M Lloyd Bank.

(ii) Bharalh Bank V. K. Challaram (Refer Ch.30.1)

CHAPTER 11

BANK ADVANCES

11.1 Advances against Stock Exchange Securities :

Stock exchange securities generally are those securities which are regularly "bought and sold" in recognised stock exchanges, these include—

(i) **Gilt-edge Securities** : Central and State Government securities, securities of Municipalities, and Corporations, Port-Trust and other securities issued by the Government.

(ii) Shares and debentures: of Industrial and Commercial Public Ltd. companies, Banks and Insurance Companies.

Advances are made by Banks **on these securities** as they are comparatively safe and secured. These are more reliable. In case of Gilt-edged securities there will be ready market and are not subject to much fluctuations. It is easier to find out the title of the customer, and the market value is easily knowable from share-brokers or from newspapers. Further, these securities yield interest or dividend; they are transferable. Hence, these securities have the above advantages.

Disadvantages : There are, of course, some disadvantages as well.

(i) Partly paid-up shares : The risk is that the Bank may be called to pay as per calls. , (ii) If the transferor's signature is forged, the risk is great.

(iii) If shares are subject to wide fluctuations OR, if they are not negotiable, there will be the risk.

(iv) Share SCRIPS may be forged and put the bank in a difficult position.

To meet these risks, the Bank should take some precautions :

(i) The Bank Manager should examine whether the shares are partly or fully paid up when transferred to Bank. If partly paid up, the Bank will be liable for further calls. Hence care is, required.

(ii) Third party securities. Should not be accepted by the Bank. If accepted a letter of renunciation from the third party should be taken.

(iii) First preference to gilt securities, then debentures to shares. Then preference shares to ordinary shares.

(iv) The Bank should keep track of the correct market price of shares from share market Reports, Journals and daily newspapers.

(v) The Bank should get a legal charge over the securities offered.

If equitable charge is created, the Bank should take necessary precautions.

(vi) The securities should not be parted with until the advances are paid up.

11.2 Advances against Goods and documents of title to goods

(1) **Goods** : Banks generally advance funds against goods, produce and documents of title to goods, and the opinions are divided on these as valuable securities. Sir John Paget, a leading authority, says that these are good securities if the Bank is dealing with *honest and*

responsible persons, Some have called these securities as "**utterly worthless**". However, modern developments and commercial activities and facilities have changed these concepts. There are definitely many advantages in these securities.

Goods documents of title to goods form tangible security and the Bank may sell the goods, if circumstances so warrant. The price fluctuation of them, would not be much and can be ascertained from the market. It would be much easier to sell them to realise the amount advanced if they are necessities of life. Further, the advance is for a short period on them. Apart from these, the merchants in these goods, would be in a position to stock sufficiently and supply the necessities of life easily and at cheaper rates. This is a social cause.

In spite of these advantages there are some drawbacks:

- (i) Risk of deterioration in storage.
- (ii) Fall in prices of goods
- (iii) Storage and verification may pose problems and there may be frauds.

Hence, Banks should take precautions:

Unpopularity: The main reasons for goods being unpopular as a good security in India are—

1. Wide range of price fluctuations.
2. Means of transportation not adequate.
3. Public warehousing facilities are still inadequate, although there is much progress in this, under the Central and State warehousing Corporations.
4. Storing Conditions are much improved but, still there is room for improvement.

Documents of title to goods :

These documents serve as proof of possession. These are : Bill of lading, Dock warrants, warehouse certificates (receipts) Delivery orders, Lorry Receipts and Railway Receipts.

Bill of lading is a document signed and issued by the captain or by authority of the captain of the ship, that the goods stated in B/L have been received on Board. The goods are delivered at the port of destination to the consignee on surrendering the B/L and by signing it-Dock Warrant is a receipt issued by warehouse keeper of the goods received by him.

Warehouse-keeper's Certificate is a certification by the Warehouse-keeper that certain goods described in the certificate are held by him as per the tenor of the certificate. It is just like a goods deposit receipt.

Nowadays, only receipts are issued. While. Advancing financial facilities against these receipts Banks should take the precautions as they do in respect of document of title to goods whether receipt is genuine, whether customer is entitled to goods etc.

Delivery orders are documents which are addressed to the owner of the Warehouse instructing him about the delivery of his goods in the warehouse. Banks do accept these as security for making advances'--. jute or Tea delivery orders.

Railway Receipts and Lorry Way Bills are documents of title to goods of the consignor. Leading case is **MORVI Mercantile Bank v. Union of India**. The customer had

dispatched goods of Rs. 35,000/- and had endorsed Railways Receipt in favour of the Bank and took Rs. 20,000/- The goods were lost. The Bank sued the Railways. Held, Bank was entitled to Rs. 35,000/- and Railways was liable.

CHAPTER 12 MISCELLANEOUS

Ch 12.1 Travellers cheques

Issue of Travellers cheque is one of the subsidiary services of the banks. These are useful to travelers to enable them to carry with them these cheques instead of cash, and encash them at the banks of his travel destinations.

Like the currency notes, these cheques are for certain denominations like 5, 10, 50, 100 etc. US \$ (or other currencies). They are issued against payment to the bank. The purchaser puts his signature on the cheques at the time of purchase and he can encash at his destinations at the bank's branch or agents, by putting his signature. No identification or indication required. (Generally the passport serves this purpose.)

Enough if signatures tally. If these cheques are lost, he should notify to the issuing bank. If payment is made for forged cheques the bank will be liable to the purchaser.

Dena Bank V. Alexander : A had purchased travelers cheques for Rs.19,000. They were stolen and A informed the Bank about theft. A claimed refund. Bank refused. A sued the bank. On some cheques, the Manager had paid negligently upto Rs.10,000. Held, bank liable for Rs.10,000.

12.2 Unit Trust of India :

The UTI is a statutory body established under the UTI Act 1963. This is a public sector investment institution operating since July 1964. This is set up to encourage savings and investment, especially by small investors.

The UTI sells its "units" under different schemes. These savings are then invested by the UTI in shares and debentures of good companies. The income from these units is given as dividend to the unit holders. Both the investor and industries are thus benefitted. There are income-tax and wealth tax benefits to UTI investors.

The Unit investment is very useful .to-small investors and middle class families as it provides safety, assured income and liquidity. These investors are saved from the risks and hazards of making speculation in open share markets. This task is done by UTI experts who .have special knowledge of share markets.

12.3 Industrial Development Bank of India (IDBI) :

This was established in 1964 as a statutory body under the IDBI Act 1964, This is a giant step forward taken to meet the growing tempo) in industrialization in India. It provides the long term finance to industries. It was formerly linked with RBI, but was separated in

1976 and since then it is an autonomous institution. It is playing an Apex role.

Objectives: (i) Planning, promoting and developing industries; (ii) Coordinating and assisting such industries; (iii) Providing technical and administrative assistance; (i-v) Conducting investment research and surveys etc.

Resources: (i) Share capital and reserves; (ii) Borrowing from Government of India and RBI; (iii) Issue of Bonds; (iv) Foreign currency borrowing etc, (Authorised capital in 1986–Rs.2,000 crore.)

Assistance: There is great flexibility. It can finance to all types of industries. It can finance R & D units also.

Export Finance is taken over by EXIM Bank.

Direct Assistance: (i) Project finance scheme; (ii) Modernisation; (iii) Technical, Equipment etc. finance schemes.

Indirect Assurances Projects upto 3 crores are assisted indirectly by IDBI, through State Level Finance Institutions or through commercial banks.

IDBI is doing a commendable job in promoting and developing industries in India, and in giving a new thrust towards* greater industrialization.

Ch. 12. 4: Bill of Lading:

i) **Bill of lading (B/L)** is a document signed and issued by the captain or ; the shipping company • acknowledging that the goods stated in the B/L have been received by him or the company.

It is a document of title to goods, serves as proof of possession of the goods by the captain or shipping company as bailee. The goods will be delivered at the port of destination to the consignee, on his signing and surrendering the B/L.

i) It is not a negotiable instrument.

ii) B/L is transferable by endorsement and delivery of the instrument. The transferee cannot get a better title than the transferor.

iii) Banks advance loans on B/L by purchasing (discounting) the B/L. Banks should take precautions as usual but check whether the goods are insured against marine risks by taking out a marine policy. The Banks should get all the copies (stamped as originals) of B/L. Generally three sets are drawn,

iv) The shipping company may not know the contents, but it is responsible for the number of packages or weight.

In **Sanders V. Maclean**, -it was held that the shipping company is discharged when it delivers the goods at destination to the consignee (or endorsee) on the first set of B/L received by it, and, other sets become ineffectual. [Shipping Company is liable if it issues a B/L not on Board.]

For damage to goods from the time of delivery to the shipping Company, until delivered/ or discharged, at the port of destination, the Marine Insurance Company becomes liable as per the terms of the policy taking out a marine policy. The Banks should get all the copies (stamped as originals) of B/L. Generally three sets are drawn,

iv) **The shipping company may not know the contents, but it is responsible for the number of packages or weight.**

Ch. 12.5 Hundi;

Hundi comes from the Sanskrit word "Hundi" meaning "to collect". A system of drawing "Hundi" was prevalent during the time of "Mahabharatha" and hence it is of ancient origin. The Indian Bankers, and the public had mutual confidence and hence the bankers were accepting the Hundi issued by the merchant community. The purpose was well served during those years. This system continued in the middle ages. An illustration is that of one Bastupal Tejpal who drew a Hundi, for Rupees Ten crores on Nayar Seth of Ahmedabad and, the temples of Dilwara were built with that money. But, this is historical. The hundi business community had thus developed a system of their own in the discount of Hundi, money lending etc. Transfers of Funds were carried on with the help of Hundi,

Hundi is a Bill of Exchange, and it is still in vogue and, has all the essentials of Bill of Exchange. **As per the amendment to N. I. Act no stamps are required for drawing Hundi or B/E**

ADD FROM AUTHOR'S N/I ACT definition & essentials of B/ill ofExchange.

Ch. 12.6 Garnishes Order: [Issued under Sn. 6(ii) C.P.C.:]

In the relationship between the banker & the customer, honouring customer's cheques is one of the main obligations of the banker. There are many limitations to this rule, one such limitation is the Garnishee order.

A Garnishee order according to Sn. 6 (4) C. P. C. is an execution order issued by the court; on a petition filed by decree-holder. It is issued against the Garnishee by serving a notice of the order on him. A Garnishee is a person who owes money to the judgment debtor. To collect the money, in satisfaction of the decree, this order is issued, attaching the money due by him to the judgment debtor.

Such a Garnishee order may be issued to the Bank which has the accounts of the judgment debtor, prohibiting it from honouring the cheques issued by such customer.

DH [decree holder], a creditor obtains a decree against JD [judgment debtor], for Rs. 50,000/-. In execution, the court issues a Garnishee order on the Bank of JD, prohibiting it from honouring the cheques issued by JD. This is Garnishee order & operates from the date of service on the Bank.

Scope

The scope of the order depends on the nature of the Court's order; Whether the whole of the customer's account is garnished; or whether it is for a specified sum only. If it is for a specified sum only, the banker may honour his customer JD's cheque, after earmarking the specified amount, or transferring to suspense account to meet the Garnishee order of the Court.

Thus, the Banker is 'legally empowered to stop payments.

In **Herschorn V. Evans**, a couple H & W had a joint account in a Bank. The Civil Court issued a garnishes order where H alone was the judgment debtor. The Court held that the joint account could not be garnished. (The question 'whether the joint account could be garnished was not decided by the bank).

THE END

REFERENCE SECTION

SELECTED SECTIONS

BANKING REGULATION ACT, 1949

Sn.5

. Interpretation];

(b) "**banking**" means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise.

(c) "banking company" means any company which transacts the business of banking [in India];

Explanation: Any company which is engaged in the manufacture of goods or carries on any trade and which accepts deposits of money from the public merely for the purpose of financing its business as such manufacturer or trader shall not be deemed to transact the business of banking within the meaning of this clause;

12[(ca) "banking policy" means any policy which is specified from time to time by the **Reserve Bank in the interest of the banking system or in the interest of monetary stability or sound economic growth, having due regard to the interests of the depositors**, the volume of deposits and other resources of the bank and the need for equitable allocation and the efficient use of these deposits and resources;]

12[(gg) "**managing agent**" includes- (i) secretaries and treasurers,

(ii) where the managing agent is a company, any director of such company, and any member thereof who holds substantial interest in such company,

(iii) where the managing agent is a firm, any partner of such firm;]

14[(h) "**managing director**", in relation to a banking company, means a Director who, by virtue of agreement with the banking company or of a resolution passed by the banking company in general meeting or by its Board of Directors or, by virtue of its memorandum or articles of association, is entrusted with the management of the whole, or substantially the whole of the affairs of the company, and includes a Director occupying the position of a Managing Director, by whatever name called;]

(n) "**secured loan or advances**" means a loan or advance made on the security of assets the market value of which is not at any time less than the amount of such loan or advance; and "unsecured loan or advance" means a loan or advance not so secured;

(ii) in relation to a firm, means the beneficial interest held therein by an individual or his spouse or minor child, whether singly or taken together, which represents more than ten per cent of the total

6. Form and business in which banking companies may engage

(1) In addition to the business of banking, a banking company may engage in any one or more of the following forms of business, namely,-

(a) the borrowing, raising, or taking up of money; the lending or advancing of money either upon or without security; and drawing, making, accepting, discounting, buying, selling, collecting and dealing in bills of exchange, hundies, promissory notes, coupons, drafts, bill of lading, railway receipts, warrants, debentures, certificates, scrips and other instruments, and securities whether transferable or negotiable or not; the granting and issuing of letters of credit, travellers' cheques and circular notes; the buying, selling and dealing in bullion and specie; the buying and selling of foreign exchange including foreign bank notes; the acquiring, holding, issuing on commission, underwriting and dealing in stock, funds, shares, debentures, debenture stock, bonds, obligations, securities and investments of all kinds; the purchasing and selling of bonds, scrips or other forms of securities on behalf of constituents or others; the negotiating of loan and advances; the receiving of all kinds of bonds, scrips or valuables on deposit or for safe custody or otherwise; the providing of safe deposit vaults; the collecting and transmitting of money and securities;

(b) acting as agents for any government or local authority or any other person or persons; the carrying on of agency business of any description including the clearing and forwarding of goods, giving of receipts and discharges and otherwise acting as an attorney on behalf of customers, but excluding the business of a 30[Managing Agent or Secretary and Treasurer] of a company;

(c) contracting for public and private loans and negotiating and issuing the same;

(d) the effecting, insuring, guaranteeing, underwriting, participating in managing and carrying out of any issue, public or private, of State, municipal or other loans or of shares, stock, debentures or debenture stock of any company, corporation or association and the lending of money for the purpose of any such issue;

(e) carrying on and transacting every kind of guarantee and indemnity business;

(f) managing, selling and realising any property which may come into the possession of the company in satisfaction or part satisfaction of any of its claims;

(g) acquiring and holding and generally dealing with any property or any right, title or interest in any such property which may form the security or part of the security for any loans or advances or which may be connected with any such security;

(h) undertaking and executing trusts;

(i) undertaking the administration of estates as executor, trustee or otherwise;

(j) establishing and supporting or aiding in the establishment and support of associations, institutions, funds, trusts, and conveniences calculated to benefit employees or ex-employees of the company or the dependents or connections of such persons; granting pension and allowances and making payments towards insurance; subscribing to or guaranteeing moneys for charitable or benevolent object or for any exhibition or for any public, general or useful object;

(k) the acquisition, construction, maintenance and alteration of any building or works necessary or convenient for the purpose of the company;

(l) selling, improving, managing, developing, exchanging, leasing, mortgaging, disposing of or turning into account or otherwise dealing with all or any part of the property and rights of the company;

(m) doing all such other things as are incidental or conducive to the promotion or advancement of

the business of the company;

(o) any other form of business which the Central Government may, by notification in the Official Gazette, specify as a form of business in which it is lawful for a banking company to engage.

(2) No banking company shall engage in any form of business other than those referred to in sub-section (1).

8. Prohibition of trading

Notwithstanding anything contained in section 6 or in any contract, no banking company shall directly or indirectly deal in the buying or selling or bartering of goods, except in connection with the realization of security given to or held by it, or engage in any trade, or buy, sell or barter goods for others otherwise than in connection with bills of exchange received for collection or negotiation or with such of its business as is referred to in clause (i) of sub- (1) of section 6:

[10. Prohibition of employment of Managing Agents and restrictions on certain forms of employment

(1) No banking company-

- (a) shall employ or be managed by a Managing Agent; or
- (b) shall employ or continue the employment of any person-
 - (i) who is, or at any time has been, adjudicated insolvent, or has suspended payment or has compounded, with his creditors, or who, is or has been, convicted by a criminal court of an offence involving moral turpitude; or
 - (ii) whose remuneration or part of whose remuneration takes the form of commission or of a share in the profits of the company:

14[PROVIDED that nothing contained in this sub-clause shall apply to the payment by a banking company of-

(a) any bonus ;

(b) any commission to any broker (including guarantee broker), cashier-contractor, clearing and forwarding agent, auctioneer or any other person, employed by the banking company under a contract otherwise than as a regular member of the staff of the company; or]

(iii) whose remuneration is, in the opinion of the Reserve Bank, excessive; or

(c) shall be managed by any person-

[(i) who is a Director of any other company not being-

(a) a subsidiary of the banking company, or

(b) a company registered under section 25 of the Companies Act, 1956 (1 of 1956):

PROVIDED that the prohibition in this sub-clause shall not apply in respect of any such Director for a temporary period not exceeding three months or such further period not exceeding nine months as the Reserve Bank may allow; or]

(ii) who is engaged in any other business or vocation; or

(iii) [whose term of office as a person managing the company is] for a period exceeding five years at any one time:

(2) In forming its opinion under sub-clause (iii) of clause (b) of sub-section (1), the Reserve Bank may have regard among other matters to the following:-

(i) the financial condition and history of the banking company, its size and area of operation, its resources, the volume of its business, and the trend of its earning capacity;

(ii) the number of its branches or offices;

(iii) the qualifications, age and experience of the person concerned;

(iv) the remuneration paid to other persons employed by the banking company or to any person occupying a similar position in any other banking company similarly situated; and

(v) the interests of its depositors.

10A. Board of Directors to include persons with professional or other experience

(1) Notwithstanding anything contained in any other law for the time being in force, every banking company-

(a) in existence on the commencement of section 3 of the Banking Laws (Amendment) Act, 1968, or (b) which comes into existence thereafter, shall comply with the requirements of this section:

PROVIDED that nothing contained in this sub-section shall apply to a banking company referred to in clause (a) for a period of three months from such commencement.

(2) Not less than **fifty-one per cent of the total number of** members of the Board of Directors of a banking company shall consist of persons, who-

(a) shall have special knowledge or practical experience in respect of one or more of the following matters, namely,-

(i) accountancy, (ii) agriculture and rural economy, (iii) banking, (iv) co-operation, (v) economics, (vi) finance, (vii) law, (viii) small-scale industry, (ix) any other matter the special knowledge of, and practical experience, which would, in the opinion of the Reserve Bank, be useful to the banking company:

PROVIDED that out of the aforesaid number of Directors, not less than two shall be persons having special knowledge or practical experience in respect of agriculture and rural economy, co-operation or small-scale industry; and

(b) shall not-

(1) have substantial interest in, or be connected with, whether as employee, manager or managing agent-

(i) any company, not being a company registered under section 25 of the Companies Act, 1956 (1 of 1956), or

(ii) any firm, which carries on any trade, commerce or industry and which, in either case, is not a small-scale industrial concern, or

(2) be proprietors of any trading, commercial or industrial concern, not being a small-scale industrial concern.

(i) no Director of a banking company, other than its Chairman or whole-time Director, by whatever name called, shall hold office continuously for **a period exceeding eight years;**

(6) Every appointment, removal or reconstitution duly made, and every election duly held, under this section shall be final and shall not be called into question in any court.

(7) Every Director elected or, as the case may be, appointed under this section shall hold office until the date up to which his predecessor would have held office, if the election had not been held, or, as the case may be, the appointment had not been made.

(8) No act or proceeding of the Board of Director of a banking company shall be invalid by reason only of any defect in the composition thereof or on the ground that it is subsequently discovered that any of its members did not fulfil the requirements of this section.

10B. Banking company to be managed by whole-time Chairman

35[(1) Notwithstanding anything contained in any law for the time being in force or in any contract to the contrary, every banking company in existence on the commencement of the Banking Regulation (Amendment) Act, 1994, or which comes into existence thereafter shall have one of its Directors, who may be appointed on a whole-time or a part-time basis as Chairman of its Board of Directors, and where he is appointed on a whole-time basis as Chairman of its Board of Directors, he shall be entrusted with the management of the whole of the affairs of the banking company:

PROVIDED that the Chairman shall exercise his powers subject to the superintendence, control

and direction of the Board of Directors.

(10BB. Power of Reserve Bank to appoint Chairman of a banking company

(1) Where the office of the 35[Chairman of the Board of Directors appointed on a whole-times basis or the Managing Director] of a banking company is vacant, the Reserve Bank may, if it is of opinion that the continuation of such vacancy is likely to adversely affect the interests of the banking company, appoint a person eligible under sub-section (4) of section 10B to be so appointed, to be the [Chairman of the Board of Directors appointed on a whole-time basis or a Managing Director of the banking company and where the person so appointed is not a director of such banking company, he shall, so long as he holds the office of the [Chairman of the Board of Directors appointed on a whole-time basis or a Managing Director], be deemed to be a Director of the banking company.

(2) The [Chairman of the Board of Directors appointed on a whole-time basis or a Managing Director] so appointed by the Reserve Bank shall be in the whole-time employment of the banking company and shall hold office for such period not exceeding three years, as the Reserve Bank may specify, but shall, subject to other provisions of this Act, be eligible for re-appointment.

(3) The [Chairman of the Board of Directors who is appointed on a whole-time basis or a Managing Director] so appointed by the Reserve Bank shall draw from the banking company such pay and allowances as the Reserve Bank may determine and may be removed from office only by the Reserve Bank.

10C. Chairman and certain Directors not to be required to hold qualification shares

35[A Chairman of the Board of Directors who is appointed on a whole-time basis or a Managing Director] of a banking company (by whomsoever appointed) and a director of a banking company (appointed by the Reserve Bank under section 10A) shall not be required to hold qualification shares in the banking company.]

11. Requirement as to minimum paid-up capital and reserves

(1) no other banking company shall, after the commencement of this Act, commence or carry on business 11[in India], 14[unless it complies with such of the requirements of this section as are applicable to it.]

[(2) In the case of a banking company incorporated outside India-

(a) the aggregate value of its paid-up capital and reserves shall not be less **than fifteen lakhs of rupees and if it has a place or places of business in the city of Bombay or Calcutta or both, twenty lakhs of rupees;** and

[the banking company shall deposit and keep deposited with the Reserve Bank either in cash or in the form of unencumbered approved securities, or partly in cash and partly in the form of such securities-

(i) an amount which shall not be less than the minimum required by clause (a); and

(ii) as soon as may be after the expiration of each 40[***] year, an amount calculated at twenty per cent of its profit for that year in respect of all business transacted through its branches in India, as disclosed in the profit and loss account prepared with reference to that year under section 29:]

[12. Regulation of paid-up capital, subscribed capital and authorised capital and voting rights of shareholders

(1) No banking company shall carry on business in India, unless it satisfies the following conditions, namely,-

(i) that the subscribed capital of the company is not less than one-half of the authorised capital and the paid-up capital is not less than one-half of the subscribed capital and that, if the capital is increased, it complies with the conditions prescribed in this clause, within such period not

exceeding two years as the Reserve Bank may allow;

(ii) that the capital of the company consists of ordinary shares only or of ordinary shares or equity shares and such preferential shares as may have been issued prior to the 1st day of July, 1944:

(4) Every Chairman, Managing Director or Chief Executive Officer by whatever name called of a banking company shall furnish to the Reserve Bank through that banking company returns containing full particulars of the extent and value of his holding of shares, whether directly or indirectly, in the banking company and of any change in the extent of such holding or any variation in the rights attaching thereto and such other information relating to those shares as the Reserve Bank may, by order, require and in such form and at such time as may be specified in the order.]

12A. Election of new Directors

(1) The Reserve Bank may, by order, require any banking company to call a general meeting of the shareholders of the company within such time, not less than two months from the date of the order, as may be specified in the order or within such further time as the Reserve Bank may allow in this behalf, to elect in accordance with the voting rights permissible under this Act fresh Directors, and the banking company shall be bound to comply with the order.

(2) Every Director elected under sub-section (1) shall hold office until the date up to which his predecessor would have held office, if the election had not been held.

(3) Any election duly held under this section shall not be called in question in any court.].

13. Restriction on commission, brokerage, discount, etc., on sale of shares

Notwithstanding anything to the contrary contained in 48[sections 76 and 79 of the Companies Act, 1956 (1 of 1956)]¹, no banking company shall pay out directly or indirectly by way of commission, brokerage, discount or remuneration in any form in respect of any shares issued by it, any amount exceeding in the aggregate two and one-half per cent of the paid-up value of the said shares.

14. Prohibition of charge on unpaid capital

No banking company shall create any charge upon any unpaid capital of the company, and any such charge shall be invalid.

[14A. Prohibition of floating charge on assets

(1) Notwithstanding anything contained in section 6, no banking company shall create a floating charge on the undertaking or any property of the company or any part thereof, unless the creation of such floating charge is certified in writing by the Reserve Bank as not being detrimental to the interests of the depositors of such company.

(2) Any such charge created without obtaining the certificate of the Reserve Bank shall be invalid.

(3) Any banking company aggrieved by the refusal of certificate under sub-section (1) may, within ninety days from the date on which such refusal is communicated to it, appeal to the Central Government.

(4) The decision of the Central Government where an appeal has been preferred to it under sub-section (3) or of the Reserve Bank where no such appeal has been preferred shall be final.

15. Restrictions as to payment of dividend

49[(1)] No banking company shall pay any dividend on its shares until all its capitalised expenses (including preliminary expenses, organisation expenses, share selling commission, brokerage, amounts of losses incurred and any other item of expenditure not represented by tangible assets) have been completely written off.

28[(2) Notwithstanding anything to the contrary contained in sub-section (1) or in the Companies

Act, 1956 (1 of 1956), a banking company may pay dividends on its shares without writing off-

(i) the depreciation, if any, in the value of its investments in approved securities in any case where such depreciation has not actually been capitalised or otherwise accounted for as a loss;

(ii) the depreciation, if any, in the value of its investments in shares, debentures or bonds (other than approved securities) in any case where adequate provision for such depreciation has been made to the satisfaction of the auditor of the banking company;

(iii) the bad debts, if any, in any case where adequate provision for such debts has been made to the satisfaction of the auditor of the banking company.]

[16. Prohibition of common Directors

[(1) No banking company incorporated in India shall have as a Director in its Board of Directors any person who is a Director of any other banking company.

(1A) No banking company referred to in sub-section (1) shall have in its Board of Directors more than three Directors who are Directors of companies which among themselves are entitled to exercise voting rights in excess of twenty per cent of the total voting rights of all the share-holders of that banking company.

[17. Reserve Fund

(1) Every banking company incorporated in India shall create a reserve fund and 50[* **] shall, out of the balance of profit of each year, as disclosed in the profit and loss account prepared under section 29 and **before any dividend is declared**, transfer to the reserve fund a sum equivalent to not less than twenty per cent of such profit.

[(1A) Notwithstanding anything contained in sub-section (1), the Central Government may, on the recommendation of the Reserve Bank and having regard to the adequacy of the paid-up, capital and reserves of a banking company in relation to its deposit liabilities, declare by order in writing that the provisions of sub-section (1) shall not apply to the banking company for such period as may be specified in the order:

[18. Cash reserve

(1) Every banking company, not being a scheduled bank, shall maintain in India by way of cash reserve with itself or by way of balance in a current account with the Reserve Bank or by way of net balance in current accounts or in one or more of the aforesaid ways, a sum equivalent to **at least three per cent of the total of its demand** and time liabilities in India as on the last Friday of the second preceding fortnight and shall submit to the Reserve Bank before the twentieth day of every month a return showing the amount so held on alternate Fridays during a month with particulars of its demand and time liabilities in India on such Friday or if any such Friday is a public holiday under the Negotiable Instruments Act, 1881 (26 of 1881), at the close of business on the preceding working day.

[20. Restrictions on loans and advances

(1) Notwithstanding anything to the contrary contained in section 77 of the Companies Act, 1956 (1 of 1956), no banking company shall-

(a) grant any loans or advances on the security of its own shares, or

(b) enter into any commitment for granting any loan or advance to or on behalf of-

(i) any of its Directors, (ii) any firm in which any of its Directors is interested as Partner, Manager, Employee or Guarantor, or

(iii) any company (not being a subsidiary of the banking company or a company registered under section 25 of the Companies Act, 1956 (1 of 1956), or a government company, of which 15[or the subsidiary or the holding company of which] any of the Directors of the banking company is a Director, Managing Agent, Manager, Employee or Guarantor or in which he holds substantial interest, or (iv) any individual in respect of whom any of its Directors is a partner or guarantor

(2) Where any loan or advance granted by a banking company is such that a commitment for granting it could not have been made if clause (b) of sub-section (1) had been in force on the date on which the loan or advance was made or is granted by a banking company after the commencement of section 5 of the Banking Laws (Amendment) Act, 1968 (58 of 1968), but in pursuance of a commitment entered into before such commencement, steps shall be taken to recover the amounts due to the banking company on account of the loan or advance together with interest, if any, due thereon within the period stipulated at the time of the grant of the loan or advance, or where no such period has been stipulated, before the expiry of one year from the commencement of the said section 5:

PROVIDED that the Reserve Bank may, in any case, on an application in writing made to it by the banking company in this behalf, extend the period for the recovery of the loan or advance until such date; not being a date beyond the period of three years from the commencement of the said section 5, and subject to such terms and conditions, as the Reserve Bank may deem fit:

PROVIDED FURTHER that this sub-section shall not apply if and when the Director concerned vacates the office of the Director of the banking company, whether by death, retirement, resignation or otherwise.

(3) No loan or advance, referred to in sub-section (2), or any part thereof shall be remitted without the previous approval of the Reserve Bank, and any remission without such approval shall be void and of no effect.

(4) Where any loan or advance referred to in sub-section (2), payable by any person, has not been repaid to the banking company within the period specified in that sub-section, then, such person shall, if he is a Director of such banking company on the date of the expiry of the said period, be deemed to have vacated his office as such on the said date.

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[20A. Restrictions on power to remit debts

(1) Notwithstanding anything to the contrary contained in section 293 of the Companies Act, 1956 (1 of 1956), a banking company shall not, except with the prior approval of the Reserve Bank, remit in whole or in part any debt due to it by-

(a) any of its Directors, or

(b) any firm or company in which any of its Directors is interested as Director, Partner, Managing Agent or Guarantor, or

(c) any individual if any of its Directors, is his Partner or Guarantor.

(2) Any remission made in contravention of the provisions of sub-section(1) shall be void

21. Power of Reserve Bank to control advances by banking companies

(1) Where the Reserve Bank is satisfied that it is necessary or expedient in the public interest 86[or in the interests of depositors] 12[or banking policy] so to do, it may determine the policy in relation to advances to be followed by banking companies generally or by any banking company in particular, and when the policy has been so determined, all banking companies or the banking company concerned, as the case may be, shall be bound to follow the policy as so determined.

(2) Without prejudice to the generality of the power vested in the Reserve Bank under sub-section (1), the Reserve Bank may give directions to banking companies, either generally or to any banking company or group of banking companies in particulars, 9[as to-

(a) the purposes for which advances may or may not be made;

(b) the margins to be maintained in respect of secured advances;

(c) the maximum amount of advances or other financial accommodation which, having regard to

the paid-up capital, reserves and deposits of a banking company and other relevant considerations, may be made by that banking company to any one company, firm, association to persons or individual;

(d) the maximum amount up to which, having regard to the considerations referred to in clause (c), guarantees may be given by a banking company on behalf of any one company, firm, association of persons or individual; and

(e) the rate of interest and other terms and conditions on which advances or other financial accommodation may be made or guarantees may be given.]

3) Every banking company shall be bound to comply with any directions given to it under this section.]

[21A. **Rate of interest charged** by banking companies not to be subject to scrutiny by courts Notwithstanding anything contained in the Usurious Loans Act, 1918 (10 of 1918), or any other law relating to indebtedness in force in any State, a transaction between a banking company and its debtor shall not be reopened by any court on the ground that the rate of interest charged by the banking company in respect of such transaction is excessive.]

22. Licensing of banking companies

14[(1) Save as hereinafter provided, no company shall carry on banking business in India unless it holds a licence issued in that behalf by the Reserve Bank and any such licence may be issued subject to such conditions as the Reserve Bank may think fit to impose.] .

(2) Every banking company in existence on the commencement of this Act, before the expiry of six months from such commencement, and every other company before commencing banking business 11 [in India], shall apply in writing to the Reserve Bank for a licence under this section:

(3) Before granting any licence under this section, the Reserve Bank may require to be satisfied by an inspection of the books of the company or otherwise that 56[***] the following conditions are fulfilled, namely:-

14[(a) that the company is or will be in a position to pay its present or future depositors in full as their claims accrue;

(b) that the affairs of the company are not being, or are not likely to be, conducted in a manner detrimental to the interests of its present or future depositors;]

10[(c) that the general character of the proposed management of the company will not be prejudicial to the public interest of its present or future depositors;

(d) that the company has adequate capital structure and earning prospects;

(e) that the public interest will be served by the grant of a licence to the company to carry on banking business in India;

(f) that having regard to the banking facilities available in the proposed principal area of operations of the company, the potential scope for expansion of banks already in existence in the area and other relevant factors the grant of the licence would not be prejudicial to the operation and consolidation of the banking system consistent with monetary stability and economic growth;

(g) any other condition, the fulfillment of which would, in the opinion of the Reserve Bank, be necessary to ensure that the carrying on of banking business in India by the company will not be prejudicial to the public interest or the interests of the depositors.]

15[(3A) Before granting any licence under this section to a company incorporated outside India, the Reserve Bank may require to be satisfied by an inspection of the books of the company or otherwise that the conditions specified in sub-section (3) are fulfilled and that the carrying on of banking business by such company in India will be in the public interest and that the government or law of the country in which it is incorporated does not discriminate in any way against banking companies registered in India and that the company complies with all the provisions of this Act applicable to banking companies incorporated outside India.]

14[(4) The Reserve Bank may cancel a licence granted to a banking company under this section:

(i) if the company ceases to carry on banking business in India; or

(ii) if the company at any time fails to comply with any of the conditions imposed upon it under sub-section (1); or

(iii) if at any time, any of the conditions referred to in sub-section (3) 15 [and sub-section (3A)] is not fulfilled:

PROVIDED that before cancelling a licence under clause (ii) or clause (iii) of this sub-section on the ground that the banking company has failed to comply with or has failed to fulfil any of the conditions referred to therein, the Reserve Bank, unless it is of opinion that the delay will be prejudicial to the interests of the company's depositors or the public, shall grant to the company on such terms as it may specify, and opportunity of taking the necessary steps for complying with or fulfilling such condition.

(5) Any banking company aggrieved by the decision of the Reserve Bank cancelling a licence under this section may, within thirty days from the date on which such decision is communicated to it, appeal to the Central Government.

(6) The decision of the Central Government where an appeal has been preferred to it under sub-section (5) or of the Reserve Bank where no such appeal has been preferred shall be final.]

(4) Where, in the opinion of the Reserve Bank, a banking company has, at any time, failed to comply with any of the conditions imposed on it under this section, the Reserve Bank may, by order in writing and after affording reasonable opportunity to the banking company for showing cause against the action proposed to be taken against it, revoke any permission granted under this section.

THE END

