

Chapter 02

Paying Banker and Collecting Banker

Introduction:

Paying Banker

Meaning:

The banker on whom a cheque is drawn or the banker who is required to pay the cheque drawn on him by a customer is called the paying or drawee bank.

According to section-31 of the Negotiable Instrument Act 1881 a banker is bound to honour his customer's cheques, to the extent of the funds available and the existence of no legal bar to payment further, the cheque must be in order and it must be duly presented for payment at the branch, where the account is kept. The paying banker should use reasonable care and diligence in paying a cheque, if the paying banker wrongfully dishonours cheque, he will be asked to pay heavy damages.

Precautions before honouring a cheque:

The following precautions should be observed by the paying banker:

1) Presentation of cheque:

A paying banker should note whether the presentation of the cheque is correct. It can be found out by paying attention to the following factors:

a) Type of the cheque: Before honouring a cheque, he must find out the type to which it belongs, cheques may generally be of two types-open or crossed. If it is an open, the payment may be made at the counter.

If it is crossed, the payment must be made only to a fellow banker. If it is specially crossed the payment must be specifically made to that banker, in whose favour it has been crossed.

b) Branch: The paying banker should see whether the cheque is drawn on the branch where the account is kept. If it is drawn on another branch, without any prior arrangement, the banker can safely return the cheque.

c) Account: Even in the same branch, a customer might have opened two or more account. For each account, a separate cheque book would have been issued. Hence the paying banker should see that the cheque of one account is not used for withdrawing money from another account. For withdrawal of money from an account, only the cheque relating to that account must be used for withdraws of money.

d) Banking hours: The paying banker should also note whether the cheque is presented during the banking hours on a business day. Payment outside the banking hours does not amount to payment in due course.

However, a banker is justified in extending the time during peak days, for those who are still waiting for encashing a cheque, The hours of banking business are statutorily laid down even public holidays are notified under the negotiable instrument act.

e) Mutilation: If the cheque is torn into pieces or cancelled or mutilated, then, the paying banker should not honour it. He should return the cheque for the drawer's confirmation. In

case a cheque is torn accidentally, the drawee must confirm it by writing such words as “accidentally torn by me” and affixing his full signature. A cheque torn into two or more pieces is generally returned with a remark “mutilated”.

2) Form of the cheque:

Before honouring a cheque, banker should see the form of the cheque and find out whether it is regular or not.

a) Printed form: The cheque must be in the proper form. It must satisfy all the requirements of law. The customer should draw cheques only on the printed leaves, supplies by the banker are, failing which, the banker may refuse to honour it.

b) Unconditional order: The cheque should not contain any condition. If it is a conditional one, the paying banker's position will become critical and he may not honour it.

c) Date: Before honouring a cheque, the bank must see whether there is a date on the instrument. If it is undated, it cannot be regarded as a valid instrument. The cheque can be paid if it has not become stale by that time. A cheque which is presented after six months, from the date of its issue, is a stale one. If a cheque is post-dated, he should honour it only on its due date.

d) Amount: The next important precaution is that the banker should see whether the amount stated in the cheque both in words and figures, agree with each other. If the amount is stated only in figures, the banker should return it with a remark “amount required to be stated in words”. However, if the amount is stated only in words, the banker may honour it. Supposing, there is a different in the amount stated in words and figures, then the banker can take any one of the following courses available to him.

1. He can dishonour the cheque.
2. He can honour the amount stated in words or.
3. He can honour the smaller amount.

f) Material alteration: A paying banker should be very cautious in finding out the alterations that may appear on a cheque. If there is any material alteration, the banker should return it with a memorandum “Alteration required drawer's confirmation”. If the alteration is confirmed by the drawer by means of his full signature, then the banker can have no objection to honour it.

3) Sufficient balance:

here must be sufficient balance to meet the cheque. If the funds available are not sufficient to honour a cheque, the paying banker is justified in returning it. Before honouring a cheque, he must check up the present state of his customer's account. For this purpose, he must compute the balance in the account of his customer. He should not disclose the state of affairs of his customer's account to anybody. He must not offer a part of the amount of the cheque, if the balance is insufficient to meet the full amount of the cheque. Under certain circumstances, a banker, in order to protect the customer, may combine the accounts and pay a cheque. Provided if the customers have more than two accounts in the bank. Hence the paying banker should pay a special attention to the computation of balance.

4) Signature of the drawer:

The duty of paying banker is to compare the signature of his customer found on cheque with that of his specimen signature. If he fails to do so and he pays a cheque which contains a forged signature of the drawer, then the payment will not amount to payment in due course. If the signature has been two skilfully forged to find it out by the banker even then the banker is liable. However, if the customer facilitates the forgery of his signature by his conduct, then the banker will be relieved from his liability.

5) Endorsement:

Before honouring a cheque, the banker must verify the regularity of endorsement, if any that appears on the instrument. It is more so in case of order cheque, which requires an endorsement before its delivery.

6) Legal bar:

The existence of legal bar like garnishee order limits the duty of the banker to pay a cheque.

7) Minor precautions:

8) A paying banker should look into the following minor details also before honouring a cheque.

- a. He must see whether there is any order of the customer not to pay a cheque.
- b. He must see whether there is any evidence of misappropriation of money.
- c. He must see whether he has got any information about the death or insolvency or insanity of his customer

Circumstances under which a cheque can be dishonoured:**Meaning of dishonour of a cheque:**

A cheque is said to be dishonoured when it is not paid by the paying banker on presentation.

There are certain circumstances under which the cheques are dishonoured. They are:

- a. When the cheque is a conditional one (i.e., when a condition is attached by the drawer of the cheque to his order), the paying banker can dishonour that cheque
- b. When the customer stops the payment of any cheque, the banker must refuse to make the payment for that cheque. If the banker fails to stop the payment, he becomes liable to compensate the customer.

It is true that the paying banker is bound to carry out the stop payment, only if the following conditions are satisfied:

- The instruction is in writing.
 - It is signed by the drawer.
 - It mentions clearly the details, i.e., slumber date, amount and payee of the cheque whose payment should be stopped.
- c. When the banker receives a notice from the holder about the loss of the cheque, he cannot ignore that notice and make the payment. However, in such a case banker should direct the holder to obtain a stop payment order from the drawer.

- d. On receipt of a notice of the drawer's death, the banker must stop the payment of cheques issued by the drawer. The banker should not act on mere rumours about the drawer's death. To the banker, it is the time of receipt of notice of the drawer's death that is important, and not the actual time of the drawer's death.
- e. When the banker receives a notice of the drawer's insolvency, he must dishonour the cheque issued by the customer.
- f. When a garnishee order is served on the banker by a court attaching the customer's funds, the banker is bound to comply with the garnishee order.
- g. When the banker receives a prohibitive order from any government authority like, income-tax authority, sales tax authority, etc, freezing the customer's funds, the banker is required to comply with that prohibitive order.
- h. If the bank account is trust account and if the banker comes to know that the customer, who is operating the trust account intends to use the funds in the trust account in breach of trust for his personal use, the banker must stop payment for the cheques issued by the trustee.
- i. If a cheque is presented or payment after the customer's account is closed, the banker must refuse payment for a cheque.
- j. The banker must not make payment for a cheque bearing the forged signature of the drawer; the banker must not make the payment for such account.
- k. When a crossed cheque is presented at the count for payment.
- l. If the drawer is a foreigner, and if there is an outbreak of war with the drawer's country, the banker must refuse payment for the cheque issued by that customer during the time of war.
- m. When the drawer's signature on the cheque differs from his specimen signature, the banker may refuse payment.
- n. If a cheque is post-dated and is presented for payment before its due-date, the banker may refuse payment for the same.
- o. When a cheque is undated, the banker may refuse the payment.
- p. When a cheque bears an incomplete date, the banker may refuse payment.
- q. If a cheque has become stale, payment may be refused.
- r. If a cheque is presented for payment outside banking hours, payment may be refused.

Answer to a dishonoured cheque:

Even though it is not obligatory on the part of paying banker to give reasons while dishonouring a cheque, in practice, he gives such reasons to satisfy the rules of clearing hours. In giving the reasons, he must be very cautious and must see that his answer neither damages the customer's credit nor misleads the party presenting the cheque. Most of the banks have slip containing the reasons printed on it and they put tick mark against the

appropriate reasons.

Generally, the answer given by the banker or slip is very brief. The following are some of the answers commonly given for dishonoured cheque

- a. R.D (refer to drawer).
- b. N.S (not sufficient).
- c. N.F (no funds).
- d. N.E (no effects).
- e. E.I (endorsement irregular).
- f. E.N.C (effects
- g. N.A.F (not arrangement
- h. E.A (exceeds arrangement).
- i. W.& F.D (words & figures

PROTECTION TO PAYING BANKER:

The paying banker is given some statutory protection in respect of risk or difficulties by him.), The protection to the paying banker is laid down in section-, 85(1), (2), 85A, 89 and 128 of the Negotiable Instruments Act of 1881.

a) Protection in respect of an order cheque bears forged endorsement of the payee:

Section 85(1) of Indian Instrument Act 1881 give protection to the paying banker respect of payments made on an order cheque which the payee's endorsement (i.e., payee's sign) is forged.

This protection is given to the paying banker only on the fulfilment of two conditions.

- The endorsement of the payee must be correct.
- The payment must be a payment in due course.

b) Protection to a case of forgery of any subsequent endorsement:

According to section- 16(2) extends his protection to a case of forgery of any subsequent endorsement (i.e., the forgery of any endorsee's signature) this protection given to the paying banker only on the fulfilment of two conditions:

The endorsement of the endorsee must be regular or correct.

- The payment must be a payment in due course.
- The payment must be a payment in due course.

c) Protection in respect of a bearer cheque:

Section-85(2) gives protection to the paying banker in respect of a bearer cheque. "Where a cheque is originally expressed to be payable to bearer, the drawee is discharge by payment in due course to the bearer thereof notwithstanding any endorsement whether in full or in blank appearing there on, and such endorsement exclude further negotiation".

As such, the paying banker is protected is following conditions are satisfied:

There is matting to arouse suspicious about the bearer of the cheque.

- The payment is made to the bearer in due course
- There is matting to arouse suspicious about the bearer of the cheque.

d) Protection in respect of an order draft bearing forged endorsement:

Section-85A gives protection to the paying banker in respect of payment made on an order draft bearing forged endorsement. "Where any draft, that is, an order to pay money, drawn by one office of a bank upon another office of the same bank for a sum of money paying to order on demand, purports to be endorsed by

on behalf of the payee, the bank is discharged by payment in due course”.

This protection is given to the paying bank only on the fulfilment of the two conditions:

- The endorsement on the draft must be regular.
- The payment must be a payment in due course.

e) Protection in respect of a materially altered cheque:

Section-89 protects the paying banker in respect of payment made on a materially altered cheque. Normally, a paying banker cannot claim any statutory protection for a materially altered cheque.

Negotiable Instrument act gives protection in case materially, altered cheque provided:

- The banker is liable to pay.
- An alteration is not apparent.
- The banker has made payment in due course.

f) Protection in respect of crossed cheque:

Section-128 gives protection to paying banker in respect of payment made on a crossed cheque to a party other than the true owner of the cheque. According to this section, if a banker pays a crossed cheque in due course, he is discharged from liability, even though the amount of the cheque is not received by the true owner. Payment of crossed cheque in due course means payment to any banker, when it is crossed generally, when it is crossed specially.

PAYMENT IN DUE COURSE:

To claim protection under section-85, the cheque should have been paid in due course.

Section-10 of the Indian Negotiable Instrument act defines payment in due course as follows:

“Payment in due course means payment in accordance with the apparent tenor of the instrument, in good faith and without negligence, to any person in possession thereof, under circumstances which do not afford a reasonable ground for belief that, he is not entitled to receive payment of the amount therein mentioned”.

Thus, concept of payment in due course has three essential features:

- a. Apparent tenor:** The payment should be made in accordance with the apparent tenor of the instrument i.e. the payment should be made in accordance with the intention of the parties as it appears on the face of the cheque.
- b. Payment in good faith and without negligence:** The payment should be made honestly and with reasonable skill and care. A payment made negligently will not be a payment in due course.
- c. The payment must be made to a person who is in possession of the cheque:** The payment must be made to the lawful holder. If the payment is not made to the lawful holder, the paying banker cannot get the statutory protection.

Holder:

Holder is the person who is entitled in his own name to the possession of a negotiable instrument. Normally a payee or endorsee is a holder. Please note that holder may be or may not be with possession of the Instrument. If the payee or endorsee dies, then the legal heir is the holder. If there is a forged endorsement then, last endorsee is the holder. If it is a bearer cheque, the person in whose name it is made is a holder. If it is damaged the payee

or last endorsee is the holder. If it is stolen, then also payee or last endorsee is holder because a thief cannot become holder. The holder has the right to obtain a duplicate of instrument is lost. A holder can cross a cheque if it is not already crossed.

Holder in Due Course:

Holder in due course means a person who must have the possession of the instrument. This is the basic difference between the Holder and Holder in Due course. Holder in Due course must obtain the instrument in Good Faith. If the instrument bears not-negotiable crossing, then the NO person can be a holder in due course. If the instrument bears A/C payee crossing and restricted endorsement then NO person can be a holder in due course. Forgery / theft / deceit do not convey any title.

Collecting Bankers:

Meaning of a Collecting Banker:

The collecting banker is the banker who collects cheques drawn upon other banker for and on customers. He is called the collecting banker as he behalf of his undertakes the work of collection of cheques.

Procedure followed in collection of cheques:

The following procedure is adopted by a collecting banker for the collection of cheques drawn upon another banker.

First, he receives from his customers the cheques which are required to be collected. Then, he presents that cheque to the drawer or paying banker either through clearing or through post for payment. If the cheques presented to the paying banker is honoured or realized, he credits the amount realized to his customers account and informs the customer about the realization of the cheques within a reasonable time. In case the cheques presented for payment is dishonoured he gives a notice to his customer about the dishonour of the cheque within a reasonable time so as to enable the customer to take necessary steps to receive the amount of the cheque from the parties liable thereto. The collecting banker charges his customers account with a small amount of commission for his service whether the cheque is realized or dishonoured.

Capacities in which Banker collects cheques:

While collecting his customer's cheque a banker may act either:

1. As a holder for value.
2. As an agent of his customer for collection.

1. Collecting Banker as a holder for value:

A collecting banker becomes a holder for value is he has paid the value of the cheque to the customer before the cheque to the customer before the cheque is actually collected. In other words, a collecting banker becomes a holder for value when he collects his customer's cheque for himself and not for the customer.

In the following circumstances a collecting banker becomes a holder for value.

- a) When he acquires from the customers the cheque meant for collection in exchange for cash.

- b) When he pays to the customers the amount of the cheque deposited for collection before it is Collected.
- c) When he expressly or impliedly allows the customer to draw against the cheque deposited for collection before it is collected.
- d) When he receives from the customer the cheque meant for collection in settlement of an existing debt\advance.
- e) When he leads to the customers on the strength of the cheque deposited for collection.
- f) When he exercises his lien on the cheque deposited for collection for any amount due from the customer.

Rights of the collecting Banker as a holder for value:

- a) As he has already paid the value of the cheque to the customer, he can receive the amount of the cheque in his own name and retain the amount for himself.
- b) In case the cheque accepted for collection is dishonour he can recover the amount from all or any of the endorser of the cheque.
- c) If any of the endorsements on the cheque accepted for collection is forged, he can recover the amount from all or any of the endorser subsequent to the forgery.
- d) If his customer has no title or has a defective title to the cheque accepted for collection, he can recover the amount from all the previous endorser of the cheque as holder in due course.

Liabilities of the collecting banker as a holder for value:

- a) If he collects for himself an uncrossed cheque bearing any forged endorsement, he becomes liable to the true owner of the cheque.
- b) If he collects for himself an uncrossed or a crossed cheque to which his customer has a title or has a defective title, he becomes liable to the true owner of the cheque.

2)Collecting Banker as an agent of his customer:

A collecting banker becomes an agent of his customer as he collects a cheque for and a behalf of his customer. In other words, he becomes an agent of his customer, if he credits his customers account with the amount of the cheque after it is actually realized from the drawee banker (i.e. the paying banker).

Rights of collecting banker as an agent of his customer:

When a collecting banker collects a cheque as an agent of his customer, he has no rights of his own. His rights or title to the cheque will be the same as that of the customer of his customer has a good title to the cheque, he too will have a good title to the cheque on the other hand if his customer has no title or has a defective title to the cheque, he too will have either no title or defective title to the cheque.

Liabilities of collecting banker as an agent of his customer:

- a) While acting as an agent of his customer, if he fails to do his duty to his customer properly and if his customer suffers losses as a direct result of his negligence, he becomes liable to make good the losses suffered by his customer.
- b) If he, as an agent of his customer collects a cheque bearing any forged endorsement or a cheque to which his customer has no title or has a defective title, he becomes liable to compensate the third party i.e. the true owner of the cheque. Under the doctrine of conversion.

Duties of a collecting Banker:**a) Exercise reasonable care and diligence in his collection work:**

When a banker collects a cheque for his customer, he acts only as an agent of the customer. As an agent he should observe utmost care when presenting a cheque or a bill for payment. Reasonable care and diligence depend upon the circumstances of each case.

b) Present the cheque for collection without any delay:

The banker must present the cheque for payment without any delay. If there is delay in presentment, the customer may suffer losses due to the insolvency of the draw or insufficiency of funds in the account. In such cases, the banker should bear the loss.

c) Notice to customer in the case of dishonour of a cheque:

If the cheque, he collects has been dishonoured, he should inform his customer without any delay. The negotiable instruments act has prescribed a reasonable time for giving the notice of dishonour. If he fails to do so, and consequently, any loss arises to the customer, the banker has bear the loss.

d) Present the bill for payment:

The banker should present bills for payment in proper time and at proper place. If he fails to do so, and if any loss occurs to the customer, then the banker will be liable. According to section 66 of the negotiable instrument act a bill must be presented for payment on maturity section 22 lays down that the maturity of the bill is the date on which it is due for payment, to which 3 days of grace are added. Thus, the rules for calculating the maturity dates are given in sec 23, 24 and 26 of the negotiable instruments act.

e) Protest and note a foreign bill for non-acceptance:

In case of dishonour of a bill by non-acceptance or non-payment, it is the duty of the collecting banker to inform the customer immediately generally he returns the bill to the customer. If the bill in should have it protested and noted by a notary public and then forwarded it to the customer.

Conversion by collecting banker:

Conversion refers to the unlawful taking, using, disposing\destroying of goods or property which is inconsistent with the owner's right of possession. In other words, it means depriving the true owner or the possession and ownership of the goods\property to which he is entitled. The following are the common circumstance under which a collecting banker may be held liable for conversion:

1. If he collects for a customer a bill exchange or a promissory note bearing a forged endorsement or defective title.

2. If he takes as a holder for value a bill of exchange, a promissory note or a cheque bearing a forged endorsement or defective title.
3. If he collects a cheque crossed with the words “Account payee” for a person other than the payee. If he delivers a property entrusted to him for safety custody to a wrong person (i.e. person other than the depositor.)

Protection to collecting Banker:

The protection to the collecting banker is laid down in sec 131&131a of the Indian Negotiable Instruments Act of 1881.

Sec 131 gives protection to the collecting banker in respect of a cheque bearing a forged endorsement or in respect of a cheque to which the customer has no title or has a defective title. The protection given under sec 131 can be claimed by the collecting banker only if the following conditions are satisfied.

- a) This protection is available only for a crossed cheque. Which has no protection is granted for an open or uncrossed cheque, as it need not be collected through a banker.
- b) This protection can be claimed only for that cheque which has been crossed before it reaches the collection banker.
- c) This protection can be claimed only when the collecting banker has collected the cheque as an agent for his customer. If he collects the cheque for himself as holder for value or for an on customer, he will not get protection.
- d) This protection can be claimed only if the collecting banker has collected the cheque in good faith and without negligence.