

# Article

## Bounced Cheques: SC offers new interpretation

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## *Article*

*The present article seeks to highlight the facts and the principles relied on in the recent judgment passed by the Hon'ble Supreme Court with respect to the ambit of section 138 of the Negotiable Instrument Act, 1881.*

### **I. BACKGROUND**

Chapter XVII of the Negotiable Instruments Act, 1881 (“**Act**”) was enacted to give effect to the legislative intent of the statute which it sought to achieve and to inculcate faith in the efficacy of banking operations and maintaining the credibility of the banking transactions. It seeks to prevent the misuse of the provisions of the Act and therefore, necessitates that a wider interpretation be imparted to it. However, over the years the operation of section 138 of the Act has not been adequate to meet the needs of the society. The language of the section itself is unsatisfactory as it restricts the scope thereof as well as does not make the bouncing of cheques and non-payment on notice, a summary offence. The section has not been utilized very effectively and its administration has been very languid.

The Hon'ble Supreme Court, has assumed the role of a Parliamentarian to ensure the effective compliance of law through a recent case of *M/S Laxmi Dyechem v. State Of Gujarat & Ors.*<sup>1</sup>(“**Laxmi Dyechem**”), together with another recent ruling in *Msr. Leathers v. S. Palaniappan and Anr.*<sup>2</sup>(“**Msr Leathers**”), wherein it has endeavoured to accord to the section a broad scope to cover all aspects for prevention of misuse of the provisions of the Act, which may occur due to the restricted language of section 138 of the Act. However, in the present era when there is an increasing dependency on the electronic mode of payment in all spheres of life, many milestones are yet to be achieved to ensure the longevity of the statute. For instance, with the onset of internet banking, phone / mobile banking, electronic transfers, etc., cheques are getting antiquated as a mode of payment. Hence, requisite provisions regulating the electronic mode of payment have to be incorporated. Despite the fact that an electronic mode of payment does not constitute a ‘negotiable’ trade paper, this cannot be the reason for not giving it credibility equivalent to that which the cheques warrant. Secondly, it is inevitable that the courts should resort to effective and proficient methods for the expeditious and speedy disposal of cases. Presently, the number of backlog cases in the courts across the country is estimated to

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<sup>1</sup> <http://indiankanoon.org/doc/17256619/>

<sup>2</sup> <http://indiankanoon.org/doc/142060872/>



## *Article*

be over an unreasonable amount of 3.5 crores<sup>3</sup> which poses a serious question on the reliability of the courts and the same is a major concern which needs to be adhered to as urgently as possible.

### **II. SCOPE OF S.138 PRIOR TO THE SC RULING IN LAXMI DYE CHEM**

According to the limited scope assigned to section 138 of the Act, a dishonour of cheque would constitute an offence under section 138\142 only in the event of following two contingencies:

- i. Insufficiency of funds in the bank account of the drawer, i.e. the amount promised to be honoured through the cheque exceeds the amount standing to the credit of the drawer's account; or
- ii. The amount to be paid by the drawer through the cheque exceeds the amount arranged to be paid from that account by an agreement with the bank. It, therefore, essentially provides that the bank cannot make payment from an account in excess of what is agreed between the banker and the respective drawer.

Prior to the present judgment of Laxmi Dyechem, the scope of the section was broadened by the Hon'ble Supreme Court to include within its ambit, the following grounds, based on which an action can lie under section 138\142:

- i. Instructions by drawer to bank to stop payment after the cheque has been issued<sup>4</sup>;
- ii. Closing the bank account with the *mala fide* intention of not honouring the liability/debt<sup>5</sup>.
- iii. Dishonour of cheque even after notice to the payee to not present the cheque<sup>6</sup>.

In *Modi Cements Ltd.*<sup>7</sup>, the Apex Court held with reference to an instruction for stopping payment resulting in dishonour of the cheque that if such acts are excluded from the scope of the section, it would nullify the effect of the enactment and further amount to misuse of the section in the sense that the drawer of a cheque unwilling to discharge his liability/debt, by giving instructions to his bank to stop payment after issuing a cheque, can escape the penal consequences of the section notwithstanding the fact that a deemed offence was committed

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<sup>3</sup> [http://articles.timesofindia.indiatimes.com/2012-07-05/kanpur/32550840\\_1\\_backlog-of-civil-cases-magisterial-courts-crore-cases](http://articles.timesofindia.indiatimes.com/2012-07-05/kanpur/32550840_1_backlog-of-civil-cases-magisterial-courts-crore-cases)

<sup>4</sup> *Modi Cements Limited v. Kuchil Kumar Nandi*, (1998) 3 SCC 249

<sup>5</sup> *NEPC Micon Ltd. v. Magma Leasing Ltd.*, (1999) 4 SCC 253

<sup>6</sup> *Electronics Trade & Technology Development Corporation Ltd. v. Indian Technologists and Engineers (Electronics) (P) Ltd.*, (1996) 2 SCC 739

<sup>7</sup> See supra Note 2

## Article

with a mala fide purpose. Additionally, in the case of *Goalplast (P) Ltd. v. Chico Ursula D' Souza and Anr.*<sup>8</sup>, it was held that ordinarily the stop payment instruction is issued to the bank by the account holder when there is no sufficient amount in the account.

In both the cases as abovementioned, another question which arose for determination was with respect to section 139 of the Act which raises a presumption that a cheque issued under section 138 of the Act shall be presumed to be so issued with the purpose of discharging the debtor's liability/debt. However, it was observed in both the cases that such presumption may be rebutted by adducing evidence for the same and the burden of proof lies on the person wanting to rebut such presumption. The presumption when coupled with the object that the Act seeks to achieve, leads to the conclusion that by cancellation of the payment of a post-dated cheque, a dishonest drawer should not be allowed to escape from the consequences of the penal provision of section 138 of the Act.

In all the aforementioned instances, the Court has taken into consideration the situations and contingencies arising out of deliberate acts of omission or commission on the part of the drawer of the cheques which would inevitably result in dishonour of the cheque issued by them. For instance, this Court has held that if after issue of the cheque the drawer closes the account it must be presumed that the amount in the account was nil and hence, insufficient to meet the demand of the cheque.

### III. OVERVIEW OF PRESENT RULING: "LAXMI DYECHEM CASE"

#### A. FACTS:

The present case is the consequence of an appeal directed against the orders of the Gujarat High Court ("HC") which has quashed 40 different complaints filed by the appellants against the respondents under section 138 of the Act. Reliance was placed on the ruling of *Vinod Tanna & Anr. v. Zaheed Siddiqui & Ors.*<sup>9</sup>, based on which the HC held that an action under section 138 of the Act can lie only if they fulfil any of the 2 contingencies as stipulated therein (which have been set out above) and the same being a penal provision, a strict interpretation should be

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<sup>8</sup> (2003) 3 SCC 232

<sup>9</sup> (2002) 7 SCC 541



## *Article*

assigned to it so as not to include within its scope the dishonour of cheque on grounds of mismatch of signature; incomplete signature, image not found and other similar instances.

In the instant case, the appellant company is a proprietorship firm engaged in the sale of chemicals and had an amount of approximately Rs. 5 crores outstanding against the respondent-company. Certain post-dated cheques signed by the authorised signatories of the Company were issued to the appellants in discharge of the debts as were remaining to be satisfied. However, out of the 117 cheques issued to the appellants, some were dishonoured with an endorsement stating 'mismatch of signature' to be the reason of such dishonour. On receiving such endorsement, the appellant, in compliance with the statutory provisions as provided under the section, sent a notice to the respondent company to issue fresh cheques in their favour. The respondent company cited the 'change in the mandate' to be the reason of such dishonour and undertook to issue fresh cheques on return of the dishonoured cheques and further on the precondition of settlement of the account. Nevertheless, the same remained unpaid by the respondent company thus compelling the appellants to take recourse to legal action as a last and final resort under section 138\142 of the Act.

### **B. PRINCIPLES**

This Division Bench of the Supreme Court placed reliance on a plethora of judgements and succeeded in preserving the efficacy of the provisions of the Act. Reiterating what had also been observed in *NEPC Micon Ltd.*<sup>10</sup>, it was held by this Hon'ble Court that the expression 'amount of money is insufficient' appearing in section 138 of the Act is the 'genus' of which all other reasons of dishonour, for instance, 'account closed', 'payment stopped' and like are only the 'species'. Similarly, reasons such as 'signature mismatch', 'illegible signature', 'image not found' are also species of the genus and hence liable to action under section 138 of the Act.

The Hon'ble Supreme Court, in the instant case, opined on the principles that a change in the mandate of the authorised signatories, or a deliberate mismatch in the signature may be caused with a dishonest and fraudulent intention which would undoubtedly result in the dishonour of cheque signed by the previous signatories or as the case may be. The Hon'ble Court held that irrespective of whatever may be the reason, but if a certain act is done or omitted to be done

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<sup>10</sup>See *supra* Note 3



## *Article*

with a purpose of preventing the honour of a cheque issued by the drawer, it will necessarily fall within the scope of section 138 of the Act.

The Hon'ble Court also took into consideration situations where the dishonour of cheque due to the above reasons may not be intended by the drawer and is caused bona fide, for example, on account of changes genuinely made in the mandate of the authorised signatories or changes occurring in the ordinary course of business of a company, partnership firm or an individual. A prosecution can be initiated only after the pre-conditions in the proviso to the section are exhausted. The proviso makes it mandatory for the payee to issue a notice to the drawer 15 days' after receiving information of dishonour of cheque from the bank giving sufficient opportunity to the drawer to discharge his liability by issuing a fresh cheque within 15 days' of receipt of such notice. Only on the failure to do so, can an action be initiated under the said section. Hence, the Hon'ble Court observed that sufficient protection is provided to a bona fide drawer to honour his commitment and discharge his liability before a prosecution can be initiated.

### **C. JUDGEMENT**

In view of the observations made above, the Apex Court disregarded the contentions of the respondent company that the section being a penal provision should be strictly construed and that dishonour on ground of mismatch of signature does not fall within the scope of section 138 of the Act. It also did not accept the contention of the signatories who contended that they should not be held liable for the dishonour of cheques issued by the respondent company as they ceased to form a part of the same post their retirement.

Thus, in light of all the observations made in the course of proceedings, the impugned order of the HC was set aside and the appeal allowed. Further, the trial court was directed to proceed with the complaints made by the complainants.

### **IV. CONCLUSION**

In the wake of the increasing fraudulent and dishonest acts with respect to issue of negotiable instruments, it is only imperative and inevitable that a liberal construction be accorded to the provisions of a statute which seeks to protect the society against the wrongs suffered by it.

## *Article*

Giving effect to the intention of the Act and the provisions therein, the wrongdoers should not be allowed to escape the consequences by reason of adopting a strict interpretation to such provisions under the garb that it is a penal provision. Thus, this step of the Apex Court, combined with its previous decisions, go a long way to fulfil the objectives of the Act and is a constructive measure to prevent the misuse of the provisions of law which are enacted for the protection of the society rather than to encourage the illegal acts and misdeeds of the offenders of the society. It is also appreciable that the Hon'ble Supreme Court has taken into consideration the genuine cases and suggested to follow the principle of the Laxmi Dyechem on a case to case basis as it is also necessary to properly judge the intention of the accused to avoid wrongful conviction. Hopefully our legislature in near future shall incorporate the principles laid down by the judiciary into the statute by way of a much needed amendment to section 138 of the Act to avoid any ambiguity as well as consider the inclusion of electronic operation of the bank accounts within the ambit of section 138 of the Act.

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<sup>i</sup> This article has been published in [www.moneylife.in](http://www.moneylife.in) and can be accessed at <http://moneylife.in/article/bounced-cheques-sc-offers-a-new-interpretation/30098.html>