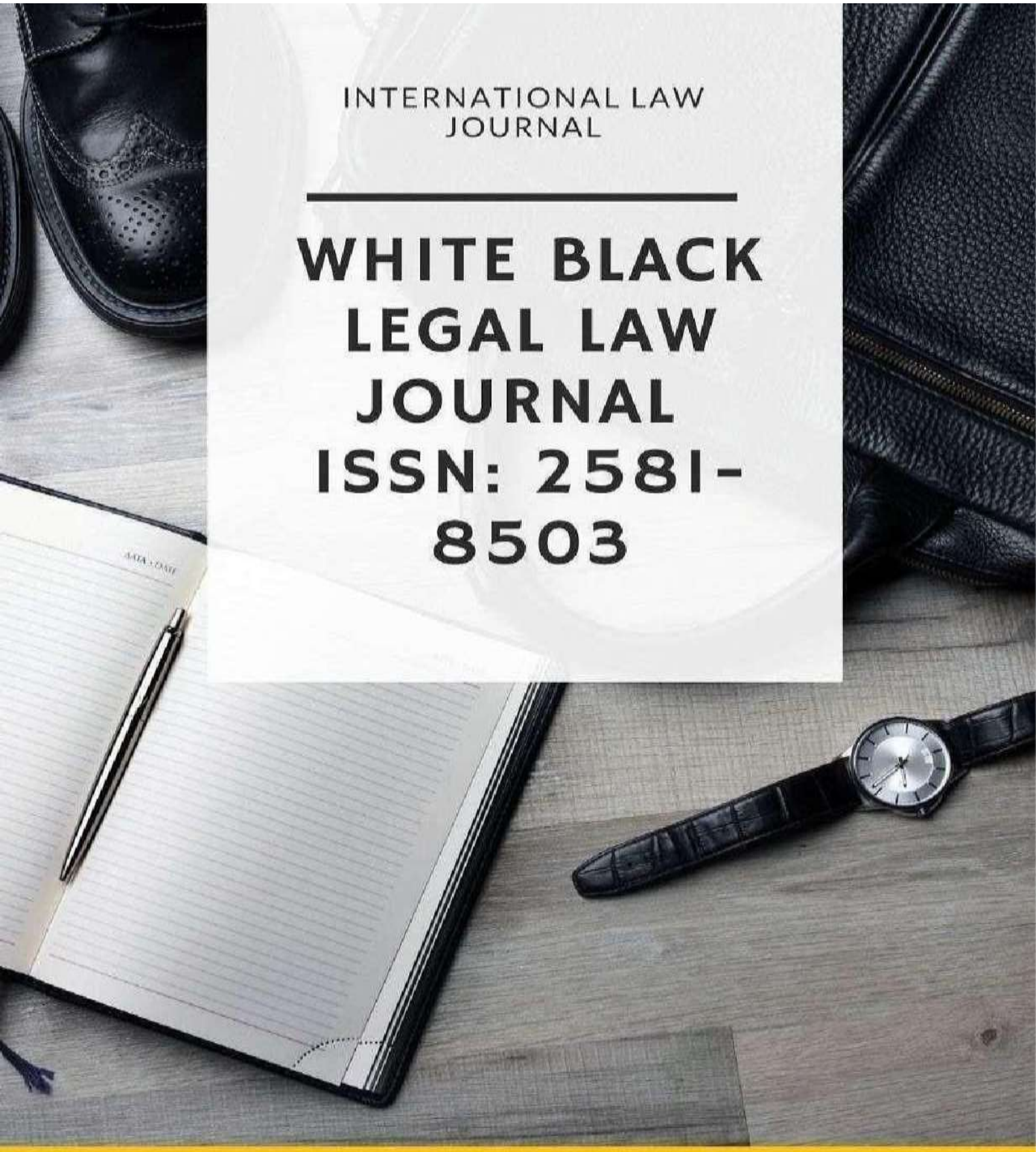

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WHITE BLACK LEGAL is an open access, peer-reviewed and refereed journal providededicated to express views on topical legal issues, thereby generating a cross current of ideas on emerging matters. This platform shall also ignite the initiative and desire of young law students to contribute in the field of law. The erudite response of legal luminaries shall be solicited to enable readers to explore challenges that lie before law makers, lawyers and the society at large, in the event of the ever changing social, economic and technological scenario.

With this thought, we hereby present to you

A STUDY ON WHEN A DRAWER OF A DISHONOURED CHEQUE IS PROTECTED FROM THE CLUTCHES OF THE NEGOTIABLE INSTRUMENTS ACT, 1881

AUTHORED BY - AADITYA THORAT

Abstract

Cheques were introduced in India in the late 18th century; usage of cheques has always increased from its inception. With its grown usage, the credibility of this negotiable instrument also became an alarming issue, the legislature to promote usage of cheque and to ensure its credibility added Chapter XVII in Negotiable Instruments Act, 1881 to penalise cheque dishonour; such penalty is unavailable in any other negotiable instrument. The Act mandates a presumption in favour of the holder of cheque and therefore, to prove when an offence under the Act is not made becomes a meticulous task as it has to be carried out by the accused only. When there is an interplay between the usage of cheque and the provision of law of dishonour, the law is not able to answer in toto, in every scenario. Save the proviso of the provision, there exists a gap as to how the law is to be applied in a certain situation to decide the liability of the drawer. There lie certain ambiguities which the law is unable to provide solution for; whether a cheque always represents an enforceable debt or liability, to what extent the key managerial person can be impleaded in a dishonour case and whether cheques issued for security or as advance payment attract liability when they get dishonoured. These become the fundamental question to suffice the study in this paper. To fill the gap which is solved by courts in many instances, the paper studies the legislative intent and analysis of provisions of the Act. The paper has appreciated the judicial trend as well as precedents and interpretation on dishonour of cheques to find out answers for the problem. The paper aims to cull out protection available to the drawer of a dishonoured cheque. These protections are sustained on judicial pronouncements and a creative interpretation of law helps in getting a broad vision over the topic and practise.

Keywords- Cheque Dishonour, Negotiable Instrument, Cheque for Security, Director Liability, Cheque for Advance.

1. Research Questions

1.1. Whether a cheque always represent a legally enforceable debt or liability?

1.2. When can a key managerial person of a company be protected from the clutches of the Negotiable Instruments Act, 1881?

1.3. Whether a dishonoured cheque attracts liability when it is issued for advance payment or for security.

2. Aims of the Research

2.1. To study the safeguard available to the drawer of the cheque.

2.2. To find out the legislative intent and judicial interpretation on dishonour of cheques.

3. Introduction

The sanctity of the cheque had eroded with usage and therefore, the Negotiable Instruments Act, 1881 (for brevity, 'Act') was amended in 1988 by adding Chapter XVII in the scheme of Act. "The object of the Act is to enhance the acceptability of cheques and inculcate faith in the efficiency of negotiable instruments for transaction of business."[1] Section 138 creates a deeming offence i.e., what is otherwise a civil liability is now also deemed to be an offence, since this liability is made punishable by law. The transaction spoken of is a commercial transaction. The real object of the provision is not to penalise the wrongdoer for an offence that is already made out, but to compensate the victim. "The provisos prescribe stipulations to safeguard the drawer of the cheque by providing them the opportunity of responding to the notice and an opportunity to repay the cheque amount. The conditions stipulated in the provisos need to be fulfilled in addition to the ingredients in the main provision of Section 138."[2]

Provisions of Section 138 makes it clear that the liability is strict and mens rea is not an ingredient of the offence. The facts and circumstances behind a cheque dishonour may differ and these might not always square up a person or corporation into the offence. The paper aims to answer few questions which have surfaced while courts are engaged in deciding these matters. It is not that every

[1] Dashrathbhai Trikambhai Patel vs. Hitesh Mahendrabhai Patel and Ors AIR 2022 SC 4961, see para 13.
[2] supra, see para 25.

dishonour of cheque leads to penalty; the proviso and interplay of the parties provide safeguard to the drawer of the cheque, this paper aims to answer as to when a liability is not attracted in case of dishonour. It carves out few scenarios where the liability is not made, these incidences are supported by the letter of law and the judiciary while declaring the correct law. The paper firstly deals with understanding the essential of a dishonour then it answers the questions as to whether a cheque represents enforceability liability always or not. Then when are key managerial persons protected in case of dishonour and finally how dishonour of advance payment and security cheques do not fasten liability on the drawer.

4. The Part XII of Negotiable Instruments Act, 1881

The purpose of the Act is to make sure that this instrument shall be equated with goods passing from one hand to other. Essentials of section 138 are discussed below.

a) There shall be a cheque drawn by a person from an account maintained with a banker

b) That shall be for the discharge of any debt or liability (means legally enforceable debt or other liability)- in 'whole or part', towards any person

c) That the cheque drawn shall be returned by the bank because the credit balance of that account is insufficient to honour the cheque or,

d) the amount exceeds the amount arranged to be paid from the account by the agreement made between banker and drawer.

The proviso tells us unless some mandatory conditions are not fulfilled, offence won't be made out. These have to be followed by the holder of cheque which are- it provides for presentment of cheque in a stipulated time, the payee or the holder in due course of the cheque is required to make a demand for the payment of the amount by serving the drawer a notice within 30 days of receiving notice of dishonour, and the drawer has to fail in repaying the amount back to the payee or the holder in due course of the cheque (within fifteen days of the receipt of the said notice). Further, "debt or other liability" means a legally enforceable debt or other liability.

Under Section 139, a presumption is raised that the holder of a cheque received the cheque for the discharge, in whole or in part, of any debt or other liability. This presumption has to be rebutted by a proving a contrary case, i.e., removing all the incriminating factors and making court believe that the hypothesis which the accused is showing is true and certain for the case.

5. A cheque that ceases to represent enforceable debt or liability

It is the cardinal rule that to enforce the liability of section 138 the cheque which is dishonoured must have been paid, in part or whole, in lieu of an enforceable debt or liability. An enforceable debt may not arise when a cheque has been used to pay for non-business transaction; out of love etc., but cheque being a negotiable instrument has to be honoured in any of the ways prescribed in the Act; and when a part payment in lieu of this negotiable instrument is done, the amount mentioned on the cheque shall not mean the amount which is due payable. Therefore, dishonour of that amount does not fall into the meaning of debt or liability. Below are in-detail discussions of the averments above.

5.1. When a cheque is drawn, not to pay, in whole or part, a liability.

Crucial question to determine applicability of Section 138 of the Act is whether the cheque represents the discharge of existing enforceable debt or liability or whether it represents advance payment without there being subsisting debt or liability. Debt, is defined "as a sum payable in respect of a liquidated money demand recoverable by action."[3] It is necessary to allege specifically in the complaint that there was a subsisting liability and an enforceable debt and to discharge the same, the cheques were issued. By legally enforceable debt we mean that such amount of debt or liability for which a civil suit can be contested by the Complainant for recovery.

For e.g.- a cheque drawn by father on his son, for paying any amount, if dishonoured, cannot be brought under the act. As it was in lieu of natural love or affection and not for payment of any legally recoverable debt or liability.

"A cheque given not for the satisfaction of any debt or other liability, partly or wholly, even if it is returned unpaid due to insufficiency of funds or the stop payment instructions, it would not attract the consequences provided in Section 138 of the Act."[4] In other words, "drawing of the cheque in discharge of existing or past adjudicated liability is sine qua non for bringing an offence under Section 138."[5] The drawer can always put forward his evidences to rebut the presumption enshrined under

[3] Stroud's Judicial Dictionary, (4th edition, volume 2)
[4] Triton Ratial Private Limited and Ors. vs. State of Gujarat and Ors. MANU/GJ/0663/2017, see para 27.
[5] Indus Airways Pvt. Ltd. and Ors. vs. Magnum Aviation Pvt. Ltd. and Ors. MANU/SC/ 0288/2014, see para 13.

section 139.

5.2. When part payment of the amount represented on the cheque is paid by the drawer of the cheque before its presentation or maturity.

A drawer of cheque is not liable for dishonour in a case where he issues post-dated cheques to the drawee and in between this issuance of cheque and presentment of the cheque for encashment by drawee, the drawer pays part or whole of the sum represented on the cheque, which makes the 'legally enforceable debt' amount reduced and therefore whenever the notice is issued for the amount mentioned on the cheque; and a case filed in furtherance, such notice becomes omnibus and the case required to be dismissed. The drawer has already reduced the liability which the negotiable instrument has put on him, and if he is prosecuted for the cheque amount, such prosecution is entitled to be rejected.

For the commission of an offence under Section 138, the cheque that is dishonoured must represent a 'legally enforceable debt' on the date of presentation or maturity. This situation has been declared by a two-judge bench of Supreme Court in Dashrathbhai Trikambhai Patel vs. Hitesh Mahendrabhai Patel and Ors., wherein drawer after issuing the cheque had paid an amount in cash thereby reducing the liability on the instrument, the payee had presented the cheque for encashment which got dishonoured. Later he had sent the statutory notice of the amount mentioned on the cheque. The Trial Court had rejected the complaint and the High Court also reaffirmed the judgement of Trial Court. The Supreme Court held that such prosecution for the amount on mentioned on cheque cannot be made if the drawer has partly paid off the liability of the cheque through any means. It held that-

"If the drawer of the cheque pays a part or whole of the sum between the period when the cheque is drawn and when it is encashed upon maturity, then the legally enforceable debt on the date of maturity would not be the sum represented on the cheque." [6]

Anyone would use this unscrupulous way in dealing with transactions, wherein by paying back a petty amount would set free the drawer from the clutches of section 138, but the Act itself provides for a remedy to cure such mis-chief under Section 56; which allows scope for part-payment of the negotiable instrument-

[6] AIR 2022 SC 4961, see para 30.

"…but where such amount has been partly paid a note to that effect may be indorsed on the instrument, which may then be negotiated for the balance." Thereby protecting the interest of drawee. So, to speak, the drawee is not entitled to the amount written on the cheque as it is not the real 'debt'.

6. Protection available to Directors and authorised signatories

The key managerial person are the directing minds of the company their acts are the acts of the company, if a company has dishonoured the cheque; its human agency is bound to be vicariously liable as Section 138 is a criminal law as well. Therefore, the study on their liability and protection becomes crucial.

6.1. Where the cheque is issued by such key managerial person who was not in charge and responsible for the conduct of the business of company.

To bring the Directors within the mischief of Section 138 of the Act, it shall be necessary to allege that they were in 'charge of and responsible to' the conduct of the business of the Company. It is necessary ingredient which would be sufficient to proceed against such Directors. Section 141 of the Act makes the Directors in charge and responsible to Company "for the conduct of the business of the Company" within the mischief of Section 138 of the Act and not particular business for which the cheque was issued. Casting liability on director is based on the principle of Vicarious Liability. The complaint shall specifically point out that the director who is impleaded was involved in the affairs of the company.[7] A non-executive director, usually is not involved in the day-to-day affairs of the running of its business and only monitors the executive activity and if he can show such fact he can set free from the clutches of the Act.

To fasten vicarious liability under Section 141 on such person, it has to be seen that, "at the material time, that person was at the helm of affairs of the company; and actively looked after the day-to-day activities of the company and was particularly responsible for the conduct of its business. Then only such liability can be fastened. Simply because a person is a director of a company, does not make him

[7] Pooja Ravinder Devidasani v. State of Maharashtra and Anr. (2014) 16 SCC 1, see para 20.

liable under the NI Act. Every person connected with the company will not automatically fall into the ambit of the provision."[8] Only individuals who were in control of and accountable for the company's business operations at the time the act was committed can be held criminally liable. "A person's vicarious culpability must be pleaded, proven, and not just assumed."[9] The court in S.M.S. Pharmaceuticals Ltd. v. Neeta Bhalla has clearly drawn a distinction as to who can be impleaded. "Liability depends on the role one plays in the affairs of a company and not on designation or status. If being a director or manager or secretary was enough to cast criminal liability, the section would have said so. Instead of "every person" the section would have said "every director, manager or secretary in a company is liable" ..., etc. Therefore, only persons who can be said to be connected with the commission of a crime at the relevant time have been subjected to action."[10]

Any evidence showing that the concerned director was not the directing mind or negligence was not caused because of his acts or omission, vicarious liability cannot be enforced on him. Additionally, a person not holding any office or designation in a company may be liable if he satisfies the main requirement of being in charge of and responsible for the conduct of business of a company at the relevant time. Thus, a director, who was not in charge of and was not responsible for the conduct of the business of the Company at the relevant time, will not be liable for an offence under Section 141 of the Act.

6.2. Where drawer of the cheque is only an employee given an authority to seal and sign the cheque, and is not involved in the affairs of the company.

A just reading of sec. 138 of the Act makes it evident that the said section is controlled by the expression "where in a cheque drawn by a person on an account maintained by him". To attract liability under this section, it is quintessential that a cheque must be drawn on an account maintained by the drawer. Albeit interpretation of word 'drawer' in a catena of judgments has made us realise the meaning, of drawer, does not include an authorised signatory, when such person is merely a signatory and he is not connected with the affairs of company or we can say that he is not a directing mind albeit working hands of company; whose actions are controlled by another person in charge.

[8] supra, see para 17.
[9] National Small Industries Corpn. Ltd. v. Harmeet Singh Paintal, (2010) 3 SCC 330, see para 25.
[10] (2005) 8 SCC 89, see para 19 (b).

The Bombay High Court has recently in the case of Shadab Khan v. The State of Maharashtra & Anr,[11] rejected authorised signatory who merely was an employee to be understood as drawer. Placing its reliance on- Aneeta Hada and Ors. vs. Godfather Travels and Tours Pvt. Ltd. and Ors.[12] and N. Harihara vs J Thomas[13] held that every person signing cheque does not become drawer of the cheque. "…48. Reading paragraphs 21 and 22 of the judgment in N. Harihara (supra), it is clear that the subsequent bench of the Apex Court, after noticing and relying on Aneeta Hada (supra), has observed that every person signing a cheque on behalf of a company on whose account a cheque is drawn does not become the drawer of the cheque and such signatory is only a person duly authorized to sign the cheque on behalf of the company/drawer of the cheque, the Apex Court has made these observations after noticing and relying on Aneeta Hada (supra) would be binding on this Court. Therefore, respondents' submission of including "authorized signatory" within the expression "drawer" under sections 143A and 148 of the Negotiable Instruments Act, 1881 cannot be accepted…"

7. A cheque issued for security and advance payment does not always attract liability in dishonour

It is very common in business dealing to issue cheques for advance payment and for security when a loan is taken. The holder sometimes deposits the cheques before the due date of their agreement as to when it has to encashed, and it this juncture the issue of whether there would be liability arises.

7.1. Where cheques are issued only as security.

'Security' in its true sense is the state of being safe and the security given for a loan is something given as a pledge of payment. A cheque issued as security pursuant to a financial transaction cannot be considered as a worthless piece of paper under every circumstance. It is given, to ensure that the loan is secured and until its instalments are being paid, it won't be presented. These cheques for security are given as 'post-dated' cheques and are frequently used in trade and commerce. Two cases can be carved out so as to understand whether dishonour of cheque issued as security will be treated as offence or not-

First, If a loan is advanced in a transaction and the borrower agrees to pay it back within a certain

[11] WP 4128-2021 and connected matters, Amit Borkar, J., Pronounced On: March 8, 2023, see page 54.
[12] MANU/SC/0335/2012.
[13] (2008) 13 SCC 663.

amount of time and issues a cheque as security to secure such repayment, and if the loan amount is not repaid in any other form before the due date or if there is no other understanding or agreement between the parties to postpone the payment of amount, the cheque issued as security would mature for presentation and the payee of the cheque would be entitled to present the cheque. If then the cheque is not honoured, the liability in Section 138 would follow.Second, in the same transaction as referred above, where the specified timeframe of the loan is not completed yet, and if the cheque is presented before the due date of agreement, the legally enforceable debt or liability as under section 138 is not present and therefore, dishonour of the same would not amount to offence under Section 138 as the essentials are not fulfilled. "If the loan has been discharged before the due date or if there is an 'altered situation', then the cheque shall not be presented for encashment."[14] The borrower always has the option of repaying the loan amount in any other form and if the amount of loan due has been disbursed within the agreed period, the cheque issued as security cannot be presented as the purpose of giving it is fulfilled. "Therefore, the prior discharge of the loan or there being an altered situation due to which there would be understanding between the parties is a sine qua non to non-present the cheque which was issued as security. These are only the defences that would be available to the drawer of the cheque in a proceeding initiated under Section 138 of the Act."[15]

7.2. A dishonour of the cheque which issued as an advance payment, but the goods or services agreed are not delivered before presentment of cheque.

When a cheque is drawn for advance payment in an agreement, only civil remedies can be claimed, there lies no criminal liabilities on drawer if the cheque is dishonoured. "Explanation to Section 138 of the Act clearly makes it clear that the cheque shall be related to an enforceable liability or debt as on the date of the issuing of the cheque; and there is no existing liability on the date of the issuance of cheque because the title in the property had not passed on to the accused since the goods were not delivered."[16] The judgment of Indus Airways Pvt. Ltd. and Ors. vs. Magnum Aviation Pvt. Ltd. and Ors. wherein question on dishonour of cheques which were given as 'advance payment' was dealt the court held that- "If at the time of entering into a contract, it is one of the conditions of the contract that the purchaser has to pay the amount in advance and there is breach of such condition then

[14] Ibid note 1, see para 12.
[15] Sripati Singh through his Son Gaurav Singh vs. The State of Jharkhand and Ors., MANU/SC/1002/2021, see para 17.
[16] Swastik Coaters Pvt. Ltd v. Deepak Brothers and Ors. MANU/AP/0124/1996, see para-03.

purchaser may have to make good the loss that might have occasioned to a seller but that does not create a criminal liability under Section 138. For a criminal liability to be made out under Section 138, there should be legally enforceable debt or other liability subsisting on the date of drawal of the cheque."[17] "If a cheque is issued as an advance payment for purchase of the goods and for any reason purchase order is not carried to its logical conclusion either because of its cancellation or otherwise and material or goods for which purchase order was placed is not supplied by the supplier, the cheque cannot be said to have been drawn for an existing debt or liability."[18]

Thus, these authoritative guidelines provide us that no criminal liability under section 138 of the act can be inflicted (after the dishonour) upon the drawer who has issued cheque as an advance payment.

8. Conclusion

Therefore, we see that, cheque is still a widely used means to disburse payment, it forms an essential part of means of payment. The Act only provides criminal liability on the dishonour of cheques and not on any other negotiable instrument. There are many facets to the case of dishonour of cheque not every time a criminal liability arises out of the dishonour of the cheque, in a few cases and factors as above discussed, a dishonour of cheque does happen but it is inappropriate to incriminate/ fasten liability a person, as the essentials of the crime are not fulfilled.

Cases of dishonour have to be dealt with due diligence as this is a civil liability which combines itself with a criminal punishment as well. Cheque being a widely used payment method requires a detailed study where liability does not arise. Every dishonour of cheque cannot be dealt in the same manner, facts and circumstances must be looked into with the judicial pronouncements for aid. This study is an effort to pen down few scenarios in a paper, except to safeguards provided in the Act, where the drawer of the cheque can be protected. In a going concern, cheque is frequently drawn and deposited sometimes even without knowledge a cheque may get dishonoured; the golden thread which binds this special provision of dishonour is the scope for compounding it, thence absolving all proceeding at once.

[17] MANU/SC/0288/2014, see para 19.
[18] supra, see para 13.