Lawnotes V. SEM

Law of Banking and Negotiable Instruments

1. Salient features of Banking Regulation Act 1949.

Ans. The law relating to banking in India today is the outcome of gradual process of evolution befor 1949 .The Indian companies Act 1913 contained special provisions relating to banking companies, which were inadequate and were subsequently incorporated in the comprehensive legislation passed in 1949 under the name of Banking Regulation Act 1949.This Act was suitably amended a number of times to insert new provisions and to amend the existing ones to suit the needs of changing circumstances.

Structure of the Act :-The original Act had 56 sections housed in five parts and five schedules. After the amendments the Act of 1949 has 70 sections in Ten parts.

Salient features of the Act :-

1. A comprehensive definition of banking so as to bring within the scope of the legislation all institutions which receive deposits, repayable on demand or otherwise for lending or investment.
2. Prohibition of non-banking companies from accepting deposits repayable on demand.
3. Prohibition of trading to eliminate non-banking risks.
4. Prescription of minimum capital standards
5. Limiting the payments of dividends.
6. Inclusion the scope of legislation of banks registered outside the provinces of India.
7. Introduction of comprehensive system of licensing of banks and their branches.
8. Prescription of a special form of balance sheet and conferring of powers on the Reserve Bank to call for periodical returns.
9. Inspection of books and accounts of a bank by Reserve Bank.

10. Empowering the central government to take action against banks conducting their affairs in a manner detrimental to the interests of the depositors.
11. Provision for bringing the Reserve Bank of India into closer touch with banking companies.
12. Provision of an expeditious procedure for liquidation
13. Bringing the imperial bank of India within the purview of some of the provisions of the Bill.
14. Widening the powers of the Reserve Bank of India so as to enable it to come to the aid of banking companies in times of emergencies.
15. Provision for the extension of the Act to acceding states.

2. Relationship between Banker and the customer?

Ans. Before going to examine the relationship between the Banker and the customer it is very necessary that one must understand the two terms Banker and Customer.

Banker definition according to "Paget":

"One claiming to be a banker, he must satisfy **four** important conditions. They are

1. The Banking business must be part of his occupation and should not be a subsidiary one.
2. The banker must take deposit account , current account to issue cheques and pay cheques Crossed or uncrossed cheques for his customers.

Definition of Customer according to "L.Hart".

Account Theory:

"A customer is a person who has an account with a banker and he keeps either a current or a deposit account with the bank".

Definition of a customer according to "John Paget".

Duration Theory:

According to this theory if a person operates his account only one time, or takes too much long time for further transaction, is not a customer.

Modern View:

The modern view has incorporated the elements of both “The Account Theory “and “Duration Theory” and amended them according to modern times.

After innumerable experiences the bankers have been adopting certain procedures to safeguard banking business so that better services could be rendered to the customers. Now it has become statutory obligation on the banker to procure all the information relating to the customer.

The decided case laws of English and India in the modern times say that even a single transaction can constitute a person a customer of a bank.

Perquisites to constitute a person as a customer:

1.**BankAccount :**To constitute a customer a person must have a bank account which may be a savings, current or fixed deposit operated in his name by making the necessary deposit of money.

2. Single transaction:A person is regarded as a customer even if there is a single transaction. A single transaction is sufficient to treat him as a customer.

3. Frequency of transactions:is anticipated but it is not compulsory, and it is insisted upon.

4. Banking nature: The dealings between the banker and the customer must be of banking nature.Operating safe deposit locker doesnot come under banking nature.Therefore a person who has a bank locker is not a customer because in this banker performs the duties of bailee.

Similarly if a person takes change for hundred notes or so from bank cannot become a customer.

3. Debtor and creditor relationship.

Ans. Generally we can compare the banker and customer relationships with the other relations in commercial transactions .There are mainly three types of relationships.

1. Debtor and creditor relationship

2.Trustee and beneficiary relationship

3. Agent and Principal relationship

1. Debtor and Creditor Relationship: The relationship between the banker and the customer is that of debtor and creditor, the

relationship differs from similar relationship arising out of ordinary commercial debts in the following respects

a). **Demand is necessary in case of debt due from banker**: In case of ordinary debt the debtor pays the amounts on the specified date or earlier or whenever creditor demands.But in case of deposit in the bank,the debtor (bank)is not bound to pay on his own account because the banker is not an ordinary debtor; he accepts the deposits with an additional obligation to pay only when it is demanded.Hence a banker is considered to be Privileged debtor.

Caselaws Foley vs. Hill, Joachinsonvs. Swiss Banking Corporation.

2.**Proper place to demand**: A commercial bank having number of branches is considered to be one unit. The locality was an essential part of a debt due by the banker to the customer and the banker's obligation to repay the debt was confined to the place where the account was kept.

Case law :JoachinsonVs Swiss Banking Corporation

3.**Proper time to demand:** Customer can withdraw the money only during the business hours of the Bank.

4.**Proper manner to demand :** According to section 5 (b)definition for the banker, the demand for refund of money must be made through proper method followed by custom or usage amongst bankers i.e. either by cheques or drafts or orders otherwise . It should not be oral.

5. **Partly demand:-** The demand by the customer may be any part of his debt or deposit.

6. **Banker and the law of limitation :**According to Article 22of the limitation Act 1963 the period of limitation to the deposit is three years , which starts from the date of demand by the customer and not from the date of deposit and for a fixed deposit, it applies from the date of maturity . But in case of ordinary commercial debts the period of limitation starts from the date of debt.So this is also a peculiar feature of banker and customer relationship.

4. **Agent and Principal relationship.**

Ans.One of the important relationships between the banker and the customer is the relationship of **agent and principal**.The banker acts as an agent for the customer – principal in the following circumstances.

1. Collection of cheques, dividends, bills or promissory notes on behalf of the customer.
2. Buying and selling securities on behalf of the customer.
3. Acting as a trustee, attorney, executor, correspondent or representative of a customer.
4. Payment of insurance premiums, telephone bills water bills, amount for shares etc.

In the above circumstances the banker acts as an agent for his principal customer.**The law of Agency** applies to both the parties in such circumstances. The banker as an agent is bound to conduct the business of the agency with reasonable diligence. There is a liability on the part of the negligence, want of skill or misconduct but not in respect of loss or damage which are indirectly or remotely caused by such negligence, want of skill or misconduct.

It is the duty of the agent to communicate his principal in cases of difficulty,
to use all reasonable diligence in communicating with his principal and
seeking to obtain his instructions.

Section 182 of Indian Contract Act 1872 defines Agent and Principal. An **Agent**
is a person employed to do any act for another or to represent another in dealings with third persons. The person for whom such act is done or who is represented is called the **Principal**.

Sections from 182 to 238 of Indian Contract Act 1872 deal with "**Law ofAgency** ". All these provisions are applicable in case of the relationship of the banker-- agent and Customer –principa**l.**

5. **Banker and Customer - Bailor and Bailee**.

Ans. In certain occasions, a customer may entrust his valuables to his banker for the safe custody. In such cases the banker becomes **Bailee**and the customer as **Bailor.** The provisions of chapter in (Ss 148 – 181) of the Indian Contract Act, 1872 shall apply to the **banker bailee** and the **customer bailor.**

Duties and rights of Banker as Bailee

1**. Duty of reasonable care :-** Section 151 of Indian Contract Act lays that it is the duty of the bailee totake reasonable care in handling the goods , whichare entrusted to him.Section 152 provides that the bailee is not liable for loss destruction or deterioration of the things bailed, if he has taken the amount of care of them.

2. Duty not to make unauthorized use: Goods must be used by the bailee strictly for the purpose for which they have been bailed. Section 154 provides that the bailee is liable to make compensation to the bailor, if he uses unauthorizedly .

3. Duty not to mix : Ss 155 to 157 imposes the duty that the bailee should not mix the goods of the bailor with others.

4.Duty to Return: Section 160 provides that it is the duty of the bailee to return goods or deliver according to the bailor's directions after expiry of the bailment.

Rights of the Bailee:

1. Right to compensation
2. Right to expenses or remuneration
3. Right to sue
4. Right to lien

6.Garnishee order:

Ans. Generally when debtor owes some money to his creditor and he fails to pay the amount, the latter (creditor) may file a suit against the debtor and he may get a decree from the court for the payment of his debt. Sometimes creditor may not get any property from the debtor for execution of his decree, but there may be some person who is having debtor's property. In such case the creditor may request the court to issue an order so as to attach the debtor's property which is in the hands of third party. If

court issues an order such an order is called “Garnishee Order “ .Since Banker is also a third party who is always keeping customer’s money , court may also order to the banker to freeze the customer’s deposits in his hand . He (banker) must obey the court order.

The word “**Garnishee** “is derived from a Latin word “garnir**”**
Which means to warn the third party. Since it is a warning to the party with regard to property of others in his hand.It is named as Garnishee order. Indian law on this point is governed by Sec 60 of the Civil Procedure Code.

The court issues the garnishee order to the following people:

1. The judgment debtor is the person against whom the court issues a decree to pay the money to his creditor.
2. Judgment creditor is another person in whose favour the decree is issued.
3. The Banker to whom this order is directed to stop the operation of the customer’s account.

Garnishee order is of two kinds.

1. Order Nisi or preliminary order
2. Order absolute or final order.

Oder Nisi : It is preliminary order issued to the banker to

a.Stop the payment over the customer’s account

b.Give explanation why the judgment debtor’s credit balance in his account should not be used for the purpose of payment of the judgment creditor.

c.It is also duty of the bank to inform the same to his customer.

Order Absolute: It is final order issued by the court to the banker to pay the amount from the judgement debtor’s account to the judgement creditor (decree holder) according to the direction given by the court.

Limitations to application of Garnishee Order :

The following are the amounts not covered by this order;

1.The Negotiable Instrument deposited with the banker for collection.

2.When a cheque is marked for “Good for payment”

3. Any amount deposited after the order.

4.The money held at abroad

5.The safe custody deposits.

Garnishee Order's application.

1. **Joint account :** An account which is opened in the name of two or more personsis called joint account. This order cannot attach this joint account, if only one of account holders is a judgement debtor. If all holders are judgement debtors, it can be attached.
2. **Partnership firm Account :** For the debts incurred by the firm the person's individual account cannot be attached . In the same way for a partner's individual debts firm's account cannot be attached.
3. **Trust account**:A trust account though standing by trustee in name of a person in his capacity as trustee cannot be attached for the payment of his personal liabilities.

7. Negotiable instruments Act 1881.

Ans. Negotiable Instruments Act cameinto force in 1—3---1882.It is a true copy of English Law of Negotiable Instruments i.e. Bills of ExchangeAct 1882.Both Acts followed the English Common law.

NI Definition : Section 3 of the NI Act defines a NI as " Negotiable Instrument means a Promissory Note , Bill of exchange ,or cheque payable to order or bearer whether the words order or bearer appears on the instrument or not.

A simple words Negotiable Instrument is a piece of paper which contains some value and transferable by simple delivery or sometime by endorsement and delivery.

Featuresof Negotiable Instrument:

1 **Transferability :** Negotiable Instruments are easily transferable from one person to another by mere delivery in case of an order instrument.

2 **Absolute title :** A Negotiable instrument confers absolute and good title on the transferee,who takes it in good faith , even though the transfer had defective title such transferee is called holder in due course and his interest in the instrument is protected by law

3 **Right to sue :** The holder of a NI who is legally called as holder in due course has a right to sue upon the instrument in his own name.

Kinds of Negotiable Instruments:

1. Promissory Note (sec 4)
2.Bill of Exchange (sec 5)
3.Cheque (Sec 6)

1. PromissoryNote : Section4. Of NI Act 1881

Definition: "A Promissory Note is an instrument in writing containing an unconditional undertaking signed by the maker,to pay certain sum of money only to or the order of, a certain person, or to the bearer of the instrument.

Elements of the Promissory Note :

- It must be in writing.
- It must be an undertaking to pay
- The promises to pay should be unconditional.
- It must be signed by the maker.
- The maker must be certain.
- The sum payable also must be certain.
- It must contain a promise to pay money and money only.
- Stamping of Promissory Note is essential under the Indian Stamps Act 1899.An unstamped promissory Note is not admissible in evidence and no suit can be maintained.
- It must contain date.
- The limitation period for a Promissory note file suit is three years from the date of execution or from the date of acknowledgement

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Bill of exchange :Section 5 of NI Act 1881

Definition : It is an instrument in writing containing an unconditional order , signed by the maker ,directing a certain person to pay certain sum of money only to or to the order of a certain person or to the bearer of the instrument.

Elements of Bill of Exchange :

- **Unconditional order :** The order contains in it should be unconditional.
- **Money only :** The consideration of a bill of exchange should be paid in by way of money only. The amount to be paid should be certain

- **Time of Payment :** The time of payment must be indicated in the bill with certainty.
- **Order to pay :** Order in this section (5) does not mean a command, but a request or a direction.
- **Drawer's sign:** The signature of the drawer is necessary and there cannot be a bill even if the instrument is accepted without the signature of the drawer.
- **Drawee:** It must indicate a drawee who should be called on to accept or pay it.The drawee must be named or otherwise indicated in the bill with reasonable certainity.
- **Date and Time:** It should specifically mention the date and place of the payment or the place where it is drawn.
- **Stamp Duty:** Every bill of exchange must be stamped according to the provisions of the Indian Stamp Act 1899.
- **Statutory Protection:** Such protection is available in case of bills of exchange.
- **Presentation :** In case of Bills of exchange the period for presentation is not strictly followed as in cases of cheques.
- **Notice of dishonor :** Where a bill of exchange is not paid and not honoured, a notice of dishonor should be sent to drawer to change him.
- **Civil remedies :** In case of dishonor of bill of exchange the aggrieved party has only civil law remedies.

8. **Cheque Section (6) NI Act 1881.**

Ans..Definition:"A bill of exchange drawn on a specified banker and not

expressed to be payable otherwise than demand and it includes electronic image of a truncated (shorten by cutting off the top or the end) cheque and a cheque in the electronic form

.**Elements of a cheque :**

- **A cheque must be an order in writing**:A cheque must be an order in writing. Therefore oral orders cannot be regarded as cheques
- **Unconditional order :** A Bill of exchange which also includes cheque must be drawn unconditionally. It is the essence of the cheque that it should be payable at all events and it must appear so on its face.A cheque made payable on the

happening of a contingent event is void ab initio and is not validated by happening of such event.

- **Banker :**A cheque must be drawn on a banker.
- **Signature:** A cheque must be signed by the maker.There must be full signature which can tally with the specimen on the signature.
- **Amount:** The amount must be specifically mentioned in figures and words. At the end only words should be written.
- **Payable to order or bearer:** A cheque may be drawn payable to order or bearer .There are two kinds of cheques.
  a. It may be a bearer or order cheque
  b. It may be self cheque.
- **Date:** The cheque must contain the date.The bank is not under any obligation to honor undated Cheque.The date is important because it can be cashed with in **6 months** time from date of issue in ordinary banks.In case of Reserve Bank the period of cheque is only **three months.**
- **Post dated cheque**: In certain circumstances the maker of the cheque may write **Post Date on the** cheque according to the terms and conditions and understanding between drawer and drawee.However the payee should submit that cheque on or after that postdate.Prior to that post date he is not entitled to submit to the bank for payment.
  Characteristics of a cheque: Section (6)
- **Transferability** : A cheque may be transferred
  a. By mere delivery
  b. By endorsement and delivery
  When a cheque is transferred to a person, the ownership of it passes to such person for such transfer no other document is required.
- **Holder in due course : "**Nemo dat quod non habet ".General principle of law. This principle does not apply in case of cheques. **A holder in due course** gets a valid title to it despite any defect in the transferor's title.
- **Right of action :** The holder of a cheque has right to sue there on in his own name .

9.Crossing 0f cheques.

Ans. Cheques may be classified into two kinds
a. Open cheques

b. Crossed cheques

- **Open Cheque :**Open cheque is one which has no crossing and which can be presented by the holder to the banker upon whom it is drawn and is paid over the counter of the bank.
- **Crossed Cheque;** A crossed cheque is one which has two transverse parallel lines, marked across its face , with or without the words and company or any abbreviation thereof.

Crossing is an instruction from the drawer to the paying banker to pay the amount of a cheque through bank only and directly to the person presenting it at the counter.

Crossing may be hand –written,stamped, printed or perforated. Crossing does not affect the negotiability of the instrument.Crossed cheques can only be encashed through bank of which the payee of a cheque is a customer. The holder of a cheque who has account can also obtain the amount by endorsing in favour of some person who has got an account with the banker.

Purpose of crossing:

- It protects the interests of the true owner of the holder.
- Cheque becomes more safe.
- It reduces the danger of unauthorized persons getting the cheques and encashing them

Types of crossing : There are two types of crossing. They are

1. General Crossing **2.** Special Crossing

General Crossing: Any cheque bears across its face two parallel transverse lines with or without any words then the cheque is generally crossed. It is defined in Sec 123. The lines should normally be drawn, across a corner, usually the left hand top corner.

The effectof general crossing is that the cheque must be presented to the paying banker through any other banker and not by the payee himself at the counter.

Special Crossing: A cheque bears the name of the bank between the transverse lines or sometimes without transverse lines then the cheque is called a specially crossed cheque.It is defined in Section 124 of the Act as

“A special crossing requires the name of the banker to be written across and on the face of thecheque. Two parallel

transverse lines are not necessary for a special crossing although they are usually drawn, or also the words **& co** or their abbreviations since special crossing itself specifies the name of the banker."

A cheque crossed specially will be paid only when it is presented by the bank named between the parallel lines. The banker to whom the cheque is specially crossed may appoint another banker as his agent for collection of such cheques. Thus a special crossing makes the cheques still more safe.

Double Crossing: When a cheque is crossed specially in favour of two banks it is called double crossing. Generally double crossing is invalid .However there is an exception to this rule.The NI Act permits two special crossings on a cheque provided the special crossing is in favour of banker acting as an agent of the first banker for collection **Sec 127.**

A cheque bearing a double crossing shall not be honoured by the banker unless the word "agent for collection "are included in the special crossing**.**

Account Payee Crossing

Account Payee Crossing: Very often the words "Account Payee "or Account Payee Only "are Included to the crossing, general or special,on a cheque. These words have special significance they intended to make the cheque more safe.

These words are not recognized by NI Act but are in usage on the basis of practice prevalent in the business community. These words constitute an instruction to the paying banker that he should collect the amount of the cheque for the benefit of the payee's account only which means to credit the amount to account of the payee only and nobody else.

Account payee crossing does not restrict the transferability of the cheque which
can be endorsed further, but in practice it shall not prove to be effective because
the collecting banker is being directed by drawer to credit the proceeds (receipts)

to the account of payee only. If he ignores the direction he will loose the statutory protection granted to him as a collecting banker. The payee banker need not take any special precaution except to confirm from the collecting banker that the payment is being secured for the benefit of the payee only. If the cheque bears any endorsement.

Bankers draft

Banker's draft: A banker's draft is prepaid and issued by the bank.It is also known as cheque, is **like** asking a bank to write a cheque for us. Cheques can be bounced but bankdrafts cannot be bounced as they are prepaid.

If we pay money in the bank, the bank will prepare a banker's draft by taking
prescribed charges. We usually need to give the bank 24 hours' notice
to prepare a bankers draft.

Precautions to be taken while accepting bank drafts.:

- One should be careful while accepting banker's draft especially for larger sums, due to the number of instances of fake drafts being presented. For example for the payment of cars.
- Banker's drafts are not guaranteed against fraud.If anyone looses a bankdraft or it is stolen,someone else can use it fraudulently. So one should take extra care regarding bank drafts.
- One should keep a record of each cheque his/her cheque book and check against his/her statement and should report any problems to the bank straight away.
- There are a number of ways to transfer money to anyone from one's account which can be faster and safer than using a banker's draft.
  Banker's drafts are often used for larger amounts and when people or organizations won't accept a personal cheque the money on Banker's draft is accessible within fourdays after it has been paid in. It is

subject to the Bills of Exchange Act 1882 and is cleared in the same way as a cheque.

Conclusion: Abank draft or banker's draft is a payment on behalf of a payer that is guaranteed by the issuing bank. Banks will review the bankdraft requestor's account to see if sufficient funds are available for the cheque to clear. Once it has been confirmed, the bank effectively sets aside the funds from his/her personal account to be given out when the bankdraft is issued.

Dividend warrants

Dividend warrants': A dividend warrant is an instrument by which a company pays dividend in the form of cash to its share holders from the profits it has made out its business operations.

Dividend is the part ofprofits payable to the owners of the company i.e. share holders.Some companies instead of paying dividends in the form of cash give in the form of documents by mentioning the warrant price and other details. The price mentioned in it is also called **exercise price**. Sometimes company may not specify the name of the holder.The holder of the document can fill it, Dividend warrant is mandatorily issued in the name of sole holder or to the primary holder in case of joint or multiple holders.

Advantages of dividend warrant :

- It helps to the company from paying tax.
- It is easy to transfer from one person to other without any formalities.
- It helps to increase the share capital of the company.

Conclusion: Dividend is the part of profits payable to the owners of the company.ie shareholders. Dividend warrant is an order of payment (such as cheque payable to a shareholder) in which a dividend is paid.

POSTAL ORDER &MONEY ORDER

PO and MO:

The Postal Order, Postal Note or Money Order is a financial instrument usually intended for sending money through the mail. It is purchased at a post office and is payable at another post office to the named recipient. A small fee for the service, known as **poundage** is paid by the purchaser.In the United States this is known as a postal money order.Postal Money Orders are not legal tender, but a type of promissory note, similar to a cheque.

The use of Postal Orders was extended to most countries that are now part of Common wealth nations plus to a few foreign countries.

Money Order:

A money order is a service provided by Indian Postal Service. A payer who wants to send money to a payee pays the amount and a small commission at a postoffice and receives a receipt for the same.The amount is then delivered as cash to the payee after a few days by a postal employee at the address specified by the payer.A receipt from the payee is collected and delivered back to the payer at his address. This is more reliable and safer than sending in mail. It is commonly used for transferring funds to payee who is in a remote, rural area where banks may not be conveniently accessible or where many people may not use a bank account at all.Money Orders are the most economical way of sending money in India for smaller
amounts. In United States MOs are typically sold by third parties such as
US Postal Services, Grocery Stores and convenience stores.

Traveller'sCheques

Traveller's Cheques:

A traveller's cheque is a medium of exchange utilized as an alternative to hard currency.The product typically is used by people on vacation to foreign countries.They (traveller Cheques)offer a safe way to travel overseas without cash. The

issuing party, usually a bank,provides security against lost or stolen cheques.
A traveller cheque is similar to regular cheque because it has a unique cheque number or serial number. When a customer reports a cheque is stolen
or lost ,the issuing company (bank) cancels that cheque and provides a new one.It is for a prepaid fixed purchaser can use it to buy goods or services
When travelling. A customer can exchange a traveler's cheque for cash. Major financial Institutions issue traveller's cheques and banks and credit unions sell them.
Some companies charge 1% to 4 % fee to issue traveler cheques.Other banks offer the cheques for free if a customer maintains a high minimum account
balance. They are available in all countries currencies in several fixed denominations.However with the rising use of prepaid debit and credit cards an increasing number of retailers and merchants are not accepting traveller
Cheques.

Circular note: In banking, a circular note is document request by a bank to its foreign correspondents to pay a specified sum of money to a named person.The correspondents must be satisfied of the identity of the applicant before payment and the requisite proof of such identity is usually furnished, upon the applicant's producing a letter with his signature, by a comparison of signatures. These are also similar to letters of credit.

Paying Banker

Paying Banker:
The bank who receives money and pays back the money to his customer is called Paying Banker and also the Drawee Bank In the simple words the paying banker makes payments against his customer's cheques.
Paying Banker and Statutory Protection: There are some sections in NI Act which protect the paying Banker .This is called Statutory Protection, because it is statutorily recognized in many

sections of the Act.On the basis of the nature of the protection available to the banker, it may be divided into three headings.

- **Statutory Protection in caseof open instrument.**: Open instrument is one which is not crossed,some protection also provided to the banker for the payment over open instrument. Again this protection is divided into two categories.
  a) **Protection in case of Bearer instruments:** According to sec 85 (2) the paying banker is not required to verify the regularity of endorsements on bearer cheques. In such cases the banker is liable even if he (banker) makes payment against stolen bearer cheque.
  b) **Protection in case of ordered cheques:** According to sec 85 (1) where a banker makes payment against an order cheque with forged endorsement the drawee (paying banker) is discharged from liability .after insertion of 16 (2) this protection is extended to other endorsements also.To avail statutory protection under section 85 (1) the following two conditions are to be satisfied.
  1. The endorsement must be regular.
  2. The payment must be in due course.

Case law: UOI vs. AT Hussain & Co

C)**Statutory Protection in case of Materially altered:**section 89 protects the interest of the paying banker when he pays the amount over material altered instruments/cheques. Material alteration discharges the liability of the banker over the cheque provided the following conditions are satisfied.

a) When such alteration is not apparent (clear)
b) When the banker has made the payment in due course.
c) When the banker is liable to that cheque.

Liability of paying banker:- The paying banker is under statutory obligation to honour his customer's cheques .Otherwise he is liable U/S 31 of NI Act to compensate the drawer (customer) for any loss he may suffer .This liability /duty U/S 31 of the Act is subject to the fulfillment of the following conditions.

1. There must subsist the banker and customer relationship i.e. the account must not have been closed.

2. The customer must have sufficient funds to honour the cheque.
3. When the banker is under obligation to pay the cheque only when duly required It means
   a) The cheque is presented in the branch where his account is kept.
   b) It is presented during banking hours.
   c) The funds are properly applicable to the cheque.

Banker's liability for wrongful dishonour :

If the paying banker wrongfully dishonours a **customer**'s cheque he is liable for the damages to the customer.

Forgeries

Forgeries in Negotiable instruments (like cheque/billof exchange/promissory note: A instrument is called forged instrument when forgery takes place in signature of the endorser and alteration in name of the payee, alteration in amount alteration in date etc validated by forged signature.

A forged instrument is meaningless as far as drawer /endorser whose signature is forged is concerned because holder of such instruments is not protected under law.

Forgery is void ab-initio and confers no title to the holders.Therefore transfereewill not be able to enforce payment from parties to the bill, cheque and promissory note .In case such transferee gets payment can be claimed back from him/her.

For example:when the forged endorsement will be held responsibleand may have to return the proceeds collected by it.

Collecting banker statutory protection:

Even though there is no legal obligation, most of the Banks collect cheques and bills as an agency service, when we refer the definition **Sir John Paget**, We can understand that the collection of cheques whether crossed or uncrossed is one of the functions of the banker. In this role the banker

is referred as the collecting banker.While collecting the cheques on behalf of his customers, the banker may come across with many difficulties.To overcome these difficulties the statutory protection is recognized to collecting banker in sections 131 and 131 A of NI Act.

Need for Statutory Protection:

One of the functions of the banker is to collect cheques .In case of crossed cheques,the payment should be through Bank only. Every time it is not possible to the banker to identify the signature of the endorser.Since the banker is busy person in his regular transactions with the public, it is common that he can also commit some mistakes in collection of the cheques. In this regard the collecting banker is exposed to various risks. So statutory protection is necessary to the collecting banker because he collects the cheques of others and it turned to be fault, this amounts to **conversion*** against true owner.

* **Conversion** means unlawful taking, suing deposing or destroying of goods
which is inconsistent (opposed to) with the owner's right of possession .

So if banker commits the conversion statutory protection is not provided to him
under section 131 of NI Act 1881 .A collecting banker is entitled to statutory
protection provided the following conditions are fulfilled.

1.The cheque mustbe crossed.: The collecting banker gets statutory protection in case of crossed cheques only.The crossing may be general or special.Otherwise he is liable for conversion, defective title (of the cheque)etc.Section 128 and section 131 extends this protection to crossed drafts also.

2.**Collection for customer only:** The statutory protection is available to the collecting banker if he collects the cheque as an agent of the customer, not as a holder for its value.

* **Holder for value :** When a customer presents an outstation cheque for collection and the banker gives immediate credit to his customer's account without waiting

for its clearance , then the position of banker is holder for value.

3. **In good faith and without negligence:** The collecting banker is entitled to avail statutory protection when he receives payment in good faith and without negligence.

Banker's Lien

Banker's Lien:

Another important feature of the relationship between the banker and the customer is that a banker may in the absence of a contract to the contrary, retain as a security for the general balance of account any goods or securities bailed to him.

There are two types of Lien Rights :

1. Particular Lien 2. General Lien.

Particular Lien: This is a right available to one person to retain the goods or articles of other for not performing obligation attached to that property. In this type of lien a person can retain particular property which some obligation is attached. Particular lien is available only against those goods or articles on which some skill or labor have been expended.

Examples: Tailor, watch repairer, Gold smith etc. can enjoy particular lien.

General Lien :

Section 171 of Indian Contract Act says that Bankers, Warfingers , attorneys of High Court and Policy Brokers can exercise right of general lien over the articles or securities deposited with them.

Example: If two securities are given to banker but a loan is taken against one of them he (banker) may retain both the securities until his claim is satisfied.

Essential Features of the Banker's General Lien :

1. Banker should have received items of the customer in his capacity

as banker.

2. Banker's Lien equals to implied pledge.
3. Banker can exercise this right only when they are deposited with the

Customer's name

4. Bankers can also exercise this right even after closing the account.
5. Thereshould not be any contract to the contrary to exercise this lien.

Limitations on Banker's Lien:

1. Banker cannot exercise lien right over securities and other items

deposited for custody.

2. He has no right to exercise this lien over the negotiable instruments

entrusted him for special purpose.

3. Banker has no lien on bonds and coupons deposited for collection.
4. No lien for the amount not due.
5. Banker has no lien on the securities left with him inadvertently

(unknowingly)

6. No lien on money deposited for special purpose.
7. No lien in respect of trust Account.
8. No lien on securities left with the banker after the repayment of loan.

Caselaw: wilkivision Vs. London and Country Bank

Banker's Right of Set-Off

Banker's Right of Set-Off:

Right to set off is nothing but the mutual claims of the debtor and the

creditor are adjusted together and the remaining amount payable by the

debtor. This right of set-off is a statutory right which enables a banker to

combine two accounts in the name of the same customer and to adjust the

debt balance of one account with the credit balance of the other.

Conditions necessary to exercise the Right of Set-off:

1. There should not be agreement express or implied contrary to it.

2. It can be exercised only after the notice is served.

3. The accounts must be in the same name and same capacity.

4. The debt must be certain or definite

5.The right can be exercised by the banker before the Garnishee order is made effective.

Automatic Right of set off arises in the following cases:

a. On the death, insanity, or insolvency of the customer.
b. On the insolvency of the partner of the firm or on the winding up of a company.
c. On the receipt of Garnishee Order On
d. On receiving notice of assignment of a customer's credit balance.
e. On receiving notice of second mortgage over the security charged to the banker.

Advances

Advances:

The term advance is credit facility granted by banks for short term purposes.

A credit facility repayable within one year is called advance. The terms loans and advances are frequently used in the bank transactions interchangeably. However there are slight differences between them.

The banks charge **10%** to **16%** for the loans and advances and also processing fee, advocate's fee etc. Banks pay interest at therate of **6%** to **10%** depending upon the nature of deposit and period of the deposit subject to regulation of the RBI. The difference in the percentage of interests is the profit for the banks.

Advantages :

1. The loans and advances are helpful in increasing the business world and to meet the needs of the common man and employees.

2. The rate of interest is charged very high by money lenders and NBFCs whereas the rate of interest charged by commercial bank is very reasonable.
3. The Banks maintain secrecy of the borrowers
4. By the loans and advances, the central and State Governments also get income such as stamp duty and **registration charges @0.50 per Rs.100/- on loans or advances.**

kinds of loans and Advances:

There are three kinds of loans available from the banks to the traders.

1. Loans 2.Cash Credits 3. Overdrafts.

1. Loans: These are two types
a. Demand Loans b.Term Deposits

a) Demand Loans: These are generally given for the working capital purposes. This type of loan shall be repayable at a short notice given by the banker .The borrower shall have to submit security by way of materials or goods in stock, shares of companies or any other asset.

b) Term Loans: These are two types
1. Long term 2. Short term

Long term loans are given for **more than 15 months** and **short term loans** are given for a period of **one year to 15 months.** The term loans include medium term loans also. These loans are granted for the purchase of immovable property for the establishment of a factory or a unit of such factory, purchase of machinery, extension of industry.

Letter of credit

Letters of credit:"A letter of credit means a document provided Example: for the exporter, by the importer, so that the exporter can draw his amount from the Bank.It usually states the period within which it can be drawn, the maximum amount, and refers to the documents accompanying it. A letter of Credit ranks as cash and must be honoured.

Object:

A letter of credit is documentary credit, which facilitates commercial relationship between an importer and an exporter, or in financing the shipment of merchandise from one country to another. The international laws govern the commercial Letters of Credit. The Law of Contract applies to every step in the Letter Of Credit from its commencement to the ending.

After issuing the Letter Of Credit, The bank is liable to pay the payment. According to the terms of the contract, a Letter of Credit stipulates either for a **sight draft** or for a **usance draft**. A **sight draft** means payable on demand. A **usance** draft means payable at a later date prescribed by the parties.

Types of Letters of Credit: There are different kinds of Letters of Credit they are

1. **Revocable of Letter of credit:** In this system the issuing or advising Bank does not give any undertaking that drafts issued there under will be honoured. The issuing bank can cancel it any time by merely advising the beneficiary through the correspondent bank.
2. **Irrevocable Letter of Credit:** In this system, once the issuing bank undertakes to issue the Letter Of Credit, it cannot revoke its decision, and the drafts issued there under will compulsorily be honoured.
3. **Confirmed Letter Of Credit:** It constitutes a definite undertaking cannot be modified or cancelled without the agreement of all concerned.
4. **Unconfirmed Letter of Credit:** The issuing bank advises the credit as either revocable or irrevocable but the correspondent bank does not add its confirmation thereto.
5. **Revolving Credit:** It is a renewable credit. Under this system, the beneficiary can avail the amount up to Rs.1,00,00,000/- and one consignment to another consignment regularly , just with formal renewal with the bank.
6. **Transferable Credit:** In this system, besides the buyer and seller, a merchant or agent enters into the agreement.

First the Letters of Credit isissued in favour of that merchant or agent incorporating the term "transferability". When all the formalities are completed, the letters of Credit is transfered to the **beneficiary.**

7. **Negotiation Credit :** In this system the bills are drawn on the importer himself.The bank's services in the matter being requisitioned in order that exporter may be able to negotiate the bills he has drawn on the buyer.The credit is communicated by the bank to the beneficiary who can negotiate (sell) his draft to his local banker.