




RESPONSIBILITY OF PAYING BANK



Chapter 13 Part 1 Module A PPB by Ashish Sir





◆ Section 31 of the Negotiable Instruments Act & Paying Banks

Key Provisions of Section 31:


✓ The drawee bank must honor a cheque if there are sufficient funds  in the account.

✓ If the bank refuses payment **wrongfully**, it must **compensate the drawer** for any loss.

🔍 Important Considerations:

	Clause	Explanation
#1	Applies Only to Banks 	Only banks can be held responsible for dishonoring cheques under Sec. 31.
#2	Sufficient Funds 	The account must have enough balance for cheque clearance.
#3	Properly Available Funds 	The funds should not be under legal restrictions [e.g., lien, freeze, etc.).]
#4	Duly Required to Pay 	The cheque must be properly drawn, signed, and presented within validity. <i>Apparent Tenor</i>

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#5	Liability to Drawer  <u>Imp.</u>	If wrongfully dishonored, compensation is due only to the drawer (not the endorsee). 🔥🔥🔥🔥🔥🔥🔥🔥🔥
#6	Exceptions to Bank Protection 🚫	(a) If the bank is wound up , the holder can claim as a creditor. (b) If the bank ignores a crossing , the true owner can claim damages.
#7	Altered Instruments & Liability ✍️	Under Sec. 89, the bank is protected if an alteration was <u>not apparent</u> .

📌 Real-Life Example:

✍️ **Wrongful Dishonor Case:** A businessman issued a cheque of ₹5 lakh, which was dishonored despite sufficient balance. The court ordered the bank to **compensate him ₹50,000** for loss of reputation.



Sec 128 NIA **Liability of Paying Banker for Forged Signatures** ✍️🛑

📌 **Key Provisions (Sec. 128 & Court Judgments):**

- ✓ If a **customer's signature is forged**, the bank **cannot debit** their account.
- ✓ The bank is **fully liable** if it pays on a forged cheque.

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Case 	Key Issue	Court's Verdict 
Canara Bank vs. Canara Sales Corporation (1987)	Accountant forged <u>42 cheques worth ₹83.26 lakh</u>	Bank held liable for wrongful payments. Supreme Court ruled no mandate existed.
Bihta Co-operative vs. Bank of Bihar (1967)	Joint account: One <u>signature was forged</u>	Bank was liable – no valid mandate existed. Bank admitted negligence but still lost the case.

Real-Life Example:



Cheque Fraud Case: A bank employee in Mumbai forged a company director's signature on multiple cheques, leading to wrongful withdrawals. The bank had to refund ₹25 lakh to the company due to negligence.

3. Summary: Bank's Liability in Cheque Payments  

Scenario	Bank's Liability	Legal Reference 
Sufficient Funds, but Cheque Dishonored	Liable for compensation to the drawer	Section 31 of the NI Act
Forged Signature on Cheque	Bank cannot debit customer's account	Canara Bank Case, Bihta Co-op Case
Joint Account - One Forged Signature	Bank must not pay	Supreme Court Verdict

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 Altered Cheques (Not Apparent)	Bank protected if alteration is not visible	Section 89 of the NI Act
 Ignoring Crossing on a Cheque	Bank liable to the true owner	Exception under Sec. 31

Payment in Due Course: Protection for Paying Banks

1. Meaning & Importance of Payment in Due Course

Key Principle:

- ✓ A bank **can seek protection under Sec. 85** of the Negotiable Instruments Act **only** when the payment has been made in **due course**.
- ✓ Payment must be made to the holder, his authorized agent, or servant as per banking norms.

Definition (Sec. 10, NI Act):

 **Payment in due course** means payment made:

- ✓ In accordance with the **apparent tenor** of the instrument.
- ✓ In **good faith** and **without negligence**.
- ✓ To a person **rightfully entitled** to receive it.

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◆ 2. Landmark Court Cases on Payment in Due Course 

📌 (i) Bank of Bihar vs. Mahabir Lal (1964) - Supreme

Court Ruling

Issue:

- ◆ The bank entrusted cash to its own employee (Potdar) for payment to a wholesaler, but Potdar absconded with the money.
- ◆ The bank sued the customer (firm) for repayment.

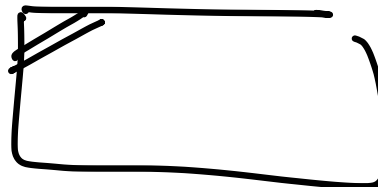
Verdict:

- ✓ The **bank lost the case** ✗ because it did **not** make payment to the firm or its **authorized agent**.
- ✓ **Lesson: A payment to a bank's own agent is not** a valid payment under Sec. 85.

#2 📌 (ii) Bhutoria Trading Co. vs. Allahabad Bank (1977) -

Calcutta High Court

Issue:



- ◆ BTC received an uncrossed cheque, which was encashed by its **Manager** over the counter.
- ◆ BTC sued the bank, claiming wrongful payment.

Verdict:

✓ The **bank won the case** ✓ as payment was made:

- In **good faith** ¹⁰⁰
- Without **negligence** ✓
- Based on proper **identification & authentication** 📄

✓ **Lesson:** If the cheque is properly endorsed and presented by an authorized person, payment **is in due course**.

#3  **(iii) Madras Provincial Co-op Bank vs. Official Liquidator (1945) - Madras High Court**

Issue:

◆ The **Official Liquidator** of a company **cash**ed a cheque instead of depositing it in the official liquidation account.

- ◆ He later **misappropriated** the funds.
- ◆ The new liquidator **sued the bank** for negligence.

Verdict:





✗ The **bank lost the case** because:

- ◆ The bank **knew** the liquidator was required to **deposit the cheque** and **not encash it**.
- ◆ Allowing cash withdrawal was a **clear breach of statutory duty**.

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✓ **Lesson: A bank cannot ignore legal obligations related to an instrument & must act with due diligence.**

◆ 3. Key Takeaways on Payment in Due Course

Scenario	Bank's Protection Under Sec. 85	Court Verdict 
 Payment to Bank's Own Agent (Potdar Case)	✗ No protection – Not an authorized agent of customer	Bank lost the case
 Payment to Properly Identified Manager (BTC Case)	✓ Yes, protected – Good faith & no negligence	Bank won the case
 Cheque Issued to Liquidator But Cashed Instead of Deposited	✗ No protection – Bank should have ensured deposit	Bank lost the case

◆ 4. Practical Implications for Banks & Customers

- ✓ **Banks should verify the authority** of persons presenting cheques before making payments.
- ✓ **Customers should issue crossed cheques** where required to avoid unauthorized encashment.
- ✓ **If a bank acts negligently**, it will **not** be protected under Sec. 85 and may face liability.

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PIDC - Sec 6



 Payment in Good Faith Without Negligence:

Protection Under Sec. 89 & 10 of NI Act  

 **1. Meaning of Protection Under Sec. 89** 



 **When is a Bank Protected?**

✓ If a **cheque** is altered, but the alteration is **not apparent**, and payment is made:

- #1  According to the **apparent tenor** at the time of payment.
- #2  In good faith and without negligence.

 **When is a Bank NOT Protected?**



- #1  If the alteration is **visible** and **not authenticated** by the drawer, payment is NOT protected.
- #2  If the bank **fails to take reasonable care** in verifying the authenticity of the cheque.

📍 2. Landmark Court Cases on Payment in Good Faith

& Negligence

#1 (i) Bank of Maharashtra vs. Automotive Engineering Co. (1993) - Supreme Court

Issue:

- ◆ A cheque for ₹795.98 was altered to ₹76,500 using chemicals.
- ◆ The bank visually examined the cheque, found no issues, and passed it for payment.
- ◆ Later, the fraud was detected under an **ultraviolet (UV) lamp**.
- ◆ The bank was **sued for negligence** for not using a UV lamp.

Verdict (Supreme Court Ruling):

- ✓ The bank was protected under Sec. 89 because:
 - ✓ There was **no visible alteration** on the cheque.
 - ✓ The bank followed normal verification procedures (checking signature, serial number).
 - ✓ The law **does not mandate** using advanced technology (UV lamp) for every cheque.

✗ What Banks Can Learn:

- ✓ Good faith & normal diligence = No liability.

- ✗ Negligence in basic scrutiny** = Bank is liable.

#2

(ii) Brahma Shumshere Jung Bahadur vs. Chartered Bank of India (1956) - Calcutta HC

Issue:

- ◆ A cheque of ₹7,256 was fraudulently altered to ₹72,34,081.
- ◆ The bank **did not notice the forgery** and processed the payment.
- ◆ The customer sued the bank, claiming negligence.

Verdict:

- ✓ The **bank was protected** because:
 - ✓ The **alteration was not apparent**.
 - ✓ The customer **habitually issued cheques written by others**, so there was **no reason for suspicion**.

✗ What Banks Can Learn:

- ✓ If **no visible alterations exist**, banks **cannot be held liable**.
- ✗ Banks **should check customer patterns** before clearing large transactions.

#3 (iii) Tanjore Permanent Bank vs. S.R. Rangachari (1959) -

Madras HC

Issue:

- ◆ A customer sent blank signed cheques to the bank manager.
- ◆ The bank's accountant filled in amounts: ₹7,600 and ₹4,200 (fraud).
- ◆ The bank cleared the payments **despite visible alterations.**
- ◆ The customer refused liability and sued the bank.

Verdict:

- ✗ Bank was NOT protected under Sec. 89 because:
- ✗ Alterations were visible.
- ✗ No authentication from the drawer.
- ✗ Bank failed to verify the altered cheques.

Lesson:

- ✓ Visible alterations must be authenticated before payment.
- ✓ Failure to do so = Bank is liable for wrongful payment.

#4 (iv) Bareilly Bank Ltd. vs. Naval Kishore (1964) -

Allahabad HC

Issue:

- ◆ A customer deposited ₹19,900 and was issued a cheque book of 25

cheques.

◆ 17 months later, he issued his first cheque, but it **bounced**.

◆ Bank records showed **three cheques (₹19,500) were already withdrawn!**

◆ The customer **denied issuing the cheques.**

⚖️ **Verdict:**

✗ Bank was found guilty of fraud & negligence:

✗ **The cheques used were from a different cheque book (not issued to the customer).**

✗ The **bank's employees** were found involved in forgery.

✓ The bank was **ordered to repay the amount.**

✓ **Lesson:**

✓ Banks must track issued cheque books properly.

✓ Any **discrepancy in cheque issuance** = Red flag for potential fraud.

📊 **3. Summary: When is the Bank Protected?** 🏦 ✓ ✗

Case	Alteration Visible?	Bank's Action	Court Verdict
Bank of Maharashtra vs. Automotive Engg. (1993)	✗ No	No UV lamp check, but normal verification was done.	✓ Bank protected

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Brahma Shumshere Jung Bahadur vs. Chartered Bank (1956)	❌ No	Customer habitually used third-party handwriting.	✅ Bank protected
Tanjore Permanent Bank vs. Rangachari (1959)	✅ Yes	Bank failed to verify altered cheques.	❌ Bank liable
Bareilly Bank vs. Naval Kishore (1964)	✅ Yes	Bank allowed fraudulent cheque book usage.	❌ Bank liable

💡 4. Key Takeaways for Banks & Customers 💡

For Banks:

- ✅ Always check for alterations before clearing payments.
- ✅ If an alteration is visible, DO NOT process without authentication.
- ✅ Keep clear records of issued cheque books.
- ✅ Good faith & standard verification protects banks.
- ❌ Ignoring visible alterations = Liability for wrongful payment.

For Customers:

- ✓ Cross your cheques to prevent unauthorized cashing.
 - ✓ Do not issue blank signed cheques to anyone.
 - ✓ Monitor bank statements regularly for fraud.
 - ✓ Immediately report suspected fraudulent transactions.
-  Understanding these legal protections ensures safer banking for both banks & customers! 💰🔍

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Payment by Bank Under Mistake – Whether

Recoverable?

1 Legal Perspective on Mistaken Payment of a Forged Cheque

 **Case: United Bank of India vs. AT Ali Hussain & Co.**

(1978) - Calcutta HC

 **Facts of the Case:**

✓ A forged cheque of ₹75,000 was presented by the collecting bank to the paying bank.

✓ The paying bank cleared the cheque, as the forgery was so perfect that even a trained eye could not detect it.

✓ Later, upon discovering the forgery, the paying bank filed a suit against both:

⇒ The collecting bank (which presented the cheque).

⇒ The payee (who received the payment).

✓ The trial court dismissed the suit, stating the paying bank had no valid cause of action.

✓ The bank appealed to the High Court.

High Court Judgment: Is the Bank Entitled to Recover the Money?

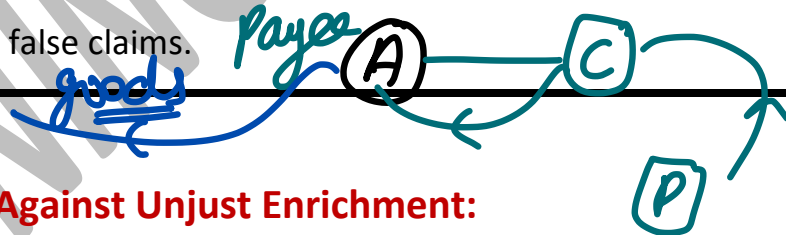
✗ Verdict: The Paying Bank Cannot Recover the Amount

✓ **Key Legal Principles Considered:**

#1 **Principle of Good Faith:** Both the collecting bank and the payee acted in good faith, with no knowledge of the forgery.

#2 **Doctrine of Estoppel:** Since the paying bank voluntarily paid the cheque, it cannot later claim it back.

- The **Doctrine of Estoppel** ensures fairness in cheque transactions.
- It **prevents fraudulent denials** by any party involved in cheque issuance, endorsement, or payment.
- **Banks, drawers, and holders** must act in **good faith**, or they risk being legally estopped from making false claims.



#3 **Equitable Principle Against Unjust Enrichment:**

- If the payee had retained the money without changing his position, he would have had to return it.
- **However, since the payee had already parted with goods in exchange for the payment, he cannot be held liable.**

The Mistake Was the Bank's Responsibility: Even though there was no negligence, **the burden of loss remains with the paying bank.**

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Judge's Conclusion:

👉 "If the payee has changed his position to his detriment by acting in good faith, he **cannot be made liable to return the money**. Since the payee did not unjustly enrich himself, he should not suffer the loss."

📌 3 When Can the Bank Recover the Mistaken Payment? 🏦💰✅

Scenario	Can the Bank Recover the Payment?	Reasoning
#1 Payee still holds the money (no change in position)	✅ Yes	The payee has not suffered any loss and must return the mistakenly received amount.
#2 Payee has parted with the money/goods in good faith	❌ No	The payee acted in good faith and was not unjustly enriched.
#3 Collecting bank was negligent in verifying the cheque	✅ Yes	If the collecting bank failed in its duty to verify the cheque, it may be held liable.
#4 Paying bank was negligent in verification	❌ No	The loss remains with the paying bank due to its mistake.

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4 Lessons for Banks: How to Prevent Such Losses?

#1 Implement Stronger Cheque Verification Measures

✓ Use **AI-powered fraud detection tools** to identify suspicious transactions.

Positive pay

✓ **Cross-check high-value cheques** with the drawer before clearing.

#2 Enhance Staff Training on Fraud Detection

✓ Train employees to recognize subtle signs of forgery.

✓ Use **multi-level verification** for large cheque clearances.

#3 Introduce Delayed Clearing for High-Value Cheques

✓ Allow a **mandatory waiting period** for high-value cheques to verify authenticity.

✓ Seek **customer confirmation** before finalizing large payments.

#4 Use Real-Time Cheque Authentication Systems

✓ Introduce **secure cheque scanning technology** to detect alterations.

✓ Verify **customer signatures electronically** rather than relying on manual checks.