

# **THE GROUNDS OF DISHONOUR OF CHEQUES – AN EXPOSITION**

By

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**The Delhi Judicial Academy recently (October, 05) published a compilation described as “Study Material on Section 138, Negotiable Instruments Act, 1881”. The compilation is divided into three parts preceded by a short preface. Part-I entitled “Introduction” contains the Essential Ingredients of Section 138 (N.I. Act for short hereafter) and the procedural requirements in a case thereunder. Part-II contains four articles previously published in the Journal of the Delhi Judicial Academy dealing with specific aspects of Section 138 of the N.I. Act. Part-III contains a list of cases under Section 138 decided by the Supreme Court and the High Court of Delhi. Part-I at page 7 and 8, the first two articles in Part-II at page 28 and 44 to 49 and Part-III at page 71 and 72, contain references both passing and detailed to “grounds of Dishonour of cheque”. A perusal of the entire compilation has been instructive. The references to the “grounds of dishonour of cheques”, however, appear to need further exploration and understanding. This need is the immediate encouragement for this writing, a sort of supplement to the references to the “grounds of dishonour of cheque” in the compilation indicated above. This writing focuses on only the said specific aspect of Section 138 of the N.I. Act.**

## **THE LAW**

**By Section 10 of the Negotiable Instruments Act, 1885, Chapter XVII dealing with Notaries Public was added to the N.I. Act. This chapter was repealed by the Notaries Act, 1952. By the Banking Public Financial Institutions and Negotiable Instruments Law (Amendment) Act, 1988 a new chapter XVII was added to the N.I. Act with effect from 01.04.1989. This chapter contained Section 138 to 142 and for the first time a penal provision was incorporated in a statute dealing with, Promissory Notes, Bills of exchange and Cheques. By the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act 2002 chapter XVII was further amended and presently with effect from 06.02.2003 this chapter contains Section 138 to 147 in addition to certain amendments to**

original Section 138 to 142. Despite these alterations and addition, the grounds of dishonour of cheques with which the present essay is concerned remained unaltered. The heading of the chapter XVII is "OF PENALTIES IN CASE OF DISHONOUR OF CERTAIN CHEQUES FOR INSUFFICIENCY OF FUNDS IN THE ACCOUNTS" The heading prefixed to Section 138 reads, "DISHONOUR OF CHEQUE FOR INSUFFICIENCY, ETC, OF FUNDS IN THE ACCOUNT." The crux of the provisions of Section 138 in so far as the purpose of the present writing is concerned reads thus :

"Where any cheque ..... is returned by the Bank unpaid, either because of the amount of money standing to the credit of that account is insufficient to honour the cheque or that it exceeds the amount arranged to be paid from that account by an agreement made with that Bank,....."

If one looks at any specimen of a Bank's slip or memo, indicated in Section 146 of the N.I. Act, returning the cheque after dishonour it would appear that the reason for dishonour listed in the memos are around forty in number. "Insufficiency of fund" and "exceeds arrangement" are only two among the reasons listed there. The Bank's memo is not a statutory document. The Memo may vary in its details from one Bank to another. Parliament on the other hand has statutorily listed only two reasons for dishonour which may sound in a prosecution under Section 138 of the N.I. Act. This apparent dichotomy in the law and Bank's slip has resulted in a flood of cases particularly in the High Court under Section 482 of the Code of Criminal Procedure either because the Magistrate relying on the Bank's slip refuses to issue process or because the Magistrate despite the Bank's slip not conforming the statutory provisions, issues process. In the former contingency the complainant reaches the High Court and in the latter the accused does likewise.

## THE INTERPRETATION OF THE LAW

### 1. THE VOICES FROM THE HIGH COURTS

The High Courts have spoken on the matter under examination in two distinct voices. One group of cases spoke for strict or literal construction of the provisions contained in Section 138 of N.I. Act as regards the reasons for dishonour. The reasoning runs like this. Section 138 creates an offence and a penal provision

as is well known should be construed strictly. The Legislature has consciously chosen two reasons out of several possible reasons for dishonour. Therefore the intention is to punish other ingredients being fulfilled, only if the cheque is returned because of one or the other of the two reasons pointedly mentioned in the Section. Above all the language of the provision in as much as it used the decisive expression "either or" clinches the matter in favour of strict construction.

A few of the decisions advocating strict construction may be noticed at this stage. Perhaps one of the earliest cases is the one from the Karnataka High Court. Reference is G.F. Hunasikathimath -Vs- State of Karnataka (1991) 1 Crimes 226 rendered by a Single Judge where the cheque was returned with the Bank's endorsement "Account closed". The Magistrate refused to issue process as according to him closure of account is not within the grounds indicated in Section 138 N.I. Act. The High Court moved under 482 Cr.P.C upheld the Magistrate's conclusion. As usual in the precedent bound judicial system of ours a few other High Courts followed the easy way of holding likewise because the Karnataka High Court held as above. Some of these decisions do not contain any other reason except the reason that the Karnataka High Court has held thus therefore I hold likewise. For the sake of brevity such judgments may be described as heldhold judgments. These "held hold" judgments variously dealt with endorsements such as "Account closed", "refer to drawer" and "stopped payment" in the Bank's slip. A common feature of these judgments is that all are Single Bench judgments rendered under Section 482 Cr.P.C. These judgments are -Prasanna -Vs- R. Vijaya Laxmi, 1992 Cr.L.J. 1233, from the Madras High Court; Bhageerathy -Vs- Beena 1992 Cr. L.J. 3946 from the Kerala High Court; Omprakash -Vs- Smti. Swati Girish Bhide (1992) 3 Crimes 306 from the Bombay High Court; M/s Union Roadways (P) Ltd. -Vs- M/s Shah Ramanlal Satesh Kumar (1992) 2 Crimes 215 from the Andhra Pradesh High Court and Abdul Samad -Vs- Satya Narayan Mahawar (1993) 76 Com Cas 241 from the Punjab and Haryana High Court.

Opposed to the above is the other group of decisions advocating purposive construction of the provision containing reasons for dishonour of a cheque. This view based on Mischief Rule has been expounded brilliantly by four Division Bench decisions of four different High Courts.

In THOMAS VARGHESE -VS- P. JEROME, 1992 Cr. L.J.3080 dated 05.06.1992 one can read the following :

" The rule of strict interpretation of penal statutes in favour of an accused is not of rigid or universal application. It must be considered alongwith other well established

rules of interpretation. When it is seen that the scheme and object of the statute are likely to be defeated by the strict interpretation, Courts must endeavour to resort to that interpretation which furthers the object of the legislation  
 .....

In this circumstance, we are not in a position to hold that a complaint under S.138 of the Act should be thrown out at the threshold if the banker's endorsement while returning the cheque is anything other than that the amount of money standing to the credit of the account of the drawer is insufficient to honour the cheque or that it exceeds the amount arranged to be paid from that account by an agreement made with the bank. If the circumstances contemplated by Section 138 of the Act are made out, the Court has to examine whether the return of the cheque was on account of insufficiency of funds belonging to the drawer. This can be done even without reference to the endorsement made by the banker. Endorsements like "refer to drawer", "account closed", "payment has been stopped", etc made by the banker at the time of the return of the cheque are having the effect of proving that the cheque has been bounced."

Next on 29.07.1992 a Division Bench of Bombay High Court decided **RAKESH NEMKUMAR PORWAL -VS- NARAYAN DHONDU JOGLEKAR**, 1993 CR.L.J. 680. In that case the Magistrate issued process in cases relating to cheques returned with the endorsement "refer to drawer, even though the complaint cases were filed before expiry of the 15 days notice period. The petition for quashing of the complaints succeeded on the ground that complaints were filed before expiry of the fifteen day notice period. Despite the fact that later decision of the Supreme Court namely **Narasingh Das Topadia AIR 2000 S.C. 1953** would not support this ground as well, of importance for the present purpose is the following statement of law in the Judgment :-

"18. A clear reading of the S. 138 leaves no doubt in our mind that the circumstances

under which such dishonour takes place are required to be totally ignored. In this case, the law only takes note of the fact that the payment has not been forthcoming and it matters little that any of the manifold reasons may have caused that situation.....  
.....  
.....  
.....

25 ..... The wording and the endorsement from the bank or the circumstances under which a cheque is returned are not the guiding criterion but the fact that on presentation of the cheque, the payment was not made .....”

The Division Bench Judgment of Andhra Pradesh High Court dated 30.09.1992, namely; M/S SYED RASOOL & SONS -VS- M/S AILDAS & COMPANY, 1992 CR.L.J 4048 dealt with a case of dishonour of cheques returned with the endorsement “refer to drawer”. The Division Bench refused to quash the complaints mainly on the ground that in banking parlance “refer to drawer” signifies insufficiency of funds. However, in reaching such a conclusion the Division Bench stressed the point that “words used by the bank in dishonour of cheque” are not important.

Perhaps the clearest statement of the law that the bank’s endorsement in returning the cheque is immaterial can be read in the Division Bench Judgment of the Madras High Court dated 19.10.1994 namely VEERARAGHAVAN -VS- LALITH KUMAR 1995 Cr.L.J 1882. The Judgment considered both the strict and liberal interpretation doctrines, drew largely on Rakesh Porwal (Supra) and Thomas Verghese (Supra) and then answered the point relating to grounds of dishonour thus :

“ 22..... We are, therefore, of the firm view that the reasons, as given by the bank for the return of the cheque may not at all reflect the reality of the situation relatable to the sufficiency or otherwise of the funds in the accounts of the drawer or whether it exceeds the amount arranged to be paid by the drawer by agreement with the bank.”

With regard to “what is necessary and requisite for a complaint to be taken cognizance of, in respect of an alleged offence under Section 138 of the Act”, the Division Bench listed the dishonour of the cheque whatever be the reason, the presentation within the period of validity, the non compliance with the notice demanding payment and institution of the complaint within one month of such non-compliance as the essentials. It further held thus:

“ Such being the case the non mentioning in the complaint by way of a specific averment made therein as to the insufficiency of funds in the account of the drawer, is of no consequence and the question whether there was sufficiency of funds or not in the account of the drawer on the date when the cheque had been drawn, will be relevant during the stage of trial and such question is capable of being decided, with ease and grace, by the Court on the adduction of evidence .....

Finally the Division Bench answered the questions centering round the reason for dishonour of cheques in these words :

“(i) It shall be competent for a Magistrate to take cognizance of a private complaint, when the return by the bank of the cheque bears endorsement of any of the contingencies or eventualities other than the one mentioned in Section 138 of the Negotiable Instruments Act.

(ii) Invoking the inherent power Under Section 482, Code of Criminal Procedure is not permissible to put an end to the prosecution, merely because the averments in the complaint as relatable to insufficiency of funds, not being specifically mentioned, especially when the details as to the factum of dishonour of a cheque, whatever be it reasons ..... Presentation within the period of validity or six months coupled with the non-compliance by the drawer of the demand made on him and institution of the prosecution within one month from such non-compliance are all specifically mentioned in the complaint.....”

It may now be seen what view the Supreme Court has chosen out of the two views exposed so far from the High Courts.

## 2. THE VOICES FROM THE SUPREME COURT

In so far reported cases go the Supreme Court has spoken on the matter at hand in nine cases till 20.11.2003 when GOA PLAST(P) LTD -VS- CHICO URSULA D'SOUZA, AIR 2004 S.C. 408 was decided. The earliest of these cases was decided on 22.01.1996. In this case, namely, ELECTRONICS TRADE & TECHNOLOGY DEVELOPMENT CORPORATION LTD. -VS- INDIAN TECHNOLOGISTS & ENGINEERS PVT. LTD., AIR 1996 S.C. 2339 the Supreme Court dealt with a Bank's Memo returning a cheque containing the endorsements "1. referred to drawer, 2. Instructions for stopping payment 3. exceeds arrangement." The complaint also contained the averment that the dishonest intention of the accused is evident from his conduct in instructing the Bank to stop payment. Further, that he has so instructed the Bank as he has no funds to his credit. Despite those averments the High Court quashed the complaint relying solely on the endorsements in the Bank's Memo. The Supreme Court held that endorsements like the three quoted above amounts to dishonour within the meaning of Section 138 of the Act. The Judgment also contains certain observations like "presumption of dishonest intention" and held that after issuing the cheque if drawer issued a notice to the payee not to present the cheque for encashment and yet the cheque was presented Section 138 would not be attracted. A later larger Bench of the Supreme Court, however overruled those observations and the said holding as not laying down correct law.

On 08.10.1996 another Two Judge Bench of the Supreme Court decided K.K. SIDHARTHAN -VS- T.P. PRAVEENA CHANDRAN (1996) 6 SCC 369. That again was a case dealing with the endorsement stopping payment. The High Court refused to quash the complaint but the Supreme Court relying on Electronic Trade (Supra), specially the observations later overruled by a Larger Bench already indicated, quashed the complaint. The Larger Bench Decision is considered in the next paragraph.

A Three Judge Bench of the Supreme Court decided MODI CEMENTS LTD. -VS- KUCHIL KUMAR NANDI AIR 1998 S.C. 1057 on 02.03.1998. Metropolitan Magistrate 11<sup>th</sup> Court Calcutta took cognizance of three complaints relating to three cheques returned unpaid by the bank with an endorsement "payment stopped by the drawer". After entering appearance in response to process issued by the Court the accused Kuchil Kumar Nandi filed three petitions under Section 482 Cr.P.C. in the High Court of Calcutta for quashing the complaints. The High Court quashed the three complaints on the grounds (1) that neither insufficiency of funds in the account nor exceeding of arrangement, which are necessary

ingredient of Section 138 of the Act having been pleaded cognizance could not have been taken (2) that the endorsement "payment stopped" being not an ingredient of the offence Under Section 138 of the Act cognizance could not have been taken on its basis.

The first of the above two reasons, however passed sub-silentio and the decision that quashing by the High Court was erroneous was based only on the second reason upholding the Electronics Trade (Supra) and K.K. Sidhartan (Supra) to the limited extent that endorsement "stop payment" is covered by Section 138 of the Act. It was firmly and clearly held that irrespective of the fact that the "stop payment" instructions to the Bank or "do not present now" notice to the holder is issued before presentation of the cheque, the instruction or information would be within Section 138. The observations in the two earlier Two Judge decision discussed above regarding presumption of dishonesty etc. were also firmly held to be not laying down correct law in these words :

"The aforesaid propositions in both these reported Judgments , in our considered view, with great respect are contrary to the spirit and object of Section 138 and 139 of the Act. If we are to accept this proposition it will make Section 138 a dead letter, for, by giving instructions to the bank to stop payment immediately after issuing a cheque against a debt or liability the drawer can easily get rid of the penal consequences notwithstanding that a deemed offence was committed.

The further observation in Electronic Trade (Supra) that the intention is to prevent dishonesty on the part of the drawer in drawing a cheque without sufficient funds in the account and that Section 138 draws presumption that one commits the offence if he issues the cheque dishonestly were criticized as not laying down the law correctly. The Judgment clarifies that sufficiency or otherwise of funds to honour the cheque would have to be judged as on the date of presentation or dishonour of the cheque and not on the date of its issue by the drawer. Section 138 of the Act, it says, gets attracted only when the cheque is dishonoured. There is no doubt that the Judgment supports purposive interpretation of Section 138 and not strict interpretation alluded to in the High Court Section of this writing. Incidentally, His Lordship S.P. Kurdukar, J. who constituted the Division Bench of the Bombay High Court in RAKESH NEM KUMAR PORWAL (Supra) spoke for the three Judge Bench of the Supreme Court.

Unlike the above referred three Judgments of the Supreme Court NEPC MICON LTD. -Vs- MAGMA LEASING LTD., AIR 1999 S.C. 1952 decided on 29.04.199 considered the two competing views emanating from High Courts indicated earlier. The Two Judge Bench of the Supreme Court impliedly approved Madras and Bombay Division Bench Judgments in VEERARAGHAVAN (supra) and RAKESH NEMKUMAR PORWAL (supra) and impliedly overruled G.F. HUNASIKATHIMATH (supra), PRASANNA (supra) and OMPRAKASH (supra). The accused there as usual reached the High Court under Section 482 Cr. P.C. and on being rebuffed by the High Court took the matter to the Supreme Court. The cheque there was returned by the banker of the accused person with the endorsement "account closed". The Judgment relying on the Mischief Rule expounded in Heydon's case 76 ER 637 held that "even with regard to penal provision any interpretation, which withdraws the life and blood of the provision and makes it ineffective and a dead letter should be averted". It also held that the real meaning of the phrase "account closed" is that the amount standing at the credit of that account is nil on the relevant date which is another way of saying that funds are not sufficient to honour the cheque. The Supreme Court also held that "reading Section 138 and 140 together, it would be clear that dishonour of the cheque by a bank on the ground that the account is closed would be covered by the phrase "the amount of money standing to the credit of that account is insufficient to honour the cheque. Incidentally His Lordship K.T. Thomas, J. who formed the Division Bench of the Kerala High Court in THOMAS VARGHESE (supra) happened to be one of the Judges of the Two Judge Bench of the Supreme Court in this case.

In M/S M.M.T.C. LTD. -VS- M/S MEDCHL CHEMICALS, AIR 2002 S.C. 182 decided on 19.11.2001 the Supreme Court throws further light on the problem while dealing with a case of dishonour of cheques with the endorsement "payment stopped by the drawer" Two complaints for offences under Section 138 of the Act were quashed by the High Court. Besides the ground relating to the endorsement as above two other grounds which found favour with the High Court were (1) that the complainant being a Corporate Body proper authority did not file them and as such they were not maintainable, (2) that complaints lacked necessary averments regarding debt or liability and the absence of such vital allegations impairs the maintainability. The Supreme Court rejected all three grounds as above. On the ground with which this writing is concerned relying on MODI CEMENTS (supra) rather further explaining the said three Judge decision the Supreme Court held thus:-

"It has been held that even though the cheque is dishonoured by reason of "stop

payment” instruction an offence under Section 138 could still be made out. It is held that presumption under Section 139 is attracted in such a case also. The authority shows that even when the cheque is dishonoured by reason of stop payment instructions by virtue of Section 139 the Court has to presume that the cheque was received by the holder for the discharge in whole or in part, of any debt or liability. Of course this is a rebuttable presumption. The accused can thus show that the stop payment instruction were not issued because of insufficiency or paucity of funds. If the accused shown that in his account there was sufficient funds to clear the amount of the cheque at the time of presentation of the cheque for encashment at the drawer bank and that the stop payment notice had been issued because of other valid causes including that there was no existing debt or liability at the time of presentation of the cheque for encashment, then offence under Section 138 would not be made out. (*Underlining supplied*).

**GOA PLAST PVT. LTD -VS- CHICO URSULA D'SOUZA**  
**AIR 2003 S.C. 2035** decided on 07.03.2003 dealt with the same problem in relation to a post dated cheque afflicted with a stop payment instruction issued before the due date. The High Court quashed the complaint. The Supreme Court reiterating the position of law indicated in the earlier Judgments reversed the Order. After full trial GOA PLAST (supra) again reached Supreme Court in AIR 2004 S.C. 408 decided on 20.11.2003. In this case also the legal position expounded in MODI CEMENTS (supra) M.M.T.C. (supra) in so far the matter at hand is concerned has been reiterated and the order of acquittal passed by the trial Court and confirmed by the High Court had been set aside.

The other two Supreme Court decisions completing the group of nine indicated earlier have been left to the end for two different reasons. **BHUPENDRA -VS- PRITHVIRAJ 1999 (1) SCALE 15** decided on 15.01.199 only reiterates the legal position that Bank's endorsement of “payment stopped” is sufficient to take cognizance. The full report of the Judgment could not be perused.

**VINOD TANNA -VS- ZAHER SIDDIQUE (2002)7 SCC 541** decided on 17.09.2001 has been kept to the last because the

Judgment does not appear to be in consonance with the other eight Supreme Court cases and the four Division Bench Judgments from the High Courts considering hereinabove. What can be gathered from the barest outline of the facts in that case is that the cheque was dishonoured on the ground of drawer's signature being incomplete. The High Court refused to quash the complaint relying on MODI CEMENTS (supra). In the Supreme Court the counsel for the accused contended that the High Court failed to appreciate the ratio in MODI CEMENTS (supra) wherein the Three Judge Bench expressed complete agreement with the legal proposition enunciated in Electronics Trade (Supra) and K.K. Sidharthan (supra). However, it is factually incorrect to say that in these two cases cheques were dishonoured for "insufficiency of funds" Both were cases dealing with "stop payment" endorsement. In the narrow sense that Modi Cements (supra) dealt only with "stop payment" endorsement and as such cannot rule the case relating to an endorsement reading "signature incomplete" or "signature does not tally" or "dates overwritten" etc. which have been described as "structural defects" in the cheque may be true. This will amount to going back to the voice of the strict constructionists and not the voice of the purposive constructionist ringing loud and clear in the four Division Bench Judgments from the High Courts and the Supreme Court Judgments beginning at least from MODI CEMENTS (supra) to GOA PLAST (P) LTD.(Supra). VINOD TANNA (supra) appears to reason that reliance on Modi Cements (supra) is wrong therefore the complaint has to be quashed. There is no ratio discernible for holding that endorsement incomplete signature will not be covered by Section 138 at the stage of taking cognizance. In the report there is no mention of any counsel for the complainant who expectedly would have placed NEPC MICON (supra) which is a further development on MODI CEMENTS (supra) and which impliedly approved the Division Bench Judgments of Bombay and Madras High Courts already discussed. Because of absence of any counter argument on behalf of the complainant an opportunity to clarify the law further appears to have been missed in this Judgment.

#### THE SUMMING UP

In the light of what has been narrated above a statement of the law as regards grounds of dishonour of cheque in Section 138 of the N.I. Act may be as follows :-

“(1) At the stage of taking cognizance the Magistrate need not at all be influenced by the endorsement in the Bank's slip or Memo.

(2) Irrespective of the endorsement if at the trial it is proved that on the date of presentation of the cheque for encashment the drawer had sufficient money to honour the cheque or it did not exceed arrangement the accused cannot be convicted for an offence under Section 138 although he may be guilty of other offences such as under Section 420 of the penal code. Similarly, if it is proved at the trial that on the relevant date the drawer had no sufficient fund in the account to honour the cheque even if the Bank's endorsement shows a ground other than the two mentioned in Section 138 such as even a "structural defect" the drawer will fall foul of the penal provision.

(3) Logically it follows that quashing of a complaint merely on the ground of absence of averments regarding the grounds of dishonour as indicated in Section 138 or merely relying on the grounds mentioned in the Bank's Memo returning the cheque will be illegal.

(4) Mens rea is not an ingredient of the offence created under Section 138 of the N.I. Act. Therefore even at the trial stage whether the endorsement like stop payment, account closed and structural defects in the cheque came to be made dishonestly or through an honest mistake is not a relevant factor.

Incidentally the phrase "structural defect" coined in **BABULAL NAINMAL JAIN -Vs- KHIMJI RATANSHI DEDHIA** 1998 Cr. L.J. 4750 (Bombay) where the Magistrate took cognizance of a complaint relating to a cheque returned by the bank with an endorsement "refer to drawer" was quashed by the High Court because of so called "structural defect" will fly in the face of the Division Bench Judgment of the Bombay High Court besides those of the Supreme Court considered earlier.

It may be stated here that the statement in the middle extracts from **VEERARAGHVAN** (supra) as regards the relevant date for determining insufficiency or otherwise of funds in the drawer's account has been overruled in **MODI CEMENTS** (supra) which

**clarified that the relevant date is the date of presentation of the cheque for encashment and not the date of drawing of the cheque.**

**To end this writing a final comment having some bearing on public policy seems apposite. Much of the litigation centering round grounds of dishonour of cheques could possibly be lessened either through Legislation or by the Reserve Bank acting Under Section 35-A of the Banking Regulation Act, 1949. Legislation may provide for mandatory mention of either of the two grounds of dishonour indicated in Section 138 in addition to other grounds emanating from the drawer's action. The Reserve Bank may issue similar suitable directions as regards the content of the Bank's memo returning a cheque on dishonour. Untill then conflicting voices on the point will continue.**