

## Quadrant II – Transcript and Related Materials

**Paper Code: COG111**

**Module Name: Obligations of the Bank**

**Module No: 3**

---

### Notes

#### OBLIGATIONS OF THE BANK

##### 1. Obligation to honour cheques

Accepting of deposits of money from the public is one of the essential functions of a banker according to the definition of banking as given in the Banking Regulation Act, 1949. The bulk of the resources of the banks are mobilized by accepting deposits from the public. The most important statutory obligation of the banker is to honour the cheques drawn by the customers against their respective accounts. It is the duty of the banker to refund the money deposited by the customer whenever he (customer) demands by issuing cheques either in his own favour or in favour of third parties.

It is clearly mentioned in section 5 (b) of the Banking Regulation Act, 1949, that banking means “acceptance for the purpose of lending or investment of deposits of money from the public, repayable on demand or otherwise and withdrawable by cheques, draft, order or otherwise.” Accordingly, banking business implies the receipt of deposits repayable on demand.

By opening a current account in the name of a customer the bank undertakes to honour cheques drawn by a customer, so long as the latter’s balance is sufficient, cheques are in proper form and are presented in a reasonable time. The banker has also such an obligation even if there is not sufficient money to the credit of the customer if the customer has obtained an overdraft facility covering the amount of the cheque. According to practice, banks do not honour cheques presented six months after their ostensible date of issue. Such cheques are called ‘stale cheques’.

The obligation of the banker to honour the cheques of the customer is a statutory obligation. Section 31 of the Negotiable Instruments Act reads as follows:

(i) The drawee of cheque, having sufficient funds of the drawer in his hands, required properly applicable to the payment of cheque, must pay the cheque duly required, to do so and in default of such payment he must compensate the drawer for any loss or damage, caused by such default.

(ii) This obligation may be extended by an agreement, express or implied to the amount of overdraft agreed upon. In the absence of an overdraft arrangement, the banker can dishonour the customer's cheque if there is no credit balance in favour of the customer, or if it is not sufficient to meet the cheque. The banker need not make a part payment of the cheque presented to him for payment (to the extent of the balance available); he can dishonour the cheque in its entirety.

(iii) Sometimes a customer may deposit cheque and bills for collection and credit to his account. He may draw a cheque on the banker in anticipation of such collection. The banker is not bound to honour the customer's cheque, if the customer's cheque and bills are not realised by the time the cheque is presented for payment. The banker must take reasonable time for crediting the funds before they can be drawn against.

**Garnishee Order:** The banker's obligation to honour a customer's cheques is extinguished on receipt of a court order known as the Garnishee order which is under order 21, Rule 46 of the Code of Civil Procedure, 1908.

Garnishee order is a judicial decree passed by a competent court on the banker. directing him to withhold or suspend payment of any money belonging to a debtor who may be found to have defaulted in satisfying the debts owing to his creditor. The creditor for whom it is issued is called 'judgement creditor, the debtor is called 'judgement debtor' and the third party on whom order is issued is called as 'Garnishee'.

**This order is issued in two parts:**

(a) The court directs the banker to stop payment out of the account of the judgement debtor. It is an order called 'Order Nisi' seeking explanation from the banker as to why the funds in the said account should not be utilised for meeting the judgement creditors' claim.

(0) After the banker files his explanation, if any, the court issues the final order called 'Order Absolute' whereby the funds in the account are attached to be handed over to the judgement creditor.

Thus it is an order by the court served on a third party known as Garnishee directing him not to release any money due to the judgement debtor as the amount is attached by the court.

**Effects of Garnishee Order:** When Garnishee order is issued, the following will be the effect on the banker:

(i) The banker has to suspend operation of the account of the judgement debtor.

(ii) The cheques drawn by the judgement debtor on the Garnishee account should not be honoured after the order is issued on the bank.

(iii) When the order is made absolute, the balance available should be made over to the judgement creditor as per the direction of the court. If the customer's balance is not sufficient to cover the dues, then the banker has to pay whatever is available on the judgement debtor's account.

(iv) It restrains the banker from paying the debts due or occurring due (i.e. current account as

well as fixed deposit account).

(v) The suspended account of the judgement debtor may be revived after payment has been made to the judgement creditors as per the direction of the court.

Thus on receipt of such an order, the banker is bound to pay the funds to the judgement creditors and his liability towards his customer is thus discharged. The banker is prohibited from paying amount due on the date of receipt of the Order Nisi.

**Non-appliance of Garnishee order:** The Garnishee Order is not binding upon the banker in the following cases:

(i) When the banker proves that judgement debtor identified as quoted in the order is doubtful.

(ii) When the judgement debtor's account with the banker is overdrawn and unused portion of the cash credit.

(iii) if the account of the judgement debtor is previously assigned to a third party and the banker has a due notice of it.

(iv) If the banker himself is entitled to a 'set-off' a debt due from the judgement debtors, then the banker is to be given the prior right to recover his dues.

(v) When the judgement debtor holds funds in trust and the banker is aware of this fact.

(vi) Joint account in the name of the judgement debtor and any other person cannot be attached in respect of a debt due from the judgement debtor alone. . .

(vii) In case of funds coming into the banker's hands subsequent to receipt of the Garnishee order, they are not attached.

(viii) In the case of a firm's account it is not attached by Garnishee order provided the order is issued against only one of the partners.

Thus the obligation of a banker to honour his customer's cheque is extinguished on receipt of a Garnishee order issued by the court under code of civil procedure.

### **Consequences of wrongful Dishonours:**

(1) A banker has the statutory obligation to honour his customer's cheques unless there are valid reasons for refusing payment of the same. In case the banker dishonours the cheque intentionally or by mistake, he is liable to compensate the customer for the loss suffered by him. According to Section 31 of the Negotiable Instruments Act, 1881, the words "Loss or damage" do not mean only pecuniary loss, but also a loss of credit or injury to reputation.

Thus, it is to be noted that the banker is liable to compensate the drawer not only for the actual monetary loss suffered by him but also for the loss of his credit or injury to reputation. It is more significant and it is the foundation on which his business depends. Therefore, he is entitled to claim not only the general damages, but substantial damages for such loss or

damage suffered by him.

(2) Without appropriate reasons if a customer's cheque is dishonoured by a banker, he incurs the liability of paying damages for affecting adversely the customer's credit and goodwill. A customer has every right to claim substantial damages from a banker where he can prove in a court of law that his reputation has been spoiled even where he has not incurred monetary loss. The compensation payable need not have any relation to the amount of the cheque. On the other hand, the smaller the amount of the cheque dishonoured, the larger may be the compensation payable by a banker. In assessing the damage, the court will take into consideration various factors like financial positions, business reputation of the customer, custom of the trade in which he is engaged, etc.

**Conditions to honour cheques:** Thus, the banker is bound to honour his customer's cheques provided the following conditions are fulfilled:

- (a) There must be sufficient funds of the drawer in the hands of the bank.
- (b) The funds must be properly applicable to the payment of the cheque i.e., if some funds are earmarked by the customer for some specific purpose, the said funds are available for honouring his cheques issued for such purposes.
- (c) The banker must be duly required to pay. This means that the cheque must be presented before the banker at proper time, i.e., within a period of six months from the date of issue.
- (d) A banker is not bound to credit his customer's account with the amount of cheques or drafts drawn upon other banks, sent in for collection, before they are realized. The amount must, however, be credited to the customer's account with a reasonable time after realisation. The question what constitutes a reasonable time depends upon the circumstances in each case.
- (e) There is no legal cause (ex. service of a Garnishee Order) which makes the credit balance or the agreed overdrafts limit unavailable.
- (f) They are presented during banking hours.

Therefore, for wrongful dishonour of cheques, the defaulting banker will be liable for the damages as under:

1. If a customer is a trader or businessman, he is entitled to claim heavy and Substantial compensation for the damage done to his credit as a result of wrongful dishonour of cheques. It was decided in the case of Roline vs. Steward. He need not prove that he has actually sustained loss or credit standing has been adversely affected, because damage to reputation follows as a matter of course, when the customer is in trade or business.

2. In case of a customer who is a non-trader, the actual damages caused to his reputation must be proved to support the claim for compensation. The court may ask the banker to pay nominal or reasonable damages to the non-trading customer on the merits of each case (Gibbons vs. Westminster Bank Ltd.).

3. Even if cheques were dishonoured due to oversight or inadvertent errors on the part of bankers, substantial damages are to be paid to the customers in business (Roline vs. Steward).

4. Even if the cheque is for small amount, its wrongful dishonour may entail award of heavy damages (Davidson vs. Barclays Bank).

5. If it is proved that the customer concerned has nothing to lose either in financial terms or in form of credit status, then the banker may escape the liability.

Thus, if a banker dishonours cheque without proper grounds, the customer can claim damages for the injury caused to his credit. The amount of compensation is fixed by the amount of loss or damage suffered by the customer owing to such dishonour.

## **2. Obligation to maintain Secrecy:**

Another special feature of the relationship between the banker and customer is that the banker should not, except on reasonable and proper occasions, disclose matters relating to the customer's account. This restriction is imposed because the disclosure of customer's financial position may do considerable damage to his credit standing and business reputation. This obligation to maintain secrecy was judiciously recognised only in 1924 in the case of *Tousier vs. National Provincial Bank of England*. According to that decision, a banker should not disclose the condition of his customer's account except on reasonable and proper occasions. This obligation does not cease even after the customer's account is closed.

What is to be regarded as a reasonable and a proper occasion is a matter to be answered. Instances of proper occasions are disclosing the state of affairs to a proposed guarantor or under the compulsions of law. In case an overdraft is guaranteed, it would be appropriate that the guarantor has a right to be informed of the extent of his liability and the banker has every right to disclose to him the condition of the customer's account so far as it is necessary for the purpose. In the case of *Robshan vs. Smith (1878)*, it was considered as an uncodified duty of a banker to answer the queries relating to his customer's general position and character, when asked by a person who is contemplating business relations with that customer.

But the legal sanction has been provided under section 13 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970. It orders the nationalized banks to observe (except as otherwise required by law) the practices and usages customary amongst bankers, and in particular not to divulge any information. This duty, according to Sir John Paget, exists not only during the existence of the customer's account but also after the customer's death; it is immaterial whether the account is in debit or credit.

Disclosure of information: According to section 13 of the Banking Companies Act, the duty of maintaining secrecy may be dispensed with under two circumstances. They are:

(1) Statutory necessity and (2) Bankers practices and usages. In *Tousier's* case it was agreed that the duty is not absolutely qualified, but it was asserted that the duty is a legal one 'arising out of contract'. Hence the banker will not be liable for disclosing his customer's account in reasonable and proper occasions. The learned judge in the above mentioned case has classified the 'occasions' under four heads:

- (a) Disclosure under compulsion of law.
- (b) Where there is duty to the public to disclose.
- (c) Where the interest of the bank required disclosure.
- (d) Where the disclosure is made by the express or implied consent of the customer.

**(a) Disclosure under compulsion of law:**

A banker is obliged to disclose particulars of his customer's account when he is compelled by court to do so. There are also provisions under the various other statutes which provide for similar powers as are vested in a civil court when trying a suit in respect of (i) discovery and inspection; (ii) enforcing the attendance of any person including any officer of a bank and examining-him on oath; (iii) compelling the production of books of accounts and other documents, and (iv) issuing commissions.

It is the duty of banker to disclose information relating to his customer's account when the law compels him to do so.

**(b) Disclosure as duty to the public:**

A bank is also justified in disclosing its customer's affairs on the ground of 'duty to the public'. The banker may disclose his customer's account to prevent frauds and crimes, for example, if a customer is trading with enemy country during times of war, the banker is justified in disclosing this in the interests of the state. Thus, in the following situations the banker can disclose the information in the interest of general public:

- (i) His customer is engaging in the prohibited trading activity.
- (ii) In case of breach of faith to the state.
- (iii) His customer is having dealings with enemy countries.
- (iv) His customer is violating the provisions of any law.
- (v) His customer is receiving sizeable funds from a foreign country.

Thus in the abovementioned situations the banker must report to the Government and furnish necessary information in public interest.

**(c) Disclosure on own interest of banks:**

A banker will not make himself liable if he discloses the customer's account to protect his own interest.

- (i) When a customer fails to pay money due to the bank, the banker has to file a suit for recovery of the debt. In such a case he has to reveal the state of the customer's account to the guarantor.
- (ii) If the banker has to recover the dues from the customer or the guarantor, disclosure of necessary facts to the solicitors or guarantor becomes necessary and is justified.
- (iii) The interest of the bank will involve disclosure of details of the customer's account particularly when there is a litigation between the two. When a banker makes a claim or brings an action against a third party (for example, a guarantor) disclosure is inevitable.
- (iv) A case on the point of banker's right to disclose was well brought out in *Sunderland vs. Barclays Bank Ltd.* Mrs. Sunderland issued a cheque on Barclays Bank in favour of a dress maker. The cheque was returned alleging lack of funds. The real reason was that she issued a cheque to a bookmaker which was honoured by the bankers. She complained about the dishonour of the cheque issued in favour of the dress maker i.e., to her husband. He directed her to take up the matter with the bank. She phoned up to the Manager. During the conversation Mr. Sunderland interfered. The Manager informed him that the cheques drawn in her account were in favour of book-makers. Mrs. Sunderland brought an action against the bank. She stated that the bank was responsible for breach of duty in disclosing her account to her husband without her consent. The judge opined that the interest of the bank required disclosure and that disclosure was made with the implied consent of the customer. The Manager was right in thinking that the wife had no objection in explaining to the satisfaction of her husband.

**(d) Disclosure on express or implied consent of the customer:**

In case where a customer expressly authorises his bank to disclose his account to a third party, he may do so. A common instance is that where a customer gives a banker's reference, when the customer introduces a person to the bank as the proposed guarantor, the banker cannot be penalised for answering surety's questions. The banker gets an implied authority to disclose his customer's affairs.

‘When the customer gives the name of his banker to other businessman for the purpose of trade reference, the banker will be justified in giving answer to the reference made because an implied consent of the customer for such disclosure is presumed to exist in such cases.

In case the customer directs the banker in writing to intimate the balance in his account to his agent or employee, the banker would be justified in furnishing to such person, of course, the required information and no more.

In certain circumstances the implied consent of the customer permits the banker to reveal the condition of the customer's account to a person who guarantees the loan taken by the customer. Implied condition should not be taken for granted in all cases even where the customer and the enquirer happen to be husband and wife.

Trade Reference : The customer may himself give the name of his banker as reference to a third party. The banker can answer all such references.

### **3. Obligation of immediate credit of outstation cheques**

The present ceiling of Rs.7, 500/- has been enhanced to Rs.15, 000/- for immediate credit of outstation / local cheques subject to the extant guidelines issued by the Reserve Bank of India from time to time.

Banks are required to observe the following guidelines for affording immediate credit in respect of outstation/ local cheques tendered for collection by their customers:

- (i) Normal collection charges may be recovered in case of outstation cheques and a charge of Rs.5/- may be recovered for local cheques.
- (ii) The bank should be satisfied about the proper conduct of the account of customer.
- (iii) The bank may extend the facility to all individual depositors without making a distinction about their status, i.e. Savings Bank, Current or Cash Credit Account.
- (iv) The banks should not lay any separate stipulation for minimum balance for extending the facility.
- (v) The facility is also to be allowed to the customers at the bank's Extension Counters subject to the usual precautions taken by banks in this regard.
- (vi) While immediate credit of cheque will amount to grant of advance, non-charging of interest on such cheque of the face value upto Rs.15, 000/- will not be viewed as violation of Reserve Bank of India's directive on interest rates on advances.
- (vii) In case where the instrument of face value exceeding Rs.15, 000/- is received for clearing and the proceeds of the instrument are credited to the account, in whatever manner, in advance of the date of actual realization of the amount, interest at the stipulated rate (in addition to the usual service charges prescribed by the bank), shall also be charged for the period for which outlay of funds is involved.
- (viii) In the event of the cheque being returned unpaid, the bank can recover interest in conformity with the applicable interest rate directive of Reserve Bank of India for the period the bank is out of funds. a. No interest is to be charged to the customer for the period between the date of credit of the outstation cheque lodged and its return. b. Banks may charge interest from the date of return of the cheque till the reimbursement of money to the bank. c. Where the cheque is credited to a savings bank account, no interest will be payable on the amount so credited if the cheque is returned unpaid.

(ix) The banks may consider introducing different pay-in-slips superimposing a notice to the effect that in the event of dishonour of the cheque, the customer will have to pay interest for the period the bank is out of funds at the normal rate.

(x) A notice regarding the availability of facility should be prominently displayed at each branch.