**Chapter Four**

**Paying and Collecting Banker**

Learning Objectives: After studying this lesson, students will be able to:

* Explain the duties and responsibilities of paying banker
* Explain the duties and responsibilities of collecting banker
* Describe the holder and holder in due course

**4.1 Duties and Responsibilities of Paying Banker**

The relationship between a banker and a customer is primarily that of debtor and creditor, the respective positions being determined by the existing state of account. If the customer has a credit balance with the bank, he is the creditor and if he has a debit balance with the bank, he is the debtor of the bank. Thus, bank does not work as a trustee of money deposited with it by the customer because, instead of money being set apart in a safe room, it is replaced by a debt due from the bank. When a bank accepts the deposits from a customer, it becomes the debtor of the customer and it will be bound to return the equivalent amount to the customer or his order on demand. In other words, it is the obligation of the bank to honor the cheques issued by the customer if the following conditions are fulfilled:

(a) There is sufficient balance in the account of the customer;

(b) The cheque is properly drawn and presented; and

(c) There is no legal restriction on payment.

The banker who is liable to pay the value of a cheque of a customer as per the contract, when the amount is due from him to the customer is called “Paying Banker” or “Drawee Bank.” The payment to be made by him has arisen due to the contractual obligation. He is also called drawee bank as the cheque is drawn on him.

While making payment he should be cautious. He cannot honor the cheque when sufficient funds are not available at the credit of the customer. If he pays by oversight he will be running the risk of making good this loss i.e., making payment without having sufficient funds. At the same time he will also run the risk when he dishonors cheque even when sufficient funds are available at the credit of the customer. He is liable for damages for this wrongful dishonor. Thus in both the cases he runs the risk. However, the customer should present the cheque at the branch where the amount is kept and should not raise any objection if the cheque is dishonored at branches where the customer does not hold the account. But he is at liberty to open accounts in any number of branches and can draw cheques, when he is having sufficient funds in each account.

**Precautions**

The banker’s duty to pay customer’s cheques is delicate and hence, to be handled judiciously as well as cautiously. The banker has to take the following precautions while honouring the cheques of his customers:

1. **Proper Form:** A banker should see whether the cheque is in the proper form. That means the cheque should be in the manner prescribed under the provisions of the commercial code. It should not contain any condition.

2. **Open or Crossed Cheque:** The most important precaution that a banker should take is about crossed cheques. A banker has to verify whether the cheque is open or crossed. He should not pay cash across the counter in respect of crossed cheques. If the cheque is a crossed one, he should see whether it is a general crossing or special crossing. If it is a general crossing, the holder must be asked to present the cheque through some banker. It should be paid to a banker. If the cheque bears a special crossing, the banker should pay only the bank whose name is mentioned in then crossing. If it is an open cheque, a banker can pay cash to the payee or the holder across the counter. If the banker pays against the instructions as indicated above, he is liable to pay the amount to the true owner for any loss sustained. Further, a banker loses statutory protection in case of forged endorsement.

For example, Madras Bank Ltd. Vs South India Match Factory Ltd., a cheque was issued by a purchaser in favour of the official liquidator of a company towards the purchase price of certain properties. The bank paid the amount of the crossed cheque to the liquidator across the counter. The liquidator mis-appropriated the amount. The court held that the banker committed breach of statutory duty and was negligent in paying direct to the liquidator over the counter and hence, was not entitled to legal protection.

If it is a ‘Not Negotiable’ crossing, the paying banker has to verify the genuineness of all the endorsements. If it is an ‘Account Payee’ crossing, the banker can credit the account of the payee named in the cheque and not that of any other person.

3. **Place of Presentment of Cheque:** A banker can honour the cheques provided it is presented with that branch of the bank where the drawer has an account. If the cheque is presented at another branch of the same bank, it should not be honoured unless special arrangements are made by the customer in advance. The reasons are:

(a) A banker undertakes to pay cheques only at the branch where the account is kept.

(b) The specimen signature of the customer will be with the office of the bank at which he has an account.

(c) It is not possible for other branches to know that the customer has adequate balance to meet the cheque.

Bank of India Vs Official Liquidator: In this case, it was held that if customer has an account in a bank which has several branches, the branches at which he has no account are justified in refusing to honour his cheques.

4. **Date of the Cheque:** The paying banker has to see the date of the cheque. It must be properly dated. It should not be either a post-dated cheque or a stale-cheque. If a cheque carries a future date, it becomes a post-dated cheque. If the cheque is presented on the date mentioned in the cheque, the banker need not have any objection to honour it. If the banker honours a cheque before the date mentioned in the cheque, he loses statutory protection. If the drawer dies or becomes insolvent or countermands payment before the date of the cheque, he will lose the amount. The undated cheques are usually not honoured.

A stale cheque is one which has been in circulation for an unreasonably long period.

The custom of bankers in this respect varies. Generally, a cheque is considered stale when it has been in circulation for more than six months. Banker does not honour such cheques. However, banker may get confirmation from the drawer and honour cheques which are in circulation for a long time. So, verification of date is very important.

5. **Mutilated Cheque:** The banker should be careful when mutilated cheques are presented for payment. A cheque is said to be mutilated when it has been cut or torn, or when a part of it is missing. Mutilation may be either accidental or intentional.

If it is accidental, the banker should get the drawer’s confirmation before honouring it. If it is intentional, he should refuse payment. The cheque is to be returned with a remark ‘Mutilated cheque’ or ‘Mutilation Requires Confirmation’. In Scholey Vs Ramsbottom, the banker was held liable for wrong payment of a cheque which was dirty and bore visible marks of mutilation.”

6. **Words and Figures:** The amount of the cheque should be expressed in words, or in words and figures, which should agree with each other. When the amount in words and figures differ, the banker should refuse payment. However, there is difference between the amount in words and figures; the amount in words is the amount payable. If the banker returns the cheque, he should make a remark ‘amount in words and figures differ.

7. **Alterations and Overwritings:** The banker should see whether there is any alteration or over-writing on the cheque. If there is any alteration, it should be confirmed by the drawer by putting his full signature. The banker should not pay a cheque containing material alteration without confirmation by the drawer. The banker is expected to exercise reasonable care for the detection of such alterations.

Otherwise, he has to take risk. Material alterations make a cheque void.

8. **Proper Endorsements:** Cheques must be properly endorsed. In the case of bearer cheque, endorsement is not necessary legally. In the case of an order cheque, endorsement is necessary. A bearer cheque always remains a bearer cheque. The paying banker should examine all the endorsements on the cheque before making payment. They must be regular. But it is not the duty of the paying banker to verify the genuineness of the endorsements, unless the cheque bears ‘Not-Negotiable’ crossing. He is not expected to know the signatures of all payees. So he gets statutory protection in case of forged endorsements. In India, even in the case of bearer cheques, bankers insist on endorsement though it is not required.

9. **Sufficiency of Funds:** The banker should see whether the credit balance in the customer’s account is sufficient to pay the cheque or not. If there is an overdraft agreement, he should see that the limit is not exceeded. The banker should not make part-payment of the cheque. He should pay either full amount or refuse payment. In case of insufficiency of funds, the banker should return the cheque with the remark ‘No Funds’ or ‘Not Sufficient Funds’.

10. **Verification of Drawer’s Signature:** The banker takes specimen signatures of his customers’ at the time of opening the account. He should compare the drawer’s signature on the cheque with the specimen signature of the customer. He should carefully examine the signature to find out whether the drawer’s signature is forged or not. If there is any difference or doubt, he should not honour the cheque. He should get the confirmation of the drawer. If there is forgery and there is negligence on the part of the banker to detect the same, there is no protection to the banker.

**4.2 Duties and Responsibilities of Collecting Banker**

The duties and responsibilities of a collecting banker are discussed below:

1. **Due Care and Diligence in the Collection of Cheques:** The collecting banker is bound to show due care and diligence in the collection of cheques presented to him.

In case a cheque is entrusted with the banker for collection, he is expected to show it to the drawee banker within a reasonable time. A cheque is not presented for payment within a reasonable time of its issue, and the drawer or person in whose account it is drawn had the right, at the time when presentment ought to have been made, as between himself and the banker, to have the cheque paid and suffers actual damage, through the delay, he is discharged to the extent of such damage, that is to say, to the extent to which such drawer or person is a creditor of the banker to a large amount than he would have been if such cheque had been paid.

In case a collecting banker does not present the cheque for collection through proper channel within a reasonable time, the customer may suffer loss. In case the collecting banker and the paying banker are in the same bank or where the collecting branch is also the drawee branch, in such a case the collecting banker should present the cheque by the next day. In case the cheque is drawn on a bank in another place, it should be presented on the day after receipt.

2. **Serving Notice of Dishonor:** When the cheque is dishonored, the collecting banker is bound to give notice of the same to his customer within a reasonable time. It may be noted here, when a cheque is returned for confirmation of endorsement, notice must be sent to his customer. If he fails to give such a notice, the collecting banker will be liable to the customer for any loss that the customer may have suffered on account of such failure.

Whereas a cheque is returned by the drawee banker for confirmation of endorsement, it is not called dishonor. But in such a case, notice must be given to the customer. In the absence of such a notice, if the cheque is returned for the second time and the customer suffers a loss, the collecting banker will be liable for the loss.

3. **Agent for Collection:** In case a cheque is drawn on a place where the banker is not a member of the ‘clearing-house’, he may employ another banker who is a member of the clearing-house for the purpose of collecting the cheque. In such a case the banker becomes a substituted agent. An agent, holding an express or implied authority to name another person to act in the business of the agency has accordingly named another person, such a person is a substituted agent. Such an agent shall be taken as the agent of a principal for such part of the work as is entrusted to him.

4. **Remittance of Proceeds to the Customer:** In case a collecting banker has realized the cheque, he should pay the proceeds to the customer as per his (customer’s) direction. Generally, the amount is credited to the account of the customer on the customer’s request in writing; the proceeds may be remitted to him by a demand draft. In such circumstances, if the customer gives instructions to his banker, the draft may be forwarded. By doing so, the relationship between principal and agent comes to an end and the new relationship between debtor and creditor will begin.

5. **Collection of Bills of Exchange:** There is no legal obligation for a banker to collect the bills of exchange for its customer. But, generally, bank gives such facility to its customers. In collection of bills, a banker should examine the title of the depositor as the statutory protection.

Thus, the collecting banker must examine very carefully the title of his customer towards the bill. In case a new customer comes, the banker should extend this facility to him with a trusted reference.

From the above discussion, there is no doubt to say that the banker is acting as a mere agent for collection and not in the capacity of a banker. If the customer allows his banker to use the collecting money for its own purpose at present and to repay an equivalent amount on a fixed date in future the contract between the banker and the customer will come to an end.

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| ***Activity 4.1****Assume you are a banker (Aksum University model bank), what things need to be considered just to honour the cheque that your customer brought to you for payment to be effected?* |

**4.3 Holder In Due Course**

According to some of the Negotiable Instruments Acts in different countries, a holder means any person entitled in his own name to the possession of the negotiable instrument and to recover or receive the amount due thereon from the parties liable thereto. A holder must, therefore, have the possession of the instrument and also the right to recover money in his own name.

In other words, a holder must be in possession of it under a legal title. Holder implies de jure holder and not de facto holder.

Thus, a person who is in possession of the instrument may or may not be a holder. For example, a finder of lost instrument or a thief cannot be a holder. Similarly, a beneficiary or an agent in possession of an instrument will not be a holder. But legal representatives of deceased holder or official assignee or official receiver would be treated as holders of the instruments. It is only the holder and no other person, who can give a valid discharge for the instrument.

In English Law, a holder in due course is known as “bonafide holder for value without notice.” A holder in due course is a person who acquires a promissory note, bill or cheque bonafide for value and maturity. Section 9 of the Negotiable Instruments Act defines a holder in due course as “any person who for consideration became the possessor of a negotiable instrument if payable to bearer; or the payee or endorsee thereof, if payable to order, before the amount mentioned in it becomes payable, and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title.” In other words, a holder in due course is a person who takes the instrument in good faith and for value.

Thus, a holder in due course must satisfy the following conditions:

(a) He must have obtained the instrument for valuable consideration or value.

Consideration must not be void or illegal. The consideration must be valuable and lawful. So, the donee of a negotiable instrument is not a holder in due course.

(b) He must have become a holder of the instrument before the date of its maturity.

(c) He must have become a holder of the instrument in good faith.

(d) He must have taken the instrument complete and regular on the face of it.

It is thus obvious that every holder is not a holder in due course. A holder of a negotiable instrument will not be a holder in due course, if:

(a) He has obtained the instrument by gift, or

(b) He has obtained the instrument for unlawful consideration, or

(c) He has obtained the instrument after its maturity, or

(d) He has obtained the instrument by some illegal method, or

(e) He has not obtained the instrument in good faith.

**Privileges of a Holder in Due Course**

A holder in due course occupies a privileged position in the law of negotiable instruments.

He has a title free from equities. He enjoys certain rights and privileges which an ordinary holder can never possess. These rights and privileges are as follows:

1. **Instrument Purged or Cured of all Defects:** The holder in due course gets the instrument free from all the defects in the title. Once a negotiable instrument passes through the hands of a holder in due course, it is purged or cured of defects. It is like a current coin. Anybody who takes a negotiable instrument from a holder in due course can recover the amount from all parties prior to such holder. An instrument once free from defects is always free.

2. **Liability of Prior Parties:** All prior parties to the instrument (the drawer, acceptor or endorser) continue to remain liable to the holder in due course until the instrument is duly satisfied. The holder in due course can file a suit against the prior parties liable to pay in his own name. Every prior party to a negotiable instrument is liable thereon to a holder in due course until the instrument is duly satisfied.

3. **Rights in Case of Inchoate Instrument:** An inchoate instrument is one which is incomplete in some respects. A person who has signed and delivered a stamped but inchoate (incomplete) instrument cannot argue as against a holder in due course that the instrument has not been completed according to the authority given by him.

4. **No Effect of Conditional Delivery:** Where a negotiable instrument delivered conditionally is negotiated to a holder in due course, the other parties to the instrument cannot escape liability on the ground that the delivery of the instrument was conditional or for a special purpose only.

5. **Right in Case of Fictitious Bills:** If a bill is drawn on behalf of a fictitious person and is payable to his order, the acceptor is not relieved from his liability to holder in due course because of such fictitious name.

6. **No Effect of Absence of Consideration:** The plea of absence of consideration or unlawful consideration is not available against the holder in due course. The party responsible is liable to make the payment.

7. **Estoppel against Denying Original Validity of the Instrument:** The plea of original invalidity of the instrument cannot be put forth against the holder in due course by the drawer of a bill of exchange or cheques, or by an acceptor for the honour of the drawer.

8. **Estoppel against Denying the Capacity of the Payee to Endorse:** The maker of a promissory note or the acceptor of a bill is precluded from denying against a holder in due course the existence of the payee and his capacity to endorse.

9. **Estoppel against Endorser to Deny Capacity of Prior Parties:** An endorser of the bill by his endorsement guarantees that all previous endorsements are genuine and that all parties had capacity to enter into valid contracts. Therefore, he cannot subsequently deny signature or capacity to contract of any prior party to the instrument.

10. **Every Holder is a Holder in Due Course:** The law presumes that every holder is a holder in due course although the presumption is rebuttable.

**Distinction between Holder and Holder in Due Course**

The following are the differences between holder and holder in due course:

1. **Entitlement:** A holder is entitled in his own name to the possession of the instrument. But a holder in due course acquires the possession of the instrument for consideration.

2. **Consideration:** In case of holder, consideration is not necessary. The instrument may be given as a gift or donation. But consideration is necessary for becoming a holder in due course. A person cannot be a holder in due course if he had obtained the instrument without consideration.

3. **Before and after Maturity:** A holder may get the instrument even after it has become payable. But a holder in due course must get the possession of the instrument before its maturity.

4. **Title:** A holder does not acquire good title, if the title of any of the prior parties was defective. But a holder in due course acquires good title even though there was defect in the title of any prior parties, provided he had no notice of the defect. His title is free from defects.

5. **Presumption:** Every holder in due course is a holder, but every holder may not be a holder in due course.

6. **Right to Recover the Amount:** All prior parties to a negotiable instrument continue to remain liable to the holder in due course until the instrument is duly satisfied. But a holder of an instrument can recover the amount from maker and the transferor but not all the prior parties.

7. **Privileges:** A holder does not enjoy any special privileges, but a holder in due course enjoys certain special privileges.

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| ***Activity 4.2****Hey students! Just play a role as if you are a holder and a holder in due course of the cheque in class or in lab.* |

Summary

The banker who is liable to pay the value of a cheque of a customer as per the contract, when the amount is due from him to the customer is called “Paying Banker” or “Drawee Bank.”

In case a cheque is entrusted with the banker for collection, he is expected to show it to the drawee banker within a reasonable time. A cheque is not presented for payment within a reasonable time of its issue, and the drawer or person in whose account it is drawn had the right, at the time when presentment ought to have been made, as between himself and the banker, to have the cheque paid and suffers actual damage, through the delay, he is discharged to the extent of such damage, that is to say, to the extent to which such drawer or person is a creditor of the banker to a large amount than he would have been if such cheque had been paid.

According to some of the Negotiable Instruments Acts in different countries, a holder means any person entitled in his own name to the possession of the negotiable instrument and to recover or receive the amount due thereon from the parties liable thereto.

***Review Questions***

*DISCUSSION QUESTIONS:*

1. *What are the duties and responsibilities of paying banker?*

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1. *Mention the precautions that the banker has to take while honouring the cheques of customers.*

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1. *Briefly explain the duties and responsibilities of collecting banker.*

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1. *Differentiate among the holder and holder in due course.*

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***Self check table for students assessment***

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| ***No.*** | ***Do students grasp objectives/competencies*** | ***Yes***  | ***No.***  |
| *1* | *Explain the duties and responsibilities of paying banker* |  |  |
| *2* | *Explain the duties and responsibilities of collecting banker* |  |  |
| *3* | *Describe the holder and holder in due course* |  |  |