Shri Jai Narain Mishra P.G. Collage, Lko

Department of Law

Banking Law

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By – Mahendra kumar Baishya

Assistant Professor (Law)

Negotiable Instrument act 1881

Mahendra Kumar Baishya[1]

INTRODUCTION

The Negotiable Instruments Act was enacted, in India, in 1881. Prior to its enactment, the provision of the English Negotiable Instrument Act were applicable in India, and the present Act is also based on the English Act with certain modifications. It extends to the whole of India except the State of Jammu and Kashmir. The Act operates subject to the provisions of Sections 31 and 32 of the Reserve Bank of India Act, 1934. Section 31 of the Reserve Bank of India Act provides that no person in India other than the Bank or as expressly authorised by this Act, the Central Government shall draw, accept, make or issue any bill of exchange, hundi, promissory note or engagement for the payment of money payable to bearer on demand. This Section further provides that no one except the RBI or the Central Government can make or issue a promissory note expressed to be payable or demand or after a certain time. Section 32 of the Reserve Bank of India Act makes issue of such bills or notes punishable with fine which may extend to the amount of the instrument. The effect or the consequences of these provisions are:

1. A promissory note cannot be made payable to the bearer, no matter whether it is payable on demand or after a certain time.

2. A bill of exchange cannot be made payable to the bearer on demand though it can be made payable to the bearer after a certain time.

3. But a cheque {though a bill of exchange} payable to bearer or demand can be drawn on a person's account with a banker.

[1] Assistant Professor, Department of law, Sri JNMPG College, LKO

MEANING OF NEGOTIABLE INSTRUMENTS

According to Section 13 (a) of the Act, "Negotiable instrument means a promissory note, bill of exchange or cheque payable either to order or to bearer, whether the word "order" or "bearer" appear on the instrument or not."

In the words of Justice, Willis, "A negotiable instrument is one, the property in which is acquired by anyone who takes it bonafide and for value notwithstanding any defects of the title in the person from whom he took it".

Thus, the term, negotiable instrument means a written document which creates a right in favour of some person and which is freely transferable. Although the Act mentions only these three instruments (such as a promissory note, a bill of exchange and cheque), it does not exclude the possibility of adding any other instrument which satisfies the following two conditions of negotiability:

1. the instrument should be freely transferable (by delivery or by endorsement. and delivery) by the custom of the trade; and

2. the person who obtains it in good faith and for value should get it free from all defects, and be entitled to recover the money of the instrument in his own name.

As such, documents like share warrants payable to bearer, debentures payable to bearer and dividend warrants are negotiable instruments. But the money orders and postal orders, deposit receipts, share certificates, bill of lading, dock warrant, etc. are not negotiable instruments. Although they are transferable by delivery and endorsements, yet they are not able to give better title to the bonafide transferee for value than what the transferor has.

CHARACTERISTICS OF A NEGOTIABLE INSTRUMENT

A negotiable instrument has the following characteristics:

1. Property: The prossessor of the negotiable instrument is presumed to be the owner of the property contained therein. A negotiable instrument does not merely give possession of the instrument but right to property also. The property in a negotiable

instrument can be transferred without any formality. In the case of bearer instrument, the property passes by mere delivery to the transferee. In the case of an order instrument, endorsement and delivery are required for the transfer of property.

2. Title: The transferee of a negotiable instrument is known as 'holder in due course.' A bona fide transferee for value is not affected by any defect of title on the part of the transferor or of any of the previous holders of the instrument.

3. Rights: The transferee of the negotiable instrument can sue in his own name, in case of dishonour. A negotiable instrument can be transferred any number of times till it is at maturity. The holder of the instrument need not give notice of transfer to the party liable on the instrument to pay.

4. Presumptions: Certain presumptions apply to all negotiable instruments e.g., a presumption that consideration has been paid under it. It is not necessary to write in a promissory note the words 'for value received' or similar expressions because the payment of consideration is presumed. The words are usually included to create additional evidence of consideration.

5. Prompt payment: A negotiable instrument enables the holder to expect prompt payment because a dishonour means the ruin of the credit of all persons who are parties to the instrument.

PRESUMPTIONS AS TO NEGOTIABLE INSTRUMENT

Sections 118 and 119 of the Negotiable Instrument Act lay down certain presumptions which the court presumes in regard to negotiable instruments. In other words, these presumptions need not be proved as they are presumed to exist in every negotiable instrument. Until the contrary is proved the following presumptions shall be made in case of all negotiable instruments:

1. Consideration: It shall be presumed that every negotiable instrument was made drawn, accepted or endorsed for consideration. It is presumed that; consideration is present in every negotiable instrument until the contrary is presumed. The presumption of consideration, however may be rebutted by proof that the instrument had been obtained from, its lawful owner by means of fraud or undue influence.

2. Date: Where a negotiable instrument is dated, the presumption is that it has been made or drawn on such date, unless the contrary is proved.

3. Time of acceptance: Unless the contrary is proved, every accepted bill of exchange is presumed to have been accepted within a reasonable time after its issue and before its maturity. This presumption only applies when the acceptance is not dated; if the acceptance bears a date, it will prima facie be taken as evidence of the date on which it was made.

4. Time of transfer: Unless the contrary is presumed it shall be presumed that every transfer of a negotiable instrument was made before its maturity.

5. Order of endorsement: Until the contrary is proved it shall be presumed that the endorsements appearing upon a negotiable instrument were made in the order in which they appear thereon.

6. Stamp: Unless the contrary is proved, it shall be presumed that a lost promissory note, bill of exchange or cheque was duly stamped.

7. Holder in due course: Until the contrary is proved, it shall be presumed that the holder of a negotiable instrument is the holder in due course. Every holder of a negotiable instrument is presumed to have paid consideration for it and to have taken it in good faith. But if the instrument was obtained from its lawful owner by means of an offence or fraud, the holder has to prove that he is a holder in due course.

8. Proof of protest: Section 119 lays down that in a suit upon an instrument which has been dishonoured, the court shall on proof of the protest, presume the fact of dishonour, unless and until such fact is disproved.

<u>TYPES OF NEGOTIABLE INSTRUMENT</u>

Section 13 of the Negotiable Instruments Act states that a negotiable instrument is a promissory note, bill of exchange or a cheque payable either to order or to bearer. Negotiable instruments recognised by statute are:

(i) Promissory notes

(ii) (ii) Bills of exchange

(iii) Cheques.

Negotiable instruments recognised by usage or custom are: (i) Hundis (ii) Share warrants (iii) Dividend warrants (iv) Bankers draft (v) Circular notes (vi) Bearer debentures (vii) Debentures of Bombay Port Trust (viii) Railway receipts (ix) Delivery orders.

This list of negotiable instruments is not a closed chapter. With the growth of commerce, new kinds of securities may claim recognition as negotiable instruments. The courts in India usually follow the practice of English courts in according the character of negotiability to other instruments.

- **Promissory notes**

Section 4 of the Act defines, "A promissory note is an instrument in writing (note being a bank-note or a currency note) containing an unconditional undertaking, signed by the maker, to pay a certain sum of money to or to the order of a certain person, or to the bearer of the instruments."

Essential elements

An instrument to be a promissory note must possess the following elements:

1. It must be in writing: A mere verbal promise to pay is not a promissory note. The method of writing (either in ink or pencil or printing, etc.) is unimportant, but it must be in any form that cannot be altered easily.

2. It must certainly an express promise or clear understanding to pay: There must be an express undertaking to pay. A mere acknowledgment is not enough. The following are not promissory notes as there is no promise to pay.

If A writes:

(a) "Mr. B, I.O.U. (I owe you) Rs. 500"

(b) "I am liable to pay you Rs. 500".

(c) "I have taken from you Rs. 100, whenever you ask for it have to pay".

The following will be taken as promissory notes because there is an express promise to pay:

If A writes:

(a) "I promise to pay B or order Rs. 500"

(b) "I acknowledge myself to be indebted to B in Rs. 1000 to be paid on demand, for the value received".

(3) Promise to pay must be unconditional: A conditional undertaking destroys the negotiable character of an otherwise negotiable instrument. Therefore, the promise to pay must not depend upon the happening of some outside contingency or event. It must be payable absolutely.

(4) It should be signed by the maker: The person who promise to pay must sign the instrument even though it might have been written by the promisor himself. There are no restrictions regarding the form or place of signatures in the instrument. It may be in any part of the instrument. It may be in pencil or ink, a thumb mark or initials. The pronote can be signed by the authorised agent of the maker, but the agent must expressly state as to on whose behalf he is signing, otherwise he himself may be held liable as a maker. The only legal requirement is that it should indicate with certainty the identity of the person and his intention to be bound by the terms of the agreement.

(5) **The maker must be certain:** The note self must show clearly who is the person agreeing to undertake the liability to pay the amount. In case a person signs in an assumed name, he is liable as a maker because a maker is taken as certain if from his description sufficient indication follows about his identity. In case two or more persons promise to pay, they may bind themselves jointly or jointly and severally, but their liability cannot be in the alternative.

(6) **The payee must be certain:** The instrument must point out with certainty the person to whom the promise has been made. The payee may be ascertained by name or by designation. A note payable to the maker himself is not pronate unless it is indorsed by him. In case, there is a mistake in the name of the payee or his designation;

the note is valid, if the payee can be ascertained by evidence. Even where the name of a dead person is entered as payee in ignorance of his death, his legal representative can enforce payment.

(7) The promise should be to pay money and money only: Money means legal tender money and not old and rare coins. A promise to deliver paddy either in the alternative or in addition to money does not constitute a promissory note.

(8) The amount should be certain: One of the important characteristics of a promissory note is certainty not only regarding the person to whom or by whom payment is to be made but also regarding the amount.

However, paragraph 3 of Section 5 provides that the sum does not become indefinite merely because

(a) there is a promise to pay amount with interest at a specified rate.

(b) the amount is to be paid at an indicated rate of exchange.

(c) the amount is payable by installments with a condition that the whole balance shall fall due for payment on a default being committed in the payment of anyone installment.

(9) Other formalities: The other formalities regarding number, place, date, consideration etc. though usually found given in the promissory notes but are not essential in law. The date of instrument is not material unless the amount is made payable at a certain time after date. Even in such a case, omission of date does not invalidate the instrument and the date of execution can be independently ascertained and proved.

On demand (or six months after date) I promise to pay Peter or order the sum of rupees one thousand with interest at 8 per cent per annum until payment.

- **Bill of exchange**

Section 5 of the Act defines, “A bill of exchange is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to

pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument”.

A bill of exchange, therefore, is a written acknowledgement of the debt, written by the creditor and accepted by the debtor. There are usually three parties to a bill of exchange drawer, acceptor or drawee and payee. Drawer himself may be the payee.

Essential conditions of a bill of exchange

(1) It must be in writing: The first essential is that all negotiable instruments must be in writing. An oral agreement to pay a certain sum of money is not an instrument. The object of this requirement id to exclude oral agreement to pay from the purview of the Act. The writing may be in pencil or ink and including printing, type, photocopy, lithography and other modes of representing or reproducing words in a visible from.

(2) An Order to pay: A bill of exchange must contain an order to pay. The order to pay may be in the from of request but it should be imperative.

In *Ruff Vs. Webb,* the plaintiff Ruff was a servant of the defendant Webb. The defendant dismissed him from service and for his wages gave him a draft in the following words: “Mr. Nelson will much oblige Mr. Webb by paying to Ruff order, twenty guineas on his account.”

It was held that paper was a bill of exchange, that it was an order by one person to another to pay money to the plaintiff or his order. It is quite apparent that the language of the draft was very polite, but has been said that the in introduction of the terms of gratitude does not destroy the promise (order) to pay.

In *Hamilton Vs. Spottiswood*, the instrument read:

“To Spottiswood, Dear sir, we hereby authorise you to pay on our account to the order of William Gebtle the sum of six thousand pounds.”

The Court held, that the letter did not import an absolute intention that the money should at all events be paid but merely authorized the defendant to pay. Thus, it was not a bill of exchange.

If latter consists an order to pay in spite of polite or courteous language, it will constitute a bill of exchange.

(3) **The order must be unconditional:** Thirdly, the promise to pay the money should be unconditional or subject only to a condition which according to the ordinary experience of mankind is bound to happen. Where payment under a bill or note has been made from a special fund such order will be conditional. Thus, an order to pay Rs. 5000 out of the proceeds of the sale of a house will be a conditional order, hence no bill of exchange.

Unlike a promissory note the bill of exchange contains an order from the creditor to the debtor to pay a certain sum to a certain person after a certain period.

(4) **Money only: -** Fourthly, the order must be to pay money and money only. Money means legal tender money and not old and rare coins. A promise to deliver paddy either in the alternative or in addition to money does not constitute a promissory note.

(5) **Parties must be certain:** - A bill of exchange requires three parties i.e., drawer, drawee and payee. All the parties must be named or otherwise indicated in the bill with reasonable certainly. Sometimes the drawer and the payee are some persons as where a bill is drawn "Pay to me or my order". In such a case there are only two parties but without this minimum of two there cannot be a bill of exchange.

(6) **It must be signed by the drawer.**

(7) **It should be properly stamped:** Like promissory notes a bill of exchange must also stamped.

(8) **Indication of drawee with reasonable certainty: -** But though the payee may not be named the drawee must be designated with reasonable certainty.

In *Gray v. Milner*, however no drawee was at all indicated in the bill yet it was held to be valid.

For example, In the following cases, there is no order to pay, but only a request to pay. Therefore, none can be considered as a bill of exchange:

(a) "I shall be highly obliged if you make it convenient to pay Rs. 1000 to Suresh".

(b) "Mr. Ramesh, please let the bearer have one thousand rupees, and place it to my account and oblige"

However, there is an order to pay, though it is politely made, in the following examples:

(a) "Please pay Rs. 500 to the order of 'A'.

(b) 'Mr. A will oblige Mr. C, by paying to the order of' P".

- **Cheques**

Section 6 of the Act defines "A cheque is a bill of exchange drawn on a specified banker, and not expressed to be payable otherwise than on demand".

A cheque is bill of exchange with two more qualifications, namely, (i) it is always drawn on a specified banker, and (ii) it is always payable on demand. Consequently, all cheque are bill of exchange, but all bills are not cheque. A cheque must satisfy all the requirements of a bill of exchange; that is, it must be signed by the drawer, and must contain an unconditional order on a specified banker to pay a certain sum of money to or to the order of a certain person or to the bearer of the cheque. It does not require acceptance.

- **Distinction Between Bill of Exchange and Promissory Note**

1. Number of parties: In a promissory note there are only two parties – the maker (debtor) and the payee (creditor). In a bill of exchange, there are three parties; drawer, drawee and payee; although any two out of the three may be filled by one and the same person,

2. Payment to the maker: A promissory note cannot be made payable the maker himself, while in a bill of exchange to the drawer and payee or drawee and payee may be same person.

3. Unconditional promise: A promissory note contains an unconditional promise by the maker to pay to the payee or his order, whereas in a bill of exchange, there is an unconditional order to the drawee to pay according to the direction of the drawer.

4. Prior acceptance: A note is presented for payment without any prior acceptance by the maker. A bill of exchange is payable after sight must be accepted by the drawee or someone else on his behalf, before it can be presented for payment.

5. Primary or absolute liability: The liability of the maker of a promissory note is primary and absolute, but the liability of the drawer of a bill of exchange is secondary and conditional.

6. Relation: The maker of the promissory note stands in immediate relation with the payee, while the maker or drawer of an accepted bill stands in immediate relations with the acceptor and not the payee.

7. Protest for dishonour: Foreign bill of exchange must be protested for dishonour when such protest is required to be made by the law of the country where they are drawn, but no such protest is needed in the case of a promissory note.

8. Notice of dishonour: When a bill is dishonoured, due notice of dishonour is to be given by the holder to the drawer and the intermediate indorsers, but no such notice need be given in the case of a note.

- **Distinction Between Bills of Exchange and Cheque**

1. A bill of exchange is usually drawn on some person or firm, while a cheque is always drawn on a bank.

2. It is essential that a bill of exchange must be accepted before its payment can be claimed A cheque does not require any such acceptance.

3. A cheque can only be drawn payable on demand, a bill may be also drawn payable on demand, or on the expiry of a certain period after date or sight.

4. A grace of three days is allowed in the case of time bills while no grace is given in the case of a cheque.

5. The drawer of the bill is discharged from his liability, if it is not presented for payment, but the drawer of a cheque is discharged only if he suffers any damage by delay in presenting the cheque for payment.

6. Notice of dishonour of a bill is necessary, but no such notice is necessary in the case of cheque.

7. A cheque may be crossed, but not needed in the case of bill.

8. A bill of exchange must be properly stamped, while a cheque does not require any stamp.

9. A cheque drawn to bearer payable on demand shall be valid but a bill payable on demand can never be drawn to bearer.

10. Unlike cheques, the payment of a bill cannot be countermanded by the drawer.

Holder and Holder in Due Course

Introduction

The Negotiable Instruments Act, 1881 (hereinafter referred to as the Act) is a statute which regulates the working of instruments which can be negotiated for amount. It lays down the frame work under which these instruments operate and any contravention in these rules has been made punishable.

For the purposes of understanding the working of the negotiable instruments it is imperative to understand the complexities of the parties involved in a transaction in which a negotiable instrument is involved.

Section 8 and Section 9 of the Act discuss the concept and definition of a holder and holder in due course. Generally, a holder of a negotiable instrument is one which acquires it by a transfer.

Holder-

Sec 8 of the Act contemplates that any person who is entitled to get the possession and subsequently receive payment or recover payment from the parties for a promissory note, bill of exchange, cheque which he is entitled to possess.

If the promissory note, bill of exchange, cheque gets lost or destroyed then the holder is the person who is entitled at the time of the loss or destruction.

- **Ingredients-**

Following are the ingredients to be satisfied for qualifying to be holder:

1. The person must be entitled for possessing the instrument in his own name. It is not necessary that the person be in actual physical possession of the instrument. The principle is that there must be right a right accruing under a legal title.

- The person must be named in the instrument as a payee or indorsee. He can also be a bearer of the instrument if it is a bearer instrument. In cases where the holder dies the heir of such a holder becomes the holder even when he is not a payee or indorsee or a bearer of the instrument.

- A person must be de jure (as per law) holder and not a de facto (as per facts) holder.

2. Where a person comes to hold a negotiable instrument and he does not have a title to hold or possess it then he will not be called a holder. A person who finds an instrument lying somewhere or a thief although may acquire possession of such an instrument, no right accrues to them. Therefore, they cannot be termed as a holder.

- The person by way of the instrument must be entitled to recover or receive a sum of money or amount which the parties are liable to pay the holder. Therefore, not only possession but the right to receive is also an important aspect in order to be termed a holder. By receiving the amount, the person who was liable to pay is discharged from the liability.
- In cases where a person acquires an instrument by either finding it or where a person has committed theft of such an instrument, he is not entitled to receive the amount. Thus, he is not called a holder.
- **Rights of a Holder**

The rights of a holder are:

- As per Sec 8 of the act to possess an instrument and to receive and recover the amount which is due as per the instrument;
- As per Sec 50 of the Act to endorse the instrument;
- As per Sec 125 of the Act to cross the instrument after it is issued. Where a cheque is crossed the holder may cross it as generally or specifically. He also has the option of adding words like not negotiable or account payee;
- As per Sec 49 of the Act to convert blank endorsement to full endorsement;
- As per Sec 45 A to get a duplicate of the instrument which is lost;
- As per Sec 61 and Sec 64 of the Act to present the instrument for acceptance if it is a bill and if it is some other instrument then get payment for it.

- **Holder in Due Course-**

Sec 9 of the Act contemplates that any person who becomes the possessor of a promissory note, bill of exchange or a cheque for a consideration and the instrument is payable to bearer or payee or endorsee before the amount became payable and he believes that no defect exists in the title of the person from whom he derived his title is called a holder in due course.

If a negotiable instrument is acquired by a person bonafidely for a value and he believes there is no defect in the title from whom he took the instrument in good faith becomes the true owner of the negotiable instrument and a holder in due course.

Ingredients

Following are the ingredients to be satisfied for qualifying to be holder:

1. The person must hold the instrument for a valuable consideration;
2. The person may become the holder of the instrument before it gets matured;
3. The negotiable instrument must be complete in all forms and requisites;
4. The holder must have received the instrument in good faith.

   If a person acquires the negotiable instrument after it has matured then he does not become a holder in due course.

- **Rights of a Holder in Due Course-**

Sec 53 of the Act contemplates that a negotiable instrument get cleansed of the defects when it passes through the hands of a holder in due unless fraud was committed with regard to the instrument or there was an illegality in the instrument committed by the person holding the instrument;

1. No person who is the maker can deny the validity of a promissory note, bill of exchange or a cheque as originally drawn in a suit by the holder in due course of the instrument.

2. Sec 118 of the Act contemplates that every holder is presumed to be a holder in due course. The burden of proof is on the other parties to show that the person is not a holder in due course. Once it is proved that the holder has acquired the instrument trough illegal means then the onus shifts on the holder.
3. Sec 121 of the act contemplates that the maker of a promissory note, bill of exchange or a cheque cannot deny the validity of payee's capacity at the date of the promissory note, bill of exchange or a cheque to endorse the same. Therefore a holder in due course is entitled to recover amount mentioned in the instrument even though the payee has no capacity to endorse the instrument.
4. Sec 36 of the act contemplates that until the instrument is satisfied; all the parties to an instrument are liable to the holder in due course. The liability is joint and several.
5. Sec 58 of the act contemplates that the holder in due course has a better title to the transferor of the instrument. In cases where the title of the transferor was defective the holder in due course will get a good title. However, if the title is forged the holder in due course does not get a title since there is no defect in title but rather there is no title.
6. Sec 46 and Sec 47 of the act contemplate that the liable parties cannot deny the liability to a holder in due course who negotiates a bill of exchange or promissory note on the ground that the delivery of the instrument was subject to conditions or was for a specific purpose.
7. Sec 42 of the Act contemplates that when a bill is drawn in a fictitious person's name and the signature is of the same person who was the drawer, the acceptor cannot take the plea that the payee was a fictitious person.
8. Sec 20 of the act contemplates that when an instrument which is duly signed and stamped and left blank partially or completely and delivered to someone else to be filled up. Then if such a person fills an amount which is more than what he had been authorised to do, then the holder in due course can recover the whole

amount mentioned but the amount shall not be more than the amount of the stamp affixed on the instrument.

9. Sec 120 of the Act contemplates that when a holder in due course files a suit for recovery of amount which is due on the instrument, then the maker of the promissory note, bill of exchange or cheque cannot take the plea to evade his liability that when the instrument was drawn it was invalid.

10. Sec 122 of the Act contemplates that the endorser of a negotiable instrument cannot deny the signatures or the capacity to contract of any party in a suit filed by the holder in due course against an endorser.

- **Difference between Holder and Holder in Due Course**

	Holder	Holder in Due Course
1.	Holder is a person who can lawfully possess an instrument and receive or recover the amount from parties	A holder in due course takes the instrument in bonafide faith for a consideration before the instrument's maturity
2.	Consideration is not necessary	Consideration is necessary
3.	Possession may taken after maturity	Possession can only taken before maturity
4.	Holder does not get a better title than the previous party	The title gets cured from any defects
5.	Holder cannot recover amount from all prior parties. Only from the maker and transferor	Right to recover from all prior parties

Case law

1. In the case of *Gemini v Chandran 2007 (1) KHC 698*, it was held that there is no provision in the Act by which a holder in due course can be presumed to be a holder. There is a presumption by virtue of sec 118 of the Act that a holder is a holder in due course in some specific situations. Therefore holder in due course and holder do not mean the same.
2. In the case of *S.V. Prasad v. Suresh Kumar AIR 2005 AP 37*, it was held that a holder in due course acquires a right to recover the amount from the holder of the instrument. The endorsement can take place without having participation from the maker of the instrument. The holder in due course acquires the same right which was with the holder. He can neither improve nor modify the liability.
3. In the case of *Milind Shripad Chandurkar v. Kalim Khan (2011) 4 SCC 275*, it was held that a suit for recovery of amount which is liable through a negotiable instrument can only be filed by a person who is a holder in due course of the negotiable instrument.
4. In the case of *Braja Kishore Dikshit v. Purna Chandra Panda AIR 1957 Orissa 153* it was held that there are certain prerequisites for a person to be called a holder in due of a negotiable instrument.

- Firstly, he must have become the holder by way of a consideration.
- Secondly, he must have got the possession of the instrument before it became overdue and lastly, he must be a transferee in bonafide faith and he should have any cause to believe that the title was defective of the transferor.
- **Conclusion**

Thus, it can be concluded that a holder is a person who has a possession of a legal instrument. That person must be entitled to possess the instrument legally and also recover the amount which is due from the instrument. He must also have the legal capacity to enforce his rights in his own name.Whereas a holder in due course is a person who can possess an instrument for a consideration. The person must become the holder of the instrument before it gets matured and the negotiable instrument must be

complete in all forms and requisites and the holder must have received the instrument in good faith.

ENDORSEMENT

The word 'endorsement' in its literal sense means, writing on the back of an instrument. But under the Negotiable Instruments Act it means, the writing of one's name on the back of the instrument or any paper attached to it with the intention of transferring the rights therein. Thus, endorsement is signing a negotiable instrument for the purpose of negotiation. The person who effects an endorsement is called an 'endorser', and the person to whom negotiable instrument is transferred by endorsement is called the 'endorsee'

Essentials of a valid endorsement

The following are the essentials of a valid endorsement:

1. It must be on the instrument. The endorsement may be on the back or face of the instrument and if no space is left on the instrument, it may be made on a separate paper attached to it called allonage. It should usually be in ink.

2. It must be made by the maker or holder of the instrument. A stranger cannot endorse it.

3. It must be signed by the endorser. Full name is not essential. Initials may suffice. Thumb-impression should be attested. Signature may be made on any part of the instrument. A rubber stamp is not accepted but the designation of the holder can be done by a rubber stamp.

4. It may be made either by the endorser merely signing his name on the instrument (it is a blank endorsement) or by any words showing an intention to endorse or transfer the instrument to a specified person (it is an endorsement in full). No specific form of words is prescribed for an endorsement. But intention to transfer must be

present. When in a bill or note payable to order the endorsee’s name is wrongly spelt, he should when he endorses it, sign the name as spelt in the instrument and write the correct spelling within brackets after his endorsement.

5. It must be completed by delivery of the instrument. The delivery must be made by the endorser himself or by somebody on his behalf with the intention of passing property therein. Thus, where a person endorses an instrument to another and keeps it in his papers where it is found after his death and then delivered to the endorsee, the latter gets no right on the instrument.

6. It must be an endorsement of the entire bill. A partial endorsement i.e. which purports to transfer to the endorse a part only of the amount payable does not operate as a valid endorsement. If delivery is conditional, endorsement is not complete until the condition is fulfilled.

Who may endorse?

The payee of an instrument is the rightful person to make the first endorsement. Thereafter the instrument may be endorsed by any person who has become the holder of the instrument. The maker or the drawer cannot endorse the instrument but if any of them has become the holder thereof he may endorse the instrument. (Sec. 51).

The maker or drawer cannot endorse or negotiate an instrument unless he is in lawful possession of instrument or is the holder there of. A payee or indorsee cannot endorse or negotiate unless he is the holder there of.

Classes of endorsement

An endorsement may be:

(1) Blank or general.

(2) Special or full.

(3) Partial.

(4) Restrictive.

(5) Conditional.

(1) Blank or general endorsement (Sections 16 and 54).

It is an endorsement when the endorser merely signs on the instrument without mentioning the name of the person in whose favour the endorsement is made. Endorsement in blank specifies no endorsee. It simply consists of the signature of the endorser on the endorsement. A negotiable instrument even though payable to order becomes a bearer instrument if endorsed in blank. Then it is transferable by mere delivery. An endorsement in blank may be followed by an endorsement in full.

Example: A bill is payable to X. X endorses the bill by simply affixing his signature. This is an endorsement in blank by X. In this case the bill becomes payable to bearer.

There is no difference between a bill or note indorsed in blank and one payable to bearer. They can both be negotiated by delivery.

(2) Special or full endorsement (Section 16)

When the endorsement contains not only the signature of the endorser but also the name of the person in whose favour the endorsement is made, then it is an endorsement in full. Thus, when endorsement is made by writing the words "Pay to A or A's order," followed by the signature of the endorser, it is an endorsement in full. In such an endorsement, it is only the endorsee who can transfer the instrument.

Conversion of endorsement in blank into endorsement in full: When a person receives a negotiable instrument in blank, he may without signing his own name, convert the blank endorsement into an endorsement in full by writing above the endorser's signature a direction to pay to or to the order of himself or some other person. In such a case the person is not liable as the endorser on the bill. In other words, the person transferring such an instrument does not incur all the liabilities of an endorser. (Section 49).

Example: A is the holder of a bill endorsed by B in blank. A writes over B's signature the words "Pay to C or order." A is not liable as endorser but the writing operates as an endorsement in full from B to C.

Where a bill is endorsed in blank, or is payable to bearer and is afterwards endorsed by another in full, the bill remains transferable by delivery with regard to all parties prior to such endorser in full. But such endorser in full cannot be sued by any one except the person in whose favour the endorsement in full is made. (Section 55).

Example: C the payee of a bill endorses it in blank and delivers it to D, who specially endorses it to E or order. E without endorsement transfers the bill to F. F as the bearer is entitled to receive payment or to sue the drawer, the acceptor, or C who endorsed the bill in blank but he cannot sue D or E.

(3) Partial endorsement (Section 56)

A partial endorsement is one which purports to transfer to the endorsee a part only of the amount payable on the instrument. Such an endorsement does not operate as a negotiation of the instrument.

Example: A is the holder of a bill for Rs.1000. He endorses it "pay to B or order Rs.500." This is a partial endorsement and invalid for the purpose of negotiation.

(4) Restrictive endorsement (Section 50)

The endorsement of an instrument may contain terms making it restrictive. Restrictive endorsement is one which either by express words restricts or prohibits the further negotiation of a bill or which expresses that it is not a complete and unconditional transfer of the instrument but is a mere authority to the endorsee to deal with bill as directed by such endorsement.

"Pay C," "Pay C for my use," "Pay C for the account of B" are instances of restrictive endorsement. The endorsee under a restrictive endorsement acquires all the rights of the endoser except the right of negotiation.

(5) Conditional or qualified endorsement

It is open to the endorser to annex some condition to his owner liability on the endorsement. An endorsement where the endorsee limits or negatives his liability by putting some condition in the instrument is called a conditional endorsement. A condition imposed by the endorser may be a condition precedent or a condition subsequent. An endorsement which says that the amount will become payable if the endorsee attains majority embodies a condition precedent. A conditional endorsement unlike the restrictive endorsement does not affect the negotiability of the instrument. It is also some times called qualified endorsement. An endorsement may be made conditional or qualified in any of the following forms:

(i) **'Sans recourse' endorsement:** An endorser may be express word exclude his own liability thereon to the endorser or any subsequent holder in case of dishonour of the instrument. Such an endorsement is called an endorsement sans recourse (without recourse). Thus 'Pay to A or order sans recourse, 'pay to A or order without recourse to me,' are instances of this type of endorsement. Here if the instrument is dishonoured, the subsequent holder or the indorsee cannot look to the indorser for payment of the same.

An agent signing a negotiable instrument may exclude his personal liability by using words to indicate that he is signing as agent only. The same rule applies to directors of a company signing instruments on behalf of a company. The intention to exclude personal liability must be clear. Where an endorser so excludes his liability and afterwards becomes the holder of the instrument, all intermediate endorsers are liable to him.

Example: A is the holder of a negotiable instrument. Excluding personal liability by an endorsement without recourse, he transfers the instrument to B, and B endorses it to C, who endorses it to A. A can recover the amount of the bill from B and C.

(ii) **Facultative endorsement:** An endorsement where the endorser extends his liability or abandons some right under a negotiable instrument, is

called a facultative endorsement. “Pay A or order, Notice of dishonour waived” is an example of facultative endorsement.

(iii) **Sans frais' endorsement:** 'Where the endorser does not want the endorsee or any subsequent holder, to incur any expense on his account on the instrument, the endorsement is 'sans frais'.

(iv) **Liability dependent upon a contingency:** Where an endorser makes his liability depend upon the happening of a contingent event, or makes the rights of the endorsee to receive the amount depend upon any contingent event, in such a case the liability of the endorser will arise only on the happening of that contingent event. Thus, an endorser may write 'Pay A or order on his marriage with B'. In such a case, the endorser will not be liable until the marriage takes place and if the marriage becomes impossible, the liability of the endorser comes to an end.

- **Effects of endorsement**

The legal effect of negotiation by endorsement and delivery is:

(i) to transfer property in the instrument from the endorser to the endorsee.

(ii) to vest in the latter the right of further negotiation, and

(iii) a right to sue on the instrument in his own name against all the other parties (Section 50).

- **Cancellation of endorsement:**

When the holder of a negotiable instrument, without the consent of the endorser destroys or impairs the endorser's remedy against prior party, the endorser is discharged from liability to the holder to the same extent as if the instrument had been paid at maturity (Section 40).

Dishonour of cheque

1. Introduction

The cheque system in India is of British parentage. It is common knowledge that the London Goldsmiths were the first bankers in England and the system of payment of cash through cheques dates back to 17th century. Gradually, the cheque became widely and popularly accepted as negotiable instrument in settlement of trade and commerce transactions. Advent of cheques in the market has given a new dimension to the commercial and corporate world. Its time when people have preferred to carry and execute a small piece of paper called cheque than carrying the currency worth the value of cheque. Dealings in cheques are vital not only for banking purposes but also for the commerce and industry and the economy of the country. Rhetorically therefore a truncated cheque system is injurious to the economic health of the country as the system of cheques is a matter, a subject that concerns everybody whether he is a man on the street, a layman, a business magnate, an industrialist, a banker or a member of bench or bar. One of the biggest problems, which we are facing in the smooth functioning of the cheque system, is Dishonour of cheques, which threatens the credibility of this negotiable instrument. The problem is becoming bigger with the passage of time. It is hindering smooth business transactions. The great hardship is caused to a person if a cheque issued in his favour is dishonoured due to insufficiency of funds in the account of the drawer of the cheque. To discourage this, the dishonour of certain cheques has been made an offence by an amendment of the Negotiable Instruments Act, 1881 by the Banking Public Financial Institutions and Negotiable Instrument Laws (Amendment) Act, 1988. After this amendment, a new chapter consisting of section 138 to 142 has been inserted in the Negotiable Instruments Act, 1881. Prior to the year 1988, the act of dishonour of cheque was treated as an offence under Indian Penal Code. Other remedy was to file a suit for recovery which was civil in nature and was dilatory. To ensure promptitude in remedy against defaulters and to ensure credibility of the holders of the negotiable instrument a criminal remedy of penalty was inserted in Negotiable Instruments Act, 1881.

Section 138 of Negotiable Instruments Act, 1881

A negotiable instrument is lifeblood of commerce and to ensure this concept section 138 of Negotiable Instrument Act, 1881 was enacted. This section deals with the dishonour of cheques as a result of insufficiency of funds in the account of a drawer. The Act does not define the offence contemplated under section 138. It is a special offence not covered by the Indian Penal Code. However, the Act describes precisely the nature and conditions precedent for constituting an offence within the meaning of Section 138.

Section 138 provides that- "Where any cheque drawn by a person on an account maintained by him with a banker for payment of any amount of money to another person from out of that account for the discharge, in whole or in part, of any debt or other liability, 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, such person shall be deemed to have committed an offence and shall, without prejudice to any other provisions of this Act, be punished with imprisonment for a term which may be extended to two years, or with fine which may extend to twice the amount of the cheque, or with both: Provided that nothing contained in this section shall apply unless

(a) The cheque has been presented to the bank within a period of three months from the date on which it is drawn or within the period of its validity, whichever is earlier;

(b) The payee or the holder in due course of the cheque, as the case may be, makes a demand for the payment of the said amount of money by giving a notice in writing, to the drawer of the cheque, within thirty days of the receipt of information by him from the bank regarding the return of the cheque as unpaid; and

(c) The drawer of such cheque fails to make the payment of the said amount of money to the payee or, as the case may be, to the holder in due course of the cheque, within fifteen days of the receipt of the said notice.

Explanation

For the purposes of this section, "debt or other liability" means a legally enforceable debt or other liability" The title of the Chapter XVII makes it clear that dishonour of every cheque will not bring the case within the purview of Section 138 and a person can be held liable only if the cheque has been issued in discharge of, in whole or in part, of any legally enforceable debt or liability. This section draws presumption that one commits the offence if he issues the cheque dishonestly. It aims of not only protecting the interests of the genuine drawers of the cheques with a view to give them a final opportunity to make payments in respect of dishonoured cheques, but also imposing punishments on the guilty.

Ingredients of the Offence

To constitute an offence under Section 138 of the Negotiable Instruments Act the following ingredients are required to be fulfilled:

(1) Cheque should have been issued for the discharge, in whole or in part, of any debt or liability.

(2) The cheque should have been presented within the period of three months or within the period of its validity, whichever is earlier.

(3) The payee or the holder in due course should have issued a notice in writing to the drawer within thirty days of the receipt of information by him from the bank regarding the return of the cheque as unpaid.

(4) After the receipt of the said notice by the payee or the holder in due course, the drawer should have failed to pay the cheque amount within fifteen days of the receipt of the said notice.

(5) On non-payment by the drawer, the complaint should have been filed within one month from the date of expiry of the grace time of fifteen days, before a Metropolitan Magistrate or not below the rank of a Judicial Magistrate of first class.

(i) Issuance of Cheque for Discharge of any Debt or Other Liability:

It is essential that the dishonoured cheque should have been issued in discharge, wholly or partly, of any debt or other liability of the drawer to the payee. The expression ‘debt or other liability’ means a legally enforceable debt or other liability. If a cheque is given by way of gift or present and it is dishonoured by the bank, the maker of the cheque is not liable for prosecution. In *Maruti Udyog Ltd Vs Narender*, the Supreme Court held that by virtue of Section 139 of the Negotiable Instruments Act, the court has to presume that the holder of the cheque received the cheque for discharge of a debt or liability until the contrary is proved.

In *Tamil Nadu Retrenched Census Employees Association Vs K Thennan*, it was held that arrears of legal fee of an advocate can be classified as legally enforceable debt and complaint under section 138 cannot be quashed.

(ii) Presentation of Cheque

Legally a cheque can be presented for payment repeatedly any number of times within three months from the date of drawing of the cheque or within the period of its validity which is earlier.

In *K C Nadar Vs Chenabal M R Simon* the question was raised for the first time before the court whether a cheque may be presented on any number of times during the period of its validity. This was the case which propounded the basic theory that a cheque can be presented any number of times during the period if its validity. Further, the Supreme Court held in *Sadanandan Bhadran Vs Madhvan Sunil Kumar* that section 138 of the Act does not put any embargo upon the payee to successively present a dishonest cheque during the period of its validity and a fresh right arises with every presentation but cause of action arises only once when the notice is served.

(iii) **Reasons for Dishonour of Cheque**

(a) Stop Payment

In *Electronics Trade and technology development Corporation India Vs Indian Technologies and Engineers (Electronics) Pvt. Ltd.* The Supreme court of India

observed that if, before presentation of a cheque, notice is issued by the drawer to the payee or holder in due course not to present the cheque for payment, and it is still presented and, on the drawer's instructions, dishonoured, Section 138 is not attracted. But in another case *Modi cements Ltd. Vs Kuchil Kumar Nandi*, the Supreme Court disapproved its own observations in earlier case and held that even if a cheque is dishonoured because of "Stop Payment" instruction to the bank, section 138 would get attracted. It was further affirmed *in M/s M. M. T. C. Ltd. Vs M/s Medchl Chemicals and Pharma (P) Ltd*.

(b) Bank Account Closed

The dishonour of cheque on the ground that the account has been closed by the drawer of the cheque constitutes an offence under section 138. "Account Closed" would mean that "though the account was in operation when the cheque was issued, subsequently the account is closed. It shows that the drawer has no intention to make payment. Closing of account is one of the modes by which a drawer can render his account inadequate to honour the cheque issued by him, therefore, the closing of the account would not enable the accused to wriggle out of his liability under section 138 of the Act. In *N. A. Issac Vs Jeeman P. Abraham & Anr*, it was held that cheque issued when account has already been closed, provision of Section 138 will apply.

(c) Refer to the Drawer

"Refer to drawer" in the ordinary meaning amount to a statement of a bank, "we are not paying, go back to the drawer and ask why", or else "go back to the drawer and ask him to pay". The remarks "refer to drawer" necessarily means, as per banking custom, that the cheque has been returned for want of funds in the account of the drawer of the cheque. It is a courteous way normally adopted by a bank to show its inability to honour the cheque for want of funds. In *M/s Electronic Trade & Technology Development Corporation Ltd. Vs M/s Indian Technologist and Engineer (Electronic) Pvt. Ltd.* It was held that if cheque is returned with endorsement 'Refer to drawer' or

Instructions for stoppage of payment or exceeds arrangement, it amounts to dishonour of cheque.

(d) Post Paid Cheques

A "postdated" cheque is a bill of exchange when it is written or drawn, it becomes a 'cheque' when it is payable on demand. A post-dated cheque cannot be presented before the bank and as such question of its return does not arise. It is only when the postdated cheque becomes a cheque with effect from the date shown on the face of the said cheque, Section 138 comes into play.

(iv) Notice

Notice is a very important stage. It is the non-payment of dishonoured cheque within fifteen days from the receipt of the notice that constitutes an offence. Issuing of a cheque and its dishonour is not an offence. The offence is when the drawer receives a notice from the payee and he fails to pay the dishonoured cheque amount within the grace period of 15 days that constitute an offence any demand made after the dishonour of cheque will constitute a notice. The requirement of giving of notice is mandatory. The main problem is the serving of the notice to the accused as accused makes all efforts to avoid the receipt of the notice. In order to deal with such situations, the courts have evolved a principle called as deemed service of a notice under section 138(b). The legal position regarding deemed service of a notice U/s 138(b) has been that whenever a notice is sent by the payee to the drawer of the cheque and the said notice is refused to be taken or the addressee deliberately avoids its service, there is deemed to be service of the same.

(v) Filing of Complaint

A fair reading of Section 138 of the Act together with its proviso will make it clear the cause of action for initiating proceedings would complete when the drawer of the cheque fails to make the payment within fifteen days of receipt of the notice. The offence would be deemed to have been committed only from the date when the notice period expired. A complaint under section 138 is to be filed within one month of the date on which the cause of action arises. The day on which cause of action occurs is to

be excluded for reckoning the period of limitation for filing a complaint U/s 138 of the Act.

(vi) Jurisdiction

Hon'ble Apex Court in case of *K. Bhaskaran vs. Shankara*, had given jurisdiction to initiate the prosecution at any of the following places.

1. Where cheque is drawn.

2. Where payment had to be made.

3. Where cheque is presented for payment

4. Where cheque is dishonoured.

5. Where notice is served upto drawer.

However, in its recent decision in *Dashrath Rupsingh Rathod v. State of Maharashtra & Anr.* the Supreme court held that in cases of dishonour of cheque, only those courts within whose territorial limits the drawee bank is situated would have the jurisdiction to try the case.

Subsequently, many people had raised difficulties about this judgment. This is so because the payee of the cheque had to file the case at the place where the drawer of the cheque has a bank account. However, now the legal position has completely changed with above new Ordinance, i.e., the Negotiable Instruments (Amendment) Ordinance, 2015, which has been promulgated by the President on 15 June 2015, and which has immediately come into force with effect from 15 June 2015. The above Supreme Court judgment is now of no consequence since this Ordinance supersedes it, clarifying jurisdiction related issues for filing cases of offence committed under Sec 138.The main amendment included in this is the stipulation that the offence of rejection/return of cheque u/s 138 of NI Act will be enquired into and tried only by a Court within whose local jurisdiction the bank branch of the payee, where the payee presents the cheque for payment is situated .

The jurisdiction of filing cheque dishonour cases under Section 138 of the N.I. Act is now changed by the above Ordinance as under:

- Now a cheque bouncing case can be filed only in the court at the place where the bank in which the payee has account is located.
- Secondly, once a cheque bounce case has been filed in one particular court at a place in this manner, subsequently if there is any other cheque of the same party (drawer) which has also bounced, then all such subsequent cheque bounce cases against the same drawer will also have to filed in the same court (even if the payee present them in some bank in some other city or area). This will ensure that the drawer of cheques is not harassed by filing multiple cheque bounce cases at different locations. So, even multiple cheque bounce cases against the same party can be filed only in one court even if payee presents the cheques in different banks at different locations.
- Thirdly, all cheque bounce cases which are pending as on 15 June 2015 in different courts in India, will be transferred to the court which has jurisdiction to try such case in the manner mentioned above, i.e., such pending cases will be transferred to the court which has jurisdiction over the place where the bank of the payee is located. If there are multiple cheque bounce cases pending between the same parties as on 15 June 2015, then all such multiple cases will be transferred to the court where the first case has jurisdiction as per above principle.

Thus, this new Ordinance now introduces some clarity and uniformity in the matter of cheque dishonour cases. This Ordinance takes care of the interests of the payee of the cheque while at the same time also taking care that the drawer of the multiple cheques is not harassed by filing multiple litigations at different locations to harass him (if more than one cheque has bounced). This Ordinance supersedes the Supreme Court decision dated 1 August 2014 *[Dashrath Rupsingh Rathod v. State of Maharashtra*, (2014) 9 SCC 129] or any other judgment / decision of any court (Supreme Court or High Courts) on this issue.

(vii) Punishment

Bouncing of a cheque invites criminal prosecution under section 138 of the Negotiable Instruments Act, 1881. Punishment for the offence under Section 138 of NI Act is imprisonment up to two years or fine which may extend to twice the cheque amount or both. The offence is bailable, compoundable and non-cognizable.

(viii) Civil Action

The payee may also initiate money recovery procedure in a jurisdictional civil court apart from prosecuting the drawer for criminal offence.

Conclusion

Bounced cheques are one of the most common offences plaguing the financing world. According to the Supreme Court, there are over 40 lakhs such pending cases in the country. Although, there have been a few amendments in the Act which has made the Act, a self-contained statute, wherein provisions have been made to check the delays and to ensure speedy justice with more deterrent punishment, yet the problem of cheque bouncing is not decreasing. Moreover, the law is unnecessarily complicated and there is lack of provisions for forcing the appearance of the accused in the court. Though the amendments to the Negotiable Instruments Act, 1881 are helpful in dealing with the offence of bouncing of cheque, they are not fully proved successful in stopping the offence.

RESERVE BANK OF INDIA (RBI)

*Mahendra kumar Baishya,[2]

RBI established on April 1, 1935 under RBI Act 1934 (on the recommendations of John Hilton Young Commission 1926 - called Royal Commission on Indian Currency and Finance), is the central bank of the country and was nationalized on Jan 01, I 949. Prior to its existence, Imperial Bank of India from SBI was conducting the Central Bank's functions. Originally it was a shareholders' bank which was taken over by the Central Government under Reserve Bank (Transfer of Public Ownership) Act 1948 (paid up capital Rs.5cr). RBI's central office is in Mumbai.

Organisation: -Central Banking as a concept is of fairly recent origin. Though some Latin American countries had a central banking system in the 19th century, this system really became popular in the early 20th Century. Generally speaking, a Central Bank is considered as the leader of the money market, but several economists emphasize different roles for the Central Bank. For example, according to Whawtrey,R.G, the essential characteristic of a Central Bank is its function as the 'lender of last resort'. According to Kische& Elkin. The main function of the Central Bank is to maintain the 'stability of the monetary standard'. On the other hand, Shaw,W.R. lays emphasis on 'credit control' as the major function of Central Bank. The Bank of England founded in 1694 is perhaps the oldest Central Banking institution which provides finance for the government. The first attempt at Central Banking in India dates back to General Bank in Bengal & Bihar estd. in January, 1773 at the instance of Warren Hastings, the then Governor of Bengal. But this experiment was very short lived. Three Presidency Banks were established and started functioning in 1866. Alongwith their commercial functions they undertook some functions on behalf of the Government also. These Presidency Banks were amalgamated in 1921 to form the Imperial Bank of India which was primarily a commercial bank but used to perform certain central banking functions as well. In 1926 the Royal Commission on 'Indian Currency & Finance' (Milton Young Commission) recommended the dichotomy to be ended & the establishment of a Reserve Bank of India as its Central Bank. A Bill was introduced in the Legislative Assembly in 1927, which was later dropped. In the meantime during 1930-31 consideration for constitutional reforms in the country started being debated. Ultimately, the Reserve Bank of India Act was passed in 1934, part of which came into operation in 1935 & the remaining part in 1937. It took over the management of the currency from the Central Government and of carrying on the business of banking in accordance with the provisions of the Act. As stated in the preamble to the Act, the Bank has the responsibilities of (i) regulating the issue of Bank notes; (ii) keeping of

[2] Assistant Professor, Department of law, Sri JNMPG College, Lko

reserves with a view to securing the monetary stability in India; and (iii) generally to operate the currency and credit system of the country to its advantage.

As provided in Section 3(2) of the Act, the Bank is a body corporate having perpetual succession and common seal and shall sue and be sued in its name. The whole capital of the Bank of RS.5.00 crorcs is at present held by the Central Government. The Bank has Its Central Office in Bombay and other offices in Bombay. Calcutta. Delhi and Madras and branches in most of the State capitals and departments at a few other important .places. The matters of policy relating to banking, monetary management exchange control, inspection and supervision of banks, credit control, and economic and financial matters are formulated at the Central Office of the Bank at Bombay. The basic function of note issue and general banking business are discharged by the issue department and banking department at the local offices branches.

Organisational Model

The Reserve Bank of India (RBI) was originally constituted as a shareholders' bank with a share capital of 5 crorcs divided into 5 lakh fully paid-up shares of Rs. 1001- each. Only 2.300 shares were held by the Federal Government. The whole: country was divided into 5 areas for the operation of the Bank. viz., Bombay.Calcutta, Madras, Delhi & Rangoon*. (* closed Since 1947). In 1948, RBI was nationalised by the Reserve Bank (Transfer to Public Ownership) Act, 1948, and the entire hare capital was acquired by the Central Government.

With the introduction of the Constitution of India in 1950, RBI was put under entry 38 List I, VII Schedule U/Art226, thereby subjecting RBI to the legislative power of the Parliament. Accordingly, the Act was amended several times by the Parliament to virtually touch every section. There were some extremely important amendments which will be discussed alongwith the concerned subject. It will suffice to give the following outline of the organisational set-up of RB I as it stands today.

The RBI was initially designed on the pattern of Bank of England, theoretically subordinate to the Treasury. The Governor, 4 Deputy Governors, all Directors of the Central Board & the Local Boards are either appointed or nominated by the Central Government. The Governor & the Deputy Governor are whole time officials and hold office for such term not exceeding 5 years as may be fixed by Central Government and are eligible for re-appointment [S.8(4).] They may however be removed from their office by the Central Government at any time. This legal provision has made RBI an almost subordinate agency of the Ministry of Finance, Government of India.

There are several models of Central Banking. The dominating models are:

1. Bank of England, which is in theory as stated earlier subordinate to the Treasury but in practice has a relationship of co-operation rather than subordination (Sheldon, p.8). This model can be called (he 'functionally independent' model.

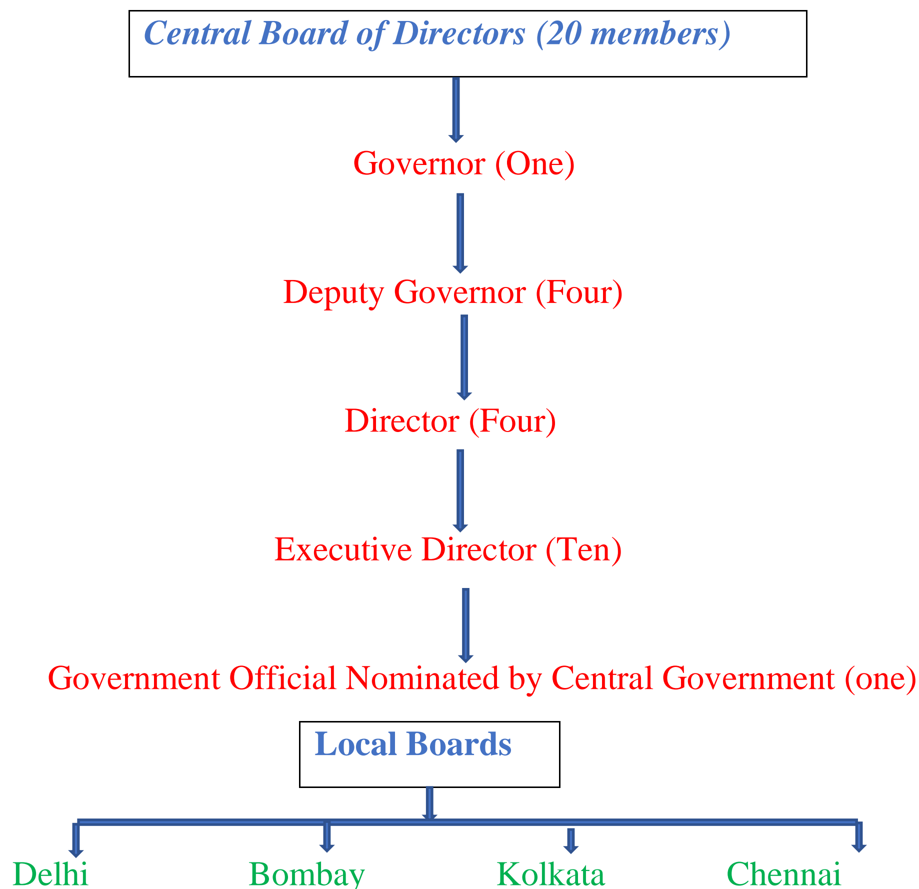
2. Federal Reserve System, USA- This system can be said to be both' functionally & statutorily independent.

3. Deutsche Bundesbank, Germany - This can be said to be constitutionally & functionally independent. The Central Bank Council & the Directorate are headed by the President & Vice President of the Deutsche Bundesbank. The President & Vice President of this' Bank are appointed by the President of Germany on recommendation of the Bundesrat (upper House of Parliament). The Bundesbank is independent of the instructions of the Federal Government. In order to maintain cooperation between the Central Bank & the Federal Government, the government is required under the Constitution to consult the President of Bundesbank on all matters of basic monetary policy. There is an autonomous Central Bank council in whose meetings the Federal government may take part but cannot participate in the voting.

The operational efficiency of an organisation predominantly depends upon the organisation structure of the institution. Several issues are important while determining this organisational structure. The organisation of RBI was modelled on the pattern of Bank of England as being subordinate to the Central Government at a time when imperial power wanted to have a positive & definite power centralisation. Continuation of the same structure in a democratic set-up may be examined in view of the need for a strong monetary system. This requires an autonomous institution to cooperate with the Central Government for laying down a strong monetary system. But the organisational structure of RBI is entirely subordinated to the Central Government. The Governor, 4 Deputy Governors and all the Directors of the Central Board and Local Boards are appointed/nominated by the Central Government (CG) and hold office during the pleasure of Central Government. In England a legal prescription of subordination to the treasury is replaced by close cooperation through establishment of sound conventions. In India on the other hand, this led to super control, so much so that even a Deputy Secretary of the Ministry of Finance became more powerful than the Governor of the RBI. This is very unscientific and injurious to the nation's economy. As for example, RBI can't refuse to supply any quantity of money to the government, against Government securities. As a result, it is unable to maintain the value of money and effectively manage the monetary affairs of the country, which is its primary consideration u/s.3 of RBI Act.

The Constitution of India is not merely a political document but it also contains the financial aspiration of the country. Therefore, the responsibility of the leader of the Bank in the national economy is enormous, which in no way is any less important than the resource distribution work of the Finance Commission of the country. As a matter of fact, the present statutory provision has not merely created an atmosphere of dependenatia, but has also made the Central Bank (i.e. RBI) gradually weaker. Since the system of governance could not build up a strong convention of autonomy and an institution of co-operation with the Central Government, it may be necessary to review the organisational structure in the light of experience of other constitutional institutions.

Organizational Structure of RBI



- Departments in the Central Office

  I. Secretariat

  2. Banking operations & development Agricultural Credit

  3. Industrial Credit

  4 Expenditure & budgetary control

  5. Rural Planning & Credit

  6. Exchange Control

  7. Currency management

  9. Govt. accounts Economic analysis & policy

  II. Credit planning cell

12 Statistical analysis & Computer

13. Management Service

14 Administration & Personnel

15. Legal Services

16. Inspection.

17. Premises

18.Bankers Training Colleges, one each at Bombay, Pune & Madras

CENTRAL BOARD & ITS FUNCTIONS

Constitution (Sec.08)

The general superintendence and direction of the affairs and business of the Bank are entrusted to a Central Board of Directors under Section 8 of the Act. However, the Board has to abide by any directions that may be given by the Central Government after consultation with the Governor of the Bank. Such directions can be given from time to time in public interest. The Central Board shall consist of the Governor, not more than 4 Deputy Governors to be appointed by the Central Government and other directors to be nominated by the Central Government as under:

(a) Four directors to be nominated by Central Government, one each from the Local Boards constituted under Section 9.

(b) Ten directors to be nominated by Central Government.

(c) One, Government official to be nominated by the Central Government.

The Governor and Deputy Governors are whole time officials of the Bank. A Deputy Governor and a Government official nominated as above [under Section 8(l)(d) may attend any meeting of the Central Board and participate in deliberations but do not have voting rights. The Governor and Deputy Governors hold office for a term fixed by the Central Government at the time of appointment, not exceeding 5 years and are eligible for reappointment. The Government official nominated under Section 8(1) (d) shall hold office at the pleasure of the Government. The directors 4 nominated from the Local Board shall continue during their membership of the Local Boards. The other directors shall hold office for 4 years and thereafter until their successors are nominated. The BR Act prescribes certain qualifications (Chartered Accountant, Lawyer, etc.) for the Directors of commercial banks, where as there are no such qualifications specified for appointment to the Board of Directors. Under Section 11, the Central Government may remove from, office the Governor or a Deputy Governor or any other director or any member of the Local Board. Central Government has also the power under Section 30 to supersede the Central Board. if the Bank fails to carry out any of the obligations imposed on it by or under the Act. In such a case the general superintendence and

direction of the affairs of the Bank shall be entrusted to any other agency determined by the Central Government. A full report of the circumstances leading to such action has to be laid before the parliament at the earliest and in any case within 3 months.

Powers

The Central Board has wide powers and may exercise all powers and do all acts and things which may be exercised or done by the Bank subject to any directions issued by the Central Government in public interest after consultation with the Governor. Further, the Governor or in his absence, the Deputy Governor nominated by him in this behalf shall also have powers of general superintendence and direction of the affairs and business of the Bank, and may exercise all the powers and functions of the Bank unless otherwise provided in the regulations made by the Central Board.

Meetings

Meetings of the Central Board have to be held at least six times a year and at least once in a quarter, The Governor or a Deputy Governor duly authorised shall preside over such meetings and he shall have casting vote (or second vote) in the event of equality of votes.

Regulations

Under Section 58 of the Act, the Central Board has the power to make regulations for giving effect to the provisions of the Act. Such regulations are to be made after previous sanction of the Central Government. These regulations are also required to be laid before both the Houses of the Parliament.

Functions

For practical convenience the Board delegated some of its functions by means of statutory regulations to a Committee called the 'Committee of the Central Board' consisting of the Governor, Deputy Governors and such other Directors as may be present at the relevant time in the area where the meeting is to be held. The Committee meets once a week, generally on Wednesday at the office of the Bank in which the Governor has his Head Quarters for the time being, to attend to the current business of the Bank, approval of the Banks weekly accounts pertaining to the issue and the banking departments. This Committee is assisted by two sub-committees: one for dealing with staff and related matters & the other for looking after matters relating to building projects. Of course, the role of these sub-committees is purely advisory in nature.

Special Provisions

The Reserve Bank is exempted from income-tax and super-tax on its profits or gains under Section 48 of the Reserve Bank of India Act. Further Section 57 provides that the Bank should not be placed under liquidation except by an order of the Central Government and in such manner as it may direct. Administrative set-up The Governor has the power of general superintendence and direction of the affairs of the Bank and

may exercise all powers of the Bank unless otherwise provided in the regulations made by the Central Board. The Deputy Governors, Executive Directors and other officers in different grades assist the Governor. The delegation of powers to different grades of officers is governed by the Reserve Bank of India General Regulations, 1949, which are statutory regulations made under Section 58 of the Act. The officers and other staff are governed by the Reserve Bank of India (Staff) Regulations, 1948. These' regulations are not statutory. As held by the Supreme Court in V.T. Khanzode V s. Reserve Bank1, besides making statutory regulations under Section 58 of the Act, Bank could also lay down service conditions of the staff administratively under Section 7(2) of the Act. Establishments the Central office [Head Quarters (H.Qrs.)] of the Bank is located at Bombay. Formulation of policies concerning banking, money management, inspection & supervision of Banks, extension of banking & credit facilities, management of foreign exchange and rendering of advice to the Central Governmental these functions are carried out from the Head Quarters. Besides these the Central office has various departments. The department of 'banking operations & development' includes Public Accounts Division (PAD), Public Debt Office (PDO), Deposit Accounts Division (DAD) & Securities Division (SO). The Head Quarters of the 'department of non-banking companies' is located in Calcutta.

LOCAL BOARDS AND ITS FUNCTIONS

Constitution

Section 9 of the Act provides for four regional Local Boards consisting of 5 members each appointed by the Central Government to represent, as far as possible, territorial and economic interest and the interests of co-operative and indigenous banks. The Local Boards have their headquarters at Bombay, Calcutta, Delhi and Madras. The Local Board has a Chairman elected from the members. The members of the Local Boards hold office for 4 years and thereafter until their successors are nominated. They are also eligible for reappointment.

Functions

The function of the Local Board is to advise the Central Board on matters generally or specially referred to it by the Central Board and also to perform any duties delegated to it by the Central Board. The advice of the Local Boards is sought on various matters of local importance, for ego applications for opening new branches of commercial banks, opening of offices in India by foreign banks, directions to be given to the banks on basis of inspection, granting of license to commercial banks, etc., In 1976, financial powers were also delegated to the Local Boards enabling them to take final decisions in matters relating to purchase of land, buildings, etc. within the limits fixed by the Central Board.

Disqualifications

There are certain disqualifications under Section 10 applicable to Directors of both Central Board and Local Boards. Thus,

(i) a person who is a salaried government official;

(ii) an adjudicated insolvent or one who has suspended payment or has compounded with his creditors;

(iii) a person of unsound mind;

(iv) an officer or employee of any bank or

(v) a director of a banking company or co-operative bank is disqualified to be a director.

However, this stipulation prohibiting a director from being a government employee or salaried government official is not applicable to the Governor, Deputy Governor and the Director nominated under Section 8(1)(d). The deficiency of a Central Banking system is to be judged by its ability to maintain price stability' inside and outside the country. Factors affecting this efficiency are,

(i) the strength of autonomous decision-making power for leading the whole banking system' it the basic objective of money management;

(ii) quick information flows a d capability of immediate assessment of the adequate power of system corrections.

FUNCTIONS

It has already been pointed out that RBI has been constituted as Central Bank of the country. Classification functions of the Central bank are the following:

Banker to the Government: Reserve Bank of India is the banker of the Central & State Governments as such it has treasury functions. It collects money for & on behalf of the Government and meets the expenses, whereas in the case of Central Government it may demand any quantity of money and the RBI is obliged to meet the demand. In case of State governments, the RBI extends a time credit facility to a maximum limit which is required to be set off against future collections.

Currency Function: RBI is the sole authority for the issue of the currency. Of course, one-rupee coins & notes & subsidiary coins are issued by the government of India, they are put into circulation only through RBI. Credit Control & Money Management of currency:

RBI regulates the value of money & controls the credit system through manipulation of cash reserve ratio, bank rate, open market buying & selling of securities & statutory liquidity ratio. Banker's Bank: RBI is the apex bank regulating, controlling & creating opportunities for ordinary commercial banks to function efficiently. It also

gives constant advice about the various goals of lending, borrowing & other banking functions. It also monitors the banking functions of the institutions of commercial banks & institutional banks. Leadership in institutional banking: RBI provides leadership to all institutional banking such as NABAD Rural Bank, IBRD, IFC in industrial banking, National Housing banking so on & so forth. These banks look forward to RBI for their policies on loans & advances. Ordinary Commercial Banking Function: RBI carry on ordinary commercial banking functions for the commercial banks and the government which many central banks of other countries do not do. These functions include bill discounting, giving loans & advances to financial institutions, dealing with foreign exchange & the like.

Functions of RBI (The India's Central Bank)

Reserve Bank of India being an apex court of the center enjoys enormous power and functions under banking system in India. It has monopoly over the issue of bank-notes and monetary system of the country. These power and functions as to issue of bank notes and currency system are governed by the Reserve Bank of India Act, 1934. Besides it the Banking Regulation Act, 1949 also empowers certain power and Function of the Reserve Bank.

Reserve bank of India as a Central Bank of the country its Functions may be broadly discussed in the following headings:

- **Main Functions of RBI**

Main functions are those functions which every central bank of each nation performs all over the world. Basically, these functions are in line with the objectives with which the bank is set up. It includes fundamental functions of the Central Bank. They comprise the following tasks.

1. Issue of Currency Notes: The RBI has the sole right or authority or monopoly of issuing currency notes except one rupee note and coins of smaller denomination. These currency notes are legal tender issued by the RBI. Currently it is in denominations of Rs. 2, 5, 10, 20, 50, 100, 500, and 1,000. The RBI has powers not only to issue and withdraw but even to exchange these currency notes for other denominations. It issues these notes against the security of gold bullion, foreign securities, rupee coins, exchange bills and promissory notes and government of India bonds.

2. Banker to other Banks: The RBI being an apex monitory institution has obligatory powers to guide, help and direct other commercial banks in the country. The RBI can control the volumes of banks reserves and allow other banks to create credit in that proportion. Every commercial bank has to maintain a part of their reserves with

its parent's viz. the RBI. Similarly, in need or in urgency these banks approach the RBI for fund. Thus, it is called as the lender of the last resort.

3. Banker to the Government: The RBI being the apex monitory body has to work as an agent of the central and state governments. It performs various banking function such as to accept deposits, taxes and make payments on behalf of the government. It works as a representative of the government even at the international level. It maintains government accounts, provides financial advice to the government. It manages government public debts and maintains foreign exchange reserves on behalf of the government. It provides overdraft facility to the government when it faces financial crunch.

4. Exchange Rate Management: It is an essential function of the RBI. In order to maintain stability in the external value of rupee, it has to prepare domestic policies in that direction. Also, it needs to prepare and implement the foreign exchange rate policy which will help in attaining the exchange rate stability. In order to maintain the exchange rate stability, it has to bring demand and supply of the foreign currency (U.S Dollar) close to each other.

5. Credit Control Function: Commercial bank in the country creates credit according to the demand in the economy. But if this credit creation is unchecked or unregulated then it leads the economy into inflationary cycles. On the other credit creation is below the required limit then it harms the growth of the economy. As a central bank of the nation the RBI has to look for growth with price stability. Thus, it regulates the credit creation capacity of commercial banks by using various credit control tools.

6. Supervisory Function: The RBI has been endowed with vast powers for supervising the banking system in the country. It has powers to issue license for setting up new banks, to open new branches, to decide minimum reserves, to inspect functioning of commercial banks in India and abroad, and to guide and direct the commercial banks in India. It can have periodical inspections an audit of the commercial banks in India.

- **Developmental / Promotional Functions of RBI**

Along with the routine traditional functions, central banks especially in the developing country like India have to perform numerous functions. These functions are country specific functions and can change according to the requirements of that country. The RBI has been performing as a promoter of the financial system since its inception. Some of the major development functions of the RBI are maintained below.

1. Development of the Financial System: The financial system comprises the financial institutions, financial markets and financial instruments. The sound and efficient financial system is a precondition of the rapid economic development of the

nation. The RBI has encouraged establishment of main banking and non-banking institutions to cater to the credit requirements of diverse sectors of the economy.

2. Development of Agriculture: In an agrarian economy like ours, the RBI has to provide special attention for the credit need of agriculture and allied activities. It has successfully rendered service in this direction by increasing the flow of credit to this sector. It has earlier the Agriculture Refinance and Development Corporation (ARDC) to look after the credit, National Bank for Agriculture and Rural Development (NABARD) and Regional Rural Banks (RRBs).

3. Provision of Industrial Finance: Rapid industrial growth is the key to faster economic development. In this regard, the adequate and timely availability of credit to small, medium and large industry is very significant. In this regard the RBI has always been instrumental in setting up special financial institutions such as ICICI Ltd. IDBI, SIDBI and EXIM BANK etc.

4. Provisions of Training: The RBI has always tried to provide essential training to the staff of the banking industry. The RBI has set up the bankers' training colleges at several places. National Institute of Bank Management i.e NIBM, Bankers Staff College i.e BSC and College of Agriculture Banking i.e CAB are few to mention.

5. Collection of Data: Being the apex monetary authority of the country, the RBI collects process and disseminates statistical data on several topics. It includes interest rate, inflation, savings and investments etc. This data proves to be quite useful for researchers and policy makers.

6. Publication of the Reports: The Reserve Bank has its separate publication division. This division collects and publishes data on several sectors of the economy. The reports and bulletins are regularly published by the RBI. It includes RBI weekly reports, RBI Annual Report, Report on Trend and Progress of Commercial Banks India., etc. This information is made available to the public also at cheaper rates.

7. Promotion of Banking Habits: As an apex organization, the RBI always tries to promote the banking habits in the country. It institutionalizes savings and takes measures for an expansion of the banking network. It has set up many institutions such as the Deposit Insurance Corporation-1962, UTI-1964, IDBI-1964, NABARD-1982, NHB-1988, etc. These organizations develop and promote banking habits among the people. During economic reforms it has taken many initiatives for encouraging and promoting banking in India.

8. Promotion of Export through Refinance: The RBI always tries to encourage the facilities for providing finance for foreign trade especially exports from India. The Export-Import Bank of India (EXIM Bank India) and the Export Credit Guarantee Corporation of India (ECGC) are supported by refinancing their lending for export purpose.

- **Supervisory Functions of RBI**

The reserve bank also performs many supervisory functions. It has authority to regulate and administer the entire banking and financial system. Some of its supervisory functions are given below.

1. Granting license to banks: The RBI grants license to banks for carrying its business. License is also given for opening extension counters, new branches, even to close down existing branches.

2. Bank Inspection: The RBI grants license to banks working as per the directives and in a prudent manner without undue risk. In addition to this it can ask for periodical information from banks on various components of assets and liabilities.

3. Control over NBFIs: The Non-Bank Financial Institutions are not influenced by the working of a monitory policy. However, RBI has a right to issue directives to the NBFIs from time to time regarding their functioning. Through periodic inspection, it can control the NBFIs.

4. Implementation of the Deposit Insurance Scheme: The RBI has set up the Deposit Insurance Guarantee Corporation in order to protect the deposits of small depositors. All bank deposits below Rs. One lakh are insured with this corporation. The RBI work to implement the Deposit Insurance Scheme in case of a bank failure.

- **Reserve Bank of India's Credit Policy**

The Reserve Bank of India has a credit policy which aims at pursuing higher growth with price stability. Higher economic growth means to produce more quantity of goods and services in different sectors of an economy; Price stability however does not mean no change in the general price level but to control the inflation. The credit policy aims at increasing finance for the agriculture and industrial activities. When credit policy is implemented, the role of other commercial banks is very important. Commercial banks flow of credit to different sectors of the economy depends on the actual cost of credit and arability of funds in the economy.