# RECENT PRONOUNCEMENTS RELATED TO DISHONOUR OF CHEQUES UNDER SECTION 138 OF THE NEGOTIABLE INSTRUMENTS ACT, 1881

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# RECENT PRONOUNCEMENTS RELATED TO DISHONOUR OF CHEQUES UNDER SECTION 138 OF THE NEGOTIABLE INSTRUMENTS ACT, 1881

The wide use of cheques as a mercantile instrument requires clarity in the law relating to dishonour of cheques. The nodal statute on the law related to negotiable instruments is the Negotiable Instruments Act, 1881 (**"the Act"**). The Supreme Court had famously observed that the law relating to negotiable instruments is the law of the commercial world, which was enacted to facilitate the activities in trade and commerce, made provisions to render sanctity to credit instruments which could be deemed to be convertible into money and easily passable from one person to another. The Apex Court had observed that the purpose of the Act was to present an orderly and authoritative statement of the leading rules of law relating to the negotiable instruments.[1]

To achieve the objective of the Act, the Legislature in its wisdom deemed it proper to create special procedures in case the obligation under the instrument was not discharged. The Act by its Section 138, casts criminal liability on the issuer of a cheque in the event of its dishonour leading to imprisonment up to two years or fine which may extend to twice the amount or with both. Failure to make payment

*[1] Shri Ishar Alloy Steels Ltd. v. Jayaswal Neco Limited (2001) 3 SCC 609*

within the statutory period despite receipt of notice of the event of cheque dishonour, raises presumption of *malafide* on the part of the issuer and suspicions regarding the credibility of the negotiable instrument. To prevent this and maintain faith in banking and business operations, Section 139 was incorporated in the Act. This provision creates a mandatory presumption that a cheque attracting Section 138 of the Act, was received by the cheque holder in partial or in complete satisfaction of a legally enforceable debt or liability. A court shall act on the basis of such presumption, and it is for the issuer to rebut the presumption and establish the contrary on the strength of evidence. Since Section 138 of the Act creates an offence and the law relating to the penal provisions must be interpreted strictly so that no person can ingeniously, insidiously or strategically be prosecuted.

Vicarious liability on directors and key managerial personnel in cheque dishonour cases for cheques issued by a corporate entity is an issue that assumes great significance Under Section 141 of the Act, where a dishonoured cheque is issued by a corporate entity, every person who was in charge and responsible to the company for the conduct of its business as well as a person whose negligence has led to the commission of the offence under Section 138 of the Act can be

held vicariously liable for the offence. However, if the accused person successfully establishes that such offence was committed without their knowledge or despite exercising due diligence, then such person shall not be held liable for the offence.

In certain recent pronouncements, the aspect of presumption of debt and vicarious liability on key managerial persons (**"KMP"**) of corporate bodies in cheque dishonour cases was examined, some of which are summarised below:

1. **Sunil Todi v. State of Gujarat**
   *[Crl. Appeal No. 446 of 2021 dated 03 December 2021 – Supreme Court]*

The primary issue before the Supreme Court in this appeal was whether the dishonour of a cheque furnished as a 'security' is a legally enforceable debt covered under the provisions of Section 138 of the Act.

The Supreme Court observed that the legal requirement which Section 138 embodies is that a cheque must be drawn by a person for the payment of money to another *'for the discharge, in whole or in part, of any debt or other liability'*. A cheque may be issued to facilitate a commercial transaction

between the parties. Where parties have executed a commercial agreement and a cheque has been issued by one of the parties as a security to discharge the obligations set out in the agreement, the issuer can easily contemplate presentation of such cheque before a bank on account of default in repayment by the issuer. In such an instance, the cheque would mature for presentation and therefore would have been presented by its holder for satisfaction of a legally enforceable debt or liability.

Dismissing the appeal and the challenge with respect to the nature of the cheque, the Court held that labelling the cheque as security to a debt would not obviate its intrinsic character as an instrument designed to meet a legally enforceable debt or liability.

2. **Sanjay Gupta v. The State & Anr.**
   *[Crl. Rev. P. No. 326/2021 & Crl. M. (Bail) No. 1244/2021 dated 24 March 2022 – Delhi High Court]*

Here, the issuer of the cheque had filed a revision petition challenging the conviction order and sentence passed by the Ld. Additional Sessions

directing the accused to pay compensation to the complainant and in the failure of such payment, undergo imprisonment for three months.

Upon examination of the trial court records, particularly the cross-examination of the accused, the Court observed that the accused had varying versions relating to the background of the issuance of the cheque. While the accused had deposed that the cheque was not issued by him in satisfaction of a debt, there was no material on record to prove that that in fact was the case.

The Court went on to hold that under the Act, the presumption of a legally enforceable debt is created in favour of the cheque holder upon admission by the accused of the issuance of the cheque and the signature. Thereafter, the onus to rebut the said presumption is on the accused. While the accused need not adduce his own evidence and could rely upon the material submitted by the complainant, a mere statement of the accused would not be sufficient to rebut the presumption.

3. **Dilip Hariramani v. Bank of Baroda**

*[Crl. Appeal No. 767 of 2022 dated 09 May 2022 – Supreme Court]*

In this case, the Appellant challenged the order convicting him under Section 138 of the Act for dishonour of a cheque issued by the firm where he was a partner even though he was not the signatory to the cheque. The partnership firm was not arraigned as an accused party in the complaint filed under Section 138 of the Act. In order to establish that the Appellant was vicariously liable, it was necessary to prove that when the cheque was issued, he was in control of the daily affairs of the business, or the cheque was issued with his consent or connivance or because of his negligence. However, the Supreme Court opined that the Appellant had not issued the cheque, either in his individual capacity or as a partner of the firm. Further, it could not be established that he was responsible for the conduct of affairs of the firm towards the issuance of the cheque. Accordingly, the conviction was set aside.

The Court observed that the statutes such as Partnership Act, 1932 the Indian Contract Act, 1872, Recovery of Debts Due to Banks and Financial Institutions Act, 1993 and the Securitisation and Reconstruction of

Financial Assets and Enforcement of Security Interest Act, 2002 create a civil liability on the Appellant to discharge a legal debt but for the Appellant to be vicariously liable under Section 141 of the Act, the accused person:

a. should be in charge of and responsible for the day-to-day business of the company or firm; or
b. should be a director, manager, secretary, or other officer of the company with whose consent or connivance or due to whose negligence, the offence was committed.

However, such vicarious liability arises only when the company or firm commits the offence as the primary offender. Therefore, where the complainant fails to establish the offence under Section 138 against the entity, the question of vicarious liability, i.e., casting a liability on the director or KMP as an agent of such company would not arise.

4. **Narinder Garg & Ors. V. Kotak Mahindra Bank Limited & Ors.**
   *[W. P. (C) No. 93/2022 dated 28 March 2022 – Supreme Court]*

The Petitioners/accused approached the Supreme Court for a writ of mandamus to quash criminal complaints filed against them under

Section 138 of the Act. The basis of the writ was that the corporate entity on whose behalf they had signed the cheques had been admitted into insolvency under the Insolvency & Bankruptcy Code, 2016 **("the Code")** and the Resolution Plan qua the entity stands approved by the Committee of Creditors. The Petitioners contended that the effect of acceptance of the Resolution Plan, which also provided for the dues owed to the complainant, would be to obliterate any pending trial under Sections 138 and 141 of the Act. Therefore, the Petitioners/accused persons also sought for quashing of criminal complaints against the erstwhile management and the director.

The Supreme Court dismissed the writ petitions and held that the moratorium under Section 14 of the Code is applicable only to the corporate entity against which insolvency resolution process commences in terms of the Code. The operation of moratorium does not protect the natural persons accused under Section 141 of the Act, and they continue to be statutorily liable under the provisions of the Act. Thus, the vicarious liability of the management would not terminate with the resolution and revival of the corporate entity.

5. **I.R Vijay Kumar v. M/S IFCI Factors Limited & Ors.**
*[Crl. M.C. 2358/2021 dated 20 December 2021 – Delhi High Court]*

The special leave petition was filed by an accused director in the company challenging the High Court order by which the High Court had refused to quash the complaint against him under Section 138 of the Act. The said director had contended that he was a dormant director in the accused company, and he was not responsible for conduct of its day-to-day affairs. It was also contended that he was not a signatory to the dishonoured cheque and therefore, the complaint failed to satisfy the necessary ingredients required under Section 138.

The Court observed that it emanates from the material placed on record that specific allegations were levelled against the director. Apart from the basic averment that the petitioner was responsible for the day-to-day business of the accused company, it was further averred that the petitioner, being a director, was in charge of the financial decision-making of the accused company and he had agreed to guarantee

repayment of all amounts payable by the accused company to the complainant.

The Court, therefore, held that the mandate of Section 141 of the Act, being a penal provision, must be construed strictly and the issue whether the conditions stipulated in Section 141 have been fulfilled in the present case shall be a matter of trial.

***KEY TAKEAWAYS***

- Section 138 of the Act is applicable even where there was no liability at the time the cheque was issued, but the debt is incurred after issuance of the cheque and before its presentation – Supreme Court

- While the accused need not adduce evidence to rebut the presumption of a legally enforceable debt created in favour of the complainant and may rely on the complainant's material, a mere statement by the accused is not enough to rebut the presumption of a legally enforceable debt – Delhi High Court

- Vicarious liability under Section 141 of the Act cannot be fastened on a person merely because of civil liability under any other statute – Supreme Court

- Moratorium applies only to the corporate debtor; KMP continue to be liable under Section 138 of the Act – Supreme Court

- Specific allegations even against a dormant director are sufficient to satisfy the conditions of Section 141 of the Act and warrant a trial – Delhi High Court

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