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Beyond Funds and Arrangements: Judicial trends in section 138 of the Negotiable Instruments Act, 1881

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ABSTRACT

This article critically examines the evolving judicial interpretation of Section 138 of the Negotiable Instruments Act, 1881, which was originally introduced to penalise cheque dishonour due to “insufficient funds” or “exceeding arrangements” with the bank. Over time, Indian courts have adopted a purposive and expansive approach, extending the applicability of this provision to other reasons for dishonour such as “stop payment,” “account closed,” and “signature mismatch.” These developments reflect a clear judicial intention to uphold the credibility and reliability of cheque-based transactions in the commercial sphere.

The paper analyses key Supreme Court decisions that have shaped this broader interpretation and argues that the grounds mentioned in Section 138 are illustrative rather than exhaustive. It also discusses the statutory presumptions under Section 139 and procedural safeguards available to drawers, including the notice period and the opportunity to rebut liability. Ultimately, the article contends that the judiciary has struck a careful balance between deterring wilful defaulters and protecting honest drawers, thereby reinforcing the importance of cheques as trusted financial instruments in India’s transactional landscape.

I. INTRODUCTION

Enacted in 1881, the Negotiable Instruments Act (NI Act) was designed to regulate financial instruments such as cheques, promissory notes, and bills of exchange, thereby promoting legal certainty and consistency in commercial practices. To address the growing issue of cheque dishonour, Section 138 was introduced through an amendment in 1988. This provision imposes criminal liability in specified cases of dishonour, aiming to deter defaults and uphold the credibility of cheques as a mode of payment.

This article examines whether the grounds for dishonour mentioned under Section 138, specifically, “insufficiency of funds” and “exceeding the arrangement”, are exhaustive. It

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analyses judicial interpretations that have expanded the provision's ambit to include other reasons such as "stop payment," "account closed," and "signature mismatch," thereby reinforcing the cheque's legal and commercial significance.

II. ESSENTIAL CONDITIONS FOR ATTRACTING LIABILITY UNDER SECTION 138

To attract liability under Section 138 of the NI Act, the following conditions must be met:

1. **Issuance by Drawer:** The cheque must be drawn by a person on an account maintained by them, ensuring accountability for the issuer.
2. **Legally Enforceable Debt:** The cheque must be issued to settle a legally recognised debt or liability, establishing the transaction's validity.
3. **Dishonour for Specific Reasons:** The cheque is returned unpaid due to (a) insufficient funds or (b) exceeding the arrangement with the bank.
4. **Demand Notice:** The payee or holder in due course must issue a written demand notice within 30 days of receiving dishonour information, providing the drawer an opportunity to rectify the default.
5. **Failure to Pay:** The drawer fails to pay the amount within 15 days of receiving the notice, triggering liability.

III. JUDICIAL INTERPRETATION OF "INSUFFICIENCY OF FUNDS" AND "EXCEEDS ARRANGEMENT" UNDER SECTION 138

The Supreme Court has consistently adopted a purposive interpretation of Section 138 of the Negotiable Instruments Act, 1881, holding that the grounds of "*insufficiency of funds*" and "*exceeds arrangement*" are illustrative, not exhaustive. This approach ensures that cheque dishonour, regardless of the stated reason, attracts liability if it reflects a failure to honour a legally enforceable debt, thereby upholding the provision's aim to enhance cheque credibility in commercial transactions. Key judgments illustrate this expansive scope, categorised by reasons for dishonour:

1. Stop payment instructions

In *Modi Cements Ltd. v. Kuchil Kumar Nandi* (1998) 3 SCC 249², the Supreme Court held that dishonour of a cheque due to "stop payment" instruction attracts liability under Section 138, provided the cheque was issued against a subsisting legal obligation. The Court rejected a narrow reading of the provision, emphasising that drawers should not be permitted to escape

² Modi Cements Ltd. v. Kuchil Kumar Nandi, (1998) 3 S.C.C. 249 (India), <https://indiankanoon.org/doc/975556/>.

liability simply by issuing stop-payment instructions, as that would defeat the legislative intent behind the 1988 amendment. Under Section 139 of the NI Act, a presumption arises in favour of the cheque holder that the instrument was issued to discharge a financial obligation. Once this presumption is triggered, it is for the drawer to rebut it by furnishing convincing evidence that no lawful debt existed at the time the cheque was drawn.

Similarly, in *MMTC Ltd. v. Medchl Chemicals and Pharma (P) Ltd. (2001)*³, the Court clarified that mere issuance of stop-payment instructions will not shield the drawer from prosecution unless they can show that the account had adequate funds and that there were legitimate grounds for such instructions.

In *Rangappa v. Sri Mohan (2010) 11 SCC 441*⁴, the Court reinforced that a cheque dishonoured due to stop-payment instructions still attract penal consequences under Section 138, even if the account had sufficient funds, so long as the cheque was issued to settle a legitimate liability. The Court reiterated that once the essential ingredients of the offence are established, the presumption under Section 139 comes into play and must be rebutted on a preponderance of probabilities.

2. Account closed

In *NEPC Micon Ltd. v. Magma Leasing Ltd. (1999) 4 SCC 253*⁵, the Court held that dishonour due to “account closed” falls within Section 138, as a closed account implies no funds, akin to insufficiency. The Court stated: “The expression ‘amount of money standing to the credit of that account is insufficient’ is a genus, and reasons like ‘account closed’ or ‘stop payment’ are species of that genus.” This interpretation aligns with the legislative goal of penalizing defaults that erode trust in cheques.

3. Signature mismatch

In *Laxmi Dyechem v. State of Gujarat (2012) 13 SCC 375*⁶, the Court addressed dishonour due to signature mismatch, ruling it within Section 138’s ambit. The Court clarified that the grounds listed in Section 138 such as “*insufficient funds*” and “*exceeds arrangement*” are illustrative and do not restrict the provision’s broader scope. Such dishonour reflects the drawer’s failure to honour a legally enforceable debt, consistent with the provision’s purpose

³ M.M.T.C. Ltd. v. Medchl Chemicals & Pharma (P) Ltd., Appeal (Crl.) Nos.1173–74 of 2001 (India), <https://www.indianemployees.com/judgments/details/m-s-m-m-t-c-ltd-anr-vs-m-s-medchl-chemicals-pharma-p-ltd>.

⁴ Rangappa v. Sri Mohan, (2010) 11 S.C.C. 441 (India), <https://indiankanoon.org/doc/150051/>.

⁵ NEPC Micon Ltd. v. Magma Leasing Ltd., (1999) 4 S.C.C.253(India),<https://api.sci.gov.in/jonew/judis/16865.pdf>.

⁶ Laxmi Dyechem v. State of Gujarat, (2012) 13 S.C.C. 375 (India), <https://indiankanoon.org/doc/19306410/>.

of preserving the credibility of cheques and banking instruments. The presumption under Section 139 remains operative, requiring the drawer to rebut it with cogent evidence, such as proof of a bank error or absence of liability.

From the above judgements, it is evident that the two grounds mentioned under section 138 for attracting the liability for dishonour – namely, “*insufficiency of funds*” and “*amount exceeds arrangement*” are not exhaustive. Other grounds for dishonour, insofar as they indicate the drawer’s default in meeting the financial obligation, may equally attract liability under the scope and purpose of Section 138 of the Negotiable Instruments Act, 1881.

Section 138 was introduced to prevent individuals from evading their financial commitments and to ensure that the cheques are honoured, thereby maintaining the credibility of cheques as reliable instruments in commercial transactions.

However, there may be situations where dishonour occurs for reasons such as “stop payment”, “account closed” or “signature mismatch”, which may arise genuinely and without any fraudulent intent. In such cases, the question arises: **Is it appropriate to treat such drawers as defaulters under section 138 of the Section 138 of the Negotiable Instruments act, 1881?**

The answer to this lies in two provisions:

1. **Section 138** provides a safeguard by granting the drawer a 15-day time from the receipt of the statutory notice to make the payment. If the drawer acts in good faith and clears the dues within this period, they can avoid criminal liability under this provision.
2. **Section 139** introduces a *rebuttable presumption* that the cheque was issued in discharge of a legally enforceable debt or liability. Once issuance and dishonour of the cheque is established, this presumption arises in favour of the holder.

Once it is established that the accused issued the cheque and it was subsequently dishonoured, the onus shifts to the drawer to disprove the existence of a legally enforceable debt or liability.

If an innocent person is wrongfully prosecuted under Section 138, they always have the legal right to rebut the presumption by adducing credible evidence to demonstrate their innocence.

What should be the standard of proof?

In *Rangappa v. Sri Mohan* (2010) 11 SCC 441⁷, the Supreme Court explained that the accused need not establish their defence beyond a reasonable doubt. Rather, the required standard is a balance of probabilities. If the accused presents a credible defence that raises

⁷ Rangappa v. Sri Mohan, (2010) 11 S.C.C. 441 (India), <https://indiankanoon.org/doc/150051/>.

doubts about the existence of a legally enforceable debt, the presumption created under Section 139 can be successfully challenged.

IV. CONCLUSION

Over time, courts have interpreted Section 138 of the *Negotiable Instruments Act* in a manner that prioritises its underlying commercial purpose and practical enforcement, rather than adhering to a narrow or literal reading. The Courts have consistently held that the two reasons expressly mentioned – “insufficient funds” and “exceeds arrangement” – are not exhaustive, but merely illustrative. Through decisions like *Modi Cements*, *NEPC Micon*, *MMTC, Rangappa*, and *Laxmi Dyechem*, the Supreme Court has reinforced that any reason for dishonour, if it reflects a failure to honour a legally enforceable liability can attract penal consequences under Section 138.

At the same time, the law incorporates fair procedural safeguards. The 15-day notice period provides an opportunity for genuine rectification, while the presumption under Section 139 though strong is rebuttable through a preponderance of probabilities. This dual framework ensures that deliberate defaulters are deterred, and the integrity of cheque-based transactions is upheld, while innocent drawers are protected from unwarranted punishment.

In sum, the judicial trend firmly leans towards protecting the credibility of cheques over a strict, literal interpretation of grounds for dishonour. The law, as it currently stands strikes a careful balance by penalising dishonest conduct without allowing technicalities to be weaponized against Bonafide drawers.
