
HONOUR BETRAYED: WRONGFUL DISHONOUR OF CHEQUES, BANKER'S LIABILITY, AND THE SEARCH FOR CUSTOMER REMEDIES IN INDIA

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ABSTRACT

A businessman in Bangalore issued a cheque despite having sufficient funds in his bank account. Due to a banking error, the cheque was dishonoured for “insufficient funds,” damaging his business reputation and causing financial loss. This situation highlights the legal liability of banks in cases of wrongful dishonour of cheques and the remedies available to customers under Indian law. The cheque remains one of the most significant negotiable instruments in commercial transactions despite the emergence of the digital banking systems. The wrongful dishonour of cheques by banks, particularly on the ground of insufficient funds or balance may arise due to banking errors, negligence, or unauthorised deductions, creating serious financial and reputational consequences for customers. In India, the relationship between banker and customer is contractual in nature and imposes a duty upon banks to honour valid cheques where sufficient funds exist. Wrongful dishonour constitutes a breach of this duty and may attract civil liability, compensation claims, and consumer protection remedies. This paper examines the legal framework governing wrongful dishonour of cheques in India with particular reference to banker’s liability and customer remedies.

Keywords: wrongful dishonour of cheque, banker’s liability, insufficient funds, customer remedies.

1. INTRODUCTION

In the modern economic landscape, the cheque system facilitates the smooth flow of commerce by enabling the transfer of funds without the physical exchange of currency. It is a written order emanating from a customer (the drawer) directing their bank (the drawee) to pay a specified sum to the person named therein (the payee) or to the bearer. The trust and reliance placed on this system are immense. Consequently, when a cheque is returned unpaid, or "dishonoured," it disrupts financial commitments, tarnishes business relationships, and can even lead to penal consequences for the drawer under laws designed to preserve the instrument's credibility.

The banker-customer relationship is fundamentally that of a debtor and creditor, but it is imbued with fiduciary duties, the most important of which is the obligation to honour its customer's mandate, provided certain conditions are met. A failure to do so a wrongful dishonour is not a trivial error. It is a breach of contract, an act of negligence, and an affront to the customer's reputation.

Dishonour of cheques may occur for several reasons, including insufficiency of funds, irregular signatures, stale instructions, stop payment instructions, or technical defects.¹ However when a cheque is dishonoured wrongfully despite the existence of adequate funds or due to errors attributed to the bank, serious legal consequences arise. And such wrongful dishonour affects not only the financial position of the customer but also damages the customer's reputation and credit worthiness.²

In India the law relating to cheques is primarily governed by the Negotiable Instruments Act, 1881³, while banker- customer obligations are derived from principles of contract law.⁴ Section 31 of the Negotiable Instruments Act, 1881 imposes liability upon drawee (the bank) for losses caused by wrongful dishonour of cheque.⁵ The growth of consumer jurisprudence under the Consumer Protection Act, 2019⁶ has further strengthened remedies available to aggrieved customers.

This paper seeks to critically analyse the legal dimensions of wrongful dishonour of cheques

¹ M.L. Tannan, *Tannan's Banking Law and Practice in India* 312 (23rd ed. 2010).

² *Marzetti v. Williams*, (1830) 109 ER 842

³ Negotiable Instruments Act, No. 26 of 1881 (India).

⁴ Indian Contract Act, 1872

⁵ Negotiable Instruments Act, No. 26 of 1881, § 31 (India).

⁶ Consumer Protection Act, 2019.

due to insufficient funds, with special emphasis on banker's liability and customer remedies in India. It evaluates statutory provisions, judicial trends, and practical challenges in enforcement while suggesting reforms for strengthening banking accountability.

1.1. RESEARCH OBJECTIVES

This paper pursues three specific objectives, they are as follows:

1. To examine the nature and legal basis of a banker's duty to honour cheques and the consequences of breach under the Indian law.
2. To identify and critically evaluate the remedies available to a customer whose cheque has been wrongfully dishonoured.
3. To assess the adequacy of the existing legal and regulatory framework and purpose reforms to strengthen customer protection.

1.2. RESEARCH QUESTIONS

1. This paper is animated by three central questions, they are as follows:
2. What is the precise legal basis of a banker's liability for wrongful dishonour, and what standard of care does Indian Law impose?
3. How adequate and accessible are the civil, consumer, and criminal remedies available to customers aggrieved by wrongful dishonour?
4. What systematic reforms are necessary to ensure that the legal entitlements of customers translate into effective and timely redress?

1.3. RESEARCH PROBLEM

The core issue this paper addresses is the disjunction between the legal entitlement of a customer to payment and the practical difficulty of obtaining adequate, timely redress when a bank wrongfully refuses that payment. While Courts have consistently held banks liable for wrongful dishonour,⁷ the remedies process involves multiple overlapping forums, disparate

⁷ Bhagwan Dass v. Punjab National Bank, AIR 1976 Del 280 (India).

evidentiary standards, and uncertain quantum of damages, factors that collectively deter aggrieved customers, particularly those with limited resources, from seeking enforcement of their rights.

1.4. RESEARCH METHODOLOGY

This study adopts a doctrinal approach. Primary sources are the Negotiable Instrument Act, 1881; the Indian Contract Act, 1872; the Consumer Protection Act, 2019; the Banking Ombudsman Scheme, 2006; and the Reserve Bank circulars are being analysed along with judicial precedents of the Supreme Court, High Courts, and the National Consumer Disputes Redressal Commission. Secondary resources like academic commentaries, and law commission reports inform normative recommendations in the conclusion section.

2. THE BANKER-CUSTOMER RELATIONSHIP AND THE DUTY TO HONOUR

2.1. Contractual Relation

At the heart of the affairs of such a bank and its current account or savings account holder is a contract of deposit, thus creating a debtor-creditor relationship. When the bank takes a deposit they become a debtor and the buyer of the deposit becomes a creditor who has the right to require the bank to return his/her money. If a bank is directed by its customer-creditor to pay a third party by making a cheque payable to the third party by making a cheque on the account of that customer and the bank subsequently fails to pay the cheque when it is required to pay the cheque, the bank's failure to pay amounts to a contractual failure to pay.

The statutory duty arises out of the contract and is incorporated into Section 31 of the Negotiable Instruments Act, 1881⁸ which states that the drawee shall pay the cheque when duly required to do so and that failure to do so shall result in compensation to the drawer for any loss or damage suffered as a result. Uses of must mean they carry a firm obligation; there are only lawful reasons for the commitment to pay the cheque that do not need to be satisfied, such as a garnishee order, a notice of the drawer's insolvency or a court injunction.⁹

⁸ Negotiable Instruments Act, No. 26 of 1881, § 31 (India).

⁹ Negotiable Instruments Act, No. 26 of 1881, § 72 (India).

2.2. Tortious and Reputational Dimensions

Indian courts, which had taken the view of the English common law as expressed in Marzetti's case, had long held that wrongful dishonour entitles one to a tort action as well as a contractual action. In *Bhagwan Dass v. Punjab National Bank*, the Delhi High Court had held that a trader's credit has suffered a presumptive loss at the time of wrongful dishonour and there was no specific requirement that the trader should suffer any monetary loss to prove an action for nominal damages.¹⁰

The Andhra Pradesh High Court stated the above in a recent judgment in the matter of *Jayalakshmi Rice Mills v. P.V.S. Bank* emphasized that the commercial reputation of the trading entity constitutes a legally protected interest, and when violation of this is done through an unjustified, dishonourable cheque issued by a bank, then it is actionable per se.¹¹ In *Canara Bank v. Canara Sales Corp.*, the Supreme Court had granted huge damages, which included damages for loss of reputation, after being wrongfully dishonoured by the bank to the corporate customer and thereby cemented the principle at the highest bench in the Indian judiciary.¹²

2.3. What Constitutes “Wrongful” Dishonour

Not all dishonour is wrongful dishonour in legal perspective. There are ways when a cheque may be dishonoured, they are, firstly, when it is presented on the account 'at a time the cheque is valid' (before the cheque's expiry date), secondly, the cheque has been issued during a period which the account has enough funds to pay it, thirdly, when 'the funds are properly applicable' to the payment, fourthly, when there is neither a Court order nor any other regulatory direction barring payment and lastly, a cheque is not irregular if, by itself, it is in an irregular or void form, or if there is already an existing order of the Court or other regulation that invalidates payment.¹³

On the contrary, a bank may refuse to pay the cheque without liability if the drawer's signature on the bill is forged; the cheque has been materially altered; if the bank has been directed to refuse payment for compliance with bank regulations; or if the bank has been told to refuse payment because of shortage of funds. Whether the dishonour is due to a failure by the bank

¹⁰ *Bhagwan Dass v. Punjab National Bank*, AIR 1976 Del 280 (India).

¹¹ *Jayalakshmi Rice Mills v. P.V.S. Bank*, AIR 1976 AP 207 (India).

¹² *Canara Bank v. Canara Sales Corp.*, (1987) 2 SCC 666 (India).

¹³ Negotiable Instruments Act, No. 26 of 1881, §§ 87–89 (India).

or to a fault of the instrument or of the bank's account, therefore, becomes a critical issue for the bank's liability.¹⁴

3. THE REMEDIAL FRAMEWORKS: AN ANALYTICAL SURVEY

3.1. Civil Suit for Damages

A suit for damages under the Indian Contract Act, 1872 in conjunction with Section 31 of the Negotiable Instruments Act, 1881 is the primary civil remedy of a customer whose claims are based on the wrongful dishonour of cheques. A breaching party may be liable to pay a natural consequence amount, which, when the contract was made, was likely to be caused by the breach, due to Section 73 of the Indian Contract Act, 1872.¹⁵

The principle of remoteness, which evolved from the English case of *Hadley v. Baxendale*,¹⁶ will control the heads of damage recoverable. The following heads are recognised by the courts, they are, firstly, nominal damages being an amount awarded by way of compensation to an account-holder on the grounds that the bank has violated his rights without actually showing him any monetary loss; secondly, general damages for the loss of credit and reputation, but not recoverable in a case of no loss; thirdly, special damages for quantifiable losses, that is, where the monetary losses in the preceding category have been incurred as a result of the bank's dishonour; and fourthly, aggravated damages if the bank operates in a high-handed or negligent manner.¹⁷

However, civil litigation is complicated for three reasons, to begin with, it's the time-consuming nature of litigation in Indian civil courts, in addition, the onus on the customer of establishing liability as well as quantum, and ultimately, the cost of litigation for the little customers and individual account holders. Such structural barriers significantly reduce the credibility of civil liability as a deterrent.¹⁸

3.2. Consumer Forum Jurisdiction

The Consumer Protection Act, 2019, provides a more user-friendly and speedy option for retail

¹⁴ *Punjab & Sind Bank v. Allahabad Bank*, AIR 1998 Del 161 (India).

¹⁵ Indian Contract Act, No. 9 of 1872, § 73 (India).

¹⁶ *Hadley v. Baxendale*, (1854) 9 Ex 341 (Eng.).

¹⁷ *Indian Overseas Bank v. Industrial Chain Concern*, AIR 1990 SC 1263 (India).

¹⁸ *Rabo India Finance Ltd. v. Vijay Ramniklal Chokhawala*, (2000) 5 SCC 515 (India).

customers. Under Section 2(42) of the Act,¹⁹ banking is a 'service' and wrongful dishonour of a cheque is a 'deficiency in service' under Section 2(11).²⁰ The complainant who has availed of the services of a bank for his personal needs and not commercial or profit seeking can raise a complaint before District Consumer Disputes Redressal Commission for getting the relief of compensation, replacement and correction on the deficiency of the bank service.

The National Consumer Disputes Redressal Commission has been consistently opining that "wrongful dishonour" is a deficiency in services reviewed under consumer protection legislation.²¹ The three-tier jurisdictional framework as revised by the Consumer Protection (Jurisdiction of the District Commission, the State Commission and the National Commission) Rules, 2021 prescribes thresholds of ₹50 lakhs, ₹2 crores, and above ₹2 crores for the District, State, and National Commissions respectively ensuring that claims even of relatively modest value receive due institutional recognition at the appropriate level.

Whereas there are restrictions in the consumer forum route. The wording does not include any commercial activity in the definition of 'consumer' excluding corporate entities and traders, thus forcing them to go through the more complicated civil court process. It may seem defensible on policy grounds, but it leaves an inconsistency – the trader class who are most likely to lose significant reputation in the event of wrongful dishonour are not eligible to access the more streamlined consumer redress.²²

3.3. The Banking Ombudsman Mechanism

The Reserve Bank – Integrated Ombudsman Scheme, 2021 (RB-IOS), under the Banking Regulation Act, 1949 (BRA), Reserve Bank of India Act, 1934 (RBIA) and Payment and Settlement Systems Act, 2007 (PASS) is a comparatively swift and inexpensive process which provides banking customers with fresh avenues for redressal of banking related grievances. The Ombudsman's jurisdiction covers wrongful dishonour of cheques and drafts, which is a failure to provide a service.²³

¹⁹ Consumer Protection Act, No. 35 of 2019, § 2(42) (India).

²⁰ Consumer Protection Act, No. 35 of 2019, § 2(11) (India).

²¹ State Bank of India v. M/s Keshav Textiles, 2003 (2) CPJ 37 (NCDRC) (India).

²² Lucknow Development Authority v. M.K. Gupta, (1994) 1 SCC 243 (India).

²³ Reserve Bank of India, The Reserve Bank – Integrated Ombudsman Scheme, 2021 (Nov. 12, 2021, updated Jan. 7, 2025).

The Ombudsman could even approve compensation of up to ₹20 lakh (as enhanced by subsequent amendments) and order the bank to address the deficiency. The scheme is of a quasi-adjudicatory nature because the Ombudsman first tries to conciliate and only ventures an award in cases where conciliation has failed. If accepted by the complainant, the bank must comply with the award scheme, or on refusal from the complainant, they will be able to approach civil courts.

The Ombudsman has proven useful in many ways, but has been criticized on several fronts for the lack of staff, long processing of complicated cases, and the lack of oral hearing for complainants who do not know how to communicate their grievances in writing. The Reserve Bank of India (RBI) has a step in the right direction with the implementation of its Reserve Bank Integrated Ombudsman Scheme (RB-IOS, 2026), which broadens the scope of the scheme, enhances the powers of the Ombudsman and further shortens the timelines for various procedures.²⁴

3.4. Criminal Liability of the Drawer vs. Banker's Responsibility

The provision of Section 138 of the Negotiable Instruments Act provides for criminal liability for the drawer of a cheque returned for insufficient funds. But in wrongful dishonour (where there actually is a credit balance) Section 138 is usually not relevant, as the bank, not the drawer, is in wrongdoing.²⁵ In *Meters and Instruments Private Limited v Kanchan Mehta*, Supreme Court made it clear that Section 138 is meant for the erring drawer and not for the honest banker.²⁶

If a bank, due to error or overrated animal, dishonours a cheque despite having enough money in the account, the drawer who is charged with a crime as a result of the reduction of his account may have a claim against the bank for indemnity. Because of this, courts have noted this triangular exposure: The bank cannot avoid civil liability just because a drawer's exposure litigated directly stems from the bank's own default.²⁷

²⁴ Reserve Bank of India, Reserve Bank – Integrated Ombudsman Scheme, 2026, Press Release No. 2025-2026/1936 (Jan. 16, 2026).

²⁵ Negotiable Instruments Act, No. 26 of 1881, § 138 (India).

²⁶ *Meters and Instruments Private Limited v. Kanchan Mehta*, (2018) 1 SCC 560 (India).

²⁷ *Jayant Verma v. Union of India*, (1999) 8 SCC 710 (India).

4. ASSESSING THE ADEQUACY OF THE FRAMEWORK: CRITICAL ANALYSIS

4.1. The Enforcement Asymmetry

The biggest structural problem with the existing system is that, perhaps most aptly, some fundamentals of the framework are referred to 'enforcement asymmetry' that is, that although banks are 'multiple potential' lenders, with multiple potential liabilities, including contractual, tortious, and regulatory liabilities, the significant practical hurdles of enforcing those obligations namely litigation costs, delays, evidentiary requirements, etc. make it "practically" more difficult for smaller customers to make their claims. The big advantage of the bank as a repeat litigant with resources is against its small counterpart who may be a first time litigator.

This asymmetry is particularly acute in cases involving modest sums. The dishonour of a cheque for ₹50,000 may result in ruining the reputation and business of a small trader who receives damages in his favour, whereas the cost of initiating civil proceedings for damages may be more than the amount that may be awarded. Proceedings of consumer forums, an alternative process which is also more expensive, exclude commercial consumers. Although the Banking Ombudsman is available, it does not have a power to order costs and penalties to seriously curb systemic bank negligence.²⁸

4.2. The Indeterminacy of Damages

Another faulty aspect is the level of damages being uncertain. In between have been nominal damages awards and huge compensatory damages awards, but with no clear methodology. The failure to lay down any written or judicial minimum compensation for wrongful dishonour as in a case of dishonour arising from insufficiency of funds, will create some uncertainty, militating against the deterrent effect of liability.²⁹

A review of the law in comparable common law countries shows that damages regimes in such countries have increasingly become more structured in bank-customer cases including the inclusion of a clause in bank accounts that prescribes liquidated damages where a customer does not perform their account obligations. India has developed sophisticated laws and regulations in certain areas, including capital adequacy and consumer protection of data, but it

²⁸ M.L. Tannan, Tannan's Banking Law and Practice in India 881–883 (23rd ed., LexisNexis 2010).

²⁹ K.P.M. Sundharam & A.N. Varshney, Banking Theory, Law and Practice 428 (24th ed., Sultan Chand & Sons 2019).

has not been able to systematically tackle this gap.³⁰

4.3. Regulatory Gaps

The Reserve Bank of India also has other duties for banks to pay compensation to customers for delays in and errors on cheque clearance, but these are capped based on a formula only, not on the actual loss suffered by customers, and the amount that a bank must pay for delay or error is not commensurate with the true loss suffered. An improved regulatory framework would include the necessity of banks to keep extensive documentation of dishonour decisions and regular audit of banks, and the introduction of RBI's Continuous Clearing and Settlement on Realisation framework, which treats unconfirmed cheques as approved, is a step in the right direction to built-in protection for customers without them having to complain formally³¹

5. REFORM PROPOSAL

Based on the above analysis this paper brings forward three major reform recommendations addressing the problem from legislative, regulatory and institutional perspectives. The aforesaid analysis leads this paper to put forward 3 fundamental reform guesses targeting both the legislative and regulatory aspects of the problem as well as the institutional aspects.

To begin with, amendment of the Negotiable Instruments Act with the introduction of a “deeming” provision to make the dishonour of a cheque a statutory wrong and exactly, but not necessarily, the same amount of compensation as is provided under Section 138 of the Act with a minimum of a specified sum. The minimum statutory damages amount of ₹25,000 per wrongful dishonour along with allowable damage claimed based on evidence, would resolve the deterrence issue posed by the indeterminate damages equation and provide the consumer a hard-and-fast motivation to litigate without complex litigation.³²

In addition, the RBI should also amend the Compensation Policy to ensure that compensation is automatically and mandatorily triggered whenever a cheque is dishonoured due to any mistake on the part of the bank or the paying bank and the trigger for compensation should be with complaints no longer. Banks must pay the fixed amount within seven days after the

³⁰ Spring v. Guardian Assurance plc, [1994] 3 All ER 129 (HL) (UK).

³¹ Reserve Bank of India, Circular No. CO.DPSS.RLPD.No.S536/04-07-001/2025-2026, Introduction of Continuous Clearing and Settlement on Realisation in Cheque Truncation System (Aug. 13, 2025).

³² Negotiable Instruments Act, No. 26 of 1881, § 138 (India); see also Bills of Exchange Act 1882, 45 & 46 Vict. c. 61, § 53 (U.K.); Uniform Commercial Code § 4-402 cmt. 1 (2002) (U.S.A.).

discovery of wrongful dishonour or penal interest, which is equivalent to prevailing RBI LAF Repo Rate plus two per cent per year, must be paid. This automatic penal interest has been implemented in case of delayed credit for NEFT, ECS and NECS cases from banks and should now be uniformly implemented in case of wrongful dishonour of cheques³³

The final but not the least, extension of the jurisdiction of the RBI Ombudsman. The Reserve Bank Integrated Ombudsman Scheme, 2026 has increased the scale of compensation for consequential loss from ₹20 lakhs to ₹30 lakhs which is welcome, but further increase to ₹50 lakhs is desirable. The RBI also noted that the framework is based on principles, although they did not accept feedback from stakeholders that wanted a cap of ₹50 lakhs. The increased authority would align the Ombudsman's remedial powers with trading customer losses resulting from wrongful dishonour, such as loss of business and reputational damage suffered by such customers.³⁴

6. CONCLUSION

Yet, despite its evident status as a violation of law, a violation which is always decried, and forms a part of a number of possible remedies, which in theory have reached impressive levels of sophistication, wrongful dishonour of cheques is quite a common source of injury to banking customers in India, depositors and traders alike, in part because the system of remedies inherited from England generally is not adequate to redress the practical injuries occasioned by wrongful dishonour.

This paper has contended that the wrongful dishonour liability of the bankers was based on contractual, tortious and statutory duty and that the consequences of such dishonour, such as its effect on reputation, could be legally recognized without a specific financial loss being admitted. It has looked at the civil, consumer and regulatory remedies available to the aggrieved customer and found key systemic weaknesses in each, that consumer litigation is too hard for small claimants, commercial customers are not included in consumer forums, there is too little autonomy over compensation provided by the Banking Ombudsman and automatic

³³ Reserve Bank of India, Master Circular — Customer Service in Banks, RBI/2015-16/59, DBR.No.Leg.BC.21/09.07.006/2015-16 (July 1, 2015, updated through 2024–25); see also Reserve Bank of India, Circular No. RBI/2019-20/67, DPSS.CO.PD No.629/02.01.014/2019-20, Harmonisation of Turnaround Time and Customer Compensation for Failed Transactions Using Authorised Payment Systems (Sept. 20, 2019).

³⁴ Reserve Bank of India, Reserve Bank – Integrated Ombudsman Scheme, 2026, Press Release No. 2025-2026/1936 (Jan. 16, 2026).

compensation provisions have not been established.³⁵

The proposals contained in the paper for reform of a statutory minimum compensation payment, automatic compensation under RBI's regulatory regime, and extension of the scope of the Ombudsman jurisdiction to correct these deficiencies are designed to strike a balance between the banking system's costs and the benefits derived from the Ombudsman. They use as an illustration of a larger rule: in any legal system whose base is the rule of law, the right to payment deserves to attend to an equally significant right to remedy where there is wrongful refusal to pay.

In the end, though, it is not just the criminal penalties attached to a drawer that gives get-rich swears cause for concern, it's the civil and regulatory ones attached to the people whose bank doesn't pay them. A system of laws which is strong enough to take action against the former and weak in the head against the latter does, in this writer's opinion, have it wrong. To fix that misalignment is not just legally required, but it's absolutely needed commercially.³⁶

³⁵ See generally M.L. Tannan, *Tannan's Banking Law and Practice in India* 312 (23rd ed. 2010).

³⁶ Negotiable Instruments Act, No. 26 of 1881, § 31 (India); *Canara Bank v. Canara Sales Corp.*, (1987) 2 SCC 666 (India).

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