
DIGITAL PAYMENTS AND DECLINE OF CHEQUE USAGE: LEGAL CHALLENGES AND FUTURE OF SECTION 138

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ABSTRACT

The rapid expansion of digital payment systems has fundamentally altered the manner in which financial transactions are conducted in India. Technological advancements, combined with regulatory initiatives and increased digital literacy, have resulted in a gradual decline in the use of traditional negotiable instruments, particularly cheques. Instruments such as the Unified Payments Interface [UPI] mobile wallets, Immediate Payment Service [IMPS] and Real-Time Gross Settlement [RTGS] have transformed payment mechanisms by offering instant, efficient and secure alternatives. This shift has significant legal implications, especially concerning the continued relevance of Section 138 of the Negotiable Instruments Act, 1881, which criminalizes cheque dishonour. While Section 138 has historically played a crucial role in reinforcing commercial trust and creditor protection, its applicability in an increasingly digital economy raises complex legal questions. This paper examines the impact of digital payments on cheque usage in India and critically analyses the challenges posed to existing legal frameworks governing financial transactions. It explores whether the deterrent rationale underlying Section 138 remains effective in the digital age and evaluates the adequacy of existing laws in addressing defaults and disputes arising from electronic payment systems. The paper further analyses judicial and regulatory responses to digital payment disputes and considers comparative international approaches. It argues that while cheque dishonour law continues to have relevance, there is a pressing need for legislative adaptation to ensure that creditor confidence and commercial certainty are preserved in modern payment systems. The study concludes that legal reform, harmonization of payment laws and development of specialised dispute resolution mechanisms are essential to address the realities of India's evolving digital financial ecosystem.

Keywords: Digital Payments, Cheque Dishonour, Section 138, Negotiable Instruments Act; Legal Reform.

Introduction:

The effectiveness of any modern economy is closely linked to the reliability, security and enforceability of its payment systems. Financial transactions form the backbone of commercial activity and the confidence of market participants largely depends on the assurance that payment obligations will be honoured. In this context, legal frameworks governing payment instruments play a crucial role in maintaining trust, ensuring accountability and preventing defaults. For decades, negotiable instruments—particularly cheques—served as one of the most widely accepted modes of deferred payment in India. They facilitated credit transactions, enabled business continuity and reduced the immediate need for cash, especially in trade and commerce. The statutory recognition of cheques under the Negotiable Instruments Act, 1881 and the subsequent introduction of penal provisions for cheque dishonour, strengthened their credibility and enforceability.

Section 138 of the Negotiable Instruments Act marked a significant legislative intervention aimed at enhancing the sanctity of cheque-based transactions. By criminalizing cheque dishonour due to insufficiency of funds or similar reasons, the provision sought to curb willful defaults and promote financial discipline. The underlying legislative intent was not merely punitive but corrective—to instill confidence in the use of cheques as a dependable payment mechanism. Over time, judicial interpretation further reinforced this objective by emphasizing the role of Section 138 in protecting commercial morality and ensuring the smooth functioning of trade and credit systems. As a result, cheques became an indispensable instrument in business transactions, loan repayments, contractual assurances and even government dealings. However, the Indian financial landscape has witnessed a profound transformation in recent years, driven by rapid technological advancements and policy initiatives promoting digitalization.

The introduction and expansion of digital payment systems such as Unified Payments Interface (UPI), internet banking, mobile wallets and electronic fund transfers have fundamentally altered the manner in which payments are made and received. These platforms offer unparalleled convenience, real-time settlement, lower transaction costs, and enhanced transparency, making them increasingly attractive to individuals, businesses and financial institutions. Government initiatives aimed at promoting a cashless economy, coupled with increased smart phone penetration and internet accessibility have further accelerated the shift towards digital transactions.

As a consequence of this digital revolution, the reliance on cheques has steadily declined, particularly in routine commercial and consumer transactions. Many businesses now prefer instant electronic transfers over cheque-based payments, which are often perceived as time-consuming and procedurally cumbersome. The risks associated with cheque dishonour, delays in clearance and prolonged litigation under Section 138 have also contributed to a gradual erosion of cheque usage. While cheques continue to be used in certain traditional sectors, high-value transactions, and formal contractual arrangements, their dominance as a primary payment instrument is increasingly being challenged by digital alternatives.

This transition from paper-based instruments to digital payments raises important legal and policy questions. The legal framework governing cheques was designed in a vastly different economic and technological context, where physical instruments formed the core of financial transactions. Digital payments, on the other hand, operate within a distinct technological architecture involving electronic authorization, automated settlement and intermediated platforms. Payment failures in digital systems may occur due to technical errors, network disruptions, cyber security breaches, or unauthorized transactions, rather than intentional issuance of payment instruments without sufficient funds. These complexities challenge the traditional notions of default and liability that underpin cheque dishonour law.

A critical concern arising from this shift is the absence of a penal mechanism comparable to Section 138 for digital payment defaults. While civil remedies and regulatory safeguards exist under banking and payment system laws, the deterrent effect associated with criminal liability is largely absent in the digital payment ecosystem. This creates an imbalance in creditor protection, where defaults arising from cheque dishonour attract penal consequences, whereas failures in digital transactions may not. Such disparity raises questions about the adequacy and consistency of the existing legal framework in ensuring trust and accountability across different modes of payment.

In addition, the continued application of Section 138 in an era of declining cheque usage has generated debates on over-criminalization, judicial backlog and the proportionality of criminal sanctions for essentially civil disputes. Indian courts are burdened with a large volume of cheque dishonour cases, leading to delays and undermining the very objective of speedy redressal. In a financial environment increasingly dominated by digital transactions, it becomes necessary to reassess whether the existing cheque-centric penal framework remains justified or requires recalibration. Against this backdrop, the present study seeks to critically examine the impact of digital payments on the use of cheques in India and the resulting legal challenges. It

explores the future relevance of Section 138 of the Negotiable Instruments Act in a digitized economy and analyses whether the law should evolve to address defaults arising from modern payment systems. By situating the discussion within the broader Indian legal and economic context, this paper aims to contribute to ongoing debates on legal reform, technological adaptation and the need for a balanced framework that protects creditor interests while promoting innovation and efficiency in payment systems.

Evolution of Digital Payments in India:

India's transition towards a digitally driven payment ecosystem has been the result of a gradual yet strategic convergence of regulatory support, technological advancement and policy-driven reform. In the initial stages, digitization of payments was largely confined to formal banking channels and high-value transactions. Electronic fund transfer systems such as the National Electronic Funds Transfer [NEFT] and Real Time Gross Settlement [RTGS] were introduced to enhance efficiency, reduce transaction time and provide secure alternatives to paper-based instruments. However, their usage remained largely restricted to institutional transfers, corporate payments and inter-bank settlements, limiting their impact on everyday retail transactions. A significant shift occurred with the introduction of the Immediate Payment Service [IMPS] which enabled round-the-clock, real-time fund transfers between bank accounts. IMPS bridged the gap between traditional electronic transfers and the need for instant retail payments, laying the groundwork for broader digital adoption. Nevertheless, the real transformation in India's payment landscape came with the launch of the Unified Payments Interface [UPI] in 2016. UPI revolutionized digital payments by offering a seamless, interoperable platform that allowed users to transfer funds instantly using mobile applications without the need for complex banking details. By simplifying user authentication and enabling low-cost transactions, UPI made digital payments accessible to individuals across diverse socio-economic backgrounds.

Government-led initiatives played a decisive role in accelerating the adoption of digital payments. The Digital India programme provided a comprehensive framework aimed at improving digital infrastructure, promoting digital literacy and ensuring the delivery of services through electronic platforms. Policy measures undertaken in the aftermath of demonetization further acted as a catalyst by encouraging individuals and businesses to explore non-cash payment alternatives. These initiatives, combined with the rapid expansion of smart phone usage and the availability of affordable internet services, contributed to a behavioral shift in both consumers and merchants, who increasingly began to favour electronic modes of payment

over traditional instruments such as cheques. The integration of digital payment systems with India's digital identity infrastructure, particularly Aadhaar, also enhanced ease of access and financial inclusion. Linking bank accounts with digital identities simplified verification processes and enabled wider participation in the formal financial system. Small traders, service providers, and rural users, who were previously dependent on cash or cheque-based transactions, increasingly adopted mobile-based payment solutions for their daily operations.

Regulatory oversight and policy support from the Reserve Bank of India further strengthened confidence in digital payment mechanisms. Through the issuance of guidelines governing payment system operations, data protection, cyber security and consumer grievance redressal, the RBI ensured that digital transactions remained secure and reliable. These measures addressed concerns relating to fraud, privacy and operational risks, thereby reinforcing public trust in electronic payment platforms. Collectively, these developments have fundamentally altered India's payment ecosystem, leading to a noticeable decline in the reliance on cheques and reshaping the legal and commercial landscape of financial transactions.

Decline of Cheque Usage:

The rapid growth of digital payment systems has significantly altered the landscape of financial transactions in India, leading to a noticeable decline in the use of cheques. Data released by banks and regulatory authorities, including the Reserve Bank of India, consistently show a downward trend in both the volume and frequency of cheque-based transactions. While cheques have not disappeared entirely from the financial system, their relevance has become increasingly limited. They continue to be used in specific situations such as government disbursements, court-mandated payments, corporate settlements and certain high-value institutional transactions where formal documentation is preferred. However, in routine commercial dealings and consumer transactions, cheques are no longer the primary mode of payment.

Multiple factors have contributed to this decline. One of the most significant reasons is the speed and efficiency offered by digital payment systems. Unlike cheques, which require physical presentation and clearance through banking channels, digital transactions enable instant or near-instant settlement. This immediacy allows businesses to manage cash flows more effectively and reduces the uncertainty associated with delayed payments. For small and medium enterprises, which often rely on timely receipts to meet operational expenses, the ability to receive payments without delay has made digital platforms far more attractive than

traditional cheque-based payments. Cost efficiency has also played a decisive role in diminishing cheque usage. Processing cheques involves substantial administrative and operational costs, including printing, handling, storage and clearing infrastructure. Banks incur significant expenditure in maintaining cheque clearing mechanisms, while businesses face indirect costs related to delays and the risk of dishonour. In contrast, digital payment systems can process large volumes of transactions at a relatively lower cost, making them economically beneficial for all stakeholders involved.

Additionally, digital payments offer enhanced transparency and traceability, which has strengthened trust in electronic transactions. Digital platforms generate real-time records that can be easily monitored, verified and audited, thereby reducing the likelihood of fraud, accounting discrepancies and disputes. These advantages, combined with increasing digital literacy and consumer preference for convenience, have encouraged businesses to adopt electronic payment modes, particularly for recurring and high-frequency transactions. As a result, cheques have gradually lost their central position in everyday commercial activities, reflecting a broader shift towards a digitally driven payment ecosystem.

Overview of Section 138 of the Negotiable Instruments Act:

Section 138 of the Negotiable Instruments Act, 1881 was introduced as a legislative response to the increasing incidence of cheque dishonour and the resulting erosion of trust in cheque-based commercial transactions. Prior to the insertion of this provision, dishonour of cheques was treated largely as a civil wrong, compelling creditor to resort to lengthy and often ineffective civil litigation for recovery of dues. Recognizing the inadequacy of existing remedies and the adverse impact of unpaid cheques on commercial confidence, the legislature enacted Section 138 to attach penal consequences to cheque dishonour under specified conditions. The provision criminalizes the dishonour of a cheque when it is returned unpaid due to insufficiency of funds or when the amount exceeds the arrangement made with the bank. However, liability under Section 138 is not automatic. The statute prescribes a structured procedure that balances creditor protection with fairness to the drawer. The payee must issue a statutory notice demanding payment within the prescribed period and the drawer is granted an opportunity to make good the payment within a specified time. Only upon failure to comply with this demand does criminal liability arise. This mechanism reflects the underlying philosophy of the provision, which is corrective and deterrent rather than purely punitive.

Judicial interpretation has played a crucial role in shaping the scope and application of Section

138. Courts have consistently held that the primary object of the provision is to enhance the credibility of cheques as reliable instruments of payment and to promote commercial morality. By reinforcing statutory presumptions in favour of the holder and discouraging technical defenses, the judiciary has strengthened the enforceability of cheque-based obligations. At the same time, courts have recognized the need to prevent misuse of the provision by encouraging compounding of offences and adopting pragmatic approaches to reduce litigation.

The hybrid civil-criminal nature of Section 138 has made it a powerful enforcement tool. It provides creditors with a remedy that combines the deterrent effect of criminal sanctions with the compensatory objective of civil recovery. This framework has significantly contributed to maintaining confidence in cheque transactions and ensuring financial discipline. However, the effectiveness of Section 138 is closely tied to the continued relevance of cheques as a commonly used payment instrument. As digital payment systems increasingly replace cheques in everyday transactions, questions arise regarding the future role and adaptability of this provision within India's evolving financial ecosystem.

Legal Challenges Arising from Digital Payments:

The rapid expansion of digital payment systems has introduced a range of legal challenges that traditional cheque dishonour laws are not designed to address. Unlike cheques, which are tangible instruments governed by clearly defined statutory presumptions and liabilities, digital payments operate through electronic commands and automated systems. In digital transactions, payment failures do not arise from the physical dishonour of an instrument due to insufficient funds, but from a variety of factors such as technical malfunctions, server downtime, connectivity issues, cyber attacks, or unauthorized access to accounts. These factors blur the distinction between intentional default and genuine transactional failure, making it difficult to assign liability under existing legal frameworks. A major challenge lies in the absence of a specific penal provision analogous to Section 138 of the Negotiable Instruments Act for digital payment defaults. While intentional non-payment through digital platforms can undermine commercial trust in much the same way as cheque dishonour, current laws largely treat such disputes as contractual or civil in nature. This creates uncertainty for creditors who lack an effective deterrent mechanism to ensure timely digital payments, particularly in commercial transactions involving deferred or post-dated electronic commitments.

Digital transactions also raise complex evidentiary issues. Electronic payment systems generate extensive digital trails, including transaction logs, timestamps and authentication

records. Although the Information Technology Act, 2000 recognizes electronic records and digital signatures as legally valid, practical difficulties persist in proving authenticity, integrity and intent. Establishing whether a payment failure was deliberate or accidental often requires technical expertise and cooperation from intermediaries such as banks, payment gateways and service providers. Jurisdictional complications further intensify these challenges. Digital payments frequently involve multiple stakeholders operating across different jurisdictions, including banks, fintech companies and cloud service providers. In cross-border transactions, determining the appropriate forum for dispute resolution and identifying the applicable law becomes particularly complex. These legal uncertainties highlight the need for a more coherent and technology-sensitive regulatory framework to address defaults in digital payment systems while ensuring adequate protection for both creditors and users.

Judicial and Regulatory Responses:

The Indian judiciary has gradually begun to engage with disputes arising from digital payment systems, adapting existing legal principles to address issues posed by electronic transactions. In the absence of a dedicated statutory framework governing digital payment defaults, courts have primarily relied on contractual obligations, banking norms and the provisions of the Information Technology Act, 2000. Judicial scrutiny in such cases often focuses on the terms of service agreed between users and payment service providers, the duty of care owed by banks, and the evidentiary value of electronic records. While this approach allows courts to resolve individual disputes, it has resulted in fragmented jurisprudence, lacking the uniformity and predictability that characterize cheque dishonour litigation under the Negotiable Instruments Act.

Regulatory intervention has played a more proactive role in shaping the digital payment landscape. The Reserve Bank of India, as the principal regulator of payment systems, has issued detailed guidelines governing electronic fund transfers, customer authentication, data protection, and grievance redressal. Mechanisms such as mandatory customer support systems, time-bound resolution of failed transactions and compensation for unauthorized electronic transfers have strengthened consumer confidence in digital payments. These regulatory measures aim to balance innovation with risk management and consumer protection, thereby promoting wider adoption of digital payment platforms.

However, regulatory safeguards primarily function as administrative remedies rather than coercive enforcement tools. Unlike Section 138 of the Negotiable Instruments Act, which

imposes penal liability to deter willful defaults, RBI guidelines rely on compliance obligations and monetary compensation. They do not address situations where parties intentionally avoid payment through digital means, nor do they provide creditors with a strong deterrent mechanism comparable to criminal sanctions. As digital transactions increasingly replace cheques in commercial dealings, this regulatory gap becomes more pronounced. The existing judicial and regulatory responses, while significant, underscore the need for a more comprehensive legal framework that can ensure accountability, consistency and deterrence in the evolving digital payment ecosystem.

Comparative International Perspectives:

Across the globe, legal systems have responded to the growth of electronic payment mechanisms by developing specialised regulatory frameworks tailored to the unique features of digital transactions. Unlike traditional negotiable instruments, electronic payments operate in real time and involve multiple intermediaries, including banks, payment service providers and technology platforms. Recognizing this complexity, many jurisdictions have prioritized regulatory oversight, transparency and consumer protection over criminal sanctions. These approaches provide useful comparative insights for evaluating India's evolving payment ecosystem and the future relevance of cheque dishonour laws. In the European Union, the Payment Services Directive [PSD and its revised version, PSD2] establishes a comprehensive legal regime governing electronic payments. It clearly defines the rights and obligations of users and service providers, mandates strong customer authentication and allocates liability in cases of unauthorized or failed transactions. The emphasis is on ensuring prompt refunds, effective grievance redressal and accountability of payment institutions through regulatory supervision. Penal consequences are generally reserved for systemic non-compliance rather than individual payment defaults, reflecting a preference for civil and administrative remedies. Similarly, in the United States, the Electronic Fund Transfer Act [EFTA] focuses on consumer rights, disclosure requirements and error resolution procedures. The statute provides clear timelines for resolving disputes and limits consumer liability in cases of unauthorized transactions. Enforcement is largely civil in nature, supported by regulatory agencies, rather than criminal prosecution of payment failures. These international models demonstrate that confidence in digital payments can be sustained through robust regulation, clear liability norms and efficient dispute resolution mechanisms. While these approaches differ from India's cheque dishonour framework under Section 138 of the Negotiable Instruments Act, they offer valuable lessons. They highlight the possibility of ensuring trust and legal certainty in digital

payments without relying heavily on criminal sanctions, thereby encouraging innovation while safeguarding commercial interests.

Need for Legal Reform:

The gradual decline in the use of cheques, coupled with the rapid expansion of digital payment systems, makes it imperative to re-examine India's existing legal framework governing payment defaults. While Section 138 of the Negotiable Instruments Act continues to serve an important function in cases involving traditional cheque transactions, its utility is inherently limited in a financial ecosystem increasingly dominated by electronic modes of payment. Digital transactions operate on fundamentally different technological and operational principles and disputes arising from such payments cannot be effectively resolved within a legal structure designed for paper-based instruments.

There is a clear need for legislative reform to ensure that the law keeps pace with technological advancement and evolving commercial practices. Such reform could take multiple forms, including the enactment of a dedicated statute regulating digital payment obligations, expansion of existing financial and technology laws to address intentional digital payment defaults, or the creation of specialised adjudicatory and dispute resolution mechanisms for electronic transactions. A modern legal framework should focus on clarity of liability, efficient remedies and proportionate enforcement, while avoiding unnecessary criminalization. By adopting a forward-looking and technology-neutral approach, legal reform can strengthen creditor protection, enhance business confidence, and ensure the continued integrity of India's rapidly evolving payment system.

Policy Recommendations:

In order to maintain creditor protection and sustain commercial confidence in an increasingly digital economy, India must adopt a comprehensive and forward-looking policy framework for electronic payment systems. One of the foremost priorities should be the strengthening of cyber security standards to safeguard digital transactions against fraud, data breaches and unauthorized access. Robust technological safeguards, coupled with mandatory compliance and regular audits, can significantly reduce payment failures arising from systemic vulnerabilities and enhance user trust.

Equally important is the need to clearly define liability standards for digital payment defaults. A transparent allocation of responsibility among banks, payment service providers, and users will help resolve disputes more efficiently and reduce legal uncertainty. Clear statutory or

regulatory guidelines on fault, negligence and compensation can ensure that creditors are not left without effective remedies in cases of intentional or reckless digital payment failures. Institutionalizing alternative dispute resolution mechanisms within digital payment platforms can further promote speedy and cost-effective resolution of conflicts. Online grievance redressal systems, mediation frameworks, and technology-enabled dispute resolution tools can reduce litigation and preserve commercial relationships. Finally, effective coordination between regulators, financial institutions, technology providers and legal authorities is essential to create a harmonized ecosystem that balances innovation with accountability and legal certainty.

Conclusion:

The gradual shift from cheque-based transactions to digital payment systems represents a transformative phase in India's financial and commercial environment. For decades, Section 138 of the Negotiable Instruments Act served as a crucial legal mechanism to enforce payment discipline, deter defaults and sustain confidence in cheque-based transactions. However, with the rapid expansion of electronic payment platforms, the functional relevance of cheques has significantly declined, limiting the practical reach of traditional cheque dishonour laws. Digital transactions operate within a technologically distinct framework that presents new forms of risk, liability and dispute, which existing legal provisions are not fully equipped to address. The challenges arising from this transition highlight the urgent need for adaptive and technology-responsive legal reforms. A modern payment ecosystem requires laws that recognize digital instruments, clearly define rights and liabilities and provide efficient and proportionate remedies for payment failures. Rather than relying on outdated frameworks, India must develop a coherent legal approach that balances innovation with accountability and creditor protection. By aligning legal principles with contemporary financial practices, India can preserve commercial trust, enhance economic efficiency and ensure long-term stability in an increasingly digital economy.

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