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# **AGENTIC BANKING AND PROPRIETARY RIGHTS: RETHINKING SECTION 171 OF THE INDIAN CONTRACT ACT IN THE AI ERA.**

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## **Abstract**

One of the most important aspects of a country's economy is the banking system. A bank is a crucial element of modern society. Without the active help that financial institutions offer, it is not possible to think of the development of any country. In reality, the banks finance business, industry, and trade. Without the different forms of finance that the banks offer, modern business and businessmen cannot carry on their business activities. It has therefore to be admitted that the banking system is the most essential part of every aspect and stage of the organization. One of the most famous examples of contract law that contains different rules regarding both general and specific contracts is the Indian Contract Act. One such agreement that falls under the Indian Contract Act, which deals with the transfer of goods from one individual to another for a particular purpose, is the Contract of Bailment. The right to lien is conferred on the bailee in this contract. Under Section 171 of the Indian Contract Act of 1872, bankers, wharfingers (an individual or an organization that owns, manages, or operates a wharf, pier, or dock and acts as a custodian for goods being loaded or unloaded from ships), factors, high court attorneys, and policy brokers all possess a general right to a lien. Section 171 of the Indian Contract Act of 1872 grants the universal right to a banker's lien. Until the customer's dues are cleared, the bank temporarily possesses the goods under the universal right by possession granted to them. Whether the banker's power to lien and set off was a general and customary right granted to them was in question in the historic case of *Syndicate Bank v. Vijay Kumar and Others*. Misuse of this, Doctrine of Banker's Lien may result in legal repercussions, especially when banks go beyond their legal limits. The most prominent misuse of this doctrine is in the following aspects: using specific-purpose deposits to secure general debts, using safe custody articles to secure loans, creating liens without prior notice, and holding securities after repayment. Moreover, banks are not authorized to create liens on title deeds for specific mortgages or for

un-matured debts. This paper will attempt to grasp the scope and applicability of the banker's lien in India in light of the Indian Contract Act, 1872. Further, it will also attempt to understand the circumstances in which the banker's right to the lien is not valid and proceed to make a critical analysis of the present position of the law and statutes related with it.

**Keywords:** Banker's Lien, Contract of Bailment, Indian Contract Act, 1872, Banker–Customer Relationship, Misuse of Banker's Lien.

## **1. Introduction**

### **1.1 Background of Banker–Customer Relationship**

The banker-customer relationship is the cornerstone of the Indian banking system. It is a relationship of trust, of legal obligations, and of a complex web of rights and liabilities that are made effective through the medium of financial transactions.<sup>1</sup>

The relationship arises when a person or an entity opens an account with a bank and the bank agrees to open the account. After the opening of the account, a contractual relationship is established, which is primarily regulated by the Indian Contract Act, 1872, and banking laws and statutes that have been specially enacted to regulate this relationship.<sup>2</sup>

The Indian Contract Act has several provisions that cover the legal aspects of different contracts. One such provision is the contract of bailment. This is defined under section 148 as the “delivery of goods by one person to another for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them”.<sup>3</sup>

It further explains that the person who is delivering the goods is known as the bailor, and the person receiving the goods is known as the bailee as per sections 149 – 171, The Indian laws cover two kinds of lien – particular and general<sup>4</sup>. Particular lien is exercised by a bailee over a particular good bailed to them for a specific purpose. They do not have the right to lien over any other goods of the bailor<sup>5</sup>. General Lien, however, grants the right to lien to the bailee over any general goods bailed to them by the bailor. This right however is limited to bankers, factors, wharfingers, attorneys and policy brokers unless there is a contract to the contrary.<sup>6</sup>

<sup>1</sup> R.M. Goode, Commercial Law 574–75 (5th ed. 2016).

<sup>2</sup> Indian Contract Act, No. 9 of 1872 (India).

<sup>3</sup> Indian Contract Act, No. 9 of 1872, § 148 (India).

<sup>4</sup> Id. §§ 149–171.

<sup>5</sup> Id. § 170.

<sup>6</sup> Id. § 171.

### ***Meaning and Definition of a Banker***

The meaning of the term 'banker' is a person or firm engaged in the business of receiving moneys, and collecting drafts, for customers liable to honor cheques drawn by them from time to time to the extent of the amount available on their current accounts. There is no consensus on the meaning of the term banker. We have mentioned below some of the important definitions of the term banker.<sup>7</sup>

- *G. Crowther*: "A banker is a dealer in debt, his own and other people."<sup>8</sup>
- *Macleod*: "The essential business of banker is to buy money and debts, by creation of other debts. A banker is therefore essentially a dealer in debts or credit."<sup>9</sup>
- *Dr. H.L. Hart*: "A banker or bank is a person or company carrying on the business of receiving moneys, and collecting drafts, for customers subject to the obligation of honouring cheques drawn upon them from time to time by the customers to the extent of the amount available on their current accounts."<sup>10</sup>

### ***Meaning and Definition of a Customer***

The definition of the customer of a bank is not defined by law. In common language, a person maintaining an account with a bank is regarded as its customer. The customer too causes some difficulty in the context of definition. There is no statutory definition of the customer in Bangladesh or in England. But the judicial decisions in this regard give some idea about the meaning of the term.<sup>11</sup>

According to an old view, as stated by Sir John Paget, "to constitute a customer, there must be some recognizable course or habit of dealing in the nature of regular banking business..... It has been thought difficult to reconcile the idea of a single transaction with that of a customer that the word predicates, even grammatically, some minimum of custom, antithetic to an isolated act."<sup>12</sup> According to this view, in order to constitute a customer of a bank, two conditions are to be fulfilled.

(a) There must be some recognizable course or habit of dealing between the customer and the banker.

(b) The transactions must be in the form of regular banking business.<sup>13</sup>

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<sup>7</sup> Banking Regulation Act, No. 10 of 1949, § 5(b) (India).

<sup>8</sup> G. Crowther, *An Outline of Money* 12 (1967).

<sup>9</sup> Henry Dunning Macleod, *Theory and Practice of Banking* 2 (6th ed. 1902).

<sup>10</sup> H.L.A. Hart, *Definition of Banker*, in *Essays in Jurisprudence* 45 (1983).

<sup>11</sup> *Great Western Ry. Co. v. London & County Banking Co.*, [1901] A.C. 414 (H.L.).

<sup>12</sup> John Paget, *Paget's Law of Banking* 63 (14th ed. 2014).

<sup>13</sup> *Id.*

Further, for a person to be a customer of a bank he should have some sort of account with the bank and the initial transaction in opening an account would not constitute the relation of banker and customer; there should be some kind of continuity. The concept of duration does not hold good any longer. At present to constitute a customer, duration is not essential.<sup>14</sup>

### ***Shift from trust-based banking to compliance-driven banking***

As banks strive to digitally transform their operations, they have to contend with challenges in the realms of regulation, risk, and compliance, amid unprecedented transformations in the banking industry itself. As digital continues to change the face of financial services, regulatory, risk, and compliance strategies would also have to change<sup>15</sup>. Banking institutions that are successful would include those that are good at managing the impact of digital on compliance, accountabilities, transparency, risks, and data. To accomplish this, the banks will need to work with all the market players and achieve their objectives regarding the improved service quality, while at the same time being safe for the customers as well as the financial markets.<sup>16</sup> Global Regulatory Network (GRN) and risk and compliance professionals provide assistance to bank CEOs and other boardroom executives to respond to dynamically developing bank risk management, prudential regulation, and accounting rules.<sup>17</sup>

### **Relationships between Banker and Customer<sup>18</sup>**

<b>Type of Relationship</b>	<b>When It Arises</b>	<b>Position of Bank</b>	<b>Position of Customer / Third Party</b>	<b>Key Legal Features &amp; Duties</b>	<b>Relevant Law / Case</b>
<b>Debtor and Creditor</b>	When money is deposited in a bank account	<b>Debtor</b> (bank owes money)	<b>Creditor</b> (customer)	<ul style="list-style-type: none"> <li>• Deposited money becomes bank's property</li> <li>• Bank can use it for business</li> <li>• Customer has the</li> </ul>	<i>Canara Bank v. Canara Sales Corporation</i>

<sup>14</sup> Central Bank of India v. Gopinath Nair, AIR 1971 SC 1913 (India).

<sup>15</sup> Reserve Bank of India, Report on Trend and Progress of Banking in India (2022).

<sup>16</sup> Id

<sup>17</sup> Basel Comm. on Banking Supervision, Compliance and Risk Management Principles (2021).

<sup>18</sup> Indian Contract Act, 1872; Transfer of Property Act, 1882; Canara Bank v. Canara Sales Corp., (1987) 2 SCC 666 (India).

				right to demand repayment	
<b>Creditor and Debtor (Reverse Role)</b>	When the customer borrows money from the bank	<b>Creditor</b>	<b>Debtor</b>	<ul style="list-style-type: none"> <li>• Customer has a legal obligation to repay loan</li> </ul>	General principles of Contract Law
<b>Pledger and Pledgee</b>	When Movable property is given as security for a loan	<b>Pledgee (Pawnee)</b>	<b>Pledger (Pawnor)</b>	<ul style="list-style-type: none"> <li>• Bank retains goods till loan repayment</li> <li>• Rights and duties governed by Contract Act</li> <li>• Applicable in gold loans, pledge of shares, warehouse goods</li> </ul>	Indian Contract Act, 1872
<b>Bailor and Bailee</b>	When goods are delivered to the bank for custody or security	<b>Bailee</b>	<b>Bailor</b>	<ul style="list-style-type: none"> <li>• Bank must take reasonable care of goods</li> <li>• Bank liable for negligence</li> <li>• Applies to jewellery, documents, ornaments, tangible securities</li> </ul>	Section 148, Indian Contract Act, 1872
<b>Lessor and Lessee</b>	When a bank provides safe deposit lockers	<b>Lessor</b>	<b>Lessee (Customer)</b>	<ul style="list-style-type: none"> <li>• Customer pays locker rent</li> <li>• Bank provides secure locker facility</li> <li>• Bank responsible for safety despite not knowing contents</li> </ul>	Section 105, Transfer of Property Act, 1882

<b>Trustee and Beneficiary</b>	When bank holds money/securities for a specific purpose	<b>Trustee</b>	<b>Beneficiary</b>	<ul style="list-style-type: none"> <li>• Bank must use funds only for specified purpose</li> <li>• Misuse may attract legal consequences</li> <li>• Strict compliance required.</li> </ul>	Trust principles & contractual obligations
<b>Agent and Principal</b>	When bank performs tasks on behalf of customer	<b>Agent</b>	<b>Principal (Customer)</b>	<ul style="list-style-type: none"> <li>• Bank must act within authority</li> <li>• Must strictly follow customer's instructions</li> <li>• Includes cheque collection,</li> </ul>	Law of Agency (Indian Contract Act, 1872)
<b>Guarantor and Beneficiary</b>	When bank issues a guarantee on behalf of a customer	<b>Guarantor</b>	<b>Beneficiary (Third Party)</b>	<ul style="list-style-type: none"> <li>• Bank must honour guarantee on customer's default.</li> </ul>	Law relating to Bank Guarantees

**1.2 Meaning and Origin of Banker's Lien**

The origins of the lien can be traced back to the common law, it is the right that is given to a person "to retain that which is rightfully and continuously in his possession belonging to another until the present and accrued claims of the person in possession is satisfied"<sup>19</sup>

The nature of lien is very limited; it only is a right which can be exercised on the possession of personal property till the owner of the property discharges the amount which is due from him to the person executing the lien<sup>20</sup>. In common parlance the word "lien' is used in a legal sense to mean having a "charge or claim on property, either real or personal, as security for the payment of some debt or obligation".<sup>21</sup>

It is often mistaken to understand that with regard to lien, the right of the person is on or in the

<sup>19</sup> 3 Halsbury's Laws of England ¶ 100 (5th ed.).

<sup>20</sup> Id

<sup>21</sup> Black's Law Dictionary (11th ed. 2019).

property; however, the fact of the matter is that lien is more in nature of charge which is created by virtue of the person being in debt of the person executing a debt.

The concept of lien is an important part of the Indian Contract Act, 1872<sup>22</sup>, which defines the Indian law concerning contractual agreements. A lien is a legal claim or interest asserted by a lender/creditor on some property pertaining to the debtor/borrower until the debt or debt obligation is fulfilled. The right of lien is a right provided to a bailee as per the ICA.

The right to lien is enjoyed by the bailee, and this is where the bailee has the right to retake possession of the goods that were bailed by the bailor until the charges are paid on the goods. This right would be applicable in instances where there was a legal contract between the two parties, i.e., the contract of bailment.

As per the Indian Contract Act of 1872, there are mainly two kinds of liens:<sup>23</sup>

- General Lie, Section 171 of ICA deals with General Lien. A general lien enables the creditor to keep possession of the debtor's property until the debt owed by the debtor is settled. This type of lien is not for a specified type of debt and can be imposed on any type of debt owed to a creditor. General liens are applicable to a variety of professions including:
  - Bankers
  - Factors (Agents who sell goods)
  - Wharfingers (Individual who has or runs a Wharf)
  - Attorneys
- Particular Lien, It is defined under section 170 of the ICA. A particular lien, on the other hand, provides that the creditor gets to keep possession of specific property until the debt related to that particular item is paid. This lien is more restricted than a general lien and is often used in contexts such as: Repairers of goods Bailees (temporary possessors of goods)

### **1.3 Bankers' Rights of Appropriation, Lien and Combination**

Banks are entrusted with a number of legal tools to protect their financial interests in the case where customers fall short of their obligation, the most prominent being the appropriation right, lien, and combination of accounts. The application of these rights is based on the laws, which enable the bank to handle conflicting claims over different accounts or properties owned by the

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<sup>22</sup> Indian Contract Act, 1872.

<sup>23</sup> Id. §§ 170–171.

customer to determine the outstanding debts.

The right of appropriation enables the bank, in the absence of any express order from its customers, to appropriate funds in any manner it deems fit. For example, if an individual maintains multiple accounts with a given bank, it may appropriate funds deposited in one account towards settling obligations in another. Likewise, if there are debits and credits in a running account, it is up to the bank to decide which funds to apply against which obligations. In the absence of an election by the parties, the rule applicable would be the rule in Clayton's Case, which held that funds would be presumed to be applied in the order in which they are received.<sup>24</sup>

Closely allied, but conceptually distinct, is the banker's lien, entitling a bank to retain securities belonging to the customer that come into its possession in the ordinary course of banking business, as security for the general balance of account. A banker's lien is thus a general lien, extending to all monies owed by the customer rather than confined to a specific debt.<sup>25</sup> Unlike a mortgage or pledge, a lien arises by operation of law and does not depend upon any express agreement between the parties.

Owing to its wide scope - and its power of sale - the banker's lien has sometimes loosely been equated with an implied pledge, particularly as it extends to negotiable instruments and securities deposited in the normal course of business.<sup>26</sup> Such securities may include share certificates, insurance policies, bills of exchange, shipping documents, and money transfer orders, provided they are not held under a separate contractual arrangement. But documents held merely for safe custody or pursuant to a distinct agreement - such as trust property or collateral furnished under a mortgage - are outside the lien.

The right to combination, also referred to as the right to consolidate accounts, allows the bank to offset one account against another account held by the same customer for the determination of the net position of indebtedness.<sup>27</sup> It has sometimes been judicially and academically equated with the concept of lien or set-off, but the right to combination has also been held to be conceptually different from these concepts. It is not based on possession, nor the existence of mutual claims, in the same way that they relate to set-off and lien, because the banker-customer relationship, being based on debtor and creditor, was held in the case of *Foley v Hill*, "money standing to the credit of a customer's account... is the property of the bank, the customer having

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<sup>24</sup> *Devaynes v. Noble (Clayton's Case)* [1816] 1 Mer. 529 (Eng.).

<sup>25</sup> *Brandao v. Barnett* (1846) 3 C.B. 519 (Eng.).

<sup>26</sup> *Id*

<sup>27</sup> *Re K* [1990] 2 All E.R. 562, 566 (Eng.).

only a personal right to sue for repayment.”<sup>28</sup> It was also noted in that case, in the now-apocryphal judgment of Buckley LJ, “no man can have a lien on his own property.”<sup>29</sup>

Moreover, this right to combine must not be confused with set-off, which, strictly defined, stipulates the presence of mutual and enforceable crossclaims between parties. In contrast, this right to combine is independent of litigation or counterclaims and is intended merely to assist the bank in ascertaining the true position with regard to payment or the lack thereof, between itself and the customer.<sup>30</sup> The bank reserves this right, for example, when one account is overdrafted and another is in credit, or even for the interest of the customer to ensure that a cheque is honored despite insufficient funds being held in the drawer’s account.

This right of combination accrues automatically by the operation of law and does not require a customer to be notified in advance. Nonetheless, prior notification can be effected for the purpose of good banking practice.<sup>31</sup> The right to combine can also be excluded by the agreement of the two parties to keep their accounts separate, as was held in *Buckingham v. London and Midland Bank Ltd.*<sup>32</sup> Nevertheless, it is possible that the agreement will be subject to termination by notice or will be frustrated by other circumstances, including the insolvency or liquidation of the customer as in the case of *Halesowen*.<sup>33</sup> In the context of insolvency, the provisions of statutory set-off override any agreement to the contrary.

<b>Basis</b>	<b>Right of Appropriation</b>	<b>Banker’s Lien</b>	<b>Right of Combination</b>
<b>Meaning</b>	Bank’s right to apply payments as it chooses	Bank’s right to retain customer’s property	Bank’s right to merge debit & credit balances
<b>Purpose</b>	Allocation of payments	Security for recovery of debts	Determine net indebtedness
<b>Applies To</b>	Incoming payments	Customer’s securities/property with bank	Multiple accounts of same customer
<b>Customer Instructions</b>	Bank acts only if customer gives no	No instructions required	No instructions required

<sup>28</sup> *Foley v. Hill* (1848) 2 H.L. Cas. 28 (Eng.).

<sup>29</sup> *Halesowen Presswork & Assemblies Ltd. v. Nat’l Westminster Bank Ltd.* [1972] A.C. 785 (H.L.).

<sup>30</sup> *Nikolaos Antoniou v. Cyprus Popular Bank* [1994] 1 A.A.D. 720 (Cyprus).

<sup>31</sup> *Garnett v. McKewan* (1872) L.R. 8 Exch. 10 (Eng.).

<sup>32</sup> *Buckingham v. London & Midland Bank Ltd.* (1895) 12 T.L.R. 70 (Eng.).

<sup>33</sup> *Halesowen Presswork & Assemblies Ltd. v. Nat’l Westminster Bank Ltd.* [1972] A.C. 785 (H.L.).

	instructions		
<b>Nature of Right</b>	Contractual / operational	Possessory security right	Legal right arising by law
<b>Legal Character</b>	Adjustment of payments	General lien (not pledge/mortgage)	Not true set-off or lien
<b>Notice to Customer</b>	Not required	Not required	Not required (Halesowen)
<b>Key Case Law</b>	Clayton's Case	Brandao v Barnett	Re K; Halesowen
<b>Limitations</b>	Subject to Clayton's rule	Excludes trust/safe custody items	Barred where trust, special purpose, or third-party rights exist
<b>Typical Use</b>	Decide which debt is paid first	Hold securities till debt cleared	Offset overdraft with credit balance

#### **1.4 Research Objectives**

- i. To examine the statutory and doctrinal foundations of banker's lien in India,
- ii. To analyse the scope, conditions, and limitations governing the exercise of banker's lien,
- iii. To critically evaluate judicial trends and regulatory approaches relating to banker's lien,
- iv. To assess the misuse of banker's lien in contemporary banking practices,
- v. To examine the constitutional and consumer protection implications of banker's lien.

#### **1.5 Research Methodology**

The research adopts a doctrinal and analytical legal research methodology, supplemented by comparative and policy-oriented analysis. The study is primarily based on secondary sources of law and focuses on the interpretation and critical evaluation of statutory provisions, judicial decisions, and regulatory frameworks governing banker's lien.

#### **1.6 Hypothesis**

The doctrine of banker's lien, as presently applied in India, suffers from over-breadth and lack of procedural safeguards, resulting in frequent misuse that undermines customer rights, constitutional guarantees, and principles of fair banking, thereby necessitating a reform-

oriented and regulated approach to its exercise.

## **2. Legal Framework Governing Bankers Lien in India**

### **2.1 Section 171 of Indian Contract Act, 1872**

The doctrine of banker's lien in India is based upon a contractual framework regulated by Section 171 of the Indian Contract Act, 1872, which recognises the notion of a general lien in favour of some classes of bailees. This section specifically provides bankers, wharfingers, factors, brokers in insurance policies, and attorneys of the High Courts with a lien, unless a contractual commitment to the contrary exists. The section is as follows: "*Bankers, factors, wharfingers, attorneys of a high court and policy brokers may, in the absence of a contract to the contrary, retain, as a security for a general balance of account, goods bailed to them.*"<sup>34</sup>

Unlike the lien under a specific lien under Section 170, wherein the banks can only keep the goods for the dues pertaining to the said specific goods, the general lien under Section 171 allows bankers to hold the goods or the securities towards the satisfaction of the dues in general. This special favor upon the bankers by the Act makes them superior to other such bailees, thereby highlighting the significance of banking in the credit system of the economy.

Judicial interpretation has always taken note of the fact that Section 171 neither presumes nor supports the idea of banker's lien as such but rather accepts and confirms the existence of an established trade usage<sup>35</sup> prior to the common law. This section, therefore, begins with a statutory declaration of the banker's special position in contractual relationships.

The Supreme Court in *Syndicate Bank v. Vijay Kumar* explained that banker's lien is a legal incident of banking business and does not depend upon any express agreement between the parties<sup>36</sup>. The right, according to the Court, extends to securities deposited in the ordinary course of business, unless they are deposited for some specific purpose which is inconsistent with the existence of lien.

### **2.2 Banker's Lien under Banking Laws**

Although the Banking Regulation Act of 1949 does not specifically define or enact the concept known as the banker's lien, it nevertheless recognizes the existence of the latter through implied provisions. The Banking Regulation Act of 1949 mainly intends to promote good banking practices with the goal of protecting depositors and maintaining systemic stability, in which

<sup>34</sup> Indian Contract Act, No. 9 of 1872, § 171 (India).

<sup>35</sup> *Brandao v. Barnett*, (1846) 12 Cl & Fin 787 (HL).

<sup>36</sup> *Syndicate Bank v. Vijay Kumar*, (1992) 2 SCC 330 (India). ←

the banker's lien assists as a mediated recovery tool.

“Banking” as defined in sections 5(b) and 6 of the Banking Regulation Act is the acceptance of deposits for lending or investment, repayable on demand or otherwise.<sup>37</sup>

The above criteria emphasize the relationship between the debtor and creditor in the case of the bank and its customer—a conceptual framework in the enforcement of banker's lien rights in certain assets held by the bank. The point to be noted in the above context, however, is the fact that the bank accounts actually become the property of the bank and thus present peculiarities in their enforcement that are not the same as those in securities and documents of title.

### **2.3 RBI Circulars and Regulatory Guidelines Governing Banker's Lien**

The Reserve Bank of India has an incredibly significant role to play in the formulation of the actual essence of banker's lien through the framing of circulars, master directions, and policy guidelines. Even though the Reserve Bank of India has not explicitly regulated the word “lien” as a principle or concept, its regulation of customer service, recovery practices, and operations has a significant impact.

Correspondingly, RBI instructions regarding the freezing of bank accounts—on account of regulatory compliance, investigation, or recovery—mandate that banks follow due procedure and give reasons wherever possible.<sup>38</sup>

The regulative expectation is that the freezing of accounts or marking with a lien should not be mechanistic or automated, without human intervention. It becomes particularly pertinent in the era of core banking systems where lien marking can be system-driven and instantaneous.

The FPC, as laid down by the RBI for banks and non-banking financial companies, prohibits arbitrary recovery actions.<sup>39</sup> FPC demands that lenders be non-coercive, provide reasonable notice, and respect the dignity of the borrower. Application of banker's lien impinging on this could make banks liable not only for regulatory action but also judicial censure.

Recent trends show that courts have increasingly applied the RBI guidelines to establish whether the exercise of lien is illegal or not. It is very common to find non-compliance with relevant regulatory directions being treated as prima facie proof of arbitrariness, even when the bank claims a statutory right under Section 171. RBI circulars constitute an important and integral part of the regulatory restraint for the otherwise wide doctrine of banker's lien.

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<sup>37</sup> Banking Regulation Act, No. 10 of 1949, §§ 5(b), 6 (India).

<sup>38</sup> Reserve Bank of India, Directions on Freezing of Accounts and Compliance Requirements. ↵

<sup>39</sup> Reserve Bank of India, Fair Practices Code for Lenders. ↵

## **2.4 Banker's Lien and Special Statues**

- ***2.4.1 Banker's Lien under SARFAESI***

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, grants banks powerful legal remedies to the enforcement of the security interest without the requirement for any court intervention. However, the relationship between banker's lien and SARFAESI remedies, too, appears ambiguous. The SARFAESI Act essentially is concerned with secured aspects and does not specifically deal with banker's lien. The courts have interpreted that banker's lien and the SARFAESI Act operate together as long as they do not conflict with each other. Once a specific security arrangement had been entered into under the SARFAESI Act, the scope for a general lien under Section 171 is restricted, especially where it is in conflict with the agreed upon structure.

- ***2.4.2 Banker's Lien under the Insolvency and Bankruptcy Code,***

The changes in the regime of recovery rights, including banker's lien, have been accruing from the promulgation of the Insolvency and Bankruptcy Code, 2016. In particular, the corporate insolvency resolution process in the regime of the IBC, 2016, is governed by Section 14 of the IBC that proscribes actions against the corporate debtor.<sup>40</sup>

It has also been held by the judicial authorities that any continuance or creation of the banker's lien during the moratorium period is violative of the very intent of the IBC, which aims to protect the debtor's assets and provide fair treatment to creditors. This is due to the disruption in the balance that could be created. The liens in existence before the initiation of CIRP are to be allowed, but enforcement of such liens is to be stayed.

- ***2.4.3 Banker's Lien and the Prevention of Money Laundering Act,***

The Prevention of Money Laundering Act, 2002, in its turn, gives powers to enforcement authorities to attach and freeze funds they suspect to have been laundered. Where there is a clash in banker's lien and PMLA impulses to attach, overall superiority is granted to PMLA prescriptions in accordance with its overriding effect.<sup>41</sup> Banks have a legal obligation to comply with the enforcement directions, even if it limits the exercise of lien rights..

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<sup>40</sup> Insolvency and Bankruptcy Code, No. 31 of 2016, § 14 (India).

<sup>41</sup> Prevention of Money Laundering Act, No. 15 of 2002, § 71 (India).

### 3. Scope and Judicial Interpretation of Banker’s Lien.

**Lawful Possession:** First and foremost, the existence of a banker's lien necessarily involves the condition of lawful possession of the goods, securities, and/or funds by the banking institution in whose favor the lien is claimed. This possession cannot be accidental in nature and/or obtained by fraud and/or misrepresentation. Banker lien laws have clearly indicated and clarified that possession in a banking context need not necessarily amount to physical possession but could be constructive as well, especially with respect to securities and/or deposits that form part of its normal business transactions.

In **Syndicate Bank v. Vijay Kumar**, the Supreme Court also highlighted that: *"The banker’s lien arises only if the securities are deposited with the bank as banker and not for any special or specific purpose inconsistent with lien. If deposited for any specific purpose, such as safe custody or trust, the general lien is excluded."*<sup>42</sup>

**Absence of Contract to the Contrary:** Section 171 itself states that “the banker’s lien would depend upon the absence of contract to the contrary.” This means that it is an implied right rather than a fixed one and can, therefore, be excluded by agreement between the banker and the customer.

#### 3.1 Types of Accounts Subject to Lien

Type of Account	Applicability of Banker’s Lien	Judicial Position / Key Observations
<b>Current Accounts</b>	Generally applicable	Funds in current accounts are treated as general deposits arising in the ordinary course of banking business. Courts have permitted the exercise of banker’s lien, subject to fulfilment of statutory conditions <sup>43</sup> . However, arbitrary or blanket freezing of such accounts without prior notice has been judicially disapproved, particularly where it disrupts ongoing business operations.
<b>Fixed Deposits</b>	Conditionally applicable	Banker’s lien may be exercised over fixed deposits when they are created in the ordinary course and are not earmarked for any specific purpose. In <i>Punjab National Bank v. Arura Mal Durga Das</i> , courts upheld the bank’s

<sup>42</sup> Syndicate Bank v. Vijay Kumar, (1992) 2 SCC 330 (India).

<sup>43</sup> John Paget, Paget’s Law of Banking 642–45 (14th ed. 2014).

		right to appropriate fixed deposit amounts towards outstanding liabilities. <sup>44</sup>
<b>Savings Accounts</b>	Restricted applicability	Although savings account deposits legally vest in the bank, courts have recognised their <b>consumer-protective</b> nature. Judicial trends reflect reluctance to permit lien over savings accounts without strict adherence to procedural safeguards, including prior notice and compliance with RBI guidelines, especially where individual customers are involved <sup>45</sup> .
<b>Joint Accounts</b>	Limited and conditional	Courts have subjected joint accounts to heightened scrutiny. Banker's lien cannot be exercised over the entire balance unless all joint account holders are jointly liable for the debt. <sup>46</sup>
<b>Trust Accounts</b>	Not applicable	Trust accounts are excluded from banker's lien as the funds do not belong to the customer but are held in a fiduciary capacity. Courts have consistently held that asserting lien over trust funds violates fiduciary principles and is legally impermissible.
<b>Escrow Accounts</b>	Not applicable	Similar to trust accounts, escrow accounts are maintained for a specific contractual purpose. Courts have ruled that banker's lien cannot be exercised over escrow funds, as such accounts are impressed with a special purpose inconsistent with the concept of general lien <sup>47</sup> .

### **3.2 Landmark Judicial Pronouncement**

The judicial interpretation has played a major role in determining the shape of banker's lien in India.

➤ **Syndicate Bank v. Vijay Kumar (1992)**

This decision stands out as the most authoritative exposition on banker's lien. It clarified the position that banker's lien is a general lien and therefore encompasses all securities unless a contrary contract applies. It also distinguished between general lien

<sup>44</sup> Punjab Nat'l Bank v. Arura Mal Durga Das, AIR 1960 Punj 632 (India).

<sup>45</sup> Reserve Bank of India, Master Circular on Customer Service in Banks (2023).

<sup>46</sup> Canara Bank v. Canara Sales Corp., (1987) 2 SCC 666 (India).

<sup>47</sup> Barclays Bank Ltd. v. Quistclose Invs. Ltd., [1970] A.C. 567 (H.L.).

and pledge; however, it held that banker's lien does not require any express contract, but by implication of law.

➤ **State Bank of India v. Jayanthi (2023)**

In this recent decision, a more customer-centric approach has been adopted by the courts; however, the focus remains on the banks performing their duties in accordance with RBI guidelines and natural justice principles. This decision has highlighted the violation of natural justice principles when there is a unilateral freeze of a customer's account without notice, particularly when the customer's livelihood is impacted.<sup>48</sup>

This case represents a new approach. The language moves from creditor protection type reasoning to rights-based reasoning.

➤ **Punjab National Bank v. Arura Mal Durga Das**

The court upheld the bank's right to exercise lien over deposits but cautioned that this right must be exercised strictly in accordance with the legal requirements and should not ignore equitable principles.

➤ **NCLT/NCLAT rulings during**

In insolvency, it has been held in various cases under insolvency proceedings that banker's lien cannot exist during the moratorium period under Section 14 of the IBC. Once the CIRP process starts, banks cannot under any circumstances appropriate funds using banker's lien, as it would undermine the collective insolvency process.<sup>49</sup>

### **3.2 Banker's Lien in the Digital & Core Banking Era**

With the advent of the digitalisation of banking, lien exercise patterns have drastically changed with the implementation of Core Banking Solutions (CBS). With CBS technology in banks' backends, banks can now automatically freeze liens on accounts without even requiring manual intervention. The practice may be efficient from a technological perspective but has raised a number of legal issues that are a concern to many jurists. The system has occasionally been referred to by cases of unilateral electronic freezes whereby customers were denied access to their funds without any prior explanation or notification. It seems that machines are no exception to the law.<sup>50</sup> The issue of consumer consent is equally at the center. There have also been queries over whether generic consent provisions supplied in account-opening contracts are sufficient for the marking of liens electronically. Earlier, the general idea that had governed

<sup>48</sup> State Bank of India v. Jayanthi, 2023 SCC OnLine SC \_ (India).

<sup>49</sup> Indian Overseas Bank v. RCM Infrastructure Ltd., (2022) NCLAT (India).

<sup>50</sup> Reserve Bank of India, Guidelines on Freezing of Accounts (2022).

the traditional banker's lien was one of possession, wherein bankers were involved in dealing with paper securities, negotiable instruments, and physical goods deposited in the bank. Today, in this modern banking environment, banker's lien has seen a major change. Core banking systems, digital deposits, and online payment systems have changed this traditional approach to one of technologically mediated control.

However, this evolution has not watered down the legal basis of banker's lien under Section 171 of the Indian Contract Act, 1872. Instead, it has strengthened judicial supervision over the manner, extent, and timeliness of bank lien, considering that account freezes, debits, and online warnings can now be initiated instantly without human intervention.

Core Banking Systems help banks operate customer accounts on a single digital platform. This allows transactions across branches and channels in real time. This technological shift has increased the ease of operation for banks, but at the same time, it raises serious legal questions in terms of procedural fairness, consent of customers, and responsibility.

In modern banking practice, liens may be automatically marked:

- Flagging the account in CBS
- Restricting Debit Operations
- Internally Appropriating Balances Against Dues

Although such automation increases the degree of efficiency, the courts have cautioned that the convenience afforded by technology should not conflict with the law. It must be understood that the lien itself is a legal right and not a computer program.

Aspect	Traditional Banking	Digital / Core Banking Era
Nature of possession	Physical custody of goods	Electronic control over balances
Mode of exercise	Manual retention	Automated lien marking / freeze
Speed	Slow and deliberate	Instantaneous
Human oversight	Direct banker involvement	Often system-driven
Risk to customer	Limited	High if unchecked
Judicial concern	Minimal	Significant (due process)

One of the issues often litigated in the era of technology is the freezing of bank accounts in the name of banker's lien. The courts have increasingly ruled that:

- A lien cannot be mechanically imposed
- Unannounced mechanical halts may contravene principles of natural justice
- Banks need to show that they used mind, not system triggers

In the case of *State Bank of India v. Jayanthi*<sup>51</sup>, the Supreme Court has stressed that customer rights should not be undermined just because the bank has technological facilities to do so instantly.

Courts have also drawn a clear distinction between:

- Lien-based freezes (contractual/common)
- Statutory freezes (PMLA, CrPC, Income Tax Act)

Equating the two concepts is firmly discouraged, particularly when banks rely on internal compliance notifications as grounds for imposing extended restrictions on accounts.

Reserve Bank of India has steadily strengthened customer-oriented safeguards through:

- RBI Master Directions on Customer Service
- Guidelines on freezing of accounts
- The Code Compliant Fair Practice Code (FPC) Obligations

These instruments ask banks to make sure that any prohibition to operate the account is reasonable, proportionate, and well-motivated.<sup>52</sup>

Recent RBI circulars have indirectly affected banker's lien by:

- Mandating more transparency regarding the operation of digital accounts.
- Mandating mechanisms for grievance redressal in case of wrongful freezes.
- Emphasizing consent-based debit and appropriation

Although the RBI has not amended Section 171 directly, in substance, its regulatory stance has had the effect of narrowing the banker's lien's scope of operation in digital environments.

**Agentic Banking:-** Agentic banking systems incorporate AI-driven agents that 'continuously' monitor accounts, evaluate risks of fraud based on data, and create actions such as,

- Mark liens
- Freezing of suspicious transactions
- Recommending recovery actions

While such systems enhance risk management, they raise profound legal questions when agent-driven decisions directly affect proprietary rights of customers.

From a legal perspective, there are three main issues involved in the application of AI in lien enforcement:

- Banker's lien requires a legal satisfaction of conditions: lawful possession, debt due, and absence of contrary contract. Algorithms cannot independently assess such nuanced legal thresholds.

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<sup>51</sup> State Bank of India v. Jayanthi, (2023) 6 SCC 1 (India).

<sup>52</sup> Reserve Bank of India, Master Direction on Customer Service in Banks (updated 2023).

- Opacity and Explainability Customers are routinely given no intelligible reason for such freezing of accounts, and thus also procedural fairness under Article 14 is undermined, when it involves public sector banks.<sup>53</sup>
- Responsibility Attribution Some courts have finally started to question whether a bank can avoid liability for a wrongful freeze by pointing the finger at “system errors” or automated compliance engines.

The courts have increasingly imposed substantive limits on digital lien practices, including:

- Proportionality: It needs to correspond to the actual debt owed.
- Temporal restraint: Freezes cannot be indefinite
- Notice requirement: Particularly when the savings or joint accounts are concerned

NCLT and NCLAT have held that once a moratorium is triggered under Section 14 of the IBC, automatic lien enforcement must stop in insolvency contexts, irrespective of CBS settings.<sup>54</sup>

#### **4 Limitation, Exceptions and Misuse of Banker’s Lien**

Though the banker's lien is said to be general in amplitude and wide in sweep, it must not be overlooked that the banker's lien is not absolute. It is further not free from the dictates of law. Indian courts have been stressing the fact that the lien is restricted to the parameters of law, equity, and contract. In the case of contractual exclusion, the starting point is the contract itself. Where there has been an express agreement between the banker and the customer in the account opening contract or the loan agreement, or for that matter an undertaking that the lien is not to be exercised, the agreement binds the parties. The lien being an implied contract based on principles of mercantile practice cannot override the express contract entered into by the parties<sup>55</sup>.

A second and more fundamental limitation arises if the bank holds its money or securities in a fiduciary or trust capacity. Money or securities held as trustee, executor, guardian, or an escrow agent do not fall in the general category of the customer's assets and therefore cannot be liable to a lien for the bank's dues<sup>56</sup>.

The principle is based upon the logic that if a lien is permitted in these circumstances, there would be an element of unjust enrichment. Indian case law has held time and again that the banker's lien is based upon the principle that there is an ownership in the customer's account,

<sup>53</sup> Maneka Gandhi v. Union of India, (1978) 1 SCC 248 (India) (principle of fairness under Article 14).

<sup>54</sup> Indian Overseas Bank v. RCM Infrastructure Ltd., (2022) SCC OnLine NCLAT 356.

<sup>55</sup> Syndicate Bank v. Vijay Kumar, (1992) 2 SCC 330.

<sup>56</sup> Union Bank of India v. Venugopalan, AIR 1994 Ker 271.

which is not present in the account held in a fiduciary capacity.<sup>57</sup>

Another well-established exception is in respect of articles kept in safe custody. For example, jewels, title deeds, sealed packets, etc., are usually kept in safe custody, but no lien is exercised over these because the essential prerequisite of lawful possession, which qualifies as a banking possession, is lacking. The bank is merely a bailee, but it cannot appropriate these properties. While the banks also tried to rely on the broad lien clauses that were contained in the general contracts therein, the law has applied these clauses very restrictively, failing to extend the lien to safe custody arrangements unless informed consent was given. Collectively, these limitations emphasize the point that the banker's lien is not a weapon that can be asserted of its own accord but a "right to be asserted when all the principles of law, contract, and equity concur to sustain it."

In recent years, with the extension of facilities of digital banking and centralization of core banking, there have been new trends of misuses of banker's lien that are very disturbing. Perhaps, one of the main grievances, as visible, relates to the arbitrary blocking of salary accounts<sup>58</sup>. It is seen that salary credits, being at times the only source of sustenance for employees, are being blocked without prior information to the employees merely because they are guarantors or are defaulting borrowers.

Another questionable practice is granting lien over joint accounts in respect of individual liability applicable to one of the account holders<sup>59</sup>. It has also been seen that banks freeze or appropriate the amounts in joint family accounts even when one of the holders is not connected to the debt. The courts have disapproved of this practice on the basis that joint accounts do not provide authority to recover from all the holders unless it is joint and several.

Such misuse can also be seen in situations where the bank claims lien notwithstanding the existence of a genuine dispute with regard to such debt. When liability itself is in dispute and subject to adjudication—before a civil court or arbitration or a consumer forum—unilateral appropriation by the bank defeats the spirit of procedural due process. The lien takes on the character of coercive means to get at a quick resolution. The most alarming abuse of the law may be seen in cases where the lien is employed during the statutory period of the Insolvency and Bankruptcy Code, 2016. Section 14 of the Insolvency and Bankruptcy Code clearly prohibited the recovery and enforcement of dues during the moratorium period<sup>60</sup>. Yet, the

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<sup>57</sup> *Brandao v. Barnett*, (1846) 12 Cl & Fin 787 (HL).

<sup>58</sup> Consumer Forum / High Court decisions + RBI Ombudsman Scheme.

<sup>59</sup> *Indranarayan v. Roop Narayan* (1971) and *Prabha Kaul v. Chandra Kaul Muthoo* (2013). (Relevant High Court rulings on joint account holders.)

<sup>60</sup> Insolvency and Bankruptcy Code, 2016, § 14.

freezing of bank account and the set-off by banks have also been observed, highlighting the judicial intervention in such matters.

### **Banker's Lien and Fundamental Rights**

Banker's lien is increasingly misused as a tool against which constitutional issues do arise in cases where banks act as instrumentalities of the State. Freezing operative accounts can affect citizens' right to livelihood under **Article 21** of the Constitution<sup>61</sup>. In various instances, courts have observed that access to one's bank account is not merely a contractual privilege but a practical necessity for survival in a cashless economy. An indiscriminate lien, thus, can amount to deprivation of life with dignity.

**Article 14** is further implicated if the powers of lien are exercised capriciously or without criteria which may be intelligible. Selective freezing, absence of notice, and mechanical reliance upon internal circulars have been struck down as manifestations of non-application of mind.<sup>62</sup> The principles of fairness, reasonableness, and proportionality apply bilaterally to financial actions taken by public sector banks.

Judicial oversight shall play an important role in controlling the excesses of banker's lien. For example, decisions of the Banking Ombudsman have highlighted almost increasing importance to procedural due process. Indeed, the Banking Ombudsman directs banks to release the lien if there was no prior intimation or if the funds were unrelated to the debt. Quasi-judicial action offers speedy relief to customers.

The High Courts, through their writ powers, have become involved in dealing with matters involving Public Sector Banks, particularly when violations of constitutional rights are raised. Challenges to freeze of accounts through writ petitions have led to orders for restoration of accounts, formulation of guidelines, and even disciplinary action.

Consumer courts have taken a step ahead in allowing compensation for wrongful lien, which indicates the damage for non-monetary loss suffered by the customers. It is evident from the decisions that there is a clear message: banks may want protection for their interests, but they do not have the freedom to do so against the law.

**Impact on Borrowers & Financial Inclusion:** The unregulated use of banker's lien only increases the power gap between banks and their individual customers. At such a juncture, when small borrowers remain unaware of the law and powerless enough to be put in a

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<sup>61</sup> Maneka Gandhi v. Union of India, (1978) 1 SCC 248.

<sup>62</sup> E.P. Royappa v. State of Tamil Nadu, (1974) 4 SCC 3.

challenging situation due to the restriction of bank accounts, a sense of chilling effect becomes evident concerning the involvement of people in banking systems. The impact of freezing an account is disproportionately severe in the case of **women and elderly people**, as these people often maintain a single account for their pension, savings, or other household expenses. Without any analysis, freezing these kinds of accounts flouts the broader aim of an inclusive approach to banking.

Area of Lien Application	Common Bank Practice	Legal Position	Impact on Customers
Salary Accounts	Blanket freezing	Requires proportionality and notice	Loss of livelihood
Joint Accounts	Lien for individual debt	Permissible only for joint liability	Innocent co-holder affected
Disputed Debts	Immediate appropriation	Lien discouraged during adjudication	Procedural unfairness
IBC Moratorium	Set-off despite Section 14	Expressly prohibited	Undermines insolvency process

A key issue that dominates the current debate is the capacity of broad lien clauses in standard-form loan contracts to be characterized as unconscionable. Notably, the clauses allow banks to file a lien against any and all of the borrower's existing and future accounts without a connection to the loan deal. In consideration of the imbalance in bargaining power, which is normally a feature of standard-form contracts, courts are reviewing the clauses for their fairness and reasonableness.

A perusal of current judicial trends seems to indicate a clear shift towards a reading down of overly broad clauses of lien, especially those which operate in an harsh or disproportionate manner. The doctrine of un-conscionability<sup>63</sup>, adumbrated by consumer protection legislation, might also function as a corrective mechanism against overreaching. The banker's lien of the future is not one that is exercised at unchecked discretion, but rather in consonance with

<sup>63</sup> ICICI Bank Ltd. v. Shanti Devi Sharma, Consumer Case No. (NCDRC).

constitutional tenets and financial ethics.

## **5 Conclusion and Recommendation**

### **Conclusion**

However, while the banker's lien has throughout history been indispensable to the protection of the interests of bankers, it has to adapt with the changing economic circumstances and constitutional values. The unrestrained use of the banker's lien might compromise the dignity of the borrowers and might result in the dilution of trust in the banking system as a whole. On the other hand, over-modification of the rights of the bankers might compromise the system of credit restraint itself.

The answer lies in its reform-oriented interpretation which reconciles Section 171 with consumer protection principles, constitutional provisions, and regulatory norms. By ensuring proceduralism, clarity in law, and technological accountability, banker's lien can be shifted from its current blunt instrument character to that of a legal tool that balances both banker and human dignity.

### **Recommendation**

In view of the foregoing discussion, there are particular reforms which are now imperative. First, there is a pressing need to statutorily prescribe the requirement of mandatory prior notice before any lien is marked, except in situations of exigent circumstances. This shall include the prescription of the debt, the legal foundation of lien, and its scope in restriction.

Secondly, the law has to take account of the existence of statutory exemptions applying to salary accounts, pension accounts, and Welfare-linked accounts, subject to appropriate financial limits expressed in money terms.

Third, a uniform Standard Operating Procedure (SOP) must be framed by the RBI in respect of the exercise of Banker's Lien. In this SOP, a requirement must specifically be provided for ensuring human oversight, proportionality, and approval before implementing Banker's Lien in core banking.

Lastly, in the digitized banking environment, it is important to make the audit trail compulsory. All actions pertaining to the triggering, review, sanctioning, and execution of every lien ought to be recorded and made accessible for inspection by regulatory bodies as well as the courts.

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