UNIT-2

THE NEGOTIABLE INSTRUMENTS ACT, 1881

INTRODUCTION

Money can very easily and safely be transferred from one place to another with the help of negotiable instruments. The law relating to Negotiable Instruments is laid down in Negotiable Instruments Act, 1881. It extends to the whole of India except the State of Jammu and Kashmir.

DEFINITION

According to Section 13 of the Act, "Negotiable instrument means a promissory note, bill of exchange or cheque payable either to order or to bearer, whether the word "order" or " bearer" appear on the instrument or not."

In the words of Justice, Willis, "A negotiable instrument is one, the property in which is acquired by anyone who takes it bona fide and for value notwithstanding any defects of the title in the person from whom he took it".

Thus, the term, negotiable instrument means a written document which creates a right in favour of some person and which is freely transferable. Although the Act mentions only these three instruments (such as a promissory note, a bill of exchange and cheque), it does not exclude the possibility of adding any other instrument which satisfies the following two conditions of negotiability:

(1) the instrument should be freely transferable (by delivery or by endorsement. and delivery) by the custom of the trade; and
(2) the person who obtains it in good faith and for value should get it free from all defects, and be entitled to recover the money of the instrument in his own name.

CHARACTERISTICS OF A NEGOTIABLE INSTRUMENTS

1. Easy transferability
The property (ownership) in a negotiable instrument is transferred by mere delivery, if the instrument is payable to bearer, by delivery and indorsement if payable to order.

2. Transferee's title free from all defects
The transferee who takes it bona fide and for value and before maturity (called holder in due course) gets a good even if the title of transferor was defective.

3. Transferee can sue in his own name: The transferee of the negotiable instrument can sue in his own name, in case of dishonor.

4. Prompt payment
A negotiable instrument enables the holder to expect prompt payment because a dishonour means the ruin of the credit of all persons who are parties to the instrument.

5. Notice of transfer not necessary: The transferee is not required to give a notice of transfer to the person liable to pay the instrument.

6. Presumptions

Sections 118 and 119 of the Negotiable Instrument Act lay down certain presumptions which the court presumes in regard to negotiable instruments:

1. Consideration: It is presumed that every negotiable instrument was made drawn, accepted or endorsed for consideration.

2. Date: Every negotiable instrument is presumed to have been made or drawn on the date which it bears.

3. Time of acceptance: It is presumed that every accepted bill was accepted within a reasonable time after its issue and before its maturity.

4. Time of transfer: It is presumed that every transfer was made before its maturity.

5. Order of endorsement: The endorsements are presumed to have been made in the order in which they appear thereon.

6. Stamp: In case an instrument is lost, it is presumed that it was duly stamped.

7. Every holder is a holder in due course: Every holder is presumed to be a holder in due course.

8. Proof of protest: In case a suit is filed for dishonor of instrument, the court shall on proof of the protest, presume the fact of dishonour, unless and until such fact is disproved.

TYPES OF NEGOTIABLE INSTRUMENT

(a) Negotiable instruments recognised by statute (By the Negotiable Instruments Act):

(i) Promissory notes

(ii) Bills of exchange

(iii) Cheques

(b) Negotiable instruments recognised by usage or custom are:

(i) Hundis
(ii) Share warrants
(iii) Dividend warrants
(iv) Bankers draft
(v) Circular notes
(vi) Bearer debentures
(vii) Debentures of Bombay Port Trust
(viii) Railway receipts
(ix) Delivery orders.

PROMISSORY NOTE

Section 4 of the Act defines, "A promissory note is an instrument in writing (not being a bank-note or a currency note) containing an unconditional undertaking, signed by the maker, to pay a certain sum of money to or to the order of a certain person, or to the bearer of the instruments."

Parties to a Promissory Note:

1. Maker – The person who makes the note and promises to pay.
2. Payee- The person to whom the amount is payable.

Essential elements

An instrument to be a promissory note must possess the following elements:

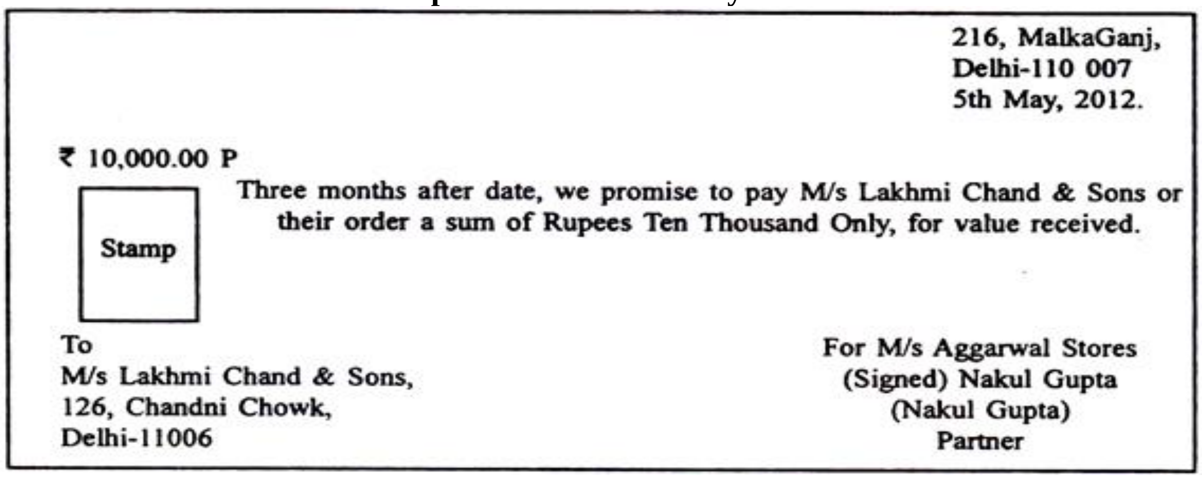
(1) It must be in writing: A mere verbal promise to pay is not a promissory note.

(2) It must contain an express promise to pay: There must be an express undertaking to pay. A mere acknowledgment of debt is not enough.

(3) Promise to pay must be unconditional: A conditional undertaking destroys the negotiable character of an otherwise negotiable instrument.

(4) It should be signed by the maker: The person who promise to pay must sign the instrument even though it might have been written by the promisor himself.
(5) The maker must be certain: The note itself must show clearly who is the person agreeing to undertake the liability to pay the amount.
(6) The payee must be certain: The instrument must point out with certainty the person to whom the promise has been made.
(7) The promise should be to pay money and money only: Money means legal tender money and not old and rare coins.
(8) The amount should be certain: the amount payable must be certain.
(9) Other formalities: The other formalities regarding number, place, date, consideration etc. though usually found given in the promissory notes but are not essential in law.

Specimen of Promissory Notes


216, MalkaGanj,
Delhi-110 007
5th May, 2012.

₹ 10,000.00 P

Stamp

Three months after date, we promise to pay M/s Lakhmi Chand & Sons or their order a sum of Rupees Ten Thousand Only, for value received.

To
M/s Lakhmi Chand & Sons,
126, Chandni Chowk,
Delhi-11006

For M/s Aggarwal Stores
(Signed) Nakul Gupta
(Nakul Gupta)
Partner

BILLS OF EXCHANGE

Section 5 of the Act defines, "A bill of exchange is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument".

Parties to Bill of Exchange
1. **Drawer :** The maker of a bill of exchange
2. **Drawee :** The person directed to pay the money by the drawer
Acceptor: After a drawee of a bill has signed his assent upon the bill, he is called the acceptor.
3. **Payee :** The person to whom the money is to be paid.

Essential conditions of a bill of exchange
(1) It must be in writing.
(2) It must be signed by the drawer.
(3) The drawer, drawee and payee must be certain.
(4) The sum payable must also be certain.
(5) It should be properly stamped.
(6) It must contain an express order to pay money and money alone.
(7) The order must be unconditional.

Specimen of Bill of Exchange

Mr. A (Drawer)
48, MP Nagar, Bhopal (M.P.)
April 7, 2015

Rs. 10,000/-
Four months after date, pay to Mr. B (Payee) a sum of Rupees Ten Thousand, for value received.

To
Mr. C (Drawee)
576, Arera Colony, Bhopal (M.P.)

Signature
Mr. A

CHEQUE

Section 6 of the Act defines "A cheque is a bill of exchange drawn on a specified banker, and not expressed to be payable otherwise than on demand".

A cheque is bill of exchange with two more qualifications, namely,

(i) it is always drawn on a specified banker, and
(ii) it is always payable on demand.

Consequently, all cheque are bill of exchange, but all bills are not cheque.

Parties to a Cheque

1. **Drawer.** the person who draws the cheque.
2. **Drawee**. It is the drawer's banker on whom the cheque has been drawn.
3. **Payee.** He is the person who is entitled to receive the payment of the cheque.

Specimen of Cheque

Date: ....

Pay...
a sum of Rupees.. Rs.

A/C No. 12345678910

ABC Bank
622, Vijay Nagar, Indore (M.P.)

Signature

01212 1125864 000253 38

Types of Cheques

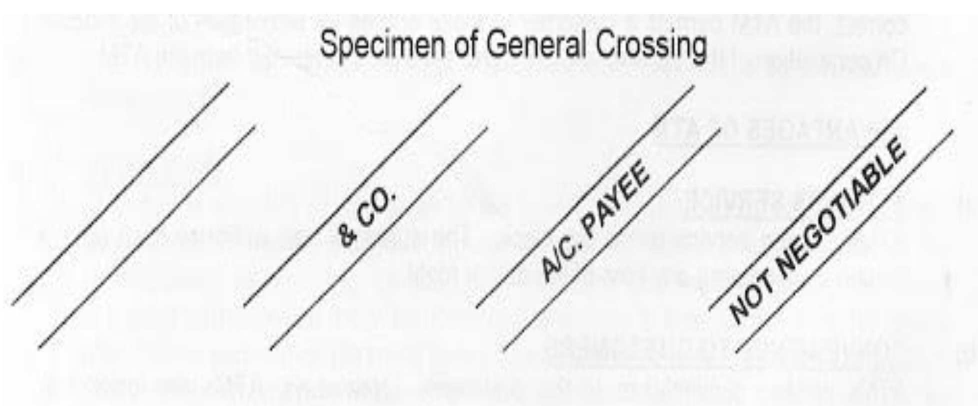
(a) Open Cheque – When the cheque is payable at the counter of the bank on whom it is drawn, it is called an open cheque. It may be of two types .

- **Bearer Cheque** - When a cheque is payable to the bearer i.e. to the person who presents the cheque to the bank for encashment, is called bearer cheque. It can be transferred by mere delivery. Hence there is a great risk. Eg. Pay 'A' or bearer.
- **Order Cheque -** When a cheque is payable to person named in the cheque or to his order, is called Order Cheque. It can be transferred only by endorsement and delivery. Eg. Pay 'A' or order.

(b) Crossed Cheque – To reduce the risk involved in open cheque, a cheque may be crossed. It is the cheque on which two parallel transverse lines are drawn across the top left , with or without the word :
(i) ' & Co.'
(ii) Not Negotiable
(iii) A/c Payee
It can not be encashed at the counter of the bank , can be received through a collecting banker.

MODES OF CROSSING

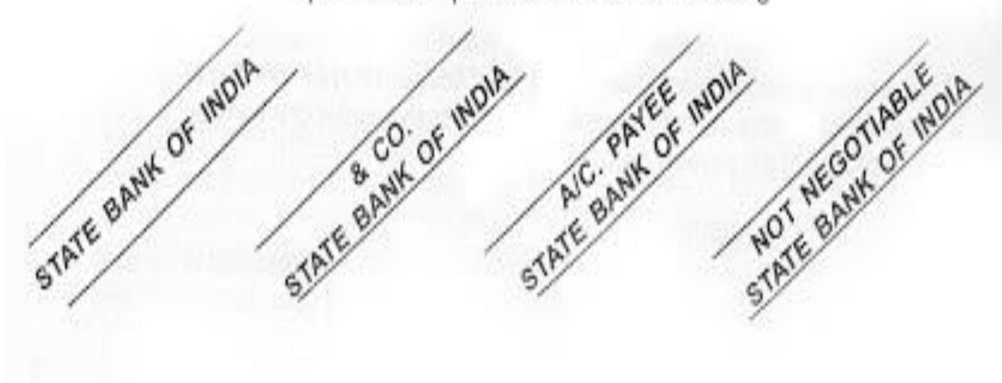
(1) General Crossing – In general crossing, simply two parallel transverse lines at the left hand side of its top corner with or without words such as 'and company' or 'not negotiable' may be drawn.
Effect - Payment can be made through bank account only, and not at the counter.



(2) Special Crossing - When a cheque bears the name of the bank in between the two parallel lines, with or without the words 'not negotiable' is called Special Crossing.

Effect - The bank will pay to the banker whose name is written in between the crossed lines.

Specimen of Special or Restrictive Crossing



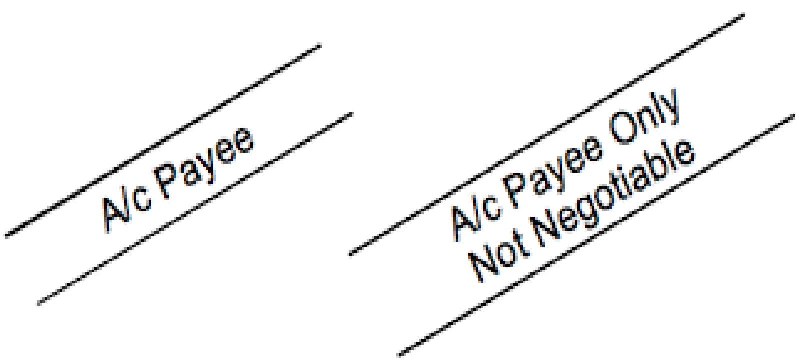
(3) Restrictive Crossing - In this, crossing of cheques is done by writing Account Payee or Account Payee only in between the crossing lines.

Effect - Payment will be credited to the account of payee named in the cheque.

(4) Not negotiable Crossing - A person taking a cheque crossed generally or specially, bearing in either case the words 'not negotiable' shall not be able to give a better title to the holder than that of the transferor.

Effect - The cheque can be transferred but the transferee will not acquire a better title to the cheque. Thus a cheque is deprived of its essential feature of negotiability.

Specimen of Not Negotiable Crossing



Comparison between Cheque and Bill of Exchange

S.N.	BASIS	CHEQUE	BILL OF EXCHANGE
1.	Meaning	A document used to make easy payments on demand and can be transferred through hand delivery	A written document that shows the indebtness of the debtor towards the creditor
2.	Defined in	Section 6 of Negotiable Instrument Act, 1881.	Section 5 of Negotiable Instrument Act, 1881.
3.	Drawee	Always a specific bank	May be any person or bank
4.	Payable to bearer on demand	Always	Cannot be made payable to bearer on demand.
5.	Acceptance	Does not require acceptance	A bill needs to be accepted.
6.	Validity period	3 months	Not applicable
7.	Days of grace	No grace period is allowed	3 days of grace allowed
8.	Can it be crossed	Yes	No
9.	Stamping	No such requirement	Must be stamped

Comparison between Bill of Exchange and Promissory Note

S.N.	BASIS	BILL OF EXCHANGE	PROMISSORY NOTE
1.	Meaning	Bill of Exchange is an instrument in writing showing the indebtedness of a buyer towards the seller of goods.	It is an instrument in writing containing an unconditional undertaking signed by maker to pay a certain sum of money to a certain person or to the bearer.
2.	Defined in	Section 5 of Negotiable Instrument Act, 1881.	Section 4 of Negotiable Instrument Act, 1881.
3.	Nature of Payment	There is an unconditional order to pay	There is an unconditional promise to pay
4.	Number of Parties	Three parties, i.e. drawer, drawee and payee.	Two parties, i.e. drawer and payee.
5.	Drawn by	Creditor	Debtor
6.	Liability of Maker	Secondary and conditional	Primary and absolute
7.	Notice of dishonour	Notice must be given to all persons liable to pay	Notice of dishonor to maker is not necessary
8.	Noting and protesting	Required in case of dishonor of a bill.	Not required in case of dishonor of a note.
9.	Payable to maker	The drawer and payee may be one person	Maker cannot pay to himself
10.	Copies	Bill can be drawn in copies.	Promissory Note cannot be drawn in copies.

NEGOTIATION

According to section 14 of the Act, 'when a promissory note, bill of exchange or cheque is transferred to any person so as to constitute that person the holder thereof, the instrument is said to be negotiated.'

Negotiation thus requires two conditions to be fulfilled, namely:
1. There must be a transfer of the instrument to another person; and
2. The transfer must be made in such a manner as to constitute the transferee the holder of the instrument.

Modes of Negotiation

Negotiation may be effected in the following two ways :

1. Negotiation by delivery (Sec. 47) : Where a promissory note or a bill of exchange or a cheque is payable to a bearer, it may be negotiated by delivery thereof.
Example : A, the holder of a negotiable instrument payable to bearer, delivers it to B's agent to keep it for B. The instrument has been negotiated.

2. Negotiation by endorsement and delivery (Sec. 48) : A promissory note, a cheque or a bill of exchange payable to order can be negotiated only be endorsement and delivery. Unless the holder signs his endorsement on the instrument and delivers it, the transferee does not become a holder. If there are more payees than one, all must endorse it.

ENDORSEMENT

As per the Negotiable Instruments Act endorsement means, the writing of one's name on the back of the instrument or any paper attached to it with the intention of transferring the rights therein. Thus, endorsement is signing a negotiable instrument for the purpose of negotiation. The person who effects an endorsement is called an 'endorser', and the person to whom negotiable instrument is transferred by endorsement is called the 'endorsee'.

Classes of endorsement: An endorsement may be :
(1) Blank or general.
(2) Special or full.
(3) Partial.
(4) Restrictive.
(5) Conditional.

(1) Blank or general endorsement (Sections 16 and 54).

It is an endorsement when the endorser merely signs on the instrument without mentioning the name of the person in whose favour the endorsement is made.
Example : A bill is payable to X. X endorses the bill by simply affixing his signature.
This is an endorsement in blank by X. In this case the bill becomes payable to bearer.
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(2) Special or full endorsement (Section 16)

When the endorsement contains not only the signature of the endorser but also the name of the person in whose favour the endorsement is made, then it is an endorsement in full. **Example :** "Pay to A or A's order,"

(3) Partial endorsement (Section 56)

A partial endorsement is one which purports to transfer to the endorsee a part only of the amount payable on the instrument. Such an endorsement does not operate as a negotiation of the instrument.

Example : A is the holder of a bill for Rs.1000. He endorses it "pay to B or order Rs.500."

(4) Restrictive endorsement (Section 50)

Restrictive endorsement is one which restricts or prohibits the further negotiatiability.

Example : "Pay C for my use," "Pay C for the account of B" .

(5) Conditional or qualified endorsement

An endorsement which limits or negatives the liability of the endorser is called a conditional endorsement. An endorsement which says that the amount will become payable if the endorsee attains majority embodies a condition precedent. An endorsement may be made conditional or qualified in any of the following ways :

(i) 'Sans recourse' endorsement : An endorser who doesnot want to take risk on the instrument may, indorse it sans recourse by adding the words "sans recourse" or "without recourse".

Example: 'Pay to A or order sans recourse, 'pay to A or order without recourse to me'.

(ii) 'Sans frais' endorsement : Where the endorser does not want the endorsee or any subsequent holder, to incur any expense on his account on the instrument, the endorsement is 'sans frais'.

(iii) Facultative endorsement : An endorsement where the endorser may curtail or waive his rights, is called a facultative endorsement.

Example: "Pay A or order. Notice of dishonour waived" .

(iv) Liability dependent upon a contingency : Where an endorser makes his liability dependent, upon the happening of a contingent event, which may or may not happen.

Example: 'Pay A or order on his marriage with B'.

HOLDER

According to Section 9 of the Act 'holder' of a promissory note, bill of exchange or a cheque means any person entitled in his own name to the possession thereof and to receive or recover the amount thereon from the parties thereto.

A holder in case of an instrument payable to order is payee or indorsee. In case the instrument is payable to bearer, holder means the possessor of the instrument.

HOLDER IN DUE COURSE

Section 9 of the Act defines 'holder in due course' as "any person who acquires a promissory note, bill or cheque bona fide, for value and before maturity".

A holder in due course must satisfy the following conditions:
1. He must be a holder for valuable consideration.
2. He must have become a holder (possessor) before the date of maturity of the negotiable instrument.
3. He must have become holder bona fide.
4. He should not have notice of defects whether actual or constructive.
4. A holder in due course must take the negotiable instrument complete and regular on the face of it.

Example
(i) A bill made out by pasting together pieces of a tom bill taken without enquiry will not make the holder, a holder in due course. It was sufficient to show the intention to cancel the bill.

Privileges of a Holder In Due Course:

1. **Instrument purged of all defects:** A holder in due course who gets the instrument in good faith in the course of its currency is not only himself protected against all defects of title of the person from whom he has received it, but also serves, as a channel to protect all subsequent holders.
Example: A obtains Bs acceptance to a bill by fraud. A indorses it to C who takes it as a holder in due course. The instrument is purged of its defects and C gets a good title to it. In case C indorses it to some other person he will also get a good title to it except when he is also a party to the fraud played by A.

2. **Rights not affected in case of an inchoate instrument :** Right of a holder in due course to recover money is not at all affected even though the instrument was originally an inchoate stamped instrument and the transferor completed the instrument for a sum greater than what was intended by the maker. (Sec. 20)

3. **All prior parties liable:** All prior parties to the instrument (the maker or drawer, acceptor and intervening indorers) continue to remain liable to the holder in due course until the instrument is duty satisfied. The holder in due course can file a suit against the parties liable to pay, in his own name (Sec. 36)

4. **Can enforce payment of a fictitious bill :** Where both drawer and payee of a bill are fictitious persons, the acceptor is liable on the bill to a holder in due course. If the latter can show that the signature of the supposed drawer and the first indorser are in the same hand, for the bill being payable to the drawer's order the fictitious drawer must indorse the bill before he can negotiate it. (Sec. 42).

5. **No effect of conditional delivery:** Where negotiable instrument is delivered conditionally or for a special purpose and is negotiated to a holder in due course, a valid delivery of it is conclusively presumed and he acquired good title to it. (Sec.46).
Example: A, the holder of a bill indorses it "B or order" for the express purpose that B may get it discounted. B does not do so and negotiates it to C, a holder in due course. D acquires a good title to the bill and can sue all the parties on it.

6. **No effect of absence of consideration or presence of an unlawful consideration:** The plea of absence of or unlawful consideration is not available against the holder in due course. The party responsible will have to make payment (Sec. 58).

7. **Estoppel against denying original validity of instrument:** The plea of original invalidity of the instrument cannot be put forth, against the holder in due course by the drawer of a bill of exchange or cheque or by an acceptor for the honour of the drawer. But where the instrument is void on the face of it e.g. promissory note made payable to "bearer", even the holder in due course cannot recover the money. Similarly, a minor cannot be prevented from taking the defence of minority. Also, there is no liability if the signatures are forged. (Sec. 120).

8. **Estoppel against denying capacity of the payee to indorsee:** No maker of promissory note and no acceptor of a bill of exchange payable to order shall, in a suit therein by a holder in due course, be permitted to resist the claim of the holder in due course on the plea that the payee had not the capacity to indorse the instrument on the date of the note as he was a minor or insane or that he had no legal existence (Sec 121)

9. **Estoppel against indorser to deny capacity of parties:** An indorser of the bill by his endorsement guarantees that all previous endorsements are genuine and that all prior parties had capacity to enter into valid contracts. Therefore, he on a suit thereon by the subsequent holder, cannot deny the signature or capacity to contract of any prior party to the instrument.

DISHONOUR OF NEGOTIABLE INSTRUMENTS

A negotiable instrument is dishohoured by non-payment. While a bill of exchange can be dishohoured, in addition, by non-acceptance also. When a negotiable instrument is dishonoured, the holder must give a notice of dishonour to all the previous parties in order to make them liable.

(a) Dishonour by non-acceptance (Section 91)

A bill of exchange can be dishonoured by non-acceptance in the following ways :

1. When the bill is duly presented and the drawee does not accept the bill within 48 hours of presentment.
2. When there are several drawees who are not partners, and any of them doesnot accept the bill within 48 hours of presentment.
3. When the drawee is a fictitious person.
4. When the drawee after reasonable search, cannot be found.
5. When the drawee is incompetent to contract.
6. When the acceptance is qualified.
7. When presentment for acceptance is excused and the bill is not accepted.

(b) Dishonour by non-payment (Section 92)

A promissory note, bill of exchange or cheque is said to be dishonoured by non-payment when the maker of the note, acceptor of the bill, drawee of the cheque or drawee in case of need, if there is any, does not pay the amount upon being duly required to pay the same.

An instrument is also dishonoured by non-payment when presentment for payment is excused and the instrument after maturity remains unpaid (Sec 76).

DISCHARGE OF NEGOTIABLE INSTRUMENTS

The term 'discharge' in relation to negotiable instruments has two meanings:
(1) the discharge of the instrument, and
(2) discharge of one or more parties from liability on the instrument.

(a) Discharge of the instrument

An instrument is said to be discharged when all rights under it are extinguished so that instrument ceases to be negotiable. This happens when the party who is primarily and ultimately liable on the instrument is discharged from liability. A negotiable instrument may be discharged by any of the following ways :

1. By payment in due course.
2. By cancellation.
3. Where the principal debtor becomes the holder.
4. Where it discharges as simple contract

(b) Discharge of one or more parties from liability on the instrument

When any particular party or parties are discharged, the instrument continues to be negotiable and the undischarged parties remain liable on it. For example, the non presentation of a bill on the due date discharges the indorsers from their liability, but the acceptor remains liable on it.
A party or parties may be discharged from liability in the following ways:

1. By cancellation
2. By release of the person liable
3. By Payment
4. By allowing drawee more than 48 hours to accept the bill.
5. By delay in presenting cheque.
6. By qualified acceptance
7. By material alternation
8. Discharge by debtor becoming its holder
9. By operation of law

Suggested Readings:

1)Avtar Singh , Company law, Lucknow, Eastern

2)Khergamwala J.S. The Negotaible Instrument Acts. Bombay, N.M. Tripathi.

3)Ramaiya, A.Guide to the Companies Act. Nagpur, Wadhwa.

4)Shah, S.M. Lectures on , Company Law. Bombay, N.M. Tripathi.

5) Tuteja S.K. business Law for Managers, New Delhi, Sultan Chand.