The Negotiable Instruments Act, 1881

Introduction

- The law relating to negotiable instruments is contained in the Negotiable Instruments Act, 1881 which applies and extends to the whole of India.

Negotiable Instruments

Definition:

The word ***negotiable*** means 'transferable by delivery,' and the word ***instrument*** means 'a written document by which a right is created in favour of some person.'

Thus, the term "***negotiable instrument***" literally means 'a written document which creates a right in favour of somebody and is freely transferable by delivery.'

A negotiable instrument is a piece of paper which entitles a person to a certain sum of money and which is transferable from one to another person by a delivery or by endorsement and delivery.

Characteristics of Negotiable Instruments

Free transferability or easy negotiability

- Negotiable instrument is freely transferable from one person to another without any formality.
- The property (right of ownership) in these instruments passes by either endorsement and delivery (in case it is payable to order) or by delivery merely (in case it is payable to bearer) and no further evidence of transfer is needed.

Title of holder is free from all defects

- A person who takes negotiable instrument bona-fide and for value gets the instrument free from all defects in the title. The holder in due course is not affected by defective title of the transferor or of any other party.

Characteristics of Negotiable Instruments

3. **Transferee can sue in his own name without giving notice to the debtor:**

- A bill, note or a cheque represents a debt, i.e., an "actionable claim" and implies the right of the creditor to recover something from hid debtor
- The creditor can either recover this amount himself or can transfer his right to another person
- In case he transfers his right, the transferee of a negotiable instrument is entitled to sue on the instrument in his own name in case of dishonor, without giving notice to the debtor of the fact that he has become holder
- In case of transfer or assignment of an ordinary "actionable claim" (i.e., a book debt evidenced by an entry by the creditor in his account book, under the transfer of property act, notice to the debtor is necessary in order to make the transferee entitled to sue in his own name

Characteristics of Negotiable Instruments

4. Presumptions:

Certain presumptions apply to all negotiable instruments.

Section 118 and 119 lay down the following presumptions:

(a) For consideration : that every negotiable instrument, was made, drawn, accepted, endorsed or transferred for consideration.

(b) As to date : that every negotiable instrument bearing a date was made or drawn on such date.

(c) As to time of acceptance : that every bill of exchange was accepted within a reasonable time after its date and before its maturity.

(d) As to transfer: that every transfer of a negotiable instrument was made before its maturity

Characteristics of Negotiable Instruments

(e) As to time of endorsements : that the endorsements appearing upon a negotiable instrument were made in the order in which they appear thereon.

(f) As to stamps : that a lost promissory-note, bill of exchange or cheque was duly stamped.

(g) As to a holder in due course: that every holder of a negotiable instrument is holder in due course (this presumption would not arise where it is proved that the holder has obtained the instrument from its lawful owner, or from any person in lawful custody thereof, by means of an offence, fraud or for unlawful consideration and in such a case the holder has to prove that he is a holder in due course

(h) As to dishonor: that the instrument was dishonored, in case a suit upon a dishonored instrument is filed with the court and the fact of protest is proved

Types of Negotiable Instruments

Negotiable instruments are of two types which are as follows:

- **Negotiable Instruments recognized by status:**
  e.g. Bills of exchange, cheque and promissory notes.

- **Negotiable instruments recognized by usage or customs of trade:**
  e.g. Bank notes, exchequer bills, share warrants, bearer debentures, dividend warrants, share certificate

Promissory Note

Definition:

According to Section 4, "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 only to, or to the order of, a certain person, or to the bearer of the instrument."

Specimen of a Promissory Note

Rs. 10,000/- New Delhi

September 25, 2002

On demand, I promise to pay Ramesh, s/o RamLal of Meerut or order a sum of Rs 10,000/- (Rupees Ten Thousand only), for value received.

To , Ramesh Sd/ Sanjeev

Address…….. Stamp

Parties to a Promissory Note

There are primarily two parties involved in a promissory note. They are:

(i) The Maker or Drawer: The person who makes the note and promises to pay the amount stated therein. In the above specimen, Sanjeev is the maker or drawer.

(ii) The Payee – the person to whom the amount is payable. In the above specimen it is Ramesh.

In course of transfer of a promissory note by payee and others, the parties involved may be –

(a) The Endorser – the person who endorses the note in favour of another person. In the above specimen if Ramesh endorses it in favour of Ranjan and Ranjan also endorses it in favour of Puneet, then Ramesh and Ranjan both are endorsers.

(b) The Endorsee – the person in whose favour the note is negotiated by endorsement. In the above, it is Ranjan and then Puneet.

Essentials of Promissory Note

1. **It must be in writing:**

- A promissory note has to be in writing
- An oral promise to pay does not become a promissory note
- The writing may be on any paper or book
- **Illustrations**: A signs the instruments in the following terms:
  - "I promise to pay B or order Rs. 500"
  - "I acknowledge myself to be indebted to B in Rs. 1000 to be paid on demand, for value received"

Both the above instruments are valid promissory notes.

Essentials of Promissory Note

2. It must contain a promise or undertaking to pay:

- There must be a promise or an undertaking to pay
- The undertaking to pay may be gathered either from express words or by necessary implication
- A mere acknowledgement of indebtedness is not a promissory note, although it is valid as an agreement and may be sued upon as such
- **Illustrations**: A signs the instruments in the following terms:
  - "Mr. B I owe you Rs. 1000"
  - "I am liable to pay to B Rs. 500"

  The above instruments are not promissory notes as there is no undertaking or promise to pay. There is only an acknowledgement of indebtedness.
- Where A signs the instrument in the following terms:
  - "I acknowledge myself to be indebted to B in Rs. 1000, to be paid on demand, for value received," there is a valid promissory note

Essentials of Promissory Note

3. The promise to pay must be unconditional:

- A promissory note must contain an unconditional promise to pay
- The promise to pay must not depend upon the happening of some uncertain event, i.e., a contingency or the fulfillment of a condition
- **Illustrations**: A signs the instruments in the following terms:
  - “I promise to pay B Rs. 500 seven days after my marriage with C”
  - “I promise to pay B Rs. 500 as soon as I can”
- The above instruments are not valid promissory notes as the payment is made depending upon the happening of an uncertain event which may never happen and as a result the sum may never become payable

4. It must be signed by the maker:

- It is imperative that the promissory note should be duly authenticated by the ‘signature’ of the maker
- ‘Signature’ means the writing or otherwise affixing a person’s name or a mark to represent his name, by himself or by his authority with the intention of authenticating a document

Essentials of Promissory Note

5. The maker must be a certain person:

- The instrument must itself indicate with certainty who is the person or are the persons engaging himself or themselves to pay
- Alternative promisors are not permitted in law because of the general rule that “where liability lies no ambiguity must lie”

6. The payee must be certain:

- Like the maker the payee of a pronote must also be certain on the face of the instrument
- A note in favour of fictitious person is illegal and void
- A pronote made payable to the maker himself is a nullity, the reason being the same person is both the promisor and the promisee

Essentials of Promissory Note

7**. The sum payable must be certain:**

- For a valid pronote it is also essential that the sum of money promised to be payable must be certain and definite
- The amount payable must not be capable of contingent additions or subtractions
- **Illustrations**: A signs the instruments in the following terms:
  - "I promise to pay B Rs. 500 and all other sums which shall be due to him"
  - "I promise to pay B Rs. 500, first deducting there out any money which he may owe me"
- The above instruments are invalid as promissory notes because the exact amount to be paid by A is not certain

8. **The amount payable must be in legal tender money of India:**

- A document containing a promise to pay a certain amount of foreign money or to deliver a certain quantity of goods is not a pronote

Bill of Exchange

- **Definition:**

  Section 5 of the Negotiable Instruments Act defines a Bill of Exchange as follows:

  "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."

Illustration:

Mr. X purchases goods from Mr. Y for Rs. 1000/-
Mr. Y buys goods from Mr. S for Rs. 1000/-
Then Mr. Y may order Mr. X to pay Rs. 1000/- Mr. S which will be nothing but a bill of exchange.

Specimen of Bill of Exchange

Rs. 10,000/-		New Delhi
		May 2, 2001

Five months after date pay Tarun or (to his) order the sum of Rupees Ten Thousand only for value received.

To	Accepted	Stamp
Sameer	Sameer	S/d
Address		Rajiv

Parties to a Bill of Exchange

There are three parties involved in a bill of exchange

(i) The Drawer – The person who makes the order for making payment. In the above specimen, Rajiv is the drawer.

(ii) The Drawee – The person to whom the order to pay is made. He is generally a debtor of the drawer. It is Sameer in this case.

(iii) The Payee – The person to whom the payment is to be made. In this case it is Tarun.

The drawer can also draw a bill in his own name thereby he himself becomes the payee. Here the words in the bill would be ***Pay to us or order*****.**

In a bill where a time period is mentioned, just like the above specimen, is called a ***Time Bill***.

But a bill may be made payable on demand also. This is called a ***Demand Bill***.

Essentials of a Bill of Exchange

1. It must be in writing
2. It must contain an order to pay. A mere request to pay on account, will not amount to an order
3. The order to pay must be unconditional
4. It must be signed by the drawer
5. The drawer, drawee and payee must be certain. A bill cannot be drawn on two or more drawees but may be made payable in the alternative to one of two or more payees
6. The sum payable must be certain
7. The bill must contain an order to pay money only
8. It must comply with the formalities as regards date, consideration, stamps, etc

Difference between Bill of Exchange and Promissory Note

Points	Bill of Exchange	Promissory Note
1) No. of parties	There are three parties-drawer, drawee and payee.	There are two parties- maker And payee
2) Promise/order	It contains an unconditional order.	It contains an unconditional Promise given by a debtor to a creditor.
3) Nature of liability	The liability of the drawer is secondary and conditional	The liability of the maker is Primary and absolute.
4) Acceptance	It requires acceptance to become a valuable instrument	It does not require any acceptance since it is a valuable instrument right from the beginning.
5) Same identity of payer and payee.	The drawer and payee may be the same person.	The maker and payee cannot be the same person
6) Payable to bearer	It can be payable to bearer. It cannot be drawn as Payable to bearer on demand	It cannot be payable to bearer
7) Protest for dishonour	It requires the protesting for dishonour	It does not require any protesting.
8) Notice of dishonour	Notice of dishonour must be given to all persons (including drawer) liable to pay.	such notice is not required to be given to the maker

Cheque

A cheque is the means by which a person who has fund in the hand of a bank withdraws the same or some part of it.

A cheque is a kind of bill of exchange but it has additional qualification namely-

1- it is always drawn on a specified banker and

2-it is always payable on demand without any days of grace.

Negotiation

One of the essentials feature of a negotiable instrument is its transferability. A negotiable instrument may be transferred from one person to another in either of the followings way-

1-By negotiation

2-By assignment

Negotiation

The transfer of an instrument by one party to another so as to constitute the transferee a holder is called Negotiation.

Negotiation means as the process by which a third party is constituted the holder of the instrument so as to entitle him to the possession of the same and to receive the amount due thereon in his own name.

Modes of negotiation

- By delivery
- Ex-A the holder of a negotiable instrument payable to bearer , delivers it to B’s agent to keep it for B. The instrument has negotiated.
- By endorsement

Capacity of minor

Not having power to contract but he may become promisee.

Discharge

"Discharge means release from obligation".

- By Payment
- By express waiver
- By cancellation
- By material alteration or lapse of time.

Dishonor

- It may be by non acceptance or non payment
- A bill of exchange can be dishonored by non acceptance in the following ways-
- 1-Does not accept 48 hours from the time of presentment
- 2-drawee is fictitious person
- 3-Drawee has become insolvent or dead
- 4-Drawee is incompetent

Crossing of Cheque

- Open cheque or bearer cheque
- Crossed cheque

Difference Between Cheque and Bill of Exchange

Points	Cheque	Bill of Exchange
1. Drawer	It is always a Bank.	It can be drawn upon an individual r.s well as a bank.
2. Payable on demand	It is always payable to bearer on demand.	It- need not always-be-payable-on demand.
3. Acceptance	It does not require an acceptance	It require an acceptance of the drawee.
4. Stamp	It does not require a stamp.	It requires a stamp.
5. Grace of days	It is not entitled to three days of grace.	A bill, unless payable on demand is entitled to three days of grace.
6. Crossing	It can be crossed	It cannot be crossed
7. Notice of dishonour	Notice of dishonour is not required	Notice of dishonour is usually required.
8. Form	Its fixed form is honoured by a bank.	There is no fixed form

Parties to Negotiable Instruments

Promissory Note

- Maker
- Payee

Bill of Exchange

- Drawer
- Drawee & Payee

On endorsement , the transferor becomes endorser and transferee becomes endorsee

Depending on the situation, other parties are also added to the negotiable instrument

Holder

- Section 8
- any person entitled in his own name to the possession thereof and to receive or recover the amount due thereon from the parties thereto

Requirements

- He must be entitled in his own name to the possession of the instrument
- He must be entitled to receive or recover the amount thereon from the parties thereto

Holder-in-Due-Course

- Section 9
- any person who for consideration became the possessor of promissory note, bill of exchange or cheque if payable to bearer or the payee or endorsee thereof, if payable to order before the amount mentioned in it became payable and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title

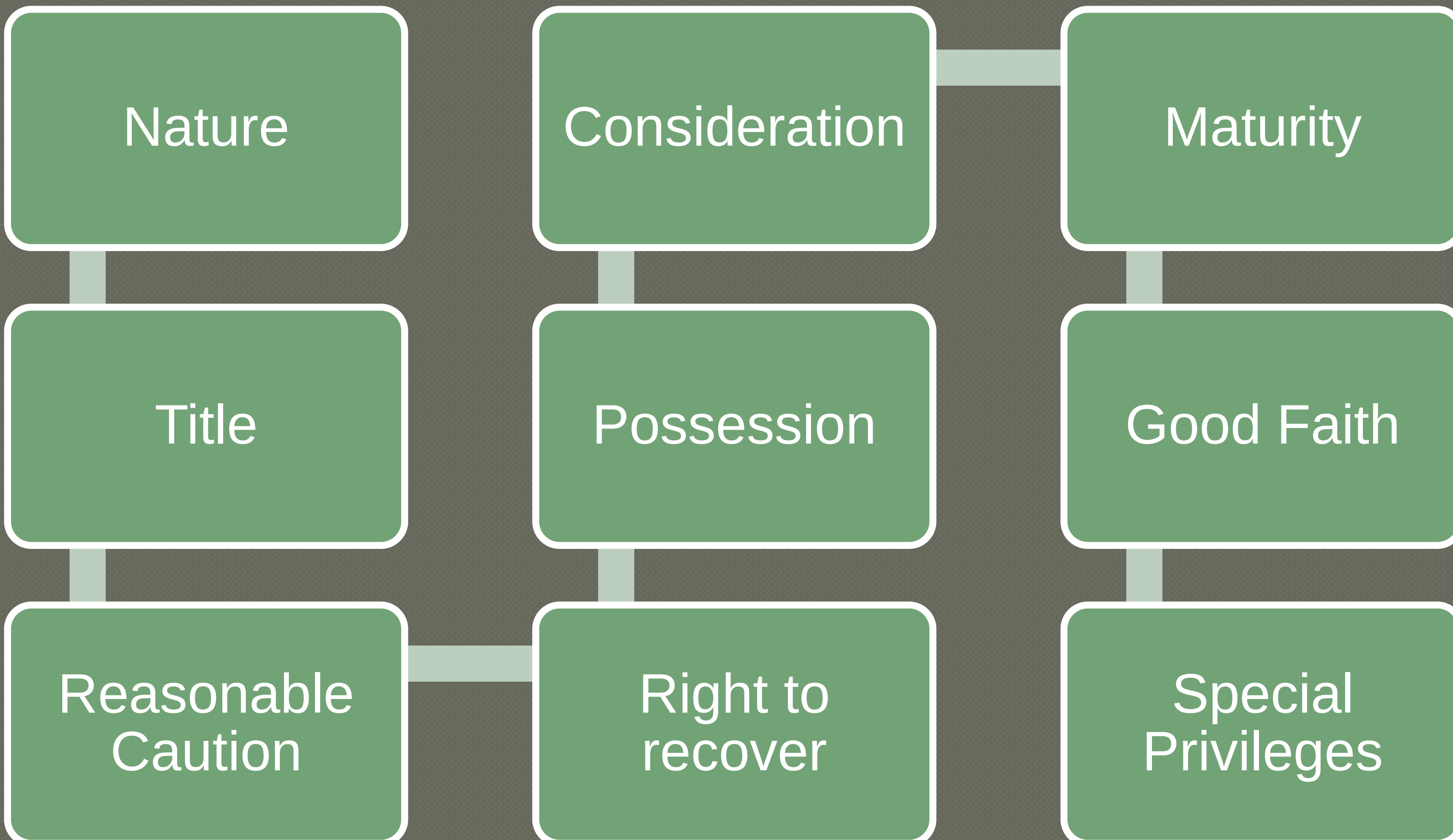
Conditions for Holder in Due Course

- Must be a holder of the instrument
- Must be a holder for valuable consideration
- Must have obtained the instrument before maturity
- Must have obtained the instrument in good faith and with reasonable caution

Privileges of a Holder in Due Course

- Right in case of an inchoate stamped instrument (Sec. 20)
- Liability of prior parties (Sec. 36)
- Right in case of a fictitious bill (Sec. 42)
- Right when the instrument is delivered conditionally (Sec. 46)
- Instrument purged of all defects (Sec. 53)
- Right in case of prior defects in the instrument (Sec. 58)
- Presumption as to title (Sec. 118)
- Estoppel against denying the original validity of the instrument (Sec. 120)

Distinction between Holder and Holder in Due Course



Capacity of Parties (Sec. 26 – 29)

- every person capable of contracting, may bind himself and be bound by making, drawing, endorsing, delivering and negotiating a promissory note, bill of exchange or a cheque

Extent of liability of different parties

1. Minor (Sec. 26): A minor may draw, endorse, deliver and negotiate a negotiable instrument so as to bind all parties except himself

Continued …

2. Person of unsound mind : Instruments made by persons of unsound mind are void against them though the other parties remain liable thereon

3. Joint Stock Company

4. Agent : every person capable of binding himself or of being bound as mentioned in Sec. 26, may bind himself or be bound by a duly authorized agent acting in his name

5. Partner

Thank You