Chapter - 18

Law Relating to Negotiable Instruments

Negotiable instrument means a document transferable from one person to another. However the Act has not defined the term. It merely says that "A negotiable instrument" means a promissory note, bill of exchange or cheque payable either to order or to bearer.

The instruments shall satisfy the following conditions of negotiability

1. Instrument should be freely transferable by the custom of trade. Transferability may be by:
   (i) delivery or
   (ii) endorsement and delivery
2. The person who obtains it in good faith & for consideration gets it free from all defects and can sue upon it in his own name.
3. The holder has the right to transfer. The negotiability continues till the maturity.

Important characteristics of negotiable Instruments are-

1. The holder of instrument is presumed to be the owner of property contained in it.
2. They are freely transferable.
3. Holder in due course gets the instrument

free from all defects of title of any previous holder.

4. The holder in due course is entitled to sue on the instrument in his own name.

5. Instrument is transferable till maturity & in case of cheque till it becomes stale.

Classification of Negotiable Instrument

Negotiable instrument may be classified as under -

1. **Bearer Instrument**

Person who is a holder of bearer instrument can obtain the payment of the instrument. A promissory note or cheque is payable when-

(i) it is expressed to be payable
(ii) last endorsement on instrument is an endorsement in blank.

2. **Order Instrument.**

A promissory note, bills of exchange or cheque is payable to order when-

(i) expressed to be payable, or
(ii) expressed to be payable to a particular person and doesn't contain any word prohibiting the transfer.

3. **Inland Instrument**

A promissory note, bill of exchange or cheque drawn or made in India & made payable to any person resident in India shall be deemed to be an inland instrument.

4. Foreign Instrument
An instrument which is not an inland instrument, is deemed to be a foreign instrument. It's essential are-
(i) it must be drawn outside India and made payable outside or inside India.
(ii) it must be drawn in India and made payable outside India & drawn on a person resident outside India.

5. Demand Instrument
Negotiable instrument in which no time for payment is specified & payable on demand.

6. Time Instrument
Time instrument are those which are payable at some time in future. Instrument payable after fixed period or on a specified day is known as a time instrument.

Ambiguous Instrument :-
An instrument, which in form is such that it may either be treated by the holder as a bill or as a note is an ambiguous instrument
Where in a bill, the drawer & the drawee are the same person or the drawee is a fictitious person or person incompetent

to contract, the holder may treat the instrument, at his opinion, either as a bill of exchange or promissory note.

Inchoate or Incomplete Instrument :- when one person sign and delivers to another a paper stamped in accordance with law relating to negotiable instruments and either wholly blank or having written thereon an incomplete instrument, he gives the authority to holder to make or complete it, such an instrument is called as an inchoate instrument.

e.g A blank cheque is an inchoate instrument.

Kinds of Negotiable Instrument :-

(i) Promissory Note -
Promissory note is an instrument in writing containing an unconditional undertaking, signed by maker to pay a certain sum of money to the order of certain person or only to bearer of the instrument.

-> Parties to promissory note :-

ⓐ Maker > the person who makes or executes the notes promising to pay.
ⓑ Payee > one to whom note is payable
ⓒ Holder > either the payee or other person to whom he may endorse the note.
ⓓ endorser
ⓔ endorsee

Essentials of Promissory Note :-

a) It must be in writing and oral promise will not work.
b) It must contain an express promise or clear undertaking to pay.
c) Promise or undertaking to pay must be unconditional.
d) maker must sign the promissory note to pay
e) maker must be a certain person.
f) Payee must be certain
g) Payment must be in legal money of the country.

A promissory note cannot be made payable or issued to bearer.

(ii) Bills of Exchange :-

Bills 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 the order of certain person or bearer of instrument.

Parties to bills of exchange :-

Drawer - Person who draws the bill
Drawee - Person to whom the bill is drawn
Accepter - one who accept the bill
Payee - one to whom the sum stated in the bill is payable.
Holder - is either the original payee or any other person to whom, payee has endorsed the bill.

Endorser - when the holder endorses the bill to anyone else he becomes the endorser
Endorsee - is the person to whom the bill is endorsed.

Essentials of Bills of Exchange :-
(1) It must be in writing
(2) must contain an unconditional order to pay money only.
(3) must be signed by the drawer
(4) Parties must be certain
(5) Sum payable must also be certain.
(6) It must comply with other formalities e.g stamp

Difference between Bill of exchange and Promissory Note :-

Promissory Note	Bill of exchange
> It is a two party instrument, with a maker and a payee.	> There are three parties drawer, drawee and payee.
> A note cannot be made payable to maker himself.	> In a bill the drawer & payee may be the same person.
> Note contains an unconditional promise by the maker to pay.	> Bill is an unconditional order to drawee to pay to the drawer.
> Promissory note cannot be made payable to bearer even if it is made on demand.	> Bill can be payable to bearer and it is not payable on demand

Page No.:
Date:

(iii) Cheques:-
Definition of cheque to include the electronic image of a truncated cheque and a cheque in the electronic form.
A cheque is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand & it includes the electronic.

Parties to a cheque:-
Drawer - The person who draws the cheque
Drawee - The banker of the drawer on whom the cheque is drawn.
Payee, holder, endorser & endorsee : same as in case of bill.

Essentials of a cheque-
(1) Always drawn on a banker
(2) Always payable on demand.
(3) It doesn't require acceptance
(4) Cheque can be drawn on bank where the drawer has an account.
(5) Cheque may be payable to the drawer himself.
(6) Banker is liable only for the drawer
(7) Cheque is valid usually for 6 months.
(8) No stamp is required to be affixed on cheque.

Difference between Cheques and Bills of Exchange:-

Cheque	Bills of Exchange
> Cheque is bill of exchange & always drawn on banker.	A bill may be drawn on any one including banker.
> Cheque can only be drawn, payable on demand.	It may be drawn or payable on demand.
> No grace period is given in case of cheque.	Grace period of 3 days is given in bill
> Notice of dishonour is not necessary.	Notice of dishonour of bill is necessary
> Cheque may be crossed.	Bill ~~may~~ is not crossed.

Cheque is always drawn on a particular banker & is always payable on demand.

When Banker must refuse Payment -

In the following cases banker may refuse to honour cheques issued by a customer-

(a) When after issuing a cheque the customer issues instruction not to honour it, the banker must not pay it.

(b) Banker receives the notice of customer's death.

(c) Customer has been adjudged an insolvent

(d) order of the court, prohibits payment

(e) The holder's title is defective and banker comes to know of it.

(f) Customer has given notice for closing his account.

When Banker may refuse Payment -

In following cases the banker may refuse to pay customer's cheque -

ⓐ When the cheque is post-dated.
ⓑ Cheque is of doubtful legality
ⓒ Banker has no sufficient funds of drawer
ⓓ Cheque is not duly presented.
ⓔ In case of joint a/c the cheque is not jointly signed.
ⓕ When the cheque is irregular, ambiguous or materially altered.

Crossing of Cheques -

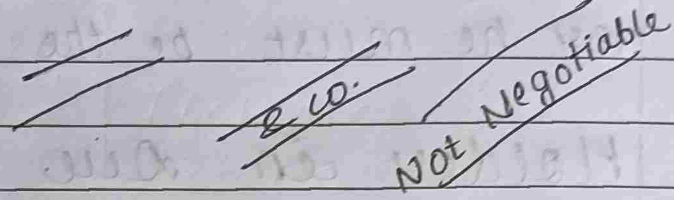
A cheque is either 'open' or 'crossed'.
→ An open cheque can be presented by the payee to the paying banker & paid over the counter.
→ A crossed cheque cannot be paid across the counter but must be collected through a banker.
The object of crossing is to secure payment & the banker may be traced who has received the payment.

Modes of crossing -

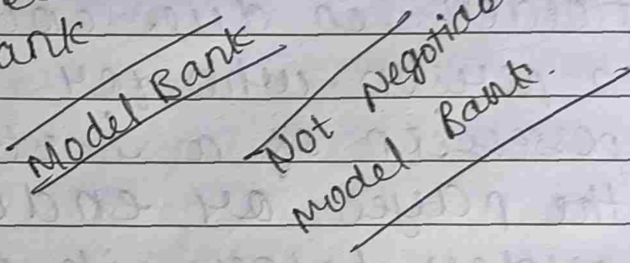
General crossing - where cheque bears a cross its face an addition of two parallel lines and the word 'and co' between them. Here the holder and payee cannot get the payment over the counter but through a bank only.

Special crossing- The paying banker is to honour the cheque only when it is prescribed through the bank mentioned in the crossing or it's agent bank.

General crossing -



Special crossing = model Bank



Maturity -

Cheques are always payable on demand but other instruments like bills, notes etc may be made payable on a specified date or after the specified period of time. Date on which payment of instrument falls due is called its maturity.

If the day of maturity falls on a public holiday, the instrument is payable on the preceeding business day.

If an instrument is payable by instalments each instalment is entitled to 3 days of grace. No days of grace are allowed for cheques, as they are payable on demand.

Holder -
A person is a holder of a negotiable instrument who is entitled in his own name to the possession of the instrument and to receive its amount from parties thereto.
To be a holder, the person must be named in the instrument as the payee or endorsee or he must be the bearer thereof.

Holder in Due course -

Holder in due course is
(i) a person who for consideration obtains possession of a instrument payable to bearer
(ii) the payee or endorsee, if payable to order before its maturity.

To be a holder in due course, a person must satisfy the following conditions -
(i) He must be the holder of instrument.
(ii) He obtained the instrument for value or consideration.
(iii) obtained the instrument before maturity
(iv) Instrument should be complete and regular on face of it.
(v) Holder should take instrument in good faith.
A holder in due course can recover the amount of instrument from all previous parties.

Page No.:
Date:

Negotiation-

A negotiable instrument may be transferred by negotiation or assignment. Negotiation is the transfer of an instrument for one person to another in such a manner as to convey title and to constitute the transferee as holder.

Endorsement

Where the maker or holder of a negotiable instrument signs the same otherwise than as such maker for the purpose of negotiation on the back or face, he is said to endorse the same, the person to whom the instrument is endorsed is called the endorsee. Endorsement means the writing of something on the back of an instrument for the purpose of transferring the right, tittle and interest therein to some other person.

Classes of endorsement -

(a) Blank or General - An endorsement is to be blank or general where the endorser merely writes his signature on back of the instrument and instrument becomes payable to bearer even through it was payable on order.

(b) Special or full - If the endorser signs his name and adds a direction to pay the amount mentioned in instrument to the order of a specified person the endorsement is said to be special or in full.

(c) Restrictive - An endorsement is restrictive which prohibits the further negotiation of an instrument.

(d) Partial - An endorsement is partial in which purport to transfer to the endorsee a part only of the amount payable on the instrument. It doesn't operate as negotiation of the instrument.

(e) Conditional or qualified - Endorsement is conditional which limits or negatives the liability of the endorser. Endorser may limit his liability in following ways -

(i) By sans recourse endorsement i.e by making it clear that he does not incur the liability of an endorser to the endorsee.

(ii) By making his liability depending upon happening of a specified event which may never happen.

Negotiation Back :-

where an endorser negotiates an instrument & again becomes its holder, the instrument is said to be negotiated back to that endorser and none of the intermediary endorsee are then liable to him.

Forged endorsement:-
If an instrument be negotiated by means of a forged endorsement, the endorsee acquires no title even through he be a purchaser for value and in good faith, for the endorsement is a nullity. Forgery conveys no title.

Presentment for Acceptance:-

It is only bills of exchange that require presentment for acceptance. Bills payable on demand or on a fixed date need not be presented. A bill payable 60 days after due date on the happening of a certain event may or may not be presented for acceptance. Following bills must be presented for acceptance -

(a) A bill payable after sight. Presentment is necessary in order to fix maturity of the bills.
(b) A bill in which there is an express stipulation that it shall be presented for acceptance before it is presented for payment.

Following are the persons to whom a bill of exchange should be presented:-

(i) The drawee or his duly authorised agent.
(ii) If there are many drawees, bill must be presented to all of them.

(iii) The legal representative of the drawee if drawee is dead.
(iv) To a drawee in case of need, if there is any.
(v) The acceptor for honour.
(iv) Official receiver or assignee of insolvent drawee.

Presentment for payment-
All notes, bills and cheques must be presented for payment by or on behalf of the holder during the usual hours of business.

No presentment is necessary and the instrument may be treated as dishonoured in following cases-

(a) where the maker, drawer or acceptor actively does something to intentionally obstruct the presentment of the instrument.
(b) where his place of business is closed on due date.
(c) where drawer is a fictitious person or incompetent to contract.
(d) where drawer or drawee are the same person
(e) where bill is dishonoured due to non-presence.

Dishonour due to non-acceptance

a) where drawee does not accept it within 48 hours from time of presentment.
b) where presentment is excused and the bill remains unaccepted.

c) Drawee is incompetent to contract
d) Drawee is a fictitious person.
e) where acceptance is a qualified one.

Notice of Dishonour :-

when a negotiable instrument is dishonoured either by non-acceptance or by non-payment the holder & other party liable thereon must give notice of dishonour to all other parties.
Notice may be oral or in writing, but it must be actual, formal notice. It must be given within a reasonable time of dishonour.

Discharge of the Instrument -

A negotiable instrument is discharged-
(a) by payment in due course.
(b) when the principal debtor becomes the holder
(c) by an act that would discharge simple contract.
(d) by renunciation
(e) by cancellation.