

CA FOUNDATION



MARATHON

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Business Laws



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Negotiable Instrument Act, 1881

By Kunal Sir



Basics

- Negotiable → **Transferable**
- Instrument → **Document in writing**
- It is a instrument in writing which can be transferred from one person to another.
- Came into force from 1st Mar. 1882
- Act applies to whole of India.
- Main Objective → To legalise system

↓

By which instruments made under it

↓

Could pass from hand to hand

↓

By negotiation like any other goods

Essential Characteristic of N.I

Shortcut

Negotiable

Instrument

Of SUM

Crores

Delivered

For Free

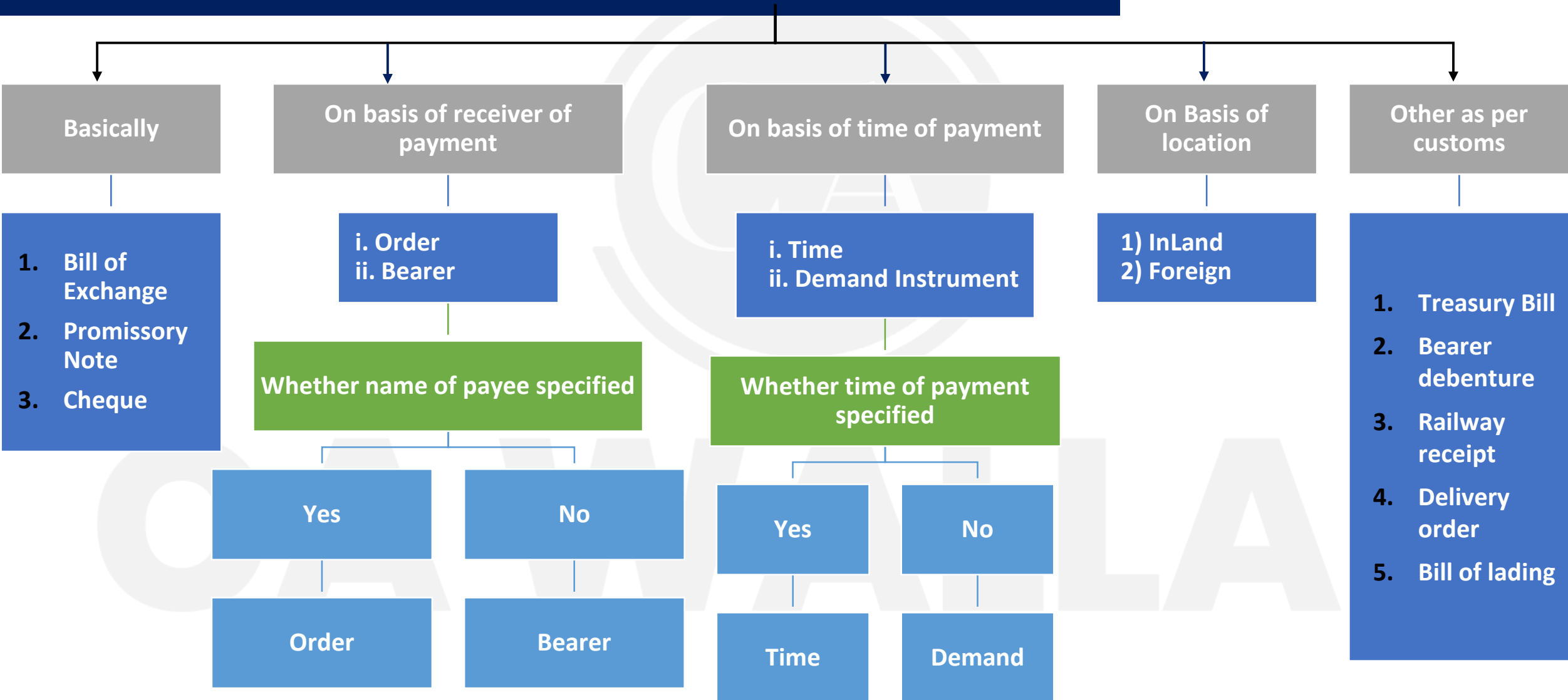
Characteristics

- 1) **Transferable** from one person to another
- 2) Can be **transferred** any no of times
- 3) Has to be in **writing**
- S → 4) **Signed** by drawer
- U → 5) Contains **unconditional** promise / order
- M → 6) Promise/ order to pay **money** only
- C → 7) Amt/ Time / Payee → **Certain**
- 8) Instrument made should be **delivered**
- 9) Holder in due course (HDC) gets title **FREE** from defect

- What are Negotiable Instruments?
Explain its essential characteristics
under the Negotiable Instruments Act,
1881. **(MTP Apr. 24) (7 Marks)**

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Types of N.I



Note : 1) If last /only endorsement is blank, it is bearer instrument

Promissory Note [Sec. 4]

Meaning

Instrument in writing

Containing a unconditional undertaking

Signed by maker

To pay certain sum of money only

To order of certain person or bearer

Parties

(1) **Maker**
→ who promise to pay
→ Debtor

(2) **Payee**
To whom amt. payable

Note : P.N cannot be bearer at all only RBI/ C.G can make bearer P.N. e.g. currency note.

Essential Characteristics

Shortcut → **WE – US – CM**

W → **Writing** → oral not allowed

E → **Express** Promise to pay
(mere acknowledgement not sufficient)

U → **Unconditional** → Promise

→ If condition then should be certain to happen

S → **Signed** by maker

S - Stamped

C → **Certain**

Sum

→ Maker

→ Payee

M → **Money** → Promise to pay **money** only

Question

State whether the following statements are promissory notes or not?

1. "I promise to pay B or order Rs. 500"
2. "Mr. B, I owe you Rs. 500"
3. "I acknowledge myself to be indebted to B in Rs. 1,000 to be paid on demand, for value received".
4. "I am liable to B, in a sum of Rs. 500 to be paid by instalments.
5. "I am bound to pay the sum of Rs. 500 which I received from you".
6. "I promise to pay B Rs. 500 and all other sums which shall be due to him".
7. "I promise to pay B Rs. 1000 and the fine according to the rules".
8. "I promise to pay B Rs. 500, first deducting there out any money which he may owe me".
9. "I promise to pay B Rs. First deducting there out any money which he may owe me".
10. "I promise to pay B a sum of Rs. 500 when convenient or able".
11. "I promise to pay B Rs. 500 when he delivers the goods".
12. "I promise to pay B Rs. 500 seven days after my marriage with C".
13. "I promise to pay B Rs. 500 on D's death
14. "I promise to pay B Rs. 500 on D's death, provided D leaves me enough to pay that sum".
15. "I promise to pay B Rs. 500 and to deliver to him my black horse on 1st January next"
16. "I promise to pay B in 20 shares and 10 bonds of XY Ltd.

Solution

1. Yes.
2. No , only acknowledgement of debt
3. Yes
4. No , conditional
5. No , mere acknowledgement of debt
6. No , sum uncertain
7. Yes , sum can be calculated as fine fixed
8. No , sum uncertain
9. No , sum uncertain
10. No , conditional
11. No , conditional
12. No , conditional
13. Yes as death is certain
14. No , conditional
15. No. Promise to pay money only
16. No. Promise to pay money only

Rama executes a promissory note in the following form, 'I promise to pay a sum of `10,000 after three months'. Decide whether the promissory note is a valid promissory note. (module)

Hint - The promissory note is an unconditional promise in writing. In the above question the amount is certain but the date and name of payee is missing, thus making it a bearer instrument. As per Reserve Bank of India Act, 1934, a promissory note cannot be made payable to bearer - whether on demand or after certain days. Hence, the instrument is illegal as per Reserve Bank of India Act, 1934 and cannot be legally enforced.

Bills of Exchange (Sec. 5) [BOE]

Meaning

Instrument in writing

Containing a unconditional undertaking

Signed by maker

Directing a certain person

To pay certain sum of money only

to certain person or his order

Parties

(1) **Drawer**
maker of BOE

(2) **Drawee**
→ Who is directed to pay
→ On acceptance he become acceptor
→ Liability primary & unconditional

(3) **Payee**
To whom money paid

Essential Characteristics

Shortcut → WE – US – CM

W → Writing

E → Express → order to pay

U → Unconditional and definite

S → Signed by drawer

C → Certain

Drawer

Drawee

Payee

Sum

(Note : BOE cannot be made payable to bearer on demand)

M → Money → order to pay money only

Distinguish Between BOE & P.N

Shortcut → Jisko

Definition

Yaad hogi →

Accept

My

liability

And

Promise

To give Party
to

Bearer

Basis	BOE	P.N
1) Definition	'Refer previous slides'	"Refer Previous Slides'
2) Acceptance	Requires acceptance	Do not require acceptance
3) Primary Liable	Drawee/Acceptor	Maker
4) Promise /Order	Order to pay	Promise to Pay
5) Parties	3 Parties (1) Drawer (2) Drawee (3) Payee	2 Parties Maker and payee
6 Bearer	Cannot be bearer on demand	Cannot be bearer at all

Cheque → Sec. 6

Meaning

↓
Cheque is BOE
↓
Drawn on specified banker
↓
Not expressed to be payable otherwise than demand
↓
Includes
a) Electronic image of truncated cheque
b) Cheque in electronic form

Parties to cheque

- ↓
- (1) **Drawer**
- Who draws cheque
 - Debtor
 - liability is primary and conditional
- (2) **Drawee**
- Bank who makes payment
 - Always banker
- (3) **Payee**
- Named in N.I to whom money is paid or his order

Essential Elements

- ↓
- 1) All essentials of BOE
 - 2) Drawee always banker
 - 3) Always a demand instrument
 - 4) All cheque are bill all bill are not cheque

Punishment →

- 1) Cheque issued for discharge of debt
- 2) Cheque presented within validity period (3 months)
- 3) Reason for Dishonour –

Dishonor of cheque (Sec. 138)

↓
2x amt of cheque or 2 years imprisonment or both
↓
Conditions

Insufficient fund or stop payment

Within 30 days →

Give notice to demand payment

↓
15 days →

Time to pay

↓
Within 1 month →

File complaint with court

Bholenath drew a cheque in favour of Surendar. After having issued the cheque; Bholenath requested Surendar not to present the cheque for payment and gave a stop payment request to the bank in respect of the cheque issued to Surendar. Decide, under the provisions of the Negotiable Instruments Act, 1881 whether the said acts of Bholenath constitute an offence? (module)

Hint - the act of Bholenath, i.e., his request of stop payment constitutes an offence under the provisions of the Negotiable Instruments Act, 1881.

Shiva gave a gift of ` 21,000 to his sister through a cheque issued in her favour on the occasion of Raksha Bandhan. Afterwards, Shiva informed his sister not to present the cheque for payment and also informed the bank to stop the payment. Examining the provisions of the Negotiable Instruments Act, 1881, decide whether Shiva's acts constitute an offence under section 138 of the Act? (MTP May 24) (3 Marks)

- Section 138 of the Negotiable Instruments Act, 1881 provides where any cheque drawn by a person for the discharge, in whole or in part, of any debt or other liability, is returned by the bank unpaid due to
- insufficiency of fund, the drawer is punishable with imprisonment upto 2 years or fine upto 2 times the amount of cheque or Both. In other words, the liability under section 138 arises only if the drawer had issued the cheque to discharge a legally enforceable debt or other liability. Thus, where the drawer issues a cheque as a gift or charity, he is not liable under section 138 even if cheque is dishonoured.
- In the instant case, Shiva gifted a cheque of Rs. 21,000 to his sister. Afterwards, Shiva informed his sister not to present the cheque for payment and also informed the bank to stop the payment.
- On the basis of above, as the cheque was given as gift, provisions of section 138 will not be applicable on Shiva.

- Priyansh purchased some goods from Sumit. He issued a cheque to Sumit for the sale price on 14th June, 2023. Sumit presented the cheque in his bank and his bank informed him on 19th June, 2023 that cheque was returned unpaid due to insufficiency of funds in the account of Priyansh. Sumit sued against Priyansh under section 138 of the Negotiable Instruments Act, 1881. State with reasons, whether this suit is maintainable?
- **(MTP Apr. 24) (7 Marks)**

* Inland Instrument or Foreign Instrument [Sec. 11 & 12]

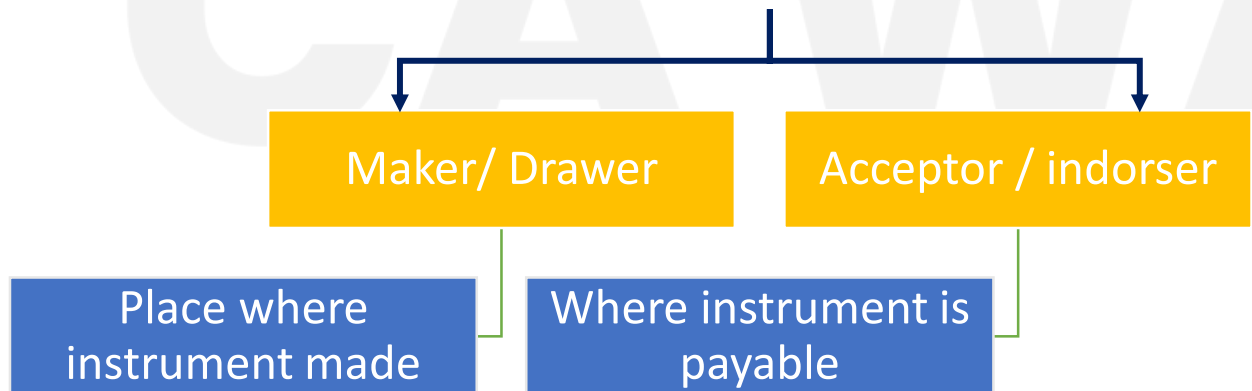
- Foreign Instrument → which is not inland
- Inland Instrument → (1) Drawn in India



- + (2) Payable in India
- or
- (3) Drawn upon Indian resident

Condition no. (1) Should always satisfy & atleast 1 condition should satisfy out of (2) & (3)

- Inland remains inland even if endorsed in foreign country
- Foreign bill → liability of (Sec. 134)



Example

A bill of exchange is drawn by A in Berkley where the rate of interest is 15% and accepted by B payable in Washington where the rate of interest is 6%. The bill is indorsed in India and is dishonoured. An action on the bill is brought against B in India. He is liable to pay interest at the rate of 6% only. But if A is charged as drawer, he is liable to pay interest at 15%.

Question

State with reasons whether each of the following instruments is an Inland Instrument or a Foreign Instrument:

1. A bill drawn in Delhi upon a merchant in Agra and accepted payable in London.
2. A bill drawn in Delhi upon a merchant in London and accepted payable in Agra.
3. A bill drawn in Delhi upon a merchant in London and accepted payable in London.
4. A bill drawn in London upon a merchant in Agra and accepted payable in Delhi.
5. A bill drawn in Delhi on a merchant in Agra but endorsed in London.
6. A bill drawn in London on a merchant in Agra and endorsed in Delhi.

Solution

1. Inland
2. Inland
3. Foreign
4. Foreign
5. Inland
6. Foreign



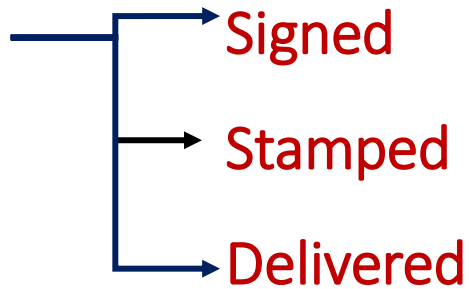
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*Inchoate Instrument [Sec. 20]

- Valid + Wholly Partially Blank



SSD



- Effect

- 1) Holder / original parties can recover only upto consideration between parties i.e. amount intended to be paid when made.
- 2) Holder in due course (HDC) can claim any amt. mentioned in instrument subject to stamp duty

Question of Inchoate Instrument



Note:

- 1) Holder in Due Course (HDC) means
- 2) If not HDC then holder
- 3) Holder gets title of transferor
- 4) HDC gets better title than transferor

Obtained Instrument

- (1) Against Consideration
- (2) Before Maturity
- (3) In good faith

Solution of Inchoate Instrument

If Instrument held by following till maturity

Hardik Pandya

- Original party
- Can recover to amt of consideration between immediate party
- 50 cr

They can recover

Ishan

- Gift so holder only
- Gets title of transferor Hardik
- 50 Cr.

Rishabh

- Gift so Holder only
- Gets Title of transferor Ishan
- 50 Cr.

Rohit

- HDC
- Can Recover amt mentioned
- 60 Cr.

Ritika

- Holder
- Gets Title of Transferor Rohit
- 60 Cr.

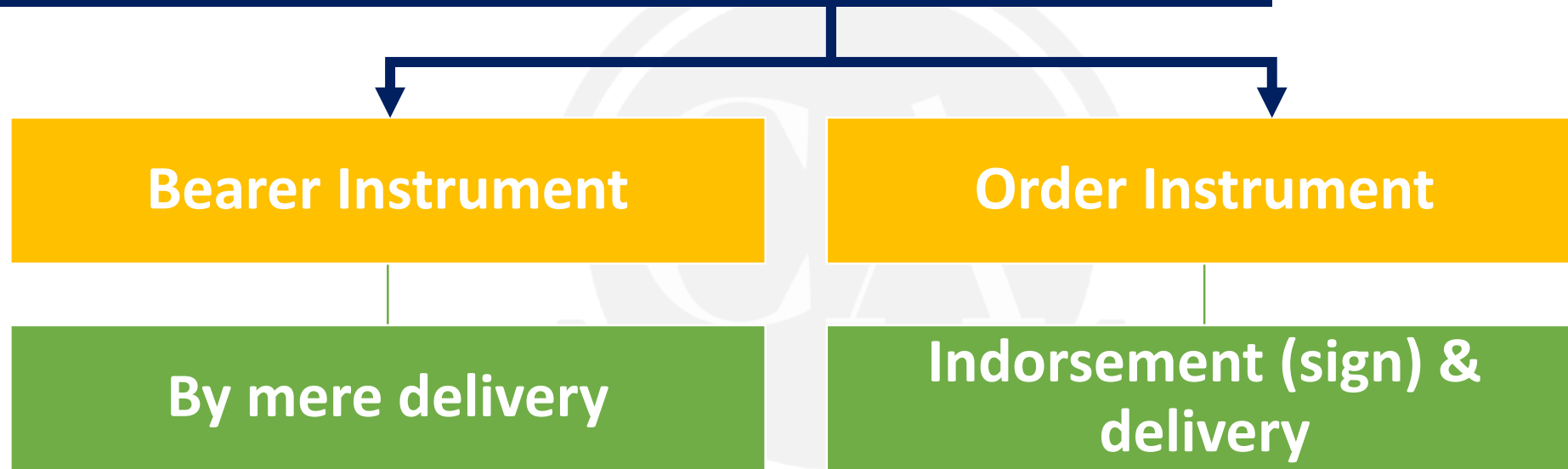
*Ambiguous Instrument [Sec. 17]

- An instrument which is vague and cannot be clearly identified either as a bill of exchange, or as a promissory note
- Holder as to assume one and transferred accordingly

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- What are Inchoate and Ambiguous Instruments under the Negotiable Instruments Act, 1881?
- **(MTP May 24) (7 Marks)**

Negotiation (transfer)



- **Delivery can be actual or constructive**
- **If delivered to transferee's agent → delivery ✓**
- X drew a cheque for Rs. 50,000 payable to Y and delivered it to him. Y indorsed the cheque in favour of Z but kept it in his table drawer. Subsequently, Y died, and cheque was found by Z in Y's table drawer. In this case, Z does not become the holder of the cheque as the negotiation was not completed by delivery of the cheque to him.

M owes money to N. Therefore, he makes a promissory note for the amount in favor of N, for safety of transmission he cuts the note in half and posts one half to N. He then changes his mind and calls upon N to return the half of the note which he had sent. N requires M to send the other half of the promissory note. Decide how rights of the parties are to be adjusted.
(module)

Hint -Delivery refers to the whole of the instrument and not merely a part of it. Delivery of half instrument cannot be treated as constructive delivery of the whole. So, the claim of N to have the other half of the P/N sent to him is not maintainable. M is justified in demanding the return of the first half sent by him. He can change his mind and refuse to send the other half of the P/N.

**Presentment for acceptance
(Only for BOE)**

BOE payable after sight must

Must be presented within a reasonable time & in business hours on a business day. (Note : 48 hours, excluding public holidays, are given to drawee for acceptance)

In default of such presentment

No party liable thereto

If Drawee not found after reasonable search, BOE is dishonored.

If BOE is directed to drawee at a particular place

Must be presented at that place

Presentment of Promissory Note for sight

P/N payable at a certain period after sight

Must be presented within a reasonable time & in business hours on a business day.

In default of such presentment

No party liable thereto

Rules regarding presentment for payment (P/N, BOE, CH)

To whom	Maker (P/N), Acceptor (BOE), Drawee (CH)
If default in presentment	No party liable thereto
Exception	If P/N is payable on demand and is not payable at a specified place, no presentment is necessary.
Time	During usual business hours
If instrument payable after date or sight	Must be presented for payment at maturity
P/N payable by instalments	Must be presented for payment on 3rd day after date fixed for payment of each instalment.
Instrument payable at specified place	Must be presented for payment at that place.
Where no exclusive place specified	Must be presented for payment at the place of business (if any) or at the usual residence
No known place of business or residence	Presentment may be made to him in person wherever he can be found
Instrument payable on demand	Must be presented for payment within a reasonable time after it is received by the holder.

Note: Delay in presentment for acceptance or payment is excused if the delay is caused by circumstances beyond the control of the holder.

- A purchased a watch from B. He issued a promissory note to B which was payable on demand but no specific place for payment was mentioned on it. On maturity, B did not present the promissory note for payment. As the promissory note was not duly presented for payment, whether A would be discharged from liability under the provisions of the Negotiable Instruments Act, 1881? **(RTP June 24)**

- Section 64 of the Negotiable Instruments Act, 1881 provides, Promissory notes, bill of exchange and cheques must be presented for payment to the maker, acceptor or drawee thereof respectively, by or on behalf of the holder as hereinafter provided. In default of such presentment, the other parties thereto are not liable thereon to such holder. Provided that where a promissory note is payable on demand and is not payable at a specified place, no presentment is necessary in order to charge the maker thereof.
- On the basis of the above law provisions and facts of the case, although non-presentment of promissory note for payment results in discharge of maker from liability but the given case is covered under the exception to section 64. Hence, A would not be discharged from liability even if the non-presentment by B as the promissory note was payable on demand and no specific place for payment was mentioned.

- Advik purchased a mobile from Bhanu. He issued a promissory note to Bhanu which was payable on demand but no specific place for payment was mentioned on it. On maturity, Bhanu did not present the promissory note for payment. As the promissory note was not duly presented for payment, whether Advik would be discharged from liability under the provisions of the Negotiable Instruments Act, 1881? **(MTP May 24) (4 Marks)**

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* When Presentment for payment unnecessary [Sec. 76]

Instrument dishonored on due date

CA → FEW → KID → Unnecessary

C → Closed POB during business day / hrs → if payable at POB.

A → Absent from place → if instrument payable at some place.

F → If cannot be Found after due search → place not specified

E → Expressed to pay → notwithstanding non presentment

W → Waives to Present

K → Knowledge of Non-Presentment

I → Party Intentionally prevents presentment

D → No Damages suffered → By Drawer → due to non Presentment

Part payment

Promise to pay on future date

Rules as to Compensation (Sec. 117)

In case of dishonor of NI, holder can claim:

- 1) Amount due on NI
- 2) Expenses incurred in presenting, noting & protesting.
- 3) Interest 18% p.a. from due date of payment to date of realization.

Note: In case of foreign currency, current rate of exchange.

- Sachin bought 1000 Kg rice from Saurabh for ` 1,50,000 on three months credit. For this purpose, Sachin issued a promissory note to Saurabh on the same date payable after 3 months. On the date of maturity, the promissory note was dishonoured. Saurabh filed suit for the recovery of the amount plus fees of advocate paid by him for defending the suit. Referring to the provisions of the Negotiable Instruments Act, 1881, what amount could be recovered by Saurabh from Sachin? **(RTP June 24)**

- According to section 117 of the Negotiable Instruments Act, 1881, the compensation payable in case of dishonour of promissory note, bill of exchange or cheque, by any party liable to the holder or any endorsee, shall be determined by the following rules:
- (a) the holder is entitled to the amount due upon the instrument, together with the expenses properly incurred in presenting, noting and protesting it;
- (b) when the person charged resides at a place different from that at which the instrument was payable, the holder is entitled to receive such sum at the current rate of exchange between the two places;
- (c) an endorser who, being liable, has paid the amount due on the same is entitled to the amount so paid with interest at 18% per annum from the date of payment until tender or realisation thereof, together with all expenses caused by the dishonour and payment;
- On the basis of the above provisions of law and facts of the case, Saurabh has right to claim price of rice plus fees of advocate plus interest @18% p.a. from the date of payment until tender or realisation thereof

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