NEGOTIABLE INSTRUMENTS ACT 1881

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

Negotiable = ‘**transferable** from one person to another in return for consideration’

Instrument = ‘**written document** by which a right is created in favor of some person’

Negotiable instrument
‘a document which entitles a person to a sum of money and which is transferable from one person to another by mere delivery or by endorsement and delivery’

NEGOTIABLE INSTRUMENTS ACT, 1881

Acc to sec 13:

Negotiable instrument means a promissory note, bill of exchange or cheque payable either to order or to bearer

CHARACTERISTICS OF NEGOTIABLE INSTRUMENTS

1. 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.

2. 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.

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 his 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 dishonour, 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

4. PRESUMPTIONS:

Certain presumptions apply to all negotiable instruments. Section 118 and 119 lay down the following presumptions:

- **For consideration** : that every negotiable instrument, was made, drawn, accepted, endorsed or transferred for consideration.
- **As to date** : that every negotiable instrument bearing a date was made or drawn on such date.
- **As to time of acceptance** : that every bill of exchange was accepted within a reasonable time after its date and before its maturity.
- **As to transfer:** that every transfer of a negotiable instrument was made before its maturity
- **Order of Indorsements:** indorsements appearing on the NI are presumed to have been made in the order in which they appear
- **Stamp:** when an instrument is lost, it is assumed that it was duly stamped
- **Every holder of NI is presumed to be a holder in due course**
- **Proof of interest:** in a suit upon an instrument which has been dishonoured, the court presumes the fact of dishonour, untill such fact is disproved.

TYPE 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

Acc. To sec. 4:

A promissory note is an **instrument** in **writing** containing an **unconditional undertaking**, **signed by the maker**, **to pay a certain sum of money** only to, or to order of a **certain person**, or to **the bearer** of the instrument

The person who makes the promissory note and promises to pay is called the **‘maker’**

the person to whom the amount is payable. **‘payee’**

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 favor of another person. In the above specimen if Ramesh endorses it in favor of Ranjan and Ranjan also endorses it in favor of Puneet, then Ramesh and Ranjan both are endorsers.

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

ESSENTIAL ELEMENTS OF A PROMISSORY NOTE

- Writing
- Promise to pay
- Definite and unconditional
- signed by the maker
- Certain Parties
- Certain sum of Money
- Promise to pay money Only
- Bank Note or currency note is not a promissory note
- formalities like number, place, date, consideration…..
- it may be payable on demand or after a definite period of time
- it cannot be made payable to bearer on demand

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. 1, 000 to be paid on demand, for value received"

Both the above instruments are valid promissory notes.

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. 1,000"
- "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. 1, 000, to be paid on demand, for value received," there is a valid 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

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 favor 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

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

Acc. To sec. 5:

It 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

The person who gives order to pay or who makes the bill is called the **'drawer'**

The person who is directed to pay is called '**drawee**'

When the drawee accepts the bill, he is called '**acceptor**'

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

- It must be in writing
- It must contain an order to pay. A mere request to pay on account, will not amount to an order
- The order to pay must be unconditional
- It must be signed by the drawer
- 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
- The sum payable must be certain
- The bill must contain an order to pay money only
- It must comply with the formalities as regards date, consideration, stamps, etc

	BILL OF EXCHANGE	PROMISSORY NOTE
Number of parties	three parties; drawer, drawee and payee; although any two out of the three may be filled by one and the same person	only two parties – the maker (debtor) and the payee (creditor)
Payment to the maker	drawer and payee or drawee and payee may be same person	It cannot be made payable the maker himself
Unconditional promise	there is an unconditional order to the drawee to pay according to the direction of the drawer.	contains an unconditional promise by the maker to pay to the payee or his order
Prior acceptance	payable after sight must be accepted by the drawee or someone else on his behalf, before it can be presented for payment	presented for payment without any prior acceptance by the maker

Primary or absolute liability	liability of the drawer of a bill of exchange is secondary and conditional	of the maker of a promissory note is primary and absolute
Relation	maker or drawer of an accepted bill stands in immediate relations with the acceptor and not the payee	of the promissory note stands in immediate relation with the payee
Protest for dishonour	Foreign bill of exchange must be protested for dishonour when such protest is required to be made by the law of the country where they are drawn	no such protest is needed in the case of a promissory note
Notice of dishonour	When a bill is dishonoured, due notice of dishonour is to be given by the holder to the drawer and the intermediate indorsers	no such notice need be given in the case of a note

CHEQUES

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.

BILL OF EXCHANGE	CHEQUE
usually drawn on some person or firm	always drawn on a bank.
It is essential that a bill of exchange must be accepted before its payment can be claimed	A cheque does not require any such acceptance.
a bill may be also drawn payable on demand, or on the expiry of a certain period after date or sight	A cheque can only be drawn payable on demand
A grace of three days is allowed in the case of time bills	no grace is given in the case of a cheque.
drawer of the bill is discharged from his liability, if it is not presented for payment	drawer of a cheque is discharged only if he suffers any damage by delay in presenting the cheque for payment

Notice of dishonour of a bill is necessary	no such notice is necessary in the case of cheque.
not needed in the case of bill	cheque may be crossed
bill of exchange must be properly stamped	cheque does not require any stamp
bill payable on demand can never be drawn to bearer.	cheque drawn to bearer payable on demand shall be valid

CLASSIFICATION OF BILLS

Bills can be classified as:

(1) Inland and foreign bills.

(2) Time and demand bills.

(3) Trade and accommodation bills.

INLAND AND FOREIGN BILLS

Inland bill:

A bill is, named as an inland bill if:

(a) it is drawn in India on a person residing in India, whether payable in or outside India, or
(b) it is drawn in India on a person residing outside India but payable in India.

The following are the Inland bills

(i) A bill is drawn by a merchant in Delhi on a merchant in Madras. It is payable in Bombay.

(ii) A bill is drawn by a Delhi merchant on a person in London, but is made payable in India.

(iii) A bill is drawn by a merchant in Delhi on a merchant in Madras. It is accepted for payment in Japan.

Foreign Bill:

A bill which is **not an inland bill is a foreign bill**. The following are the foreign bills:

- A bill drawn outside India and made payable in India.
- A bill drawn outside India on any person residing outside India.
- A bill drawn in India on a person residing outside India and made payable outside India.
- A bill drawn outside India on a person residing in India.
- A bill drawn outside India and made payable outside India.

TIME AND DEMAND BILL

Time bill: A bill **payable after a fixed time** is termed as a time bill.

In other words, bill payable "after date" is a time bill.

Demand bill: A bill **payable at sight or on demand** is termed as a demand bill.

TRADE AND ACCOMMODATION BILL

Trade bill: A bill **drawn and accepted for a genuine trade transaction** is termed as a “trade bill”.

Accommodation bill: A bill **drawn and accepted not for a genuine trade transaction but only to provide financial help to some party** is termed as an “accommodation bill”.

Example: A, is need of money for three months. He induces his friend B to accept a bill of exchange drawn on him for Rs. 1,000 for three months. The bill is drawn and accepted. The bill is an “accommodation bill”. A may get the bill discounted from his bankers immediately, paying a small sum as discount. Thus, he can use the funds for three months and then just before maturity he may remit the money to B, who will meet the bill on maturity.

In the above example A is the “accommodated party” while B is the “accommodating party”.

CROSSING OF CHEQUES

- Cheque payable at cash counter of a bank is called open cheque
- Crossed cheque is one with two transverse lines with or without the words '& co'

TYPES OF CROSSING:

- **General crossing**
  Where a cheque is crossed generally, the **drawee banker shall not pay it unless it is presented by a banker**

- **Special crossing**
  where a cheque is crossed specially **the banker on whom it is drawn shall pay it only to the banker on whom it is crossed**

- **Restrictive crossing**
  the words 'a/c payee on a cheque are a direction to the

NEGOTIATION

The transfer of NI may take place either

-By negotiation
- by assignment

Transfer by negotiation:

When a NI is **transferred by one party to another, so as to constitute the transferee the holder thereof,** the instrument is said to be negotiated

Negotiation by **delivery**
Negotiation by **endorsement and delivery**

Transfer by assignment

When a person **takes his rights to receive the payment of debt**, assignment of debt takes place,

Here the holder of an instrument transfer it to another so as to confer a right on the transferee to receive the payment of the instrument.

DISHONOUR OF A NEGOTIABLE INSTRUMENT

- 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 negotiable instrument can be dishonoured either **by non-acceptance or by non-payment.**

- A cheque and a promissory note can only be dishonoured by non-payment but a bill of exchange can be dishonoured either by non-acceptance or by non-payment.

DISHONOUR BY NON-ACCEPTANCE (SECTION 91)

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

1. **If a bill is presented to the drawee for acceptance and he does not accept it within 48 hours from the time of presentment for acceptance.**

2. When the drawee is a **fictitious person** or if he cannot be traced after reasonable search.

3. When the drawee is **incompetent to contract**, the bill is treated as dishonoured.

4. When the drawee has either become insolvent or is dead.

5. When presentment for acceptance is excused and the bill is not accepted.

DISHONOUR BY NON-PAYMENT (SECTION 92)

- A bill after being accepted has got to be presented for payment on the date of its maturity.

- **If the acceptor fails to make payment when it is due, the bill is dishonoured by non-payment.**

- In the case of a promissory note if the maker fails to make payment on the due date the note is dishonoured by non-payment.

- A cheque is dishonoured by non-payment as soon as a banker refuses to pay.

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

EFFECT OF DISHONOUR:

When a negotiable instrument is dishonoured either by non acceptance or by non-payment, the other parties thereto **can be charged with liability.**

For example if the acceptor of a bill dishonours the bill, the holder may bring an action against the drawer and the indorsers. There is a duty cast upon the holder towards those whom he wants to make liable to give notice of dishonour to them.

NOTICE OF DISHONOUR:

Notice of dishonour means the **actual notification of the dishonour of the instrument by non-acceptance or by non-payment.**
When a negotiable instrument is refused acceptance or payment notice of such refusal must immediately be given to parties to whom the holder wishes to make liable.

Failure to give notice of the dishonour by the holder would discharge all parties other than the maker or the acceptor (Sec. 93).

PENALTIES IN CASE OF DISHONOUR OF CERTAIN CHEQUES FOR INSUFFICIENCY OF FUNDS