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**DEPARTMENT OF COMMERCE (CA)**

**SUBJECT :BUSINESS LAW**

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**Unit – V**

**Law of Negotiable Instruments. (Instrument Amendment Act, 2015 – Definition –characteristics – classification- notes, bills, cheques and promissory note.)**

**What is Negotiable instrument act?**

**Negotiable Instruments Act**, 1881. From Wikipedia, the free encyclopedia. The **Negotiable Instruments Act**, 1881. An **Act** to define and **Law** relating to **negotiable instruments** which are Promissory Notes, Bills of Exchange and cheques.

**What is meant by Negotiable instrument?**

Document of title or evidence of indebtedness that is freely (unconditionally) transferable in trading as a substitute for money. **Negotiable instruments** are unconditional orders or promise to pay, and include checks, drafts, bearer bonds, some certificates of deposit, promissory notes, and bank notes (currency).

**What is meant by Negotiable instrument in Business Law?**

A **negotiable instrument** is a document guaranteeing the payment of a specific amount of money, either on demand, or at a set time, with the payer named on the document.

**Definition- Law of Negotiable Instruments**

The [Negotiable Instruments Act, 1881](https://en.wikipedia.org/wiki/Negotiable_Instruments_Act%2C_1881) in India and the Bills of Exchange Act 1914 in Mauritius. The Bills of Exchange Act:

1. defines a bill of exchange as: 'an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand, or at a fixed or determinable future time, a sum certain in money to or to the order of a specified person, or to bearer.
2. defines a cheque as: 'a bill of exchange drawn on (behalf of) a banker, which is payable on demand (by banker)'
3. defines a promissory note as: 'an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay on demand, or at a fixed or determinable future time, a sum certain in money to or to the order of a specified person or to bearer.'

Additionally most Commonwealth jurisdictions have separate Cheques Acts providing for additional protections for bankers collecting unendorsed or irregularly endorsed cheques, providing that cheques that are crossed and marked 'not negotiable' or similar are not transferable, and providing for electronic presentation of cheques in inter-bank cheque clearing systems.

**Meaning - Law of Negotiable Instruments. Instrument Amendment Act, 2015**

The **Negotiable Instruments** (**Amendment**) Bill, **2015** was passed by the Parliament in the recently concluded Winter Session of the Parliament. ... The **Negotiable Instruments Act**, 1881 was enacted to define and **amend** the **law** relating to Promissory Notes, Bills of Exchange and Cheques.

**5 characteristics of a negotiable instrument**

A negotiable instrument has the following characteristics.

#### ****1. Property****

The possessor of the negotiable instrument is presumed to be the owner of the property contained therein. A negotiable instrument does not merely give possession of the instrument but right to property also. The property in a negotiable instrument can be transferred without any formality. In the case of a bearer instrument, the property passed by mere delivery to the transferee. In the case of an order instrument, endorsement and delivery are required for the transfer of property.

#### 2. Title

The transferee of a negotiable instrument is known as holder in due course.’ A bonafide transferee for value is not affected by any defect of title on the part of the transferor or of any of the previous holders of the instrument. This is the main distinction between a negotiable instrument and other subjects of ordinary transfer. The general rule of nemo dat quod non habet does not apply to negotiable instruments.

#### 3. Rights

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

A negotiable instrument can be transferred any number of times till it is at maturity. The holder of the instrument need not give notice of transfer to the party liable on the instrument to pay.

#### 4. Presumptions

Certain presumptions apply to all negotiable instruments e.g. a presumption that consideration has been paid under it.

#### 5. Prompt Payment

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

### Examples of negotiable instruments

(a) Negotiable instruments recognized by statute :

i) Bills of exchange

ii) Promissory notes.

iii) Cheques.

# 9 Essential Features of Negotiable Instruments (Negotiable Instruments Act, 1881)

#### 1. Writing and Signature:

Negotiable Instruments must be written and signed by the parties according to the rules relating to Promissory Notes, Bills of Exchange and Cheques. Demand Drafts are also construel as Negotiable Instruments in the limiting case as they have the same property as N.I. Instrumes.

#### 2. Money:

Negotiable instruments are payable by legal tender money of India. The liabilities of the parties of Negotiable Instruments are fixed and determined in terms of legal tender money.

#### 3. Negotiability:

Negotiable Instruments can be transferred from one person to another by a simple process. In the case of bearer instruments, delivery to the transferee is sufficient. In the case of order instruments two things are required for a valid transfer: endorsement (i.e., signature of the holder) and delivery. Any instrument may be made non-transferable by using suitable words, e.g., “pay to X only.”

#### 4. Title:

The transferee of a negotiable instrument, when he fulfils certain conditions, is called the holder in due course. The holder in due course gets a good title to the instrument even in cases where the title of the transferrer is defective.

#### 5. Notice:

It is not necessary to give notice of transfer of a negotiable instrument to the party liable to pay. The transferee can sue in his own name.

#### 6. Presumptions:

Certain presumptions apply to all negotiable instruments. Example: It is presumed that there is consideration. It is not necessary to write in a promissory note the words “for value received” or similar expressions because the payment of consideration is presumed. The words are usually included to create additional evidence of consideration.

#### 7. Special Procedure:

A special procedure is provided for suits on promissory notes and bills of exchange (The procedure is prescribed in the Civil Procedure Code). A decree can be obtained much more quickly than it can be in ordinary suits.

#### 8. Popularity:

Negotiable instruments are popular in commercial transactions because of their easy negotiability and quick remedies.

#### 9. Evidence:

A document which fails to qualify as a negotiable instrument may nevertheless be used as evidence of the fact of indebtedness.

The basic types of negotiable instruments are as follows:

* Bearer Instrument
* Order Instrument
* Inland Instrument
* Foreign Instrument
* Demand Instrument
* Time Instruments

Let us understand each of these types in some detail. The negotiable instruments may be classified as under:

### 1. Bearer Instruments:

A promissory note, a bill of exchange or a cheque is payable to bearer when it is expressed to be so payable, or the last endorsement on the instrument is an endorsement in blank. A person who is a holder of a bearer instrument can obtain the payment of the instrument.

### 2. Order Instruments:

A promissory note, a [bill of exchange](https://caknowledge.in/bills-of-exchange-promissory-notes/) or a cheque is payable to order in which it is expressed to be so payable; or which is expressed to be payable to a particular person and it does not contain any words prohibiting transfer or indicating any intention that it shall not be transferable.

### 3. Inland Instruments:

A promissory note, a bill of exchange or a cheque drawn or made in India, and made payable for any person who is resident in India shall be deemed to be an inland instrument. Since a promissory note is not drawn on any person, an inland promissory note is one which is made payable in India. Subject to this exception, an inland instrument is one which is either:

* drawn and made payable in India, or
* Drawn in India upon some persons resident therein, even though it is made payable in a foreign country.

### 4. Foreign Instruments:

An instrument which is not an inland instrument is defined as a foreign instrument. To understand it in a broader way, we need to understand its essentials. The essentials of a foreign instrument include the following:

(i) it must be drawn outside India and should be made payable outside or inside India; or

(ii) it must be drawn in India and should be made payable outside India and drawn on a person resident outside India.

### 5. Demand Instruments:

A promissory note or a bill of exchange in which no time for payment is specified is an instrument payable on demand.

### 6. Time Instruments:

Time instruments are those instruments which are payable at sometime in the near future. Therefore, a promissory note or a bill of exchange payable after a fixed period, or after sight, or on a specified day, or on the happening of an event which is certain to happen, is known as a time instrument.

**Definition**
**PROMISSORY NOTE (Sec. 4)**

Promissory note is defined by Section 4 of the Negotiable Instruments Act. A promissory note is an instrument in writingcontaining an unconditional undertaking, signed by the maker,to pay a certain sum of money only to or to the order ofa certain person or to the bearer of the instrument.

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

(1)   It must be in *writing:*Mere verbal promise to pay will not do. The method of writing is important ,but it must be in a media that can not be altered easily.

(2)   It must contain an *express promise*or clear undertaking to pay: A promise to pay cannot beinferred; it must be express. A mere acknowledgement is not enough. The following are  not promissory notes, as there is no promise to pay:

* + “I am liable to pay you Rs. 1,000”.
	+ “I have taken from you Rs. 150; whenever you ask for it; I have to pay But  the  following is apromise to pay:

a promissory note is executed the promise to pay is performed because a promissory note amounts in  law to paymentand what vitiates a promise does not vitiate a payment.

(3**)   The promise to pay must be *unconditional:***

We have seen before that an instrument,to be negotiable,must contain an unconditional promise or order. So a promise topay contained in a note must beunconditional. A conditionl undertaking destroysthe negotiable character of an otherwise negotiableinstrument. But a promise to pay at a particular place or after a specified time or on the happening of anevent which must happen is not conditional. For example, I promise to pay B Rs.50 seven days after C’s death isnot conditional, for C is certain to die some time or the other.

(4***)   The maker must Sign the promissory note:***The person who draws the instrument and signs it is knownas the maker and the person to whom the promise is made is called the payee. The instrument will becomplete only when it is signed by the maker even when it is written by him and his name appears in thebody of instrument. Signature may be in any part of the instrument, and may be expressed by a thumb markor any other mark, if the executant is  illiterate.

(5)   **The maker must be a certain person:**The note itself must show clearly who is the person engaginghimself to pay, Where the promisors are more than one they may bind  themselves  jointly or jointly andseverally but not in the alternative.

(6)   *The payee must be certain:*A promissory note must contain a promise to pay to some  person orpersons ascertained by name or designation or to their order. A promissory note made payable to themaker himself it nullity but if such a note is endorsed by him, it  becomes payable to bearer and is valid.

(7)   **The sum payable must be certain**and the amount must not be capable of contingent additions  orsubstractions. Thus, if A promises to pay Rs.500 and all other sums which shall become due to him or topay 180 and all fines according to rules, the instrument is  not a promissory note.

(8)   **Payment must be in *legal money of the country****.*Thus an agreement to pay money or grain  or todeliver 100 tons of iron is not a promissory note.

(9)   A bank note or a currency note is not a promissory note within the meaning of this section.  They areexpressly excluded from the definition, as they are treated as money and not  merely securities for money. A promissory note or a draft cannot be made payable to bearer, no matter whether it is payable on demandor after a certain period.

(10) Other matters of form like number, place, date etc., are usually found given in notes,  but they are not essential in law.

A promissory note must bear the stamp duty as required under the Indian Stamp Act. It is better if the stampsaffixed  cancelled by the maker’s signature. Suit can not be maintained on an unsufficient stamped promissorynote.

**BILL OF EXCHANGE**

**Definition**

According to Section 5 of the Negotiable Instruments Act, A bill of exchange is an instrument in writing containingan unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or tothe order of, a certain person or to the bearer of the Instrument. The definition of Bill of Exchange is very similar tothat of a  promissory  note  and  for  most  purposes  the  rules  which  apply  to  notes  are  in  general applicable to bills.The  fundamental ingredients are the same. The drawer like the makers must be certain, the order to pay must beunconditional, the amount of Bill and the payee and the drawer, must be certain and the contract must be in writing.The maker of a note corresponds to the acceptor of a bill, and when a note is endorsed it is exactly similar to abill, for then it is an order by the endorser of the note upon the maker to pay the endorsee. The endorser is, as itwere, the drawer, the maker, the acceptor and the  endorsee is the payee. But a bill differs from a note in someparticulars.The usual form of a bill of Exchange is given below:

**Essentials of a Bill of Exchange**

1.     It must be in writing and may be in any language.

2.     It must be an order to pay by the drawer to the drawee.

3.    The order to pay must be unconditional. If the order to pay is conditional, the bill of exchange becomes invalid.

4.    There are three parties in a bill of exchange. (a)  Drawer: The person who makes the bill.

(b) Drawee: The person who is ordered to pay or on whom the bill is drawn.

(c) Payee: The person who is to receive the payment.

5.     The bill must be signed by the drawer otherwise it will become an inchoate instrument.

6.     The order to pay must be of a certain sum and it must be in money only.

7.     The payee and drawee must be certain.

8.     It must be properly stamped under the Indian Stamp Act.

**Distinction between Bill and Note**

The  below  given  differences  are  enumerated  from  the  above  meanings  of  both  the instruments—

(1)   In a note there are only two parties - the maker and the payee. In a bill there are three partiesnamely, drawer, drawee, and payee; though two out of three capacities may be filled  by one andthe same person. In a bill the drawer is the maker who orders the drawee to pay the bill to aperson called the payee or to his order. When the drawee accepts the bill  he is called the acceptor.

(2)   A note cannot be made payable to the maker himself, while in a bill the drawer and payee ordrawee and payee may be the same person.

(3)   A note contains an unconditional promise by the maker to pay to the payee or his order; in a billthere is an unconditional order to the drawee to pay according to the drawer’s directions.

(4)   A note is presented for payment without any prior acceptance to the maker. A bill payable aftersight must be accepted by the drawee or some one else on his behalf before it can be  presented for payment.

(5)   The liability of the maker of a note is primary and absolute, but the liability of the drawer of a billis secondary and conditional. He will be liable only if the bill is not

Accepted or paid by the drawer.

(6)   The maker of the note stands in immediate relation with the payee. while the maker or drawer of anaccepted bill stands in immediate relation with the acceptor and not the payee.

(7)   Foreign bills must be protested for dishonour when each protest is required to be made by the lawof the country where they are drawn but no such protest is necessary in the case of the  note.

(8)   When a bill is dishonoured, due notice of dishonour is to be given by the holder to the drawer andthe intermediate indorsers, but no such notice need be given in the

Case of a note .

**Types of Bill of Exchange**

A bill of exchange may be an Inland bill or a Foreign bill. Originally, bill was a means by which a trader in onecountry paid a debt in another country without the transmission of coin. An Inland bill is drawn and payable in India or drawn in India upon some person resident in India, even though it is made payable in a foreign country. A bill which isnot Inland is a Foreign Bill (Sec. 12).

**Accommodation Bill**

Legitimately speaking, an accommodation bill is not a bill as such. It is simply a mode of accommodating a friend in business. For example, A may  be  in  want  of  money  and approach his friend B and C who, instead of lending themoney directly, propose to draw an‘Accommodation Bill’ in his favour. A promises to reimburse C before the period ofthe billis up (which is generally 3 months). If the credit of B and C is good, this device enables A to get an advancefrom his banker at the commercial rate of discount. The real debtor in this case is not C, the acceptor, but A the payeewho has engaged to find the money for its ultimate payment, and A is here the principal debtor and the others merelysureties. Thus, as between the original parties to the bill the one who would prima facie be principal is in fact, thesurety whether he be drawer, acceptor or  indorser, that bill is an accommodation bill.

**Rights to Duplicate Bill**

Where the bill is not overdue but has been lost, the person who was holder of it may apply to the drawer, to givehim another bill of the same tenor, giving security to the drawer if required, to indemnify him against all personswhatever in case the bill alleged to have been lost shall be found again. If the drawer refuses to give such duplicate billmay be compelled to do so by means of a  suit.  Holder is the person who can ask for a duplicate.

**Bank Draft**

A demand draft is a bill of exchange drawn by a bank on another bank, or by itself on its own  branch, and is anegotiable instrument. It is like a cheque but differs in certainrespects. First, it can be drawn only by a bank onanother bank and not by a private individual as in the case of cheques. As against a cheque, it cannot becountermanded easily either by its purchaser or by the bank to which it is presented. Finally, it cannot be madepayable to bearer. These days it is a popular mode of making payments. Banks charge a nominal amount of commissionfor this  service.

**Bill in Sets**

Foreign bills are generally drawn in sets of three each. According to S. 132, bill of exchange may be drawn inparts, each part being numbered and containing a provision that it shall continue to be payable so long as the otherpart remains unpaid. All the parts together make a set but the whole set constitutes one bill and is extinguished whenone of the parts, if a separate bill, would  be extinguished. The bills  are  drawn  in  sets,  in  foreign  trade  in  order  to  facilitate  prompt  and  easy presentation for acceptance and payment. It also reduces the risk of loss in course of transit.

**CHEQUES**

A cheque is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than ondemand. It is like a bill of exchange always drawn on a bank payable on demand. Therefore, it must satisfy all therequirements of a bill (section 6).It must be in writing and signed by the drawer. It should contain an unconditionalorder to a specified banker to pay a certain sum of money to a particular person or to his order or to the bearer  on demand.

**Distinction between Bills and Cheques**

1.   A cheque is always drawn on a banker, while a bill may be drawn on anyone, including a banker.

2.   A cheque’s payment is made when it has been demanded whereas in case of a bill its nature may besuch that payment has to be made on demand or after the expiry of a certain period after date or sight.

3.   In case of a cheque a bearer can get payment on demand but a bill's payment can not be demanded by the bearer.

4.   Acceptance of bill is necessary for the demand of its payment, in case of cheque acceptance is not required and is aimed for quick payment.

5.   In case of bills ordinarily a provision for grace days is made (which is generally of

3 days) whereas in case of cheques no such grace is allowed.

6.   In the absence of presentment of a bill for payment the liability of bill’s drawer ceases, whereasliability of cheque’s drawer ceases when the delay caused in presentment for payment results in damages.

7.   Notice must be served when the bill is dishonoured, but when a cheque is not honoured, no such notice is necessary.

8.   A cheque being a revocable order the authority may be revoked by countermanding payment, andis determined by notice of the customer’s death or insolvency. In case of a bill the  position is different, itcan not be revoked.

9.   A cheque may be crossed to secure its payment, no such crossing can be done in case of a  bill.

**Liability of a Banker**

A banker is one whose business is to honour cheques drawn upon him by persons and for whom he receives money oncurrent accounts. If a person opens a current account by depositing  certain money  with  the  banker,  a  relationship  of  creditor  and  debtor  emerges between the customer and the banker and the banker undertakes to honour thecheques drawn by the customer so  long it has sufficient funds to the credit of the customer. If a banker withoutjustification, fails to  obey his customer’s mandate which is issued in the form of a cheque, he will be liable tocompensate the drawer for any loss or damage suffered by him. But the payee or the holder of the  cheque has nocause of action against the banker as the obligation to honour cheques is only  towards  the drawer.The customer may,however, be awarded very heavy damages, if he proves loss of credit on account of the dishonour, and the rule is thesmaller the amount of a cheque dishonoured the larger  the amount the damages.There are numerous cases in whichthe banker must refuse to honour his customer’s cheques  :

1. *When customer countermands payment.* When a customer after issuing a cheque, issues instructions not tohonour a cheque, the banker must not pay it. If the bank pays it, he will be liable  to make good the customer’sloss.

2. *When banker receives notice of customer’s death.*Notice of customer’s death terminates banker’s  authorityto honour cheques.

3. When customer becomes insolvent. When a customer has been adjudged an insolvent, all his assetsvest in the Official Assignee or the Court, and the banker must thereafter refuse to pay his  cheques.

4. When banker receives notice of customer’s insanity, he must not honour his cheques.

5. When the banker receives a garnishee order from the court relating to the customer’s money, the bankershould not honour cheques drawn against the customer’s account.

6. The banker should not honour his customer’s cheques after the customer has given notice  of  assignment of the credit balance of his account.

7. When the holder’s title is defective and banker comes to know of the defect.

8. When the banker comes to know that the customer is drawing cheques for unlawful purposes.

9. When the banker has received a notice from the customer for closing the account.

*When banker may refuse payment.*In the following cases the banker may, if he likes, refuse  to honour the cheques :

* Where the cheque is post-dated and is presented before the date noted on it. The banker is required topay the cheque on the date which the cheque bears and not before. In fact, payment before that date ismade by the banker at his own risk, for if the customer countermands payment or issues another chequebearing an earlier date, the banker cannot debit the customer’s account with the amount  of  the post-dated cheque.
* Where the banker has not got sufficient funds of the drawer with him.
* Where the funds in the hands of the banker are not properly applicable to the payment of the customer’s cheque.For example, the funds are held by the customer in trust, and the cheque is  issued  in breach of trust, the bankermay refuse to pay.
* Where the cheque is of doubtful legality. The banker may refuse to pay if the cheque is  irregular orambiguous, materially altered or drawn in a doubtful legality.
* Where the cheque is presented after office hours.
* Where the cheque is presented at a branch where the customer has no account or where his  account isoverdrawn.
* Where some persons have joint account and the cheque is not signed by all jointly, or by the survivors of them. Butif the cheques are payable to Either or survivor then thechrque signed by any of the two parties will be sufficientfor payment.
* Where the cheque has been allowed to become stale, i.e., it has not been presented for payment within a reasonabletime after the date mentioned in it. In India, a cheque

presented 6 months or more after the date is regarded as state.

**Crossing of Cheques**

A cheque is either an “Open cheque” or a “crossed cheque”. An open cheque is uncrossed and can be presented by thepayee to the banker on whom it is drawn and will be paid over the counter. An open cheque is, however, liable togreat risk in course of circulation. It may be stolen or lost and the finder may get it cashed. In order to avoid the lossesincurred by open cheques getting into the hands  of  wrong parties the custom of crossing was introduced.

A *Crossing*is a direction to the paying banker to pay the money generally to a banker or to a particular banker, asthe case may be, and not to pay to the holder across the counter. A banker paying a crossed cheque over the counterwill be liable to the customer if the holder turns out to be a  person not entitled to pet payment. The object ofcrossing is to secure payment to a banker so  that  it could be traced to the person receiving the amount of the cheque.

**There are two types of crossing - *General*and *Special****.*To these may be added another type-*Restrictive crossing.*Ageneral crossing is one where a cheque bears across its face two transverse lines with or without the words “andcompany” or “& Co.” or two parallel transverse lines with or without the words “not negotiable”. If a cheque iscrossed generally; the  paying banker shall pay only to a banker.A special crossing is defined thus: “Where a chequebears across its face an addition of the name of a banker, either with or without the word “not negotiable” thataddition shall be deemed a crossing and the cheque shall be deemed to be crossed specially and to be crossed to thatbanker.” In a general crossing the parallel transverse lines are necessary although in a special crossing they  need notbe there. But in the later case, the name of the banker is essential to whom or to whose collecting agent alone thepayment will be made. *Restrictive crossing*have been adopted by  commercial usage in order to obviate the riskof a their obtaining payment. They consist in  addition to the general or special crossing the words‘Account Payee’only. Such crossing vvarn the collecting banker that the proceeds are to be credited  only to the account of thepayee, of the party named.

If a cheque is made payable to a payee and to him only, it becomes non-transferable in the strict sense. He is theonly person who can get payment. But where a cheque is crossed and  bears  the  word  ‘not  negotiable’  it  is transferable,  but  it  loses  its  special  feature  of negotiability. Such a cheque is like any goods, the transferee ofwhich does not get a better title than that of the transferor, the transferee for value and in good faith is not aholder in due course.A cheque may be crossed by the drawner or by the holder. The holder may add the words‘notnegotiable’ to a crossing. The word not negotiable represent the desire of the drawer that it  should  not be negotiatedfurther.