

Chapter 4: Negotiable Instrument Act, 1881

1. Definition of Negotiable Instrument

As per Section 13(1) of Negotiable Instrument Act, 1881: “Negotiable Instrument” means a promissory note, bill of exchange or cheque payable either to order or to bearer.

Note: The term “negotiable instrument” means a document transferable from one person to another.

2. Important Characteristics of Negotiable Instruments

- Presumption that holder of the instrument are the owner of the property.
- Freely Transferable.
- Holder in due course gets the instrument free from all defects of title of any previous holder.
- Holder in due course is entitled to sue on the instrument in his own name.
- Instrument is transferable till maturity and in case of cheques till it becomes stale (on the expiry of 6 months from the date of issue).
- Equal presumptions are applicable to all negotiable instruments unless the contrary is proved.

3. Classification of Negotiable Instruments

<i>Bearer Instruments</i>	<i>Inland Instruments</i>	<i>Demand Instruments</i>	<i>Ambiguous Instruments</i>
<i>Order Instruments</i>	<i>Foreign Instruments</i>	<i>Time Instruments</i>	<i>Inchoate/Incomplete Instrument</i>

Bearer Instruments: A promissory note, bill of exchange or cheque is payable to bearer when it is expressed to be so payable or the only or last endorsement on the instrument is an endorsement in blank.

Order Instruments: A promissory note, bill of exchange or cheque is payable to order:

- which is expressed to be so payable; or
- which is expressed to be payable to a particular person and does not contain any words prohibiting transfer or indicating an intention that it shall not be transferable.

Inland Instruments: A promissory note, bill of exchange or cheque drawn or made in India, and made payable, or drawn upon any person, resident in India shall be deemed to be an inland instrument. Promissory note is not drawn on any person. Unlike a promissory note, 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.

Foreign Instruments: An instrument which is not an inland instrument is deemed to be a foreign instrument. The essentials of a foreign instrument include that:

- it must be drawn outside India and made payable outside or inside India; or
- it must be drawn in India and made payable outside India and drawn on a person resident outside India.

Demand Instruments: A promissory note or a bill of exchange in which no time for

payment is specified is an instrument payable on demand.

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

Ambiguous Instruments: 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.

Inchoate or Incomplete Instrument: When one person signs and delivers to another a paper stamped in accordance with the law relating to negotiable instruments and either wholly blank or having written thereon an incomplete negotiable instrument, he thereby gives prima facie authority to the holder thereof to make or complete as the case may be upon it a negotiable instrument for any amount specified therein and not exceeding the amount covered by the stamp. Such an instrument is called an inchoate instrument.

Note: *The authority to fill up a blank or incomplete instrument may be exercised by any "holder" and not only the first holder to whom the instrument was delivered. The person signing and delivering the paper is liable both to a "holder" and a "holder-in-due- course".*

4. Kinds of Negotiable Instruments

As per Section 13 of the Act, Negotiable instruments are of three kinds:

- Promissory Notes.
- Bills of Exchange.
- Cheques.

However, it does not exclude any other negotiable instrument provided instrument entitles a person to a sum of money and is transferable by delivery. Instruments written in oriental languages i.e. hundis are also negotiable instruments.

5. Promissory Notes – Meaning , Parties Involved and Essentials

Meaning	“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 to or to the order of a certain person or only to bearer of the instrument.
Parties Involved	<ul style="list-style-type: none">▪ The maker: the person who makes or executes the note promising to pay the amount stated therein.▪ The payee: one to whom the note is payable.▪ The holder: is either the payee or some other person to whom he may have endorsed the note.▪ The endorser.▪ The endorsee.
Essentials	<ul style="list-style-type: none">▪ It must contain an express promise or clear undertaking to pay.▪ It must contain the promise or undertaking to pay must be unconditional.▪ It must be in writing. An oral promise to pay will not do.▪ The maker must sign the promissory note in token of an undertaking to pay to the payee or his order.▪ The maker must be a certain person, i.e. the note must show clearly who is the person engaging himself to pay.▪ The payee must be certain.▪ The sum payable must be certain and the amount must not be capable of contingent additions or subtractions.▪ It must be properly stamped in accordance with the provisions of the Indian Stamp Act, 1899.▪ Payment must be in legal money of the country.▪ It must contain the name of place, number and the date on which it is made. However, their omission will not render the instrument invalid.

6. Bills of Exchange- Meaning , Parties Involved and Essentials

Meaning	“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.
Parties Involved	<ul style="list-style-type: none">▪ Drawer: The person who draws the bill.▪ Drawee: The person on whom the bill is drawn.▪ Acceptor: One who accepts the bill.▪ Payee: One to whom the sum stated in the bill is payable, either the drawer or any other person may be the payee.▪ Holder: Either the original payee or any other person to whom, the payee has endorsed the bill. In case of a bearer bill, the bearer is the holder.▪ Endorser: When the holder endorses the bill to anyone else he becomes the endorser.▪ Endorsee: The person to whom the bill is endorsed.▪ Drawee in case of need: Drawee in case of need may be inserted either by the drawer or by any endorser in order that resort may be had to him in case of need i.e. when the bill is dishonoured by either non-acceptance or non-payment.▪ Acceptor for honour: A person who on the refusal by the original drawee to accept the bill or to furnish better security when demanded by the notary, accept the bill supra protest in order to safeguard the honour of the drawer or any endorser, is called the acceptor for honour.
Essentials	<ul style="list-style-type: none">▪ It must be in writing.▪ It must contain an unconditional order to pay money and not merely a request.▪ It must be signed by the drawer.▪ The parties must be certain.▪ The sum payable must also be certain.▪ It must comply with other formalities e.g. stamps, date, etc.

7. Cheques- Meaning, Parties Involved and Essentials

Meaning	‘Cheque’ is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and it includes the electronic image of a truncated cheque and a cheque in the electronic form.
Parties Involved	<ul style="list-style-type: none">▪ Drawer: The person who draws the cheque.▪ Drawee: The banker of the drawer on whom the cheque is drawn.▪ Payee: One to whom the sum stated in the bill is payable either the drawer or any other person may be the payee.▪ Holder: Either the original payee or any other person to whom the payee has endorsed the bill. In case of a bearer bill, the bearer is the holder.▪ Endorser: When the holder endorses the bill to anyone else he becomes

	<p>the endorser.</p> <ul style="list-style-type: none"> ▪ Endorsee: The person to whom the bill is endorsed.
Essentials	<ul style="list-style-type: none"> ▪ It must be in writing. ▪ It must contain an unconditional order to pay money only and not merely a request. ▪ It must be signed by the drawer. ▪ The parties must be certain. ▪ The sum payable must also be certain. ▪ It must comply with other formalities e.g. stamps, date, etc.

8. Distinction between Bill of Exchange and Promissory Note

Points	Bill of Exchange	Promissory Note
Meaning	“ 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.	“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 to or to the order of a certain person or only to bearer of the instrument.
Liability of maker	Liability of the maker/drawer is secondary and conditional upon non-payment by the drawee.	Liability of the maker/drawer is primary and absolute.
Order/Promise	It contains an unconditional order.	It contains an unconditional promise.
Parties Involved	These are three parties: Drawer, Drawee and Payee.	There are two parties: Maker and Payee.
Acceptance	Acceptance by the drawee is must.	Acceptance is not required.
Payee	Drawer of the bill may be payee also.	Maker of the note cannot be payee.

9. Distinction between Cheques and Bills of Exchange

Points	Cheques	Bills of Exchange
Meaning	‘ Cheque ’ is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and it includes the electronic image of a truncated cheque and a cheque in the electronic form.	“ 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.
Drawn on	It must be drawn on a specified banker.	It may or may not be addressed to banker.
Payable to bearer	It can be made payable on bearer.	It cannot be made payable to bearer on demand.
Grace Days	There is no grace period.	If it is not payable on demand at sight or on presentment; grace period of 3 days is

		available.
On Demand	It must be made payable on demand.	It cannot be made payable "on demand".
Crossing	Cheque can be crossed.	Bill of Exchange cannot be crossed.
Presentation	Presentation for acceptance is never required.	Presentation for acceptance is required.
Stamping	Not required to be stamped.	Required to be stamped.
Due Date	No due date for presentation of cheque.	Required to be presented for payment on due date.
Noting and Protesting	It cannot be noted and protested.	It can be noted and protested.
Notice of Dishonour	Notice of dishonour is not required unless holder intends to take criminal action u/s 138.	Notice of dishonour is usually required.

10. Distinction Electronic and Truncated Cheque

Points	Electronic Cheque	Truncated Cheque
Form	Electronic Cheque is never in paper form.	Truncated Cheque is initially a regular cheque on paper. It is submitted to bank as usual for clearance.
Original Writing	Original Writing itself is in electronic form.	Truncated Cheque is duly written and signed on paper. It is subsequently converted into electronic form.
Signature	Original signature is digital signature.	Original signature is in ink.

11. Meaning of Banker and Customer

Banker	A banker is one who does banking business.
Customer	A customer in relation to bank is one who has an account with the bank or who utilises the services of the bank.

12. Cases when Payment by Banker MUST be Refused

- In case a customer countermands payment i.e., where or when a customer, after issuing a cheque issues instructions not to honour it, the banker must not pay it.
- In case the banker receives notice of customer's death.
- In case customer has been adjudged an insolvent.
- In case the banker receives notice of customer's insanity.
- In case an order of the Court prohibits payment.
- In case the customer has given notice of assignment of the credit balance of his account.
- In case the holder's title is defective and the banker comes to know of it.
- In case the customer has given notice for closing his account.

13. Cases when Payment by Banker MAY be Refused

- In case of post-dated cheque.
- In case banker has no sufficient funds of the drawer with him and there is no communication between the bank and the customer to honour the cheque.
- In case when the cheque is of doubtful legality.
- In case when the cheque is not duly presented. Ex: it is presented after banking hours.
- In case when the cheque on the face of it is irregular, ambiguous or otherwise materially altered.
- In case the cheque is presented at a branch where the customer has no account.
- In case when some persons have joint account and the cheque is not signed jointly by all or by the survivors of them.
- In case when the cheque has been allowed to become stale, i.e. it has not been presented within six months of the date mentioned on it.

14. Payment in due Course (Section 10)

Payment in Due Course means a payment in accordance with the apparent tenor of the instrument in good faith and without negligence to any person in possession thereof.

A payment will be a payment in due course if:

- it is in accordance with the apparent tenor of the instrument, i.e., according to what appears on the face of the instrument to be the intention of the parties.
- it is made in good faith and without negligence, and under circumstances which do not afford a ground for believing that the person to whom it is made is not entitled to receive the amount;
- it is made to the person in possession of the instrument who is entitled as holder to receive payment;
- payment is made under circumstances which do not afford a reasonable ground believing that he is not entitled to receive payment of the amount mentioned in the instrument;
- payment is made in money and money only.

15. Crossing of Cheques and Modes of Crossing

Crossing of Cheques	A crossed cheque cannot be paid across the counter but must be collected through a banker. A crossing is a direction to the paying banker to pay the money generally to a banker or to a particular banker, and not to pay otherwise.
Modes of Crossing	<ul style="list-style-type: none">▪ General Crossing: General crossing where a cheque bears across its face an addition of two parallel transverse lines and/or the addition of the words “and Co.” between them, or addition of “not negotiable”.▪ Special Crossing: In case of special crossing, the paying banker is to honour the cheque only when it is

	<p>prescribed through the bank mentioned in the crossing or it's agent bank.</p> <ul style="list-style-type: none"> ▪ Account Payee's Crossing: Such crossing restrict negotiability of a cheque. ▪ Not Negotiable Crossing: Cheque may be crossed not negotiable by writing across the face of the cheque the words "Not Negotiable" within two transverse parallel lines in the case of a general crossing or along with the name of a banker in the case of a special crossing.
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16. Holder and Holder In Due Course

Points	Holder	Holder in due course
Meaning	A person is a holder of a negotiable instrument who is entitled in his own name: <ul style="list-style-type: none">■ to the possession of the instrument.■ to recover or receive its amount from the parties thereto.	A holder in due course is: <ul style="list-style-type: none">■ A person who for consideration obtains possession of a negotiable instrument if payable to bearer.■ The payee or endorsee thereof; if payable to order before its maturity and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title.
Position	“Holder” may or may not be a “holder in due course”	“Holder in due course” is obviously “holder”.
Title	Holder (who is not holder in due course) cannot acquire a good title if the title of the prior party was defective.	Holder in due course acquires a good title even if title of prior party was defective.
Mode	Mere holder need not necessarily be for consideration.	Person can become “ holder in due course ” only after paying or transferring some consideration.
Acquisition of Instrument	Holder (who is not holder in due course) may acquire instrument even after maturity.	Holder in due course can enforce instrument even if it was previously obtained by unlawful means or unlawful consideration.
Enforcement of Instrument	Holder cannot enforce instrument which was previously obtained by unlawful means or unlawful consideration.	Holder in due course can claim payment on fictitious bill.
Fictitious Bill	Holder (who is not holder in due course) cannot claim payment on fictitious bill.	Holder in due course can claim payment on fictitious bill.
Fraud and Coercion	Instrument issued or obtained under fraud, coercion without consideration cannot be enforced by holder is not “holder in due course”.	“Holder in due course” can enforce instrument issued or obtained under fraud, coercion or without consideration.

17. Negotiation (Section 14)

Negotiation is the transfer of an instrument (a note, bill or cheque) for one person to another in such a manner as to convey title and to constitute the transferee the holder thereof.

In case of transfer of negotiable instrument by negotiation, the rights of the transferee may rise higher than those of the transferor depending upon the circumstances attending the negotiation.

18. Distinction between Negotiation and Assignment

- Negotiation requires mere delivery of a bearer instrument and endorsement and delivery of an order instrument to effectuate a transfer.
Assignment requires a written document signed by the transferor.
- Notice of transfer of debt (actionable claim) must be given by the assignee to the debtor in order to complete his title;
No such notice is necessary in a transfer by negotiation.
- In case of assignment, the transferee of an actionable claim takes it subject to all the defects in the title of and to all the equities and defences available against the assignor even though he took the assignment for value and in good faith.
In case of negotiation the transferee as holder-in-due course takes the instrument free from any defects in the title of the transferor.

19. Meaning of Endorsement and Classes of Endorsement

Meaning of Endorsement	‘Endorsement’ means and involves the writing of something on the back of an instrument for the purpose of transferring the right, title and interest therein to some other person.
Classes of Endorsement	An endorsement may be: <ul style="list-style-type: none">▪ Blank or General.▪ Special or Full.▪ Restrictive.▪ Partial.▪ Conditional or Qualified.

20. Negotiation Back

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

For Example:

- *A, the holder of a bill endorses it to B, B endorses to C, and C to D and endorses it again to A.*
- *A, being a holder in due course of the bill by second endorsement by D can recover the amount thereof from B, C or D and himself being a prior party is liable to all of them.*
Therefore, A having been relegated by the second endorsement to his original position cannot sue B, C and D.

21. Forged Endorsement

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

22. Dishonour by Non-acceptance (Section 91)

- When the drawee does not accept it within 48 hours from the time of presentment for acceptance.
- When presentment for acceptance is excused and the bill remains unaccepted.
- When the drawee is incompetent to contract.
- When the drawee is a fictitious person or after reasonable search cannot be found.
- Where the acceptance is a qualified one.

23. Dishonour by Non-payment (Section 92)

A promissory note, bill of exchange or cheque is said to be dishonoured by non-payment when the maker of the note, acceptor of the bill or drawee of the cheque makes default in payment upon being duly required to pay the same. Also, a negotiable instrument is dishonoured by non-payment when presentment for payment is excused and the instrument when overdue remains unpaid.

24. Notice of Dishonour

When a negotiable instrument is dishonoured either by non-acceptance or by non-payment, the holder or some party liable thereon must give notice of dishonour to all other parties whom he seeks to make liable. The object of giving notice is not to demand payment but to whom the party notified of his liability and in case of drawer to enable him to protect himself as against the drawee or acceptor who has dishonoured the instrument issued by him.

25. No notice of Dishonour is necessary

- When it is dispensed with or waived by the party entitled thereto, e.g., where an endorser writes on the instrument such words as “notice of dishonour waived”.
- When the drawer has countermanded payment.
- When the party charged would not suffer damage for want of notice.
- When the party entitled to notice cannot after due search be found.

- When the omission to give notice is caused by unavoidable circumstances, e.g., death or dangerous illness of the holder.
- Where the acceptor is also a drawer, e.g., where a firm draws on its branch.
- Where the promissory note is not negotiable. Such a note cannot be endorsed.
- Where the party entitled to notice promises to pay unconditionally.

26. Discharge

Discharge	<p>The discharge in relation to negotiable instrument may be either</p> <ul style="list-style-type: none"> • discharge of the instrument or • discharge of one or more parties to the instrument from liability.
Ways of Discharge of the Instrument	<ul style="list-style-type: none"> • By payment in due course; • By an act that would discharge simple contract; • By renunciation; • By cancellation; • When the principal debtor becomes the holder.
Ways of Discharge of a Party or Parties	<ul style="list-style-type: none"> • By cancellation by the holder of the name of any party to it with the intention of discharging him. • By release, when the holder releases any party to the instrument. • Discharge of secondary parties, i.e. endorser. • By the operation of the law, i.e. by insolvency of the debtor. • By allowing drawee more than 48 hours to accept the bill, all previous parties are discharged. • By non-presentment of cheque promptly the drawer is discharged. • By taking qualified acceptance, all the previous parties are discharged. • By material alteration.

27. Material Alteration (Section 87)

An alteration is material which in any way alters the operation of the instrument and the liabilities of the parties thereto. A material alteration renders the instrument void but it affects only those persons who have already become parties at the date of the alteration.

Examples of material alteration are:

- Alteration of the date of the instrument.
- Alteration of the sum payable.
- Alteration in the time of payment.
- Alteration of the place of payment.
- Alteration of the rate of interest.
- Alteration by addition of a new party.

28. Hundis

Meaning of Hundis	The term “Hundi” includes all indigenous negotiable instruments whether they are bills of exchange or promissory notes.
Types of Hundis	<ul style="list-style-type: none">▪ Shah Jog Hundi.▪ Jokhmi Hundi.▪ Jawabee Hundi.▪ Nam jog Hundi.▪ Darshani Hundi.▪ Miadi Hundi.

29. Presumptions of Law Regarding Negotiable Instruments

It shall be presumed that:

- Every negotiable instrument was made or drawn for consideration irrespective of the consideration mentioned in the instrument or not.
- Every negotiable instrument having a date was made on such date.
- Every accepted bill of exchange was accepted within a reasonable time before its maturity.
- Every negotiable instrument was transferred before its maturity.
- The instruments were endorsed in the order in which they appear on it.
- A lost or destroyed instrument was duly signed and stamped.
- The holder of the instrument is a holder in due course.
