

# **BUSINESS LAW**

## **NEGOTIABLE INSTRUMENTS ACT, 1881**

B. Com 2nd Semester

Unit – 4

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## **STRUCTURE**

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## **1.0 OBJECTIVES**

After reading this, you should be able to-

Understand meaning, essential characteristics and types of negotiable instruments;

## **1.1 INTRODUCTION**

The Negotiable Instruments Act was enacted, in India, in 1881. Prior to its enactment, the provision of the English Negotiable Instrument Act were applicable in India, and the present Act is also based on the English Act with certain modifications. It extends to the whole of India except the State of Jammu and Kashmir. The Act operates subject to the provisions of Sections 31 and 32 of the Reserve Bank of India Act, 1934. Section 31 of the Reserve Bank of India Act provides that no person in India other than the Bank or as expressly authorised by this Act, the Central Government shall draw, accept, make or issue any bill of exchange, hundi, promissory note or engagement for the payment of

money payable to bearer on demand. This Section further provides that no one except the RBI or the Central Government can make or issue a promissory note expressed to be payable on demand or after a certain time. Section 32 of the Reserve Bank of India Act makes issue of such bills or notes punishable with fine which may extend to the amount of the instrument.

The effect or the consequences of these provisions are:

A promissory note cannot be made payable to the bearer, no matter whether it is payable on demand or after a certain time.

A bill of exchange cannot be made payable to the bearer on demand though it can be made payable to the bearer after a certain time.

But a cheque {though a bill of exchange} payable to bearer or demand can be drawn on a person's account with a banker.

## **1.2 MEANING OF NEGOTIABLE INSTRUMENTS**

According to Section 13 (a) of the Act, "Negotiable instrument means a promissory note, bill of exchange or cheque payable either to order or to bearer, whether the word "order" or "bearer" appear on the instrument or not."

In the words of Justice, Willis, "A negotiable instrument is one, the property in which is acquired by anyone who takes it bonafide and for value notwithstanding any defects of the title in the person from whom he took it".

Thus, the term, negotiable instrument means a written document which creates a right in favour of some person and which is freely transferable. Although the Act mentions only these three instruments (such as a promissory note, a bill of exchange and cheque), it does not

exclude the possibility of adding any other instrument which satisfies the following two conditions of negotiability:

the instrument should be freely transferable (by delivery or by endorsement. and delivery) by the custom of the trade; and

the person who obtains it in good faith and for value should get it free from all defects, and be entitled to recover the money of the instrument in his own name.

As such, documents like share warrants payable to bearer, debentures payable to bearer and dividend warrants are negotiable instruments. But the money orders and postal orders, deposit receipts, share certificates, bill of lading, dock warrant, etc. are not negotiable instruments. Although they are transferable by delivery and endorsements, yet they are not able to give better title to the bonafide transferee for value than what the transferor has.

### **1.3 CHARACTERISTICS OF A NEGOTIABLE INSTRUMENT**

A negotiable instrument has the following characteristics:

**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 bearer instrument, the property passes by mere delivery to the transferee. In the case of an order instrument, endorsement and delivery are required for the transfer of property.

**Title:** The transferee of a negotiable instrument is known as 'holder in due course.' A bona fide 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.

**Rights:** The transferee of the negotiable instrument can sue in his own name, in case of dishonour. 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.

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

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

#### **1.4 PRESUMPTIONS AS TO NEGOTIABLE INSTRUMENT**

Sections 118 and 119 of the Negotiable Instrument Act lay down certain presumptions which the court presumes in regard to negotiable instruments. In other words these presumptions need not be proved as they are presumed to exist in every negotiable instrument. Until the contrary is proved the following presumptions shall be made in case of all negotiable instruments:

**Consideration:** It shall be presumed that every negotiable instrument was made drawn, accepted or endorsed for consideration. It is presumed that, consideration is present in every negotiable instrument until the contrary is presumed. The presumption of consideration,

however may be rebutted by proof that the instrument had been obtained from, its lawful owner by means of fraud or undue influence.

**Date:** Where a negotiable instrument is dated, the presumption is that it has been made or drawn on such date, unless the contrary is proved.

**Time of acceptance:** Unless the contrary is proved, every accepted bill of exchange is presumed to have been accepted within a reasonable time after its issue and before its maturity. This presumption only applies when the acceptance is not dated; if the acceptance bears a date, it will prima facie be taken as evidence of the date on which it was made.

**Time of transfer:** Unless the contrary is presumed it shall be presumed that every transfer of a negotiable instrument was made before its maturity.

**Order of endorsement:** Until the contrary is proved it shall be presumed that the endorsements appearing upon a negotiable instrument were made in the order in which they appear thereon.

**Stamp:** Unless the contrary is proved, it shall be presumed that a lost promissory note, bill of exchange or cheque was duly stamped.

**Holder in due course:** Until the contrary is proved, it shall be presumed that the holder of a negotiable instrument is the holder in due course. Every holder of a negotiable instrument is presumed to have paid consideration for it and to have taken it in good faith. But if the instrument was obtained from its lawful owner by means of an offence or fraud, the holder has to prove that he is a holder in due course.

**Proof of protest:** Section 119 lays down that in a suit upon an instrument which has been dishonoured, the court shall on proof of the protest, presume the fact of dishonour, unless and until such fact is disproved.

## **1.5 TYPES OF NEGOTIABLE INSTRUMENT**

Section 13 of the Negotiable Instruments Act states that a negotiable instrument is a promissory note, bill of exchange or a cheque payable either to order or to bearer. Negotiable instruments recognised by statute are: (i) Promissory notes (ii) Bills of exchange (iii) Cheques. Negotiable instruments recognised by usage or custom are: (i) Hundis (ii) Share warrants (iii) Dividend warrants (iv) Bankers draft (v) Circular notes (vi) Bearer debentures (vii) Debentures of Bombay Port Trust (viii) Railway receipts (ix) Delivery orders.

This list of negotiable instrument is not a closed chapter. With the growth of commerce, new kinds of securities may claim recognition as negotiable instruments. The courts in India usually follow the practice of English courts in according the character of negotiability to other instruments.

### **1.5.1 Promissory notes**

Section 4 of the Act defines, “A promissory note is an instrument in writing (note 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 to the bearer of the instruments.”

#### **Essential elements**

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

**It must be in writing:** A mere verbal promise to pay is not a promissory note. The method of writing (either in ink or pencil or printing, etc.) is unimportant, but it must be in any form that cannot be altered easily.

**It must certainly an express promise or clear understanding to pay:** There must be an express undertaking to pay. A mere acknowledgment is not enough. The following are not promissory notes as there is no promise to pay.

**If A writes:**

“Mr. B, I.O.U. (I owe you) Rs. 500”

“I am liable to pay you Rs. 500”.

“I have taken from you Rs. 100, whenever you ask for it have to pay” .

The following will be taken as promissory notes because there is an express promise to pay:

**If A writes:**

“I promise to pay B or order Rs. 500”

“I acknowledge myself to be indebted to B in Rs. 1000 to be paid on demand, for the value received”.

**Promise to pay must be unconditional:** A conditional undertaking destroys the negotiable character of an otherwise negotiable instrument. Therefore, the promise to pay must not depend upon the happening of some outside contingency or event. It must be payable absolutely.

**It should be signed by the maker:** The person who promise to pay must sign the instrument even though it might have

been written by the promisor himself. There are no restrictions regarding the form or place of signatures in the instrument. It may be in any part of the instrument. It may be in pencil or ink, a thumb mark or initials. The promote can be signed by the authorised agent of the maker, but the agent must expressly state as to on whose behalf he is signing, otherwise he himself may be held liable as a maker. The only legal requirement is that it should indicate with certainty the identity of the person and his intention to be bound by the terms of the agreement.

**The maker must be certain:** The note self must show clearly who is the person agreeing to undertake the liability to pay the amount. In case a person signs in an assumed name, he is liable as a maker because a maker is taken as certain if from his description sufficient indication follows about his identity. In case two or more persons promise to pay, they may bind themselves jointly or jointly and severally, but their liability cannot be in the alternative.

**The payee must be certain:** The instrument must point out with certainty the person to whom the promise has been made. The payee may be ascertained by name or by designation. A note payable to the maker himself is not pronate unless it is indorsed by him. In case, there is a mistake in the name of the payee or his designation; the note is valid, if the payee can be ascertained by evidence. Even where the name of a dead person is entered as payee in ignorance of his death, his legal representative can enforce payment.

**The promise should be to pay money and money only:** Money means legal tender money and not old and rare coins.

A promise to deliver paddy either in the alternative or in addition to money does not constitute a promissory note.

**The amount should be certain:** One of the important characteristics of a promissory note is certainty—not only regarding the person to whom or by whom payment is to be made but also regarding the amount.

However, paragraph 3 of Section 5 provides that the sum does not become indefinite merely because

there is a promise to pay amount with interest at a specified rate.

the amount is to be paid at an indicated rate of exchange.

the amount is payable by installments with a condition that the whole balance shall fall due for payment on a default being committed in the payment of anyone installment.

**Other formalities:** The other formalities regarding number, place, date, consideration etc. though usually found given in the promissory notes but are not essential in law. The date of instrument is not material unless the amount is made payable at a certain time after date. Even in such a case, omission of date does not invalidate the instrument and the date of execution can be independently ascertained and proved.

On demand (or six month after date) I promise to pay Peter or order the sum of rupees one thousand with interest at 8 per cent per annum until payment.

### **1.5.2 Bill of exchange**

Section 5 of the Act defines, “A 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”.

A bill of exchange, therefore, is a written acknowledgement of the debt, written by the creditor and accepted by the debtor. There are usually three parties to a bill of exchange drawer, acceptor or drawee and payee. Drawer himself may be the payee.

### **Essential conditions of a bill of exchange**

It must be in writing.

It must be signed by the drawer.

The drawer, drawee and payee must be certain.

The sum payable must also be certain.

It should be properly stamped.

It must contain an express order to pay money and money alone.

For example, In the following cases, there is no order to pay, but only a request to pay. Therefore, none can be considered as a bill of exchange:

“I shall be highly obliged if you make it convenient to pay Rs. 1000 to Suresh”.

“Mr. Ramesh, please let the bearer have one thousand rupees, and place it to my account and oblige”

However, there is an order to pay, though it is politely

made, in the following examples:

(a) “Please pay Rs. 500 to the order of ‘A’.

(b) ‘Mr. A will oblige Mr. C, by paying to the order of P’.

(7) The order must be unconditional..

## **Distinction Between Bill of Exchange and Promissory Note**

**Number of parties:** In a promissory note there are only two parties – the maker (debtor) and the payee (creditor). In a bill of exchange, there are three parties; drawer, drawee and payee; although any two out of the three may be filled by one and the same person,

**Payment to the maker:** A promissory note cannot be made payable to the maker himself, while in a bill of exchange it can be payable to the drawer and payee or drawee and payee may be the same person.

**Unconditional promise:** A promissory note contains an unconditional promise by the maker to pay to the payee or his order, whereas in a bill of exchange, there is an unconditional order to the drawee to pay according to the direction of the drawer.

**Prior acceptance:** A note is presented for payment without any prior acceptance by the maker. A bill of exchange is payable after sight and must be accepted by the drawee or someone else on his behalf, before it can be presented for payment.

**Primary or absolute liability:** The liability of the maker of a promissory note is primary and absolute, but the liability of the drawer of a bill of exchange is secondary and conditional.

**Relation:** The maker of the promissory note stands in immediate relation with the payee, while the maker or drawer of an accepted bill stands in immediate relations with the acceptor and not 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, but 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, but no such notice need be given in the case of a note.

### **Classification of Bills**

Bills can be classified as:

Inland and foreign bills.

Time and demand bills.

Trade and accommodation bills.

### **Inland and Foreign Bills**

**Inland bill:** A bill is, named as an inland bill if:

it is drawn in India on a person residing in India, whether payable in or outside India, or

it is drawn in India on a person residing outside India but payable in India.

### **The following are the Inland bills**

A bill is drawn by a merchant in Delhi on a merchant in Madras. It is payable in Bombay. The bill is an inland bill.

A bill is drawn by a Delhi merchant on a person in London, but is made payable in India. This is an inland bill.

A bill is drawn by a merchant in Delhi on a merchant in Madras. It is accepted for payment in Japan. The bill is an inland bill.

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

bill drawn outside India and made payable in India.

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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.

**Bills in sets (Secs. 132 and 133):** The foreign bills are generally drawn in sets of three, and each sets is termed as a 'via'.

As soon as anyone of the set is paid, the others becomes inoperative. These bills are drawn in different parts. They are drawn in order to avoid their loss or miscarriage during transit. Each part is despatched separately. To avoid delay, all the parts are sent on the same day; by different mode of conveyance.

**Rules:** Sections 132 and 133 provide for the following rules:

A bill of exchange may be drawn in parts, each part being numbered and containing a provision that it shall continue payable only so long as the others remain unpaid. All parts make one bill and the entire bill is extinguished, i.e. when payment is made on one part- the other parts will become inoperative (Section 132).

The drawer should sign and deliver all the parts but the acceptance is to be conveyed only on one of the parts. In case a person accepts or endorses different parts of the bill in favour of different persons, he and the subsequent endorsers of each part are liable on such part as if it were a separate bill (Sec. 132).

As between holders in due course of the different parts of the same bill, he who first acquired title to anyone part is

entitled to the other parts and is also entitled to claim the money represented by bill (Sec. 133).

### **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”.

It is to be noted that an recommendation bill may be for accommodation of both the drawer arid acceptor. In such a case, they share the proceeds of the discounted bill.

Rules regarding accommodation bills are:

In case the party accommodated continues to hold the bill till maturity, the accommodating party shall not be liable to him for payment of, the bill since the contract between them is not based on any consideration (Section 43).

But the accommodating party shall be liable to any subsequent holder for value who may be knowing the exact position that the bill is an accommodation bill and that the full consideration has not been received by the acceptor. The accommodating party can, in turn, claim compensation from the accommodated party for the amount it has been asked to pay the holder for value.

An accommodation bill may be negotiated after maturity. The holder or such a bill after maturity is in the same position as a holder before maturity, provided he takes it in good faith and for value (Sec. 59)

In form and all other respects an accommodation bill is quite similar to an ordinary bill of exchange. There is nothing on the face of the accommodation bill to distinguish it from an ordinary trade bill.

### **1.5.3 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, it is always drawn on a specified banker, and (ii) it is always payable on demand. Consequently, all cheques are bill of exchange, but all bills are not cheques. A cheque must satisfy all the requirements of a bill of exchange; that is, it must be signed by the drawer, and must contain an

unconditional order on a specified banker to pay a certain sum of money to or to the order of a certain person or to the bearer of the cheque. It does not require acceptance.

### **Distinction Between Bills of Exchange and Cheque**

A bill of exchange is usually drawn on some person or firm, while a cheque is 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 cheque can only be drawn payable on demand, a bill may be also drawn payable on demand, or on the expiry of a certain period after date or sight.

A grace of three days is allowed in the case of time bills while no grace is given in the case of a cheque.

The drawer of the bill is discharged from his liability, if it is not presented for payment, but the 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, but no such notice is necessary in the case of cheque.

A cheque may be crossed, but not needed in the case of bill.

A bill of exchange must be properly stamped, while a cheque does not require any stamp.

A cheque drawn to bearer payable on demand shall be valid but a bill payable on demand can never be drawn to bearer.

Unlike cheques, the payment of a bill cannot be countermanded by the drawer.

### **1.5.4 Hundis**

A “Hundi” is a negotiable instrument written in an oriental language. The term hundi includes all indigenous negotiable instrument whether they be in the form of notes or bills.

The word ‘hundi’ is said to be derived from the Sanskrit word ‘hundi’, which means “to collect”. They are quite popular among the Indian merchants from very old days. They are used to finance trade and commerce and provide a fascile and sound medium of currency and credit.

Hundis are governed by the custom and usage of the locality in which they are intended to be used and not by the provision of the Negotiable Instruments Act. In case there is no customary rule known as to a certain point, the court may apply the provisions of the Negotiable Instruments Act. It is also open to the parties to expressly exclude the applicability of any custom relating to hundis by agreement (Indur Chandra vs. Lachhmi Bibi, 7 B.I.R. 682).

#### **Reference :-**

1. Indian Negotiable Instruments Act, 1881 by Dr. S.S Kundu
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