Shri Jai Narayan P.G.College, Lucknow

B.Com Semester II

Paper II- Business Laws

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Unit IV (Important Questions with Answers)

Negotiable Instruments

Q1) Define the term Negotiable Instruments? What are its essential characteristics?

As per Sec 13 of Negotiable Instruments Act, 1881, "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."

The word *negotiable* means transferable by delivery and the word *instrument* means a written document by which a right is created in favour of some person. Negotiable Instrument is generally a signed document that is freely transferable in nature and once it is transferred, a transferee or the holder of an instrument will get legal right to use it in whatsoever manner as he deems appropriate.

- Negotiable Instruments are a written order which guarantees the payment of money on a predetermined date or on demand of the party name on it or to any other person in order or the bearer of an instrument.
- It has characteristics of a valid contract like consideration should be transferred from one party to another.
- Negotiable Instruments is nothing but an **evidence of indebtedness**, as the holder of the instrument has an unconditional right to recover the amount of money stated in the instrument from its maker. These Instruments are used as a substitute of money to safely transfer the payments between the merchants and have a risk free business transactions.
- There are so many types of negotiable instruments that are primarily in use such as Promissory Notes, Cheques, Bills of Exchanges, Currencies, etc.

Characteristics/Features of a Negotiable Instrument

1. Property: The prossessor 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.

2. 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.

3. 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.

4. 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.

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

Q2) What are the two conditions of Negotiability? Can share certificates, money orders, dock warrants etc. be classified as Negotiable Instruments?

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**:

1. the instrument should be **freely transferable** (by delivery or by endorsement. and delivery) by the custom of the trade; and
2. 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.

Q3) What are the presumptions as to Negotiable Instruments?

The following presumptions shall be made in case of all negotiable instruments:

1. 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.

2. 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.

3. 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.

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

5. 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.

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

7. 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.

8. 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.

Q4) What are the different types of Negotiable Instruments?

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 instruments 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 accordance with the character of negotiability to other instruments.

Q5) Define a Promissory Note. What are its essential features?

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."

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.

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

1. 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.
2. 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:

- (a) "Mr. B, I.O.U. (I owe you) Rs. 500"
- (b) "I am liable to pay you Rs. 500".
- (c) "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:

- (a) "I promise to pay B or order Rs. 500"
- (b) "I acknowledge myself to be indebted to B in Rs. 1000 to be paid on demand, for the value received".

3. 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.

4. 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 pronote 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.

5. 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

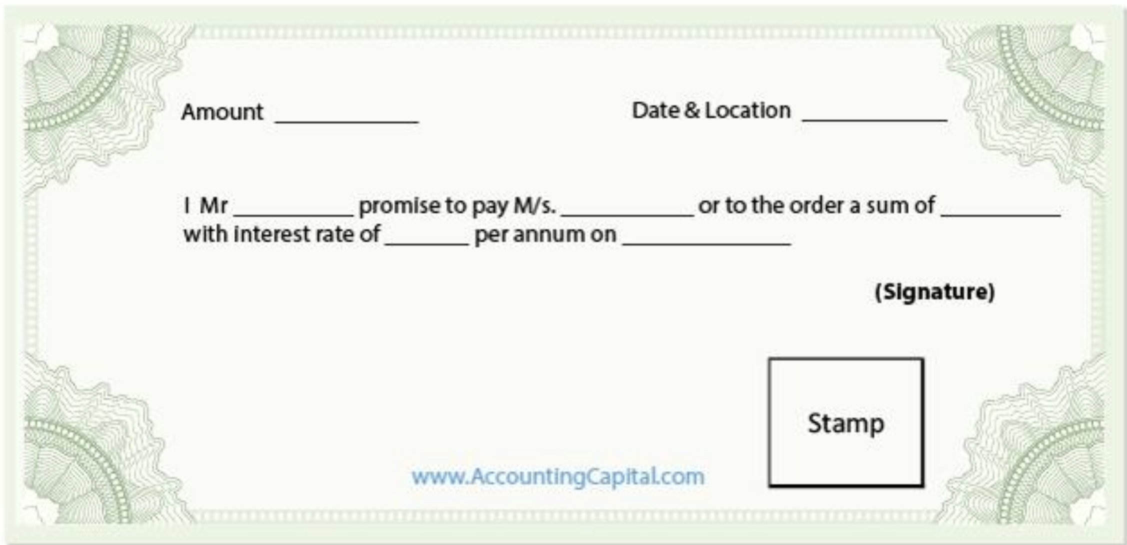
assumed name, he is liable as a maker because a maker is taken as certain if from his description sufficient indication follows about his identity. In case two or more persons promise to pay, they may bind themselves jointly or jointly and severally, but their liability cannot be in the alternative.

6. 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.

7. 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.

8. 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.

Sample Format of Promissory Note


Amount ___________ Date & Location ___________

I Mr _________ promise to pay M/s. __________ or to the order a sum of _________ with interest rate of ______ per annum on _____________

(Signature)

Stamp

www.AccountingCapital.com

Q6) Who are the parties to a Promissory Note?

Parties to a Promissory Note

1. Maker. He is the person who promises to pay the amount stated in the note. He is the debtor.
2. Payee. He is the person to whom the amount is payable i.e. the creditor.
3. Holder. He is the payee or the person to whom the note might have been indorsed.
4. The indorser and indorsee (the same as in the case of a bill).

Q7) What is a Bill of Exchange? What are its essential elements?

"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

(1) It must be in writing.
(2) It must be signed by the drawer.
(3) The drawer, drawee and payee must be certain.
(4) The sum payable must also be certain.
(5) It should be properly stamped.
(6) 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**:

(a) "I shall be highly obliged if you make it convenient to pay Rs. 1000 to Suresh".

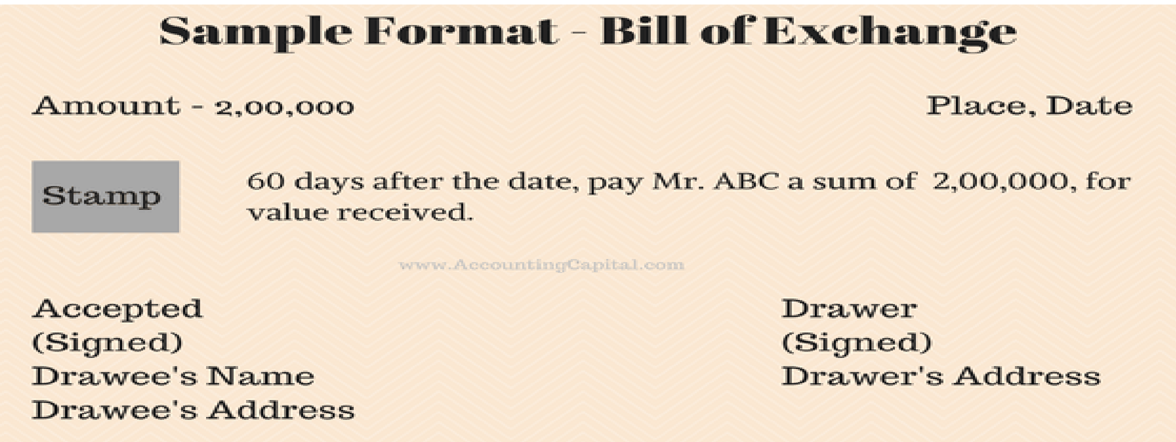
(b) "Mr. Ramesh, please let the bearer have one thousand rupees, and place it to my account and oblige"

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.**


Sample Format - Bill of Exchange

Amount - 2,00,000

Place, Date

Stamp

60 days after the date, pay Mr. ABC a sum of 2,00,000, for value received.

Accepted
(Signed)
Drawee's Name
Drawee's Address

Drawer
(Signed)
Drawer's Address

Q8) Who are the parties to a Bill of Exchange?

Parties to Bill of Exchange:

1. **Drawer**: The maker of a bill of exchange is called the 'drawer'.

2. **Drawee**: The person directed to pay the money by the drawer is called the 'drawee',

3. **Acceptor**: After a drawee of a bill has signed his assent upon the bill, or if there are more parts than one, upon one of such pares and delivered the same, or given notice of such signing to the holder or to some person on his behalf, he is called the ' acceptor'.

4. **Payee**: The person named in the instrument, to whom or to whose order the money is directed to be paid by the instrument is called the 'payee'. He is the real beneficiary under the instrument. Where he signs his name and makes the instrument payable to some other person, that other person does not become the payee.

5. **Indorser**: When the holder transfers or indorses the instrument to anyone else, the holder becomes the 'indorser'.

6. **Indorsee**: The person to whom the bill is indorsed is called an 'indorsee'.

7. **Holder**: A person who is legally entitled to the possession of the negotiable instrument in his own name and to receive the amount thereof, is called a 'holder'. He is either the original payee, or the indorsee. In case the bill is payable to the bearer, the person in possession of the negotiable instrument is called the 'holder'.

8. **Drawee in case of need**: When in the bill or in any endorsement, the name of any person is given, in addition to the drawee, to be resorted to in case of need, such a person is called 'drawee in case of need'.
   In such a case it is obligatory on the part of the holder to present the bill to such a drawee in case the original drawee refuses to accept the bill. The bill is taken to be dishonoured by non-acceptance or for nonpayment, only when such a drawee refuses to accept or pay the bill.

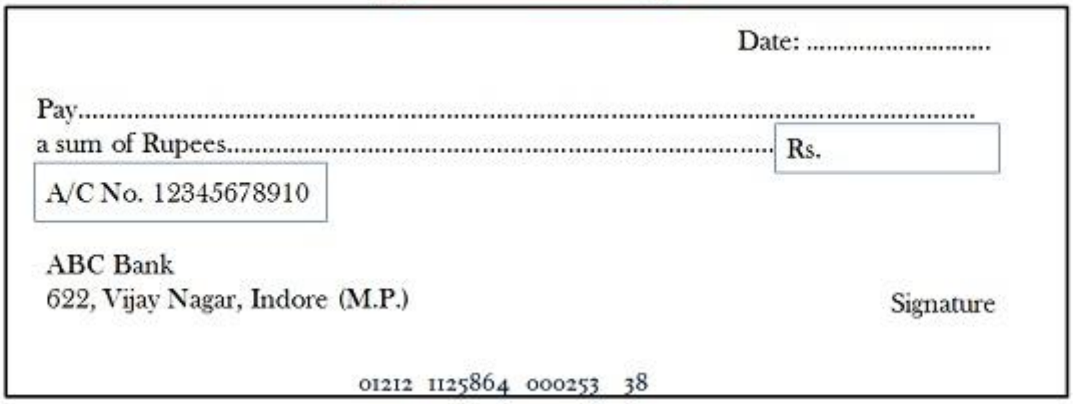
9. **Acceptor for honour**: In case the original drawee refuses to accept the bill or to furnish better security when demanded by the notary, any person who is not liable on the bill, may accept it with the consent of the holder, for the honour of any party liable on the bill. Such an acceptor is called 'acceptor for honour'.

Q9) What is a Cheque? What are its essential features?

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 a 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. 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.

Specimen of Cheque



Date: ....

Pay..

a sum of Rupees.. Rs.

A/C No. 12345678910

ABC Bank

622, Vijay Nagar, Indore (M.P.)

Signature

01212 1125864 000253 38

There are three parties involved in case of cheque:

- **Drawer:** The maker or issuer of the cheque.
- **Drawee:** The bank, which makes payment of the cheque.
- **Payee:** The person who gets the payment of the cheque or whose name is mentioned on the cheque.

Electronic Cheque: A cheque in electronic form is known as an electronic cheque.
Truncated Cheque: A cheque in paper form is known as truncated cheque.
Following are the essentials of a Cheque

1. It must be in writing.

2. It must be drawn on a banker.

3. It must be in the form of an order.

4. The order must be unconditional.

5. It must be signed by the drawer.

6. It must be payable on demand.

7. The amount in the cheque must be a certain sum of money.

8. The payment must be made to a person, bearer, or self.

Q10) Distinguish between a Bill of Exchange and Promissory Note.

Basis of Comparison	Bills of Exchange	Promissory Notes
1. Meaning	Bills of exchange are negotiable instruments which demand money from debtors within a stipulated period of time.	Promissory notes are also negotiable instruments which promise to pay a certain amount within a particular period of time.
2. What it’s all about?	Ordering to pay the money that is due.	Promising to pay the money that is due.
3. Issued by	Creditors.	Debtors.
4. Acceptance	Bills of exchange need to be accepted by the debtors to be called as valid.	There’s no such norm.
5. Parties involved	There are three parties involved – drawer, drawee, and payee.	Here, two parties are involved – drawer and payee.
6. Application of copies	Bills of exchange can be drawn in copies.	Promissory notes can’t be drawn in copies.
7. In case of dishonour	When the bill is dishonoured, a notice is given to all parties that are involved.	When a promissory note is dishonoured, notice is not issued to the maker (debtor).

Q11) Distinguish between Bill of Exchange and Cheque.

BASIS FOR COMPARISON	CHEQUE	BILL OF EXCHANGE
Meaning	A document used to make easy payments on demand and can be transferred through hand delivery is known as cheque.	A written document that shows the indebtedness of the debtor towards the creditor.
Defined in	Section 6 of The Negotiable Instrument Act, 1881	Section 5 of The Negotiable Instrument Act, 1881
Validity Period	3 months	Not Applicable
Payable to bearer on demand	Always	Cannot be made payable on demand as per RBI Act, 1934
Grace Days	Not Applicable, as it is always payable at the time of presentment.	3 days of grace are allowed.
Acceptance	A cheque does not require acceptance.	Bill of exchange needs to be accepted.
Stamping	No such requirement.	Must be stamped.

BASIS FOR COMPARISON	CHEQUE	BILL OF EXCHANGE
Crossing	Yes	No
Drawee	Bank	Person or Bank
Noting or Protesting	If the cheque is dishonoured it cannot be noted or protested	If a bill of exchange is dishonoured it can be noted or protested.

*When a promissory **note** or bill of exchange has been dishonoured by non- acceptance or non-payment, the holder may, within a reasonable time, cause such dishonour to be **noted** and certified by a notary public. Such certificate is called a **protest**. **Protest** for better security.

Readings:

1. M.C.Kuchhal and Vivek Kuchhal, **Mercantlile Law,** Eighth Edition, Chapters 25 and 26.
2. www.ddegjust.ac.in/studymaterial/mcom/mc-207-f.pdf
3. https://keydifferences.com/difference-between-cheque-and-bill-of-exchange.html
4. https://www.accountingcapital.com/differences/difference-between-bill-of-exchange-and-promissory-note/