Q. Define the term 'negotiable instrument' and explain its characteristics.

The term 'negotiable' means transferable and the word 'document' means 'in writing'. Therefore, negotiable means a written promise or order to pay money which may be transferred from one person to another.

Section 13 of the Negotiable Instruments Act, 1881 states – "A negotiable instrument means a promissory note, bill of exchange or cheque payable either to order or to bearer." A negotiable instrument may be made payable to two or more payees jointly, or it may be made payable in the alternative to one of two, or one or some of several payees. [Section 13(2)].

The characteristics of a Negotiable Instrument are:

1. **Witting and Signature according to the rules –** A Negotiable Instrument must be in writing and signed by the parties according to the rules relating to (a) promissory notes, (b) Bills of Exchange and (c) Cheques.
2. **Payable by Money –** Negotiable Instruments are payable by the legal tender money of India. The Liabilities of the parties are governed in terms of such money only.
3. **Unconditional Promise –** If the instrument is a promissory note, it must contain an unconditional promise to pay. If the instrument is a bill or cheque, it must be an unconditional order to pay money.
4. **Freely transferable –** A negotiable instrument is transferable from one person to another by delivery or by endorsement and delivery.
5. **Acquisition of Property** – Any person who possesses a negotiable instruments, becomes its owner and entitled to the sum of money, mentioned on the face of the instrument. When it is payable to bearer, the property in its passes from one holder to another by mere delivery. If it is payable to order, the property passes by endorsement, i.e. by the signature of its holder on its back and its delivery.
6. **Acquisition of Good Title** – The holder in due course, i.e. the transferee of a negotiable instrument in good faith and for value, acquires a good title to the instrument even if the title of the transferor is defective. Further his title will not be affected, by any defect in the title of the transferor.
7. **No Need of Giving Notice –** There is no need of giving a notice of transfer of a negotiable instrument to the party liable to pay the money.
8. **Right of the Holder in Due Course –** The holder in the due course remains unaffected by certain defences, which might be available against previous holders, as for example , fraud, to which he is not a party.
9. **Certain Presumptions** – Unless contrary proved certain presumptions are in the made case of all negotiable instruments. Consideration, date, signature of holder in due course, for example, is presumed in the case of all instruments. The presumptions from Special rules of Evidence under section 118 to 119.

Q. SHORT NOTES

A] PROMISSORY NOTE

"A 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 only to, or to the order of, a certain person, or to the bearer of the instrument.." **[Section 4]**

Illustrations

A signs instruments in the following terms:

(a) "I promise to Pay B or order Rs.500".

(b) "I acknowledge myself to be indebted to B in Rs.1,000, to be paid on demand, for value received."

(c) "Mr B I.O.U Rs.1,000."

(d) I promise to pay B Rs. 500 seven days after my marriage with C.

(e) I promise to pay B Rs.500/- on 01-10-2005.

(f) "I promise to pay B Rs. 500 and all other sums which shall be due to him."

(g) "I promise to pay B Rs. 500 first deducting thereout any money which he may owe me."

The instruments respectively marked (a), (b) and (e) are promissory notes. The instruments respectively marked (c), (d), (f) and (g) are not promissory notes.

The essentials of a valid Promissory note are :-

1. **Writing –** A Promissory note must be in writing.
2. **Express promise to Pay –** The promissory note must contain an express promise to pay. A mere implied promise to pay or an acknowledgement of debt is not a promissory note. Therefore illustrations at (c) is not a Promissory note.
3. **Promise to pay unconditional** – The promise to pay an amount must be unconditional. However, a Promissory note conditional on an event bound to happen is a valid promissory note. Therefore illustrations at (d) is not a valid Promissory note while (e) is a valid Promissory note.
4. **Promise to pay in terms of money** – The instrument must be payable in terms of money and money only.
5. **Sum payable to be certain –** The amount payable must be certain. Therefore instrument at (f) and (g) are not valid promissory note.
6. **Parties certain –** The parties to the instrument must be certain. The person making the payment and the person receiving the payment must be identifiable.
7. **Must be signed –** The instrument is complete only when it is signed by the maker.
8. **Must bear the stamp –** A promissory note must be properly stamped in accordance with the Indian Stamp Act, 1899 and must also be properly cancelled.
9. **Other formalities –** Formalities such as date, place, consideration, etc. are usally found in a promissory note.
10. **Requisites of a contract to be complied with** – All requisites of a valid contract like capacity to contract, consideration, free consent, lawful object must be present.

Specimen of a Promissory note

Rs.1,000	Mumbai, July 2, 2005
Three months after date I promise to pay Shyam Sunder or order the sum of one thousand rupees, for value received.	
To, Shyam Sunder 222, D.N.Nagar, Andheri(W), Mumbai – 400 053.	Stamp sd/-

B] BILL OF EXCHANGE

As per **Section 5** 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."

The **essentials of a Bill of Exchange** are :-

1. **Number of parties** - A bill of exchange has 3 parties –
   a) the drawer, who draws the bill of exchange
   b) the drawee, who has to make the payment
   c) the payee, who is entitled to the payment.
   Sometimes the drawer and the payee can be one and the same person.
2. **Must be writing** – The Bill of Exchange must be in writing.
3. **Express order to pay** – This is the essence of a bill of exchange. There must be an 'order by the drawer to the drawee to pay'. The order must be a command and not an excessive request.
4. **Order must be unconditional** – The order to pay must be unconditional. In other words the happening of the condition must be certain.
5. **Order to pay money only** – Just as a promissory note, the instrument must be for money only.
6. **Sum payable to be certain –** The amount payable must be certain. There should be no ambiguity in the amount to be paid through the Bill of Exchange.
7. **Must be signed –** The instrument is complete only when it is signed by the drawer and the drawee.
8. **Must bear the stamp –** A Bill of Exchange must be properly stamped in accordance with the Indian Stamp Act, 1899 and must also be properly cancelled.
9. **Other formalities –** Formalities such as date, place, consideration, etc. are usally found in a Bill of Exchange.

10. **Requisites of a contract to be complied with** – All requisites of a valid contract like capacity to contract, consideration, free consent, lawful object must be present.

Specimen of a Bill of Exchange

Rs.5,000 Mumbai, July 20, 2005

Three months after date I promise to pay Ramkumar Tripathi or order the sum of five thousand rupees, for value received.

To, Ramkumar Tripathi 20, D.N.Nagar, Andheri(W), Mumbai – 400 053.	Accepted Ram Kumar Tripathi Sd/-	Stamp sd/-

C] HUNDI

A local instrument – Hundi is an indigenous instrument similar to Negotiable Instrument. The term is derived from Sanskrit word 'hund' which means 'to collect'. If it is drawn in local language, it is governed by local usage and customs.

D] CHEQUE

A Cheque is a special type of Bill of Exchange. It is drawn on banker and is required to be made payable on demand.

Provisions

A "cheque" is defines as "a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand." **[Section 6]** 'Cheque' includes electronic image of a truncated cheque and a cheque in electronic form. The definition is amended by Amendment Act, 2002, making provision for electronic submission and clearance of cheque. The cheque is one form of Bill of Exchange. It is addressed to Banker. It cannot be made payable after some days. It must be made payable 'on demand'.

The **essentials of a Cheque** are :-

1. **Essentials of Bill of Exchange** – As a cheque is a bill of exchange, it must contain the essentials of a bill of exchange. In addition there are few more essentials as below.
2. **Drawn on a specified banker –** The drawee in case of a cheque is always a specified banker.
3. **Payable on demand –** The cheque is always payable on demand.
4. **No Stamp –** A Cheque does not require a stamp.
5. **Acceptance –** No acceptance is necessary by the draw before the demand for payment.
6. **Payable to bearer** – A cheque can be made payable to bearer.

Specimen of a Cheque

………., 20…
Pay ………………………………………………………………………
……………………………………………………………… OR BEARER
Rupees………………………………………………………… Rs.
A/C No……….. L.F…………
ICICI Bank Ltd. Andheri (W) Mumbai – 400 058.

E] Payment in due course

As per **Section 10** "Payment in due course" means payment in accordance with the apparent tenor of the instrument in good faith and without negligence to any person in possession thereof under circumstances which do not afford a reasonable ground for believing that he is not entitled to receive payment of the amount therein mentioned.

Payment in due course, which results in discharge of a negotiable instrument, must satisfy the following conditions:

1. The payment must be in accordance with the apparent tenor of instrument.
2. The payment must be made by or on behalf of the drawee or acceptor.
3. The person to whom the payment is made should be in possession of the instrument and should also be entitled to receive the payment on it.
4. The payment should be made in good faith, without negligence and under bonafide circumstances.
5. There should not exist any ground for believing that the possessor is not entitled to receive payment.

Q. Distinguish between 'Promissory Note' and 'Bill of Exchange'.

	Promissory Note	**Bill of Exchange**
Parties	There are 2 parties – maker or promisor and payee or promisee	There are 3 parties – drawee, drawer and payee
Nature of payment	It contains an unconditional promise to pay	It contains an unconditional order to pay
Acceptance	It is payable by a person, who is making it. Therefore, no acceptance is necessary	It is payable by the other person directed. Therefore, it should be presented to the drawee for acceptance. It may be accepted conditionally.
Liability	The maker of the Promissory note is	The maker of the bill of exchange is

	primarily and absolutely liable to payee. Promisor stands in the immediate relation to the payee.	secondarily and conditionally liable to payee. He becomes liable to pay only when the drawee refuses to honour the bill. Drawer stands in immediate relation to the drawee or acceptor and not the payee.
Notice	In case the note is dishonoured, no notice of dishonour is necessary to maker.	Notice to dishonour must be given to all the parties liable on the bill.
Maker as payee	A promissory note cannot be made payable to the maker.	The maker or drawer and the payee may be one and the same person.

Q. Distinguish between 'Bill of Exchange' and 'Cheque'.

	Cheque	**Bill of Exchange**
Drawee	Only a banker can be a drawee.	Anyone can be drawee, including a banker.
Acceptance	A cheque requires no acceptance.	It must be presented for acceptance. Drawee is liable only after his acceptance.
Payment	Payable on demand without any days of grace.	A bill is normally entitled to three days of grace after maturity, unless payable on demand.
Presentment	If not presented to the banker for payment, it does not discharge the drawer unless he suffers injury or damages.	Drawer is discharged, if bill is not presented for payment to the acceptor.
Notice	In case of dishonour no notice of dishonour is necessary	Notice of dishonour is to be given to all the parties liable to pay.
Crossing	A cheque may be crossed.	Bill can never be crossed.
Stamp	Cheque requires no stamp.	Bill has to be properly stamped.
Countermanding payment	Payment of cheque may be countermanded by the drawer.	Payment of bill of exchange cannot be countermanded by the drawer.
Noting and protesting	A cheque is not required to be noted or protested for dishonour.	A bill of exchange may be noted or protested for dishonour.
Payable to bearer on demand	A cheque can be dawn payable to the bearer on demand.	A bill of exchange cannot be drawn payable to bearer on demand.

Q. When a banker is justified in dishonouring the cheque

The banker is justified in dishonouring the customer's cheques in the following cases :-

1. The signature of the drawer on the cheque does not match with the speciment signature in the records of the Bank.
2. Funds are not properly applicable to the payment of cheque. For eg. Funds are subject to lien, or banker is entitled to set-off.
3. Customer becomes insolvent.
4. Death, lunacy or insolvency of the customer and the banker has notice of the same.
5. Cheque presented beyond a period of 6 months from the date of issue.
6. If the banker is not holding sufficient funds of the drawer, unless the banker has agreed to honour the cheque without sufficient funds.
7. If the customer countermands payment and communicates the same to the bank properly.
8. Holder gives notice to the banker of loss of cheque.
9. If the cheque is not presented within the usual banking hours.
10. Where the cheque is drawn on another branch office of the same bank where the customer does not have an account.
11. Where a garnishee order has been issued by the Court attaching customer's balance.

Q. Explain the various modes of discharge of a party under a negotiable instrument.

Discharge of an Instrument and Parties

The term discharge means release. The term discharge is used in two terms viz (i) Discharge of a negotiable instrument; (ii) discharge of one or more or all the Parties from liabilities thereof.

(i) Discharge of a negotiable instrument :- A Negotiable Instrument is said to be discharge when all rights of action under it come to an end as a result of which, it ceases to be negotiable.

(ii) Discharge of one or more or all the Parties from liabilities:- A Party may be discharged from liability; however, the instrument thereby is not discharged; it may still continue to exist and be negotiable and the other parties continue to be liable for it.

Modes of Discharge of an Instrument

Discharge from liability (Section 82)

The maker, acceptor or endorser respectively of a negotiable instrument is discharged from liability thereon-

(a) By cancellation-to a holder thereof who cancels such acceptor's or endorser's name with intent to discharge him, and to all parties claiming under such holder,

(b) By release- to a holder thereof who otherwise discharges such maker, acceptor or endorser, and to all parties deriving title under such holder after notice of such discharge;

(c) By payment-to all parties thereto, if the instrument is payable to bearer, or has been endorsed in blank, and such maker, acceptor or endorser makes payment in due course of the amount due thereon.

Discharge by allowing drawee more than forty-eight hours to accept (Section 83)

If the holder of a bill of exchange allows the drawee more than forty eight hours, exclusive of public holidays, to consider whether he will accept the same, all previous parties not consenting to such allowance are thereby discharged from liability to such holder.

When cheque not duly presented and drawer damaged thereby (Section 84)

(1) Where a cheque is not presented for payment within a reasonable time of its issue, and the drawer or person on whose account it is drawn had the right, at the time when presentment ought to have been made, as between himself and the banker, to have the cheque paid and suffers actual damage through the delay, he is discharged to the extent of such damage, that is to say, to the extent to which such drawer or person is a creditor of the banker to a large amount than he would have been if such cheque had been paid.

(2) In determining what is a reasonable time, regard shall be had to the nature of the instrument, the usage of trade and of bankers, and the facts of the particular case.

(3) The holder of the cheques as to which such drawer or person is so discharged shall be a creditor, in lieu of such drawer or person, of such banker to the extent of such discharge and entitled to recover the amount from him.

Illustrations

(a) A draws a cheque for Rs. 1,000, and, when the cheque ought to be presented, has funds at the bank to meet it. The bank fails before the cheque is presented. The drawer is discharged, but the holder can prove against the bank for the amount of the cheque.

(b) A draws a cheque at Umballa on a bank in Calcutta. The bank fails before the cheque could be presented in ordinary course. A is not discharged, for he has not suffered actual damage through any delay in presenting the cheque.

Cheque payable to order (Section 85)

(1) Where a cheque payable to order purports to be endorsed by or on behalf of the payee, the drawee is discharged by payment in due course.

(2) Where a cheque is originally expressed to be payable to bearer, the drawee is discharged by payment in due course to the bearer thereof, notwithstanding any endorsement whether in full or in blank appearing thereon, and notwithstanding that any such endorsement purports to restrict or exclude further negotiation.

Section 85A- Drafts drawn by one branch of a bank on another payable to order Where any draft, that is an order to pay money, drawn by one office of a bank upon another office of the same bank for a sum of money payable to order on demand, purports to be endorsed by or on behalf of the payee, the bank is discharged by payment in due course.]

Parties not consenting discharged by qualified or limited acceptance (Section 86)

If the holder of a bill of exchange acquiesces in a qualified acceptance, or one limited to part of the sum mentioned in the bill, or which substitutes a different place or time for payment, or which, where the drawees are not partners, is not signed by all the drawees, all previous parties whose consent is not obtained to such acceptance are discharged as against the holder and those claiming under him, unless on notice given by the holder they assent to such acceptance.

Explanation: An acceptance is qualified,-

(a) Where it is conditional, declaring the payment to be dependent on the happening of an event therein stated;

(b) Where it undertakes the payment of part only of the sum ordered to be paid;

(c) Where, no place of payment being specified on the order it undertakes the payment at a specified place, and not otherwise or elsewhere; or where, a place of payment being specified in the order, it undertakes the payment at some other place and not otherwise or elsewhere;

(d) Where it undertakes the payment at a time other than that at which under the order it would be legally due.

Affect of material alteration (Section 87)

Any material alteration of a negotiable instrument renders the same void as against anyone who is a party thereto at the time of making such alteration and does not consent thereto, unless it was made in order to carry out the common intention of the original parties;

Alteration by endorsee:

Any such alteration, if made by an endorsee, discharges his endorser from all liability to him in respect of the consideration thereof.

The provisions of this section are subject to those of sections 20, 49, 86 and 125.

Acceptor or endorser bound notwithstanding previous alteration (Section 88)

An acceptor or endorser of a negotiable instrument is bound by this acceptance or indorsement notwithstanding any previous alteration of the instrument.

Payment of instrument on which alteration is not apparent (Section 89)

Where a promissory note, bill of exchange or cheque has been materially altered but does not appear to have been so altered, or where a cheque is presented for payment which does not at the time of presentation appear to be crossed or to have had a crossing which has been obliterated, payment thereof by a person or banker liable to pay, and paying the same according to the apparent tenor thereof at the time of payment and otherwise in due course, shall discharge such a person or banker from all liability thereon, and such payment shall not be questioned by reason of the instrument having been altered, or the cheque crossed.

Extinguishment of rights of action on bill in acceptor's hands (Section 90)

If a bill of exchange which has been negotiated is, at or after maturity, held by the acceptor in his own right, all rights of action thereon are extinguished.

Liability of parties

Basic liability of payment is as follows – (a) Maker in case of Promissory Note or Cheque and (b) Drawer of Bill till it is accepted by drawee and acceptor after the Bill is accepted . They are liable as ‘principal debtors’ and other parties to instrument are liable as sureties for maker, drawer or acceptor, as the case may be. When document is endorsed number of times, each prior party is liable to each subsequent party as principal debtor. In case of dishonour, notice is required to be given to drawer and all earlier endorsees.