

# **NEGOTIABLE INSTRUMENTS ACT, 1881**

## **STRUCTURE**

1.0 Objectives

1.1 Introduction

1.2 Meaning of Negotiable Instruments

1.3 Characteristics of a negotiable instrument

1.4 Presumptions as to negotiable instrument

1.5 Types of negotiable Instrument

1.5.1 Promissory notes

1.5.2 Bill of exchange

1.5.3 Cheques

1.5.4 Hundis

1.6 Parties to negotiable instruments

1.6.1 Parties to Bill of Exchange

1.6.2 Parties to a Promissory Note

1.6.3 Parties to a Cheque

1.7 Negotiation

1.7.1 Modes of negotiation

1.8 Assignment

1.8.1 Negotiation and Assignment Distinguished

1.8.2 Importance of delivery in negotiation

1.9 Endorsement

1.10 Instruments without Consideration

1.11 Holder in Due Course

1.12 Dishonour of a Negotiable instrument

1.13 Noting and protesting

1.14 Summary

1.15 Keywords

1.16 Self Assessment Questions

1.17 References/Suggested readings

## **1.0 OBJECTIVES**

After reading this lesson, you should be able to-

- Understand meaning, essential characteristics and types of negotiable instruments;
- Describe the meaning and marketing of cheques, crossing of cheques and cancellation of crossing of a cheque;
- Explain capacity and liability parties to a negotiable instruments; and
- Understand various provisions of negotiable instrument Act, 1881 regarding negotiation, assignment, endorsement, acceptance, etc. 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 or 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:

1. A promissory note cannot be made payable to the bearer, no matter whether it is payable on demand or after a certain time.
2. 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.
3. 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:

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.

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

A negotiable instrument has the following characteristics:

1. Property: The possessor of the negotiable instrument is presumed to be the owner of the property contained therein. A negotiable instrument does not merely give possession of the instrument but right to property also. The property in a negotiable instrument can be transferred without any formality. In the case of 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 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:

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 proved. 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.

### **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:

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 contain 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 prorate 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.

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

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

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

(c) 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.

(9) 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

- (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.

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

**1. 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,

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

**3. 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.

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

**5. 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.

**6. 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.

**7. 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.

**8. 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:

- (1) Inland and foreign bills.
- (2) Time and demand bills.
- (3) Trade and accommodation bills.
- (1) Inland and Foreign Bills

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

- (a) it is drawn in India on a person residing in India, whether payable in or outside India, or
- (b) it is drawn in India on a person residing outside India but payable in India.

The following are the Inland bills

- (i) 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.
- (ii) A bill is drawn by a Delhi merchant on a person in London, but is made payable in India. This is an inland bill.
- (iii) 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:

1. A bill drawn outside India and made payable in India.
2. A bill drawn outside India on any person residing outside India.
3. A bill drawn in India on a person residing outside India and made payable outside India.
4. A bill drawn outside India on a person residing in India.
5. 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:**

(i) 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).

(ii) 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).

(iii) 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).

**(2) 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.

**(3) 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 and acceptor. In such a case, they share the proceeds of the discounted bill.

**Rules regarding accommodation bills are:**

(i) 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).

(ii) 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.

(iii) 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, (i) it is always drawn on a specified banker, and (ii) it is always payable on demand. Consequently, all cheques are bills 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**

1. A bill of exchange is usually drawn on some person or firm, while a cheque is always drawn on a bank.
2. 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.
3. 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.
4. A grace of three days is allowed in the case of time bills while no grace is given in the case of a cheque.
5. 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.

6. Notice of dishonour of a bill is necessary, but no such notice is necessary in the case of cheque.

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

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

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

10. 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 facile 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).

## **1.6 PARTIES TO NEGOTIABLE INSTRUMENTS**

### **1.6.1 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 parts 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'.

### **1.6.2 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).

### **1.6.3 Parties to a Cheque**

1. Drawer. He is the person who draws the cheque, i.e., the depositor of money in the bank.

2. Drawee. It is the drawer's banker on whom the cheque has been drawn.

3. Payee. He is the person who is entitled to receive the

payment of the cheque.

4. The holder, indorser and indorsee (the same as in the case of a bill or note).

### **1.7 NEGOTIATION**

Negotiation may be defined as the process by which a third party is constituted the holder of the instrument so as to entitle him to the possession of the same and to receive the amount due thereon in his own name. According to section 14 of the Act, 'when a promissory note, bill of exchange or cheque is transferred to any person so as to constitute that person the holder thereof, the instrument is said to be negotiated.' The main purpose and essence of negotiation is to make the transferee of a promissory note, a bill of exchange or a cheque the holder thereof.

Negotiation thus requires two conditions to be fulfilled, namely:

1. There must be a transfer of the instrument to another person; and
2. The transfer must be made in such a manner as to constitute the transferee the holder of the instrument.

Handing over a negotiable instrument to a servant for safe custody is not negotiation; there must be a transfer with an intention to pass title.

#### **1.7.1 Modes of negotiation**

Negotiation may be effected in the following two ways:

1. Negotiation by delivery (Sec. 47): Where a promissory note or a bill of exchange or a cheque is payable to a bearer, it may be negotiated by delivery thereof.

Example: A, the holder of a negotiable instrument payable to bearer, delivers it to B's agent to keep it for B. The instrument has been negotiated.

2. Negotiation by endorsement and delivery (Sec. 48): A promissory note, a cheque or a bill of exchange payable to order can be negotiated only by endorsement and delivery. Unless the holder signs his endorsement on the instrument and delivers it, the transferee does not become a holder. If there are more payees than one, all must endorse it.

### **1.8 ASSIGNMENT**

Bills, notes and cheques represent debts and as such have been held to be assignable without endorsement. Transfer by assignment takes place when the holder of a negotiable instrument sells his right to another person without endorsing it. The assignee is entitled to get possession and can recover the amount due on the instrument from the parties thereto.

Of the two methods of transfer of negotiable instruments discussed, transfer by negotiation is recognised by the Negotiable Instrument Act.

#### **1.8.1 Negotiation and Assignment Distinguished**

The various points of distinction between negotiation and assignment are as below:

1. Negotiation requires delivery only to constitute a transfer, whereas assignment requires a written document signed by the transferor.
2. Consideration is always presumed in the case of transfer by negotiation. In the case of assignment consideration must be proved.
3. In case of negotiation, notice of transfer is not necessary, whereas in the case of assignment notice of the transfer

must be given by the assignee to the debtor.

4. The assignee takes the instrument subject to all the defects in the title of the transferor. If the title of the assignor was defective the title of the assignee is also defective. However, in case of negotiation the transferee takes the instrument free from all the defects in the title of the transferor. A holder in due course is not affected by any defect in the title of the transferor. He may therefore have a better title than the transferor.

5. In case of negotiation a transferee can sue the third party in his own name. But an assignee cannot do so.

23

### **1.8.2 Importance of delivery in negotiation**

Delivery is a voluntary transfer of possession from one person to another. Delivery is essential to complete any contract on a negotiable instrument whether it be contract of making endorsement or acceptance. The property in the instrument does not pass unless the delivery is fully completed. Section 46 of the Act provides that a negotiable instrument is not made or accepted or endorsed unless it is delivered to a proper person. For instance, if a person signs a promissory note and keeps it with himself, he cannot be said to have made a promissory note; only when it is delivered to the payee that the promissory note is made.

Delivery may be actual or constructive. Delivery is actual when it is accompanied by actual change of possession of the instrument.

Constructive delivery is effected without any change of actual possession.

### **1.9 ENDORSEMENT**

The word 'endorsement' in its literal sense means, writing on the back of an instrument. But under the Negotiable Instruments Act it

means, the writing of one's name on the back of the instrument or any paper attached to it with the intention of transferring the rights therein. Thus, endorsement is signing a negotiable instrument for the purpose of negotiation. The person who effects an endorsement is called an 'endorser', and the person to whom negotiable instrument is transferred by endorsement is called the 'endorsee'.

#### Essentials of a valid endorsement

The following are the essentials of a valid endorsement:

1. It must be on the instrument. The endorsement may be on the back or face of the instrument and if no space is left on the instrument, it may be made on a separate paper attached to it called allonge. It should usually be in ink.
2. It must be made by the maker or holder of the instrument. A stranger cannot endorse it.
3. It must be signed by the endorser. Full name is not essential. Initials may suffice. Thumb-impression should be attested. Signature may be made on any part of the instrument. A rubber stamp is not accepted but the designation of the holder can be done by a rubber stamp.
4. It may be made either by the endorser merely signing his name on the instrument (it is a blank endorsement) or by any words showing an intention to endorse or transfer the instrument to a specified person (it is an endorsement in full). No specific form of words is prescribed for an endorsement. But intention to transfer must be present.

When in a bill or note payable to order the endorsee's name is wrongly spelt, he should when he endorses it, sign the name as spelt in the instrument and write the correct

spelling within brackets after his endorsement.

5. It must be completed by delivery of the instrument. The delivery must be made by the endorser himself or by somebody on his behalf with the intention of passing property therein. Thus, where a person endorses an instrument to another and keeps it in his papers where it is found after his death and then delivered to the endorsee, the latter gets no right on the instrument.

6. It must be an endorsement of the entire bill. A partial endorsement i.e. which purports to transfer to the endorsee a part only of the amount payable does not operate as a valid endorsement.

If delivery is conditional, endorsement is not complete until the condition is fulfilled.

Who may endorse?

The payee of an instrument is the rightful person to make the first endorsement. Thereafter the instrument may be endorsed by any person who has become the holder of the instrument. The maker or the drawer cannot endorse the instrument but if any of them has become the holder thereof he may endorse the instrument. (Sec. 51).

The maker or drawer cannot endorse or negotiate an instrument unless he is in lawful possession of instrument or is the holder thereof. A payee or indorsee cannot endorse or negotiate unless he is the holder thereof.

Classes of endorsement

An endorsement may be:

(1) Blank or general.

(2) Special or full.



(3) Partial.

(4) Restrictive.

(5) Conditional.

(a) Blank or general endorsement (Sections 16 and 54).

It is an endorsement when the endorser merely signs on the instrument without mentioning the name of the person in whose favour the endorsement is made. Endorsement in blank specifies no endorsee. It simply consists of the signature of the endorser on the endorsement. A negotiable instrument even though payable to order becomes a bearer instrument if endorsed in blank. Then it is transferable by mere delivery.

An endorsement in blank may be followed by an endorsement in full.

Example: A bill is payable to X. X endorses the bill by simply affixing his signature. This is an endorsement in blank by X. In this case the bill becomes payable to bearer.

There is no difference between a bill or note indorsed in blank and one payable to bearer. They can both be negotiated by delivery.

(b) Special or full endorsement (Section 16)

When the endorsement contains not only the signature of the endorser but also the name of the person in whose favour the endorsement is made, then it is an endorsement in full. Thus, when endorsement is made by writing the words "Pay to A or A's order," followed by the signature of the endorser, it is an endorsement in full. In such an endorsement, it is only the endorsee who can transfer the instrument.

Conversion of endorsement in blank into endorsement in full:

When a person receives a negotiable instrument in blank, he may without signing his own name, convert the blank endorsement into an endorsement in full by writing above the endorser's signature a direction

to pay to or to the order of himself or some other person. In such a case the person is not liable as the endorser on the bill. In other words, the person transferring such an instrument does not incur all the liabilities of an endorser. (Section 49).

Example: A is the holder of a bill endorsed by B in blank. A writes over B's signature the words "Pay to C or order." A is not liable as endorser but the writing operates as an endorsement in full from B to C.

Where a bill is endorsed in blank, or is payable to bearer and is afterwards endorsed by another in full, the bill remains transferable by delivery with regard to all parties prior to such endorser in full. But such endorser in full cannot be sued by any one except the person in whose favour the endorsement in full is made. (Section 55).

Example: C the payee of a bill endorses it in blank and delivers it to D, who specially endorses it to E or order. E without endorsement transfers the bill to F. F as the bearer is entitled to receive payment or to sue the drawer, the acceptor, or C who endorsed the bill in blank but he cannot sue D or E.

#### (c) Partial endorsement (Section 56)

A partial endorsement is one which purports to transfer to the endorsee a part only of the amount payable on the instrument. Such an endorsement does not operate as a negotiation of the instrument.

Example: A is the holder of a bill for Rs.1000. He endorses it "pay to B or order Rs.500." This is a partial endorsement and invalid for the purpose of negotiation.

#### (d) Restrictive endorsement (Section 50)

The endorsement of an instrument may contain terms making it restrictive. Restrictive endorsement is one which either by express words restricts or prohibits the further negotiation of a bill or which expresses

that it is not a complete and unconditional transfer of the instrument but is a mere authority to the endorsee to deal with bill as directed by such endorsement.

“Pay C,” “Pay C for my use,” “Pay C for the account of B” are instances of restrictive endorsement. The endorsee under a restrictive endorsement acquires all the rights of the endorser except the right of negotiation.

### **Conditional or qualified endorsement**

It is open to the endorser to annex some condition to his own liability on the endorsement. An endorsement where the endorsee limits or negatives his liability by putting some condition in the instrument is called a conditional endorsement. A condition imposed by the endorser may be a condition precedent or a condition subsequent. An endorsement which says that the amount will become payable if the endorsee attains majority embodies a condition precedent. A conditional endorsement unlike the restrictive endorsement does not affect the negotiability of the instrument. It is also some times called qualified endorsement. An endorsement may be made conditional or qualified in any of the following forms:

(i) ‘Sans recourse’ endorsement: An endorser may by express word exclude his own liability thereon to the endorser or any subsequent holder in case of dishonour of the instrument.

Such an endorsement is called an endorsement sans recourse (without recourse). Thus ‘Pay to A or order sans recourse, ‘pay to A or order without recourse to me,’ are instances of this type of endorsement. Here if the instrument is dishonoured, the subsequent holder or the indorsee

cannot look to the indorser for payment of the same.

An agent signing a negotiable instrument may exclude his personal liability by using words to indicate that he is signing as agent only. The same rule applies to directors of a company signing instruments on behalf of a company. The intention to exclude personal liability must be clear.

Where an endorser so excludes his liability and afterwards becomes the holder of the instrument, all intermediate endorsers are liable to him.

Example: A is the holder of a negotiable instrument.

Excluding personal liability by an endorsement without recourse, he transfers the instrument to B, and B endorses it to C, who endorses it to A. A can recover the amount of the bill from B and C.

(ii) **Facultative endorsement:** An endorsement where the endorser extends his liability or abandons some right under a negotiable instrument, is called a facultative endorsement. “Pay A or order, Notice of dishonour waived” is an example of facultative endorsement.

(iii) **‘Sans frais’ endorsement:** Where the endorser does not want the endorsee or any subsequent holder, to incur any expense on his account on the instrument, the endorsement is ‘sans frais’.

(iv) **Liability dependent upon a contingency:** Where an endorser makes his liability depend upon the happening of a contingent event, or makes the rights of the endorsee to receive the amount depend upon any contingent event, in such a case the liability of the endorser will arise only on the

happening of that contingent event. Thus, an endorser may write 'Pay A or order on his marriage with B'. In such a case, the endorser will not be liable until the marriage takes place and if the marriage becomes impossible, the liability of the endorser comes to an end.

Effects of endorsement

The legal effect of negotiation by endorsement and delivery is:

- (i) to transfer property in the instrument from the endorser to the endorsee.
- (ii) to vest in the latter the right of further negotiation, and
- (iii) a right to sue on the instrument in his own name against all the other parties (Section 50).

### **Cancellation of endorsement**

When the holder of a negotiable instrument, without the consent of the endorser destroys or impairs the endorser's remedy against prior party, the endorser is discharged from liability to the holder to the same extent as if the instrument had been paid at maturity (Section 40).

Negotiation back

'Negotiation back' is a process under which an endorsee comes again into possession of the instrument in his own right. Where a bill is re-endorsed to a previous endorser, he has no remedy against the intermediate parties to whom he was previously liable though he may further negotiate the bill.

### **1.10 INSTRUMENTS WITHOUT CONSIDERATION**

A person cannot pass a better title than he himself possesses. A person who is a mere finder of a lost goods or a thief or one who obtains any article by fraud or for an unlawful consideration does not get any title to the thing so acquired. The true owner can recover it not only from

him but from any person to whom he may have sold it. But there is a difference between the transfer of ordinary goods and negotiation of negotiable instruments. The Negotiable Instruments Act provides protection to those persons who acquire the instruments in good faith and for valuable consideration. A holder in due course who has no means to discover the defect of title in an instrument of any previous holder when the instrument may have passed through several hands must be protected if he obtains the instrument for value and in good faith.

Section 58 of the Act provides that no person in possession of an instrument with a defect of title can claim the amount of the instrument unless he is a holder in due course. The moment an instrument comes  
31

into the hands of a holder in due course, not only does he get a title which is free from all defects, but having passed through his hands the instrument is cleaned of all defects.

### **Lost instruments**

Where the holder of a bill or note loses it, the finder gets no title to it. The finder cannot lawfully transfer it. The man who lost it can recover it from the finder. But if the instrument is transferable by mere delivery and there is nothing on its face to show that it does not belong to the finder, a holder obtaining it from the finder in good faith and for valuable consideration and before maturity is entitled to the instrument and can recover payment from all the parties thereof. If the instrument is transferable by endorsement, the finder cannot negotiate it except by forging the endorsement.

The holder of the instrument when it is lost must give a notice of loss to all the parties liable on it and also a public notice by

advertisement. The holder of a lost bill remains owner in law and as such on maturity can demand payment from the acceptor, and if is dishonoured he must give notice of dishonour to prior parties. The owner of the lost bill has a right to obtain the duplicate from the drawer and on refusal he can sue the drawer for the same.

#### Stolen instrument

The position of thief of an instrument is exactly the same as that of a finder of lost instruments. A thief acquires no title to an instrument if he receives payment on it the owner can sue him for the recovery of the amount. But if an instrument payable to bearer is stolen and if transferred to a holder in due course, the owner must suffer.

#### Instruments obtained by fraud

It is of the essence of all contracts including those on negotiable instruments, that they must have been brought about by free consent of the parties competent to contract. Any contract to which consent has been obtained by fraud is voidable at the option of the person whose consent was so obtained. A person who obtains an instrument by fraud gets a defective title. But if such an instrument passes into the hands of a holder in due course, the plea of fraud will not be available against him. If however, it could be shown that a person without negligence on his part was induced to sign an instrument it being represented to him to be a document of a different kind he would not be liable even to a holder in due course.

#### Instrument obtained for an unlawful consideration

The general rules as to the legality of object or consideration of a contract apply to contracts on negotiable instruments also. An instrument given for an illegal consideration is void and does not convey a valid title to the holder. He cannot enforce payment against any party

thereto. Thus, a bill of exchange given in consideration of future illicit cohabitation is void. But if such an instrument passes into the hands of a holder in due course, he obtains a good and complete title to it.

#### Forged instrument

Forgery confers no title and a holder acquires no title to a forged instrument. A forged instrument is treated as anullity. Forgery with the intention of obtaining title to an instrument would include:

- (1) fraudulently writing the name of an existing person,
- (2) signing the name of a fictitious person with the intention that it may pass that of a real person, or
- (3) signing one's own name with the intention that the signature may pass as the signature of some other person of the same name.

Example: A bill is payable to Ram Sunder or order. At maturity it wrongfully comes into the possession of another Ram Sunder who knows that he has no claim on the bill. He puts his own signature and the acceptor pays him. The bill is not discharged and the acceptor remains liable to Ram Sunder who is the owner of the bill.

A forged instrument has no existence in the eyes of law. A title which never came into existence cannot be improved even if it passes into the hands of a holder in due course. A forges B's signature on a promissory note and transfers the same to C who takes it in good faith for value. C gets no title of the note even though he is a holder in due course.

Examples: (a) On a note for Rs.1000, A forges B's signature to it as maker. C, a holder who takes it bonafide and for value acquires no title to the note.

(b) On a bill for Rs.1000 A's acceptance to the bill is forged. The



bill comes into hands of B, a bonafide holder for value, B acquires no title to the bill.

#### Forged endorsement

The case of a forged endorsement is slightly different. If an instrument is endorsed in full, it cannot be negotiated except by an endorsement signed by the person to whom or to whose order the instrument is payable, for the endorsee obtains title only through his endorsement. If an endorsement is forged, the endorsee acquires no title to the instrument even if he is a bonafide purchaser. On the other hand, if the instrument is a bearer instrument or has been endorsed in blank, and there is a forged endorsement the holder gets a good title because holder in such a case derives title by delivery and not by endorsement. Bankers are specially protected against forged endorsement under section 85 of the Act.

Examples: (a) A bill is endorsed, "Pay X or order." X must endorse the bill and if his signature is forged, the bill is worthless.

(b) A bill is payable to "X or order." It is stolen from X and the thief forges X's endorsement and endorses it to Y who takes it in good faith and for value. Y acquires no title to the bill.

(c) A bill payable to "A or order" is endorsed in blank by A. It comes into the hands of B. B by simple delivery passes it to C. C forges B's endorsement and transfers it to D. As D does not derive his title through the forged endorsement of B, but through the genuine endorsement of A, he obtains a good title to the instrument in spite of the intervening forged endorsement.

#### Instrument without consideration

Sections 43 to 45 of the Negotiable Instrument Act deal with the consequences of failure or absence of consideration in negotiable

instruments. In the case of negotiable instruments consideration is presumed to exist between the parties unless the contrary is proved. As between immediate parties, if an instrument is made, drawn or endorsed without consideration, or for a consideration which subsequently fails, it is void. As between immediate parties, failure of consideration has the same effect as the absence of consideration. For instance if a promissory note is delivered by the maker to the payee as a gift, it cannot be enforced against such maker.

Examples: (a) C the holder of a bill endorses it in blank to D receiving no value. D for value transfers it by delivery to E. E is a holder of value.

(b) A is the holder of a bill for consideration. A endorses it to B, without consideration. The property in the bill passes to B. The bill is dishonoured at maturity. B cannot sue A on the bill.

As between remote parties, the defence of absence or failure of consideration is not available at all. The holder in due course who has paid consideration can recover it from all prior parties immaterial of the fact whether any of them has received consideration or not.

Where there is a partial absence or failure of consideration, as between immediate parties, only that part can be recovered which was actually paid. However, a holder in due course is not affected by this rule. But even between immediate parties, where the part of the consideration which is absent or cannot be ascertained without collateral inquiry, the whole of the amount is recoverable.

Examples: (a) A owes B Rs. 500. B draws a bill on A for Rs. 1000. A to accommodate B and at his request accepts it. If B sues A on the bill he can only recover Rs. 500.

(b) A draws a bill on B for Rs. 500 payable to the order A. B accepts

the bill but subsequently dishonours it by non-payment. A sues B on the bill. B proves that it was accepted for value as to Rs. 400 and as an accommodation to A (the plaintiff) for Rs. 100. A can only recover Rs. 400. But if this bill gets into the hands of a holder in due course, he can recover the full amount of Rs. 500.

### **1.11 HOLDER IN DUE COURSE**

Section 9 of the Act defines 'holder in due course' as any person who (i) for valuable consideration, (ii) becomes the possessor of a negotiable instrument payable to bearer or the indorsee or payee thereof, (iii) before the amount mentioned in the document becomes payable, and (iv) without having sufficient cause to believe that any defect existed in the title of the person from whom he derives his title. (English law does not regard payee as a holder in due course).

The essential qualification of a holder in due course may, therefore, be summed up as follows:

1. He must be a holder for valuable consideration.

Consideration must not be void or illegal, e.g. a debt due on a wagering agreement. It may, however, be inadequate. A donee, who acquired title to the instrument by way of gift, is not a holder in due course, since there is no consideration to the contract. He cannot maintain any action against the debtor on the instrument. Similarly, money due on a promissory note executed in consideration of the balance of the security deposit for the lease of a house taken for immoral purposes cannot be recovered by a suit.

2. He must have become a holder (passessor) before the date of maturity of the negotiable instrument. Therefore, a person who takes a bill or promissory note on the day on which it becomes payable cannot claim rights of a holder in due course because he takes it after it

becomes payable, as the bill or note can be discharged at any time on that day.

3. He must have become holder of the negotiable instrument in good faith. Good faith implies that he should not have accepted the negotiable instrument after knowing about any defect in the title to the instrument. But, notice of defect in the title received subsequent to the acquisition of the title will not affect the rights of a holder in due course. Besides good faith, the Indian Law also requires reasonable care on the part of the holder before he acquires title of the negotiable instrument. He should take the instrument without any negligence on his part. Reasonable care and due caution will be the proper test of his bona fides. It will not be enough to show that the holder acquired the instrument honestly, if in fact, he was negligent or careless. Under conditions of sufficient indications showing the existence of a defect in the title of the transferor, the holder will not become a holder in due course even though he might have taken the instrument without any suspicion or knowledge.

Example:

(i) A bill made out by pasting together pieces of a torn bill taken without enquiry will not make the holder, a holder in due course. It was sufficient to show the intention to cancel the bill. A bill should not be taken without enquiry if suspicion has been aroused.

(ii) A post-dated cheque is not irregular. It will not preclude a bonafide purchase instrument from claiming the rights of a holder in due course.

It is to be noted that it is the notice of the defect in the title of his immediate transferor which deprives a person from claiming the right of

a holder in due course. Notice of defect in the title of any prior party does not affect the title of the holder.

4. A holder in due course must take the negotiable instrument complete and regular on the face of it.

Privileges of a holder in due course

1. Instrument purged of all defects: A holder in due course who gets the instrument in good faith in the course of its currency is not only himself protected against all defects of title of the person from whom he has received it, but also serves, as a channel to protect all subsequent holders. A holder in due course can recover the amount of the instrument from all previous parties although, as a matter of fact, no consideration was paid by some of the previous parties to instrument or there was a defect of title in the party from whom he took it. Once an instrument passes through the hands of a holder in due course, it is purged of all defects. It is like a current coin. Who-so-ever takes it can recover the amount from all parties previous to such holder (Sec. 53). It is to be noted that a holder in due course can purify a defective title but cannot create any title unless the instrument happens to be a bearer one.

Examples:

(i) A obtains B's acceptance to a bill by fraud. A indorses it to C who takes it as a holder in due course. The instrument is purged of its defects and C gets a good title to it. In case C indorses it to some other person he will also get a good title to it except when he is also a party to the fraud played by A.

(ii) A bill is payable to "A or order". It is stolen from A and the thief forges A's signature and indorses it to B who takes it as a holder in due course. B cannot recover the money. It is not a case of defective title

but a case where title is absolutely absent. The thief does not get any title therefore, cannot transfer any title to it.

(iii) A bill of exchange payable to bearer is stolen. The thief delivers it to B, a holder in due course. B can recover the money of the bill.

2. Rights not affected in case of an inchoate instrument:

Right of a holder in due course to recover money is not at all affected even though the instrument was originally an inchoate stamped instrument and the transferor completed the instrument for a sum greater than what was intended by the maker. (Sec. 20)

3. All prior parties liable: All prior parties to the instrument (the maker or drawer, acceptor and intervening indorsers) continue to remain liable to the holder in due course until the instrument is duly satisfied. The holder in due course can file a suit against the parties liable to pay, in his own name (Sec. 36)

4. Can enforce payment of a fictitious bill: Where both drawer and payee of a bill are fictitious persons, the acceptor is liable on the bill to a holder in due course. If the latter can show that the signature of the supposed drawer and the first indorser are in the same hand, for the bill being payable to the drawer's order the fictitious drawer must indorse the bill before he can negotiate it. (Sec. 42).

5. No effect of conditional delivery: Where negotiable instrument is delivered conditionally or for a special purpose and is negotiated to a holder in due course, a valid delivery of it is conclusively presumed and he acquired good title to it. (Sec. 46).

Example: A, the holder of a bill indorses it "B or order" for the express purpose that B may get it discounted. B does not do so and negotiates it to C, a holder in due course. C acquires a good title to the

bill and can sue all the parties on it.

6. No effect of absence of consideration or presence of an unlawful consideration: The plea of absence of or unlawful consideration is not available against the holder in due course. The party responsible will have to make payment (Sec. 58).

7. Estoppel against denying original validity of instrument:

The plea of original invalidity of the instrument cannot be put forth, against the holder in due course by the drawer of a bill of exchange or cheque or by an acceptor for the honour of the drawer. But where the instrument is void on the face of it e.g. promissory note made payable to “bearer”, even the holder in due course cannot recover the money.

Similarly, a minor cannot be prevented from taking the defence of minority. Also, there is no liability if the signatures are forged. (Sec. 120).

8. Estoppel against denying capacity of the payee to

indorsee: No maker of promissory note and no acceptor of a bill of exchange payable to order shall, in a suit therein by a holder in due course, be permitted to resist the claim of the holder in due course on the plea that the payee had not the capacity to indorse the instrument on the date of the note as he was a minor or insane or that he had no legal existence (Sec 121)

9. Estoppel against indorser to deny capacity of parties: An

indorser of the bill by his endorsement guarantees that all previous endorsements are genuine and that all prior parties had capacity to enter into valid contracts. Therefore, he on a suit thereon by the subsequent holder, cannot deny the signature or capacity to contract of any prior party to the instrument.

## **1.12 DISHONOUR OF A NEGOTIABLE INSTRUMENT**

When a negotiable instrument is dishonoured, the holder must

give a notice of dishonour to all the previous parties in order to make them liable. A negotiable instrument can be dishonoured either by nonacceptance or by non-payment. A cheque and a promissory note can only be dishonoured by non-payment but a bill of exchange can be dishonoured either by non-acceptance or by non-payment.

Dishonour by non-acceptance (Section 91)

A bill of exchange can be dishonoured by non-acceptance in the following ways:

1. If a bill is presented to the drawee for acceptance and he does not accept it within 48 hours from the time of presentment for acceptance. When there are several drawees even if one of them makes a default in acceptance, the bill is deemed to be dishonoured unless these several drawees are partners. Ordinarily when there are a number of drawees all of them must accept the same, but when the drawees are partners acceptance by one of them means acceptance by all.
2. When the drawee is a fictitious person or if he cannot be traced after reasonable search.
3. When the drawee is incompetent to contract, the bill is treated as dishonoured.
4. When a bill is accepted with a qualified acceptance, the holder may treat the bill of exchange having been dishonoured.
5. When the drawee has either become insolvent or is dead.
6. When presentment for acceptance is excused and the bill is not accepted. Where a drawee in case of need is named in a bill or in any indorsement thereon, the bill is not



dishonoured until it has been dishonoured by such drawee.

Dishonour by non-payment (Section 92)

A bill after being accepted has got to be presented for payment on the date of its maturity. If the acceptor fails to make payment when it is due, the bill is dishonoured by non-payment. In the case of a promissory note if the maker fails to make payment on the due date the note is dishonoured by non-payment. A cheque is dishonoured by non-payment as soon as a banker refuses to pay.

An instrument is also dishonoured by non-payment when presentment for payment is excused and the instrument when overdue remains unpaid (Sec 76).

Effect of dishonour: When a negotiable instrument is dishonoured either by non acceptance or by non-payment, the other parties thereto can be charged with liability. For example if the acceptor of a bill dishonours the bill, the holder may bring an action against the drawer and the indorsers. There is a duty cast upon the holder towards those whom he wants to make liable to give notice of dishonour to them.

Notice of dishonour: Notice of dishonour means the actual notification of the dishonour of the instrument by non-acceptance or by non-payment. When a negotiable instrument is refused acceptance or payment notice of such refusal must immediately be given to parties to whom the holder wishes to make liable. Failure to give notice of the dishonour by the holder would discharge all parties other than the maker or the acceptor (Sec. 93).

Notice by whom: Where a negotiable instrument is dishonoured either by non- acceptance or by non-payment, the holder of the instrument or some party to it who is liable thereon must give a notice of dishonour to all the prior parties whom he wants to make liable on the

instrument (Section 93). The agent of any such party may also be given notice of dishonour. A notice given by a stranger is not valid. Each party receiving notice of dishonour must, in order to render any prior party liable give notice of dishonour to such party within a reasonable time after he has received it. (Sec. 95)

When an instrument is deposited with an agent for presentment and is dishonoured, he may either himself give notice to the parties liable on the instrument or he may give notice to his principal. If he gives notice to his principal, he must do so within the same time as if he were the holder. The principal, too, in his turn has the same time for giving notice as if the agent is an independent holder. (Sec. 96)

Notice to whom?: Notice of dishonour must be given to all parties to whom the holder seeks to make liable. No notice need be given to a maker, acceptor or drawee, who are the principal debtors (Section 93). Notice of dishonour may be given to an endorser. Notice of dishonour may be given to a duly authorised agent of the person to whom it is required to be given. In case of the death of such a person, it may be given to his legal representative. Where he has been declared insolvent the notice may be given to him or to his official assignee (Section 94). Where a party entitled to a notice of dishonour is dead, and notice is given to him in ignorance of his death, it is sufficient (Section 97).

Mode of notice: The notice of dishonour may be oral or written or partly oral and partly written. It may be sent by post. It may be in any form but it must inform the party to whom it is given either in express terms or by reasonable intendment that the instrument has been dishonoured and in what way it has been dishonoured and that the person served with the notice will be held liable thereon.

What is reasonable time?: It is not possible to lay down any hard and fast rule for determining what is reasonable time. In determining what is reasonable time, regard shall be had to the nature of the instrument, the usual course the dealings with respect to similar instrument, the distance between the parties and the nature of communication between them. In calculating reasonable time, public holidays shall be excluded (Section 105).

Section 106 lays down two different rules for determining reasonable time in connection with the notice of dishonour (a) when the holder and the party to whom notice is due carry on business or live in different places, (b) when the parties live or carry on business in the same place.

In the first case the notice of dishonour must be dispatched by the next post or on the day next after the day of dishonour. In the second case the notice of dishonour should reach its destination on the day next after dishonour.

Place of notice: The place of business or (in case such party has no place of business) at the residence of the party for whom it is intended, is the place where the notice is to be given. If the person who is to give the notice does not know the address of the person to whom the notice is to be given, he must make reasonable efforts to find the latter's address. But if the party entitled to the notice cannot after due search be found, notice of dishonour is dispensed with.

Duties of the holder upon dishonour

(1) Notice of dishonour. When a promissory note, bill of exchange or cheque is dishonoured by non-acceptance or non-payment the holder must give notice of dishonour to all the parties to the instrument whom he seeks to make liable thereon. (Sec. 93)

(2) Noting and protesting. When a promissory note or bill of exchange has been dishonoured by non-acceptance or non-payment, the holder may cause such dishonour to be noted by a notary public upon the instrument or upon a paper attached thereto or partly upon each (Sec. 99). The holder may also within a reasonable time of the dishonour of the note or bill, get the instrument protested by notary public (Sec. 100).

(3) Suit for money. After the formality of noting and protesting is gone through, the holder may bring a suit against the parties liable for the recovery of the amount due on the instrument.

Instrument acquired after dishonour: The holder for value of a negotiable instrument as a rule, is not affected by the defect of title in his transferor. But this rule is subject to two important exceptions (i) when the holder acquires it after maturity and (ii) when he acquires it with notice of dishonour.

The holder of a negotiable instrument who acquired it after dishonour, whether by non-acceptance or non-payment, with notice thereof, or after maturity, has only, as against the other parties, the rights thereon of his transfer. (Sec. 59).

### **1.13 NOTING AND PROTESTING**

When a negotiable instrument is dishonoured the holder may sue his prior parties i.e the drawer and the indorsers after he has given a notice of dishonour to them. The holder may need an authentic evidence of the fact that a negotiable instrument has been dishonoured. When a cheque is dishonoured generally the bank who refuses payment returns back the cheque giving reasons in writing for the dishonour of the cheque. Sections 99 and 100 provide convenient methods of authenticating the fact of dishonour of a bill of exchange and a

promissory note by means of 'noting' and 'protest'.

### Noting

As soon as a bill of exchange or a promissory note is dishonoured, the holder can after giving the parties due notice of dishonour, sue the parties liable thereon. Section 99 provides a mode of authenticating the fact of the bill having been dishonoured. Such mode is by noting the instrument. Noting is a minute recorded by a notary public on the dishonoured instrument or on a paper attached to such instrument.

When a bill is to be noted, the bill is taken to a notary public who represents it for acceptance or payment as the case may be and if the drawee or acceptor still refuses to accept or pay the bill, the bill is noted as stated above.

Noting should specify in the instrument, (a) the fact of dishonour, (b) the date of dishonour, (c) the reason for such dishonour, if any (d) the notary's charges, (e) a reference to the notary's register and (f) the notary's initials.

Noting should be made by the notary within a reasonable time after dishonour. Noting and protesting is not compulsory but foreign bills must be protested for dishonour when such protest is required by the law of the place where they are drawn. Cheques do not require noting and protesting. Noting by itself has no legal effect. Still it has some advantages. If noting is done within a reasonable time protest may be drawn later on. Noting without protest is sufficient to allow a bill to be accepted for honour.

### **Protest**

Protest is a formal certificate of the notary public attesting the dishonour of the bill by non-acceptance or by non-payment. After noting, the next step for notary is to draw a certificate of protest, which is a

formal declaration on the bill or a copy thereof. The chief advantage of protest is that the court on proof of the protest shall presume the fact of dishonour.

Besides the protest for non-acceptance and for non-payment the holder may protest the bill for better security. When the acceptor of a bill becomes insolvent or suspends payment before the date of maturity, or when he absconds the holder may protest it in order to obtain better security for the amount due. For this purpose the holder may employ a notary public to make the demand on the acceptor and if refused, protest may be made. Notice of protest may be given to prior parties. When promissory notes and bills of exchange are required to be protested, notice of protest must be given instead of notice of dishonour. (Sec. 102) Inland bills may or may not be protested. But foreign bills must be protested for dishonour when such protest is required by the law of the place where they are drawn (Sec. 104).

Where a bill is required to be protested under the Act within a specified time, it is sufficient if it is 'noted for protest' within such time. The formal protest may be given at anytime after the noting (Sec. 104A)

### **Contents of protest**

Section 101 of the Act lays down the contents of a regular and perfect protest which are as follows:

1. The instrument itself or a literal transcript of the instrument; and of everything written or printed thereupon.
2. The name of the person for whom and against whom the instrument has been protested.
3. The fact of and reasons for dishonour i.e. a statement that payment or acceptance or better security, as the case may be, has been demanded of such person by the notary public

from the person concerned and he refused to give it or did not answer or that he could not be found.

4. The time and place of demand and dishonour.

5. The signature of the notary public.

6. In the case of acceptance for honour or payment for honour the person by whom or for whom such acceptance or payment was offered and effected.

### **1.14 SUMMARY**

A negotiable instrument is a piece of paper which entitles a person to a sum of money and which is transferable from one person to another by mere delivery or by endorsement and delivery. The characteristics of a negotiable instrument are easy negotiability, transferee gets good title, transferee gets a right to sue in his own name and certain presumptions which apply to all negotiable instruments. There are two types of negotiable instruments (a) Recognised by statute: Promissory notes, Bill of exchange and cheques and (b) Recognised by usage: Hundis, Bill of lading, Share warrant, Dividend warrant, Railway receipts, Delivery orders etc. The parties to bill of exchange are drawer, drawee, acceptor, payee, indorser, indorsee, holder, drawee in case of need and acceptor for honour. The parties to a promissory note are maker, payee, holder, indorser and indorsee while parties to cheque are drawer, drawee, payee, holder, indorser and indorsee.

Negotiation of an instrument is a process by which the ownership of the instrument is transferred by one person to another. There are two methods of negotiation: by mere delivery and by endorsement. In its literal sense, the term 'indorsement' means writing on an instrument but in its technical sense, under the Negotiable Instrument Act, it means the writing of a person's name on the face or back of a negotiable instrument

or on a slip of paper annexed thereto, for the purpose of negotiation. A bill may be dishonoured by non-acceptance (since only bills require acceptance) or by non-payment, while a promissory note and cheque may be dishonoured by non-payment only. Noting means recording of the fact of dishonour by a notary public on the bill or paper or both partly. Protest is a formal notarial certificate attesting the dishonour of the bill. The term 'discharge' in relation to negotiable instrument is used in two senses, viz., (a) discharge of one or more parties from liability thereon, and (b) discharge of the instrument.

### **1.15 KEYWORDS**

**Negotiable instrument:** A negotiable instrument is one, the property and the title in which is acquired by anyone who takes it as bonafide and for value notwithstanding any defect in the title of the person from whom he/she took it.

**Promissory note:** A promissory note is an instrument in writing (not being a bank note or 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.

**Bills of exchange:** 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.

**Accommodation bills:** Those bills, which are drawn without any actual consideration, merely, to help out friends and relatives are known as accommodation bills.

**Banker's draft:** It is a bill of exchange in which a bank orders its branch or another bank, as the case may be, to pay a specified amount to a specified person or to the order of the specified person.



Cheque: Cheque is a kind of bill of exchange, which is always drawn upon a specific bank and is payable on demand.

Crossing of a cheque: When two angular parallel lines are drawn on the face of the cheque, then the cheque said to be crossed.

Usances: The time fixed by the custom of countries for payment of bills drawn in one country but are payable in another country is known as a usance.

Payment in due course: Payment in due course means payment of the instrument after the expiry of the duration of the instrument, in good faith and without any negligence, to the possessor thereof and without the existence of any circumstances that may lead one to believe that the person receiving the payment is not entitled to it.

Assignment: Assignment of any object means the transfer of its title to another person through a written and registered deed under the Transfer of Property Act.

### **1.16 SELF ASSESSMENT QUESTIONS**

1. What is meant by negotiation? How is it effected and how does it differ from an assignment?
2. Define endorsement. What are the various classes of endorsement?
3. Explain the privileges granted to a holder in due course.
4. In what different ways may a negotiable instrument be dishonoured? What are the duties of a holder of a dishonoured bill?
5. How and when should a notice be served on a bill being dishonoured by either non-acceptance or non-payment?  
Under what circumstances is notice of dishonour unnecessary?

