

The Negotiable Instrument Act, 1881

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Unit 2

- Meaning and characteristics of negotiable instrument
: Promissory notes , Bills of Exchange , Cheque.
- Holder and Holder in Due Course , Privileges of
Holder in Due Course
- Negotiation : Types of Indorsement
- Crossing of Cheque
- Bouncing on cheque

INTRODUCTION

The law relating to negotiable instruments is contained in the Negotiable Instrument Act, 1881 which deals with Promissory notes , bills of exchange ,cheques and which applies and extends to the whole of India.

DEFINITION

Negotiable – Transferable by delivery



Instrument – A written document



Negotiable Instrument – A written document which creates a right in favour of somebody

CHARACTERISTICS OF NEGOTIABLE INSTRUMENT

- ◉ Freely transferable
- ◉ Title of holder is free from all defects
- ◉ Recovery
- ◉ Presumption
 - i. Consideration
 - ii. Date
 - iii. Time of acceptance
 - iv. Time of transfer
 - v. Order of endorsement
 - vi. Stamp
 - vii. Holder presume to be holder in due course

Types of Negotiable Instrument

◉ Negotiable instrument are of two types

- 1. Negotiable instrument by statute :**
Promissory note, Bills of exchange ,
Cheque.
- 2. Negotiable instrument by Custom
or Usage:**
Banker's draft , pay orders, railway
receipts for goods .

PROMISSORY NOTE

○ Definition :

According to Section 4 ,”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 .”

Specimen of a Promissory Note

Payee

Rs. 10,000

Delhi
July 10, 2017

Three months after date I promise to pay Shyam Sundar , s/o Ramlal of Meerut or order a sum of Rs. 10,000 (Rupees Ten Thousand only) , for value received.

To ,
Shayam Sundar
222, Ashok Vihar
Delhi - 110 052

Stamp

Sanjeev

Sd/-

Maker

Parties to a Promissory Note

- Two parties involved in a promissory note . They are :
 1. Maker – the person who makes the promissory note and promise to pay.
 2. Payee - the person to whom the payment is to be made .

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- In course of transfer of a promissory note by payee and others , the parties involved may be
 1. The Endorser- the person who endorses the note in favour of another person . In the above specimen if Shayam sundar endorses it in favour of Ranjan and Ranjan also endorses in favour of Puneet, then Shayam Sundar and Ranjan both are endorser .
 2. The Endorsee- the person in whose favour the note is negotiated by endorsement , In the above , it is Ranjan and then Puneet.

Essential elements of Promissory Note

- I. Writing
- II. Promise to pay
- III. Definite and unconditional
- IV. Signed by the maker
- V. Certain parties (Maker and Payee)
- VI. Certain sum of money
- VII. Promise to pay money only
- VIII. Bank note or currency note is not a promissory note
- IX. It may be payable on demand or after a definite period of time .
- X. It cannot be made payable to bearer on demand .

BILL OF EXCHANGE

- According to 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. ”

Eg. – Mr. A purchases goods from Mr. B for Rs. 1000/-

Mr. B buys goods from Mr. X for Rs. 1000/-

Then Mr. B may order Mr. A to pay Rs. 1000/- to Mr. X which will be a Bill of Exchange

Specimen of Bill of Exchange

Rs. 500

Mumbai
Jan. 10,

2017

Three months after date pay to Ram or order the sum of five hundred rupees, for value received.

To
Shyam
235, Subhash Marg ,
Delhi- 110 006

In case of need with
Canara bank, Delhi

Accepted Shyam

Sd/-

Stamp

Krishan

Parties to a Bill of Exchange

- There are three parties involved in a Bill of Exchange
 - i. **The Drawer** – The person who gives the order to pay or who makes the bill .
(Krishna)
 - ii. **The Drawee** - the person who is directed to pay (Shayam)
 - iii. **The Payee** – The person to whom the payment is to be made (Ram)

Essential elements of Bill of Exchange

1. It must be in writing.
2. It must contain an order to pay . A mere request to pay on account , will not amount to an order.
3. The order must be unconditional.
4. It require three parties .
5. The parties must be certain
6. It must be signed by the drawer.
7. The sum payable must be certain.
8. It must contain order to pay money only.
9. It must comply with the formalities as date, consideration , place etc. (are not essential in law),but a bill must affixed with the necessary stamp.

Distinction between Bill of Exchange and Promissory note

Basis	Promissory Note	Bill of Exchange
No. of parties	2 parties- the maker and the payee	3 parties – the drawer, the drawee , the payee
Promise / order	Unconditional promise to pay .	Unconditional order to pay.
Maker / Drawer of bill	Debtor and he himself undertakes to pay	Creditor who directs the drawee (his debtor) to pay.
Nature of liability	Liability of maker is primary and absolute.	Liability of drawer is secondary and conditional.
Same identity of payer and payee	The maker & payee cannot be the same person.	The drawer & payee may be the same person .
Acceptance	It requires no acceptance as it is signed by the person who is liable to pay.	After sight or after certain period must be accepted .
Payable to bearer	It cannot be payable to bearer.	It can be payable to bearer.

CHEQUE

- ◉ Section 6
- ◉ A Cheque is a species of a bill of exchange ; but it has the following two additional qualification .
 - i. It is always drawn on a specified banker
 - ii. It is always payable on demand .

All cheques are bills of exchange , but all bills of exchange are not cheques.

Distinction between a Bill of Exchange and a Cheque

Basis	Bill of Exchange	Cheque
Drawer	It may be drawn on any person or a bank	It is always drawn on a banker.
Payment	It need not always be payable on demand.	It is always payable to bearer on demand.
Grace of days	A bill which is not expressed to be payable on demand is entitled to 3 days of grace .	Cheque is not entitled to any days of grace.
Crossing	It cannot be crossed	It can be crossed.
Stamp	It requires a stamp	It does not require a stamp.
Countermanded (revoked or cancelled)	Payment of bill cannot be countermanded.	It may be countermanded by the drawer.
Notice of dishonour	Notice of dishonour is usually required.	Notice of dishonour is not required.

Crossing of Cheque

- ◉ There are two types of cheques
 - **Open cheque / Bearer cheque** - cheque which is payable in cash across the counter of bank .
 - **Crossed Cheques**- cheque on which two parallel transverse lines with or without the words ' & co.' are drawn. The payment of such a cheque can be obtained only through a banker.

Types of crossing

- Two types of crossing
 - **General Crossing**- where it bears across its face an addition of –
 - ✓ The word 'and company' or any abbreviation thereof
 - ✓ Two parallel transverse lines simply , either with or without the word 'not negotiable' the drawee banker shall not pay it unless it is presented by a banker.

Not negotiable means that the title of tranferee of such a cheque cannot be better than that of its transferor.

- **Special crossing** - the payment of specially crossed cheque can be obtained only through the particular banker whose name appears across the face of the cheque or between the transverse lines .

Another type of crossing developed out of business usage.

- **Restrictive crossing**- In this crossing 'A/c payee' are added to general or special crossing.

Holder

- Holder (Sec 8)- The holder of a promissory note, bill of exchange and cheque means any person entitled in his own name
 - i. To the **possession** thereof and
 - ii. To **receive or recover the amount** due thereon from the parties thereto.

Where a person obtains possession of an instrument by theft or under a forged indorsement, he is not a holder, as he cannot recover the payment of the instrument.

Holder in due course

- (Sec 9) Any person is a ' holder in due course ' if he fulfils the following condition :
 - That, for **consideration** , he became
 - i. The possessor of negotiable instrument if payable to bearer.
 - ii. The payee or indorsee thereof , if payable to order
 - That he became holder of the instrument **before its maturity**.
 - That he became the holder of the instrument **in good faith**.

A holder of negotiable instrument will **not be** holder in due course if –

- a. He has obtain the instrument by gift or for an unlawful consideration or by some illegal method
- b. He has obtain the instrument after its maturity
- c. He has not obtain the instrument bona fide.

Privileges of a holder in due course (Sec 9)

- ◉ A holder in due course gets title to a negotiable instrument free from equities.
 1. Inchoate stamped instrument
 2. Liability of prior parties
 3. Fictitious payee
 4. Negotiable instrument without consideration
 5. Conditional delivery
 6. Instrument cleansed of all defects
 7. Every holder is a holder in due course

Negotiation

The negotiable instrument is freely transferable from one person to another.

The transfer may take place either

–

1. By negotiation
2. By assignment

Transfer by Negotiation

- 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. (sec 14)

There are 2 methods of negotiation

- Negotiation by **delivery** – if the instrument is payable to **bearer**.
- Negotiable by **indorsement and delivery**- if the instrument is payable **to order** , it is negotiable by the holder by indorsement and delivery.

Indorsement

- It means writing of a person's name on an instrument for the purpose of negotiation.
- The person who indorses the instrument is called the 'indorser'
- the person to whom it is indorsed is called the 'indorsee'

Types of Indorsement

- ◉ Blank or General indorsement
- ◉ Full or Special indorsement
- ◉ Restrictive indorsement
- ◉ Partial indorsement
- ◉ Conditional or Qualified indorsement

Thank you