Negotiable Instruments Act, 1881

Introduction

- The law relating to negotiable instruments is contained in the Negotiable Instruments Act of 1881 which applies and extends to the whole of India. (Act No 26 of 1881)
- It is a pre independence Act which helps to complete valid contracts which are signed by either two or three parties.
- It is based on English common Law.

- Negotiable Instruments are the most common credit devices used in modern business.
- They are basically written promises or orders to pay certain money & it is transferred from one person/one account/one place to another.
- The chief objective of this law is to legalize the system under which negotiable instruments pass from one hand to other like an ordinary goods

Object of the Act

- The main object of the Negotiable Instruments Act is to legalise the system by which instruments contemplated by it could pass from hand to hand by negotiation like any other goods. The purpose of the Act was to present an orderly and authoritative statement of leading rules of law relating to the negotiable instruments To achieve the objective of the Act, the Legislature thought it proper to make provision in the Act for conferring certain privileges to the mercantile instruments contemplated under it and provide special procedure in case the obligation under the instrument was not discharged.

Definitions

- The word negotiable' means "transferable by delivery" and instrument means "a written document by which a right is created in favor of some person or persons.
- Thus, the term negotiable instrument literally means a written document which creates a right in favor of somebody and is freely transferable from one person to anothers.

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- A negotiable instrument is a piece of paper which entitles a person to a certain sum of money and which is transferable from one to another person by a common delivery or by endorsement and delivery.
- Eg - Promissory note, Cheque and a Bill of exchange.

Types of Negotiable Instruments

Negotiable instruments are of two types which are as follows:

- **Negotiable Instruments recognized by status:** e.g. Bills of exchange, cheque and promissory notes.
- **Negotiable instruments recognized by usage or customs of trade:** e.g. Bank notes, Exchequer bills, share certificate ,share warrants, stamp papers, Travelers cheques, Dividend certificates, warrants,.Hundis,Treasury Bills etc.

Characteristics of Negotiable Instruments

1) **Free transferability or easy negotiability** Negotiable instrument is freely without any formality transferable from one person to another because it is a property.

2) **Title of holder is free from all defects** A person who takes negotiable instrument bona-fide and for value gets the instrument is free from all defects in the title. The holder in due course is not affected by defective title of the transferor or of any other party.

Presumptions:

3) **Consideration** : that every negotiable instrument is made or drawn for certain consideration.

4) **As to date** : that every negotiable instrument bearing a date is important as it was made or drawn on such date. It defines its validity of payment.

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5)**<u>As to time of endorsements</u>** : that the endorsements appearing on the negotiable instrument should be made in the order in which they appear always.

6)**<u>As to time of acceptance :</u>** that every negotiable instrument must be accepted within a reasonable time after its date and before its maturity.(Cheque : 6 Months)

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- **7)As to stamps** : that a promissory-note, bill of exchange or cheque must be duly stamped if required by drawer/maker.
- **8)As to a holder in due course** : that every holder of a negotiable instrument is also a holder in due course.(Authority of receipt of payment)
- **9)As to time of transfer** : that every transfer of a negotiable instrument must be made before its maturity.otherwise it expires.

- 10)**<u>The legal Remedy</u>** :The holder can sue to the defaulter and can seek the legal remedy for compensations.

Section 4. "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. "Promissory Note"

- ***Illustrations***

(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 and to deliver to him my black horse on 1st January next."

The instruments marked (a) and (b) are promissory notes. The instruments marked (c) and (d) are not promissory notes.

Essential features

- An instrument is a promissory note if there are present the following elements:-

1. **Writing :** The first essential is that all negotiable instruments must be in writing. An oral engagement to pay a sum of money is not an instrument, much less negotiable.
2. **Promise to pay :** Secondly, it must contain a promise to pay. A mere acknowledgement of debt is not a promissory note. "I.O.U., E.A. Gay, the sum of seventeen dollars for value received." Has been held not to be a promissory note. A mere receipt for money does not amount to a promissory note, even though it might contain the terms of repayment. In **Mange Lal Vs. Lal Chand, AIR 1995, Rajasthan High Court** has held that a document which was in the form of a letter acknowledging receipt of certain sums and affixed with 20 paise revenue stamp was held to be a receipt and not a promissory note. In the case of **Muthu Sastrigal Vs. Visvanatha AIR 1914 Madras High Court , it has been held** that a document containing the following words "Amount of cash borrowed of you by me is Rs.350. I shall in two weeks time returning this sum with interest, get back this letter." Has been held to be a promissory note because there is an unconditional undertaking to repay the borrowed money.

Essential features

- **3. Unconditional :** Thirdly, the promise to pay the money should be unconditional, or subject only to a condition which according to the ordinary experience of mankind is bound to happen. Thus **in Beardsley Vs. Baldwin (1741),** a written undertaking to pay a sum of money within so may days after the defendant's marriage was not recognised as a promissory note because possibly the defendant may never marry and the sum may never become payable. Similarly in **Roberts Vs Peake (1757),** an action was bought upon a promissory note made in the following form.

  "We promise to pay AB £ 116.11s value received, on the death of George Hindshaw, provided he leaves either of us sufficient money to pay the said sum or if we shall be otherwise able to pay."

  The court pointed out that if the note had merely been made payable on the death of G.H., it would have been a good promissory note, be cause death is an event so certain and necessary that it is bound to happen and therefore the not must have become payable at one time or the other. But the other condition that it would be payable provided there would be sufficient funds left behind made the instrument bad, because that was an uncertain event, and a note payable on an uncertain contingency can never be a negotiable instrument.

Essential features

- **4. Money only and a certain sum of money**:
- Fourthly, the instrument must be payable in money and money only. If the instrument contains a promise to pay something other than money or something in addition to money, it will not be a promissory note. The sum of money payable must also be certain. Negotiable instruments are meant for free circulation and if they are value is not apparent on their face, their circulation would be materially impeded. Accordingly, in **Smith Vs Nightingale (1818)** a promissory note made in the following form was held bad.
- "I promise to pay to JE… the sum of £65 with lawful interest for the same, 3 months after date, and also all other the sums which may be due to him."
- It was held that the instrument was too indefinite to be considered a promissory note. It contained a promise to pay interest for a sum not specified and not otherwise ascertained than by reference to the defendant's book.

Essential features

- **5. Certainties of parties**:
- Fifthly, the parties to the instrument must be designated with reasonable certainity. There are two parties to a promissory note, viz , the person who make the note and is known as the maker and the payee to whom the promise is made. Both the maker and the payee must be indicated with certainity on the face of the instrument. In Brij Raj Sharan Vs. Saha Raghunandan Sharan AIR 1955, Rajasthan HC, a letter was addressed to A continuing the following statement.
- “In your account Rs. 4668 – 15 – 0 are due from my son Mahesh Chandra, I shall pay the amount by December 1948. You rest assured.”
- It was contended that it should not be treated as a promissory note because the person to whom the amount was to be paid was not indicated therein. However, Wanchoo C J, holding it be a good note, said “By looking to illustration ‘b ‘ of Section 4… it I cleared that if the person to whom the payment is to be made is certain from the words used in the document, the fact that the name is not mentioned after the words ”I shall pay” would not mean that the payee is uncertain. Since the letter was addressed to A it was clear that A was intended to be the payee”

Essential features

- **6 Signed by the maker:**
- Lastly, the promissory note should be signed by the maker. Signature may be on any part of the document. Where an instrument is in the hand writing of a person and it is addressed by him to another, that is sufficient evidence of his signature. The Allahabad High Court in the case of Raj Bahadur Singh Vs. Hari Pd. Mehra AIR 1983 Patna High Court has held that if a document satisfies all the requirements of a valid promissory note, it would not make any difference to its character as a negotiable instrument that it was an attested document. The Court said: Though attestation of a promissory note is neither required nor prohibited by law, a document which is otherwise a promissory note does not cease to be so merely because it is attested in as much as the document was unilateral and was not bilateral which was necessary for being an agreement.
- To consider whether a document is a promissory note or not the following tests are helpful : (i) Is the sum to be paid a sum of money and is that sum certain ? (ii) Is the payment to be made to or to order of a person who is certain or to the bearer of the instrument ? (iii) Has the maker signed the document ? (iv) Is the promise to pay made in the instrument the substance of the instrument ? and (v) Did the parties intend that the document should be a promissory note ?

Kinds of Promissory Notes

- S.4 recognizes three kinds of promissory notes :

  (1) A promise to pay a certain sum of money to a certain person,

  (2) A promise to pay a certain sum of money to the order of a certain person, and

  (3) A promise to pay the bearer:

Specimen of a promissory note

Rs. 5000/- Pune November 25, 2008

Three months after on 26th of the date of that month, I promise to pay to Mr. X of Mumbai or order a sum of Rupees Fifty Thousand for value received by me.

To

Mr.

Address………..

…………….

Stamp

Mumbai

Signature of Mr Y

Section 5 : "Bill 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.

Characteristics and Requirements

- An essential character of a bill of exchange is that it contains an order to accept or to pay and that the acceptor should accept it, in the absence of such a direction to pay, the document will not be a bill of exchange or a hundi.

1) It must be in writing
2) The bill of exchange must contain an order to pay. The order to pay may be in the form of a request, but it must be imperative. In Ruff Vs Webb(1974), the plaintiff Ruff was a servant of defendant Webb. The defendant dismissed him from service and for his wages gave him a draft in the following words: ”Mr Nelson will much oblige Mr Webb by paying to J. Ruff or order, twenty guineas on his account. “

- Lord Kenyon was of the opinion that “paper… was a bill of exchange , that it was an order by one person to another to pay money to the plaintiff or his order. It is quite apparent that the language of the draft was very polite, but it has been said that “the introduction of the terms of gratitude does not destroy the promise (or order) to pay. “

Characteristics and Requirements

- But if the language of the draft does not show any “order to pay”, the draft will not be a bill of exchange. In Little Vs Slackford, the defendant issued a paper addressed to the plaintiff in the following words:
- “Mr Little, please to let the bearer have 7 £, and to place them to my account, and you will oblige. Yours humble servant, R. Slackford.”
- It was held that the paper does not purport to be a demand made by a part having a right to call on the other party to pay. The fair meaning is you will oblige by doing it.“
- The order must be such as to require the other to pay the money at all events. Merely to give him the authority to pay is not sufficient.
- From the definition of the term ‘bill of exchange’ given S.5 of the Negotiable Instruments Act, it can easily be found that hundi can be of two types: (1) payable to order and (2) payable to bearer. If the hundi is payable to order, the payee or endorsee is holder in due course; it is not necessary to show that they had obtained the bill of exchange/hundi for consideration. But if the hundi is payable to bearer the person possessing it will be holder in due course only if he had come to possess it for consideration

Following are Bills of Exchange

(1) A banker's draft

(2) A demand draft even if it drawn upon another office of the same bank

(3) An order issued by a District Board Engineer on Government Treasury for payment to or order of a certain person.

Specimen of a Bill of Exchange

Rs. 100000/- New Delhi,15 November, 2010

Three months after the date pay to Mr. Manjeet Singh Randhawa or order the sum of rupees one lakh only, for the value received.

To

Mr.Alok Saxena

Address : 135 Sadar Bazar,

New Delhi 110011. Stamp

------------------------ Signature of Mr Basha

Accepted & Signature of Mr. Alok Saxena.

Section 6 : "Cheque"

- A "cheque is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and it includes the electronic image of a truncated cheque and a cheque in the electronic form.

Section 6 : “Cheque”

Explanation I – For the purpose of this section, the expression

(a) “ a cheque in the electronic form” means a cheque which contains the exact mirror image of a paper cheque, and is generated, written and signed in a secure system ensuring the minimum safety standards with the use of digital signature (with or without biometrics signature) and asymmetric crypto system ;

(b) “ a truncated cheque” means a cheque is truncated during the course of a clearing cycle, either by the clearing house or by the bank whether paying or receiving payment, immediately on generation of an electronic image for transmission, substituting the further physical movement of the cheque in writing.

Section 6 : "Cheque"

- Explanation II -- For the purpose of this section, the expression "clearing house" means the clearing house managed by the Reserve Bank of India or a clearing house recognised as such by the Reserve Bank of India.
- A cheque being a bill of exchange must possess all the essentials of a bill and should also meet the requirements of Section 6. For instance, in the case of **Cole Vs. Milson (1951)** a document was drawn absolutely in the form of a cheque. It was made payable to "cash or order". The question was whether it was a valid cheque. Section 5 of the Indian Act and Section 3(1) of the English Act require that a bill of exchange must be made payable to or to the order of a specified person or the bearer. This document was made payable to "cash or order". Hence it was not payable to any person or to bearer and therefore was not a bill of exchange, it could not be a cheque either.

Bill and Cheque Compared

- A cheque is no doubt essentially a bill of exchange but it has some peculiarities which distinguish it from a bill of exchange. Some of the peculiarities were clearly stated by **PARKHE B in Ram Churun Mullick Vs. Luchmee Chand (1854)** He said that a cheque "is a peculiar sort of instrument, in many respects resembling a bill of exchange, but in some entirely different. A cheque does not require acceptance, in ordinary course it is never accepted; it is not intended for circulation, it is given for immediate payment, it is not entitled for days of grace." This passage was cited with approval by Lord Wright in Bank of Baroda Vs. Punjab National Bank(1944). His Lordship made his own valuable contribution to explaining the nature of a cheque. He said: "In addition it is to be noted a cheque is presented for payment, whereas a bill in the first instance is presented for acceptance unless it is a bill on demand. A bill is dishonoured by non-acceptance, this is not so in case of a cheque

Bill and Cheque Compared

- These essential differences (besides others) are sufficient to explain why in practice cheques are not accepted. Acceptance is not necessary to create liability to pay as between the drawer and the drawee bank. The liability depends on contractual relationships between the bank and the drawer drawer, it customer. Other things being equal, in particular if the customer has sufficient funds or credit available with the bank, the bank is bound either to pay a cheque or dishonour it at once….It is different in case of an ordinary bill; the drawee is under no liability on the instrument until he accepts; his liability on the bill depends on the acceptance of it."
- A cheque is always to be made payable on demand, whereas an ordinary bill of exchange can be made payable after a fixed period.
- a) future dated cheque, being not payable on demand, may not be regarded as a cheque in the real sense of the word unless the date arrives and it becomes payable on demand.
- A cheque is exempted from stamp duty, but a promissory note as well a bill of exchange attracts stamp duty under the Indian Stamp Act, 1899.

Post dated cheque

- *A post dated cheque remains a bill of exchange till the date written on the face of it. On that date it becomes a cheque. One of the effects is that liability for criminal prosecution under Section 138 would not be attracted and 3 months period would be reckoned from the date appearing on the cheque.*

Pay Order

- A pay order is not a cheque. It is issued by one branch of a bank to another branch of the same bank or under arrangement, to another bank with a direction to credit the amount to the account of the party on whose demand it is issued. Therefore, neither a pay order is equivalent to a cheque no for its dishonour. Section 138 would be attracted, nor the banker who is directed to pay make the payment can be a proper complainant because he is not the payee of the instrument. (Ramesh Deshpande Vs. Punjab and Sindh Bank 2001)
- The decision of the Supreme Court on this is different.
- A “pay order” has been held to b covered by the definition of a cheque in Section 6 of the Act. A complain under Section 138 for dishonour of a pay order was held to be maintainable. (Punjab and Sindh Bank Vs. Vinkar Sahakari Bank Limited 2001)

Section 7 “Drawer” “Drawee”

- The maker of a bill of exchange or cheque is called the “drawer”, the person thereby directed to pay is called the “drawee”
- **“Drawee in case of need” -** When in the bill or in any endorsement thereon the name of any person is given in addition to the drawee to be resorted to in case of need - such person is called a “Drawee in case of need”.
- **“Acceptor”** – After the drawee of a bill has signed his assent upon the bill, or, if there are more parts thereof 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”.
- **“Acceptor for Honour”** – When a bill of exchange has been noted or protested for non-acceptance or for better security and any person accepts it, supra protest for the honour of the drawer or of any one of the endorsers, such person is called an “acceptor for honour”.
- **“Payee”-** The person named in the instrument, to whom or to whose order the money is buy the instrument directed to be paid, is called the “payee”

Section 7 "Drawer" "Drawee"

- A bill of exchange being an order upon the drawee to pay the money is not binding to him unless he accepts it, but acceptance is not necessary to the validity of the bill. If it is not accepted, it does not become invalid; it only becomes dishonoured by non-acceptance. The usual mode of acceptance is that the drawee will sign his acceptance on his face. Section 7 requires that the drawee should sign his assent and return it to the holder it give notice to him that he has done it and then he becomes the acceptor. The holder of the bill (a hundi) alleged that when it was presented to the drawees, they made an entry of it in their register and noted the register number on the hundi. The Lahore High Court held that there had been no acceptance within the meaning of Section 7. the Section requires that the drawee should sign his assent.(Gurudasmal Vs. Khemchand, AIR 1930 Lahore High Court). The Court said "It is clear that the mere writing of some figures on the hundi cannot amount to signing of its assent. It was held in **Pannalal Vs. Hargopal Khubiram 1919** that an oral acceptance of a bill does not make the person accepting it an acceptor of the bill within the meaning of Section 7 and the same view was taken by the Allahabad High Court.

Section 7 “Drawer” “Drawee”

- Where a bill is duly accepted by the drawee and is dishonoured by him by non-payment, it cannot be validly presented for payment to the drawee in case of need, If it was not first presented to him for acceptance. (**Dove Vs. Karachivalal , 1938)**
- An acceptance should be signed on the original bill and not on the copy of the bill. (**Ardeshir Sorabsha Vs. Khushal Das)**
- Section 33 declares that a bill can be accepted by the drawee or by all or some of several drawees or by a person mentioned in the instrument as drawee in case of need or by a person who accepts it for the honour of the drawee. No other person can bind himself by acceptance.
- According to Section 34, where there are several drawees of the bill who are not partners, each can accept for himself and not for others unless so authorised.

Section 8 – "Holder"

- The holder of a promissory note, bill of exchange or cheque means any person entitled in his own name to his position thereof and to receive or recover the amount due thereon from the parties thereto.
- Where the note, bill or cheque is lost or destroyed, its holder is the person so entitled at the time of such loss or destruction.
- The use of the phrase "entitled in his own name" is significant because of the institution of "benami". Its significance is thrown into full relief by the case of **Sarjoo Prasad Vs. Rampyari Debi, AIR 1952, Patna.** The plaintiff advanced a sum of Rs 2459 under a hand note. The note was executed not in the name of the plaintiff, but in the name of one X who was a name lender or a benamidar. On maturity the plaintiff brought an action to recover the amount. The High Court of Patna rejected his claim. He was not entitled to the position of the note 'in his own name' and therefore was not the holder.

Section 8 – "Holder"

- Similarly in Suraj Bali Vs Ramchandra, 1950 the real holder of promissory note had disappeared but was civilly alive. On maturity his son suit for the amount. But the Court dismissed his action on the ground that he was no entitled "in his own name' to the position of the instrument. He was as much stranger to the instrument as a thief or a finder would have been. In a matter of this kind, in the case of Harkishore Barna Vs. Gura-mia Chaudhary, 1930, the Calcutta High Court observed "the property in a promissory note including the right to recover the amount thereon is vested by statute in the holder of the note. The Negotiable Instrument's Act was enacted for the benefit of trade and commerce and the principle underlying it is that promissory notes, bills of exchange and cheques should be negotiable as apparent on their face without reference to the secret title to them."

Section 9 – "Holder In Due Course"

- Holder in due course means any person, who for consideration became the possessor of a promissory note, bill of exchange or cheque if payable to the bearer,
- Or the payee or indoresee, thereof if payable to order, before the amount mentioned in it becomes payable and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title.
- The phrase "in good faith and for value" has been split up by Section into four elements all of which must concur to make a holder in due course. They are:
- (1) The holder must have taken the instrument for value (2) He must have obtained the instrument before maturity (3) The instrument must be complete and regular on its face (4) He must have taken the instrument in good faith and without notice of any defect either in the instrument or in the title of the person negotiating it to him.

Section 9 – "Holder In Due Course"

- **1. Consideration -** A negotiation instrument contains a contract and therefore must be supported by consideration. A person who takes a bill or note without consideration cannot enforce it. In order, however, to secure free circulation of negotiable securities the doctrine of consideration has been relaxed in certain respects. Firstly, if a person wants to enforce a simple contract, he must prove that he has given consideration for it. But in case of negotiable instruments consideration is always present to have been given. "The presumption in such a case is that the instrument was given for good consideration and if the defendant intends to set up a defence that value has not been given… the burden of proving that lies on him." (**Talbot Vs. Von Boris, 1911)** every holder, therefore is presumed to be a holder for value. The presumption applies for full force where the instrument is payable to order and the holder has obtained it by endorsement. It becomes less forceful in the case of a bearer instrument.

Section 9 – "Holder In Due Course"

- In **Madhya Bharat Khadi Sangh Vs. b. K Kapoor AIR 1979** the Allahabad High Court has held "if the hundi is payable to order then the payee or endorsee is holder in due course. In their case, it is not necessary to show that they obtained it for consideration, but if the hundi is payable to the bearer, then the person possessing will be holder in due course only if he has come in possession of the hundi for consideration."
- The facts of the case were that certain goods were sent to the defendant according to his order and the railway receipt and a hundi for the price drawn on him and payable to the collecting agents were sent through the agents. The defendant accepted the hundi which was payable after 21 days and obtained the railway receipt. He refused to pay the hundi amount because he had certain complaints about the quality and quantity of the goods. The collecting agents sued him. One of his contentions was that because the agents had themselves not paid any consideration to the drawers of the hundi, the were not holders in the due course. This contention was not accepted and the court expressed the opinion that the agents were holders in due course and as such entitled to recover the amount. But as they had paid nothing and lost nothing they were not entitled to proceed against the acceptor under Section 32 for compensation.

Section 9 – “Holder In Due Course”

- Secondly, “in a simple contract the only person who can sue upon it is the person from whom the consideration moves”. But in the case of a negotiable instrument “if there be a consideration for it, it does not matter from whom it moves”. Thirdly, a past consideration is sufficient to support a contract in a bill or a note. Fourthly, if the holder has taken the instrument for consideration, the party liable will not be permitted to plead any defect or want of consideration at any early stage.
- An illustration in point is the decision of the court of appeal in **Diamond Vs Graham, 1968. “** A person obtained a cheque from the plaintiff on the assurance that he would give to the plaintiff a cheque for the same amount from the defendant. When h gave such a cheque, the plaintiff allowed this cheque to be cashed. But the defendant’s cheque was dishonoured. In the action by the plaintiff on the cheque the defendant contented that he had received no consideration from the plaintiff.”
- The court allowed the plaintiff’s action. The court said that thee was no need for any direct consideration between the plaintiff and the defendant. The plaintiff had given value and obtained the cheque for value. Thus he became a holder for value.

Section 9 – “Holder In Due Course”

- **2. Before Maturity**
- In order to be holder in due course, the holder must have obtained the instrument before its maturity. It was laid down as early as 1825 in **Down Vs. Halling that** “if a bill or note or cheque be taken after it is due “, the person taking it takes at his peril. “He cannot have no better title to it than the party from whom he takes it, and therefore, cannot recover upon it if it turns out that it has been previously lost or stolen”. The Madras High Court held in a case of this kind that “a person obtaining by payment, after dishonour by drawee, delivery of a negotiable instrument payable to bearer or acquires the rights of a holder and can under Section 59 recover from the drawer, the amount due on proof of presentment and notice of dishonour.

Section 9 – "Holder In Due Course"

- **3. Complete and Regular**
- The third requirement is that the instrument should be complete and regular on the face of it. And "face" for this purpose includes back also. It is the duty of every person who takes a negotiable instrument to examine its form, for if it contains any material defect, he will not become a holder in due course. An instrument may be defective in several ways. It may be incomplete, as it was in **Hogarth Vs. Latham & Co.** (1878) The plaintiff took two bills of exchange without any drawer's name and completed them himself. The court held that he could not recover upon the bills. "Anybody who takes such an instrument as this, knowing that when it was accepted the bill had not the name of any drawer upon it, takes it at his peril." An instrument may also be incomplete because it is not properly dated or stamped. But a bill of exchange does not need acceptance to make it complete and regular. Some unusual marks on the instrument may make it defective, such as the marks of dishonour, blanks, or restrictive or conditional endorsements. An improper endorsement renders the whole of the instrument irregular.

Section 9 – “Holder In Due Course”

- This happened in the case of **Arab Bank Ltd. Vs. Ross 1954. The plaintiff bank** discounted for value two promissory notes given by the defendant. The notes had been made out in the name of “F. and F.N. Co.” as payees. One of the parterners in fraud of the others endorsed them to the bank thus: “F. and F.N.”, the word “company” being omitted. It was held, “that the omission of the word “company” was sufficient to give rise to reasonable doubt whether the payee and the endorsers were necessarily the same. Therefore the notes were not complete and regular on the face of them and the bank could not succeed as holders in due course”. The plaintiffs were, however, permitted to recover on the ground that the defendant had failed to show any defect in the title of any previous party.

Section 9 – "Holder In Due Course"

4. Good faith - The last requirement is that the holder should have received the instrument in "good faith". There are two methods of ascertaining **a person's good faith, "subjective" and "objective". In subjective test the court has to see the** holder's own mind and the only question is "did he take the instrument honestly?" In objective test, on the other hand, we have to go beyond the holder's mind and see whether he exercised as much care in taking the security as a reasonably careful person ought to have done. Subjective test requires "honesty", objective "due care and caution".

- The Supreme Court examined the position in **U. Ponnappa Moothan & Sons Vs. Catholic Syrian Bank Ltd., (1991)** After conducting a vast survey of English textbooks and Common Law, the Court accepted the view that the effect of the Indian provision should be different from that of the English law because the latter requires the holder to act in good faith and "without notice", whereas Section (requires him to act "without having sufficient cause to believe".

Section 10 – Payment in Due Course

- “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 reasonable ground for believing that he is not entitled to receive payment of the amount mentioned therein.

Negotiation

- The transfer of an instrument by one party to another so as to constitute the transferee a holder is called “negotiation”. A bearer instrument is transferable by simple delivery.
- Section 14 which defines negotiations runs as follows:

  14. **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.**

  An instrument payable to order can be transferred by endorsement and delivery.

Assignment and Negotiations Distinguished

- The negotiation of an instrument should be distinguished from transfer by assignment. When a person transfers his right to receive the payment of a debt that is called "assignment of the debt". Where, for example, the holder of a life insurance policy transfers the right to receive the payment to another person, that is an assignment. When the holder of a bill, note or cheque transfers the same to another, he, in essence, gives his right to receive the payment of the instrument to the transferee. Thus in both "negotiation", and "assignment" there is the transfer of the right to receive the payment of a debt. But with this the similarity ends, for the rights which the transferee of an instrument by negotiation acquires are substantially superior to those of an assignee.

Assignment and Negotiations Distinguished

The points of difference may be now stated:

(1) The assignee of a debt takes it subject to all the defects and equities that may exist in the title of his assignor. But the holder in due course of a negotiable instrument takes it free from all defects in the title of the previous transferors.

(2) An assignment does not bind the debtor unless a notice of the assignment has given to him and he has, expressly or impliedly, assented to it. But no information of the transfer of a negotiable instrument has to be given to the debtor. The acceptor of a bill and the maker of a promissory note are liable on maturity to the person who is at the time the holder in due course of the instrument.

(3) There are a number of presumptions in favour of a holder in due course. For example, he is presumed to have given consideration for the instrument. The burden lies upon the opposite party to show that he had given consideration. But there are no such presumptions in favour of an assignee, he has to prove that he has given consideration for the assignment.

(4) An assignment attracts stamp duty, but endorsement does not.

Section 15 – Endorsement

- When the maker or holder of a negotiable instrument signs the same, otherwise than as such maker, for the purpose of negotiation on the back or face thereof or on a slip of paper annexe thereto, or so signs for the same purpose a stamp paper intended to be completed as a negotiable instrument, he is said to endorse the same, and is called the “endorser.”
- An endorsement is completed by the delivery of the instrument to the endorsee. Indeed “every contract on a bill whether it be the drawer’s, the acceptor’s or and endorser’s, is incomplete and revocable until delivery of the instrument in order to give effect thereto.” “An endorsement means an endorsement completed by delivery.” Thus where a person endorses an instrument to another and keeps it in his papers where it is found after his death and delivered o the endorsee, the latter gets no right on the instrument.
- This is further reinforced by the provisions in Section 57 which says that a legal representative cannot buy delivery only negotiate an instrument endorsed by the deceased.

Section 15 – Endorsement

- Similarly, where a person finds or takes away an instrument duly endorsed to him, he gets no rights on the instruments. But the holder of a note cut it into two pieces and posted one half to a person whom he wanted to remit money, he was entitled to withhold delivery of the other half, because a partial delivery does not make a complete endorsement. Where the endorser is authorised to send the instrument by post, it is deemed to have been delivered to the endorsee as soon as it is posted and it is immaterial that the cheque was stolen in the post by the thief who got it cashed. (**Norman Vs. Ricketts, 1886)** Where the bank did not pay a cheque because of doubt about signature and before the doubt could be removed, the drawer of the cheque died, the gift was held to be incomplete. The bank's authority to pay was determined.

Types of Endorsements

- **1) Endorsement in Blank –** [Sections 16 and 54]
- **Section 16** – Endorsement "in blank" and "in full", "endorsee". *(1) if the endorser signs his name only, the endorsement is said to be "in blank", and if he adds a direction to pay the amount mentioned in the instrument to, or the order of, a specified person, the endorsement is said to be "in full", and the person so specified is called the "endorsee" of the instrument. (2) the provisions of this act relating to a payee shall apply with the necessary modifications to an endorsee.*
- **Section 54** – Instrument endorsed in blank – *Subject to the provisions herein after contained as the cross check, a negotiable instrument endorsed in blank is payable to the bearer thereof even though originally payable to order.*

Types of Endorsements

- Where the endorser signs only his name on the back of the instrument for the purpose of negotiating it, that is an endorsement “in blank”. The effect of a blank endorsement is to cover the order instrument into bearer. For all purposes of negotiation, it becomes a bearer instrument. It may be negotiated by simple delivery and the bearer is entitled to its payment. It remains so until the endorsement “in blank” is converted by the holder into endorsement in full. A subsequent endorsement in full will not have the effect of converting the instrument into “order.” All subsequent endorsements will be needless and forgery of a redundant endorsement will not affect the title of a subsequent party. Where a cheque is originally payable to bearer, any endorsement in blank or in full or of restrictive nature will not destroy its bearer character and the banker will be discharged for his liability by payment to the bearer.

Types of Endorsements

2) Endorsement in full – (Section 16)

- Where the endorser adds to his signature the name of a person whom or to whose order he wants the instrument to be paid, that is an endorsement in full. If, for example, A, the holder of a cheque wants to make an endorsement in full to be, he would write thus: “pay be or order. Sd. A.” He may not add the words “or order”. An endorsement to “A” will be equivalent to endorsement to “A or order”. Where an instrument was endorsed “pay the contents to L.A.”, it was held that “L.A.” could have endorsed it to another and the party liable could not object to any such endorsement. (Acheson Vs. Fountain, 1723)
- The usual form, of course, is to ad the words “or order “ after the name of the endorsee, but, since no form is prescribed, any words will do so long as they clearly show the endorser’s intention. A note was endorsed as follows:
- “I hereby assign this draft, and all benefit of the money secured thereby to J, and order maker of the note to pay him the amount thereof an all interest in respect thereof.” This was held to be not and agreement requiring and stamp but an ordinary endorsement of the note though in a very elaborate form.

Types of Endorsements

3) Effect of Endorsement and Restrictive Endorsement (Section 50)

50 Effective of Endorsement – *The endorsement of a negotiable instrument followed by delivery transfers to the endorsee the property therein with right of further negotiation; but the endorsement may, by express words, restrict or include such right, or merely constitute the endorsee an agent to endorse the instrument or to receive it contents for the endorser of our some other specified person.*

Types of Endorsements

Illustrations

B signs the following endorsements on different negotiable instruments payable to bearer:

a) "Pay the contents to C only"
b) "Pay C for my use."
c) I "pay C or order for the account of B"
d) "The within must be credited to C"

These endorsements exclude the rights of further negotiation by C

e) "Pay C."
f) "Pay C value in account with the Oriental Bank."
g) "Pay the contents to C, being part of the consideration in a certain deed of assignment executed by C to the endorser and others.

These endorsements do not exclude the rights of further negotiation by C.

Types of Endorsements

- One of the effects of the endorsements which has been completed by delivery is that the property in the instrument passes to the endorsee and he gets the right of further endorsement. But when this right of further negotiation is, by express words in the endorsement, restricted o taken away, that is called “restrictive” endorsement. The endorser may altogether exclude the right of further negotiation or only restrict it or “may merely constitute the endorsee” an agent to endorse the instrument, or to receive its contents for the endorser or for some other specified person.”
- The effect of a restrictive endorsement is tht the endorsee gets the right to receive the payment when due and sue the parties for it, but he cannot further negotiate the instrument except as authorised by the endorser. The endorsee is constituted merely as an agent for collection and the endorser remains the real owner of the instrument.

Types of Endorsements

4) Endorsement sans Recourse – (Section 52)

- **52 -** *Endorser who excludes his own liability or makes it conditional – the endorser of a negotiable instrument may by express words in the endorsement, exclude his own liability thereon or make such liability or the right of the endorsee to receive the amount due thereon depend upon the happening of a specified event, although such event may never happen.*
- *Where an endorser so excludes his liability and afterwards becomes the holder of the instrument, all intermediate endorsers are liable to him.*

Types of Endorsements

- ***Illustrations***

a) *the endorser of a negotiable instrument signs his name adding the words "Without recourse". Upon this endorsement he incurs no liability.*

b) *a is the payee and holder of a negotiable instrument., Excluding personal liability by an endorsement "without resource", he transfers the instrument to B and B endorses it to C who endorses to A . A is not only reinstates in his former rights, but has the rights of an endorsee against B and C.*

Types of Endorsements

- **Commentary**
- If the endorser does not want to incur any liability as endorser, he can insert a stipulation in his endorsement negativing or limiting his liability. He may, for example, write his endorsement thus; “ Pay D or order without recourse to me”, or “pay D or order sans recourse”, or “Pay D or order at his risk”. These words will exclude the liability of the endorser all together. A person, who was not party to a cheque, at the request of the payee wrote his name on the back thereof adding the words “ Sans Recourse”. It was held that an endorser has a right to negative his liability by suitable words “ **Wakefield V/s. Alexander and Company, 1901”**

5) Conditional Endorsement (S. 52)

- **52** The endorser can also insert a condition I his endorsement. He may for example say that " pay B or order on his marriage", or " on the arrival of a ship". A condition of this kind does not affect the position of the party who has to pay the instrument on its maturity. He may pay to the endorsee and will be discharged from liability whether the condition has been fulfilled or not. But as between the endorser and endorsee the condition is operative. If the endorsee obtains the payment without the condition being fulfilled he will hold the same in trust for the endorsee .

6 Partial Endorsement (S. 56)

- **56** *Endorsement for part of sum due – no writing on a negotiable instrument is valid for the purpose of negotiation if such writing purports to transfer only a part of the amount appearing to be due on the instrument; but where such amount has been partly paid, a note to that effect may be endorsed on that instrument, which may then be negotiated for the balance*
- An instrument cannot be endorsed for a part of its amount only if, for example, the instrument is for Rs. 100/- it cannot be endorsed for Rs. 50/- only but if the amount due has already been partly paid, a note to that effect may be endorsed on the instrument and it may then be negotiated for the balance. When an instrument has been partly paid but the fact of part payment is not entered on it and, if it is endorsed to a bonafide holder, it will be a instrument of full value ion his hand. ***Shaik Md. Hussain V/s. M Reddaiah (1979)***
- The transfer of an instrument to two different persons will mean part transfer in favour of one and part in favour of the other, it will also be inoperative under Sec. 56. Such persons, however, become joint owners of the instrument and may recover as joint payees whatever may be their mutual rate.

Noting And Protest

- ***Sec. 99*** *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.*
- *Such note must be made within a reasonable time after dishonour and must specify the date of dishonour, the reason, if any, assign for such dishonour or if the instrument has not been expressly dishonoured the reason why the holder treats it as dishonoured, and the notary's charges.*

Noting And Protest

- When a promissory note or a bill of exchange has been dishonoured by non acceptance of non payment, in order to create a proof of this fact the holder may approach a notary public and have the fact of dishonour noted either on the instrument itself or on a separate piece of paper or partly upon each.
- Noting must be made within a reasonable time after dishonour. Upon such request being received the notary inquires from the party liable to pay and if he still dishonours, the notary makes a note of the fact of dishonour. The note should contain the following particulars: (1) The fact that the instrument has been dishonoured; (2) That date on which it was dishonoured; (3) The reason, if any assigned for the dishonour; 4) If the instrument has not been expressly dishonoured the reason why the holder treats it as dishonoured, and (5) Notary charges.
- The advantage of noting is that it creates evidence of the fact of dishonour and things connected with it. But even so noting is not compulsory except for foreign bills. The holder may at his choice have the fact of dishonour noted or not.

Protest

- ***Sec: 100 –*** *When a promissory note or a bill or exchange has been dishonoured by non acceptance or non payment, the holder may, within a reasonable time, cause such dishonour to be noted and certified by a notary public. Such certificate is called a protest.*
- *Protest for better security – When the accepter of a bill of exchange has insolvent, or his credit has been publicly impeached before the maturity of the bill, the holder may, within a reasonable time, cause a notary public to demand better security of the accepter, and on it being refused may, within a reasonable time, cause such facts to be noted and certified as aforesaid. Such certificate is called a protest for better security.*

Protest

- Protest for better security is a measure of protection against the consequences of the accepters insolvency. When the accepter of a bill of exchange becomes insolvent all his credit has been publicly impeached, and this has happened before the maturity of the bill, the holder may approach a notary public and ask him to demand from the acceptor a better security than the mere bill. This should be done within a reasonable time. If the acceptor refuses to oblige with any security, the holder should have the fact of refusal noted and certified by the notary. Such a certificate is called a protest for better security. This should be done within a reasonable time after the acceptors refusal to provide security

Contents of Protest

- Section 101 requires a protest to contain certain particulars for its validity The omission of any one of such particulars for its invalid. The particulars are as follows:

1. It should contain the instrument itself or a literal transcript of it and of everything written or printed on the instrument.
2. The name of the person for whom and against whom the instrument has been protested, that is, the name of the party making the protest and against whom the protest is made.
3. It should contain a statement that acceptance, or payment or better security has been demanded from such person by the notary public, the terms of his answer, or a statement that he gave no answer or that he could not be found.

Contents of Protest

4. When the protest is against the dishonour of a bill or note, the protest should specify the time and place of dishonour. When the protest is against refusal of better security, the place and time of refusal should be noted.
5. The subscription of the notary public making the protest.
6. Where there has been acceptance or payment for honour, the protest should specify the name of the person who accepted or paid for honour and for whose honour he did so and also the manner in which such acceptance or payment was offered and effected.

- Clause (c) of the section requires the notary before preparing his certificate to make a demand for acceptance, payment or security. This section concludes with the provision that the notary may make such demand either in person or by his clerk or, where authorised by agreement or usage, by registered post.

Notice of Protest

- *102. Notice of protest.—When a promissory note or a bill of exchange is required by law to be protested, notice of such protest must be given instead of notice of dishonour, in the same manner and subject to the same conditions; but the notice may be given by the notary public who makes the protest.*
- In circumstances where a protest is a compulsory legal requirement, Section 102 requires that instead of a notice of dishonour, a notice of protest should be given. Notice of protest will have to be given in the same manner and subject to the same conditions as notice of dishonour with only this difference that notice of protest can be given by the same notary who makes the protest.

Notice of Protest

- **Protest for Non-payment**

  Section 103. Where a bill is payable at some place other than the place mentioned in the bill as the residence of the drawee and the bill has been dishonoured by non-acceptance, then, without any further presentation to the drawee, the bill may be protested for non-payment in the place specified for payment. No such protest will, however, be necessary where the bill has been paid before or at maturity.

- **Foreign Bills**

  Section 104. Protest of foreign bills.-- Foreign bills of exchange must be protested for dishonour when such protest is required by law of the place where they are drawn.

Dishonor of Cheque:

- Section 138: Dishonor of cheque for insufficie.ncy, etc., of funds in the accounts
- Where any cheque drawn by a person on an account maintained by him with a banker for payment of any amount of money to another person from out of that account for the discharge, in whole or in part, of any debt or other liability, is returned by the bank unpaid, either because of the amount of money standing to the credit of that account is insufficient to honour the cheque or that it exceeds the amount arranged to be paid from that account by an agreement made with that bank, such person shall be deemed to have committed an offence and shall without prejudice to any other provisions of this Act, be punished with imprisonment for "a term which may extend to two year", or with fine which may extend to twice the amount of the cheque, or with both:

  Provided that nothing contained in this section shall apply unless-
- (a) The cheque has been presented to the bank within a period of six months from the date on which it is drawn or within the period of its validity, whichever is earlier.

  (b) The payee or the holder induce course of the cheque, as the case may be, makes a demand for the payment of the said amount of money by giving a notice, in writing, to the drawer, of the cheque, "within thirty days" of the receipt of information by him from the bank regarding the return of the cheques as unpaid, and

  (c) The drawer of such cheque fails to make the payment of the said amount of money to the payee or, as the case may be, to the holder in due course of the cheque, within fifteen days of the receipt of the said notice.
- Explanation: For the purpose of this section, "debt or other liability" means a legally enforceable debt or other liability.

Ctd---

- Section 139: Presumption in favor of holder

  It shall be presumed, unless the Contrary is proved, that the holder of a cheque received the cheque of the nature referred to in section 138 for the discharge, in whole or in part, or any debt or other liability.

- Section 140: Defence which may not be allowed in any prosecution under section 138

  It shall not be a defence in a prosecution of an offence under section 138 that the drawer had no reason to believe when he issued the cheque that the cheque may be dishonoured on presentment for the reasons stated in that section.

Vinod Tanna Vs. Zaheer Siddiqui [MANU/SC/1475/2001]

- In case of insufficiency of funds or stop payment instructions from the party they are liable under Section 138 of the Act but not in the case where the signature was incomplete and the bank dishonored due to incomplete signature and not otherwise.

Kolla Veera Raghav Rao Vs. Gorantla Venkateswara Rao (AIR 2011 SC 641)

- The issue in this case were the accused was convicted under Section 138 of Negotiable Instruments Act for dishonor of cheque and there was another complaint made out under Section 420 of Indian Penal Code for Cheating on the same accused for dishonor.
- Court held that although the offences are different the facts are same. Hence, Section 300(1) of Cr.P.C. applies. Hence prosecution under Section 420, IPC was barred

Compoundable offence

- ***Section 147: Offences to be compoundable:***

- Notwithstanding anything contained in the Code of Criminal Procedure, 1973, (2 of 1974.) every offence punishable under this Act shall be compoundable.

Damodar S. Prabhu Vs. Sayed Babalal H.(AIR 2010 SC 1907)

- (i) In the circumstances, it is proposed as follows:
- (a) the accused could make an application for compounding of the offences at the first or second hearing of the case and compounding may be allowed without costs
- (b) If the application is made at a subsequent stage the accused will be required to pay 10% of the cheque amount to be deposited with Legal Services Authority

Contd---

- (c) Similarly, if the application for compounding is made before the Sessions Court or a High Court in revision or appeal, such compounding may be allowed on the condition that the accused pays 15% of the cheque amount by way of costs.
- (d) Finally, if the application for compounding is made before the Supreme Court, the figure would increase to 20% of the cheque amount.

Thank You