

THE NEGOTIABLE INSTRUMENTS ACT, 1881

Question 1

Pick-up the correct answer from the following:

Which of the following is not applicable to negotiable Instrument?

- (a) *It must be in writing*
- (b) *It must be transferable*
- (c) *It must be registered*
- (d) *It must be signed.*

(May 2007)

Answer

The Negotiable Instrument need not to be registered Option (c)

Question 2

PQR Limited received a cheque for Rs. 50,000 from its customer Mr. LML. After a week the company came to know that the proceeds were not credited to the account of PQR Limited due to some 'defects', as informed by the Banker. What according to you are the possible effects?

(May 2007)

Answer

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 electronic form.

Possible defects are;

1. Cheque undated.
2. Cheque becomes stale
3. Instrument inchoate
4. Cheque may be post dated
5. Inadequate funds position of the customer
6. Customer might have credit in one branch and cheque drawn on another branch.

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7. Bank might have received report of insolvency/lunacy of customer.
8. Countermanding / stop payment instruction of customer.
9. Bank receiving attachment order by a court
10. Bank receiving notice of customer's death
11. Closure of account by customer.
12. Material alterations like irregular signature, difference of amount in words and figure etc.

Question 3

State the circumstances under which the drawer of a cheque will be liable for an offence relating to dishonour of the cheque under the Negotiable Instruments Act, 1881.

Examine, whether there is an offence under the Negotiable Instruments Act, 1881, if a drawer of a cheque after having issued the cheque, informs the drawee not to present the cheque as well as informs the Bank to stop the payment. (May 2007)

Answer

Dishonour of cheque: On dishonour of a cheque the drawer is punishable with imprisonment for a term not exceeding two years or with a fine not exceeding twice the amount of the cheque or with both, if the following conditions are fulfilled:

- (i) If the cheque is returned by the bank unpaid due to insufficiency of funds in the account of drawer
- (ii) If the cheque was drawn to discharge a legally enforceable debt or other liability.
- (iii) If the cheque has been presented to the bank within a period of six months from the date on which it is drawn on or within the period of its validity, whichever is earlier.
- (iv) if the payee or the holder in due course of the cheque has given a written notice demanding payment within 30 days from the drawer on receipt of information of dishonour of cheque from the bank.
- (v) If the drawer has failed to make payment within 15 days of the receipt of the said notice. (Section 138)
- (vi) If the payee or a holder in due course has made a complaint within one month of cause of action arising under Section 138 (Section 142)

Problem

The Supreme Court held in *Modi Cements Ltd. Vs. Kuchil Kumar Nandi* that once a cheque is issued by the drawer, a presumption under Section 139 follows (i.e. the cheque has been issued for the discharge of any debt or other liability) and merely because the drawer issued a notice thereafter to the drawee as to the bank for stoppage of payment, it will not preclude an action under Section 138. Hence, the drawer of the cheque will be liable for the offence under Section 138 for dishonour of cheque.

Question 4

Pick out the correct answer from the following:

'A' signs the instrument in the following manner. State the instrument which cannot be considered as promissory note:

- (1) *I promise to pay B or order Rs. 500*
- (2) *I acknowledge myself to be indebted to B Rs. 1,000 to be paid on demand, for value received*
- (3) *I promise to pay B Rs. 10,000 after three months*
- (4) *I promise to pay B Rs. 500 seven days after my marriage with C.* (November 2007)

Answer

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

Question 5

Explain as to why the combination of 'not negotiable' with 'Account payee' crossing is considered the safest form of crossing a cheque. (November 2007)

Answer

Safest form of crossing a cheque

The addition of the words 'not negotiable' in a crossed cheque does not restrict the transferability of the instrument, but the cheque is deprived of its special feature of negotiability. The general rule about the negotiability is that the holder in due course of a bill or promissory note or cheque takes the instrument free from any defect which might be existing in the title of the transferor. According to Section 130 of the Negotiable Instruments Act, 1881 a person who takes a cheque bearing 'not negotiable' marking shall not have, and shall not be capable of giving, a better title to the cheque which the person from whom he took it, had. A bank, therefore should be extra careful in paying such cheques. The payment should be made only after he is satisfied that the person demanding payment is the person entitled to receive it.

Account payee crossing directs the collecting banker to collect it for the payee only and warns that if the amount is collected for some one else, he may be held liable for damages.

In view of the advantages explained above, the combination of 'not negotiable' and 'A/c payee' crossing can be considered the safest form of crossing.

Question 6

What is meant by maturity of a Bill of Exchange or Promissory Note? Calculate the date of maturity of the following bills of exchange explaining the relevant rules relating to determination of the date of maturity as provided in the Negotiable Instruments Act, 1881:

- (i) *A Bill of Exchange dated 31st August, 2007 is made payable three months after date.*

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- (ii) *A Bill of Exchange drawn on 15th October, 2007 is payable twenty days after sight and the bill is presented for acceptance on 31st October, 2007. (November 2007)*

Answer

The maturity of a promissory note or bill of exchange is the date on which it falls due for payment (Sec 22). Sec 22 of the Negotiable Instruments Act, 1881 further adds that for payment in calculating the maturity of a promissory note or a bill of exchange which is not payable on demand, at sight or on presentment, three days, called the days of grace, must be added to the date on which the instrument is expressed to be payable.

Bill of exchange dated 31st August, 2007: if the month in which the period would terminate has no corresponding day, the period shall be held to terminate on the last day of such month (Sec 23). In this case the bill of exchange is dated 31st August, 2007 and it is made payable 3 months this after date. Hence it falls due on 3rd day after November, 2007 (the last day of the month) i.e. on 3rd December, 2007.

Bill of exchange payable 20 days after sight: The bill is presented for acceptance on 31st October, 2007. The date of presentment for acceptance is to be excluded. Hence the instrument is at maturity on the 3rd day after 20th November, 2007 i.e. 23rd November, 2007.

Question 7

Pick out the correct answer from the following and give reasons:

A Promissory-note drawn jointly by X, a minor and Y, a major is:

- (1) void
- (2) valid but not negotiable
- (3) valid but can be enforced only against Y
- (4) None of the above. (May 2008)

Answer

Option (3) is the correct answer: because a minor can draw a promissory note to bind all parties except himself (Section 26 of the Negotiable Instruments Act, 1881).

Question 8

What is meant by 'Presentment' of a bill of exchange under the Negotiable Instruments Act, 1881? When is such a bill of exchange presented for payment? State when is the presentment not necessary. (May 2008)

Answer

Presentment of Bill of Exchange (Section 76 of the Negotiable Instruments, Act, 1881): "Presentment" means showing the instrument to the drawee or acceptor to make payment as per conditions. Generally, presentment is made during normal business hours. In the case of fixed period bill or after sight bill it must be presented on its maturity.

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Section 76 of the Negotiable Instruments Act, 1881 provides the conditions whereunder presentment is unnecessary.

When the presentment of bill is not necessary, it means that the instrument is taken as dishonoured on the due date for presentment even though it has not been presented. The result is that the holder may sue the party liable without presentment and the plea that the instrument was not presented for payment is not a defence to the claim of the holder

- (a) When drawer or acceptor knowingly prevents it; or
- (b) Is absent at such place and time despite search.
- (c) If payment is made voluntarily.
- (d) The party paying is aware that it has not been presented;
- (e) When payment is made or he promises to pay part or whole amount.

Question 9

'A' draws a bill of exchange payable to himself on 'X', who accepts the bill without consideration just to accommodate 'A'. 'A' transfers the bill to 'P' for good consideration. State the rights of 'A' and 'P'.

Would your answer be different if 'A' transferred the bill to 'P' after maturity ? (May 2008)

Answer

Accommodation Bill: Problem (Sections 43 and 59 of the Negotiable Instruments Act, 1881)

The problem is based on the provisions of Sections 43 and 59 of the Negotiable Instruments Act, 1881.

'A' cannot recover from 'X' because it is an accommodation bill drawn by 'A' and accepted by 'X' without consideration. According to Section 43, an instrument without consideration creates no obligation between the parties to the transaction i.e. 'A' and 'X' in this case.

Section 43 also provides that if such a bill is transferred to a holder for consideration, such holder may recover the amount due on such instrument from the transferor for consideration or any prior party thereto. Hence 'P' in this case can recover the amount from 'X' and 'A'.

According to Section 59, in the case of accommodation bills, a defect in the title of the transferor does not affect the title of holder acquiring after maturity. Hence the answer will be the same even if 'P' has acquired the bill for consideration after maturity.

Question 10

Pick out the correct answer from the following and give reasons:

A negotiable instrument that is payable to order can be transferred by:

1. Simple delivery
2. Endorsement and delivery

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3. *Endorsement*

4. *Registered Post*

(November 2008)

Answer

Correct answer is (2) i.e. "Endorsement and delivery" : In accordance with the provisions of section 48 of the Negotiable Instruments Act, 1881, a promissory note, bill of exchange or cheque payable to order, is negotiable by the holder by endorsement and delivery thereof, subject to the provisions of section 58. Section 58 lays down that if a negotiable instrument is lost or has been obtained by fraud or unlawful consideration only holder in due course is entitled to get amount.

Question 11

B issued a cheque for Rs.1,25,000 in favour of S. B had sufficient amount in his account with the Bank. The cheque was not presented within reasonable time to the Bank for payment and the Bank in the meantime, became insolvent.

Decide, under the provisions of the Negotiable Instrument Act, 1881 whether S can recover the money from B.
(November 2008)

Answer

The problem as asked in the question is based on Sections 72 and 74 of the Negotiable Instrument Act, 1881.

As per Section 72, it is the duty of the holder of a cheque to present the same to the bank for payment before the relationship between the bank and drawer is spoilt. It is only if he does so that he can hold the drawer liable in case of non payment and not otherwise.

As per Section 74, if the cheque is not presented by the holder for payment within reasonable time and meanwhile the relation between drawer/customer of the bank is spoilt and if the bank refuses to make payment or is incapable of making such payment, then the drawer cannot be held liable for such dishonour.

Hence applying the above provisions, S cannot recover the money from B.

Question 12

Describe in brief the advantages and protections available to a "holder in due course" under the provisions of the Negotiable Instruments Act, 1881.
(November 2008)

Answer

In accordance with the provisions of Section 9 of the Negotiable Instruments Act, 1881, 'holder in due course' means a person who for consideration became the possessor of a promissory note, bill of exchange or cheque if payable to bearer or the payee or indorsee thereof, if payable to order, before the amount mentioned in it became payable and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title.

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The holder in due course gets better title even if there was defect in title of transferor. In fact all defects are cleansed when the bill goes in the hands of holder in due course except in case where signature of endorser or maker or drawee was forged.

Hence the holder in due course has following advantages and protections:

- (a) A person who had signed an inchoate instrument is liable to holder in due course for full value as provided under Section 20.
- (b) Every prior party to the instrument is liable to holder in due course (section 36).
- (c) Even if drawer is fictitious, acceptor is liable to holder in due course if signature of drawer and endorser as appearing in the bill tallies (section 42).
- (d) Parties to instrument are liable to holder in due course or against subsequent holder even if it was an accommodation bill but the liability stands only to the consideration paid by him and not the full amount (section 43).
- (e) Even if Bill of Exchange was delivered conditionally or for a specific purpose and not for purpose of transferring property in the bill absolutely, the holder in due course is still entitled for the amount of the Bill (section 46 para 3).
- (f) Even if Bill was lost or was obtained from maker/acceptor/holder by offence or fraud for unlawful consideration the holder in due course is still entitled to get full amount of bill (Section 58).
- (g) In a suit by holder in due course, maker of promissory note, drawer of bill of exchange or cheque and acceptor of bill for honour of drawer cannot deny validity of the instrument as originally drawn (Section 120).
- (h) In a suit filed by holder in due course, maker of promissory note and acceptor of bill payable to order can not deny payee's capacity to indorse the promissory note or bill (Section 121).
- (i) Endorser can not deny signature or capacity of any prior party to the instrument (Section 122).

Question 13

Pick out the correct answer from the following and give reasons:

In legal terms, a person who takes the instrument bona fide for value before it is overdue, in good faith, is known as

- (1) *Holder in due course*
- (2) *Holder*
- (3) *Holder for value*
- (4) *None of the above.*

(June 2009)

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Answer

Answer No (1): **Holder in due course:** A person who takes the instrument bona fide for value before it is overdue, in good faith, is known as holder in due course, under Section 9 of the Negotiable Instruments Act, 1881.

Question 14

Mr. 'Wise' obtains fraudulently from 'R' a crossed cheque "Not Negotiable". He transfers the cheque to 'V', who gets the cheque encashed from ANS Bank Limited which is not the drawee bank. 'R' on coming to know about the fraudulent act of Mr. 'Wise' sues ANS Bank for the recovery of the money. Examine with reference to the relevant provisions of the Negotiable Instruments Act, 1881, whether 'R' will succeed in his claim. Would your answer be still the same in case Mr. 'Wise' does not transfer the cheque and gets the cheque encashed from ANS Bank himself?
(June 2009)

Answer

According to Section 130 of the Negotiable Instruments Act, 1881, a person taking a cheque crossed generally or specially bearing in either case the words 'not negotiable' shall not have or shall not be able to give a better title to the cheque than the title the person from whom he took had. In consequence, if the title of the transferor is defective, the title of the transferee would be vitiated by the defect.

Thus, based on the above provisions, it can be concluded that if the holder has a good title, he can still transfer it with a good title; but if the transferor has a defective title, the transferee is affected by such defects and he cannot claim the right of a holder in due course by proving that he purchased the instrument in good faith and for value. As Mr. Wise in the given case had obtained the cheque fraudulently, he had no title to it and could not give to the bank any title to the cheque or money and the bank would be liable for the amount of the cheque for encashment (*Great Western Railway Co. Ltd. vs. London and County Banking Co.*).

The answer in the second case would not change and shall remain the same for the reasons given above.

Thus R in both the cases shall succeed in his claim from ANS Bank.

Question 15

A issues an open 'bearer' cheque for Rs.10,000 in favour of B who strikes out the word 'bearer' and crosses the cheque. The cheque is thereafter negotiated to C and D. When it is finally presented by D's banker, it is returned with remarks "payment countermanded" by drawer. In response to a legal notice from D, A pleads that the cheque was altered after it had been issued and therefore he is not bound to pay the cheque. Referring to the provisions of the Negotiable Instruments Act, 1881 decide, whether A's argument is valid or not?

(June 2009)

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Answer

The cheque bears two alterations when it is presented to the paying banker. One, the word 'bearer' has been struck off and two, the cheque has been crossed. Both of these alterations do not amount to material alteration under the provisions of the Act and hence the liability of any including the drawer is not at all affected. 'A' is liable to pay the amount of the cheque to the holder.

Question 16

Pick out the correct answer from the following and give reasons:

A negotiable instrument drawn in favour of a minor is :

- (1) void
- (2) void but not enforceable
- (3) valid
- (4) None of the above.

(November 2009)

Answer

Answer: No. 3: 'Valid' : Every person capable of contracting according to the law to which he is subject may bind himself and be bound by the making, drawing, acceptance, endorsement, delivery and negotiation of a bill of exchange or cheque. A minor may draw, indorse and deliver such instruments so as to bind all parties except himself. Therefore the negotiable instrument drawn in favour of a minor is valid. Section 26 of the Negotiable Instruments Act states that a minor cannot make himself liable as drawer, acceptor or endorser but where the instrument is drawn or endorsed by him, the holder can receive payment from any other party thereto.

Question 17

'N' is the holder of a bill of exchange made payable to the order of 'P'. The bill of exchange contains the following endorsements in blank:

<i>First endorsement</i>	<i>'P'</i>
<i>Second endorsement</i>	<i>'Q'</i>
<i>Third endorsement</i>	<i>'R'</i>
<i>Fourth endorsement</i>	<i>'S'</i>

'N' strikes out, without S's consent, the endorsements by 'Q' and 'R'. Decide with reasons whether 'N' is entitled to recover anything from 'S' under the provisions of Negotiable Instruments Act, 1881.

(November 2009)

Answer

According to Section 40 of the Negotiable Instruments Act, 1881, where the holder of a Negotiable Instrument without the consent of the endorser destroys or impairs the endorser's

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remedy against a prior party the endorser is discharged from liability to the holder to the same extent as if the instrument had been paid at maturity. Therefore if the endorsements of 'R' and 'Q' are struck out without the consent of 'S', 'N' will not be entitled to recover anything from 'S', the reason being that as between 'R' and 'S' 'R' is the principal debtor and 'S' is the surety. If 'R' is released by the holder under Section 39 of the Act, 'S' being surety will be discharged. In this given problem, the rule may be stated thus that when the holder without the consent of the endorser impairs the endorser's remedy against a prior party, the endorser is discharged from liability to the holder.