What is a Negotiable Instrument?

The Negotiable Instruments Act does not define a negotiable instrument but merely states, *" a negotiable instrument means a promissory note, bill of exchange or cheque payable either to order or bearer."* (Section 13). This section does not prohibit any other instrument that satisfies the essential features of portability.

Justice K. C. Willis defines these as, " *one the property in which is acquired by anyone who takes it bonafide and for value notwithstanding any defect in title in the person from whom he took it*."

Thomas defines it in his book "Commerce, Its theory and Practice "*A negotiable instrument is one which is, by a legally recognized custom of trade or by law, transferable by delivery in such circumstances that (a) the holder of it for the time being may sue on it in his own name and (b) the property in it passes, free from equities, to a bona-fide transferee for value, notwithstanding any defect in the title of the transferor."*

It :

(1) entitles a person to a sum of money

(2) is transferable (by customs of trade) by delivery, like cash, or by Endorsement and delivery and delivery, and

(3) is capable of being used upon by the person holding for the time being i.e. the person to whom it is transferred becomes entitled to money and also a right to further transfer it.

Characteristics of negotiable instruments

The important characteristics are as follows –

(1) Free Transferability : A negotiable instrument may be transferred by delivery if it is a bearer instrument or by endorsement and delivery if it is an instrument payable to order.

Thus, a Fixed Deposit Receipt, which is marked as '*not transferable'is* not a negotiable instrument. On the other hand all instruments which are transferable are not negotiable instruments e.g. share certificate. An instrument to be negotiable must possess other features also.

Further, a negotiable instrument may be transferred any number of times till it is discharged.

(2) Title to transferee : The transferee, who takes the instrument *bona fide* and for valuable consideration, obtains a good title despite any defects in the title of the transferor. To this extent, it constitutes an exception to the general rule that no once can give a better title then he himself has.

(3) Entitlement to sue : The holder can sue in his own name.

4) Presumptions : Every negotiable instrument is subject to certain presumptions which are as under –

Presumption as to negotiable instrument

For deciding cases in respect of rights of parties on the basis of a bill of exchange, the Court is entitled to make certain presumptions. These are briefly stated as follow :

1. Consideration : That every negotiable instrument is made or drawn for a consideration. Thus, this need not necessarily be mentioned.

2. Date : That the negotiable instrument was drawn on the date shown on the face of it.

3. Acceptance before maturity : That the bill of exchange was accepted before its maturity, i.e., before it became overdue.

4. Transfer before maturity : That the negotiable instrument was transferred before its maturity.

5. Order of Endorsements : That the Endorsements appearing upon a negotiable instrument were made in the order in which they appear.

6. Stamping of the instrument : That an instrument which has been lost was properly stamped.

7. Holder is Holder in due course : That the holder of a negotiable instrument is the 'holder in due course', except where the instrument has been obtained from its lawful owner or its lawful custodian by means of offence or fraud.

8. Proof of dishonour : If a suit is filed upon an instrument which has been dishonoured, the Court shall, on proof of the protest, presume the fact of dishonour unless it is disproved. (Section 119)

Rules of estopped applicable to negotiable instruments

(Sections 120 to 122)

Certain rules of estoppel are applicable to negotiable instruments . These are as follows :

(1) Estoppel against denying original validity of instrument : The maker of the note and drawer of the bill of exchange or cheque are directly responsible for the bringing into existence of the instrument and, thus, cannot be allowed afterwards to deny the validity of the instrument. (Section 120)

(2) Estoppel against denying capacity of the payee to endorse : The maker of a promissory note or an acceptor of a bill shall not, in a suit by holder in due course, be allowed to deny the capacity of the payee to endorse the bill. (Section 121)

(3) Estoppel against denying signature or capacity of prior party : An endorser of a negotiable instrument shall, in a suit thereon by the subsequent holder, be allowed to deny the signature or capacity to contract of any prior party to the instrument.

Payee in a negotiable instrument

All three kinds of negotiable instruments mentioned under section 13 of the Act could be made payable in any of the following ways –

- Payable to bearer; or
- Payable to order.

Payable to bearer : The expression "*bearer instrument*" signifies an instrument, be it promissory note, bill of exchange or a cheque, which is expressed to be so payable or on which the last endorsement is in blank. This character of the instrument can be altered subsequently e.g. an endorsee can convert an '*Endorsement in blank*' into an '*Endorsement in full*'. In such a case, the holder of the instrument would not be able to negotiate the instrument by mere delivery. He will be required to endorse the instrument before delivering it.

Payable to order : An instrument is payable to order when it is payable to:

(i) the order of a specified person, or

(ii) a specified person or his order, or

(iii) a specified person without the addition of the words "*or his order*" and does not contain words prohibiting transfer or indicating an intention that it should not be transferable.

When an instrument is not payable to bearer, the payee must be indicated with reasonable certainty

Promissory Note

The term Promissory note has been defined under Section 4 of the Negotiable Instruments Act, as under :

"*A promissory note is an instrument (not being a bank note or a currency-note) in writing 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.*

Illustrations

A signs instrument in the following terms :

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

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

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

(d) *"I promise to pay B Rs.500 and all other sums that shall be due to him."*

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

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

(g) *"I promise to pay B Rs.500 and D's death, provided D leave me enough to pay that sum."*

(h) *"I promise to pay B Rs.500 and to deliver to him my black horse on 1" January next*."

The instruments respectively numbered as (a) and (b) are promissory notes. The instruments numbered (c), (d), (e), (f), (g) and (h) are not promissory notes."

Essentials of a promissory note

(1) It must be in writing :

(2) Promise to pay : The promissory note must contain an express promise or undertaking to pay. An implied undertaking cannot make a document a promissory note.

(3) The promise to pay must be unconditional : The promise to pay must be unconditional or subject to only such conditions which according to the ordinary experience of mankind is bound to happen.

- *" I acknowledge myself to be indebted to B of Rs.500 to be paid on demand, for value received*". This instrument would be a promissory note.

- *"I promise to pay Q Rs. 500 on A's death provided A leaves me enough to pay the sum"* is not a promissory note as it is conditional.

(4) There must be a promise to pay money only : The instrument must be payable only in money.

(5) A definite sum of money : Certainty

(a) as to the amount, and

(b) as to the persons by whose order and to whom payment is to be made

(6) The instrument must be signed by the maker : A promissory note is incomplete till it is so signed. Since the signature is intended to authenticate the instrument it can be on any part of the instrument.

Two or more persons may make a promissory note and they may be liable thereon jointly or severally (Joint family of MR Bhagwandas V. State Bank of Hyderabad 1971 SC 449). It must be clearly understood, however, that the two makers cannot be liable in alternate.

Where a pronote was shown to have been executed by two persons and later it was found that signature of one of the persons were forged, the person whose signature was forged cannot be held liable. The other person will, however, be liable.

(7) The person to whom the promise is made must be a definite person : The payee must be a certain person. Where the name of the payee is not mentioned as a party, the instrument becomes invalid. It is to be kept in mind that a promissory note cannot be made payable maker himself. Thus, a note which runs "*I promise to pay myself*" is not a promissory note and hence invalid. However, it would become valid when it is endorsed by the maker. This is because it then becomes payable to bearer, if endorsed in blank, or it becomes payable to the endorsee or his order, if endorsed specially.

A promissory note must point out with certainty the person who is entitled to receive the money. Where it is made payable to the bearer, the bearer is the definite person to whom payment is to be made. The words 'certain person' means a person who is capable of being ascertained at the time of making of the instrument. Therefore, if any person has not been named in the instrument but sufficient description of such person have been included therein by which such person may be ascertained, the requirement is fulfilled (*Ponnuswami V. Velliamuthu AIR 1957 Mad 355).* If the payee is mentioned as 'you', it does not indicate any certainty about the person (*Naraindas V. Purnidas AIR 1959 Orissa 176).*

Section 4 of the Act recognizes three kinds of promissory notes –

(a) payable to a specified person

(b) payable to the order of a specified person

(c) payable to a bearer

A promissory note cannot be made payable to the bearer on demand. It has been prohibited under the RBI Act.

(8) Other points : The following points shall also be remembered in connection with promissory notes :

(a) Consideration need not be mentioned.

(b) Place and date of making it need not be mentioned. A promissory note on which date is not mentioned is deemed to have been drawn on the date of its delivery.

(c) An ante-dated or post dated instrument is not invalid.

(d) Place of payment also need not be mentioned in the promissory note. However, it can be made payable at any specified place.

(e) It cannot be made payable to bearer on demand or payable to bearer after a certain time. (Section 31 of the Reserve Bank of India Act)

(f) It may be made payable on demand or after a certain time. A demand promissory note becomes time barred on expiry of three years from the date it bears.

(g) It must be duly stamped as per the state laws in which it is executed, under the Indian Stamp Act. A promissory note which is not stamped is a nullity. Stamping may be before or after the execution.

(h) A promissory note cannot be made payable to the maker himself. Such a note is nullity. But, if it is endorsed by the maker to some other person, or endorsed in blank, it becomes a valid promissory note (*Gay V. Landal (1848) LT CP 286).*

(i) Where two or more persons sign the promissory note, their liabilities will be joint as well as several. A note cannot be signed in alternative.

(j) It is usual to mention in a promissory note the words '*for value received*', but such a statement is not essential for the validity of the note, because the note is presumed to be for consideration unless contrary proved.

(k) A promissory note is not invalid by reason only that it contains any matter in addition to promise to pay e.g. a recital that the maker has deposited the title deeds with the payee as a collateral security.

Promissory note payable on demand

Mumbai October 25 , 200X

On demand I promise to pay Ravi Naik or order the sum of Rupees one thousand only, for value received.

Rs. 1000 Ram Laxman

Promissory note payable after date with interest

Mumbai October 25, 200X

On month after date I promise to pay Ravi Naik or to his order the sum of Rupees one thousand only, with interest @12% per annum until payment..

Rs. 1000 Ram Laxman

Joint Promissory note

Mumbai October 25, 200X

On month after date we promise to pay Ravi Naik or to his order the sum of Rupees one thousand only, with interest @12% per annum until payment..

Rs. 1000 Ram and Laxman

Joint and Several Promissory Note

Mumbai October 25, 200X

On month after date we jointly and severally promise to pay Ravi Naik or to his order the sum of Rupees one thousand only, with interest @12% per annum until payment..

Rs. 1000 Ram and Laxman

BILL OF EXCHANGE

A Bill of Exchange has been defined under section 5 of the Act as "*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 certain persons or to the bearer of the instrument*."

In England it has been defined as " *an unconditional order in writing, addresses by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed rate or determinable future time a sum certain in money or to the order of a specified person, or to the bearer*."

Characteristic features of a Bill of Exchange

(i) It must be in writing : The Bill of Exchange must be in writing.

(ii) Order to pay : There must be an order to pay. It is of the essence of the bill that its drawer orders the drawee to pay money to the payee. The term ‘order’ does not mean command. Any request or direction or other words, which show an intention of the drawer to cause a payment being made by the drawee is sufficient. Politeness may be admissible but excessive politeness may prompt one to disregard it as an order.

(iii) Unconditional order : This order must be unconditional, as the bill is payable at all events. It is absolutely necessary for the drawer’s order to the drawee to be unconditional. The order must not make the payment of the bill dependent on a contingent event. A conditional Bill of Exchange is invalid.

(iv) Signature of the drawer : The drawee must sign the instrument. The instrument without the proper signature will be inchoate (unclear or unformed or undeveloped) and hence ineffective. It is permissible to add the signature at any time after the issue of the bill.

(v) Drawee : A bill, in order to be perfect, must indicate a drawee who should be called upon to accept or pay it.

(vi) Parties : The drawer, the drawee (acceptor) and the payee- the parties to a bill are to be specified in the instrument with reasonable certainty.

(vii) Certainty of amount : The sum must be certain.

(viii) Payment in kind is not valid : The medium of payment must be money and money only. The distinctive order to pay anything in kind will vitiate the bill.

(ix) Stamping : A Bill of Exchange, to be valid, must be duly stamped as per the Indian Stamp Act.

(x) Cannot be made payable to bearer on demand : A Bill of Exchange as originally drawn cannot be made payable to the bearer on demand.

Bill of Exchange payable to order on demand

Mumbai December 25, 200X

On demand pay Mr. Ravi Naik or order the sum of Rupees one thousand only.

Rs. 1000/- Thomas
Mathew

To.

Mr.______________

____

Order Bill payable on presentment or sight

Mumbai December 25, 200X

On presentment (or sight) pay Mr. Ravi Naik or order the sum of Rupees one thousand only.

Rs. 1000/- Thomas
Mathew

To.

Mr._______________

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Ordinary bill payable to the order after date or sight with interest

Mumbai December 25, 200X

Three months after the date (or sight or presentment) pay Mr. Ravi Naik or order the sum of Rupees one thousand only with interest thereon at 18% per annum.

Rs. 1000/- Thomas
Mathew

To.

Mr._______________

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Bill payable to bearer

Mumbai December 25, 200X

Fifteen days after date (or sight) please pay the bearer the sum of Rupees one thousand only.

Rs. 1000/- Thomas
Mathew

To.

Mr._______________

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PARTIES TO THE BILL OF EXCHANGE

1. Drawer : The maker of a bill of exchange or cheque is called drawer.

2. Drawee : The person who is directed to pay by the drawer.

3. Acceptor : One who accepts the bill. Generally the drawee is the acceptor but a stranger may accept it on behalf of the drawee.

4. Payee : Person to whom the sum stated in the bills is payable.

5. Holder : Section 8 of the Negotiable Instruments Act states that "The 'holder' of a promissory note, bill of exchange or cheque means "*any person entitled in his own name to the possession thereof and to receive or recover the amount due thereon from the parties thereto."*

6. Holder in due course : A person who for consideration becomes the possessor of a promissory note, bill of exchange or cheque (if payable to bearer).

7. Endorser : Holder who endorses the bill in favour of any other person.

8. Endorsee : Person in whose favour the bill is endorsed by the endorser.

9. 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 as the ‘drawee in case of need’.

10. Acceptor for honour : When a bill of exchange has been noted and protested for non-acceptance or for better security, any other person accepts it supra protest for honour of the drawer or of any of the endorsers, such person is called the ‘Acceptor for honour’.

Special benefits of Bill of Exchange

Following special benefits associated with the Bill of Exchange :

1. A Bill of Exchange is a double secured instrument i.e. where the drawee fails to honour the order, the holder of the instrument may look to the drawer for payment.

2. In case of immediate requirement a Bill may be discounted with a bank.

3. The drawer or any endorser thereof may mention a person as ‘drawee in case of need’ to be resorted to for payment by the payee in case of dishonour of the bill by the drawee.

Distinction between a promissory note and a bill of exchange

The distinctive features of these two types of negotiable instruments are tabulated below :

Promissory Note	Bill of Exchange
It contains a promise to pay.	It contains an order to pay.
The liability of the maker of a note is primary and absolute (S.32).	The liability of the drawer of a bill is secondary and conditional.
It is presented for payment without any previous acceptance by the maker.	If a bill is payable some time after sight, it is required to be accepted either by the drawee himself or by some one else on his behalf, before it can be presented for payment.
The maker of a promissory note stands in immediate relationship with the payee and is primarily liable to the payee or the holder.	The maker or drawer of an accepted bill stands in immediate relationship with the acceptor and the payee.
It cannot be made payable to the maker himself. The maker and the payee cannot be the same person.	The drawer and payee or the drawee and the payee may be the same person.
In the case of a promissory note there are only two parties, viz., the maker (debtor) and the payee (creditor).	There are three parties, viz, drawer, drawee and payee, and any two of these three capacities can be filled by one

	and the same person.
A promissory note cannot be drawn in sets.	The bills can be drawn in sets.
A promissory note can never be conditional.	A bill of exchange too cannot be drawn conditionally, but it can be accepted conditionally with the consent of the holder.
In case of dishonour no notice of dishonour is required to be given by the Holder.	A notice of dishonour must be given in case of dishonour of a Bills of Exchange.

BILLS IN SETS

Section 132 : Set of Bills

Bills 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 the parts together make a set; but the whole set constitutes only one bill, and is distinguished when one of the parts if a separate bill, would be extinguished.

Exception : When a person accepts or endorses different parts of the bill in favour of different persons, he and subsequent endorser of each part are liable on such parts as if it were a separate instruments.

Section 133 : Holder of the first acquired part entitled to all

As between holders in due course of different parts of the same set, he who first acquired title to his part is entitled to the other parts and the money represented by the bill.

Foreign bills are generally drawn in set of two or three and such a bill is said to have been drawn in set. All these parts form one bill. Each part of the bill is numbered and contains a reference to other parts. This operates as a notice to the holder taking up that all parts constitute one bill and puts him on guard to make inquiries as to the remaining parts of the bill. A person who negotiates a bill drawn in set is bound to deliver up all the parts in his possession.

All parts of the Bill are sent to the destination through different routes so as to ensure safe transmission of at least one part to the drawee and its acceptance by him at the earliest possible opportunity and also to avoid unnecessary inconvenience that may be caused due to loss in transit.

Kinds of bills

(1) Accommodation Bill (Sections 43-45)

All bills are not genuine trade bills, as some times they may be drawn for accommodating a party. An accommodation Bill is quite similar to that of a Bill of Exchange but it is distinguished from an ordinary bill by the fact that such a bill is not supported by any consideration or transaction. The drawer does not give any consideration to the drawee. The relationship between the drawer and drawee are not that of a debtor and creditor.

The party lending his name to oblige the other party is known as the accommodation or accommodating party and the party being obliged is known as accommodated party. The accommodating party is not liable to the accommodated party on the instrument as there is no consideration and the instrument was drawn only to help the accommodated party. But the accommodating party is liable to the 'holder for value'.

Rules for Accommodation Bill

1. An accommodation bill creates no obligation of payment between the parties to the transaction. The accommodation party is not liable to the accommodated party on the maturity date.

2. No party for whose accommodation a negotiable instrument has been made, drawn, accepted or endorsed can, if he has paid the amount thereof, recover thereon such amount from any person who became a party to such instrument for his accommodation.

3. An accommodation bill can be negotiated even after its maturity i.e. when it becomes overdue, with all benefits of a 'holder in due course' to the transferee. (Section 59)

4. Non-presentment of the accommodation bill to the acceptor for payment does not discharge the drawer from his liability.

5. In the case of dishonour of an accommodation bill, failure to give notice of dishonour does not discharge the liability of prior parties as against the case in the Ordinary bill.

(2) Fictitious Bill

A Bill of Exchange in which the name of both the drawer and the payee are fictitious i.e. imaginary. Such a bill cannot be enforced by law but it is good in the hands of a holder in due course if it has been accepted by a genuine person. This is provided that he can show that the first Endorsement on the bill and the signature of the supposed drawer (being the holder as well) are in the same hand writing, and the acceptor is liable on the bill to him. In this connection section 42 of the Act states:

"*An acceptor of a bill of exchange drawn in a fictitious name and payable to the drawer's order is not, by reason that such name is fictitious, relived from the liability to any holder in due course claiming under an Endorsement by the same hand as the drawer's signature, and purporting to be made by the drawer."*

(3) Forged Bill

A bill in which name of the drawer or the payee has been forged. Such a bill cannot be enforced by law and does not hold good even in the hands of holder in due course.