CHEQUE

"*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).*

(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 which 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.

(c) "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.'.

Characteristics

1. A cheque is an unconditional order on a specified banker where the drawer has his account.

2. A cheque can be drawn for a certain sum of money.

3. Cheque is payable by the banker only on demand.

4. A cheque does not require acceptance by the banker as in the case of bill of exchange.

5. A cheque may be drawn up in three forms i.e.

(i) Bearer cheque is one which is either expressed to be so payable or on which the last or only endorsement is an endorsement in blank);

(ii) Order cheque is one which is expressed to be so payable or which is expressed to be payable to a particular person without containing any prohibitory words against its transfer or indicating an intention that it shall not be transferable (Section 18); and

(iii) Crossed cheque is a cheque which can be collected only through a banker.

6. The cheque is a revocable mandate and the authority can be revoked by countermanding payment.

7. The cheque is determined by notice of death or insolvency of the drawer.

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

Bank draft

A bank draft is an order drawn by an office of a bank upon another of the same bank instructing the later to pay a specified sum to a specified person or his order. These are also knows as Managers Cheques or Cashiers Cheques.

A draft can be drawn either against cash deposited at the time of its purchase or by debiting the buyer's current/ savings account the banker maintains. The buyer of the draft should furnish particulars of the person to whom the amount of the draft should be paid and where (at the time he requests the draft). The banker charges for his services a small commission. The draft like a cheque, can be made payable to drawer on demand without any legal objection thereto.

Specific features of a draft

1. It is only issued by a bank on another bank or on one of its branches. It cannot be issued by an individual.

2. It cannot be made payable to bearer.

The legal position with respect to bank drafts was clarified in the case of *Tukaram Bapuji Nikam V. Belgaum Bank Ltd. AIR 1976 Bom 185,* as follows :

1. The relationship of the purchaser of draft and the bank from which the draft has been purchased is merely that of the debtor and creditor.

2. The purchaser of the bank draft can call upon the bank from which he has purchased it to cancel the draft and pay back the money to him at any time before the draft has been delivered to the payee.

3. If the sole object of the issue of the draft was to transit the money to another person, a fiduciary relationship is created between the purchase of the draft and the bank which issued it, and the purchaser of the draft can countermand payment only if the bank has not actually parted with the money held by it as agent thus terminating the relationship of principal and agent.

4. Ordinarily, a bank issuing a draft cannot refuse to pay the amount thereof, unless there is some doubt as to the identity of the person presenting it as being or properly representing the person in whose favour it was drawn, or in other words, unless there is reasonable ground for disputing the title of the person presenting the draft; and

5. Once the draft has been delivered to the payee or his agent, the purchaser is not entitled to ask the issuing bank to stop payment of the draft to the payee on other grounds such as matters relating to consideration.

6. The issuing bank can after the issue of a draft pay back the amount of the draft to the purchaser of the draft only with the consent of the payee.

Marked Cheques

Since a cheque is not required to be presented for acceptance the drawee of the cheque i.e. the banker, is under no liability, to the person in whose favour the cheque is drawn. However, he is liable to his customer (drawer), if he wrongly refuses to honour the cheque. In such a case, action can be taken by the drawer against the banker for the loss of his reputation.

In certain cases a cheque is marked or certified by the banker on whom it is drawn as ‘good for payment’. Such a certification or marking does not amount to acceptance but it is very similar to it and protects the person to whom the cheque is issued against the cheque being refused for payment subsequently. In the United States, these are known as cashiers’ cheques. Banks in India, as a rule, do not mark or certify cheques in this manner and bankers in India, are not liable even if a bank has marked a cheque as “good for payment”.

Crossing of cheques

A cheque may be a open cheque or a crossed cheque. An open cheque is one that can be paid by the paying banker across the counter while crossed cheque cannot be paid across the counter.

Crossing of cheques is a universally adopted practice. Crossing on a cheque is a direction to the paying banker that the payment shall not be made across the counter. The payment on a crossed cheque can be collected only through a banker.

Cheques are usually crossed as a measure of safety. Crossing is made by drawing two parallel traverse lines across the face of the cheque with or without the addition of certain words. The usage of crossing distinguishes cheques from other bills of exchange.

In this regard section 123 of the Negotiable Instruments Act states:

"Where a cheque bears across its face an addition of the words 'and company' or any abbreviation thereof, between two traverse lines, or of two parallel traverse lines simply, either with or without the words 'not negotiatble' that addition shall be deemed a crossing, and the cheque shall be deemed to be crossed generally".

Who may cross the cheque

Crossing of a cheque is an instance of an alteration which is authorized by the Act. Thus, the following parties may cross a cheque :

(1) *Drawer :* The drawer of the cheque may cross the cheque generally or specially.

(2) *Holder :* Where the drawer does not cross the cheque, the holder may cross it generally or specially. Even if the cheque is already crossed the holder may add the words 'not negotiable'.

(3) *Banker :* Where a cheque crossed specially the collecting banker may again cross it specially to another banker as its agent for collection. This is the only case where the Act allows a second special crossing by a banker and for the purpose of collection

Types of crossing

Crossing may be either (1) general or (2) special.

(1) *General crossing :* Section 123 of the Act refers to general crossing. Where a cheque bears across its face two traverse lines with or without the words "and Co." or any abbreviation thereof or the words 'not negotiable, the cheque is said to have been crossed generally.

"*Where a cheque is crossed generally, the banker on whom it is drawn shall not pay it otherwise than to the banker" (Section 126).*

The payee may get the cheque collected through a bank of his choice.

(2) *Special crossing* Special crossing implies the specifications of the name of the banker on the face of the cheque. The object of special crossing is to direct the drawee banker to pay the cheque only if it is presented through the particular bank mentioned.

In the case of special crossing the addition of two parallel transverse lines is not essential though generally the name of the bank to which the cheque is crossed specially is written between the two parallel transverse line (Section 124).

Section 126 of the Act provides that –

> "*Where a cheque is crossed specially, the banker on whom it is drawn shall not pay it otherwise than to the banker to whom it is crossed, or his agent for collection."*

Section 127 of the Act provides that –

> "*Where a cheque is crossed specially to more than one banker, except when crossed to an agent for the purpose of collection, the banker on whom it is drawn shall refuse payment thereof."*

Special crossing may take any of the following shapes :

"Account Payee" crossing or restrictive crossing

This type of crossing acts as a warning to the collecting bankers that the proceeds are to be credited into the account of the payee.

These words are a mere direction to the receiving or collecting banker. These do not affect the paying banker who is under no duty to ascertain that the cheque in fact has been collected for the account of the person names as the payee.

It has been held that crossing cheque with the words “Account Payee” and mentioning a bank is not a restrictive endorsement so as to invalidate further negotiation of the cheque by the endorsee.

It has been decided by the courts that an “account payee” crossing is a direction to the collecting banker as to how the proceeds are to be applied after receipt. The banker can disregard the direction only at his own risk and responsibility.

Cheque marked “not negotiable”

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. If the holder takes the instrument in good faith, before maturity and for valuable consideration, his claim is not defeated or affected by the defective title of the transferor. In case of any dispute, it is the transferor with the defective title who is liable.

Addition of the words “not negotiable” to the crossing of a cheque, makes the position different. The principle of ‘nemo date quod non habet – (nobody can pass on a title better than what he himself has) will be applicable to a cheque with a “not negotiable” crossing.

Section 130 of the Negotiable Instruments Act provides that –

> *“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 of person from whom he took had.”*

The effect of such a crossing is that the title of the transferee would be vitiated by the defect in the title of the transferor. The transferee of such a crossed cheque cannot get a better title than the transferor himself. The transferee cannot claim the right of a holder in due course by proving that he purchased the instrument in good faith for value.

Bankers liability on payment of crossed cheque in due course

In respect of a crossed cheque it is presumed that the banker, on whom it is drawn, has made payment to the true owner of the cheque, though in fact, the amount of the cheque may not reach the true owner. In other words, the banker making payment in due course is protected, whether the money is or is not, in fact, received by the true owner of the cheque (Section 128).

Bankers liability on wrong payment of a crossed cheque

Section 126 of the Act states that:

a. in the case of generally crossed cheque the banker shall not pay it otherwise than to a banker, and

b. in the case of a specially crossed cheque it shall not be paid by the banker otherwise than to the banker to whom it is crossed or to his agent for collection.

Where the drawee banker pays a crossed cheque otherwise than in accordance with the provisions of Section 126 it shall be liable to the true owner of the cheque for any loss he may have sustained (section 129)

Protection of banker in respect of uncrossed cheques

Section 85(2) reads:

When a banker makes payment on an uncrossed cheque in due course he is authorized to debit the account of his customer with the amount so paid irrespective of the genuineness of the Endorsement thereon.

For example, a cheque is drawn payable to N or order and it is stolen. Thereafter, the thief or someone else forges N's endorsement and presents the cheque to the bank for encashment. On paying the cheque, the banker would be able to debit the drawer's account with the amount of the cheque.

The original character of the cheque issued as bearer, is not altered by subsequent endorsements , so far as the paying bank is concerned, provided that the payment is made in due course. Hence the proposition that "*once a bearer instrument always a bearer instrument".*

Protection in respect of crossed cheques

When a banker pays a cheque drawn by his customer in accordance with section 126 of the Act he can debit the drawer's account with the amount paid, even though the amount of the cheque does not reach the true owner.

Prerequisites for claiming protection

The protection in both the cases referred above can be availed of only if the payment has been made in due course i.e.

a. According to the apparent tenor of the instrument,

b. In good faith and without negligence.

c. To any person in possession thereof,

d. In circumstances that do not incite any suspicion that he is not entitled to receive payment of the cheque.

Liability of drawee of cheque

Section 31 of the Act states that:

The drawee bank is under a duty to pay the cheque, provided he has in his hands sufficient funds of the drawer and the funds are properly applicable to such payment. If the banker refuses payment without sufficient cause being shown, he must compensate the drawer, not the holder, for any loss caused by such improper refusal (Section 31).

The banker must pay the cheque only when he is duly required to do so e.g. if there is an agreement between the drawer and the banker that the former shall not draw more than one cheque every week, the banker is not bound to pay the second cheque.

The amount of compensation that the drawee would have to pay to the drawer is to be measured by the loss or damage say loss of credit, suffered by the drawer. The principle is : "*The lesser the value of the cheque dishonoured, the greater the damage to the credit of the drawer*".

When banker shall refuse the payment

A banker will be justified or bound to dishonour a cheque in the following cases, viz;

(i) The cheque is undated.

(ii) The cheque is *stale* i.e. it has not been presented within the validity period of the cheque.

(iii) The instrument is inchoate (unclear or unformed or tentative) or not free from reasonable doubt.

(iv) The cheque is post-dated and presented for payment before its ostensible date.

(v) The customer's funds in the banker's hands are not 'properly applicable' to the payment of cheque drawn by the former.

(vi) The customer has credit with one branch of a bank and he draws a cheque upon another branch of the same bank in which either he has account or his account is overdrawn.

(vii) A garnishee or other legal order from the Court attaching or otherwise dealing with the money in the hand of the banker, is served on the banker.

(viii) Authority of the banker to honour a cheque of his customer is determined by the notice of the drawer's death, lunacy and insolvency. However, any payment made prior to the receipt of the notice of death is valid.

(ix) Notice in respect of closure of the account is served by either party on the other.

(x) The cheque contains material alterations, irregular signature of irregular endorsement.

(xi) The customer has countermanded payment.

(xii) Any ambiguity in the material part of the cheque including the defects resulting from the crossing of the cheque.

(xiii) Any difference between the amount of cheque in words and in figures.

(xiv) Any irregular endorsements.

(xv) The cheque is mutilated.

(xvi) Signature of the drawer has been forged.

Liability of payee's banker

Section 131 of the Act provides that –

> "*A banker who has in good faith and without negligence received payment for a customer of a cheque crossed generally or specially to himself, shall not, in case the title to the cheque proves defective, incur any liability to the true owner of the cheque by reason only of having received such payment."*

Section 131 of the Act confers a special protection on the collecting banker which is available to him subject to fulfillment of certain conditions. If the following conditions do not co-exist, this protection would be denied to the collecting banker :

(i) *The collecting banker should have acted in good faith and without negligence:* In Lloyds Savouy Co. (1933) A.C. 201, the court held that if the banker receives payment of a cheque to which the customer has no title, the onus is on him to disprove negligence. What amounts to negligence is, however a question of fact in each case. "Negligence" means want of "reasonable care" with reference to the interest of the true owner. The test of "negligence" is whether the transaction of paying in any given cheque coupled with the circumstances antecedent and present was so flagrantly out of the ordinary course that it ought to have aroused suspicion in the mind of the banker and caused him to make enquiry (Bopulal Prem Chand v. The Nath Bank Ltd. 48 Bom. L.R.393).

(ii) *That the collecting banker acts only to receive payment of the crossed cheque for a customer :* To make a person a customer of a bank it is essential that there must be some sort of account, either a deposit or a current account or some similar relationship. Protection under section 131 is available only when the banker is acting as an agent for collection but not to a case where the banker is himself the holder.

(iii) *That crossing had been made before the cheque fell into the hands of the collecting banker :* Section 131 does not provide an absolute immunity to the collecting banker and unless the banker brings himself within the conditions stipulated under this section, he is left to his common law for conversion. The onus of proving that he had taken all reasonable steps to ensure compliance with the requirements of this section lies on the banker.

It shall be the duty of the banker who receives payment based on an electronic image of a truncated cheque held with him, to verify the *prima facie* genuineness of the cheque to be truncated and any fraud, forgery or tampering apparent on the face of the instrument that can be verified with due diligence and ordinary care.

Dishonour of cheque

Dishonour

Section 92 of the Act reads as under –

> *"A promissory note, bill of exchange or cheque is said to be dishonoured by non-payment when the maker of the note, acceptor of the bill or drawee of the cheque makes default in payment upon being duly required to pay the same."*

If on presentation the banker does not pay then dishonour takes place and the holder acquired at once the right of recourse against the drawer and the other parties on the cheque.

Effects of dishonour

The important point to be noted in connection with the dishonour of a cheque is that its negotiability is lost.

Types of dishonour

Dishonour of cheque can be divided into two categories i.e.

(a) *Rightful dishonour :* Dishonour of cheque by the drawee banker for any of the reasons specified above or for any other rightful reason. In this case there is no remedy available against the banker but the holder in due course has remedy both civil and criminal against the drawer.

(b) *Wrongful dishonour* : Dishonour of cheque by the banker due to negligence or carelessness by its employees. The drawer may bring an action against the bank for losses suffered by him. The payee has no action against the banker in this case.

Dishonour of cheque is an offence

Section 138 of the Negotiable Instruments Act states that the return of a cheque by a banker because the money standing to the credit of the accountholder is insufficient to honour the cheque or that it exceeds the amount arranged to be paid from the account by an agreement made with the bank, is a criminal offence. The drawer shall be deemed to have committed an offence and such offence will be punishable with imprisonment for a term up to two years imprisonment or with a fine twice the amount of the cheque or both.

Provisions of section 138 of the Act are applicable only if –

(a) The cheque in question has been issued in discharge of a liability only. Unless contrary is proved, as per the provisions of section 139, a cheque is presumed to have been received by the holder in discharge of a debt or liability. A cheque given as gift will not fall in this category.

(b) The cheque is presented to the bank for payment within six months or its specific validity period, whichever is earlier.

(c) The payee or holder in due course has given notice demanding payment within thirty days of the receiving information of dishonour which should be for a reason other than insufficiency of funds.

(d) The drawer does not make payment within 15 days of the receipt of the notice. The complaint can be made only by the payee/holder in due course, within one month.

Offences by companies

If the person committing an offence under section 138 is a company, every person who was in charge of the affairs of the company and was responsible for the business of the company at the time offence was committed shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly. (Section 139) However, a person shall not be punishable under section 139 if it is proved that the offence has been committed without his knowledge or consent and that he had taken all due care to prevent commission of the offence.

Action to be taken

If a cheque is dishonored for lack of funds, the drawer can be punished with imprisonment upto one year and/ or withn a fine upto double the amount of the cheque if:

·The cheque has been presented to the bank within a year from the date on which it was drawn or within its validity.

The payee or holder makes a demand for payment by giving notice in writing to the drawer within thirty days of the receipt of the information.

The drawer of the cheque fails to make payment within fifteen days of receipt of the notice.

Classification of instruments

Negotiable instruments may be divided into following categories :

(1) Bearer and order instruments

(2) Inland and foreign instrument

(3) Ambiguous and inchoate bills

(4) Sight and time bills etc.

(5) Escrow

Bearer and order instruments

An instrument may be payable or to order his order

(a) Bearer; or

(b) A specified person or to his order.

(a) Payable to bearer : An instrument is payable to bearer when it is expressed to be so payable. The wording could be "Pay to X or bearer". It also becomes payable to bearer when the last endorsement on it is in blank.

Any person in lawful possession of a bearer instrument is entitled to enforce payment due on it.

An instrument made 'payable to bearer' is transferable merely be delivery, i.e., without any further endorsement thereon (section 46 of the NI Act). However, section 49 provides that a holder of a negotiable instrument endorsed in blank may, without signing his own name, by writing above the endorser's signature a direction to pay any other person as endorsee, convert the endorsement in blank into an endorsement in full and the holder does not thereby incur the responsibility of the endorser.

It shall be noted that a promissory note cannot be made payable to bearer and a bill of exchange cannot be made payable to a bearer on demand.

In the case of a cheque, as per Section 85(2), where a cheque is originally expressed to be payable to bearer, the drawee is discharged by payment in due course to the bearer thereof, notwithstanding any endorsement whether in blank or full appearing thereon and notwithstanding that any such instrument purported to restrict or exclude further negotiation. Thus, the original character of the cheque is not altered so far as the paying bank is concerned provided that the payment is made in due course. Hence the proposition that "once a bearer instrument always a bearer instrument".

(b) Payable to order : An instrument is payable to order when it is expressed to be payable to,

(i) the order of a specified person or e.g. "Pay to order of X",

(ii) a specified person or his order, e.g. "Pay to X or 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.

Inland and foreign instrument

Inland bills : As per Section 11 of the Act " a promissory note, bill of exchange or cheque drawn or made in India and made payable in or drawn upon any person resident in India shall be deemed to be an inland instrument".

Foreign bills : As per Section 12 any such instrument, not so drawn, made or payable shall be deemed to be a foreign instrument.

Thus, foreign bills are:

(i) bills drawn outside India and made payable in or drawn upon any person resident in any country outside India;

(ii) bills drawn outside India and made payable in India, or drawn upon any person resident in India;

(iii) bills drawn in India upon persons resident outside India and made payable outside India.

In connection with the liability of the maker or foreign bill section 134 states:

"*In the absence of a contract to the contrary, the liability of the maker or drawer of a foreign promissory note, bill of exchange or cheque is regulated in all essential matters by the law of the place where he made the instrument, and the respective liability of the acceptor and endorser by the law of the place where the instruments is made payable."*

Illustration : A bill of exchange was drawn by A in California where the rate of interest is 5%, and accepted by B, payable in Washington where the rate of interest is 6%. The bill is endorsed in India and is dishonoured. An action on the bill is brought against B in India. He is liable to pay interest at the rate of 6% only; but if A is charged as drawer, A is liable to pay interest at 5 per cent.

Protest in case of dishonour : Inland bills need not be protested for dishonour (protest is optional). Foreign bills must be protested if the law of the place of making or drawing them requires such protest.

Ambiguous and inchoate bills

Ambiguous bill Section 17 of the Act states that an instrument which may be construed either as a promissory note or as a bill of exchange (Section 17) is considered as an ambiguous instrument.

In the following cases the instrument is treated as ambiguous instrument :

1. where the drawer and drawee are the same person.
2. where the drawee is a fictitious person
3. where the drawee is a person incapable of entering into contract.

The holder of such a bill is at liberty to treat the instrument as a bill or a promissory note. The holder shall decide it once for all. After having made his choice he cannot afterwards fall back and say that it is the other kind of instrument.

Inchoate Instrument Section 20 of the Act states:

"*Where one person signs and delivers to another a paper stamped in accordance with the law relating to negotiable instruments then in force in India and either wholly blank or having written thereon an incomplete negotiable instrument, he thereby give prima facie authority to the holder thereof to make or complete, as the case may be, upon it a negotiable instrument, for an amount specified therein and not exceeding the amount covered by the stamp. The person so signing shall be liable upon such instrument, in the capacity in which he signed the same, to any holder in due course for such amount……. Provided that no person other than a holder in due course shall recover from the person delivering the instrument anything in excess of the amount intended to be paid by him to be paid there under."*

From the above it can be said that an incomplete or blank negotiable instrument properly stamped and signed is termed as inchoate instrument.

Principles of estoppel : In case of inchoate instruments principal of estoppel is applicable i.e. when a person gives possession to his signature on a blank stamped paper to any other person, he prima facie authorizes the latter as his agent to fill it up and give to the world an instrument as accepted by him. By signing an incomplete instrument the person binds himself as drawer, maker, acceptor or endorser. Signature of a person on an inchoate instrument purports to be an authority to the holder to fill up the blank, and complete the paper as a negotiable instrument, and no action is maintained on it.

Prerequisites for applicability of rule of estoppel : For applicability of the provisions of section 20 of the Act it is necessary that –

1. the instrument is signed by the person who delivers it.
2. the instrument is delivered to another person by the signer;
3. the paper so signed and delivered must be stamped in accordance with the law prevalent at the time of signing and on delivering.

In absence of above requirements the principal of estoppel, as discussed above, will not apply and the signer can show that the instrument was filled without his authority.

Liability of the signer : In accordance with provision of section 20 the signer is liable to the 'holder' as well as the 'holder in due course' but the holder can recover only what the signer intended to be paid under the instrument, while holder in due course can recover the whole amount made payable by the instrument provided that it is covered by the stamp.

Sight (demand) and time bills etc.

Sight Bills: Bills and notes are payable either on demand or at a fixed future time. Cheques are always payable on demand.

Instrument payable on demand : Section 19 of the Act provides that –

"*A promissory note or a bill of exchange, in which no time for payment is specified, and a cheque, are payable on demand".*

A bill or promissory note is also payable on demand when it is expressed to be payable "on demand" or "at sight" or "on presentment". The expression "on demand" means "immediately payable". For these instruments the period of limitations begins to run from the date on which the instrument is executed except in the cases of sight bills in which the time for limitation period starts running from the date of presentment for sight.

Such an instrument must be presented within a reasonable time after its issue in order to make the drawer liable and within a reasonable time after its endorsement to render the endorser liable. It will become overdue if it remains in circulation for an unreasonable length of time.

Time Bills : An instrument made payable on a fixed date or after a specified period is a time instrument. An instrument made payable after the happening of a certain event is also a time instrument.

In the case of time bills the period of limitation starts running from the date of maturity of the instrument.

Escrow

A bill, endorsed or delivered to a person subject to the understanding that it will be paid only if certain conditions are fulfilled, is called an "Escrow". Regarding these bills there is no liability of the drawer until the conditions agreed are fulfilled. However, the rights of a holder in due course will not be affected.

Holder and Holder in due course

Holder: Holder is defined in Section 8 as:

"*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.*

Where the note, bill or cheque is lost or destroyed, its holder is the person entitled at the time of such loss or destruction."

From the above definition it is clear that for being a holder a person must be entitled to –

a. the possession of the instrument in his own name; and

b. receive or recover the amount due thereon from the parties liable thereto.

'Possession' of the instrument by the holders refers to 'de factor' control and not the actual possession. The person must be named in the instrument either as a payee or as endorsee. Meaning of 'de facto' contract becomes clear in the event of death of the actual holder. The legal heir of a deceased holder does not have his name endorsed on the instrument but he becomes holder by operation of law.

Any person in wrongful possession of the instrument cannot be the holder. Therefore, the finder of a lost instrument payable to bearer, or a person in wrongful possession of such instrument, is not a holder.

Further, the possession of the instrument and being named in it as the payee does not make a person a 'holder' thereof. He shall also be entitled to receive payment and to give a valid discharge. Thus, a beneficiary cannot be termed as holder of the instrument and any payment by the drawer to the beneficiary cannot discharge him from his liability. *Bacha Prasad V. Janki Rai, 1957 BLJR 331 (FB).*

Any person who is in possession of the instrument as payee will not be a holder within the meaning of section 8 of the Act if he has been prohibited from receiving payment by an order of Court.

The payee may authorize his agent to receive payment and to give a valid discharge for the same but this does not make the agent the holder of the instrument since he cannot bring an action for recovery of money in the instrument in his own name.

Holder in due course

Section 9 of the Act defines a 'holder in due course' as:

"*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 bearer, or the payee or the endorsee 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."*

Holder in due course means a holder who takes the instrument *bona fide* for value before it is overdue, and without any notice of defects in the title of the person who transferred it to him.

Holder in due course for bearer instruments

In the case of an instrument payable to bearer, holder in due course means any person who for consideration became its possessor before the amount mentioned in it becomes payable.

Holder in due course for instruments payable to order

In the case of an instrument payable to order, "holder in due course" means any person who become the payee or endorsee of the instrument before the amount mentioned in it became payable.

Prerequisites for being holder in due course

A person who claims to be holder in due course' is required to prove:

(i) That he is a holder :

(ii) That he is a holder for consideration:

(iii) Acquisition before maturity :

(iv) That he has no knowledge of defective title :

(v) The instrument was complete at the time of possession :

Privileges of a "holder in due course"

(i) *In case of an inchoate instrument :* As per section 20, a person, who signed and delivered to another a stamped but otherwise inchoate instrument, is estopped from asserting, as against a holder in due course, that the instrument has not been filled in accordance with the authority given by him provided the amount filled is covered by the stamps affixed.

In addition, if a subsequent transferor completed the instrument for a sum greater than what was the intention of the maker, the right of a holder in due course to recover the money of the instrument is not affected (section 20).

(ii) *Fictitious name :* If a bill of exchange is drawn on behalf of a fictitious person and is payable to his order, the acceptor is not relieved of his liability to the holder in due course because of the fictitious name. It is essential though that the holder in due course proves that the document bears the endorsement with signature in the same hand as that of the drawer and purporting to be made by the drawer (Section 42).

(iii) *Title free from defects :* He possesses title free from all defects. He always possesses better title than that of the transferor or any of the previous parties and can give to subsequent parties the good title that he possesses.

(iv) *Lost or obtained by fraud or unlawful consideration :* A person liable on a negotiable instrument cannot defend himself against a holder in due course on the ground that the instrument was lost or obtained from him by means of an offence or for an unlawful consideration (Section 58)

(v) Estoppel against denying validity of the instrument originally made : "*No maker of a promissory note and no drawer of a bill of exchange or cheque and no acceptor of a bill of exchange for the honour of the drawer shall in a suit thereon by holder in due course, be permitted to deny the validity of the instrument as originally made or drawn"(Section 120)*

(vi) *Payees incapacity:* No maker of a promissory note and no acceptor of a bill of exchange payable to order shall, in a suit thereon by a holder in due course, be permitted to deny the payee's capacity at the date of note or bill to endorse the same. (Section 121).

(vii) *All prior parties liable :" Every prior party to a negotiable instrument (maker or drawee, acceptor or endorser) is liable thereon to a holder in due course until the instrument is duly satisfied (Section 36)."*This means that a holder in due course can recover the amount of the negotiable instrument from any or all of the previous parties to the instrument.

(viii) *Title of previous parties :* No endorser of a negotiable instrument shall in a suit thereon by a subsequent holder, be permitted to deny the signature or capacity of any prior party to the instrument (section 122) .

Distinction between a holder and a holder in due course

(i) *Consideration :* A holder may become the possessor or payee of an instrument even without consideration, whereas a holder in due course is one who acquires possession for consideration.

(ii) *Time of possession :* A holder in due course as against a holder, must become the possessor payee of the instrument before the amount thereon become payable.

(iii) *Good faith :* A holder in due course as against a holder, must have become the payee of the instrument in good faith i.e., without having sufficient cause to believe that any defect existed in the transferor's title.

Capacity to incur liability under negotiable instruments

Section 26 of the Act states that every person who is capable of entering into a contract and to bind himself can make, draw, accept or negotiate a negotiable instrument, Section 27 provides that the negotiable instruments may also be drawn, accepted, and negotiated by an authorized agent on behalf of the principal. Therefore, a person not capable of entering into a contract cannot bind himself by being a party to the negotiable instrument.

Different cases of parties' capacity to incur liability under a negotiable instrument are discussed below :

Minor : A minor is not competent to contract and, therefore, he cannot bind himself by becoming a party to the negotiable instrument. Section 26 provides that "*A minor may draw, endorse, deliver and negotiate such instruments so as to bind all parties except himself*." An instrument does not void just because a minor is party to it. It remains binding on all other parties.

Lunatics : A lunatic or drunken person who is incapable of understanding the effect of contracting on his interest is on the same footing as that of minor.

Corporation : the contractual capacity of a company or corporation depends on the provisions contained in its memorandum of association or the charter. It may become a party to the negotiable instrument only if so authorized by the charter of the company. In this connection section 26 provides that "*Nothing herein contained shall be deemed to empower a corporation to make, endorse or accept such instrument except in cases in which, under the law for the time being in force, they are so empowered*."

Agency : A person capable of contracting may also bind himself through his duly authorized agent acting in his name. But a general authority to transact business and to receive and discharge debts does not confer upon an agent the power of accepting or indorsing bills of exchange so as to bind the principal. Thus, an agent who has specifically been authorized to draw, accept and negotiate negotiable instruments only can bind his principal.

The agent has to make it clear that he is acting in a representative capacity. The form of signature must show that he intends to act as agent or that he does not intend to incur any personal liability. If this is not so done, he becomes personally liable. (Sections 27 and 28)

Legal representative : A legal representative of a deceased person who signs his personal name to a promissory note, bill of exchange or cheque is liable personally thereon unless he expressly limits his liability to the extent of the assets received by him as such (Section 29),

The term “legal representative” includes heirs, executors and administrators.

Liabilities of Parties to Negotiable Instruments

Liability of drawer

Section 30 of the Act states:

> “*The drawer of a bill of exchange or cheque is bound in case of dishonour by the drawee or acceptor thereof, to compensate to the holder, provided due notice of dishonour has been given to, or received by, the drawer as hereinafter provided.”*

> *(a) case of dishonour by non-acceptance*
>
> *(b) case of dishonour by payment :*

Liability of drawee cheque

Section 31 of the Act states:

> *“The drawee of a cheque having sufficient funds of the drawer in his hands properly applicable to the payment of such cheque when duly required to do so, and in default of such payment, must compensate the drawer for any loss or damage caused by such default”.*

The drawee of a cheque who is always a banker is liable to the drawer if he, having sufficient funds of his customer, wrongfully refuses or fails to honour his customer’s cheque.

The liability of the drawee arises only when the cheque has been dishonored by mistake. But where the cheque is dishonoured for any of the reasons explained earlier in this chapter, the banker does not incur any liability for rightful dishonour.

Liability of maker of note and acceptor of bill

Section 32 of the Act stats:

> “*In the absence of a contract to the contrary, the maker of a promissory note and the acceptor before maturity of a bill of exchange are bound to pay the amount thereof at maturity according to the apparent tenor of the note or acceptance respectively, and the acceptor of a bill of exchange at or after maturity is bound to pay the amount thereof to the holder on demand”.*

The maker of a promissory note is bound to pay the amount at maturity, according to the tenor of the note and in case of default of such payment, he is bound to compensate any party to the note for any loss sustained by reason of such default.

A promisor in case of promissory note and a drawer in the case of bill of exchange or cheque is the principal debtor. But after acceptance by the drawee the acceptor becomes the principal debtor. Therefore, in case of a bill the liability of the drawee arises only when the accepts the bills (Section 32). In the absence of a contract to the contrary, (An acceptor of a bill of exchange may become surety and the principle liability may have been agreed to be that of the drawer), the acceptor (drawee) of a bill is bound to pay the amount only at maturity, in accordance with the apparent tenor of the acceptance. In the event of the bill being accepted after maturity, he is bound for the amount to the holder on demand. In default of such payment, he is bound to compensate any party to the bill for any loss or damage caused to him by such a default.

The following persons incur liability by acceptance; (1) drawee (2) person named as drawee in case of need, and (3) acceptor for honour. Where there are several drawers, each can accept only for himself, unless they are partners.

Effect of forged Endorsement on acceptor’s liability

An acceptor of a bill already endorsed is not relieved from liability by reason that such endorsement is forged, if he knew or had reason to believe that the Endorsement was forged when he accepted the bill (Section 41).

Liability of acceptor of a bill drawn in a fictitious name

Section 42 of the Act provides that 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, relieved from 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.

Liability of endorser

The endorser of an instrument by endorsing and delivering the instrument, before maturity, undertakes the responsibility that –

1. That on the due presentment it shall be accepted, (if a bill), and paid; and
2. That if it is dishonoured by the drawee, acceptor or maker, he will indemnify the holder or subsequent endorsers who are compelled to pay, provided due notice of dishonour is received by him.

But he may or make his liability conditional. In this respect, his position is better than that of a drawer or an acceptor, neither of whom can exclude his liability.

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

Liability of parties to holder in due course

Every prior party (i.e. maker or drawer, acceptor and all intervening endorsers to an instrument is liable to a holder in due course until the instrument is satisfied (paid). Therefore, the maker and endorsers of a note are jointly and severally liable for the payment and may be sued jointly.

Liability on an instrument made drawn etc. without consideration

An instrument made, drawn accepted, endorsed or transferred without consideration creates no obligation of payment between the parties to the transaction. Further, a bill drawn or accepted without consideration does not impose any liability either on the drawer or on the acceptor to pay the holder. Similarly, if an instrument is endorsed without consideration, the endorser is not liable.

But if any party to such an instrument has transferred the instrument to a holder for a consideration such holder and every subsequent holder deriving title from him, may recover the amount due on such instrument from the transferor for consideration or from any party prior thereto.