

The Negotiable Instruments Act, 1881

⇒ Came into force on first day of March 1882.

Recent developments:-

The act was amended several several times by:-

⇒ The Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002,

⇒ The Negotiable Instruments (Amendment) Act, 2015, and

⇒ The Negotiable Instruments (Amendment) Act, 2018.

Definition:- The Act does not define the term "Negotiable Instrument".

However, Section 13 provides for only 3.

⇒ Promissory Note

⇒ Bill of Exchange.

⇒ Cheques.

- Payable either to order or bearer.

Meaning :- Every document

- ⇒ which entitles a person
- ⇒ to a sum of money and
- ⇒ which is transferable
- ⇒ by delivery or
- ⇒ by endorsement & delivery.

To sum up :- Therefore, an instrument may be negotiable either by :-

### Statute (law)

- Promissory Note
- Bills of Exchange.
- Cheque.

### Usage (in India)

- Hundi,
- Beasat debentures,
- Share warrants,
- Dividend warrants
- Delivery orders
- Railway receipts.



## \* Order Instrument v/s Bearer Instrument :-

### • Order Instrument :-

- ⇒ It is expressed to be so payable,
- ⇒ When it is expressed to be payable to a specified person and does not contain words prohibiting its transfer. (i.e. it is transferable by endorsement and delivery)

### • Bearer Instrument :-

- ⇒ A negotiable instrument which is expressed to be payable to bearer.
- ⇒ A negotiable instrument on which the last endorsement is in blank.

## \* Endorsement of Negotiable Instrument :-

Meaning :- Endorsement means

⇒ Signing - on the face or back of Negotiable Instrument; or

- on a slip of paper annexed to Negotiable Instrument

⇒ by - the holder of negotiable instrument

⇒ for the purpose of negotiating such Negotiable Instrument.

### \* Essential requirements of a valid endorsement:-

(a) Writing :- The endorsement must be in writing.

(b) Signed :- The endorsement shall not be valid unless it is signed.

(c) By holder :- The endorsement shall be valid only if the Negotiable Instrument is signed by holder.

### \* Essential Characteristics of Negotiable Instrument :-

⇒ In writing,

⇒ Signed.

⇒ freely transferable from one person to another.

⇒ Holder's title is free defects.



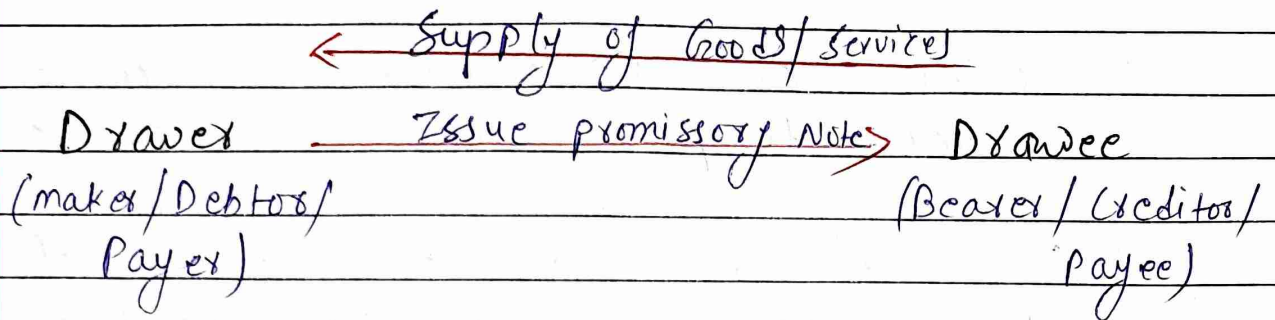
- ⇒ Can be transferred any number of times till its satisfaction.
- ⇒ Contain an unconditional promise or order to pay some money only.
- ⇒ The sum payable, the time of payment, the payee, must be certain.
- ⇒ Delivery is must.

### \* Promissory Notes (Sec. 4)

Meaning:- A "promissory note" is

- an instrument in writing (not being a bank ~~note~~ - note or a currency note)
- ⇒ containing an unconditional undertaking.
- ⇒ signed by the maker to pay a certain sum of money only to
  - ⇒ a certain person; or
  - ⇒ the order of a certain person; or
  - ⇒ the bearer of the instrument.

## \* Parties to Promissory Note :-



- makes promise to pay.
- To whom amount on note is payable.
- Debtor
- Must sign.

## \* Essential Characteristics of Promissory Note :-

- (a) In writing: An oral promise to pay is not sufficient.
- (b) There must be an express promise to pay, mere acknowledgement of debt is sufficient.

Example 1:- "I acknowledge myself to be indebted to B in Rs. 1000 to be paid on demand, for value received."

(Valid PN as the promise to pay is definite)



Example 2:- "Mr. B, I. O. U Rs. 1000"

(Invalid PN as there is no promise to pay. It is just ~~as~~ an acknowledgment of debt)

(c) Definite & Unconditional Promise.

Example 3:- "I promise to pay B Rs. 500 seven days after my marriage to C"

(Invalid PN as marriage with C may or may not happen).

**Exceptions**:- An instrument is made payable on the happening of certain event which is bound to happen, it is valid promissory note.

Example 4:- "I promise to pay B Rs. 500 on D's death."

(as death of D is certain, promise is unconditional. Thus, the PN is valid.)

Example 5:- "I promise to pay B Rs. 500 on D's death, provided D leaves me enough to pay that sum."

(Invalid PN as promise is dependent on D's leaving behind money which is not certain).

(d) Signed by the maker otherwise it is incomplete and ineffective.

(e) Promise to pay money only.

Example 6:- "I promise to pay B Rs. 500 and to deliver to him my black horse on 1st January next."

(Invalid PN, as the promisor needs to deliver its black horse which is not money.)

Example 6a:- "I promise to pay B in 30 shares and 20 Bonds of a Company."

(Invalid PN).

(f) Promise to pay a certain sum.

Example 7:- "I promise to pay B Rs. 500 and all other sums which shall be due to him."



(Invalid PN of the amount payable is not certain.)

But sometimes, the language of a promissory note is such that the amount payable can be easily ascertained. In such cases, the promissory note will be valid.

Example 8 - "I promise to pay B Rs. 500. along with simple interest at the rate of 12% p.a."

(2) maker & payee must be certain, definite and different persons:-

A PN cannot be made payable to bearer.

Only RBI or CG can make or issue a promissory note 'payable to bearer' (Sec. 31 of the Bank of India Act, 1934)

Sometimes, party may be described by designation - Eg. Branch manager of SBI, Kamla Nagar, Aggra.

(h) Stamped: A promissory note must be stamped.

## \* Bills of Exchange (Sec. 5):

Meaning :- A "bill of exchange" is an instrument in writing

- ⇒ containing an unconditional order,
- ⇒ signed by the maker,
- ⇒ directing a certain person
- ⇒ to pay a certain sum of money only to
- ⇒ or to the order of a certain person
- ⇒ or to the bearer of the instrument.

E.g. :- A wrote and signed an instrument ordering B to pay Rs 500 to C. This is a bill of exchange. In this instrument B has been ordered to pay Rs. 500 to C.

## \* Parties to Bills of Exchange :-

### • Drawer :-

⇒ who draws or makes the bill.



⇒ His liability is secondary and conditional.

⇒ His liability is primary and conditional until the bill is accepted.

### • Drawee:-

⇒ On whom the bill is drawn.

⇒ On acceptance of the bill:-

(a) he is called as acceptor.

(b) he becomes liable for the payment of the bill.

(c) his liability is primary and unconditional.

### • Payee:-

⇒ To whom or to whose order the money is, by the instrument, directed to be paid.

### \* Essential Characteristics of Bills of Exchange:-

(a) In writing: An oral promise to pay is not sufficient.

- (b) There must be an express order to pay.
- (c) Definite & Unconditional order.
- (d) Signed by the maker otherwise it is incomplete and ineffective.
- (e) Drawer, drawee, and payee must be certain. All these three parties may not necessarily be three different persons. One can play the role of two. But there must be two distinct persons in any case.

As per Sec. 31 of RBI Act, 1934, a BOE cannot be made "payable to bearer on demand."

Example 9:- "on demand pay to the bearer the sum of Rs. 500, for value received."

It is Invalid BOE.

However, a BOE payable on demand, in which name of the payee is mentioned, is valid.

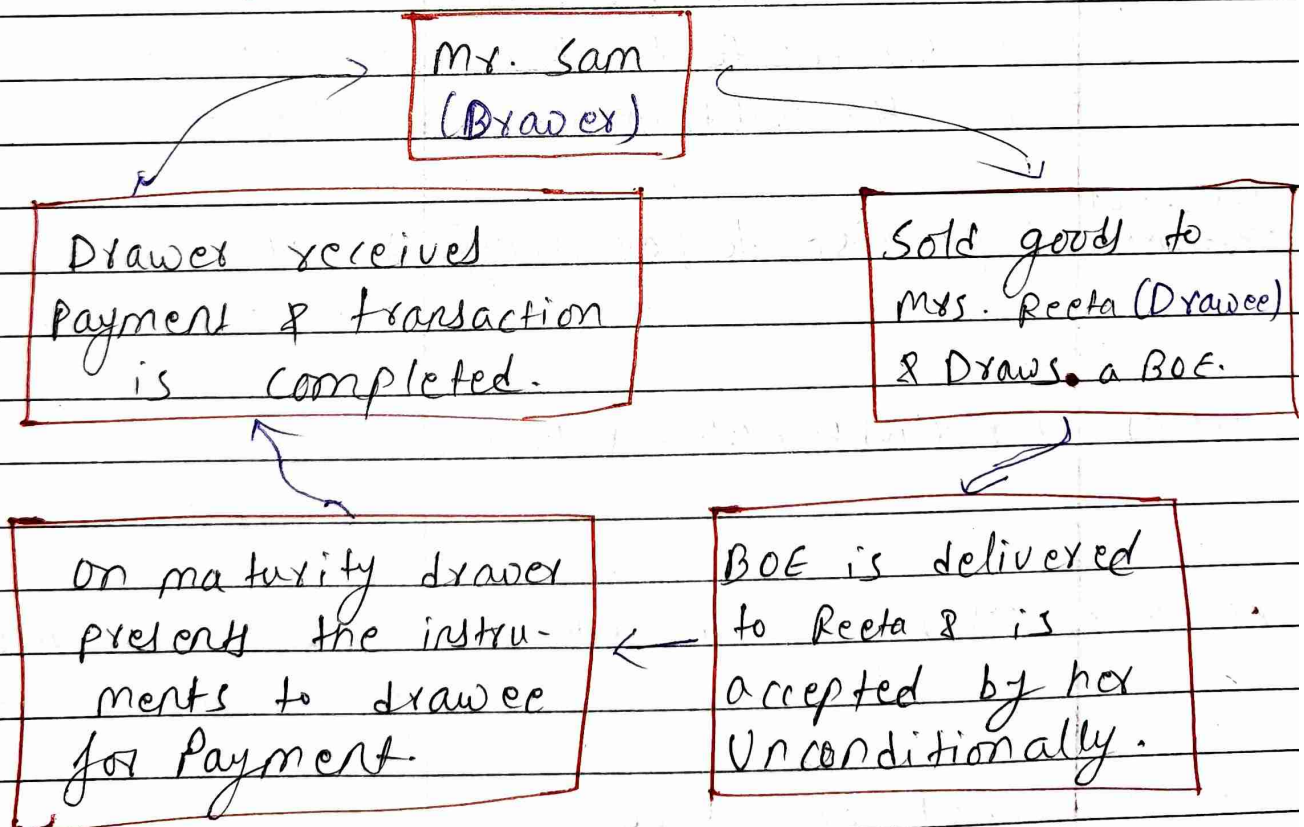


Example 10:- "On demand pay to A or order Rs. 500 for value received."

It is valid BOE.

- (f) Order to pay a certain sum.
- (g) Order to pay money only.
- (h) Stamped: A BOE must be stamped.

### \* Process of Bills of Exchange:-



\* Difference between PN & BOE:-

Basis	Promissory Note	Bills of Exchange
Definition.	An instrument in writing (not being bank note or a currency-note) containing an unconditional <del>and</del> 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.	An instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument.
Nature of Instrument	A promise to pay money.	An order for making payment.
Parties	2 Parties :- maker & Payee	3 Parties :- drawer, drawee & payee.
Acceptance	Does not require any acceptance.	Needs acceptance from the drawee.
Payable to bearer.	Cannot be made payable to bearer.	Can be payable to bearer. However, it cannot be payable to bearer on demand.



## \* Cheque (Sec. 6) :-

Meaning :- ~~drawn on~~ A "Cheque" is a BOE

⇒ drawn on a specified banker.

⇒ and not expressed to be payable otherwise than on demand. (i.e., it is ~~always~~ always payable on demand).

⇒ and it includes

- 'the electronic image of truncated cheque';

- 'a cheque in electronic form'.

To be Noted :- A "Cheque" requires.

⇒ All the essentials of a bill of exchange.

⇒ Drawn on a specified banker.

⇒ Payable on demand.

A "Cheque" does not require  
(a) stamping (b) acceptance.

Payable on demand ~~must mean~~ - It should be payable whenever the holder chooses to present ~~to~~ it to the drawee (banker).

The expression "Banker" includes any person acting as a banker and any post office saving Bank.  
(Sec. 3).

### \* Explanation I :-

- (a) Cheque in the electronic form - means a cheque drawn in electronic form by using any computer resource, and signed in a secure system with a digital signature (with/without biometric signature) and asymmetric crypto system or electronic signature, as the case may be;

**NOTE** - For the purposes of this Section, the expressions "asymmetric crypto system", "computer resource", "digital signature", "electronic form" and "electronic signature" shall have same meanings respectively assigned to them in the Information Technology Act, 2008.

- (b) "a truncated cheque" means a cheque which is truncated during a clearing cycle, either by the



clearing house or by the bank whether paying or receiving payment, immediately on generation of a electronic image for transmission, substituting the further physical movement of the cheque in writing.

### \* Explanation II :-

⇒) For the purpose of this section, the expression "clearing house" means the clearing house managed by the Reserve Bank of India or a clearing house recognized as such by the Reserve Bank of India.

### \* Explanation III :-

⇒) For the purposes of this section, the expressions "asymmetric crypto system", "computer resource", "digital signature", "electronic form" and "electronic signature" shall have the same meanings respectively assigned to them in the Information Technology Act, 2008.

## \* Parties to Cheque :-

### • Drawer :-

- ⇒ Who draws or makes the cheque.
- ⇒ His liability is secondary and conditional.

### • Drawee :-

- ⇒ The specific bank on whom cheque is drawn.

### • Payee :-

- ⇒ The person to whom money is to be paid.
- ⇒ The payee may be the drawer himself or a third party.

"drawee in case of need" :- When in the bill or in any indorsement thereon, the name of any person is given in addition to the drawee to be resorted to in case of need such person is called a "drawee in case of need".



## \* Classification of Negotiable Instrument:-

### • Bearer Instrument (Sec. 13):-

⇒ A NI which is expressed to be payable to bearer. or.

⇒ A NI on which the last endorsement is in blank.

⇒ Negotiated by merely delivery.

⇒ As per the provisions of the RBI Act, 1934:-

PN - cannot be made payable to bearer.

BOE - cannot be made payable to bearer on demand.

### • Order Instrument (Sec. 13):-

⇒ A NI payable to a particular person.

⇒ A NI payable to a particular person or his order.

⇒ A NI on which the last endorsement is in full.

⇒ Negotiated by endorsement & delivery.

## \* Classification of Negotiable Instruments:-

- Inland Instrument (Sec. 11):- 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.

Place where instrument drawn and made is payable	Residence of person on whom instrument is drawn	Nature of Instrument
PN, BOE, C drawn + made in India.	+ Payable in India OR + drawn upon a person resident in India.	Inland Instrument

### Example 11:-

- (i) (a) A promissory note made in Kolkata and payable in Mumbai.
- (ii) A bill drawn in Varanasi on a person resident in Jodhpur (although it is stated to be payable in Singapore)



# Classification of NZ

(iii) A, a resident of Agra, drew (i.e. made) a bill of exchange in Agra on B, a merchant in New York. And B accepted the bill of exchange as payable in Delhi. It is an inland bill of exchange. In this case, the bill of exchange was drawn in India and also payable in India.

(iv) A, resident of Mumbai, drew a bill of exchange in Mumbai on B, a merchant in Mathura. And B accepted the bill of exchange as payable in London. It is also an inland bill of exchange. In this case, the bill of exchange was drawn in India on a person resident in India. It is immaterial that the amount is payable in London.

An inland instrument remains inland even if it has been endorsed in a foreign country.

(v) If the bill of exchange mentioned in above two examples, are endorsed in France, they will remain inland bills.

# Classification of NI

## \* Foreign Instrument (Sec. 12) :-

=> A foreign instrument is one which is not an inland instrument. In other words, can be understood as follows:-

Place where instrument drawn.	Residence of person on whom drawn and place where made payable.	Nature of Instrument
P/N, BOE, C drawn made outside India.	On a person resident in or outside India + payable in India.	Foreign Instrument
	On a person residing outside India + payable outside India.	
	On a person residing outside India + payable outside India.	

E.g. 1:- A drew a bill of exchange in India on B, a merchant residing



## Classification of NZ

in London. It was also made payable in London. It is a foreign bill of exchange.

E.g.-2 :- A drew a bill of exchange in London on B, a merchant residing in London. But the bill of exchange was made payable in India. It is also a foreign bill.

### \* Liability of maker/ drawer of foreign bill:-

⇒ In the absence of a contract to the contrary, the liability of the maker or drawer of a foreign P/N or BOE or Cheque is regulated in all essential matters by the law of the place where he made the instrument & the respective liabilities of the acceptor and indorser by the law of the place where the instrument is made payable (Section 134).

Example 12:- A BOE is drawn by A in Berkeley where the rate of interest is 15% and accepted by B payable in Washington where the rate of interest is 6%.

## Classification of NI

The bill is indorsed 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 8% only. But if A is charged as drawer, he is liable to pay interest at 15%.

### \* Inchoate Instrument:-

- ⇒ An inchoate instrument is a blank or an incomplete instrument.
- ⇒ When a person signs and delivers to another a blank or incomplete stamped instrument, he authorizes the other person to complete to a NI for any amount not exceeding the amount covered by the stamp.
- ⇒ When the NI is so filled up, the person signing the instrument becomes liable, in the capacity in which he has signed, to any holder in due course for such amount.
- ⇒ The liability of the signer is



## Classification of NI

restricted to the amount specified in the instrument which is covered by the stamp.

⇒ It may be noted here that no person other than a holder in due course can recover from the person delivering the instrument anything in excess of the amount intended to be paid by him.

Example 13:- A owed Rs. 500 to B. He gave a stamped and signed promissory note to B leaving blank the space for amount. And B filled Rs. 700, in the space left for amount. In this case, B cannot recover Rs. 700 from A as B is not a holder in due course. He can recover Rs. 500 only, which A intended to pay under the instrument.

If after completing the promissory note for Rs. 700, B transfer it to C, a holder in the due course, then C will be entitled to recover the full amount of Rs. 700 if the stamp affixed is sufficient to cover

## Classification of NI

Page No. \_\_\_\_\_

Date \_\_\_\_\_

Rs. 700. And A will be bound to pay the full amount to C.

### \* Ambiguous Instrument :-

⇒ An ambiguous instrument is one which in form is such that it may either be treated as a P/N or B.O.E.

⇒ In such cases, the holder may either treat it as a P/N or B.O.E.

⇒ ~~Be~~ Once he exercises his option, he is bound by it, i.e., he cannot fall back that it is the other kind of instrument.

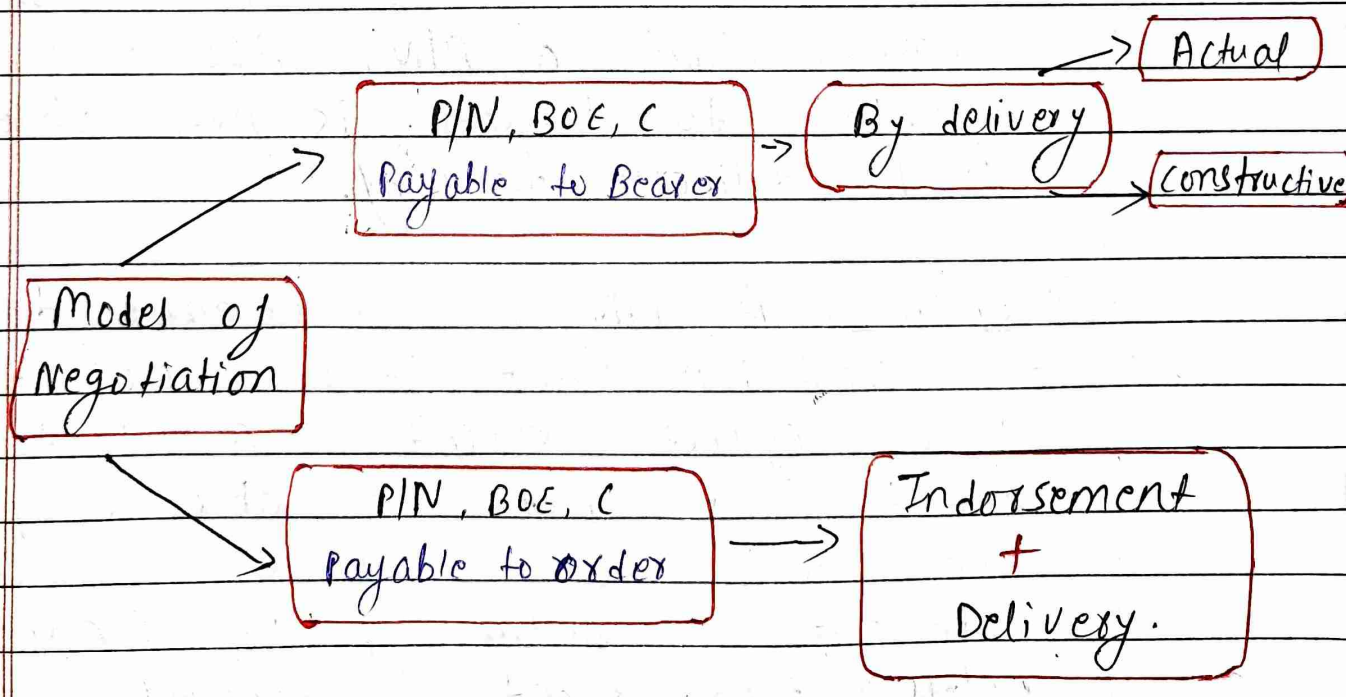
Example a:- A firm was carrying on its business in Bombay and Delhi. Its Bombay branch drew a B.O.E. on the Delhi branch. In this case, the holder of B.O.E. may also treat it as a promissory note drawn by the Bombay branch payable in Delhi. The person for the same is that the drawer and the drawee of the bill of exchange are the same person.



# \* Negotiation of Negotiable Instrument :-

## Meaning :-

- ⇒ NI is freely transferable from one person to another.
- ⇒ by negotiation.
- ⇒ As per Sec. 14 of N.I. Act, when a NI is transferred to any person with a view to constitute the person holder thereof, the instrument is deemed to have been negotiated.
- ⇒ Thus, there is a transfer of ownership of the instrument.



Example 14:- X drew a Cheque for Rs. 50,000 payable to y and delivered it to him. Y indorsed the Cheque in favour of Z but kept it in his table drawer. Subsequently, Y died, and Cheque was found by Z does not become the holder in Y's table drawer. In this case, Z does not become the holder of the Cheque as the negotiation was not completed by delivery of the Cheque to him.

### \* Negotiation by Delivery

⇒ Subject to section 58 [instrument obtained by unlawful means or for unlawful consideration], a PIN, BOE, or Cheque payable to bearer is negotiable by delivery thereof.

Exception:- A PIN, BOE or Cheque delivered on condition that it is not to take effect except in a certain event is not negotiable (except in the hands of a holder for value without notice of the condition) unless such event happens.



Example 15(a):- A, the holder of a NI payable to bearer, delivers it to B's agent to keep for B. The instrument has been negotiated.

Example 15(b):- A, the holder of a negotiable instrument payable to bearer, which is in hand of A's banker, who is at the time the banker of B, directs the banker to transfer the instrument to B's credit in the banker's account with B. The banker does so, and accordingly now possesses the instrument as B's agent. The instrument has been negotiated, and B has become the holder of it.

### \* Some Important Points regarding Delivery:-

- ⇒ Delivery of an instrument is essential.
- ⇒ The delivery may be actual or constructive.
- ⇒ Actual delivery takes place when the instrument changes hand physically.
- ⇒ Constructive delivery takes place when the instrument is delivered to the

the agent, clerk or servant of the indorsee on his behalf or when the indorser, ~~after~~ after indorsement, holds the instrument as an agent of the indorsee.

⇒ When an instrument is conditionally or for a special purpose only, the property in it does not pass to the transferee, even though, it is indorsed to him, unless the instrument is negotiated to a holder in due course.

⇒ The rights in the instrument are not transferred to the indorsee unless after the indorsement the same has been delivered.

⇒ If a person makes the indorsement of instrument but ~~is~~ before the same could be delivered to the indorsee, the indorser dies then the legal representatives of the deceased person cannot negotiate the same by mere delivery thereof. (Sec. 57).



## \* Dishonour of Cheque (Sec. 138 to Sec. 142) :-

- ⇒ Debt - Cheque was issued to discharge a legally enforceable debt.
- ⇒ Reason for dishonour - insufficiency of funds.
- ⇒ Presentation of cheque - Within 3 months or validity period of cheque.
- ⇒ Demand made from drawer - Within 30 days of dishonour.
- ⇒ Default by drawer to pay - within 15 days of demand made.
- ⇒ Complaint by holder - within 1 month, with the court.

## \* Nature of liability :-

- ⇒ If a cheque issued by the drawer is dishonoured.
- ⇒ due to insufficiency of funds,
- ⇒ the drawer is punishable with
- ⇒ Imprisonment upto 2 years or

⇒ fine upto 2 times the amount ~~of~~ of Cheque or

⇒ Both.

\* Cheque issued to discharge a liability:-

⇒ Conditions for attracting liability u/s 138

- The liability u/s 138 arises only if the drawer had issued the cheque to discharge a legally enforceable debt or other liability.

⇒ Thus, where the drawer issues a cheque as a gift or charity, he is not liable under section 138 even if cheque is dishonoured.

⇒ Presumption in favour of holder (sec. 139). It shall be presumed that the holder of a cheque received the cheque in whole or in part, of any debt or other liability.

⇒ Thus, the burden to prove that the cheque in a particular case was not given to discharge a legally enforceable debt or liability, lies on the drawer.



### \* Dishonour due to insufficiency of funds :-

⇒ The Cheque must have been dishonoured due to insufficiency of funds in the account of the drawer.

### \* Presentment of Cheque within validity period :-

⇒ Cheque must have been presented for payment to bank within 3 months from the date on which it was drawn.

### \* Notice to drawer :-

⇒ The payee/holder must give a notice to the drawer of the Cheque. The notice must fulfill the following conditions :-

⇒ It must be in writing.

⇒ must be given within 30 days of receipt of information of dishonour of Cheque from bank.

⇒ The notice must require the drawer to make payment of the money.

due on the cheque, i.e., the payee/holder must demand the money due under the cheque.

### \* Default in payment by drawer:

⇒ The liability u/s 138 is attracted only if, within 15 days of receipt of notice from the payee/holder, the drawer fails to pay the whole of the money due under the cheque.

⇒ If drawer makes only a part payment, it is considered as a default by drawer. Thus, the cause of action arises on 16<sup>th</sup> day from the day of receipt of notice from the payee/holder.

### \* Payee/holder must make a complaint with Court (Sec. 142) :-

⇒ Following ~~points~~ points are worth noting in this regard:-

- The complaint must be in writing.
- Within 1 month from the date when



Cause action arose, i.e. ~~at~~ within 1 month from the last day on which drawer was liable to pay the money to the payee/holder.

- Complaint shall be made with a court not inferior to that of a metropolitan mag magistrate or a judicial magistrate of the first class.

### \* Defence not allowed (Sec. 140):-

- ⇒ It shall not be defence in a prosecution of an offence u/s 138.
- ⇒ That the drawer had no reason to believe.
- ⇒ When he issued the Cheque.
- ⇒ That cheque may be dishonoured on presentment for the reason stated in that section.

### \* Effect of "Stop payment" order :-

- ⇒ When the drawer makes 'stop payment' order.
- ⇒ to the banker (i.e. he countermands payment)

resulting in dishonour of the Cheque,

⇒ It has the same effect as if the Cheque had been dishonoured

⇒ due to insufficiency of funds.

⇒ Thus, the proceedings u/s 138 may be initiated against the drawer.

## \* Presentment of Instrument

### \* Presentment for acceptance (Sec. 61) :-

⇒ A BOE payable after sight must be presented to the drawee thereof for acceptance by a person entitled to demand acceptance, within a reasonable time after it is drawn and in business hours on a business day.

⇒ In default of such presentment no party liable. If the drawee cannot be found after reasonable time search, BOE is dishonoured.

⇒ If the BOE is directed to drawee at a particular place, must be



presented at that place, if Drawee not found after reasonable search, BOE is dishonoured.

⇒ Authorised by agreement or usage, a presentment through the post office by means of a registered letter is sufficient.

### \* Presentment of promissory note for sight (Sec. 62):

⇒ P/N payable at a certain period after sight must be presented

- within reasonable time &
- in business hours.
- on a business day.

⇒ In default of such presentment no party liable thereto.

### \* Rules regarding presentment for payment (P/N, BOE, Cheque):

⇒ To whom - maker (P/N), Acceptor (BOE), Drawee (Cheque).

⇒ In default in presentment - No party liable thereto.

⇒ Exception - If PIN is payable on Demand and is not payable at a specified place, no presentment is necessary.

⇒ Time - During usual business hours.

⇒ If instruments payable after date or sight - must be presented for payment at maturity.

⇒ PIN payable by ~~installments~~ instalments - must be presented for payment on 3<sup>rd</sup> day after date fixed for payment.

⇒ Instrument payable at specified place - must be presented for payment at that place.

⇒ Where no exclusive place specified - must be presented for payment at the place of business (if any) or at the usual residence.

⇒ No known place of business or residence - presented ~~to~~ may be made to him in person wherever he can be found.



=> Instrument payable on demand - must be presented for payment within a reasonable time after it is received by the holder.

**NOTE:** Delay in presentment for acceptance or payment is excused if the delay is caused by circumstances beyond the control of the holder.

### \*\* When Presentment Unnecessary

\* NI is dishonoured on due date :-

1. Maker, Drawee, or acceptor intentionally prevents the presentment.
2. Payable at business place & that's closed on business day during usual business hours,
3. Payable at specified place & liable party doesn't attend place,
4. Not payable at specified place & liable party not found after due search,
5. liable party engaged engaged to pay

notwithstanding non-presentment

6. Liable party makes part payment
7. Liable party waves off his right to take advantage.
8. If drawer could not suffer from damage from want of such presentment

### ★ Rules of Compensation (Sec. 117)

★ NI is dishonoured on due date:

⇒ In case of dishonour of NI, holder can claim:-

- Amount due on NI
- Expenses incurred in presenting, noting & protesting.
- Interest 18% p.a. from due date of payment to date of realisation.

NOTE:- In case of foreign currency, current rate of Exchange.