THE NEGOTIABLE INSTRUMENTS ACT, 1881

1. MEANING OF NEGOTIABLE INSTRUMENTS

- Negotiable Instruments is an instrument (document) which is freely transferable from one person to another by mere delivery or by indorsement and delivery.
- The property in such an instrument pass to a *bonafide* transferee for value.
- The Act does not define the term 'Negotiable Instruments'.
- However, Section 13 of the Act provides for only **three kinds of negotiable instruments** namely **bills of exchange, promissory notes and cheques, payable either to order or bearer.**

It is to be noted that Hundies, Treasury Bills, Bearer Debentures, Railway Receipts, Delivery Orders, Bill of Lading etc. are also considered as negotiable instruments either by mercantile custom or usage.

Type of Negotiable Instrument		
Promissory Note	**Bill of Exchange**	**Cheque**

- A negotiable instrument is ***payable to order*** when:
  - ✓ 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 transferrable by indorsement and delivery)
- A negotiable instrument is ***payable to bearer*** when:
  - ✓ When it is expressed to be so payable e.g. pay bearer
  - ✓ When the only or last indorsement the instrument is an indorsement in blank i.e., the person who possesses it can demand payment.

For example,. ***A cheque made payable to specified person and that cheque is endorsed by signing on the back of the cheque by that specified person.***

Essential Characteristics of Negotiable Instruments

1. It is necessarily in writing and be signed.
2. It is freely transferable from one person to another.
3. Holder's title is free from defects.
4. It can be transferred any number of times till its satisfaction.
5. Every negotiable instrument must contain an unconditional promise or order to pay money. The promise or order to pay must consist of money only.
6. The sum payable, the time of payment, the payee, must be certain.

The instrument should be delivered. Mere drawing of instrument does not create liability.

PROMISSORY NOTE

According to section 4 of the NI Act, 1881,

- "A *'promissory note'* is an instrument in writing (not being a bank-note or a currency-note)
- containing an *unconditional undertaking*
- to pay a certain sum of money, signed by the maker,
- only to, or to the order of, a certain person, or
- to the bearer of the instrument."

Specimen of Promissory note

₹ 50,000 Lucknow

Three months after date, I promise to pay Shri ADITYA KAMDAR (Payee) or to his order the sum of Rupees Fifty Thousand, for value received.

Stamp
Sd/- Ram

To,

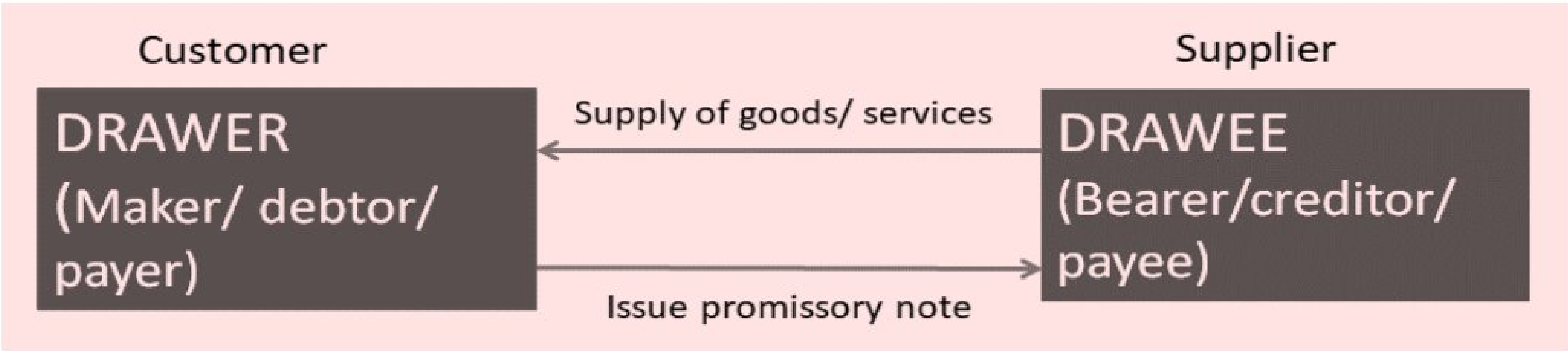
Shri ADITYA KAMDAR,

B-20, Green Park, Mumbai.

Parties to promissory note

Maker: The person who makes the promise to pay is called the Maker. He is the debtor and must sign the instrument.

Payee: Payee is the person to whom the amount on the note is payable.



Essential Characteristics of a Promissory Note

- In **writing**- An oral promise to pay is not sufficient.
- There must be **an express promise to pay**. Mere acknowledgment of debt is insufficient.

Example 1: I acknowledge myself to be indebted to B in Rs 1,000, to be paid on demand, for value received. (Valid promissory note as the promise to pay is definite)

Example 2: "Mr. B, I.O.U Rs 1,000." – Invalid promissory note as there is no promise to pay. It is just an acknowledgement of debt.

- The promise to pay should be ***definite and unconditional***. Therefore, instruments payable on performance or non-performance of a particular act or on the happening or non-happening of an event, are not promissory notes. *However, the promise to pay may be subject to a condition, which according to the ordinary experience of mankind, is bound to happen.*

Example 3: I promise to pay B Rs 500 seven days after my marriage with C. (the promissory note is invalid as marriage with C may or may not happen.)

Example 4: I promise to pay B Rs 500 on D's death- as the death of D is certain, promise in unconditional. Thus, the promissory note 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 promissory note as promise is dependent on D's leaving behind money which is not certain.

A promissory note must be ***signed by the maker*** otherwise it is incomplete and ineffective.

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. It is not a valid promissory note, as the promisor needs to deliver its black horse which is not money.

Promise to pay a ***certain sum.***

Example 7: "I promise to pay B ` 500 and all other sums which shall be due to him."- Promissory note invalid as 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 500 alongwith simple interest at the rate of 12% per annum.

The ***maker and payee must be certain, definite and different persons***. A promissory note cannot be made payable to the bearer [Section 31 of the Bank of India Act, 1934 (RBI Act)]. **Only the Reserve Bank or the Central Government can make or issue a promissory note 'payable to bearer'.**

Stamping: A promissory note must be properly stamped in accordance with the provisions of the Indian Stamp Act and such stamp must be duly cancelled by maker's signatures or initials on such stamp or otherwise.

BILLS OF EXCHANGE

- A "bill of exchange" is an instrument in writing
- containing an unconditional order,
- signed by the maker,
- directing a certain person to pay a certain sum of money only to, or
- to the order of, a certain person or to the bearer of the instrument.

Specimen of Bill of Exchange

Mr. A (Drawer) 48, MP
Nagar, Bhopal (M.P.)
April 10, 2022

Rs 10,000/-
Four months after date, pay to Mr. B (Payee) a sum of Rupees Ten Thousand, for value received.
To,
Mr. C (Drawee)
576, Arera Colony, Bhopal (M.P.)

Signature
Mr. A

Parties to the bill of exchange

a. **Drawer:** The maker of a bill of exchange.

b. **Drawee**: The person directed by the drawer to pay is called the 'drawee'. He is the person on whom the bill is drawn. On acceptance of the bill, he is called an acceptor and is liable for the payment of the bill. ***His liability is primary and unconditional.***

c. **Payee**: The person named in the instrument, to whom or to whose order the money is, by the instrument, directed to be paid.

Essential characteristics of bill of exchange

- It must be in writing.
- Must contain an express order to pay.

- The order to pay must be definite and unconditional.
- The drawer must sign the instrument.
- 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 Section 31 of RBI Act, 1934, a bill of exchange cannot be made payable to bearer on demand.

Example : "On demand pay to the bearer the sum of rupees five hundred, for value received." It is invalid BOE.

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

(a) The sum must be certain.

(b) The order must be to pay money only.

(c) It must be stamped.

Example 10: "On demand pay to A or order the sum of rupees five hundred for value received." It is valid BOE.

- firstly the seller sold goods to the buyer/customer and
- then draws a bill of exchange on him.
- The Bill of exchange is delivered by the buyer who accepts it without any condition.
- On maturity of bill of exchange, the buyer will pay the amount due to the payee. (The payee may be the drawer himself or a third party.)

Difference between promissory note and bill of exchange

Basis	Promissory Note	Bill of Exchange
Definition	"A Promissory Note" is an instrument in writing (not being a banknote or a currency-note) containing an unconditional undertaking signed by the maker, to pay a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument.	"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.
Nature	In a promissory note, there is a promise to pay money.	In a bill of exchange, there is an order for making payment.
Parties	In a promissory note, there are only 2 parties namely: i. the maker and ii. the payee	In a bill of exchange, there are 3 parties which are as under: i. the drawer ii. the drawee iii. the payee
Acceptance	A promissory note does not require any acceptance, as it is signed by the person who is liable to pay.	A bill of exchange needs acceptance from the drawee.
Payable to bearer	A promissory note cannot be made payable to bearer.	n the other hand, a bill of exchange can be drawn payable to bearer. However, it cannot be payable to bearer on demand.

1.CLASSIFICATION OF NEGOTIABLE INSTRUMENTS

"Bearer instrument" and "order instrument" [Section 13]

Bearer Instrument:

- It is an instrument where the name of the payee is blank or
- where the name of payee is specified with the words "or bearer" or
- where the last indorsement is blank.
- Such instrument can be negotiated by mere delivery.

Order Instrument:

- It is an instrument which is payable to a person or
- Payable to a person or his order or
- Payable to order of a person or
- where the last indorsement is in full,
- such instrument can be negotiated by indorsement and delivery.

Bearer Instrument	Order Instrument
name of the payee is blank or	**payable to a person, or**
name of payee is specified with the words "or bearer" or	**Payable to a person / his order, or**
the last indorsement is blank	**Payable to order of a person, or**
negotiated by mere delivery	**the last indorsement is in full,**

"Inland instrument" and "Foreign instrument" [Sections 11 & 12]

"Inland instrument":

- 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	Residence	Nature of Instrument
P/N, BOE C drawn/made in India ,	+ Payable in India OR	are Inland Instruments
	+ drawn upon a person resident in India.	

Examples :

(i) 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)

(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 bills of exchange mentioned in above two examples, are endorsed in France, they will remain inland bills.

"Foreign instrument":

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

Place where bill is drawn	Residence of Person on whom drawn and place where made payable	Nature
P/N, BOE, C drawn/made outside India	on a person resident in or outside India + made payable in India	are foreign bills.
	on a person residing outside India + payable outside India.	
	on a person residing in India + payable outside India	

Liability of maker/ drawer of foreign bill

In the absence of a contract to the country, the liability of the maker or drawer of a foreign promissory note or 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 liabilities of the acceptor and indorser by the law of the place where the instrument is made payable (Section 134).

***Example** : A bill of exchange is drawn by A in Berkley where the rate of interest is 15% and accepted by B payable in Washington where the rate of interest is 6%. 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 6%*

Inchoate and Ambiguous Instruments

Inchoate Instrument:

- It means an instrument that is incomplete in certain respects.
- The drawer/ maker/ acceptor/ indorser of a negotiable instrument may
- sign and deliver the instrument to another person in his capacity leaving the instrument,
- either wholly blank or having written on it the word incomplete.
- _and this gives a power to its holder to make it complete by writing any amount either within limits specified therein or within the limits specified by the stamp's affixed on it.
- **The principle of this rule of an inchoate instrument is based on the principle of estoppel.**

1. ***Liability on drawing inchoate instrument:*** The person signing and delivering the inchoate instrument is liable both to a holder and holder in due course. However, there is a difference in their respective rights:
2. ***The holder*** of such an instrument cannot recover the amount in excess of the amount intended to be paid by the signor.
3. ***The holder in due course*** can, however, recover any amount on such instrument provided it is covered by the stamp affixed on the instrument.

Section 20 of the Act reads as

"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 gives prima facie authority to the holder thereof to make or complete, as the case may be, upon it a negotiable instrument, for any 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 by him to be paid thereunder***".

Example : ***A person signed a blank acceptance on a bill of exchange and kept it in his drawer. The bill was stolen by X and he filled it up for ₹ 20,000 and negotiated it to an innocent person for value. It was held that the signer to the blank acceptance was not liable to the holder in due course because he never delivered the instrument intending it to be used as a negotiable instrument. Further, as a condition of liability, the signer as a maker, drawer, indorser or acceptor must deliver the instrument to another. In the absence of delivery, the signer is not liable. Furthermore, the paper so signed and delivered must be stamped in accordance with the law prevalent at the time of signing and on delivering otherwise the signer is not estopped from showing that the instrument was filled without his authority.***

Ambiguous Instrument:

"Where an instrument may be construed either as a promissory note or bill of exchange, the holder may at his election treat it as either, and the instrument shall be thenceforward treated accordingly."

- An instrument which is vague and cannot be clearly identified either as a bill of exchange, or as a promissory note, is an ambiguous instrument.
- In other words, such an instrument may be construed either as promissory note, or as a bill of exchange.
- Section 17 provides that the holder may, at his discretion, treat it as either and the instrument shall thereafter be treated accordingly.
- Thus, after exercising his option, the holder cannot change that it is the other kind of instrument.