THE NEGOTIABLE INSTRUMENTS ACT, 1881

❖ INTRODUCTION

- The Law in India relating to negotiable instruments is contained in the Negotiable Instruments Act, 1881.
- This is an Act to define and amend the law relating to promissory notes, bills of exchange and cheques.
- The Act applies to the whole of India, but nothing herein contained affects the Reserve Bank of India Act, 1934, (section 21 which provides the Bank to have the right to transact Government business in India), or affects any local usage relating to any instrument in an oriental language.
- Recent developments:
  - The Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002;
  - The Negotiable Instruments (Amendment) Act, 2015, and
  - The Negotiable Instruments (Amendment) Act, 2018.

❖ MEANING OF NEGOTIABLE INSTRUMENTS

Negotiable Instruments is an instrument (document) which is freely transferable (by customs of trade) 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. 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.

1. **A negotiable instrument is payable to order when:**
   a) It is expressed to be so payable
   b) 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)
2. **A negotiable instrument is payable to bearer when:**
   a) When it is expressed to be so payable e.g. pay bearer
   b) When the only or last indorsement (indorsement means signing of the instrument) on the instrument is an indorsement in blank i.e., the person who possesses it can demand payment.

❖ Essential Characteristics of Negotiable Instruments

1. It is necessarily in **writing**.
2. It should be **signed**.
3. It is **freely transferable** from one person to another.
4. Holder's **title is free** from defects.
5. It **can be transferred any number of times** till its satisfaction.
6. It must contain an unconditional promise or order to pay money. The promise or order to pay must consist of money only.
7. The sum payable, the time of payment, the payee, must be **certain**.
8. 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 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."

Specimen of Promissory note

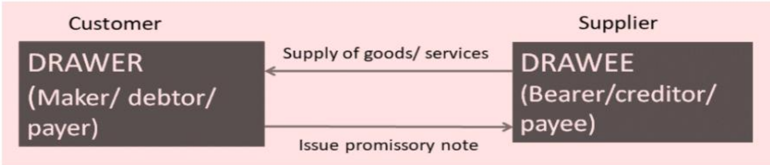
₹ 10,000 Lucknow
April 10, 2022

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

Stamp
Sd/-
Ram

To,
Shri Ramesh,
B-20, Green Park,
Mumbai.
(Maker)

Parties to promissory note
1. **Maker:** The person who makes the promise to pay is called the Maker. He is the debtor and must sign the instrument.
2. **Payee:** Payee is the person to whom the amount on the note is payable.



Essential Characteristics of a Promissory Note

a) **In writing- An** oral promise to pay is not sufficient.
b) There must be an express **promise to pay.** Mere acknowledgment of debt is insufficient.
c) The promise to pay should be **definite** and **unconditional**.
d) A promissory note must be **signed by the maker** otherwise it is incomplete and ineffective.
e) Promise **to pay money only**.
f) Promise **to pay a certain sum**.
g) The maker and payee must be certain, definite and different persons. Only the Reserve Bank or the Central Government can make or issue a promissory note 'payable to bearer'.
h) **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

₹ 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

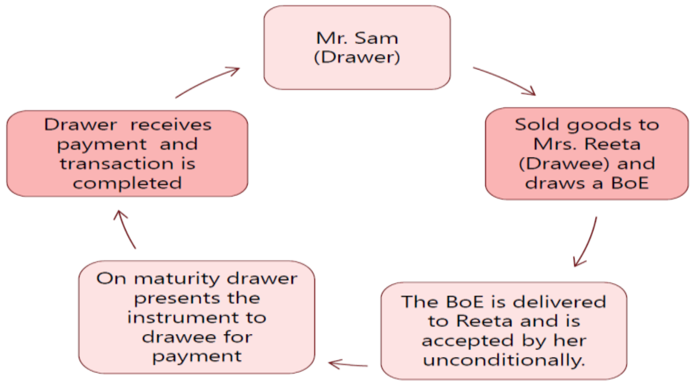
Parties to the bill of exchange

a) **Drawer:** The maker of a bill of exchange.
b) **Drawee:** The person directed by the drawer to pay is called the 'drawee'. 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

a) It must be in writing.
b) Must contain an express order to pay.
c) The order to pay must be definite and unconditional.
d) The drawer must sign the instrument.
e) Drawer, drawee, and payee must be certain.
f) The sum must be certain.
g) The order must be to pay money only.
h) It must be stamped.

Process of bill of exchange



- **Difference between promissory note and bill of exchange**

S.no	Basis	Promissory Note	Bill of Exchange
1	**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.
2	**Nature of Instrument**	In a promissory note, there is a promise to pay money.	In a bill of exchange, there is an order for making payment.
3	**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
4	**Acceptance**	A promissory note does not require any acceptance, as it is signed by the person who is liable to pay.	A bills of exchange needs acceptance from the drawee.
5	**Payable to bearer**	A promissory note cannot be made payable to bearer.	On the other hand, a bill of exchange can be drawn payable to bearer. However, it cannot be payable to bearer on demand.

CHEQUE [SECTION 6]

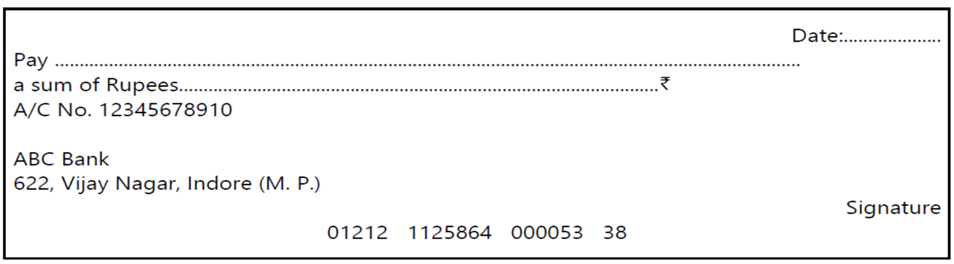
A "cheque" is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and it includes the electronic image of a truncated cheque and a cheque in the electronic form.

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

The expression "Banker" includes any person acting as a banker and any post office saving bank.

"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 an electronic image for transmission, substituting the further physical movement of the cheque in writing.

Specimen of Cheque



Parties to Cheque

1. **Drawer:** The person who draws a cheque i.e., makes the cheque (Debtor). His liability is primary and conditional.
2. **Drawee:** The specific bank on whom cheque is drawn. He makes the payment of the cheque. In case of cheque, drawee is always banker. **"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".
3. **Payee:** The person named in the instrument (i.e., the person in whose favour cheque is issued), to whom or to whose order the money is, by the instrument, directed to be paid, is called the payee. The payee may be the drawer himself or a third party.

Essential Characteristics of a cheque

According to the definition of cheque under section 6, a cheque is a species of bill of exchange. Thus, it should fulfil:

a. all the essential characteristics of a bill of exchange
b. Must be drawn on a specified banker.
c. It must be payable on demand.

All cheques are bills while all bills are not cheques.

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.

❖ **"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.

"Foreign instrument": A foreign instrument is one which is not an inland instrument.

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

❖ **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. Such an instrument is called an inchoate instrument 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.

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:

The holder of such an instrument cannot recover the amount in excess of the amount intended to be paid by the signor.

The holder in due course can, however, recover any amount on such instrument provided it is covered by the stamp affixed on the instrument.

Ambiguous Instrument: 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. 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.

NEGOTIATION (TRANSFER) OF NEGOTIABLE INSTRUMENTS

The rights in a negotiable instrument can be transferred through negotiation. According to Section 14 of the N.I. Act, when an instrument is transferred to someone to make them the holder, it is considered negotiated, transferring ownership. Negotiable instruments can be negotiated either by delivery (if payable to bearer) or by indorsement and delivery (if payable to order).

- **Modes of Negotiation**

i. A promissory note, bill of exchange or cheque payable to bearer is negotiable by the delivery thereof.
ii. A promissory note, bill of exchange or cheque payable to order is negotiable by the holder by indorsement and delivery thereof.

- **Negotiation by delivery:** Subject to the provisions of section 58 [Instrument obtained by unlawful means or for unlawful consideration], a promissory note, bill of exchange or cheque payable to bearer is negotiable by delivery thereof. Exception: A promissory note, bill of exchange, or cheque given with a condition that it will only be valid if a specific event occurs cannot be negotiated. However, if a holder for value receives it without knowing about the condition, it can still be negotiated unless the specific event happens.

- **Negotiation by indorsement:** Subject to the provisions of section 58, a promissory note, bill of exchange or cheque payable to order, is negotiable by the holder by indorsement and delivery thereof.

- **Importance of Delivery in Negotiation:** Delivery of an instrument is necessary for negotiation, whether payable to bearer or order. The delivery must be voluntary, aiming to transfer ownership of the instrument. Delivery can be actual or constructive:
  Actual delivery: Physical transfer of the instrument.
  Constructive delivery: Transfer to an agent, clerk, or servant of the indorsee or when the indorser retains it as the indorsee's agent after indorsement. As per Section 46, if an instrument is transferred conditionally or for a special purpose, ownership does not pass to the transferee, even if it is endorsed to them, unless it is negotiated to a holder in due course. A contract on a negotiable instrument remains incomplete and revocable until delivery. Delivery is required both at the time of negotiation and when the instrument is made or drawn. Rights in the instrument are not transferred to the indorsee unless it is delivered after indorsement. If the indorser dies before delivery, the legal representatives cannot negotiate the instrument by merely delivering it.

Delivery when effective between the parties

Negotiation of instruments between the parties	How delivery is to be made
As between parties standing in immediate relation	Delivery to be effectual must be made by the party making, accepting, or endorsing the instrument, or by a person authorized by him in that behalf.
As between such parties and any holder of the instrument other than a holder in due course	It may be shown that the instrument was delivered conditionally or for a special purpose only, and not for the purpose of transferring absolutely the property therein.

DISHONOUR OF CHEQUES FOR INSUFFICIENCY OF FUNDS IN THE ACCOUNTS [SECTION 138 TO 142]

➢ **DISHONOR OF CHEQUE FOR INSUFFICIENCY, ETC., OF FUNDS IN THE ACCOUNTS [SECTION 138]**
Where any cheque drawn by a person on an account maintained by him with a banker—
- for payment of any amount of money
- to another person from that account
- for the discharge, in whole or in part, of any debt or other liability,
- is returned by the bank unpaid,
- either because of the—
  - amount of money standing to the credit of that account is insufficient to honor the cheque, or
  - that it exceeds the amount arranged to be paid from that account by an agreement made with that bank, such person shall be deemed to have committed an offence and shall, be punished with imprisonment for a term which may extend to two years, or with fine which may extend to twice the amount of the cheque, or with both.

When section 138 shall be not apply: unless the below given conditions are complied with—
a) **Cheque presented within validity period:** The cheque has been presented to the bank within a period of three months from the date on which it is drawn or within the period of its validity, whichever is earlier.
b) **Demand for the payment through the notice:** the payee or the holder in due course of the cheque, as the case may be, makes a demand for the payment of the said amount of money by giving a notice, in writing, to the drawer of the cheque, within 30 days of the receipt of information by him from the bank regarding the return of the cheque as unpaid, and

c) **Failure of drawer to make payment:** the drawer of such cheque fails to make the payment of the said amount of money to the payee or, as the case may be, to the holder in due course of the cheque, within fifteen days of the receipt of the said notice. Explanation: For the purpose of this section, "debt or other liability" means a legally enforceable debt or other liability. Therefore we may conclude that compliant can be filed after 45 days of dishonor of the cheque i.e., 30 days of notice period +15 days of the receipt of the said notice.

Penalty: According to Section 138 of the Act, the dishonour of cheque is a criminal offence and is punishable with imprisonment up to 2 years or fine up to twice the amount of cheque or both.

- **PRESUMPTION IN FAVOR OF HOLDER [SECTION 139]**
  When a cheque is dishonoured, it is presumed (unless proven otherwise) that the holder received it to settle a debt or liability, as per Section 138. This presumption is "rebuttable," meaning the issuer can prove otherwise. The presumption shifts the burden of proof to the accused.

- **DEFENCE WHICH MAY NOT BE ALLOWED IN ANY PROSECUTION UNDER SECTION 138 [SECTION 140]**
  It shall not be a defence in a prosecution of an offence under section 138 that the drawer had no reason to believe when he issued the cheque that the cheque may be dishonoured on presentment for the reasons stated in that section.

PRESENTMENT OF INSTRUMENTS

- **Presentment for acceptance:** A bill of exchange payable after sight must be presented to the drawee for acceptance within a reasonable time after being drawn, during business hours on a business day. If no presentment is made, the parties are not liable to the defaulting party. If the drawee cannot be found after reasonable search, the bill is dishonoured. If directed to a specific place, it must be presented there; failure to find the drawee after reasonable search at that place also results in dishonour. Presentment via registered post is acceptable if authorised by agreement or usage.
- **Presentment of promissory note for sight:** A promissory note payable after sight must be presented to the maker for sight within a reasonable time after it is made, during business hours on a business day, by a person entitled to demand payment. If not presented, the parties are not liable to the defaulting party.
- **Drawee's time for deliberation:** The holder must, if so required by the drawee of a bill of exchange presented to him for acceptance, allow the drawee 48 hours (exclusive of public holidays) to consider whether he will accept it.
- **Presentment for payment:** Promissory notes, bills of exchange, and cheques must be presented for payment to the maker, acceptor, or drawee, respectively, by or on behalf of the holder. Without such presentment, other parties are not liable to the holder. Presentment via registered post is sufficient if authorised by agreement or usage.
  Exception: For a promissory note payable on demand and not at a specified place, no presentment is required to charge the maker. For a truncated cheque, if an electronic image is presented, the drawee bank may request further details or the original cheque if there is suspicion of fraud, forgery, or tampering. If demanded, the drawee bank retains the truncated cheque upon payment.
- **Hours for presentment:** Presentment for payment must be made during the usual hours of business, and, if at a banker's within banking hours.
- **Presentment for payment of instrument payable after date or sight:** A promissory note or bill of exchange, made payable at a specified period after date or sight thereof, must be presented for payment at maturity.
- **Presentment for payment of promissory note payable by instalments:** A promissory note payable by instalments must be presented for payment on the third day after the date fixed for payment of each instalment; and non-payment on such presentment has the same effect as non-payment of a note at maturity.
- **Presentment for payment of instrument payable at specified place and not elsewhere:** A promissory note, bill of exchange or cheque made, drawn or accepted payable at a specified place and not elsewhere must, in order to charge any party thereto, be presented for payment at that place.
- **Instrument payable at specified place**: A promissory note or bill of exchange made, drawn or accepted payable at a specified place must, in order to charge the maker or drawer thereof, be presented for payment at that place.
- **Presentment where no exclusive place specified**: A promissory note or bill of exchange, not made payable as mentioned in sections 68 and 69, must be presented for payment at the place of business (if any) or at the usual residence, of the maker, drawee or acceptor thereof, as the case may be.
- **Presentment when maker, etc., has no known place of business or residence:** If the maker, drawee or acceptor of a negotiable instrument has no known place of business or fixed residence, and no place is specified in the instrument for presentment for acceptance or payment, such presentment may be made to him in person wherever he can be found.

- **Presentment of cheque to charge drawer:** Subject to the provisions of section 84, a cheque must, in order to charge the drawer, be presented at the bank upon which it is drawn before the relation between the drawer and his banker has been altered to the prejudice of the drawer.
- **Presentment of cheque to charge any other person:** A cheque must, in order to charge any person except the drawer, be presented within a reasonable time after delivery thereof by such person.
- **Presentment of instrument payable on demand:** Subject to the provisions of section 31, a negotiable instrument payable on demand must be presented for payment within a reasonable time after it is received by the holder.
- **Presentment by or to agent, representative of deceased, or assignee of insolvent:** Presentment for acceptance or payment may be made to the duly authorised agent of the drawee, maker or acceptor, as the case may be, or, where the drawee, maker or acceptor has died, to his legal representative, or, where he has been declared an insolvent, to his assignee.
- **Excuse for delay in presentment for acceptance or payment:** Delay in presentment for acceptance or payment is excused if the delay is caused by circumstances beyond the control of the holder, and not imputable to his default, misconduct or negligence. When the cause of the delay ceases to operate, presentment must be made within a reasonable time.

When presentment unnecessary (Section 76)

No presentment for payment is necessary, and the instrument is dishonoured at the due date for presentment, in any of the following cases:

a) (i) If the maker, drawee or acceptor intentionally prevents the presentment of the instrument, or (ii) if the instrument being payable at his place of business, he closes such place on a business day during the usual business hours, or (iii) if the instrument being payable at some other specified place, neither he nor any person authorised to pay it attends at such place during the usual business hours, or (iv) if the instrument not being payable at any specified place, he cannot after due search be found;

b) as against any party sought to be charged therewith, if he has engaged to pay notwithstanding non-presentment;

c) as against any party if, after maturity, with knowledge that the instrument has not been presented—
   - o he makes a part payment on account of the amount due on the instrument,
   - o or promises to pay the amount due thereon in whole or in part,
   - o or otherwise waives his right to take advantage of any default in presentment for payment;

d) as against the drawer, if the drawer could not suffer damage from the want of such presentment.

Liability of banker for negligently dealing with bill presented for payment (Section 77)

If a bill of exchange, accepted for payment at a specific bank, is presented there for payment and is dishonored, the bank must handle it carefully. If the bank is careless or handles or returns the bill improperly, causing a loss to the holder, the bank must compensate the holder for that loss.

RULES OF COMPENSATION (Section 117)

The compensation payable in case of dishonour of promissory note, bill of exchange or cheque, by any party liable to the holder or any endorsee, shall be determined by the following rules:

a) the holder is entitled to the amount due upon the instrument, together with the expenses properly incurred in presenting, noting and protesting it;

b) when the person charged resides at a place different from that at which the instrument was payable, the holder is entitled to receive such sum at the current rate of exchange between the two places;

c) an endorser who, being liable, has paid the amount due on the same is entitled to the amount so paid with interest at 18% per annum from the date of payment until tender or realisation thereof, together with all expenses caused by the dishonour and payment;

d) when the person charged and such endorser reside at different places, the endorser is entitled to receive such sum at the current rate of exchange between the two places;

e) The party entitled to compensation can draw a bill (payable at sight or on demand) on the party liable to compensate, covering the amount owed and any reasonable expenses incurred. This bill must be accompanied by the dishonored instrument and its protest (if applicable). If this new bill is also dishonored, the party who dishonors it is responsible for compensating in the same way as for the original bill.