Negotiable Instruments ACT, 1881 (Part - 1)

[Academic Script]

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Hello Friends! Welcome to the class of Legal aspects of business where we will be studying the Negotiable Instruments Act 1881. Now we all know and you might have studied transactions which are required to be done in business. Business transactions happen through different modes or different instruments. Some of such instruments are Negotiable Instruments. There are certain set of instruments which comes under the act of Negotiable Instrument Act 1881.

There are certain documents which are freely used in commercial transactions and monetary dealings. These documents, if satisfy certain conditions, are known as 'Negotiable Instruments'. The word '**Negotiable'** means **"transferable from one person to another in return for consideration**." While **'instrument'** means a **"written document by which right is created in favour of some person".**

The law relating to Negotiable Instrument is contained in Negotiable Instrument Act 1881. The Act came into force on **first day of March, 1882**.

According to Section 13 (a) of the Act, "Negotiable instrument means a promissory note, bill of exchange or cheque payable either to order or to bearer, whether the word "order" or " bearer" appear on the instrument or not."

Introduction

In the words of Justice, Willis, “A negotiable instrument is one, the property in which is acquired by anyone who takes it bonafide and for value notwithstanding any defects of the title in the person from whom he took it”.

A negotiable instrument may be defined as "an instrument. The property in which is acquired by anyone who takes it *bona fide,* and for value, notwithstanding any defect of title in the person from whom he took it, from which it follows that an instrument cannot be negotiable unless it is such and in such a state that the true owner could transfer the contract or engagement contained therein by simple delivery of instrument" (Willis- *The Law of Negotiable Securities, Page 6).*

According to this definition the following are the conditions of negotiability:

(i) The instrument should be freely transferable. An instrument cannot be negotiable unless it is such and in such state that the true owner could transfer by simple delivery or endorsement and delivery.

(ii) The person who takes it for value and in good faith is not affected by thedefect in the title of the transferor.

(iii) Such a person can sue upon the instrument in his own name.

Negotiability involves two elements namely, transferability free from equities and transferability by delivery or endorsement (Mookerjee J. In *Tailors Priya*v. *Gulab Chand,* AIR 1965 Cal).

But the Act recognises only three types of instruments viz., ci Promissory Note, a Bill of Exchange and a Chequeas negotiable instruments. Howewer, it does not mean that other instruments are not negotiable, instruments provided that they satisfy the following conditions of negotiability:

1. The instrument should be freely transferable by the custom of trade.

Transferability may be by (i) delivery or (ii) endorsement and delivery.

2. The person who obtains it in good faith and for consideration gets it free fromall defects and can sue upon it in his own name.

3. The holder has the right to transfer. The negotiability continues till thematurity.

As we know that most of the important characteristic of Negotiable Instrument is Negotiability which makes them being a part of this act.

One of the essential characteristics of a negotiable instrument is that it is freely transferable from one person to another. This transfer takes place either by (i) Negotiation or (ii) Assignment

Negotiation

Negotiation may be defined as the process by which a third party is constituted the holder of the instrument. This is to entitle him to the possession of the same and to receive the amount due thereon in his own name. According to section 14 of the Act, 'when a promissory note, bill of exchange or cheque is transferred to any person so as to constitute that person the holder thereof, the instrument is said to be negotiated.' The main purpose and essence of negotiation is to make the transferee of a promissory note, a bill of exchange or a cheque the holder there of.

Negotiation thus requires **two conditions** to be fulfilled, namely:

1. There must be a transfer of the instrument to another person; and
2. The transfer must be made in such a manner as to constitute the transferee the holder of the instrument.

Handing over a negotiable instrument to a servant for safe custody is not negotiation; there must be a transfer with an intention to pass title.

There are basically two modes of transfer of Negotiation, namely, 1**. Negotiation by delivery** (Sec. 47): Where a promissory note or a bill of exchange or a cheque is payable to a bearer, it may be negotiated by delivery thereof.

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

2. **Negotiation by endorsement and delivery** (Sec. 48): A promissory note, a cheque or a bill of exchange payable to order can be negotiated only be endorsement and delivery. Unless the holder signs his endorsement on the instrument and delivers it, the transferee does not become a holder. If there are more payees than one, all must endorse it.

Assignment

In this when a person transfers his right to receive the payment of a debt; 'assignment of the debt' takes place. Thus where the holder of an instrument transfers it to another so as to confer a right on the transferee to receive the payment, transfer by assignment takes place.

Effect of Negotiability

The general principle of law relating to transfer of property is that no one can pass a better title than he himself has *(nemodat quad non-habet). The* exceptions to this general rule arise by virtue of statute or by a custom. A negotiable instrument is one such exception, which is originally a creation of mercantile custom.

Thus a *bona fide* transferee of negotiable instrument for consideration without notice of any defect of title, acquires the instrument free on any defect, *i.e.,* he acquires a better title than that of the transferor.

Important Characteristics of Negotiable Instruments

Following are the important characteristics of negotiable instruments:

(1) The holder of the instrument is presumed to be the owner of the propertycontained in it.

(2) They are freely transferable.

(3) A holder in due course gets the instrument free from all defects of title of any previous holder.

(4) The holder in due course is entitled to sue on the instrument in his own name.

(5) The instrument is transferable till maturity and in case of cheques till it becomes stale (on the expiry of 6 months from the date of issue).

(6) Certain equal presumptions are applicable to all negotiable instruments unless the contrary is proved.

Classification of Negotiable Instruments

The negotiable instruments may be classified as under:

(1) Bearer Instruments

A promissory note, bill of exchange or cheque is payable to bearer when (i) it is expressed to be so payable, or (ii) the only or last endorsement on the instrument is an endorsement in blank, A person who is a holder of a bearer instrument can obtain the payment of the instrument.

(2) Order Instruments

A promissory note, bill of exchange or cheque is payable to order (i) which is expressed to be so payable; or (ii) which is expressed to be payable to a particular person, and does not contain any words prohibiting transfer or indicating an intention that it shall not be transferable.

(3) Inland Instruments (Section 11)

A promissory note, bill of exchange or cheque drawn or made in India, and made payable, or drawn upon any person, resident in India shall be deemed to be an inland instrument. Since a promissory note is not drawn on any person, an inland promissory note is one which is made payable in India. Subject to this exception, an inland instrument is one which is either:

(i) drawn and made payable in India, or

(ii) drawn in India upon some persons resident therein, even though it is madepayable in a foreign country.

(4) Foreign Instruments

An instrument, which is not an inland instrument, is deemed to be a foreign instrument. The essentials of a foreign instrument include that:

(i) It must be drawn outside India and made payable outside or inside India; or

(ii) It must be drawn in India and made payable outside India and drawn on aperson resident outside India.

(5) Demand Instruments (Section 19)

A promissory note or a bill of exchange in which no time for payment is specified is an instrument payable on demand.

(6) Time Instruments

Time instruments are those which are payable at sometime in the future. Therefore, a promissory note or a bill of exchange payable after a fixed period, or after sight, or on specified day, or on the happening of an event, which is certain to happen, is known as a time instrument. The expression "after slight" in a promissory note means that the payment cannot be demanded on it unless it has been shown to the maker. In the case of bill of exchange, the expression "after sight" means after acceptance, or after noting for non-acceptance or after protest for non -acceptance.

(7) Ambiguous Instruments (Section 17)

An instrument, which in form is such that it may either be treated by the holder as a bill or as a note, is an ambiguous instrument. Section 5(2) of the English Bills of Exchange Act provides that where in a bill, the drawer and the drawee are the same person or where the drawee is a fictitious person or a person incompetent to contract, the holder may treat the instrument, at his option, either as a bill of exchange or as a promissory note. Bill drawn to or to the order of the drawee or by an agent on his principal, or by one branch of a bank on another or by the direction of a company or their cashier are also ambiguous instruments. A promissory note addressed to a third person may be treated as a bill by such person by accepting it, while a bill not addressed to anyone may be treated as a note. But where the drawer and payee are the *same e.g.,* where A draws a bill payable to A's order, it is not an ambiguous instrument and cannot be treated as a promissory note. Once an instrument has been treated either as a bill or as a note, it cannot be treated differently afterwards.

(8) Inchoate or Incomplete Instrument (Section 20)

When one person signs and delivers to another a paper stamped in accordance with the law relating to negotiable instruments, 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. Such an instrument is called an inchoate instrument. The person so signing shall be liable upon such instrument, in the capacity in which he signs 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 thereon.

The authority to fill up a blank or incomplete instrument may be exercised by any "holder" and not only the first holder to whom the instrument was delivered. The person signing and delivering the paper is liable both to a "holder" and a "holder-in-due-course". But there is a difference in their respective rights. A "holder" can recover only what the person signing and delivering the paper agreed to pay under the instrument, while a "holder-in- due-course" can recover the whole amount made payable by the instrument provided that it is covered by the stamp, even though the amount authorized was smaller.

The **important parties** which hold these negotiable instruments are explained in the next point which is known as Holder and Holder in due course.

HOLDER

The holder of the promissory note, bill of exchange or cheque means any person entitled in his own name (i) to the possession there of and (ii) to receive or recover the amount thereon from the parties thereto. If the note or bill or cheque is lost or destroyed, its holder is the person so entitled at the time of such loss or destruction.

In order to be allowed to keep the instrument in his own name, the holder must be named there in as the payee or the endorsee in case the instrument is payable to order or he must be the bearer if the instrument is payable o bearer.

HOLDER IN DUE COURSE

The definition of holder in due course in section 9 means that any person who for the consideration paid becomes the possessor of a negotiable instrument, before its maturity, in good faith and without any sufficient reason to believe that any defect existed in the title of the person from whom he obtained it.

(a) He must be a holder in due course

According to the law due course means no citizen may be denied his or her legal rights and all laws must conform to fundamental, accepted legal principles. He must be a holder eventually.

(b) He must be a holder of valuable consideration
Valuable Consideration is a necessary element of a contract, which tells about a benefit on the other party. Valuable consideration can include money, work, performance, assets, a promise, or abstaining from an act.

(c) He must become a holder of the negotiable instrument before the date of maturity

(d) He must be of good faith
Good faith means someone who has honest intent to act without taking an unfair advantage over another person or to fulfil a promise to act, even when some legal technicality is not fulfilled. The term is applied to all kinds of transactions.

Now that we have understood the meaning of Negotiable Instruments lets understand the instruments included in Negotiable Instrument Act. Main negotiable instruments which are to be studied are promissory note, bill of exchange and cheques. Let’s first understand Promissory Note

Promissory Note

According to Section 4 of the Act, A Promissory note is an instrument in writing (not being a bank note or currency note) containing an unconditional undertaking, signed by the maker, to pay a certain sum of money only to, or to order of, a certain person, or to the bearer of the instrument.

The person who makes the promissory note and promises to pay is called the maker. The person to whom the payment is to be made is called the payee.

For example Mr A signs an instrument like

"I Promise to pay Mr B or order Rs 500." This means the parties to Promissory note are Mr A who is the maker who promises to pay and Mr B is the payee to whom promise has been done by the maker.

Parties to a Promissory Note:

Let us now try to first understand the parties to a Promissory Note.

A promissory note has the following parties:

(a) *The maker:* the person who makes or executes the note promising to pay theamount stated therein.

(b) *The payee:* one to whom the note is payable.

(c) *The holder:* is either the payee or some other person to whom he may have

endorsed the note.

(d) *The endorser.*

(e) *The endorsee.*

Now let's understand the essentials or characteristics of Promissory Note.

Essential,Characteristics, Requirements of Promissory Note

As you know each instrument which is being a part of Negotiable Instrument Act contains certain features which make them different from others and easy to understand. Below are features of promissory note

1. It must be in writing: The instrument must be in writing. A Mere verbal promise is not enough and isn't considered a promissory note. There is no prescribed language or method (print, typewrite, pencil, ink). It must be in such a form which cannot be altered easily.
2. Promise to Pay: It must contain an expression to promise to pay. A mere acknowledgement is not enough. Like Mr A writes-"I promise to pay B or order Rs. 500" or "I acknowledge myself to be indebted to B in Rs. 1000 to be paid on demand, for the value received". CASE
3. Definite and unconditional: the condition or promise to pay must be definite and unconditional. If it is conditional or uncertain then the instrument is not valid.
4. Signed by the maker: the note must be signed by the maker otherwise it is incomplete. Even if it is made by maker himself with his name on the note still his signature must be there.

5. Certain parties: the instrument must point out the parties very certainly which are mentioned in the promissory note. Where the maker and the payee are not identified with certainty from the instrument even if it contains an unconditional promise to pay, is not a promissory note.
6. Amount must be certain: the sum to be paid must be certain and must not be able of contingent additions or subtractions.

Summary

So today we have learnt about the Negotiable instrument Act 1881 which includes certain instruments which are negotiable which means they can be transferred from one person to another. After that we saw the characteristics of negotiable instruments, the various classifications of negotiable instruments and Parties to the instruments. The instrument studied by us was promissory note. Promissory note is an instrument in writing which is unconditional and signed by the maker to pay a certain sum of money to a certain person. Hope this introductory Lecture on Negotiable Instrument Act will help you in understanding the act and the instruments included in it which we learnt today as well as in further sessions. Thank you.