

THE NEGOTIABLE INSTRUMENTS ACT, 1881

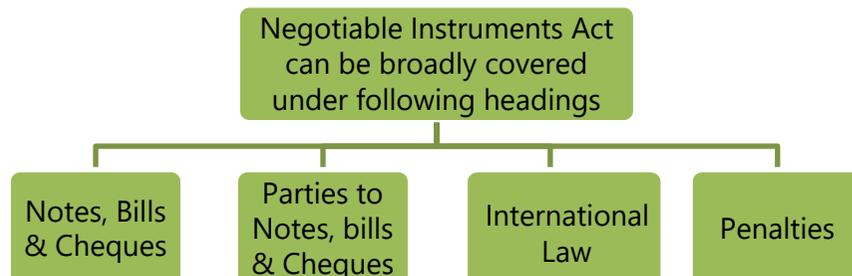


LEARNING OUTCOMES

At the end of this chapter, you will be able to:

- ❑ Understand the meaning, characteristics and elements of different kinds of negotiable instruments
- ❑ Identify Various ways of negotiation, Classification of Instruments and Discharge from liability on instruments.
- ❑ Know the various concepts related to dishonour of instrument

CHAPTER OVERVIEW



1. INTRODUCTION

The law relating to negotiable instruments is the law of the commercial world which was enacted to facilitate the activities in trade and commerce making provision for giving sanctity to the instruments of credit which could be deemed to be convertible into money and easily passable from one person to another. In the absence of such instruments, the trade and commerce activities were likely to be adversely affected as it was not practicable for the trading community to carry with it the bulk of the currency in force. The source of Indian law relating to such instruments is admittedly the English Common Law.

The **main objective** of the Act is to legalise the system by which instruments contemplated by it could pass from hand to hand by negotiation like any other goods.

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.

Provided that such usages may be excluded by any words in the body of the instrument, which indicate an intention that the legal relations of the parties thereto shall be governed by this Act; and it shall come into force on the first day of March, 1882.

The provisions of this Act are also applicable to Hundis, unless there is a local usage to the contrary. Other native instruments like Treasury Bills, Bearer Debentures etc. are also considered as negotiable instruments either by mercantile custom or under other enactments.

Recent developments: The Act was amended several times. Recent three amendments made in the Negotiable Instruments Act, 1881 (N.I. Act) were the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002; the Negotiable Instruments (Amendment) Act, 2015 and Negotiable Instruments (Amendment) Act, 2018.

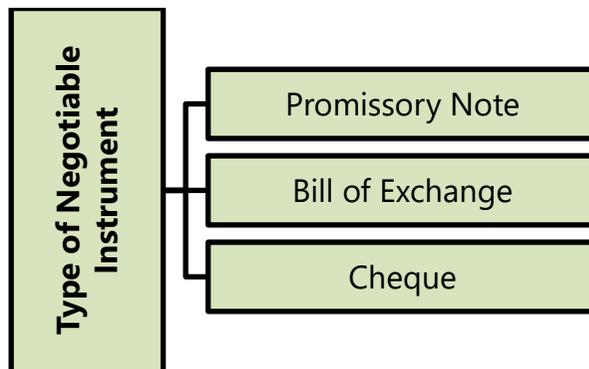
The Negotiable Instruments (Amendment) Act, 2018 received the assent of the President and was notified in the Official Gazette on 2nd August, 2018 and came into effect from September 1, 2018.

The Amendment Act 2018 contains two significant changes – the introduction of Section 143A and Section 148. These sections provide for interim compensation during the pendency of the criminal complaint and the criminal appeal.

2. MEANING OF NEGOTIABLE INSTRUMENTS

Negotiable Instruments is an instrument (the word instrument means a 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 passes 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.**



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)

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

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. Every negotiable instrument 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.

Presumptions as to Negotiable Instruments [Section 118]

Presumptions made in relation	Presumptions drawn
Until the contrary is proved, the following presumption shall be made:	
of consideration	every negotiable instrument was made or drawn for consideration
as to date	every negotiable instrument bearing a date was made or drawn on such date
as to time of acceptance	every accepted bill of exchange was accepted within a reasonable time after its date and before its maturity
as to time of transfer	every transfer of a negotiable instrument was made before its maturity;
as to order of indorsements	indorsements appearing upon a negotiable instrument were made in the order in which they appear thereon
as to stamps	lost promissory note, bill of exchange or cheque was duly stamped
as to holder	the holder of a negotiable instrument is a holder in due course

Note: The above presumptions are rebuttable by evidence to the contrary.

3. PROMISSORY NOTE

Meaning

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, 2020
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

- 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.

- b. 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 ₹ 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 ₹ 1,000." – Invalid promissory note as there is no promise to pay. It is just an acknowledgement of debt.

- c. 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 ₹ 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 ₹ 500 on D's death- as the death of D is certain, promise is unconditional. Thus, the promissory note is valid.

Example 5: I promise to pay B ₹ 500 on D's death, provided D leaves me enough to pay that sum. Invalid promissory note as promise is dependent on D leaving behind money which is not certain.

- d. A promissory note must be **signed by the maker** otherwise it is incomplete and ineffective.
- e. Promise **to pay money only**.

Example 6: I promise to pay B ₹ 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.

- f. 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.

- g. 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 Reserve 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'.

- 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 or otherwise.

4. 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, 2020
₹ 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

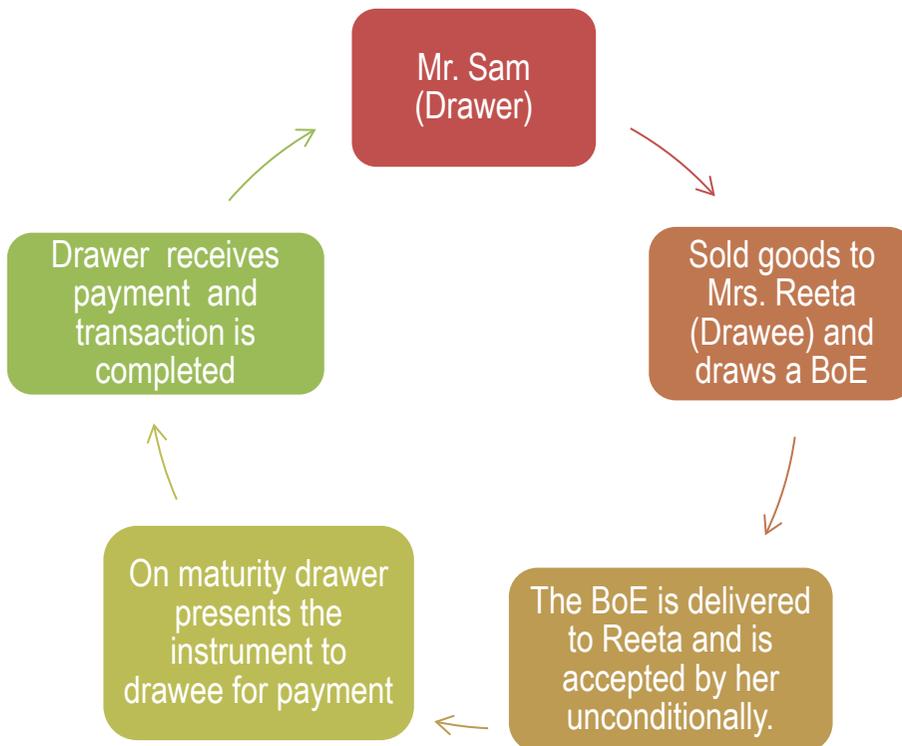
Parties to the bill of exchange

- 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

- (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. 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.
- (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



In above image, 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

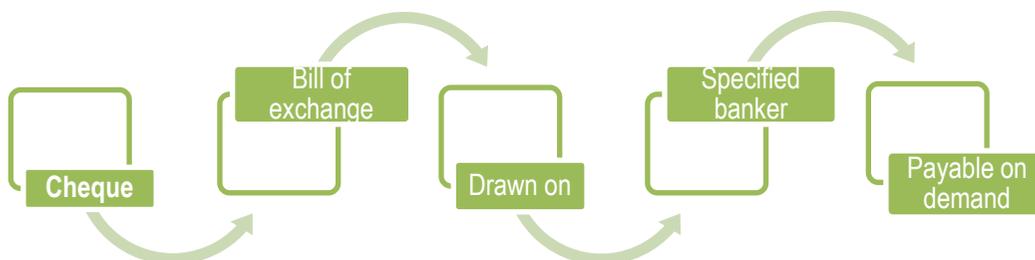
accepts it without any condition. On maturity of bill of exchange, the buyer will pay the amount due to the payee. (The payee may be the drawer himself or a third party.)

Difference between promissory note and bill of exchange

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

5. 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 [Section 3]

Explanation I: For the purposes of this section, the expressions-

- (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 the same meanings respectively assigned to them in the Information Technology Act, 2000.

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

Explanation II: For the purposes 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, 2000.

A combined reading of sections 5 and 6 tells us that a bill of exchange is a negotiable instrument in writing containing an instruction to a third party to pay a stated sum of money at a designated future date or on demand. Whereas a cheque is also a bill of exchange but is drawn on a banker and payable on demand.

Specimen of Cheque

Date:.....
Pay
a sum of Rupees..... ₹
A/C No. 12345678910
ABC Bank
622, Vijay Nagar, Indore (M. P.)
Signature
01212 1125864 000053 38

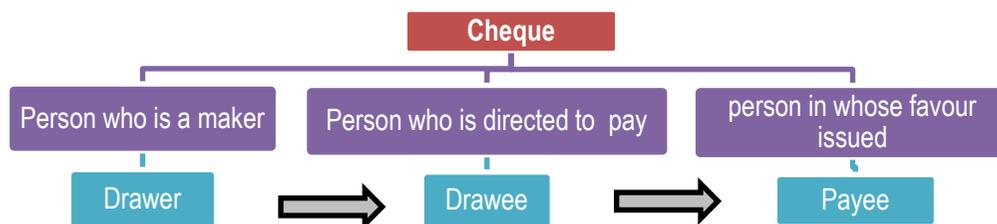
Parties to Cheque

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.

Note: These two additional features distinguish a cheque from bill. Thus, all cheques are bills while all bills are not cheques.

6. CROSSING OF CHEQUES [SECTION 123 – 131]

There are two types of cheques, **open cheques** and **crossed cheques**. A cheque which can be presented to the banker and can be paid at the counter of the bank is called an open cheque. If the drawer loses an open cheque, the finder of it may go to the bank and get payment unless its payment has been stopped. The finder may also transfer it to a holder in due course who is entitled to the money represented by the cheque. It was to prevent the losses incurred by open cheques getting into the hands of wrong person.

When a cheque bears across its face two parallel transverse lines, the cheque is said to be crossed. The lines are usually drawn on the left hand top corner but may be drawn anywhere.

Meaning of crossing: Crossing of a cheque means an instruction to the drawee i.e., the paying bank that the payment is not to be made at the counter but through a bank.

Objects of Crossing: A crossing is a warning to the bank not to make payment of the crossed cheque over the counter. Crossing operates as a caution to the paying banker.

- i) **Crossing affects the mode of payment of cheque-** An open or uncrossed cheque is payable to the payee or holder at the counter of the bank. In such a case, if a wrong person takes away the payment of cheque, it is difficult to trace him.

The payment of a cross cheque can be obtained only through a banker. Thus, crossing is a mode of assuring that only the rightful holder (i.e., the person entitled to receive money) gets payment.

- ii) **Crossing does not affect the transferability or negotiability of cheque-** a crossed cheque can be negotiated just the same way as an open cheque. A

person acquiring a crossed cheque in good faith becomes its holder in due course just as in case of open cheque.

- iii) **Crossing is a material alteration** but crossing of cheque by the holder does not in any way affect his rights in respect of cheques (section 125).

TYPES OF CROSSING:

- (a) **General Crossing:** Where a cheque bears across its face two parallel, transverse lines without any words or with words 'and company' or/and 'not negotiable' written in between these two parallel lines, it is called general crossing. Where a cheque is crossed generally, the banker on whom it is drawn shall not pay it otherwise than to a banker (Sec. 126)
- (b) **Special Crossing:** where the lines of crossing bear the name of a banker either with or without any additional words. The effect is that its payment can be obtained only through particular banker whose name appears between the lines.

According to Section 127, where a cheque is crossed specially to more than one banker, the banker on whom it is drawn shall refuse payment thereof except where the banker to whom it is crossed may cross it specially to another banker, his agent for collection.

- (c) **A/c payee crossing:** When the words "A/C payee" or "A/C payee only" are added to a general or special crossing, it is called restrictive crossing. The effect of "Account payee" crossing is that the banker is supposed to collect the cheque on behalf of that payee only whose name appears on the face of the cheque. If banker collects this cheque from an indorsee (i.e. person other than named payee), he can be held responsible in case that indorsee turns out to be a wrongful holder of cheque. Thus, liability of a banker enhances to a great extent. Such type of crossing is not statutorily recognised.
- (d) **Not negotiable Crossing:** This requires writing of words "not negotiable" in addition to the two parallel lines. These words may be written inside or outside these lines. According to Section 130, a person taking a cheque crossed generally or specially, bearing in either case the word "not negotiable" shall not have, and shall not be capable of giving a better title to the cheque than that which the person from whom he took it. It is a statutory crossing. A cheque with such crossing is not negotiable but continues to be transferable as before. Ordinarily, in a negotiable instrument, if the title of the transferor is defective, the transferee, if he is a HDC, will have a good title. When the words "not negotiable" are written, even a HDC will get the same

title as that of transferor. Thus, if the title of the transferor is defective, the title of transferee will also be so.

Thus, the addition of the words not negotiable does not restrict the further transferability of the cheque, but it entirely takes away the main feature of negotiability, which is that a holder with a defective title can give a good title to the subsequent holder in due course.

Who may cross? [Section 125]

A cheque may be crossed by the following parties:

- (a) *By Drawer:* A drawer may cross it generally or specially.
- (b) *By Holder:* A holder may cross an uncrossed cheque generally or specially. If the cheque is crossed generally, the holder may cross specially. If cheque crossed generally or specially, he may add words "not negotiable".
- (c) *By Banker:* A banker may cross an uncrossed cheque, or if a cheque is crossed generally he may cross it specially to himself. Where a cheque is crossed specially, the banker to whom it is crossed may again cross it specially to another banker, his agent, for collection.

PROTECTION OF LIABILITY OF THE PAYING BANKER:

The banker who makes the payment of a crossed cheque is called the paying banker.

- (a) **Cheque payable to order [Section 85(1)]:** Where a cheque payable to order **purports to be indorsed by or on behalf of the payee**, the banker is discharged by payment in due course. The banker, in other words, can debit his customers account even though the indorsement by the payee might turn out to be forgery or the indorsement might have been placed by the payee's agent without his authority.
- (b) **Cheque payable to bearer [Section 85(2)]:** As regards bearer cheque, the rule is "once a bearer always a bearer". A banker gets a good discharge by payment in due course of the amount on a bearer cheque to the holder of the cheque. It does not matter whether the apparent holder is the owner of the cheque or not.
- (c) **Payment of cheque crossed generally:** Where a cheque is crossed generally, the banker on whom it is drawn shall not pay it otherwise than to a banker.

- (d) **Payment of cheque crossed specially:** 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.
- (e) **Payment in due course of crossed cheque [Section 128]:** Where the banker on whom a crossed cheque is drawn has paid the same in due course, the banker paying the cheque, and (in case such cheque has come to the hands of the payee) the drawer thereof, shall respectively be entitled to the same rights, and be placed in the same position in all respects, as they would respectively be entitled to and placed in if the amount of the cheque had been paid to and received by the true owner thereof
- (f) **Payment of crossed cheque out of due course [Section 129]:** Any banker paying a cheque crossed generally otherwise than to a banker, or a cheque crossed specially otherwise than to the banker to whom the same is crossed, or his agent for collection, being a banker, shall be liable to the true owner of the cheque for any loss he may sustain owing to the cheque having been so paid.

EXCEPTION: Payment of a cheque on which drawer signatures were forged: If any drawee banks made the payment on a cheque on which drawer signatures were forged then such bank shall be liable to the true owner. Thus, the paying banker shall be liable if it makes the payment of the cheque on which drawers' signature was forged.

PROTECTION OF LIABILITY OF THE COLLECTING BANKER

The bank which receives the payment of a crossed cheque on behalf of its customer is known as the **collecting banker**.

Section 131- Non liability of banker receiving payment of cheque: 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 of the cheque proves defective, incur any liability to the true owner of the cheque by reason only of having received such payment.

In order to avail such a protection, the banker needs to prove the following:

- (a) That the banker had received the payment of crossed cheque
- (b) That the collection was made by the bank on behalf of the customer
- (c) That the collecting bank must have acted in good faith and without negligence.



7. ACCEPTOR AND ACCEPTOR FOR HONOR

ACCEPTOR AND ACCEPTOR FOR HONOUR

“Acceptor” [Section 7] - After the drawee of a bill has signed his assent upon the bill, or, if there are more parts thereof than one, upon one of such parts, and delivered the same, or given notice of such signing to the holder or to some person on his behalf, he is called the “acceptor”. Thus, an acceptor is the drawee who has signed his assent upon the bill and delivered it to the holder.

“Acceptor for honour” [Section 7] - When a bill of exchange has been dishonoured by non-acceptance and any person accepts it for honour of the drawer or of any indorsers, such person is called “an Acceptor for honour”.

The payment which he makes is known as “payment for honour. In other words, it is an undertaking by a third party to accept and pay a bill of exchange that was dishonoured, either by non-acceptance (see dishonor by non-acceptance) or by non-payment (see dishonor by non payment) by the party on whom it was drawn. It is also called acceptance supra protest.

How acceptance for honor must be made: A person desiring to accept for honor must, [by writing on the bill under his hand], declare that he accepts under protest the protested bill for the honor of the drawer or of a particular indorser whom he names, or generally for honor.

Example 8: The acceptor for honor may write across the bill of exchange “Accepted Supra Protest” or “Accepted for AB (the name of drawee)”.

Essentials of valid acceptance for honor

- 1) The holder must consent to acceptance for honor. The holder cannot be compelled to assent to acceptance for honor.
- 2) The bill must have been noted or protested for the non-acceptance or for better security.
- 3) Acceptance for honor can be made by a person who is not already liable on the bill. Drawee of the bill when he refuses to accept the bill becomes a stranger. He may, therefore, accept the bill for honor of any party thereto.
- 4) It must be made by writing on the bill.
- 5) It must be for the whole amount due on the bill
- 6) Acceptance must be for the honor of any party already liable on the bill.
- 7) Acceptance for honor must be made before bill is overdue.

- 8) Stranger paying for honor must, before payment, declare before a Notary Public the party for whose honor he pays and the Notary Public must have recorded such a declaration.

Rights and liabilities of an acceptor for honour (Sections 111 & 112)

- 1) Acceptor for honor binds himself to all the subsequent parties to pay the amount of the bill if the drawee does not pay.
- 2) The party for whose honor he accepts to pay the amount and all prior parties are liable to compensate the acceptor for honor for all loss or damage sustained by him in consequence of such acceptance. The liability of an acceptor for honor is conditional and he is liable only if the drawee fails to pay the bill.

The bill of exchange should be presented at its maturity to the drawee for payment and it must be dishonoured by the drawee and noted or protested for non-payment to charge an acceptor for honor (Section 112). The bill must be presented or forwarded for presentment to the drawee not later than the day next after the day of its maturity.

8. HOLDER AND HOLDER IN DUE COURSE

“Holder” [Section 8] — 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 so entitled at the time of such loss or destruction.

Broadly speaking, a holder means the owner of a negotiable instrument. What is required is a right to possession. A person in possession of an instrument without having a right to possess cannot be called a holder.

Example 9: A person who finds or steals a bearer instrument or takes an instrument under forged indorsement is not a holder. The reason is that the holder of a negotiable instrument must have right to receive or recover the money thereon from the parties thereto.

Example 10: An agent holding an instrument for his principal is not a holder. The reason being that, although agent can receive payment of the instrument, he has no right to sue on the instrument in his own name.

“Holder in due course” [Section 9]— “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 indorsee 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.

Example 11: A draws a cheque for ₹ 5,000 and hands it over to B by way of gift. B is a holder but not a holder in due course as he does not get the cheque for value and consideration. His title is good and bonafide. As a holder he is entitled to receive ₹ 5000 from the bank on whom the cheque is drawn.

Example 12: On a Bill of Exchange for ₹ 1 lakh, X’s acceptance to the Bill is forged. ‘A’ takes the Bill from his customer for value and in good faith before the Bill becomes payable. State with reasons whether ‘A’ can be considered as a ‘Holder in due course’ and whether he (A) can receive the amount of the Bill from ‘X’.

Answer: According to section 9 of the Negotiable Instruments Act, 1881, ‘holder in due course’ means any person who for consideration becomes the possessor of a promissory note, bill of exchange or cheque if payable to bearer or the payee or indorsee thereof, if payable to order, before the amount 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.

As ‘A’ in this case *prima facie* became a possessor of the bill for value and in good faith before the bill became payable, he can be considered as a holder in due course.

But where a signature on the negotiable instrument is forged, it becomes a nullity. The holder of a forged instrument cannot enforce payment thereon. In the event of the holder being able to obtain payment in spite of forgery, he cannot retain the money. The true owner may sue on tort the person who had received. This principle is universal in character, by reason where of even a holder in due course is not exempt from it. A holder in due course is protected when there is defect in the title. But he derives no title when there is entire absence of title as in the case of forgery. Hence ‘A’ cannot receive the amount on the bill.

ESSENTIALS TO BECOME HOLDER IN DUE COURSE (HDC):

- a) The holder must have paid **valuable consideration**:
 - i) To become a holder in due course, a person must obtain a negotiable instrument by paying valuable and lawful consideration for it.
 - ii) When given as a gift or has been inherited, the transferee cannot be a holder in due course.
- b) A holder must **acquire the instrument before its maturity** in order to attain the status of holder in due course.
- c) The holder must have **obtained the instrument in good faith**.
- d) The instrument must be **complete and regular** on the face of it.
- e) He must have received the instrument as a holder- i.e. A HDC may be either payee, or the possessor (if the instrument is payable to bearer), or the indorsee (if the instrument is payable to order).

PRIVILEGES OF BEING A HOLDER IN DUE COURSE:

- (i) **In case of Inchoate Instrument:** A person signing and delivering to another a stamped but otherwise inchoate instrument (When you execute an unfilled up but duly signed negotiable instrument such as a cheque or a promissory note, it is an inchoate negotiable instrument) is debarred from asserting, as against a holder in due course, that the instrument has not been filled in accordance with the authority given by him, the stamp being sufficient to cover the amount (Section 20).

Example 13: A signs his name on a blank but stamped instrument which he gives to B with an authority to fill up as a note for a sum of ₹ 3 000 only. But B fills it for ₹ 5,000. B then transfers it to C for a consideration of 5000 who takes it in good faith. Here in the case, C is entitled to recover the full amount of the instrument because he is a holder in due course whereas B, being a holder cannot recover the amount because he filled in the amount in excess of his authority.

- (ii) **In case of fictitious bill:** In case a bill of exchange is drawn payable to the drawer's order in a fictitious name and is indorsed by the same hand as the

drawer's signature, it is not permissible for acceptor to allege as against the holder in due course that such name is fictitious (Section 42)¹.

- (iii) **In case of conditional instrument or 'escrow':** In case a bill or note is negotiated to a holder in due course, the other parties to the bill or note cannot avoid liability on the ground that the delivery of the instrument was conditional or for a special purpose only.
- (iv) **In case of instrument obtained by unlawful means or for unlawful consideration;** The person liable in a negotiable instrument cannot set up against the holder in due course the defenses that the instrument had been lost or obtained from the former by means of an offence or fraud or for an unlawful consideration (Section 58). Thus, a holder in due course acquires a title free from all defects.
- (v) **In case original validity of the instrument is denied;** No maker of a promissory note, and no drawer of a bill or cheque and no acceptor of a bill for the honour of the drawer shall, in a suit thereon by a holder in due course be permitted to deny the validity of the instrument as originally made or drawn (Section 120). In short, a holder in due course gets a good title to the bill.
- (vi) **In case Payee's capacity to indorse is denied:** No maker of a promissory note and no acceptor of a bill 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 the note or bill, to indorse the same (Section 121). In short, a holder in due course gets a good title to the bill.

"Payment in due course" [Section 10]—"Payment in due course" means payment in accordance with the apparent tenor of the instrument in good faith and without negligence to any person in possession thereof under circumstances which do not afford a reasonable ground for believing that he is not entitled to receive payment of the amount therein mentioned.

¹ According to section 42, 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 indorsement by the same hand as the drawer's signature, and purporting to be made by the drawer.



9. 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]

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.

Example 14: (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)

“Foreign instrument”

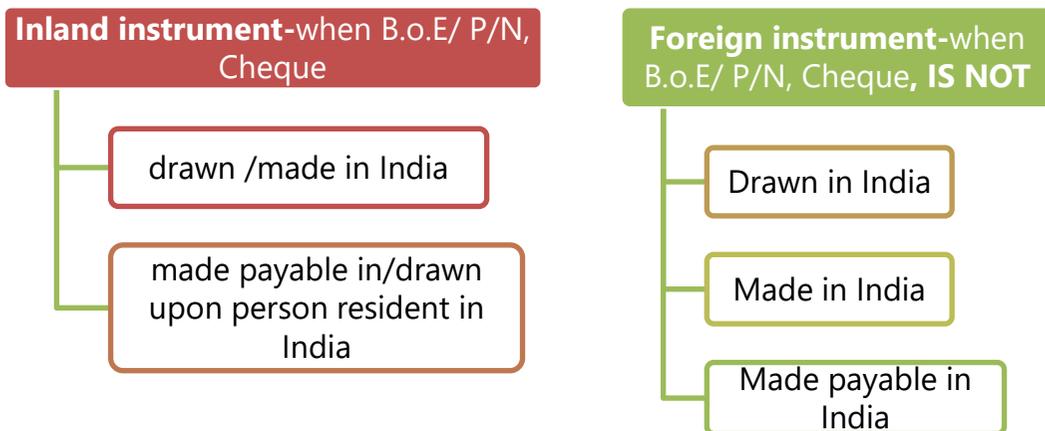
Any such instrument not so drawn, made or made payable (as that of Inland Instrument), shall be deemed to be foreign instrument. In other words,

Place where bill is drawn	Residence of Person on whom drawn and place where made payable	Nature of Instrument
Bills drawn outside India	on a person resident in or outside India + made payable in India	are foreign bills.
	on a person residing outside India + payable in India or outside India.	
	on a person residing in or outside India + payable outside India	

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 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 15: 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% only. But if A is charged as drawer, he is liable to pay interest at 15%.



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.

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.

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 16: 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: Section 17 of the Act, reads as: "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."

Thus, 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.

Where amount is stated differently in figures and words [Section 18]

If the amount undertaken or ordered to be paid is stated differently in figures and in words, the amount stated in words shall be the amount undertaken or ordered to be paid.

Demand and Time Instrument

Demand Instruments (Section 19): A promissory note or bill of exchange in which no time for payment is mentioned, is payable on demand. Bills and notes are payable either on demand or at a fixed future time. Cheques are always 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 "presentment" (Section 21). The expression "after sight" means, in a promissory note, after presentment for sight, and, in a bill of exchange after acceptance, or noting for non-acceptance, or protest for non-acceptance.

Time instrument (Section 22): A bill or note which is payable:

- a) After a fixed period or
- b) After sight or
- c) On a specified day or
- d) On the happening of an event which is certain to happen

is known as time instrument.

"AT SIGHT", "ON PRESENTMENT", "AFTER SIGHT" [SECTION 21]

In a promissory note or bill of exchange the expressions "at sight" and "on presentment" means on demand.

The expression "after sight" means, in a promissory note, after presentment for sight, and, in a bill of exchange after acceptance, or noting for non-acceptance, or protest for non-acceptance.

"MATURITY OF NEGOTIABLE INSTRUMENT"

Where bill or note is payable at a fixed period after sight, the question of maturity becomes important. The maturity of a note or bill is the date on which it falls due.

Days of grace: A note or bill, which is not expressed to be payable on demand, at sight or on presentment; is at maturity on the third day after the day on which it is expressed to be payable. Thus, a time instrument payable after sight is allowed three days grace period (**Section 22**).

Calculation of maturity [Section 23]: In calculating the date at which a promissory note or bill of exchange, made payable at stated number of months after date or after sight, or after a certain event, is at maturity, the period stated shall be held to terminate on the day of the month, which corresponds with the day on which the instrument is dated, or presented for acceptance or sight, or noted for non-acceptance, or protested for non-acceptance, or the event happens or, where the instrument is a bill of exchange made payable at stated number of months after sight and has been accepted for honor, with the day on which it was so accepted. If the month in which the period would terminate has no corresponding day, the period shall be held to terminate on the last day of such month.

Example 17:

- (a) A negotiable instrument dated 29th January, 2019, is made payable at one month after date. The instrument is at maturity on the third day after the 28th February, 2019, i.e, on 3rd March 2019.
- (b) A negotiable instrument, dated 30th August, 2019, is made payable three months after date. The instrument is at maturity on the 3rd December, 2019.
- (c) A promissory note or bill of exchange, dated 31st August, 2019, is made payable three months after date. The instrument is at maturity on the 3rd December, 2019.

Calculating maturity of bill or note payable so many days after date or sight [Section 24]

In calculating the date at which a promissory note or bill of exchange made payable at certain number of days after date or after sight or after a certain event is at maturity, the day of the date, or of presentment for acceptance or sight, or of protest for non-acceptance, or on which the event happens, shall be excluded.

Example 18: Bharat executed a promissory note in favour of Bhushan for ₹ 5 crores. The said amount was payable three days after sight. Bhushan, on maturity, presented the promissory note on 1st January, 2019 to Bharat. Bharat made the payments on 4th January, 2019. Bhushan wants to recover interest for one day from Bharat. As per Section 24 of the Negotiable Instruments Act, 1881 states that where a bill or note is payable after date or after sight or after happening of a specified event, the time of payment is determined by excluding the day from which the time begins to run.

Therefore, in the given case, Bharat will succeed in objecting to Bhushan's claim. Bharat paid rightly "three days after sight". Since the bill was presented on 1st January, Bharat was required to pay only on the 4th and not on 3rd January, as contended by Bhushan.

When the day of maturity is a holiday [Section 25]

When the day on which a promissory note or bill of exchange is at maturity is a public holiday, the instrument shall be deemed to be due on the next preceding business day.

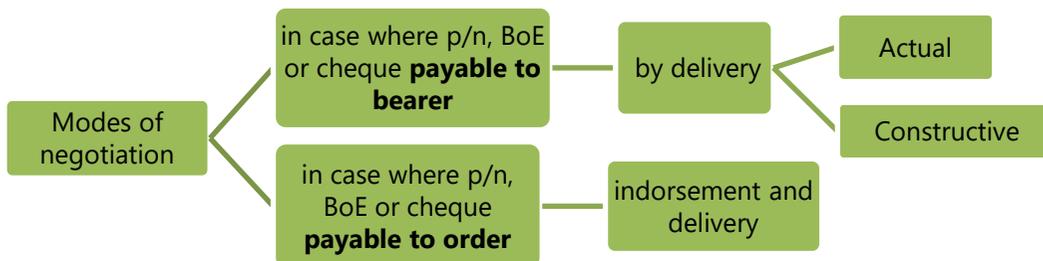
Explanation: The expression "Public Holiday" includes Sundays and any other day declared by the Central Government, by notification in the Official Gazette, to be a public holiday.

10. NEGOTIATION (TRANSFER) OF NEGOTIABLE INSTRUMENTS

One of the essential characteristics of a negotiable instrument is that it is freely transferable from one person to another. The rights in a negotiable instrument can be transferred from one person to another by negotiation.

According to Section 14 of the N.I. Act, when a negotiable instrument 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. Negotiable instruments may be negotiated either by delivery when these are payable to bearer or by indorsement and delivery when these are 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 [Section 47]

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 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 19:

- (1) A, the holder of a negotiable instrument payable to bearer, delivers it to B's agent to keep for B. The instrument has been negotiated.
- (2) A, the holder of a negotiable instrument payable to bearer, which is in the hands 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.

Negotiation by indorsement [Section 48]

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 [Section 46]

Delivery of an instrument is essential whether the instrument is payable to bearer or order for effecting the negotiation. The delivery must be voluntary, and the object of delivery should be to pass the property in the instrument to the person to whom it is delivered. The delivery can 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 agent, clerk or servant of the indorsee on his behalf or when the indorser, after indorsement, holds the instrument as an agent of the indorsee.

Section 46 also lays down that 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 contract on a negotiable instrument **until delivery remains incomplete** and revocable. The delivery is essential not only at the time of negotiation but also at the time of making or drawing of negotiable instrument. 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 before the same could be delivered to the indorsee the indorser dies, the legal representatives of the deceased person cannot negotiate the same by mere delivery thereof. (Section 57)²

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.

INDORSEMENT OF INSTRUMENT (Section 15)

Meaning: When the maker or holder of a negotiable instrument signs the same otherwise than as such maker, for the purpose of negotiation, on the back or face thereof or on a slip of paper annexed thereto known as *allonge* (a French word meaning a slip of paper attached to the end of a BoE to give room for further indorsements)- he is said to indorse the same and called as the indorser. The person to whom the instrument is indorsed is called the indorsee. The indorsement, therefore, means, signatures of the person which are generally made at the back of the instrument, for the purpose of negotiation i.e. transfer of rights to another person. The signature may also be on the face of the instrument. No particular form of words is necessary for an indorsement.

² According to section 57, the legal representative of a deceased person cannot negotiate by delivery only, a promissory note, bill of exchange or cheque payable to order and indorsed by the deceased but not delivered.

A legal representative is not an agent of the deceased. Therefore, a legal representative cannot complete the instrument if the instrument was executed by the deceased but could not be delivered because of his death.

INDORSEMENT: When the maker or holder of a negotiable instrument, signs the same (otherwise than as such maker)—

- for the purpose of negotiation
- on the back or face thereof or on a slip of paper annexed thereto, or so signs for the same purpose a stamped paper intended to be completed as a negotiable instrument,
- he (maker/holder) is said to indorse the same, and is called the “indorser”.

Example 20: X, who is the holder of a negotiable instrument, writes on the back thereof: “pay to Y or order” and signs the instrument. In such a case, X is deemed to have indorsed the instrument to Y. If X delivers the instrument to Y, X ceases to be the holder and Y becomes the holder.

Indorsement “in blank” and “in full” “indorsee” [Section 16]

- (1) If the indorser signs his name only, the indorsement is said to be “in blank”, and if he adds a direction to pay the amount mentioned in the instrument to, or to the order of, a specified person, the indorsement is said to be “in full”, and the person so specified is called the “indorsee” of the instrument.
- (2) The provisions of this Act relating to a payee shall apply with the necessary modifications to an indorsee.

Example 21: Blank (or general): No indorsee is specified in an indorsement in blank, it contains only the bare signature of the indorser. A bill so indorsed becomes payable to bearer.

Specimen

Motilal Poddar

Example 22: Special (or in full): In such an indorsement, in addition to the signature of the indorser the person to whom or to whose order the instrument is payable is specified.

Specimen

Pay to B, Batliwala or order.

S. Shroff

Various Kinds of Indorsement:

1. **Indorsement in Blank (only signature):** Where the indorser just puts his signature without specifying the indorsee, the indorsement is said to be in blank (Section 16). The effect of such an indorsement is to render the

instrument payable to bearer even though originally payable to order (Section 54).

2. **Indorsement in Full (name and signature):** Where along with indorser's signature, the name of the indorsee is specified, the indorsement is called 'indorsement in full' (Section 16). Thus, where the instrument states, 'Pay X or order' and is signed by A, the payee, it constitutes 'indorsement in full'.
3. **Partial indorsement:** An indorsement which purports to transfer only a part of amount of the instrument is called as partial indorsement. As per section 56, such an indorsement is invalid under law.

Example 23: A is a holder of a bill for ₹ 10000. A indorses it thus: "Pay B or order ₹ 5000". This is partial indorsement and invalid for the purpose of negotiation.

Exception: Second part of section 56 states that if a bill has been paid in part, the fact of the part payment may be indorsed on the instrument and it may then be negotiated for the residue.

Example 24: A bill may be indorsed: Pay A or order ₹ 5000 being the unpaid residue of the bill. It is a valid indorsement.

4. **Restrictive Indorsement:** An indorsement is restrictive when the indorser while making indorsement restricts or excludes the right of the indorsee to further transfer the instrument or constitutes the indorsee as an to indorse the instrument or to receive its content for the indorser or for some other specified person (Section 50). An indorsement is "restrictive" when it prohibits or restricts the further negotiability of the instrument. It merely entitles the holder of the instrument to receive the amount on the instrument for a specific purpose.

Example 25: D signs the following indorsements on different negotiable instruments payable to bearer:

- (a) Pay the contents to G only
- (b) Pay G for my use
- (c) Pay G or order for the account of H

These indorsements exclude the right of further negotiation by G.

5. **Conditional indorsement:** Section 52 gives power to an indorser to insert in the indorsement by express words, a stipulation negating (excluding) or limiting his own liability to the holder by making such liability or the right of

the indorsee to receive the amount due thereon upon the happening of a specified event although such event may never happen.

Conditional indorsement can be achieved by an indorser in any of the following ways:

- (1) **Sans recourse indorsement**- By excluding his liability e.g. the holder of a bill may indorse it thus: 'Pay A or order without recourse to me, or Pay A or order sans recourse, or Pay A or order at his own risk'. In these cases, the holder does not incur any liability on the bill as an indorser.
- (2) **Liability dependent upon a contingency**- By making his liability dependent upon the happening of a specified event which may never happen, in such a case the liability of the holder as an indorser, arises only upon the happening of the event specified, and is extinguished if the event becomes impossible, or the conditions specified are not fulfilled. But the indorsee can sue the prior parties before the happening of the event.
- (3) **Facultative indorsement** – An indorser by express words abandons some right or increases his liability under an instrument. For example, the holder may waive presentment of the instrument for acceptance or notice of dishonor by the holder. An indorsement, 'Pay A order. Notice of dishonor waived' is a facultative indorsement.
- (4) **'Sans frais' indorsement** – Where the indorser does not want the indorsee or any subsequent holder to incur any expenses on his account on the instrument, the indorsement is 'sans frais'.

CONVERSION OF INDORSEMENT IN BLANK INTO INDORSEMENT IN FULL [SECTION 49]

The holder of a negotiable instrument indorsed in blank may—

- without signing his own name, by writing above the indorser's signature a direction to pay to any other person as indorsee, convert the indorsement in blank into an indorsement in full; and the holder does not thereby incur the responsibility of an indorser.

According to **Section 55**, if a negotiable instrument, after having been indorsed in bank, is indorsed in full, the amount of it cannot be claimed from the indorser in full, except by the person to whom it has been indorsed in full, or by one who derives title through such person.

Example 26: A is the payee holder of a bill. A indorses it in blank and delivers it to B. B indorses it in full to C or order. C without indorsement transfers the bill to D. D as the bearer is entitled to receive payment or to sue drawer, acceptor, or A who indorsed the bill in blank, but he cannot sue B or C. C can sue B as he received the bill from B by indorsement in full. If, however, C instead of passing the bill to D without indorsement passes it by a regular indorsement, D can claim against all prior parties.

Thus, if an indorsement in blank is followed by an indorsement in full, the instrument still remains payable to bearer and negotiable by delivery against all parties prior to the indorser in full, though the indorser in full is only liable to a holder who made title directly through his indorsement, and person deriving title through such holder.

Essentials of a valid indorsement

- (a) **Signature of indorser:** The indorsement must be signed. The indorsement may be made by the indorser either by merely signing his name on the instrument or by specifying in addition to his signature, the person to whom or to whose order the instrument is payable. When, in a bill payable to order, the indorsee's name is wrongly spelled, he should when he indorses it, sign the name as spelled in the instrument and write the correct spelling within brackets after his indorsement.
- (b) **Who may indorse or negotiate-** Every sole maker, drawer, payee or indorsee, or all of several joint makers, drawers, payees or indorsee's of a negotiable instrument may indorse and negotiate the same unless negotiability of such instrument has been restricted or excluded as mentioned in Section 50.

Explanation: It is however, necessary that such maker or drawer who wants to indorse is in lawful possession of the instrument. (Section 51)

Example 27: A bill is drawn payable to A or order. A indorses it to B, the indorsement not containing the words "or order" or any equivalent words. B may negotiate the instrument.

- (c) **Effect of indorsement:** The indorsement of a negotiable instrument followed by delivery transfers to the indorsee the property therein with the right of further negotiation, but the indorsement may by express words, restrict or exclude such right, or may merely constitute the indorsee an agent to indorse the instrument, or to receive its contents for the indorser, or for some other specified person.

Example 28: B signs the following indorsements on different negotiable instruments payable to bearer,—

- (a) “pay the contents to C only”.
- (b) “pay C for my use”.
- (c) “pay C on order for the account to B”.
- (d) “the within must be credited to C”.

The above indorsements exclude the right of further negotiation by C.

The below indorsements do not exclude the right of further negotiation by C:

- (a) “pay C”.
- (b) “pay C value in account with the Oriental Bank”.
- (c) “pay the contents to C, bring part of the consideration in a certain deed of assignment executed by C to indorser and others”.

Indorser who excludes his own liability or makes it conditional [Section 52]

The indorser of a negotiable instrument may,

- by express words in the indorsement, exclude his own liability thereon, or
- make such liability or the right of the indorsee to receive the amount due thereon depend upon the happening of a specified event, although such event may never happen.

Where an indorser so excludes his liability and afterwards becomes the holder of the instrument all intermediates indorsers are liable to him.

Example 29:

- (1) The indorser of a negotiable instrument signs his name, adding the words “without recourse”. Upon this indorsement he incurs no liability.
- (2) A is the payee and holder of a negotiable instrument. Excluding personal liability by an indorsement, “without recourse”, he transfers the instrument to B, and B indorses it to C, who indorses it to A. A is not only reinstated in his former rights, but has the rights of an indorsee against B and C.

INSTRUMENT OBTAINED BY UNLAWFUL MEANS OR FOR UNLAWFUL CONSIDERATION [SECTION 58]

- When a negotiable instrument has been lost, or
- has been obtained from any maker, acceptor or holder thereof by means of

- o an offence or
- o fraud, or
- o for an unlawful consideration,

no possessor or indorsee who claims through the person who found or so obtained the instrument is entitled to receive the amount due thereon from such maker, acceptor or holder, or from any party prior to such holder, unless such possessor or indorsee is, or some person through whom he claims was, a holder thereof in due course.

INSTRUMENT ACQUIRED AFTER DISHONOR OR WHEN OVERDUE [SECTION 59]

The holder of a negotiable instrument, who has acquired it after dishonour, whether by—

- non-acceptance
- or non-payment,
- with notice thereof, or
- after maturity,

has only, as against the other parties, the rights thereon of his transferor.

Accommodation note or bill: Provided that any person who, in good faith and for consideration, becomes the holder, after maturity, of a promissory note or bill of exchange made, drawn or accepted without consideration, for the purpose of enabling some party thereto to raise money thereon, may recover the amount of the note or bill from any prior party.

Example 30: The acceptor of a bill of exchange, when he accepted it, deposited with the drawer certain goods as a collateral security for the payment of the bill, with power to the drawer to sell the goods and apply the proceeds in discharge of the bill if it were not paid at maturity. The bill not having been paid at maturity, the drawer sold the goods and retained the proceeds, but indorsed the bill to A. A's title is subject to the same objection as the drawer's title.

Instrument negotiable till payment or satisfaction [Section 60]

A negotiable instrument may be negotiated (except by the maker, drawee or acceptor after maturity) until payment or satisfaction thereof by the maker, drawee or acceptor at or after maturity, but not after such payment or satisfaction.

Cancellation of indorsement: Where the holder of a negotiable instrument, without the consent of the indorser, destroys or impairs the indorser's remedy against a prior party, the indorser is discharged from liability to the holder to the same extent as if the instrument had been paid at maturity (Sec. 40).

Example 31: A is the holder of a bill of exchange made payable to the order of B, which contains the following indorsements in blank: 1st indorsement - 'B', 2nd indorsement - C, 3rd indorsement - D, 4th indorsement - E. A puts this bill in suit against C and strikes out, without E's consent, the indorsements by C and D. A is not entitled to recover anything from E.

Negotiation Back ("taking up of a bill")

In the course of negotiation, if a negotiable instrument is circulated/negotiated back by an indorser to any of the prior party on the negotiable instruments, it is termed as negotiation back. The person who becomes the holder in due course under this negotiation back cannot make any of the intermediate indorsers liable on the instruments. But where an indorser had excluded his liability, by the use of the words 'sans recourse' or 'without recourse to me' and after that becomes the holder of the instrument in his own right under the 'negotiation back' all intermediate indorsers are liable to him and in case of dishonour, he can recover the amount from all or any one of them.



11. DISCHARGE FROM LIABILITY ON NOTES, BILLS AND CHEQUES

When a party, who is liable on a negotiable instrument, ceases to be liable he is said to be discharged from liability. Discharge from liability of a party to an instrument is different from the discharge of negotiable instrument itself. When only some of the parties to an instrument are discharged from liability but others continue to be liable thereon, it is only discharge of some of the parties from liability.

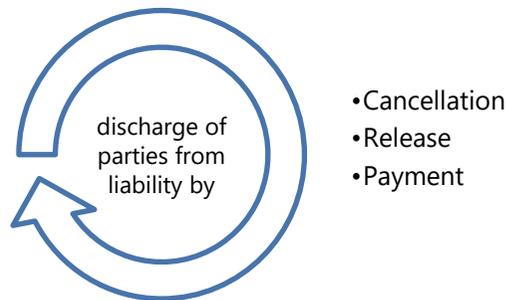
When the rights against all the parties on an instrument come to an end, the instrument is discharged. After the instrument is discharged no person, even a holder in due course, can claim the amount of the instrument from any party thereto.

Thus, when the maker of a promissory note or the acceptor of a bill is discharged, all the other parties liable on the instrument are automatically discharged and in that case the instrument itself is deemed to be discharged. So long as the instrument is discharged it can continue to be negotiated.

Chapter VII (Sections 82 to 90) of the Negotiable Instruments Act, 1881, deal with the discharge of the parties to a negotiable instrument.

Modes of discharge from liability on Instruments

The parties to a negotiable instrument may be discharged in the following ways:



As per section 82, the maker, acceptor or indorser of a negotiable instrument is discharged from liability thereon by cancellation, release or payment. Further, there are other modes of discharge of liability that co-exist (along with section 82) as prescribed under various sections of the Negotiable Act.

Thus, the parties to the negotiable instrument may be discharged in the following ways—

(a) **By cancellation [Section 82 (a)]**

When the holder of a negotiable instrument or his agent cancels the name of a party on the instrument with an intention to discharge him, such party and all subsequent parties, who have a right of recourse against the party whose name is cancelled, are discharged from liability to the holder.

(b) **By release [Section 82 (b)]**

Where the holder of a negotiable instrument releases any party to the instrument by any method other than cancellation, the party so released is discharged from liability.

For **example** discharge by an agreement between the parties, and includes waiver, release, accord and satisfaction.

The party so released and all parties subsequent to him who have a right of action against the party so released are discharged from liability. Thus, the effect of release is the same as that of cancelling a party's name.

(c) **By payment [Section 78]³**

When payment on an instrument is made in due course, both the instrument and the parties to it are discharged subject to the provision of Sec. 82(c). The payment on an instrument may be made by any party to the instrument. It may even be made by a stranger provided it is made on account of the party liable to pay.

(d) **By the holder allowing the drawee of a bill more than 48 hours to accept [Section 83]**

If the holder of a bill of exchange allows the drawee more than forty eight hours, exclusive of public holidays, to consider whether he will accept the same, all previous parties not consenting to such allowance are thereby discharged from liability to such holder.

(e) **By the Holder agreeing to a qualified or limited acceptance of bill of exchange [Section 86]:**

If the holder of a bill agrees to a qualified acceptance all prior parties whose consent is not obtained to such an acceptance are discharged from liability. Acceptance of a bill is deemed to be qualified, for example, when the acceptance is conditional, declaring the payment to be dependent on the happening of an event therein stated, or wherein alters the payment of the sum ordered to be paid, or when the acceptor accepts to pay at a specified place only and not elsewhere.

(f) **By the Drawer not duly presenting a cheque for payment [Section 84]:**

If a holder does not present a cheque within reasonable time after its issue, and the bank fails causing damage to the drawer, the drawer is discharged as against the holder to the extent of the actual damage suffered by him.

Example 32: "A draws a cheque for ₹ 1000 and, when the cheque ought to be presented, has funds at the bank to meet it. The bank fails before the cheque is presented. The drawer is discharged, but the holder can prove against the bank for the amount of the cheque".

Example 33: "A draws a cheque at Ambala on a bank in Kolkata. The bank fails before the cheque could be presented in ordinary course. A is not

³ According to section 78, subject to the provisions of section 82, clause (c), payment of the amount due on a promissory note, bill of exchange or cheque must, in order to discharge the maker or acceptor, be made to the holder of the instrument.

discharged, for he has not suffered actual damage through any delay in presenting the cheque”.

(g) **By the bill coming to the acceptor’s hands after maturity (Section 90)**

If a bill of exchange which has been negotiated is, at or after maturity, held by the acceptor in his own right, all rights of action thereon are extinguished. This rule is based on the general principle that a present right and liability united in the same person cancel each other.

(h) **Discharge by material alteration**

“Any material alteration of negotiable instruments renders the same void as against anyone who is a party thereto at the time of making such alteration and does not consent thereto, unless it was made in order to carry out the common intention of the original parties” (First para, Section 87)

The second para of section 87 provides that “if a material alteration is made by an indorsee, the indorser will be discharged from his liability even in respect of the consideration thereof.” If the holder of a negotiable instrument makes a material alteration of instrument he loses his right of action against those parties who would otherwise have been liable towards him.

The provisions of Section 87 are subject to those of sections 20, 49, 86 and 125. It is generally an accepted rule of law that a material alteration of an instrument by a party to it, without the consent of the other party, renders it void.

By material alteration the identity of original instrument is destroyed and those parties who had agreed to be liable on the original instrument cannot be made liable on the new contract contained in the altered instrument to which they never consented (*Gour Chandra vs Prasanna Kumar 33 Cal 812*). It makes no difference whether the alteration is made by a party who is in possession of the same, or by a stranger while the instrument was in the custody of a party, because the party in custody of instrument is bound to preserve it in its integrity. The rule is defended on the ground that no man shall be permitted to take the chance of committing a fraud without running any risk of loss by the event when it is detected.

The party who consents to the alteration as well as the party who makes the alteration are disentitled to complain against such alteration e.g. the drawer of the cheque himself altered the date of the cheque for validating or re-validating the same instrument, he cannot take advantage of it by saying that the cheque becomes void as there was a material alteration thereto. It is

always open to a drawer to voluntarily re-validate a negotiable instrument including a cheque [*Veera Exports v T. Kalavathy (2002) 1 SCC97*].

Alteration must be material: An alteration is material which in any way alters the operation of the instrument and affects the liability of parties thereto.

Any alteration is material

- (a) which alters the business effect of the instrument if used for any business purpose.
- (b) which causes it to speak a different language in legal effect form which it originally spoke or which changes the legal identity or character of the instrument.

By material alteration, the liability of the parties is avoided, whether the change be prejudicial or beneficial to the parties. A material alteration is one which varies the rights, liabilities or legal position of the parties as ascertained by the original instrument [*Loonkaran sethiya v Ivan E. John (1977) SCC*].

“The following alteration are specifically declared to be material: any alteration of (i) the date, (ii) the sum payable, (iii) the time of payment, (iv) the place of payment, or the addition of a place of payment.”

Following are the **examples** of material alteration: -

- (a) Alteration of date e.g., time of payment accelerated or postponed, or where date in the instrument inserted subsequent to the execution of instrument (*A. Subba Reddy v Neelapa Reddy AIR 1966 A.P. 267*).
- (b) Alteration of rate of interest (if specified) [*Seth Tulsidas Lalchand v Rajagopal (1967) 2 MLJ 66*].
- (c) Alteration of the sum payable, e.g., a bill for ₹ 5000 altered into a bill for ₹ 500.
- (d) Alteration in the time of payment, e.g., a bill payable 3 months after date is altered to be payable 1 month after date.
- (e) Alteration of the place of payment e.g., change of bank at which the bill is payable [*Tidamarsh v Grover (1813) 23 LJ QB 261*]. Likewise, alteration by addition of place for payment e.g. where a place of payment is not given but is subsequently added without the acceptor’s consent.
- (f) Alteration by addition of parties (from one maker/payee to two makers/payees).

- (g) Alteration by tearing material part of the instrument.
- (h) Alteration by increasing or affixing stamps (*Challamma v Padmanabhan Nair 1970 KLR 682*).
- (i) Alteration by erasure of an "account payee" crossing (*J. Ladies Beauty v State Bank of Indian AIR 1984 Guj33*).
- (j) Alteration of an order cheque to a bearer cheque, except by or with consent of the drawer.

The following alterations **do not affect** the liability of parties thereto:

- (a) If the alteration is unintentional and due to pure accident (e.g. accidental disfigurement of document).
- (b) Alteration made by a stranger without the consent of holder and without any fraud and negligence on his part.
- (c) An alteration made to correct a clerical error or a mistake, thus, if instead of 1823, the date entered was 1832, the agent of drawer held entitled to correct mistake [*Brutt v pikard (1824) Ry & M 37*]. Such correction is deemed to be giving effect to the original intention of the parties.
- (d) Alteration made to carry out common intention of original parties is permitted by Section 87. For example, where the words "or order" after the name of payee, inserted subsequently [*Byrom v Thomson (1839) 11 A&E 31*].
- (e) Alteration with the consent of the parties liable thereto.
- (f) An alteration made before the completion or the issue of negotiable Instrument.
- (g) A material alteration doesn't affect the liability of those parties who become liable after the alteration is made. Section 88 provides that the acceptor or indorser is bound by his acceptance or indorsement notwithstanding any previous alteration of the instrument.
- (h) An alteration which is not material e.g. when a bill payable to bearer is converted to bill payable to order/or an incomplete name of a person converted into the complete name of same person.

- (i) Alterations permitted (Exceptions to Section 87)
- (a) **Section 20** – Incomplete instrument (e.g. column of sum left blank) can be filled up by the holder.
 - (b) **Section 49** – It enables the holder of an instrument indorsed in blank to convert it into indorsement in full (by writing above the indorser's signature a direction to pay to any other person as indorsee). Thus, addition of parties allowed here.
 - (c) **Section 125**- the holder of an uncrossed cheque may cross it or may convert general into special crossing or may make it 'not negotiable'.
 - (d) **Apparent alteration** – The alteration should be apparent on the face of the instrument otherwise it remains a valid security in the hands of a holder in due course. Section 89 provides that where an instrument has been materially altered but does not appear to have been so altered, the party paying it will be discharged by payment in due course.

But in such case, the acceptor is liable only for the original tenor of the instrument and not for its altered tenor.

Similarly, where a cheque at the time of presentment is crossed but the crossing is not apparent, the banker will be discharged by payment in due course.

Example 34: A promissory note was made without mentioning any time for payment. The holder added the words "on demand" on the face of the instrument. As per the above provision of the Negotiable Instruments Act, 1881 this is not a material alteration as a promissory note where no date of payment is specified will be treated as payable on demand. Hence adding the words "on demand" does not alter the business effect of the instrument.

Example 35: The alterations made in the given case are not material alterations in nature:

- (i) The holder of the bill inserts the word "or order" in the bill,
- (ii) The holder of the bearer cheque converts it into account payee cheque,

The following material alterations have been authorised by the Act and do not require any authentication:

- (a) filling blanks of inchoate instruments [Section 20]
- (b) Conversion of a blank indorsement into an indorsement in full [Section 49]

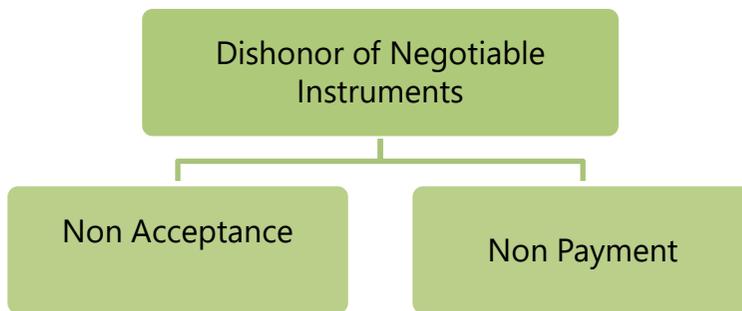


12. DISHONOUR OF NEGOTIABLE INSTRUMENTS

Dishonour of a bill

A bill may be dishonoured by:

- (a) Non-acceptance, or
- (b) Non-payment.



Dishonour by Non-acceptance

A bill of exchange is said to be dishonoured by non-acceptance in any one of the following ways (Section 91):

- (a) When a bill is duly presented for acceptance, and the drawee, or one of several drawees not being partners, **refuse acceptance within forty eight hours from the time of presentment**, the bill is dishonored. In other words, when the drawee makes default in acceptance upon being duly required to accept the bill.
- (b) where **presentment is excused**, and the bill is not accepted.
- (c) Where the **drawee is incompetent** to contract, the bill may be treated as dishonored.
- (d) Where the **drawee is a fictitious person**.
- (e) Where **the drawee could not be found** even after reasonable search
- (f) When a **drawee gives a qualified acceptance**, the holder may treat the instrument dishonored.

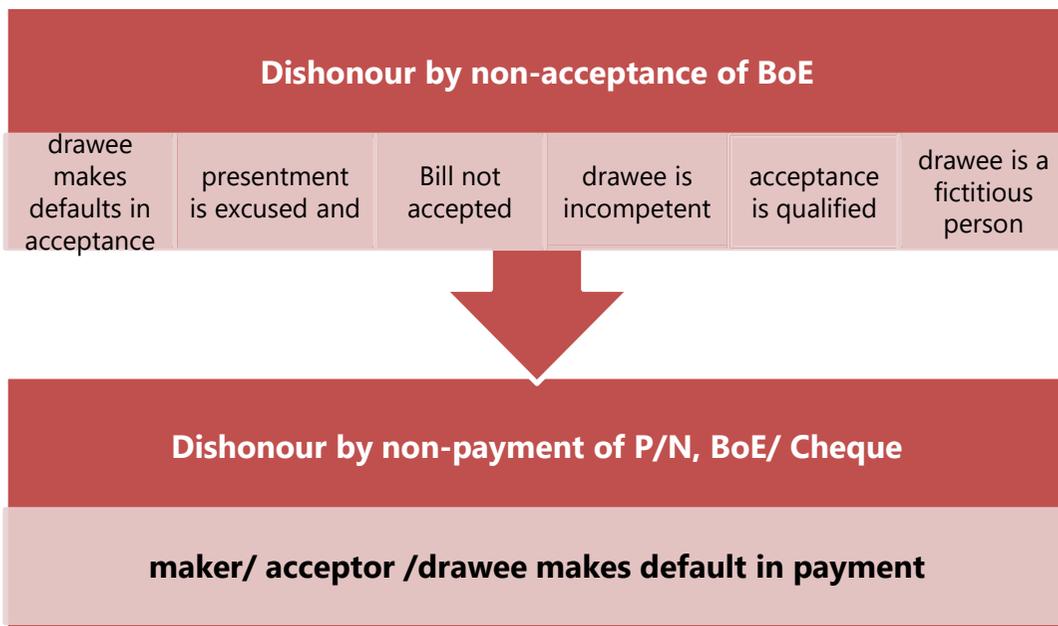
The effect of dishonoured by non-acceptance is that the holder of the bill can start an action against the drawer and the indorsers and need not wait for maturity of the bill.

Dishonour by non-payment

A promissory note, bill of exchange and 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 (Sec. 92).

Again, a negotiable instrument is dishonoured by non-payment when presentment for payment is excused and the instrument when overdue remains unpaid (Sec. 76).

Where a promissory note was sent by registered post and the party liable refused to receive the post, the bill was held to be dishonoured [*K. Venkatasubbayya v P.R. Rao Tobacco Co. AIR 1972 A.P.72*]



Notice of Dishonour

When negotiable instrument is dishonoured either by non-acceptance or by non-payment, the holder must give a notice of dishonour to the drawer or his previous holder in order to make them liable on the instrument. If he fails to do so, except in cases when notice of dishonour maybe excused, he will forfeit his right of action against prior parties entitled to the notice of dishonour.

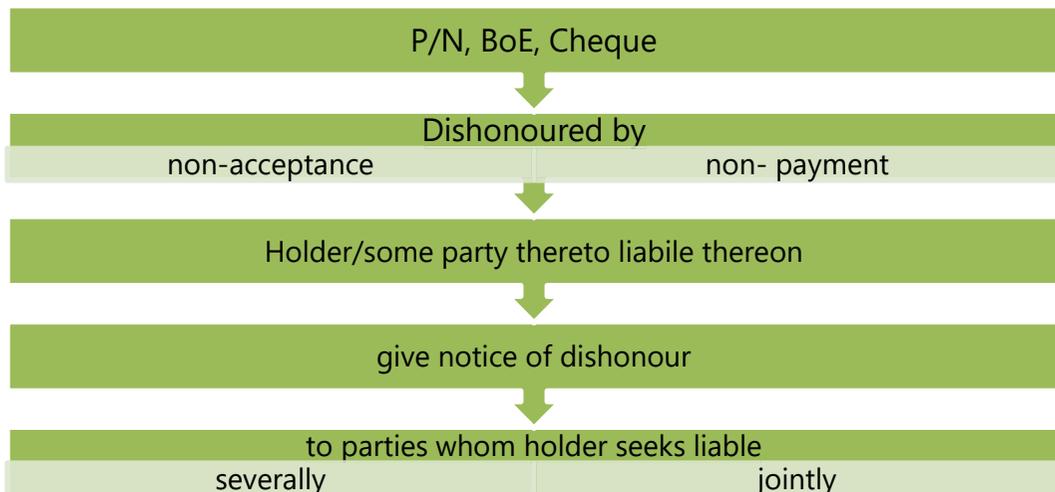
Object of notice of Dishonour

The object of notice of dishonour is to inform (or warn) the party or the person who is liable on instrument about the dishonour of the instrument. Also, in the case of drawer to enable him to protect himself as against the drawee or acceptor who has

dishonoured his bill. The notice is necessary whatever the nature of the instrument i.e., whether it is payable at sight or on demand or whether it is an accommodation bill.

In order to make the drawer liable, on the dishonour by the drawee or the acceptor, it is necessary that a 'notice of dishonour' must have been given to him. The omission on the part of holder to give due notice of dishonour would discharge the drawer not only from his liability upon the cheque, but also upon the original debtor consideration. The doctrine of notice of dishonour is based upon the principle of just and equity.

By and to whom notice should be given [Section 93]



Notice by whom: Notice of dishonour must be given by the holder, or by a person liable on the instrument. But it is not necessary that the notice should always emanate from the holder, for he is entitled to avail himself of a notice given by any party liable on the instrument. Notice of dishonour given by the stranger is of no effect. Even a notice given by a party to the instrument is not valid, if at the time of giving such notice he is not liable thereon.

Notice to whom: Notice of dishonour must be given to all parties other than the maker or the acceptor or the drawee whom the holder seeks to make liable. Notice of dishonour to the acceptor of a bill or to the maker of a note or the drawee of cheque is not necessary as per section 93 of the Act. They are the parties primarily liable upon the instrument, on the due date and at the proper place. It is they who dishonour the instrument by no-acceptance or non-payment and notice to them will merely be notice of fact already known to them.

Modes of giving Notice

Notice of dishonour may be given to a duly authorized agent of the person to whom it is required to be given, or, where he has died, to his legal representative or, where he has been declared insolvent, to his assignee; may be oral or written; may, if written, be sent by post; and may be in any form; but it must inform the party to whom it is given, either in express term or by reasonable intendment, that the instrument has been dishonoured, and in what way, and that he will be held liable thereon; and it must be given within reasonable time after dishonour, at the place of business or (in case such party has no place of business) at the residence of the party for whom it is intended.

If the notice is duly directed and sent by post and miscarries, such miscarriage does not render the notice invalid (Section 94).

Party receiving must transmit notice of dishonor

Any party receiving notice of dishonour must, in order to render any prior party liable to himself, give notice of dishonour to such party within reasonable time, unless such party otherwise receives due notice as provided by Section 93 (Section 95).

Thus, a person receiving notice must transmit it to prior parties whom he wishes to make liable to himself because the holder may have omitted to give notice to some of the prior parties.

Agent of presentment

When instrument is deposited with an agent for presentment, the agent is entitled to the same time to give notice to his principal as if he were the holder giving notice of dishonour, and the principal is entitled to a further like period to give notice of dishonour (Section 96).

When party to whom notice given is dead

When the party to whom notice of dishonour is dispatched is dead, but the party dispatching the notice is ignorant of his death, the notice is sufficient (Section 97).

When notice of dishonor is unnecessary [Section 98]

No notice of dishonour is necessary, -

- (a) **Waiver:** When it is dispensed with by the party entitled thereto; a waiver of notice may be made at the time of drawing or indorsing the instrument, or before or after the time for giving notice has arrived. A waiver by a party to receive notice ensures for the benefit of all the parties coming after him.
- (b) **in order to charge the drawer,** when he has countermanded payment.

- (c) **No damage:** when the party charged could not suffer damages for want of notice.
- (d) when the **party entitled to notice cannot after due search be found;** or the party bound to give notice is, for any other reason, unable without any fault of his own to give it.
- (e) to charge the drawers, **when the acceptor is also a drawer.**
- (f) in the case of a **promissory note which is not negotiable.**
- (g) **Promise to pay** - when the party entitled to notice, knowing the facts, promises unconditionally to pay the amount due on the instrument.

Example 36: Is notice of dishonour necessary in the following cases:

- (1) X having a balance of ₹ 1,000 with his bankers and having no authority to over draw, drew a cheque for ₹ 5,000/-. The cheque was dishonored when duly presented for repayment.
- (2) X, drawer of a Bill informs Y, the holder of the bill that the bill would be dishonored on the presentment for payment.

Answer: Notice of dishonour is not necessary in both the cases. [Section 98 of the Negotiable Instruments Act, 1881].



13. 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, [A cheque given as gift or donation, or as a security or in discharge of a mere moral obligation, or for an illegal consideration, would be outside the purview of this section]
- 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**.

Provided that this section shall not apply, unless—

(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.

Example 37: X issued a post-dated cheque to Y on the account of discharge of its liability. Further, X instructed to the bank to stop the payment due to unavailability of the adequate amount in the account. Here, in this instance section 138 of the Act is attracted as when a cheque is dishonoured on account of stop payment instructions sent by the drawer to his banker in respect of a post-dated cheque irrespective of insufficiency of funds in the account. A post-dated cheque is deemed to have been drawn on the date it bears and the three months period for the purposes of section 138 is to be counted from that date. So, X will be liable for dishonour of cheque. Once a cheque is issued by the drawer, a presumption under section 139 must follow.

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 shall be presumed, unless the contrary is proved, that the holder of a cheque received the cheque of the nature referred to in section 138 for the discharge, in whole or in part, or any debt or other liability.

Presumption prescribed here is a "rebuttable presumption" as the provisions clearly provides that the person issuing the cheque is at liberty to prove to the contrary. The effect of this presumption is to place the evidential burden on 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.

OFFENCES BY COMPANIES [SECTION 141]

- (1) If the person committing an offence under section 138 is a company, every person who, at the time the offence was committed—
- was in charge of, and
 - was responsible to the company for the conduct of the business of the company,

as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly.

Exception: Provided that nothing contained in this sub-section shall render any person liable to punishment if he proves that the offence was committed **without his knowledge**, or that he **had exercised all due diligence** to prevent the commission of such offence.

Where a person is nominated as a director of a company by virtue of his holding any office or employment in the Central Government or State Government or a financial corporation owned or controlled by the Central Government or State Government, as the case may be, he shall not be liable for prosecution under this chapter.

- (2) **Where any offence under this Act**, has been committed by a company and it is proved that the offence has been committed with the consent or

connivance of, or is attributable to, any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

Explanation: For the purpose of this section

- (a) "Company" means any body corporate and includes a firm or other association of individuals; and
- (b) "Director", in relation to a firm, means a partner in the firm.

Example 38: A promoter who has borrowed a loan on behalf of company, who is neither a director nor a person-in-charge, sent a cheque from the company's account to discharge its legal liability. Subsequently, the cheque was dishonoured and the complaint was lodged against him. So, according to Section 138 of the Negotiable Instruments Act, 1881, 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/out of that account for discharging any debt or liability, and if it is dishonoured by banker on sufficient grounds, such person shall be deemed to have committed an offence and shall be liable. However, in this case, the promoter is neither a director nor a person-in-charge of the company and is not connected with the day-to-day affairs of the company and had neither opened nor is operating the bank account of the company. Further, the cheque, which was dishonoured, was also not drawn on an account maintained by him but was drawn on an account maintained by the company. Therefore, he has not committed an offence under section 138.

COGNIZANCE OF OFFENCES [SECTION 142]

- (1) Notwithstanding anything contained in the Code of Criminal Procedure, 1973—
 - (a) **Cognizance on written complaint:** Notwithstanding anything contained in Code of Criminal Procedure, 1973, a written complaint should have been made to a metropolitan or a first-class judicial magistrate by the payee, or holder in due course of the cheque.
 - (b) **Limitation for filing of complaint:** such complaint is made within one month of the date on which the cause of action arises under clause (c) of the proviso to section 138.

Provided that the cognizance of a complaint may be taken by the court after the prescribed period, if the complainant satisfies the court that he had sufficient cause for not making a complaint within such period.

- (c) **Jurisdiction of court:** no court inferior to that of a Metropolitan Magistrate or a Judicial Magistrate of the first class shall try any offence punishable under section 138.
- (2) **Jurisdiction of courts for the trial of offence [Section 142 (2)]:** The offence under section 138, which deals with the dishonor of cheque, shall be inquired into and tried only by a court within whose local jurisdiction,—
- (a) **if the cheque is delivered for collection through an account**, the branch of the bank where the payee or holder in due course, as the case may be, maintains the account, is situated; or
- (b) **if the cheque is presented for payment by the payee or holder in due course**, otherwise through an account, the branch of the drawee bank where the drawer maintains the account, is situated.

Explanation— For the purposes of clause (a), where a cheque is delivered for collection at any branch of the bank of the payee or holder in due course, then, the cheque shall be deemed to have been delivered to the branch of the bank in which the payee or holder in due course, as the case may be, maintains the account.”

Example 39: Mr. A holds an account in Navrangpura Branch, Ahmedabad of “XYZ” Bank, issues a cheque payable in favour of B. B, who holds an account with the M.S University Road Branch, Vadodara of the “PQR” bank, deposits the said cheque at Surat Branch of ‘PQR bank’ and the cheque is dishonoured. The complaint will have to be filed before the court having jurisdiction where the M.S University Road branch is situated.

VALIDATION FOR TRANSFER OF PENDING CASES [SECTION 142A]

- (1) Notwithstanding anything contained in the Code of Criminal Procedure, 1973 or any judgment, decree, order or direction of any court, all cases transferred to the court having jurisdiction under sub-section (2) of section 142, as amended by the Negotiable Instruments (Amendment) Ordinance, 2015, shall be deemed to have been transferred under this Act, as if that sub-section had been in force at all material times.
- (2) Notwithstanding anything contained in sub-section (2) of section 142 or sub-section (1), where the payee or the holder in due course, as the case may be,

has filed a complaint against the drawer of a cheque in the court having jurisdiction under sub-section (2) of section 142 or the case has been transferred to that court under sub-section (1) and such complaint is pending in that court, all subsequent complaints arising out of section 138 against the same drawer shall be filed before the same court irrespective of whether those cheques were delivered for collection or presented for payment within the territorial jurisdiction of that court.

The above sub-section deals with respect to filing of subsequent complaints. The payee has filed a complaint against the drawer in a court with the appropriate jurisdiction, all subsequent complaints against that person regarding cheque bouncing will be filed in the same court. This will be irrespective of the mode of presentation of cheque.

(3) If, on the date of the commencement of the Negotiable Instruments (Amendment) Act, 2015, more than one prosecution filed by the same payee or holder in due course, as the case may be, against the same drawer of cheques is pending before different courts, upon the said fact having been brought to the notice of the court, such court shall transfer the case to the court having jurisdiction under sub-section (2) of section 142, as amended by the Negotiable Instruments (Amendment) Ordinance, 2015, before which the first case was filed and is pending, as if that sub-section had been in force at all material times.

This sub-section deals with where more than one case filed by the same payee against the same drawer before different courts. If more than one case is filed by the same payee against the same drawer before different courts, the case will be transferred to the court with the appropriate jurisdiction before which the first case was filed.

POWER OF COURT TO TRY CASES SUMMARILY [SECTION 143]

(1) **Trial of Offence:** Notwithstanding anything contained in the Code of Criminal Procedure, 1973, all offences under this Chapter shall be tried by a Judicial Magistrate of the first class or by a Metropolitan Magistrate and the provisions of sections 262 to 265 (both inclusive) of the said Code shall, as far as may be, apply to such trials.

In case of summary trial: Provided that in the case of any conviction in a summary trial under this section, it shall be lawful for the Magistrate to pass a sentence of imprisonment for a term not exceeding one year and an amount of fine exceeding five thousand rupees.

In case where no summary trial can be made: Provided further that when at the commencement of, or in the course of, a summary trial under this section, it appears

to the Magistrate that the nature of the case is such that a sentence of imprisonment for a term exceeding one year may have to be passed or that it is, for any other reason, undesirable to try the case summarily, the Magistrate shall after hearing the parties, record an order to that effect and thereafter recall any witness who may have been examined and proceed to hear or rehear the case in the manner provided by the said Code.

(2) **Speedy Trial:** The trial of a case under this section shall, so far as practicable, consistently with the interests of justice, be continued from day to day until its conclusion, unless the Court finds the adjournment of the trial beyond the following day to be necessary for reasons to be recorded in writing.

(3) **Speedy and efficient Disposal:** Every trial under this section shall be conducted as expeditiously as possible and an endeavour shall be made to conclude the trial within six months from the date of filing of the complaint.

POWER TO DIRECT INTERIM COMPENSATION [SECTION 143A]

(1) Notwithstanding anything contained in the Code of Criminal Procedure, 1973, the Court trying an offence under section 138 may order the drawer of the cheque to pay interim compensation to the complainant—

- (a) in a summary trial or a summons case, where he pleads not guilty to the accusation made in the complaint; and
- (b) in any other case, upon framing of charge.

(2) The **interim compensation under sub-section (1) shall not exceed twenty per cent.** of the amount of the cheque.

(3) The **interim compensation shall be paid within sixty days from the date of the order** under sub-section (1), or within such further period not exceeding thirty days as may be directed by the Court on sufficient cause being shown by the drawer of the cheque.

(4) If the drawer of the cheque is acquitted, the Court shall direct the complainant to repay to the drawer the amount of interim compensation, with interest at the bank rate as published by the Reserve Bank of India, prevalent at the beginning of the relevant financial year, within sixty days from the date of the order, or within such further period not exceeding thirty days as may be directed by the Court on sufficient cause being shown by the complainant.

(5) The interim compensation payable under this section may be recovered as if it were a fine under section 421 of the Code of Criminal Procedure, 1973.

- (6) The amount of fine imposed under section 138 or the amount of compensation awarded under section 357 of the Code of Criminal Procedure, 1973, shall be reduced by the amount paid or recovered as interim compensation under this section.

OFFENCES TO BE COMPOUNDABLE [SECTION 147]

Notwithstanding anything contained in the Code of Criminal Procedure, 1973, every offence punishable under this Act shall be compoundable.

POWER OF APPELLATE COURT TO ORDER PAYMENT PENDING APPEAL AGAINST CONVICTION [SECTION 148]

- (1) Notwithstanding anything contained in the Code of Criminal Procedure, 1973, in an appeal by the drawer against conviction under section 138, the Appellate Court may order the appellant to deposit such sum which shall be a minimum of twenty per cent of the fine or compensation awarded by the trial Court:

Provided that the amount payable under this sub-section shall be in addition to any interim compensation paid by the appellant under section 143A.

- (2) The amount referred to in sub-section (1) shall be deposited within sixty days from the date of the order, or within such further period not exceeding thirty days as may be directed by the Court on sufficient cause being shown by the appellant.
- (3) The Appellate Court may direct the release of the amount deposited by the appellant to the complainant at any time during the pendency of the appeal:

Provided that if the appellant is acquitted, the Court shall direct the complainant to repay to the appellant the amount so released, with interest at the bank rate as published by the Reserve Bank of India, prevalent at the beginning of the relevant financial year, within sixty days from the date of the order, or within such further period not exceeding thirty days as may be directed by the Court on sufficient cause being shown by the complainant.

Explanation: Thus, Section 148 provides that in the event of the conviction of the drawer of the cheque, if the drawer proceeds to file an appeal, the Appellate Court has the power to order the drawer of a cheque to deposit a minimum of 20% of the fine or compensation awarded by the Magistrate Court in the appeal preferred against his/her conviction. This amount can be ordered anytime during the pendency of the appeal. The procedure relating to payment of the above stated fine and refund of the same if the appeal succeeds, is similar to what has been laid down in Section 143A of the Act.

SUMMARY

- ◆ A promissory note is an unconditional undertaking, written and signed by the maker to pay a certain sum of money only to or to the order of a certain person. It does not include a bank note or currency note.
- ◆ A bill of exchange is an unconditional written order signed by the drawer, directing a certain person to pay a certain sum of money to the specified person or to his order or to the bearer of the bill.
- ◆ A cheque is a bill of exchange drawn on a specified banker and payable only on demand and it includes the electronic image of a truncated cheque and a cheque in the electronic form.
- ◆ A bearer instrument is one which is expressed to be payable to its bearer or which has last indorsement in blank.
- ◆ An instrument payable to order is the one which is expressed to be payable to a particular person.
- ◆ A negotiable instrument drawn or made in India and made payable in, or drawn upon any person resident in India shall be deemed to be inland instrument.
- ◆ Any instrument which is not an inland instrument is a foreign instrument.
- ◆ When the nature of an instrument is not clear, it is termed as ambiguous instrument. There such an instrument may be treated as either promissory or as a bill of exchange.
- ◆ Inchoate instrument is an instrument that is signed and duly stamped but otherwise wholly or partially blank.
- ◆ "At sight", "on presentment", expressions in reference to promissory note or bill of exchange means on demand. Whereas expression "After sight" in a case of promissory note means after presentment for sight and in reference to bill of exchange means after acceptance/noting/protest for non-acceptance.
- ◆ Maturity is the date of any instrument at which its payment becomes due. Any instrument is at maturity on the third day after the day on which it is expressed to be payable.
- ◆ Negotiation means transfer of a negotiable instrument by one person to another in order to make the transferee the holder of the instrument.
- ◆ Negotiation may be made by delivery or by indorsement and delivery.

- ◆ A bank under certain conditions may refuse payment of cheque or is bound to dishonor cheque and when the cheque is dishonored for insufficiency of funds in the account of a customer, it is treated as offence. The guilty may be punished with imprisonment for a term which may extend to two years or with fine of twice the amount of the cheque or with both.
- ◆ Mode of discharge—The instrument is discharged when rights and obligations or claims of all the parties are extinguished.
- ◆ Material alteration means the alteration in the material part of the instrument resulting in the alteration in the basic nature and legal effects of the instruments and the liabilities of the parties.
- ◆ An instrument is dishonored by non-acceptance and non-payment of the instrument when duly presented.
- ◆ Notice of dishonor is served by the holder formally against the parties to the effect that instrument has been dishonored by non-acceptance or non-payment.
- ◆ In respect, to decide the rights of parties on the basis of negotiable instrument, the Court is entitled to make certain presumptions of consideration, as to date, as to time of acceptance, as to time of transfer, as to order of indorsements, as to stamps and that holder is a holder in due course.

TEST YOUR KNOWLEDGE

Question 1

Discuss with reasons, whether the following persons can be called as a 'holder' under the Negotiable Instruments Act, 1881:

- (i) *X who obtains a cheque drawn by Y by way of gift.*
- (ii) *A, the payee of the cheque, who is prohibited by a court order from receiving the amount of the cheque.*
- (iii) *M, who finds a cheque payable to bearer, on the road and retains it.*
- (iv) *B, the agent of C, is entrusted with an instrument without indorsement by C, who is the payee.*
- (v) *B, who steals a blank cheque of A and forges A's signature.*

Answer

Person to be called as a holder: As per section 8 of the Negotiable Instruments Act, 1881 'holder' of a Negotiable Instrument means any person entitled in his own name to the possession of it and to receive or recover the amount due thereon from the parties thereto.

On applying the above provision in the given cases—

- (i) Yes, X can be termed as a holder because he has a right to possession and to receive the amount due in his own name.
- (ii) No, he is not a 'holder' because to be called as a 'holder' he must be entitled not only to the possession of the instrument but also to receive the amount mentioned therein.
- (iii) No, M is not a holder of the Instrument though he is in possession of the cheque, so is not entitled to the possession of it in his own name.
- (iv) No, B is not a holder. While the agent may receive payment of the amount mentioned in the cheque, yet he cannot be called the holder thereof because he has no right to sue on the instrument in his own name.
- (v) No, B is not a holder because he is in wrongful possession of the instrument.

Question 2

M drew a cheque amounting to ₹ 2 lakh payable to N and subsequently delivered to him. After receipt of cheque N indorsed the same to C but kept it in his safe locker. After sometime, N died, and P found the cheque in N's safe locker. Does this amount to Indorsement under the Negotiable Instruments Act, 1881?

Answer

No, P does not become the holder of the cheque as the negotiation was not completed by delivery of the cheque to him. (Section 48, the Negotiable Instruments Act, 1881)

Question 3

M owes money to N. Therefore, he makes a promissory note for the amount in favor of N, for safety of transmission he cuts the note in half and posts one half to N. He then changes his mind and calls upon N to return the half of the note which he had sent. N requires M to send the other half of the promissory note. Decide how rights of the parties are to be adjusted.

Answer

The question arising in this problem is whether the making of promissory note is complete when one half of the note was delivered to N. Under Section 46 of the N.I. Act, 1881, the making of a Promissory Note (P/N) is completed by delivery, actual or constructive. Delivery refers to the whole of the instrument and not merely a part of it. Delivery of half instrument cannot be treated as constructive delivery of the whole. So, the claim of N to have the other half of the P/N sent to him is not maintainable. M is justified in demanding the return of the first half sent by him. He can change his mind and refuse to send the other half of the P/N.

Question 4

State briefly the rules laid down under the Negotiable Instruments Act for determining the date of maturity of a bill of exchange. Ascertain the date of maturity of a bill payable hundred days after sight and which is presented for sight on 4th May, 2020.

Answer

Calculation of maturity of a bill of exchange: The maturity of a bill, not payable on demand, at sight, or on presentment, is at maturity on the third day after the day on which it is expressed to be payable (Section 22, of Negotiable Instruments Act, 1881). Three days are allowed as days of grace. No days of grace are allowed in the case of bill payable on demand, at sight, or presentment.

When a bill is made payable at stated number of months after date, the period stated terminates on the day of the month which corresponds with the day on which the instrument is dated. When it is made payable after a stated number of months after sight the period terminates on the day of the month which corresponds with the day on which it is presented for acceptance or sight or noted for non-acceptance or protested for non-acceptance. When it is payable a stated number of months after a certain event, the period terminates on the day of the month which corresponds with the day on which the event happens (Section 23).

When a bill is made payable a stated number of months after sight and has been accepted for honour, the period terminates with the day of the month which corresponds with the day on which it was so accepted.

If the month in which the period would terminate has no corresponding day, the period terminates on the last day of such month (Section 23).

In calculating the date a bill made payable a certain number of days after date or after sight or after a certain event is at maturity, the day of the date, or the day of

presentment for acceptance or sight or the day of protest for non-accordance, or the day on which the event happens shall be excluded (Section 24).

Three days of grace are allowed to these instruments after the day on which they are expressed to be payable (Section 22).

When the last day of grace falls on a day which is public holiday, the instrument is due and payable on the next preceding business day (Section 25).

Answer to Problem: In this case the day of presentment for sight is to be excluded i.e. 4th May, 2020. The period of 100 days ends on 12th August, 2020 (May 27 days + June 30 days + July 31 days + August 12 days). Three days of grace are to be added. It falls due on 15th August, 2020 which happens to be a public holiday. As such it will fall due on 14th August, 2020 i.e. the next preceding business day.

Question 5

Mr. V draws a cheque of ₹ 11,000 and gives to Mr. B by way of gift. State with reason whether -

- (1) *Mr. B is a holder in due course as per the Negotiable Instrument Act, 1881?*
- (2) *Mr. B is entitled to receive the amount of ₹ 11,000 from the bank?*

Answer

According to section 9 of the Negotiable Instrument Act, 1881, "Holder in due course" means-

- any person
- who for consideration
- becomes the possessor of a promissory note, bill of exchange or cheque (if payable to bearer), or the payee or indorsee 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.

In the instant case, Mr. V draws a cheque of ₹ 11,000 and gives to Mr. B by way of gift.

- (i) Mr. B is holder but not a holder in due course since he did not get the cheque for value and consideration.
- (ii) Mr. B's title is good and bonafide. As a holder he is entitled to receive ₹ 11,000 from the bank on whom the cheque is drawn.

Question 6

Bholenath drew a cheque in favour of Surendar. After having issued the cheque; Bholenath requested Surendar not to present the cheque for payment and gave a stop payment request to the bank in respect of the cheque issued to Surendar. Decide, under the provisions of the Negotiable Instruments Act, 1881 whether the said acts of Bholenath constitute an offence?

Answer

As per the facts stated in the question, Bholenath (drawer) after having issued the cheque, informs Surendar (drawee) not to present the cheque for payment and as well gave a stop payment request to the bank in respect of the cheque issued to Surendar.

Section 138 of the Negotiable Instruments Act, 1881, is a penal provision in the sense that once a cheque is drawn on an account maintained by the drawer with his banker for payment of any amount of money to another person out of that account for the discharge in whole or in part of any debt or liability, is informed by the bank unpaid either because of insufficiency of funds to honour the cheques or the amount exceeding the arrangement made with the bank, such a person shall be deemed to have committed an offence.

Once a cheque is issued by the drawer, a presumption under Section 139 of the Negotiable Instruments Act, 1881 follows and merely because the drawer issues a notice thereafter to the drawee or to the bank for stoppage of payment, it will not preclude an action under Section 138.

Also, Section 140 of the Negotiable Instruments Act, 1881, specifies absolute liability of the drawer of the cheque for commission of an offence under the section 138 of the Act. Section 140 states that it shall not be a defence in a prosecution for 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.

Accordingly, the act of Bholenath, i.e., his request of stop payment constitutes an offence under the provisions of the Negotiable Instruments Act, 1881.

Question 7

Mr. Muralidharan drew a cheque payable to Mr. Vyas or order. Mr. Vyas lost the cheque and was not aware of the loss of the cheque. The person who found the cheque forged the signature of Mr. Vyas and indorsed it to Mr. Parshwanath as the consideration for goods bought by him from Mr. Parshwanath. Mr. Parshwanath encashed the cheque, on the very same day from the drawee bank. Mr. Vyas intimated

the drawee bank about the theft of the cheque after three days. Examine the liability of the drawee bank.

Answer

Cheque payable to order [Section 85 of the Negotiable Instruments Act, 1881]

- (1) Where a cheque payable to order purports to be indorsed by or on behalf of the payee, the drawee is discharged by payment in due course.
- (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 indorsement whether in full or in blank appearing thereon, and notwithstanding that any such indorsement purports to restrict or exclude further negotiation.

As per the given facts, cheque is drawn payable to "Mr. Vyas or order". It was lost and Mr. Vyas was not aware of the same. The person found the cheque and forged and indorsed it to Mr. Parshwanath, who encashed the cheque from the drawee bank. After few days, Mr. Vyas intimated about the theft of the cheque, to the drawee bank, by which time, the drawee bank had already made the payment.

According to above stated section 85, the drawee banker is discharged when it has made a payment against the cheque payable to order when it is purported to be indorsed by or on behalf of the payee. Even though the signature of Mr. Vyas is forged, the banker is protected and is discharged. The true owner, Mr. Vyas, cannot recover the money from the drawee bank in this situation.

Question 8

What are the circumstances under which a bill of exchange can be dishonored by non-acceptance? Also, explain the consequences if a cheque gets dishonored for insufficiency of funds in the account.

Answer

As per section 91 of the Negotiable Instruments Act, 1881, a bill may be dishonoured either by non-acceptance or by non-payment.

Dishonour by non-acceptance may take place in any one of the following circumstances:

- (a) When a bill is duly presented for acceptance, and the drawee, or one of several drawees not being partners, refuse acceptance within forty eight hours from the time of presentment, the bill is dishonoured. In other words, when the drawee makes default in acceptance upon being duly required to accept the bill.

- (b) where presentment is excused and the bill is not accepted.
- (c) Where the drawee is incompetent to contract, the bill may be treated as dishonoured.
- (d) Where the drawee is a fictitious person.
- (e) Where the drawee could not be found even after reasonable search
- (f) When a drawee gives a qualified acceptance, the holder may treat the instrument dishonoured.

Dishonour of Cheque for insufficiency, etc. of funds in the account: As per section 138 of the Negotiable Instruments Act, 1881, where any cheque drawn by a person on an account maintained by him with a banker for payment is dishonoured due to insufficiency of funds, he 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.

Question 9

Rama executes a promissory note in the following form, 'I promise to pay a sum of ₹10,000 after three months'. Decide whether the promissory note is a valid promissory note.

Answer

The promissory note is an unconditional promise in writing. In the above question the amount is certain but the date and name of payee is missing, thus making it a bearer instrument. As per Reserve Bank of India Act, 1934, a promissory note cannot be made payable to bearer - whether on demand or after certain days. Hence, the instrument is illegal as per Reserve Bank of India Act, 1934 and cannot be legally enforced.