Module 3

The Negotiable Instruments Act 1881

- In India law relating to negotiable instruments is contained in negotiable instruments Act 1881.
- "A negotiable instrument means a promissory note, bill of exchange or cheque payable either to order or to bearer".

Features of Negotiable Instruments

1. Negotiability- it means transferability. It can be transferred without any formality.
2. Property- The possessor of negotiable instrument is presumed to be the owner of the property contained therein.
3. Equivalent to cash- Even though is a document it is as good as cash.
4. Recovery- The transferee of the negotiable instrument can sue in his own name, in case of dishonor for the recovery of the amount without giving notice to the debtor.
5. Contract- A negotiable instrument is a contract to pay money.
6. Prompt payment-A negotiable instrument enables the holder of the instrument to expect prompt payment.
7. A negotiable instrument can be transferred any number of times till it is at maturity and the holder of the instrument need not give any notice of transfer to the debtor

Important concept and explanations under the Negotiable Instruments Act

The Paying Banker

The bank on which a cheque is drawn (the bank whose name is printed on the cheque) and which pays the amount for which the cheque is written and deducts that sum from the customer's account.

A Banker who holds the account of the drawer of the cheque and is obliged to make payment, if the funds of the customer are sufficient to cover the amount of he cheque drawn or if overdrawing facility is given to the customer**.**

Protection Available to PayingBanker

- Banker's Protection Negotiable Instruments Act 1881
- Certain Sections of the Act

Cheque

- A cheque is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand. That is the drawer directs the bank to pay a certain sum to payee on his demand.

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

<u>Definition</u>

"A bill of exchange drawn upon a specified banker and payable on demand"

<u>Rules</u>

1. All Cheques are bill of exchange but all bill of exchanges are not Cheques.
2. Usually banks provide their customers with printed cheque forms which are filled up and signed by the drawer.
3. The signatures must tally with specimen signature of the drawer kept in the bank.
4. A cheque must be dated.
5. A cheque becomes due for payment on the date specified in it.
6. A cheque drawn on a future date is valid but it is payable on and after the date specified. Such Cheques are called postdated Cheques.

Essentials of a Cheque

1. It must be unconditional order
2. It must be in writing
3. It must be drawn on a specified banker
4. it must be signed by the drawer
5. The order must be for the payment of a certain sum of money only
6. Drawer, drawee and payee must be certain
7. The payee must be certain
8. The amount must be payable on demand

Dishonor of Cheques

- A negotiable instrument may be dishonored by non-payment or non-acceptance.
- A cheque and promissory note may be dishonored by non-payment and

- a bill of exchange may be dishonored either by;
    1. Non acceptance or by
    2. Nonpayment.

1. Dishonor by Non Acceptance

A bill of exchange is said to be dishonored by any one of the following **reasons;**

a) If the drawee does not accept the bill within 48 hrs from the time of presentment

b) If there are several drawees and all of them do not accept

c) When the presentment of acceptance is excused, and the bill is not accepted. (Say some excuse for acceptance)

d) When drawee become insolvent or died

e) When the drawee gives a limited acceptance

f) When the drawee is incompetent to contract

g) When the drawee is a fictitious person

2. Dishonour by Non-Payment

A promissory note, bill of exchange, or cheque is said to be dishonoured by nonpayment if the maker fails to make payment on the date of maturity.

A cheque is dishonored by non payment as soon as a banker refuses to pay.

Notice of dishonour

- When a negotiable instrument is dishonoured the holder must give notice of dishonour to all the prior parties

<u>Notice by whom?</u>

1. Notice by holder or any other a party
2. Chain method of notice of dishonour
3. Notice by principal or agent

<u>Form of Notice</u>

1. It may be oral or written
2. Clearly indicate the reason for dishonour
3. It must be given within in a reasonable time

Circumstances when a banker is bound to dishonour of a cheque

1. When the customer countermands payment

2. Garnishee order (issued by high court)
3. Death, Insolvency or insanity of the customer
4. Notice of assignment (letter to transfer)
5. Defective title of the party
6. Loss of cheque
7. Postdated or stale cheque
8. When the cheque is irregular (may change cheque book, any information missing)
9. Closing of account
10. On transfer of accounts
11. When a cheque is Mutilated (Torn)
12. When there is material alteration
13. When the amount in words and figures differs
14. If the cheque is undated
15. he cheque is not presented in banking hours

Negotiation

It is the transfer of an instrument from one person to another in such a manner so as to convey the title and constitute the transferee the holder thereof. It may be;

<u>a. Negotiable by mere delivery</u>

Payable even to agent to keep it for payee

b. <u>Negotiable by endorsement and delivery</u>

Unless the holder signs his endorsement on the instrument, the transferee does not become a holder.

Endorsement

The literal meaning of the word endorsement is writing on the back of an instrument. Under the NI Act, it means, writing of the name of the endorsee on the back of the instrument by the endorser under his signature with the object of transferring the rights therein.

If an instrument is fully covered with endorsements and no space is left, further endorsement can be made on a slip of paper (called **alonge**) annexed thereto

<u>Kind of Endorsement</u>

1. Blank or general endorsement

Just put the signature 0of endorser without mention the name of endorsee

Eg: sd/-

D.Mohan

2. Special or full endorsement

Including the name of endorsee

Eg:

Pay to Ghosh or order sd/-

D.Mohan

3. Restrictive endorsement

An endorsement, when it prohibits or restricts the further negotiation of the instrument.

Eg: pay to Ghosh only sd/-

D.Mohan

4. Conditional or Qualified

An endorsement is conditional or qualified if it limits or negates the liability of the endorser

Eg: pay to ghosh on Signing a receipt Sd/-

D.mohan

5. Partial endorsement

When an endorser endorses only a part of the amount mentioned in the instrument. it is irregular

The collecting Banker

A Collecting Banker is one who undertakes to collect various types of instruments representing money in favour of his customer or his own behalf from the drawers of these instruments; some are negotiable instruments as provided for in the negotiable instruments Act. 1881 and some are quasi negotiable instruments.

Duties & Responsibilities of Collecting Bankers:

Acting as agent: While collecting an instrument, whether for credit to customer's account or for himself, the Bankers works as agent of his customer. As an agent he has generally to take such steps & precautions to protect the interest or his customer as a man of ordinary prudence would take to safe-guard his own interest.

Scrutinizing the instruments: Name of the holder, Branch name, date, amount in world and figure, any cutting without signature, material alteration of any to be checked carefully.

Checking the endorsement: Bankers has to check the instrument whether it has been endorsed properly.

Presenting the instrument in due time: It is the responsibility of the collecting bank to present the instrument in due time to the paying bank.

Collecting the proceeds in the payee's account: It is the duty of collecting banks to collect and credit the proceed of the instruments to the proper/correct account.

Notice of dishonor and returning the instruments: If any instrument is dishonored by the paying bank it should be informed to the customer on the business day following the receipt of the unpaid instruments.

Collecting Banker's Protection:

Under section 131 of negotiable instrument Act the collecting banker is not liable to the true owner of a cheque or a banker's draft if his title to the instrument proves defective provided the cheque or draft was one crossed generally or specially to himself and collected for a customer is good faith and without negligence.

The above statutory protection is available to the collecting banker only if he fulfills the following conditions:

- The cheque he collected is a crossed cheque.
- He collected such crossed cheque only for his customer as an agent & not as a holder for value.
- He collected such crossed cheque in good faith and without negligence.

Negligence

There are a variety of ways in which a bank can be considered to be negligent in undertaking its duties towards its customers, many of which are noted in the discussion above by implication. In broad terms, for the customer to raise the issue, it will be necessary to challenge the efficiency of the security mechanisms put in place by the bank or offer a credible alternative explanation for what happened.

Bill of exchange

A bill of exchange is an instrument in writing containing the 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".

<u>Three parties:</u>

- The maker of bill of exchange is called the drawer.
- The person who is directed to pay is called the drawee.
- The person who will receive the money is called the payee

Specimen of bill of exchange

- Rs 5000 Place.

Date.

On demand pay to Rajesh or order, the sum of Rs 5000/- (Rupees Five thousand only) for value received.

To Ajith Sd- Stamp

(Address) Babu

- Here Babu is the drawer
- Ajith is the drawee (Acceptor)
- Rajesh is the payee

Essentials of bill of exchange

- The instrument must be in writing.
- The instrument must contain an order to pay.
- There must be three parties.
- The instrument must be signed by the drawer.
- The amount of money to be paid must be certain.
- The payee must be certain.
- It must comply with the formalities as regards date, stamp etc.

Promissory note

"A promissory note is an instrument in writing 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".

<u>Two parties</u>:

- The person who makes the promissory note and promises to pay is called the maker.
- The person to whom the payment is to be made is called the payee.
- Eg I promise to pay A or order Rs 500.

Essentials of a promissory note

1. Pro notes must be in writing
2. A Promise to pay must be express.
3. Definite and unconditional
4. To be signed by the maker
5. Certainty in the case of parties.
6. Certainty in the case of sum of money
7. Promise to pay money only
8. Formalities are not essential. Formalities like time, place registration Number etc is not required. But it must be stamped as per stamp act.
9. It may be payable on demand or after a definite period of time - Where there is no time is mentioned the note is payable on demand.

Discharge of negotiable instruments

- An instrument is said to be discharged when all rights of action under it are completely extinguished and when it ceases to be negotiable.
- This would happen when the party who is ultimately liable on the instrument is discharged from liability.
- In such a case even in holder in due course does not acquire any right under the instrument

Modes of Discharge

1. by payment.

2. By Debtor as a holder

2. By express waiver- holder gives up his right.

3. By cancellation-holder may cancel the instrument.

4. by material alteration or lapse of time.

Discharge of a party or parties

1. By payment
2. By cancellation
3. By release (let loose)
4. By allowing drawee more than 48 hours

5. By delay in presentment of cheque
6. Cheque payable to order (fraudlent payee)
7. By operation of law
8. By material alteration
9. By taking limited acceptance
10. By not giving notice of dishonour

Hundis

A **hundi** is a financial instrument that developed in Medieval India for use in trade and credit transactions. **Hundis** are used as a form of remittance instrument to transfer money from place to place, as a form of credit instrument or IOU to borrow money and as a bill of exchange in trade transactions.

Types of Hundis

- **Sahyog Hundi**: This is drawn by one merchant on another, asking the latter to pay the amount to a third merchant. In this case the merchant on whom the hundi is drawn is of some 'credit worthiness' in the market and is known in the bazaar. A sahyog hundi passes from one hand to another till it reaches the final recipient, who, after reasonable enquiries, presents it to the drawee for acceptance of the payment. Sahyog means co-operation in Hindi and Gujrati, the predominant languages of traders. The hundi is so named because it required the co-operation of multiple parties to ensure that the hundi has an acceptable risk and fairly good likelihood of being paid, in the absence of a formalized credit monitoring and reporting framework.
- **Darshani Hundi**: This is a hundi payable on sight. It must be presented for payment within a reasonable time after its receipt by the holder. Thus, it is similar to a demand bill.
- **Muddati Hundi**: A muddati or miadi hundi is payable after a specified period of time. This is similar to a time bill.