**Legal Aspect of Business**

**Unit-2 (I)**

**The Negotiable Instruments Act 1881**

# Introduction

For commercial transaction, it is always not possible for a business man to carry huge amount of cash. Businessman, therefore adopt a new method of exchanging documents- Bills of Exchange, Cheques etc, in place of money. These documents which are used as a substitution for money are known as negotiable instrument. The Law relating to negotiable instrument is contained in the **Negotiable Instrument Act, 1881.**

# The word negotiable means „transferable by delivery‟ & Instrument means any written document by which a right is creates in favor of some person

Thus, the term ―**negotiable instrument**‖ literally means ‗a written document which creates a right in favor of somebody and is freely transferable by delivery.‘

A negotiable instrument is a piece of paper which entitles a person to a certain sum of money and which is transferable from one to another person by a delivery or by endorsement and delivery.

A **negotiable instrument** is a document guaranteeing the payment of a specific amount of money, either on demand, or at a set time, with the payer named on the document

The term Negotiable instrument literally means ‗a written document transferable by delivery ‘. According to this Act ―A negotiable instrument means a Promissory Note, Bill of exchange or Cheque payable either to order or to bearer ―.

# Negotiable Instruments can be of two kinds:-

1. **Negotiable by Statute:** The Act mentions only three kinds of instruments by Law, i.e. Promissory Note, Bill of Exchange and Cheque.
2. **Negotiable by Custom or Usage:** Other than above three, all other custom and usage based locally negotiable instruments belong to this type. Ex:- Hundis, Bankers Draft , Treasury Bill..Etc

# Characteristics of Negotiable Instruments

* A negotiable instrument must be in writing
* A negotiable instrument must be signed by its maker
* A negotiable instrument must contain an unconditional promise or order to pay some money
* A negotiable instrument must contain a certain amount of money only
* A negotiable instrument must be freely transferable from one person to another
* On the transfer of a negotiable instrument from one person to another, the transferee who receives it in a good faith and for value has the right to recover the amount mentioned in the negotiable instrument in his own name. Such person is known as holder in due course. His rights are not affected by any defect in the title of the transferee or any prior party.

**Presumptions**- Section 118 and 119 lay down the following presumptions:

1. **Consideration**: It shall be presumed that every negotiable instrument was made drawn, accepted or endorsed for consideration. It is presumed that, consideration is present in every negotiable instrument until the contrary is presumed. The presumption of consideration, however may be rebutted by proof that the instrument had been obtained from, its lawful owner by means of fraud or undue influence.
2. **Date**: Where a negotiable instrument is dated, the presumption is that it has been made or drawn on such date, unless the contrary is proved.
3. **Time of acceptance**: Unless the contrary is proved, every accepted bill of exchange is presumed to have been accepted within a reasonable time after its issue and before its maturity. This presumption only applies when the acceptance is not dated; if the acceptance bears a date, it will prima facie be taken as evidence of the date on which it was made.
4. **Time of transfer**: Unless the contrary is presumed it shall be presumed that every transfer of a negotiable instrument was made before its maturity.
5. **Order of endorsement**: Until the contrary is proved it shall be presumed that the endorsements appearing upon a negotiable instrument were made in the order in which they appear thereon.
6. **Stamp**: Unless the contrary is proved, it shall be presumed that a lost promissory note, bill of exchange or cheque was duly stamped.

1. **Holder in due course**: Until the contrary is proved, it shall be presumed that the holder of a negotiable instrument is the holder in due course. Every holder of a negotiable instrument is presumed to have paid consideration for it and to have taken it in good faith. But if the instrument was obtained from its lawful owner by means of an offence or fraud, the holder has to prove that he is a holder in due course.
2. **Proof of protest**: Section 119 lays down that in a suit upon an instrument which has been dishonoured, the court shall on proof of the protest, presume the fact of dishonour, unless and until such fact is disproved.

# Essential Elements of negotiable instruments

* It must be in writing
* Promise to pay
* Unconditional
* Money only and a certain sum of money
* Certainties of parties
* Signed by the maker

# Types of Negotiable Instruments

* **Negotiable Instruments recognized by status:** e.g. Bills of exchange, cheque and promissory notes.

# Negotiable instruments recognized by usage or customs of trade:

e.g. Bank notes, exchequer bills, share warrants, bearer debentures, dividend warrants, share certificate

# CLASSIFICATION OF NEGOTIABLE INSTRUMENT

* Inland instruments
* Foreign instruments
* Bearer instruments
* Order instruments
* Instrument payable on demand
* Time instrument

1. ***Bearer and Order instruments:*** An instrument may be made payable: (1) to bearer; (2) to a specified person or to his order.(Section 13)

**An instrument is payable to bearer** which is expressed to be so payable on which is expressed ‗thus ―Pay to R or bearer‖‘. It is also payable to bearer when ***a instrument which is originally payable in order but on which*** the only or the last endorsement, is an endorsement in blank.

(ii)**An instrument is payable to order**, (1) when it is payable to the order of a specified person or (2) when it is payable to a specified person or his order or,

(3) when it is payable to a specified person without the addition of the words

―or his order‖ and does not contain words prohibiting transfer or indicating an intention that it should not be transferable. When an instrument, either originally or by endorsement, is made payable to the order of a specified person and not to him or his order, it is payable to him or his order, at his option.(Section 13).

When an instrument is not payable to bearer, the payee must be indicated with reasonable certainty.

***Reserve Bank of India Act. Thus, a bill if payable on demand should be an order one and not bearer.]***

1. ***Inland 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.

***Examples:*** (i)A promissory note made in Chennai and payable in Delhi.

A bill drawn in Pune on a person resident in Jaipur (although it is stated to be payable in London)

Any such instrument, not so drawn, made or payable shall be deemed to be a foreign instrument.

*Examples :*(i) A promissory note made in India but made payable in England .

(ii) A bill drawn in England and payable in Paris although it may have been endorsed in India.

# Thus, the foreign bills are:

1. bills drawn outside India and made payable in or drawn upon any person resident in any country outside India;
2. bills drawn outside India and made payable in India, or drawn upon any person resident in India;
3. bills drawn in India made payable outside India or drawn upon any resident outside India, but not made payable in India.
4. ***Ambiguous and inchoate bills:*** According to section 17, an ambiguous bill means an instrument which can be construed either as a promissory note or as

bill of exchange ( *e.g.,* a bill drawn by a person on himself in favour of a third person or where the drawee is a fictitious person), ***at the selection of the holder and the instrument shall be thenceforward be treated accordingly.*** The law on the point is that the holder of such a bill is at liberty

to treat the instrument as bill or a promissory note. The nature of the instrument will be as determined by the holder.

In the following cases *an instrument may be treated as an ambiguous instrument*, where the holder may treat the instrument either as a bill of exchange or as a promissory note:

1. Where the drawer and the drawee of a bill are the same person
2. Where the drawee of a bill is a fictitious person.
3. Where the drawee of a bill is a person not having capacity to contract.

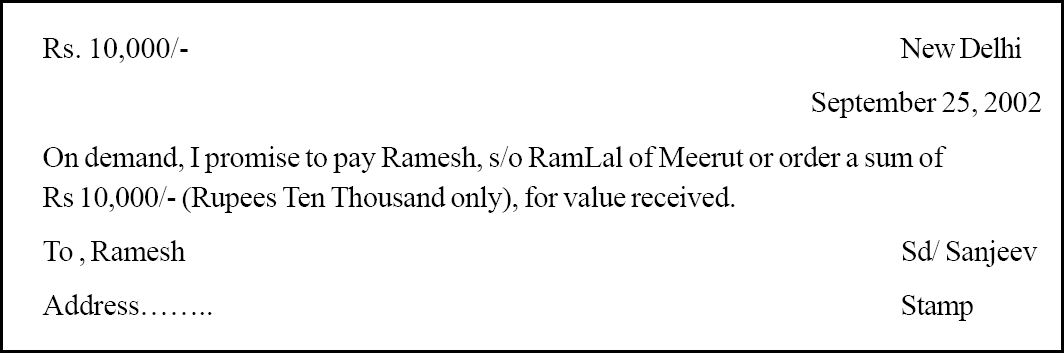
## Where an instrument is made in terms or in form so ambiguous that it is doubtful whether it is a bill of exchange or a promissory note.

# Key points

* + A bearer instrument is one which is expressed to be payable to its bearer or which has last endorsement 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

# PROMISSORY NOTE

**Definition:** According to Section 4, ―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.‖



# Parties to Promissory note

* + - The maker
    - The payee
    - The holder
    - The endorser
    - The endorsee

# There are primarily two parties involved in a promissory note. They are:

* **The Maker or Drawer:** The person who makes the note and promises to pay the amount stated therein. In the above specimen, Sanjeev is the maker or drawer.
* **The Payee –** the person to whom the amount is payable. In the above specimen it is Ramesh. In course of transfer of a promissory note by payee and others, the parties involved may be –

1. **The Endorser –** the person who endorses the note in favour of another person. In the above specimen if Ramesh endorses it in favour of Ranjan and Ranjan also endorses it in favour of Puneet, then Ramesh and Ranjan both are endorsers.
2. **The Endorsee –** the person in whose favour the note is negotiated by endorsement. In the above, it is Ranjan and then Puneet.

# Essentials of Promissory Note

1. **It must be in writing:** A promissory note has to be in writing. An oral promise to pay does not become a promissory note. The writing may be on any paper or book

# Both the above instruments are valid promissory notes.

1. **It must contain a promise or undertaking to pay:**

There must be a promise or an undertaking to pay. The undertaking to pay may be gathered either from express words or by necessary implication. A mere acknowledgement of indebtedness is not a promissory note, although it is valid as an agreement and may be sued upon as such

# Illustrations: A signs the instruments in the following terms:

―Mr. B I owe you Rs. 1,000‖

―I am liable to pay to B Rs. 500‖

The above instruments are not promissory notes as there is no undertaking or promise to pay. There is only an acknowledgement of indebtedness.

Where A signs the instrument in the following terms:

―I acknowledge myself to be indebted to B in Rs. 1, 000, to be paid on demand, for value received,‖ there is a valid promissory note

# The promise to pay must be unconditional:

* A promissory note must contain an unconditional promise to pay
* The promise to pay must not depend upon the happening of some uncertain event, i.e., a contingency or the fulfillment of a condition
* **Illustrations**: A signs the instruments in the following terms:
* ―I promise to pay B Rs. 500 seven days after my marriage with C‖
* ―I promise to pay B Rs. 500 as soon as I can‖
* The above instruments are not valid promissory notes as the payment is made depending upon the happening of an uncertain event which may never happen and as a result the sum may never become payable

# It must be signed by the maker:

* It is imperative that the promissory note should be duly authenticated by the ‗signature‘ of the maker
* ‗Signature‘ means the writing or otherwise affixing a person‘s name or a mark to represent his name, by himself or by his authority with the intention of authenticating a document

# The maker must be a certain person:

* The instrument must itself indicate with certainty who is the person or are the persons engaging himself or themselves to pay
* Alternative promisors are not permitted in law because of the general rule that

―where liability lies no ambiguity must lie‖

# The payee must be certain:

Like the maker the payee of a pro-note must also be certain on the face of the instrument. A note in favour of fictitious person is illegal and void. A pronote made payable to the maker himself is a nullity, the reason being the same person is both the promisor and the promisee

# The sum payable must be certain:

For a valid pronote it is also essential that the sum of money promised to be payable must be certain and definite

The amount payable must not be capable of contingent additions or subtractions

**Illustrations**: A signs the instruments in the following terms:

―I promise to pay B Rs. 500 and all other sums which shall be due to him‖

―I promise to pay B Rs. 500, first deducting there out any money which he may owe me‖

The above instruments are invalid as promissory notes because the exact amount to be paid by A is not certain

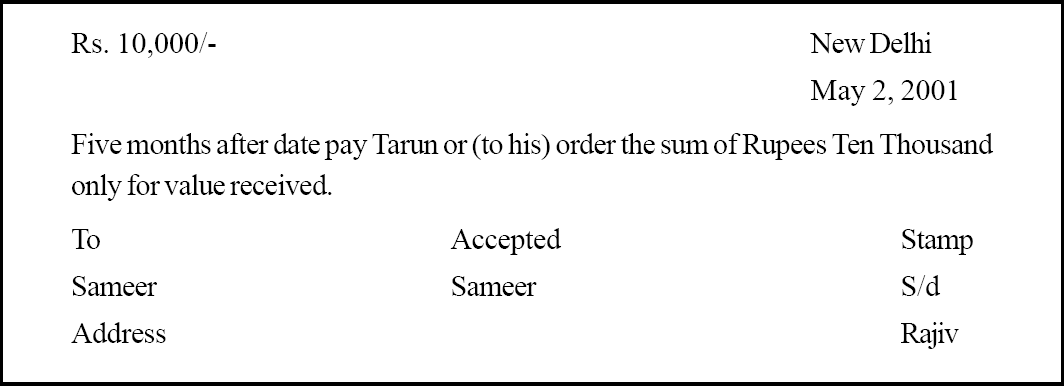
# The amount payable must be in legal tender money of India:

* A document containing a promise to pay a certain amount of foreign money or to deliver a certain quantity of goods is not a pronote

# BILL OF EXCHANGE

# Section 5 of the Negotiable Instruments Act defines a Bill of Exchange as follows:

* ―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.‖
* Mr. X purchases goods from Mr. Y for Rs. 1000/- Mr. Y buys goods from Mr. S for Rs. 1000/-Then Mr. Y may order Mr. X to pay Rs. 1000/- Mr. S which will be nothing but a bill of exchange.



# There are three parties involved in a bill of exchange

1. The Drawer – The person who makes the order for making payment. In the above specimen, Rajiv is the drawer.
2. The Drawee – The person to whom the order to pay is made. He is generally a debtor of the drawer. It is Sameer in this case.
3. The Payee – The person to whom the payment is to be made. In this case it is Tarun.

# Essentials of bills of exchange

* It must be in writing
* It must contain an order to pay. A mere request to pay on account, will not amount to an order
* The order to pay must be unconditional
* It must be signed by the drawer
* The drawer, drawee and payee must be certain. A bill cannot be drawn on two or more drawees but may be made payable in the alternative to one of two or more payees
* The sum payable must be certain
* The bill must contain an order to pay money only
* It must comply with the formalities as regards date, consideration, stamps, etc

# Distinction between “Bill of Exchange” and Promissory Note

1. **Number of parties:** In a promissory note there are only two parties – the maker (debtor) and the payee (creditor). In a bill of exchange, there are three parties; drawer, drawee and payee; although any two out of the three may be filled by one and the same person,
2. **Payment to the maker:** A promissory note cannot be made payable the maker himself, while in a bill of exchange to the drawer and payee or drawee and payee may be same person.
3. **Unconditional promise:** A promissory note contains an unconditional promise by the maker to pay to the payee or his order, whereas in a bill of exchange, there is an unconditional order to the drawee to pay according to the direction of the drawer.
4. **Prior acceptance:** A note is presented for payment without any prior acceptance by the maker. A bill of exchange is payable after sight must be accepted by the drawee or someone else on his behalf, before it can be presented for payment.
5. **Primary or absolute liability:** The liability of the maker of a promissory note is primary and absolute, but the liability of the drawer of a bill of exchange is secondary and conditional.
6. **Relation:** The maker of the promissory note stands in immediate relation with the payee, while the maker or drawer of an accepted bill stands in immediate relations with the acceptor and not the payee.
7. **Protest for dishonour:** Foreign bill of exchange must be protested for dishonour when such protest is required to be made by the law of the country where they are drawn, but no such protest is needed in the case of a promissory note.
8. **Notice of dishonour:** When a bill is dishonoured, due notice of dishonour is to be given by the holder to the drawer and the intermediate indorsers, but no such notice need be given in the case of a note.

**Classification of Bills:**Bills can be classified as:

(1) Inland and foreign bills.(2) Time and demand bills.(3) Trade and accommodation bills.

# Inland and Foreign Bills

**Inland bill:** A bill is, named as an inland bill if:

1. it is drawn in India on a person residing in India, whether payable in or outside India, or
2. it is drawn in India on a person residing outside India but payable in India.

# The following are the Inland bills

1. A bill is drawn by a merchant in Delhi on a merchant in Madras. It is payable in Bombay. The bill is an inland bill.
2. A bill is drawn by a Delhi merchant on a person in London, but is made payable in India. This is an inland bill.
3. A bill is drawn by a merchant in Delhi on a merchant in Madras. It is accepted for payment in Japan. The bill is an inland bill.

**Foreign Bill:** A bill which is not an inland bill is a foreign bill. The following are the foreign bills:

1. A bill had drawn outside India and made payable in India.
2. A bill drawn outside India on any person residing outside India.
3. A bill drawn in India on a person residing outside India and made payable outside India.
4. A bill drawn outside India on a person residing in India.
5. A bill drawn outside India and made payable outside India.

**Bills in sets (Secs. 132 and 133):** The foreign bills are generally drawn in sets of three, and each sets is termed as a ‗via‘. As soon as anyone of the set is paid, the others become inoperative. These bills are drawn in different parts. They are drawn in order to avoid their loss or miscarriage during transit. Each part is dispatched separately. To avoid delay, all the parts are sent on the same day; by different mode of conveyance.

# Time and Demand Bill

**Time bill:** A bill payable after a fixed time is termed as a time bill. In other words, bill payable ―after date‖ is a time bill.

**Demand bill:** A bill payable at sight or on demand is termed as a demand bill.

# Trade and Accommodation Bill

**Trade bill:** A bill drawn and accepted for a genuine trade transaction is termed as a ―trade bill‖.

**Accommodation bill:** A bill drawn and accepted not for a genuine trade transaction but only to provide financial help to some party is termed as an

―accommodation bill‖.

# CHEQUE

A cheque is the means by which a person who has fund in the hand of a bank withdraws the same or some part of it.

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.

# It has following similarities:

* + Both are the bills of exchange.
  + Both have three parties, the drawer, drawee and the payee.
  + The drawer and the payee may be one and the same person in both the instruments.
  + Both must written and signed
  + Both must contain an unconditional order to pay a certain sum of money.
  + Both may be endorsed.

# A cheque is a kind of bill of exchange but it has additional qualification namely-

1. It is always drawn on a specified banker and
2. it is always payable on demand without any days of grace.

# Types of Cheque

* Bearer Cheque
* Order Cheque
* Open Cheque
* Crossed Cheque
* Anti-Dated Cheque
* Post-Dated Cheque
* Stale Cheque
* Mutilated Cheque

# Bearer Cheque

* The words ―or bearer‖ printed on the cheque, & it is not cancelled, then the cheque is called a bearer cheque.
* A bearer cheque is made payable to the bearer i.e. it is payable to the person who presents it to the bank for encashment.
* *In simple words a cheque which is payable to any person who presents it for payment at the bank counter is called ‘Bearer cheque’*

# Order Cheque

* The word "or order" is written on the face of the cheque, the cheque is called an order cheque.
* Such a cheque is payable to the person specified therein as the payee, or to any one else to whom it is endorsed (transferred).

# Open Cheque

* When a cheque is not crossed, it is known as an ―Open Cheque‖ or an

―Uncrossed Cheque‖.

* These cheques may be cashed at any bank and the payment of these cheques can be obtained at the counter of the bank or transferred to the bank account of the bearer.
* An open cheque may be a bearer cheque or an order cheque.

# Crossed Cheque

* Crossed cheque means drawing two parallel lines on the left corner of the cheque with or without additional words like ―Account Payee Only‖ or ―Not Negotiable‖.
* A crossed cheque cannot be en-cashed at the cash counter of a bank but it can only be credited to the payee‘s account. This is a safer way of transferring money then an Uncrossed or open cheque.

# Anti-Dated Cheque

* Cheque in which the drawer mentions the date earlier than the date on which it is presented to the bank, it is called as ―anti-dated cheque‖.

# Post-Dated Cheque

* Cheque on which drawer mentions a date which is yet to come (future date) to the date on which it is presented, is called post-dated cheque.
* **For example-**If a cheque presented on 10th Jan 2012 bears a date of 25th Jan 2012, it is a post-dated cheque. The bank will make payment only on or after 25th Jan 2012.
* **Mutilated Cheque :**When a cheque is torn into two or more pieces and presented for payment, such a cheque is called a mutilated cheque. The bank will not make payment against such a cheque without getting confirmation of the drawer.

# Crossing of Cheque

* Crossing of a cheque means "Drawing Two Parallel Lines" across the face of the cheque. Thus, crossing is necessary in order to have safety.

# TYPES OF CROSSING :-

1. General Crossing
2. Special or Restrictive Crossing

# General Crossing

* There are two transverse parallel lines, marked across its face, or The cheque bears an abbreviation "& Co. "between the two parallel lines, or The cheque bears the words "Not Negotiable" between the two parallel lines, or The cheque bears the words "A/c. Payee" between the two parallel lines.

# Special or Restrictive Crossing

* Crossing is that the bank makes payment only to the banker whose name is written in the crossing. Specially crossed cheques are safer than generally crossed cheques.

# Material Alteration

* Any alteration made in the cheque is Material Alteration.
* These cheque are not honored by Banks, for making This as a valid cheque then the drawer has to sign at every correction made.

# Distinction Between Bills of Exchange and Cheque

* A bill of exchange is usually drawn on some person or firm, while a cheque is always drawn on a bank.
* It is essential that a bill of exchange must be accepted before its payment can be claimed A cheque does not require any such acceptance.
* A cheque can only be drawn payable on demand; a bill may be also drawn payable on demand, or on the expiry of a certain period after date or sight.
* A grace of three days is allowed in the case of time bills while no grace is given in the case of a cheque.
* The drawer of the bill is discharged from his liability, if it is not presented for payment, but the drawer of a cheque is discharged only if he suffers any damage by delay in presenting the cheque for payment.
* Notice of dishonour of a bill is necessary, but no such notice is necessary in the case of cheque.
* A cheque may be crossed, but not needed in the case of bill.
* A bill of exchange must be properly stamped, while a cheque does not require any stamp.
* A cheque drawn to bearer payable on demand shall be valid but a bill payable on demand can never be drawn to bearer.
* Unlike cheques, the payment of a bill cannot be countermanded by the drawer.

# ENDORSEMENT

The word ‗endorsement‘ in its literal sense means, writing on the back of an instrument. But under the Negotiable Instruments Act it means, the writing of one‘s name on the back of the instrument or any paper attached to it with the intention of transferring the rights therein. Thus, endorsement is signing a negotiable instrument for the purpose of negotiation. The person who effects an endorsement is called an ‗endorser‘, and the person to whom negotiable instrument is transferred by endorsement is called the ‗endorsee‘.

# Essentials of a valid endorsement

**The following are the essentials of a valid endorsement:**

1. It must be on the instrument. The endorsement may be on the back or face of the instrument and if no space is left on the instrument, it may be made on a separate paper attached to it called allonage. It should usually be in ink.
2. It must be made by the maker or holder of the instrument. A stranger cannot endorse it.
3. It must be signed by the endorser. Full name is not essential. Initials may suffice. Thumb-impression should be attested. Signature may be made on any part of the instrument. A rubber stamp is not accepted but the designation of the holder can be done by a rubber stamp.
4. It may be made either by the endorser merely signing his name on the instrument (it is a blank endorsement) or by any words showing an intention to endorse or transfer the instrument to a specified person (it is an endorsement in full). No specific form of words is prescribed for an endorsement. But intention to transfer must be present. When in a bill or note payable to order the endorsee‘s name is wrongly spelt, he should when he endorses it, sign the name as spelt in the instrument and write the correct spelling within brackets after his endorsement.
5. It must be completed by delivery of the instrument. The delivery must be made by the endorser himself or by somebody on his behalf with the intention of passing property therein. Thus, where a person endorses an instrument to another and keeps it in his papers where it is found after his death and then delivered to the endorsee, the latter gets no right on the instrument.
6. It must be an endorsement of the entire bill. A partial endorsement i.e. which purports to transfer to endorse a part only of the amount payable does not operate as a valid endorsement.
7. If delivery is conditional, endorsement is not complete until the condition is fulfilled.

# Who may endorse?

The payee of an instrument is the rightful person to make the first endorsement. Thereafter the instrument may be endorsed by any person who

has become the holder of the instrument. The maker or the drawer cannot endorse the instrument but if any of them has become the holderthereof he may endorse the instrument. (Sec. 51).The maker or drawer cannot endorse or negotiate an instrument unless he is in lawful possession of instrument or is the holder there of.

A payee or indorsee cannot endorse or negotiate unless he is the holder

# Negotiation

* + **Section 14 which defines negotiations runs as follows: Negotiation - When a promissory note, bill of exchange or cheque is transferred to any person, so as to constitute that person the holder thereof, the instrument is said to be negotiated.**
* The transfer of an instrument by one party to another so as to constitute the transferee a holder is called Negotiation.
* Negotiation means as the process by which a third party is constituted the holder of the instrument so as to entitle him to the possession of the same and to receive the amount due thereon in his own name.
* One of the essentials features of a negotiable instrument is its transferability. A negotiable instrument may be transferred from one person to another in either of the followings way-

1-By negotiation 2-By assignment

# NEGOTIATION, NEGOTIABILITY, ASSIGNABILITY

**Negotiation:** According to section 14, 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. A negotiable instrument may be transferred in either of the two ways, viz., (1) by negotiation under the Negotiable Instruments Act,1881 (Sections 14, 46, 47, 48); and (2) by assignment of the instrument under the Transfer of Property Act,1882 (Chapter VII, Section 130). Transfer by negotiation, however, is the only mode of transfer recognised by the Act.

Under the Act, negotiable instruments may be negotiated either by delivery when these are payable to bearer or by endorsement and delivery when these are payable to order. **Some important points with respect to negotiation are:**

1. **Importance of delivery (Section 46):** Delivery is an incident of the utmost importance in the case of an instrument. It is essential to the issue of an ‗instrument‘; for ―issue‖ means the delivery of the instrument, complete in form, to a person who takes it as a holder. It is equally essential to the negotiation of an instrument, for a bearer instrument, must be transferred by delivery and in the case of any other instrument, endorsement is incomplete without delivery. In fact, a negotiable instrument is nothing but a contract which is incomplete and revocable until the delivery of the instrument is made. For *instance,* in the case of a promissory note so long as the note, remains with the maker, the payee cannot claim payment; it is the delivery of the note to the payee that entitles him to claim payment; Section 46 of the Act provides as follows:

―The making, acceptance or endorsement of promissory note, bill of exchange or cheque is completed by delivery, actual or constructive‖.

1. ***How to deliver*:** 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 authorised by him in this behalf. Thus a promissory note must be handed over to the payee by the maker himself or by someone authorised by the maker. Similarly, a bill of exchange must be delivered to the transferee by the maker, acceptor or endorser, as a case may be.
2. ***Conditional and unconditional delivery*:** An instrument may be delivered conditionally or only for a special purpose, and not for the purpose of transferring absolutely the property in the instrument. A bill delivered conditionally is called an ‗escrow‘. Although a conditional delivery is valid, the condition attaches exclusively to the delivery and not to the making or drawing of an instrument. A bill must be drawn and a note made unconditionally. When an instrument is delivered conditional or for special purpose, the property in the instrument does not pass on to the transferee until the condition is fulfilled and the transferee holds such instrument in law as trustee or agent of the transferor.
3. ***Negotiation by delivery (Section 47)*:** An instrument payable to bearer is negotiable by delivery thereof. But when such instrument is delivered on condition that it is not to take effect except in certain event, it is not negotiable (except in the hands of a holder for value without notice of the condition) unless such event happens.

The distinction between ‗delivery‘ and ‗negotiation‘ should be noticed. An instrument is said to be negotiated, when it is transferred from one person to another in such a manner as to constitute the transferee the holder thereof.

1. ***Negotiation by endorsement*:** In order to negotiate, that is to transfer title to an instrument payable to order, it is at first to be endorsed and then delivered by the holder.

The endorsement consists of the signature of the holder made on the back of the negotiable instrument with the object of transferring the instrument. If there is no space on the instrument, the endorsement may be made on a slip of paper attached to it. This attachment is known as ―Allonge‖ and it then becomes part of the bill.

## Types of Endorsements

**1) Endorsement in Blank**: No endorsee is specified in an endorsement in blank, it contains only the bare signature of the endorser. A bill so endorsed becomes payable to bearer.

# 2) Endorsement in full – (Section 16)

* ―I hereby assign this draft, and all benefit of the money secured thereby to J, and order maker of the note to pay him the amount thereof an all interest in respect thereof.‖ This was held to be not an agreement requiring and stamp but an ordinary endorsement of the note though in a very elaborate form.

# Restrictive Endorsement: Illustrations

B signs the following endorsements on different negotiable instruments payable to bearer:

1. ―Pay the contents to C only‖
2. ―Pay C for my use.‖
3. I ―pay C or order for the account of B‖
4. ―The within must be credited to C‖

These endorsements exclude the rights of further negotiation by C

1. ―Pay C.‖
2. ―Pay C value in account with the Oriental Bank.‖
3. ―Pay the contents to C, being part of the consideration in a certain deed of assignment executed by C to the endorser and others.

These endorsements do not exclude the rights of further

1. **Endorsement sans Recourse** - Endorser who excludes his own liability or makes it conditional – the endorser of a negotiable instrument may by express words in the endorsement, exclude his own liability thereon or make such liability or the right of the endorsee to receive the amount due thereon depend upon the happening of a specified event, although such event may never happen.

* Where an endorser so excludes his liability and afterwards becomes the holder of the instrument, all intermediate endorsers are liable to him.

# Illustrations

1. the endorser of a negotiable instrument signs his name adding the words

―Without recourse‖. Upon this endorsement he incurs no liability.

1. a is the payee and holder of a negotiable instrument., Excluding personal liability by an endorsement ―without resource‖, he transfers the instrument to B and B endorses it to C who endorses to A . A is not only reinstates in his former rights, but has the rights of an endorsee against B and C.

## 5 ) Conditional Endorsement

* The endorser can also insert a condition I his endorsement. He may for example say that ― pay B or order on his marriage‖.

## 6. Partial Endorsement

* Endorsement for part of sum due – no writing on a negotiable instrument is valid for the purpose of negotiation if such writing purports to transfer only a part of the amount appearing to be due on the instrument; but where such amount has been partly paid, a note to that effect may be endorsed on that instrument, which may then be negotiated for the balance

# Holder & Holder in due course

* Holder means any person entitled in his own name to the possession a promissory note bill of exchange or cheque and to recover or receive the amount due thereon from the parties thereon. A holder must therefore have the possession of the instrument and also the right to recover the money in his own name.
* ―Holder in due course means any person who for consideration became the possessor of a promissory note, billl of exchange or cheque, if payable to the bearer or the payee or indrosee thereof ,if payable to the 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 who he derived his title‘

# Difference between holder and holder in due course

* Meaning-holder means any person entitled in his own name possession of the instrument in other hand holder in due course a holder who takes the instrument in good faith for consideration before it is overdue and without any notice of defect in the title of who transferred it to him.

## Section 8 – “Holder”

* The holder of a promissory note, bill of exchange or cheque means any person entitled in his own name to his position 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.

## Section 9 – “Holder In Due Course”

The phrase ―in good faith and for value‖ has been split up by Section into four elements all of which must concur to make a holder in due course. They are:

1. The holder must have taken the instrument for value
2. He must have obtained the instrument before maturity (3) The instrument must be complete and regular on its face (4) He must have taken the instrument in good faith and without notice of any defect either in the instrument or in the title of the person negotiating it to him.
3. **Consideration -** A negotiation instrument contains a contract and therefore must be supported by consideration.

# Before Maturity

In order to be holder in due course, the holder must have obtained the instrument before its maturity.

# Complete and Regular

The third requirement is that the instrument should be complete and regular on the face of it. And ―face‖ for this purpose includes back also. It is the duty of every person who takes a negotiable instrument to examine its form, for if it contains any material defect, he will not become a holder in due course.

1. **Good faith -** The last requirement is that the holder should have received the instrument in ―good faith‖.

# PRIVILEGES OF A “HOLDER IN DUE COURSE”:

1. **In case of Inchoate Instrument:** A person signing and delivering to another a stamped but otherwise inchoate 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:* 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 `3000 only. But B fills it for `5,000. B than 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 filed in the amount in excess of his authority.

1. **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 endorsed 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).
2. **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 (Sections 46 and 47).
3. **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 defences 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).
4. **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).
5. **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 endorse the same (Section 121). In short, a holder in due course gets a good title to the bill.

# DISTINCTION BETWEEN A HOLDER AND A HOLDER IN DUE COURSE:

* 1. **On the basis of consideration:** A holder may become the possessor or payee of an instrument even without consideration, whereas a holder in due course is one who acquires possession for consideration.
  2. A holder in due course as against a holder must become the possessor payee of the instrument before the amount thereon become payable.
  3. **On the basis of good faith:** A holder in due course as against a holder must have become the payee of the instrument in good faith *i.e.,* without having sufficient cause to believe that any defect existed in the transferor‘s title.
  4. **On the basis of better title than transferor:** A holder can never get a better title than that of the transferor whereas holder in due course can acquire a better title than that of the transferor.

**Payment in due course (Section 10):** Under Section 10 of the Negotiable Instruments Act, ―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. In order that such payment may operate as a discharge of a negotiable instrument, it must fulfil the following conditions.

1. That **the payment should be in accordance with the apparent tenor of the instrument**.
2. That the **person to whom payment is made should be in possession of the instrument.**
3. That the **payment should be made in good faith**