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NEGOTIABLE INSTRUMENTS: AN OVERVIEW

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ABSTRACT

Negotiable instruments play a crucial role in facilitating commercial transactions by providing a reliable means of transferring rights and obligations between parties. This article provides a comprehensive overview of negotiable instruments, exploring their definition, characteristics, and various types. By examining key examples such as promissory notes, bills of exchange, and checks, we delve into the unique features and functions of each instrument. Furthermore, the article highlights the legal framework governing negotiable instruments, emphasizing the importance of adherence to established rules and regulations. Understanding the different types of negotiable instruments is vital for individuals and businesses alike, as it enables them to navigate the complexities of financial transactions with confidence and security.

KEYWORDS: Negotiable Instrument, Cheque, Promissory Note, Bill of Exchange, Dishonour of Cheque

I. INTRODUCTION:

Negotiable instruments Act, 1881 contains 148 Sections and 17 chapters. Negotiable instruments serve as vital tools in the realm of commercial transactions, providing a mechanism for the smooth exchange of financial obligations and rights between parties. These instruments play a significant role in facilitating economic activities by offering a secure and convenient means of transferring ownership and ensuring payment. Understanding the types and functions of negotiable instruments is essential for individuals and businesses alike to navigate the intricacies of financial transactions successfully. In this article, we aim to provide a comprehensive overview of negotiable instruments and explore their diverse forms. We will delve into the definition and characteristics of negotiable instruments, highlighting their crucial role in commercial transactions. Additionally, we will examine various types of negotiable instruments, including promissory notes, bills of exchange, and cheques. By analysing each type's unique features and functions, we will shed light on their specific uses and benefits.

Moreover, we will emphasize the legal framework governing negotiable instruments, emphasizing the importance of adherence to established rules and regulations. This article seeks to equip readers with the knowledge necessary to navigate the complexities of negotiable instruments, empowering them to engage in financial transactions with confidence and security.

II. NEGOTIABLE INSTRUMENT:

A negotiable instrument is a document that guarantees the payment of a specific amount of money to a designated person or order, or to the bearer of the document. It serves as a substitute for money and can be freely transferred from one party to another. According to Sec. 13(1) of Negotiable instruments Act, a negotiable instrument means a promissory note, bill of exchange, or cheque.

The key characteristics of a negotiable instrument include its negotiability, transferability, and legal enforceability.

A. FEATURES OF NEGOTIABLE INSTRUMENTS:

1. **NEGOTIABILITY:** A negotiable instrument is freely transferable from one person to another by mere delivery or endorsement, making it a valuable instrument in commercial transactions.
2. **UNCONDITIONAL PROMISE OR ORDER TO PAY:** A negotiable instrument contains an unconditional promise or order to pay a specific sum of money. The promise or order must be clear, definite, and not subject to any conditions or contingencies.
3. **PAYABLE TO ORDER OR BEARER:** A negotiable instrument is payable either to a specific person or their order, or to the bearer of the instrument. If it is payable to a specific person or order, it can be transferred by endorsement. If it is payable to the bearer, it can be transferred by mere delivery.
4. **PAYMENT IN MONEY:** A negotiable instrument guarantees payment in a specific monetary unit, such as currency or a recognized medium of exchange.
5. **LEGAL ENFORCEABILITY:** A negotiable instrument carries legal enforceability, meaning that the holder of the instrument can take legal action to enforce payment against the parties involved, subject to applicable laws and regulations.

B. TYPES OF NEGOTIABLE INSTRUMENTS:

1. **PROMISSORY NOTE (Sec.4):**

A promissory note is a written promise by one party (the maker) to pay a specific sum of money to another party (the payee) within a specified timeframe. It is a two-party instrument.

a) ESSENTIALS OF A PROMISSORY NOTE:

i. **PARTIES:** A promissory note must clearly identify the parties involved, namely the maker (who promises to pay) and the payee (to whom the payment is promised).

ii. **UNCONDITIONAL PROMISE:** The note must contain an unconditional promise to pay a specific sum of money. The promise should be clear, definite, and not subject to any conditions or contingencies.

iii. **PAYMENT TERMS:** The note should specify the exact amount to be paid, the due date or time frame for payment, and any interest or other charges involved.

iv. **CONSIDERATION:** There must be valid consideration for the promissory note, meaning that the maker must receive something of value in return for making the promise to pay.

v. **LEGAL COMPLIANCE:** The note should comply with the legal requirements and regulations of the jurisdiction in which it is executed, including any necessary signatures, dates, and other formalities.

vi. **TRANSFERABILITY:** The note should be transferable by endorsement, allowing the payee to transfer their rights to another party if desired.

vii. **STAMPING:** The promissory note must be stamped under Stamps Act,1940 .

viii. **ENFORCEMENT:** The note should provide for legal enforceability, allowing the holder to take legal action to enforce payment if the maker fails to fulfill their obligation.

These essentials ensure that a promissory note is valid and enforceable, providing a clear understanding of the parties' obligations and facilitating the transfer of rights.

2. **BILL OF EXCHANGE(Sec.5):**

A bill of exchange is an instrument that orders one party (the drawer) to pay a specified sum of money to another party (the payee) at a designated future date or on-demand. It involves three parties: the drawer, the drawee (the party on whom the bill is drawn), and the payee.

a) ESSENTIALS OF BILL OF EXCHANGE:

i. **WRITTEN DOCUMENT:** A bill of exchange must be in writing.

ii. **UNCONDITIONAL ORDER TO PAY:** It contains an unconditional order from

the drawer to the drawee to pay a specific amount of money.

iii. **PARTIES INVOLVED:** It involves three parties: the drawer (issuer of the bill), the drawee (the party on whom the bill is drawn), and the payee (the person who will receive the payment).

iv. **SUM CERTAIN:** The bill of exchange specifies the exact amount of money to be paid.

v. **PAYMENT DATE:** It indicates the date when the payment is due or the timeframe within which the payment must be made.

vi. **SIGNATURES:** It requires the signature of the drawer as an indication of their intent to be legally bound by the terms of the bill.

vii. **NEGOTIABILITY:** It is transferable from one party to another by endorsement, making it a negotiable instrument.

b) DIFFERENT KINDS OF BILLS OF EXCHANGE

There are different kinds of bills of exchange based on their usage and specific characteristics. Here are some common types:

i. **Trade Bill:** A trade bill of exchange is used in ordinary commercial transactions to facilitate payment between parties involved in the sale of goods or services.

ii. **Banker's Bill:** A banker's bill of exchange is issued by a bank, usually drawn on its own branch or another bank, and is used for financial transactions or international trade.

iii. **Inland Bill:** An inland bill of exchange is drawn and payable within the same country, typically used for domestic transactions.

iv. **Foreign Bill:** A foreign bill of exchange involves parties from different countries, with the bill drawn in one country and payable in another, often used in international trade.

v. **Sight Bill:** A sight bill is payable immediately upon presentation to the drawee, who must make payment without delay.

vi. **Time Bill:** A time bill of exchange specifies a future payment date or a specific period after sight or acceptance when the payment becomes due.

vii. **Documentary Bill:** A documentary bill of exchange is accompanied by relevant documents, such as shipping documents or insurance policies, which serve as proof of the underlying transaction.

viii. **Clean Bill:** A clean bill of exchange does not have any accompanying documents and relies solely on the trustworthiness and creditworthiness of the parties involved.

ix. **Accommodation Bill:** An accommodation bill of exchange is drawn and accepted without any underlying transaction, where one party acts as a guarantor or accommodates another party by lending their credit.

x. **Trade Acceptance:** A trade acceptance is a bill of exchange drawn by the seller (drawer) on the buyer (drawee), who accepts the bill to indicate their commitment to pay at a future date.

3. **CHEQUE(Sec.6):**

A cheque is a type of bill of exchange that is drawn on a bank and payable on demand. It is used to make payments from a bank account to another party.

a) STAMPING REQUIREMENT:

In case of *C.T. Joseph v. I.V. Phillip,* the Kerala High Court held that the cheques do not require any stamp under the Stamp Act. It has also been held that the Section 20 of the NI act applies only to the inchoate instruments, do not apply to cheques.

b) PERIOD OF VALIDITY OF A CHEQUE:

In general, a cheque is valid for a certain period, typically six months from the date of issue. After the expiry of this period, the

cheque may be considered stale or expired, and the drawee bank may refuse to honour it.

c) REVALIDATION OF A CHEQUE:

Revalidation of a stale or expired cheque usually requires the cooperation of the drawer and the payee. They may agree to revalidate the cheque by acknowledging that the original payment obligation is still valid and that the cheque can be honoured by the drawee bank.

d) VALIDITY OF POST-DATED CHEQUES:

In India, for example, post-dated cheques are commonly used as a means of security or future payment. The Supreme Court of India, in the case of *Rangappa vs. Sri Mohan*, held that a post-dated cheque does not lose its validity merely because it is post-dated. The Court stated that a post-dated cheque represents an unconditional promise to pay and can be enforced even before the date mentioned on the cheque, provided there is no legal impediment.

In case of *Ashok Yeshwant Badave v. Surendra Madhavroa* it has been held a post cheque is not a cheque on the date on which it is drawn. It becomes a Cheque on the date written on it and till that date the instrument remains a Bill of Exchange.

e) CROSSING OF A CHEQUE:

Crossing of a cheque refers to the marking of two parallel lines across the face of a cheque. This crossing signifies that the cheque should be paid only through a bank and not directly to the bearer of the cheque. It enhances the security of the payment transaction and prevents the misuse or fraudulent encashment of the cheque.

Crossing of a cheque can be of two types:

i. General Crossing: In a general crossing, two parallel lines are drawn across the cheque, indicating that the cheque should be deposited into a bank account only. It does not specify any particular bank and can be presented to any bank for collection or clearing.
ii. Special Crossing: In a special crossing, the parallel lines are accompanied by the name of a specific bank between the lines. This indicates that the cheque should be deposited only into an account with that particular bank.

The crossing of a cheque is usually done by the drawer (the person who writes the cheque) and serves as an instruction to the drawee bank (the bank upon which the cheque is drawn) on how the payment should be made.

Crossing a cheque provides several benefits:

i. Security: Crossing makes it difficult for unauthorized individuals to encash the cheque since it can only be paid through a bank account.
ii. Trackability: The crossing enables the tracing of the cheque through the banking system, making it easier to identify the path of the payment.
iii. Proof of Payment: Crossing provides evidence that the payment was made through a banking channel, enhancing accountability and record-keeping.

f) TYPES OF CHEQUES:

There are various types of cheques that are used for different purposes and offer specific features.

i. **Bearer Cheque:** A bearer cheque is payable to the person who presents it to the bank for payment. It does not specify a specific payee and can be encashed by anyone who possesses it.
ii. **Order Cheque:** An order cheque is payable to a specific person or their order. It requires the endorsement (signature) of the payee to transfer the cheque to another party.
iii. **Crossed Cheque:** A crossed cheque has two parallel lines drawn across its face,

indicating that it can only be deposited into a bank account and not cashed over the counter. It enhances security and prevents fraudulent encashment.

iv. **Self Cheque**: A self cheque is drawn by an account holder on their own bank account and is payable to themselves. It allows the account holder to withdraw cash or make a payment directly to themselves.

v. **Post-dated Cheque:** A post-dated cheque has a future date written on it, which is later than the date of issuance. It indicates that the cheque should not be encashed until the specified future date.

vi. **Stale Cheque:** A stale cheque is a cheque that has passed its validity period, typically six months to one year from the date of issuance. Banks may refuse to honor stale cheques, and the payee may need to request a new cheque from the issuer.

vii. **Traveler's Cheque:** A traveler's cheque is a pre-printed, fixed amount cheque issued by a financial institution that can be used by travelers as a secure form of payment while abroad. It offers the convenience of cash and can be replaced if lost or stolen.

viii. **Banker's Cheque:** A banker's cheque, also known as a cashier's cheque, is issued by a bank and guaranteed by the bank's funds. It is considered a secure form of payment as the funds are already debited from the payer's account.

ix. **Payroll Cheque:** A payroll cheque is issued by an employer to pay employees their salaries or wages. It may include additional details such as the employee's name, salary amount, and pay period.

x. **Certified Cheque:** A certified cheque is a personal cheque that has been verified and guaranteed by the bank. The bank sets aside the funds required to honor the cheque, ensuring its acceptance when presented for payment.

g) **DISHONOUR OF CHEQUES:**

Under the Negotiable Instruments Act, 1881, a cheque bounce (also known as a dishonored cheque or non-sufficient funds cheque) can attract criminal liability. Section 138 of the Act specifically deals with the consequences of dishonoring a cheque.

According to Section 138, if a cheque is dishonored due to insufficient funds in the account of the drawer or if it exceeds the amount arranged to be paid from the account, the drawer of the cheque can be held criminally liable. The following conditions must be satisfied for the offense to be considered:

i. The cheque was presented for payment within a period of six months from the date it was drawn or within the validity period, whichever is earlier.

ii. The cheque was dishonored by the bank due to insufficient funds or because it exceeded the arrangement made with the bank.

iii. The payee or the holder in due course of the cheque issued a notice in writing to the drawer of the cheque, demanding payment within 30 days of receiving the information about the dishonored cheque.

iv. The drawer of the cheque fails to make the payment within the stipulated 30-day period after receiving the notice.

If these conditions are met, the drawer of the cheque can be held liable for a criminal offense. The payee or the holder in due course can initiate legal proceedings by filing a complaint in a court of competent jurisdiction. The penalty for the offense may include imprisonment for a term which may extend to two years, or a monetary fine, or both.

III. PARTIES TO NEGOTIABLE INSTRUMENTS:

While the term "negotiable instrument" encompasses a variety of financial documents, here are the parties commonly associated with negotiable instruments:

A. **HOLDER:** The holder of a negotiable instrument is the person who possesses the instrument either as the original payee or as a subsequent transferee. The holder has the right to receive payment on the instrument.

B. **HOLDER IN DUE COURSE:** A holder in due course is a special type of holder who acquires the negotiable instrument in good faith, for value, and without notice of any defects or claims against the instrument. A holder in due course holds a superior legal position and is protected against certain defenses that may be raised against the instrument.

C. **PAYMENT IN DUE COURSE:** Payment in due course refers to the payment made in accordance with the terms of the negotiable instrument to a person entitled to receive payment. When payment is made in due course, it discharges the liability of the party making the payment.

D. **DRAWER IN CASE OF NEED:** In certain situations, the drawer of a negotiable instrument may include the name of a person as a "drawer in case of need." This person acts as a backup or alternative drawer and can be approached for payment if the original drawer fails to make payment.

E. **HOLDER FOR VALUE:** A holder for value is a party who has given consideration, such as money, goods, or services, in exchange for acquiring the negotiable instrument. Holding the instrument for value enhances the holder's rights and protection in enforcing payment.

These parties play different roles and may have distinct rights and responsibilities concerning negotiable instruments, depending on their status and the circumstances of the transaction.

IV. ENDORSEMENT:

Endorsement refers to the process of transferring the ownership or rights to a negotiable instrument, such as a check or promissory note, from one party to another. It involves the signing or endorsing of the instrument by the current holder, thereby designating the new recipient as the rightful owner or holder of the instrument.

A. PURPOSE: Endorsement allows the transfer of ownership or rights to a negotiable instrument from one party (endorser) to another (endorsee), enabling the instrument to be negotiated or further transferred to subsequent parties.

B. TYPES OF ENDORSEMENT:

1. **Blank Endorsement (Sec 16(1)):** In a blank endorsement, the current holder simply signs the back of the instrument without specifying the new payee. This converts the instrument into a bearer instrument, meaning it can be negotiated by mere possession.
2. **Special Endorsement (Sec 16(1)):** A special endorsement specifies the new payee or endorsee of the instrument. The current holder signs the back of the instrument and includes the name of the intended recipient.
3. **Restrictive Endorsement (Sec.50):** A restrictive endorsement limits or restricts further negotiation of the instrument. It may include phrases like "For Deposit Only" or "Pay to [Name of Bank]" to direct how the instrument should be processed or restrict its negotiability.
4. **Conditional Endorsement (Sec.52):** A conditional endorsement imposes certain conditions or requirements for the instrument to be valid or negotiated further. The fulfillment of these conditions is necessary for the endorsement to take effect.

C. **ENDORSEMENT PROCESS:** The endorsement is typically done by signing the back of the instrument or on a designated endorsement space. The signature should match the name of the current holder as it appears on the front of the instrument.

D. **ENDORSEMENT FOR NEGOTIATION:** Endorsement allows the negotiable instrument to be negotiated or transferred to subsequent parties, providing them with the rights and ownership of the instrument. Each subsequent holder must endorse the instrument when transferring it to another party.

E. **EFFECT OF ENDORSEMENT:** Endorsement transfers the rights to the negotiable instrument, including the right to receive payment, enforce the instrument, or further negotiate it. The endorsement creates a chain of ownership or title, establishing the rights and obligations of each party involved.

V. CONCLUSION:

The Negotiable Instruments Act of 1881 is a significant legislation that governs the usage and transfer of negotiable instruments in India. It provides a comprehensive framework for the functioning of negotiable instruments such as promissory notes, bills of exchange, and cheques. The Act establishes rules regarding their creation, endorsement, transfer, and discharge, ensuring smooth commercial transactions and promoting economic stability. It outlines the rights, liabilities, and remedies of parties involved in negotiable instruments and serves as a crucial legal foundation for financial transactions in the country. Despite its age, the Act continues to play a vital role in facilitating secure and efficient trade and commerce in India.

VI. REFERENCE:

A. JUDGEMENTS:
1. C.T. Joseph vs I.V. Philip AIR 2001 Ker 300
2. Rangappa vs Sri Mohan (2010) 11 SCC 441
3. Ashok Yeshwant Badave v. Surendra Madhavroa AIR 2001 SC 1315

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