Chapter 10

Negotiable Instruments Act

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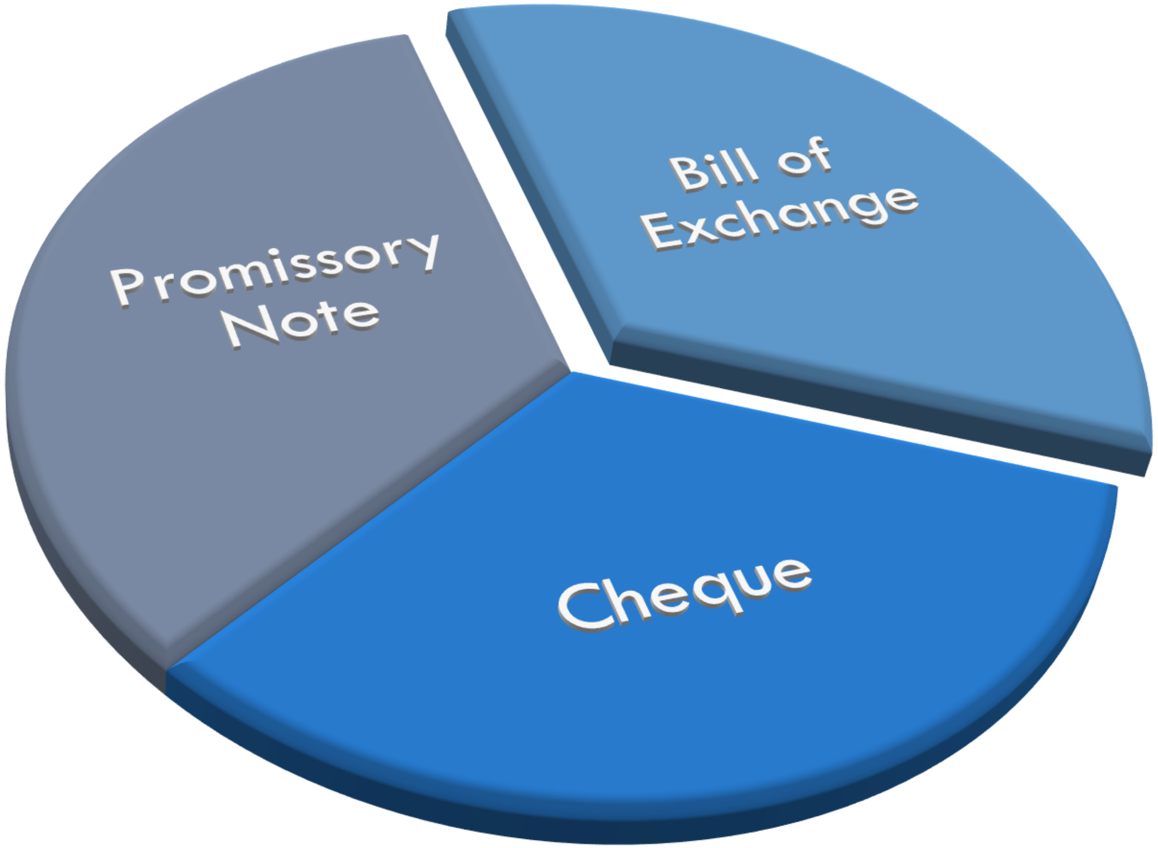

Negotiable Instruments Act

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Definition: Negotiable instruments

A negotiable instrument means a:

- ☐ Promissory note
- ☐ Bill of exchange or
- ☐ Cheque

payable either to order or to bearer.

In simple terms,

negotiable means transferable by delivery and

instrument means a written document by which a right is created in favour of some person.

Thus negotiable instrument may mean a written document transferable by delivery.

From the above definition it reveals that promissory note, bill of exchange and cheque [**PBC**] can be termed as negotiable instruments.

The law relevant applicable to negotiable instruments is the Negotiable Instruments Act, 1881.

Our Short Cut will be

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Negotiable Instrument = PBC

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Payable to order or bearer

Payable to order

A PBC is payable to order which is expressed to be payable to a particular person.

Payable to bearer

If a PBC is payable to any person whosoever bears it then it is called payable to bearer.

Please See The Example 1 to 3

Easy transferability

PBC are transferable from one person to another by mere delivery if payable to bearer and by endorsement and delivery if payable to order.

Title of holder in due course

It means that once an instrument is received in the hands of holder in due course (a holder in good faith) it becomes free from all defects.

One other than the original recipient who holds a legally effective negotiable instrument (such as a promissory note) and who has a right to collect from the issuer.

One holding PBC, received for value in good faith and with no suspicion that it might be no good.

Please See The Example 4 to 6

Parties to negotiable instrument

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Maker

The person who makes a promissory note.

Payee

The person named in an instrument, to whom or to whose order money is to be paid.

Drawer

The maker of a bill of exchange or cheque.

Drawee

The person on whom bill of exchange or cheque is drawn and who is directed to pay the amount.

Acceptor

A bill of exchange (other than a cheque) must be presented to the drawee for acceptance first, and then presented for payment on due date. Drawee becomes acceptor when he accepts the bill duly signing it.

Holder

A person is called **holder** of a negotiable instrument if he satisfies the following two conditions:

☐ He must be entitled to the possession of the instrument in his own name ("holder" does not include a beneficial owner claiming through a *Benamidar*); and

☐ He must be entitled to receive / recover the amount due on the instrument from the parties liable under the instrument

Thus a holder means the bearer of the bearer instrument and the endorsee or payee of the order instrument.

When the note, bill or cheque is lost and not found or is destroyed, the person in possession of it or the bearer at the time of loss or destruction shall be deemed to continue to be its holder.

Difference between Holder & Holder in due course

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section 1.3 of Study Text

Types of instrument

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Order instrument

A PBC is payable to order if either of the following two conditions are fulfilled:

- ☐ Which is expressed to be so payable or
- ☐ Which is expressed to be payable to a particular person and does not contain words:
- ☐ which prohibit transfer or
- ☐ indicate an intention that it shall not be transferable.

Note:

An order instrument can be transferred by an endorsement on it and then its delivery.

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Bearer instrument

A PBC is payable to bearer if either of the following two conditions is fulfilled:

- ☐ expressed to be so payable, or
- ☐ last endorsement must be an endorsement in blank.

Note:

- ☐ A promissory note cannot be made payable to the bearer.
- ☐ A bill of exchange cannot be made payable to bearer on demand.

Inland instrument

A promissory note, bill of exchange or cheque which is:

- ☐ Made or drawn in Pakistan and also made payable in Pakistan, or
- ☐ Made or drawn in Pakistan upon any person resident in Pakistan, although it may be payable in a foreign country.

is called an **inland instrument.**

Note:

- ☐ An inland instrument remains inland even if it has been endorsed in a foreign country.

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Foreign instrument

An instrument, which is not an inland instrument, is deemed to be a **foreign instrument.**

Demand instrument

Instruments payable on demand means the instrument in which no time for payment is mentioned. A cheque is always payable on demand. A promissory note or bill of exchange is payable on demand where:

- ☐ It is expressed to be so or
- ☐ It is expressed to be payable "at sight" or "presentment"; or "on demand"
- ☐ No time for payment is specified; or
- ☐ The bill or note accepted or endorsed after it is overdue, as regards to person accepting or indorsing it.

Notes

- ☐ 'At sight' and presentment means on demand.
- ☐ An instrument on demand is payable immediately.

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Time instrument

An instrument payable after a fixed time or on a specified date is called **Time Instrument.** A promissory note or bill of exchange is a time instrument when it is expressed to be payable.

- ☐ After a specified period
- ☐ On a specific day
- ☐ Certain date after sight
- ☐ On the happening of event which is certain to happen e.g. death.

Note

There can be a "time bill", "time note" but not a "time cheque" because the cheque cannot be expressed to be payable otherwise than on demand.

Endorsement

Definition: Endorsement

“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 is said to endorse the same, and is called the ‘endorser’.”

The term endorsement may be defined as signing one’s name on the negotiable instrument for the purpose of transferring it to another person.

Essentials of valid endorsement

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☐ It must be on instrument itself, if no space is left on the back of the endorsement, further endorsements are signed on a slip of paper attached to the instrument called '*allonge*'.

☐ It must be signed by the endorser for the purpose of negotiation. Signature of the endorser on the instrument without any additional words is sufficient.

☐ No particular form of words is necessary for an endorsement

☐ It must be completed by the delivery of the instrument. The delivery of the instrument with the intention of passing the property in it.

☐ Negotiation by endorsement must be of the entire instrument. Endorsement for part of the amount or to two or more endorsee severally is invalid.

Negotiation

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Definition: Negotiation

"When a PBC is transferred to any person, so as to constitute that person the holder of it, the instrument is said to be negotiated.

The analysis of the definition reveals that negotiation takes place when the negotiable instrument is transferred from one person to another and the transfer is made in such a manner so as to make the transferee the holder of the negotiable instrument and it must be transferred free from defects.

Payment in due course

Means payment in accordance with the apparent tenure of the instrument in good faith and without negligence to any person in possession of it.

Apparent tenure means the period of time as expressed in the instrument, after which it is payable.

Payment in due course, which results in discharge of a negotiable instrument, must fulfill the following conditions.

- Apparent Tenure
- In good faith and without ignorance
- Payment to proper person
- In money only.

PROMISSORY NOTE

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Definition of promissory note

"A promissory note is an instrument in writing (not being a bank note or currency note) containing an unconditional undertaking, signed by the maker, to pay on demand or at a fixed or determinable future time a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument.

The analysis of the definition shows that, a promissory note is a written and signed promise to pay a certain sum of money to a specified person or his order.

Parties to a promissory note

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Maker

It is a person who makes the promissory note and promises to pay the money stated in it. The maker is liable to pay according to tenor of the note and compensate any party to the note for loss sustained because of his default.

Payee

It is a person to whom the amount of promissory note is payable i.e. to whom the promise to pay is made.

Essential elements of a promissory note

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In writing

A promissory note has to be i n writing. An oral promise to pay does not become a promissory note. The writing may be on any paper, on any book. The words used must impart a clear undertaking to pay, but it is not necessary that the word promise should be used.

Promise to pay

There must be a promise or a clear undertaking to pay. A mere acknowledgement of indebtedness is not a promissory note, although it is valid as an agreement and may be sued upon as such.

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Definite and unconditional

The promise must not depend upon the happening of some uncertain event. i.e. a contingency or the fulfillment of a condition. If an instrument contains a conditional promise to pay, it is not a valid promissory note and will not become valid and negotiable even after happening of the condition.

Exception

But a promise to pay is not conditional if the amount is made payable

- ☐ at a particular place or
- ☐ after a specified time or
- ☐ on the happening of an event which must happen, although the time of its happening may be uncertain.

Signed by maker

It is imperative that the promissory note should be duly authenticated by the signature of the maker. If the maker is illiterate he may place his thumb mark.

Certain parties

The instrument points out with certainty as to who is the maker and who is the payee. Where the maker and the payee cannot be identified with certainty, the instrument even if it contains an unconditional promise to pay is not a promissory note.

A promissory note cannot be made payable to the maker himself. But if it is endorsed by the maker to some other person or endorse in blank it will become valid.

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Sum payable must be certain

It is essential that sum of money promised to be payable must be certain and definite. The amount payable must not be capable of contingent addition or subtraction.

Sum payable must be legal tender

A promise to pay a certain amount of foreign currency or to deliver a certain quantity of goods is not a promissory note.

BILL OF EXCHANGE

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Definition of bill 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 on demand or at a fixed or determinable future time 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 a written order that binds one party to pay a fixed sum of money to another party on demand or at a predetermined date.

Drawer

It is a person who draws a bill of exchange. The drawer is liable on a bill of exchange as principal debtor until the drawee accepts the bill.

Drawee

It is a person who is ordered to pay the amount of the bill of exchange (on whom the bill is drawn). When drawee accepts the bill of exchange (when he gives consent to make the payment) he is called the acceptor. The drawee is not liable until acceptance. On acceptance he becomes liable as acceptor to pay holder on demand after maturity.

Payee

It is a person to whom the amount of bill of exchange is payable.

Essential elements of a bill of exchange

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In writing

A bill of exchange is required to be in writing. Like promissory note, a bill of exchange also cannot be oral.

Order to pay

A bill of exchange contains an order to pay instead of a promise to pay like in promissory note. This feature distinguishes it from promissory note. Further, a request to pay money is not considered to be a bill of exchange.

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Definite and unconditional

In other words, the order to pay should not depend upon a condition or upon the happening of an uncertain event. This point has already been discussed in detail in case of a promissory note.

Signed by drawer and drawee

The instrument must be signed by the drawer and drawee.

Certain parties

All the parties must be certain i.e. indicated in a bill of exchange with reasonable certainty.

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Sum payable must be legal tender

If the instrument contains an order to pay something other than money or something in addition to money, it will not be valid bill of exchange.

Sum Payable must be certain

It is essential that sum of money ordered to be payable must be certain and definite. The amount
payable must not be capable of contingent addition or subtraction.

CHEQUE

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Definition of cheque

Cheque is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand.

The analysis of the above definition reveals that a cheque is a bill of exchange but is different in following two characteristics:

- ☐ Drawee will always be a banker
- ☐ Always payable on demand

A **cheque** is a **type of bill of exchange,** used for the purpose of making payment to any person. It is an unconditional order, addressing the drawee to make payment on behalf the drawer, a certain sum of money to the payee.

Drawer

It is a person who draws a cheque.

Drawee

It is a banker who is ordered to pay the amount of the cheque.

Payee

It is a person to whom the amount of cheque is payable.

Essential elements of a cheque

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☐ It must be in writing

☐ There must be an express order to pay and not a request to pay

☐ The order must be definite and unconditional

☐ It must be signed by the drawer

☐ The three parties (drawer, drawee and payee) must be certain.

☐ The order must be to pay a certain sum

☐ The order must be to pay money only

☐ It must always be drawn upon a specified banker

☐ It must always be payable on demand

☐ The rules of the Negotiable Instrument Act relating to cheque are also applicable to bank drafts.

☐ A cheque, of itself, does not operate as an assignment of any part of the funds to the credit of the drawer with the banker.

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Method of crossing

A cheque is said to be crossed when it bears across its face two parallel transverse lines which are usually drawn on the left hand top corner of the cheque. It is an instance of an alteration which is authorized by the Act. A crossing is a direction to the paying banker not to pay across the counter.

Purpose of crossing

The purpose of crossing is to direct the drawee (banker) to pay the amount of the cheque only to a banker so that the party who receives the payment can easily be traced.

Types of crossing

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General crossing

A cheque is said to be crossed generally where it bears across its face an addition of the words “and company” or any abbreviation of it between two parallel transverse lines.

Effect of general crossing

When a cheque is crossed generally the banker on whom it is drawn shall not pay it otherwise than to a banker.

Special crossing

A cheque is said to be crossed specially where it bears across its face an addition of:

- ☐ Name of the banker
- ☐ Parallel lines are not necessary.

Effect of special crossing

When a cheque is crossed specifically the banker on whom it is drawn shall not pay it otherwise than to a banker to whom it is crossed or his agent for collection.

Restrictive crossing

Restrictive crossing may be added with general crossing by adding the words “A/c Payee” or “A/c Payee only”.

Effect of restrictive crossing

Where a cheque is crossed as "account payee", it shall cease to be negotiable. Strictly speaking, the amount collected on the cheque must be credited only to the account of payee.

'Not negotiable' crossing

The addition of the words not negotiable does not restrict the further transferability of the cheque. It only takes away the main feature of negotiability, which is transferability free from defects.

Effect of 'not negotiable' crossing

The effect of the words 'not negotiable' on a crossed cheque is that the title of the transferee of such a cheque cannot be better than that of its transferor.

Therefore, a holder with a defective title cannot give a good title to a subsequent holder. The object of crossing a cheque not negotiable is to afford protection to the drawer or holder of the cheque against miscarriage or dishonesty in the course of transit by making it difficult for the cheque so crossed cashed, until it reaches its destination.

Crossing of a cheque after issue

A crossing authorized by the Act is a material part of the cheque. It means that it is unlawful for any person to obliterate, add or alter the crossing except as authorized under the Act.

A cheque may be crossed after its issue in the following manner:

Case	Right to cross
Where a cheque is uncrossed	The holder may cross it generally or specially.
Where a cheque is crossed generally	The holder may cross it specially by adding the name of the banker.
Where a cheque is crossed generally or specially	The holder may add the word "Not negotiable".
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.

Rules relating to payment of cheques

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Payment of cheque crossed specially more than once

Where the cheque is crossed specially to more than one banker, except when crossed to an agent for collection, the banker to whom it is drawn shall refuse payment thereof.

Payment in due course of crossed cheque

Where the banker, on whom a cross cheque is drawn, makes a payment in due course, the paying banker and the drawer are entitled to be positioned as if the cheque had been paid to and received by the true owner thereof.

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Payment of crossed cheque out of due course

Where the banker, on whom a cross cheque is drawn, makes a payment out of due course, the paying 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.

Protection to the banker in case of defective title

A collecting banker is one who receives the payment of a crossed cheque on behalf of his customer.

If the collecting banker has collected a cheque on behalf of a person whose title to the cheque was defective, he would be protected and would not be held liable in conversion to the true owner, provided he proves that:

- ☐ He acted in good faith and without negligence
- ☐ The cheque was already crossed before it reached his hands and
- ☐ He received the payment on behalf of a customer and not on his own account i.e. he acted as an agent for collection and not in the capacity of holder for value.

It may be noted that if the banker credits his customer's account with the amount of the cheque before receiving payment, he does not become a holder for value and the protection shall be available to such a collecting banker as well. This protection is not available where the banker allows the proceeds of an "Account payee crossed cheque" to be credited to any account other than the payee and the endorsement in favor of the last payee is proved forged.

Protection to the banker crediting cheque crossed ‘account payee’

Similarly, if the collecting banker has collected a cheque which does not at the time of delivery appear to be crossed “account payee” or to have had a crossing “account payee” which has been obliterated or altered, the banker, in good faith and without negligence collecting payment of the cheque and crediting proceeds thereof to a customer, shall not incur any liability by reason of the cheque having been so crossed.

Revocation of banker's authority

The duty and authority of a banker to pay a cheque drawn on him by his customer are determined by:

- ☐ Countermand of payment;
- ☐ Notice of customer's death;
- ☐ Notice of adjudication of the customer as an insolvent.

Topic Covered

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- Characteristics of negotiable instrument
- Parties to negotiable instrument
- Types of instrument
- Endorsement
- Negotiation
- Payment in due course

- Definition of promissory note
- Parties to a promissory note
- Specimen of a promissory note
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