

# **NEGOTIABLE INSTRUMENTS ACT, 1881**

## **MEANING OF NEGOTIABLE INSTRUMENTS**

According to Section 13 (a) of the Act, “Negotiable instrument means a promissory note, bill of exchange or cheque payable either to order or to bearer, whether the word “order” or “ bearer” appear on the instrument or not.”

In the words of Justice, Willis, “A negotiable instrument is one, the property in which is acquired by anyone who takes it bonafide and for value notwithstanding any defects of the title in the person from whom he took it”.

Thus, the term, negotiable instrument means a written document which creates a right in favour of some person and which is freely transferable. Although the Act mentions only these three instruments (such as a promissory note, a bill of exchange and cheque), it does not exclude the possibility of adding any other instrument which satisfies the following two conditions of negotiability:

the instrument should be freely transferable (by delivery or by endorsement. and delivery) by the custom of the trade; and

the person who obtains it in good faith and for value should get it free from all defects, and be entitled to recover the money of the instrument in his own name.

As such, documents like share warrants payable to bearer, debentures payable to bearer and dividend warrants are negotiable instruments. But the money orders and postal orders, deposit receipts, share certificates, bill of lading, dock warrant, etc. are not negotiable

instruments. Although they are transferable by delivery and endorsements, yet they are not able to give better title to the bonafide transferee for value than what the transferor has.

### **1.3 CHARACTERISTICS OF A NEGOTIABLE INSTRUMENT**

A negotiable instrument has the following characteristics:

**Property:** The possessor of the negotiable instrument is presumed to be the owner of the property contained therein. A negotiable instrument does not merely give possession of the instrument but right to property also. The property in a negotiable instrument can be transferred without any formality. In the case of bearer instrument, the property passes by mere delivery to the transferee. In the case of an order instrument, endorsement and delivery are required for the transfer of property.

**Title:** The transferee of a negotiable instrument is known as 'holder in due course.' A bona fide transferee for value is not affected by any defect of title on the part of the transferor or of any of the previous holders of the instrument.

**Rights:** The transferee of the negotiable instrument can sue in his own name, in case of dishonour. A negotiable instrument can be transferred any number of times till it is at maturity. The holder of the instrument need not give notice of transfer to the party liable on the instrument to pay.

**Presumptions:** Certain presumptions apply to all negotiable instruments e.g., a presumption that consideration has been paid under it. It is not necessary to write in a promissory note the words 'for value received' or similar expressions because the payment of consideration is

presumed. The words are usually included to create additional evidence of consideration.

**Prompt payment:** A negotiable instrument enables the holder to expect prompt payment because a dishonour means the ruin of the credit of all persons who are parties to the instrument.

## **PRESUMPTIONS AS TO NEGOTIABLE INSTRUMENT**

Sections 118 and 119 of the Negotiable Instrument Act lay down certain presumptions which the court presumes in regard to negotiable instruments. In other words these presumptions need not be proved as they are presumed to exist in every negotiable instrument. Until the contrary is proved the following presumptions shall be made in case of all negotiable instruments:

**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.

**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.

**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.

**Time of transfer:** Unless the contrary is presumed it shall be presumed that every transfer of a negotiable instrument was made before its maturity.

**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.

**Stamp:** Unless the contrary is proved, it shall be presumed that a lost promissory note, bill of exchange or cheque was duly stamped.

**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.

**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.

## **1.5 TYPES OF NEGOTIABLE INSTRUMENT**

Section 13 of the Negotiable Instruments Act states that a negotiable instrument is a promissory note, bill of exchange or a cheque payable either to order or to bearer. Negotiable instruments recognised by statute are: (i) Promissory notes (ii) Bills of exchange (iii) Cheques. Negotiable instruments recognised by usage or custom are: (i) Hundis (ii)

Share warrants (iii) Dividend warrants (iv) Bankers draft (v) Circular notes (vi) Bearer debentures (vii) Debentures of Bombay Port Trust (viii) Railway receipts (ix) Delivery orders.

This list of negotiable instrument is not a closed chapter. With the growth of commerce, new kinds of securities may claim recognition as negotiable instruments. The courts in India usually follow the practice of English courts in according the character of negotiability to other instruments.

### **1.5.1 Promissory notes**

Section 4 of the Act defines, “A promissory note is an instrument in writing (note being a bank-note or a currency note) containing an unconditional undertaking, signed by the maker, to pay a certain sum of money to or to the order of a certain person, or to the bearer of the instruments.”

#### **Essential elements**

An instrument to be a promissory note must possess the following elements:

**It must be in writing:** A mere verbal promise to pay is not a promissory note. The method of writing (either in ink or pencil or printing, etc.) is unimportant, but it must be in any form that cannot be altered easily.

**It must certainly an express promise or clear understanding to pay:** There must be an express undertaking to pay. A mere acknowledgment is not enough. The following are not promissory notes as there is no promise to pay.

#### **If A writes:**

“Mr. B, I.O.U. (I owe you) Rs. 500”

“I am liable to pay you Rs. 500”.

“I have taken from you Rs. 100, whenever you ask for it have to pay” .

The following will be taken as promissory notes because there is an express promise to pay:

**If A writes:**

“I promise to pay B or order Rs. 500”

“I acknowledge myself to be indebted to B in Rs. 1000 to be paid on demand, for the value received”.

**Promise to pay must be unconditional:** A conditional undertaking destroys the negotiable character of an otherwise negotiable instrument. Therefore, the promise to pay must not depend upon the happening of some outside contingency or event. It must be payable absolutely.

**It should be signed by the maker:** The person who promise to pay must sign the instrument even though it might have been written by the promisor himself. There are no restrictions regarding the form or place of signatures in the instrument. It may be in any part of the instrument. It may be in pencil or ink, a thumb mark or initials. The pronote can be signed by the authorised agent of the maker, but the agent must expressly state as to on whose behalf he is signing, otherwise he himself may be held liable as a maker. The only legal requirement is that it should indicate with certainty the identity of the person and his intention to be bound by the terms of the agreement.

**The maker must be certain:** The note self must show clearly who is the person agreeing to undertake the liability to pay the amount. In case a person signs in an assumed name, he is liable as a maker because a maker is taken as certain if from

his description sufficient indication follows about his identity. In case two or more persons promise to pay, they may bind themselves jointly or jointly and severally, but their liability cannot be in the alternative.

**The payee must be certain:** The instrument must point out with certainty the person to whom the promise has been made. The payee may be ascertained by name or by designation. A note payable to the maker himself is not prorate unless it is indorsed by him. In case, there is a mistake in the name of the payee or his designation; the note is valid, if the payee can be ascertained by evidence. Even where the name of a dead person is entered as payee in ignorance of his death, his legal representative can enforce payment.

**The promise should be to pay money and money only:** Money means legal tender money and not old and rare coins.

A promise to deliver paddy either in the alternative or in addition to money does not constitute a promissory note.

**The amount should be certain:** One of the important characteristics of a promissory note is certainty—not only regarding the person to whom or by whom payment is to be made but also regarding the amount.

However, paragraph 3 of Section 5 provides that the sum does not become indefinite merely because

there is a promise to pay amount with interest at a specified rate.

the amount is to be paid at an indicated rate of exchange.

the amount is payable by installments with a condition that the whole balance shall fall due for payment on a default being committed in the payment of anyone installment.

**Other formalities:** The other formalities regarding number, place, date, consideration etc. though usually found given in the promissory notes but are not essential in law. The date of instrument is not material unless the amount is made payable at a certain time after date. Even in such a case, omission of date does not invalidate the instrument and the date of execution can be independently ascertained and proved.

On demand (or six month after date) I promise to pay Peter or order the sum of rupees one thousand with interest at 8 per cent per annum until payment.

### **Bill of exchange**

Section 5 of the Act defines, "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".

A bill of exchange, therefore, is a written acknowledgement of the debt, written by the creditor and accepted by the debtor. There are usually three parties to a bill of exchange drawer, acceptor or drawee and payee. Drawer himself may be the payee.

### **Essential conditions of a bill of exchange**

It must be in writing.

It must be signed by the drawer.

The drawer, drawee and payee must be certain.

The sum payable must also be certain.

It should be properly stamped.

It must contain an express order to pay money and money alone.



For example, In the following cases, there is no order to pay, but only a request to pay. Therefore, none can be considered as a bill of exchange:

“I shall be highly obliged if you make it convenient to pay Rs. 1000 to Suresh”.

“Mr. Ramesh, please let the bearer have one thousand rupees, and place it to my account and oblige”

However, there is an order to pay, though it is politely made, in the following examples:

“Please pay Rs. 500 to the order of ‘A’.

‘Mr. A will oblige Mr. C, by paying to the order of P’.

The order must be unconditional.

### **Distinction Between Bill of Exchange and Promissory Note**

**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,

**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.

**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.

**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.

**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.

**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.

**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.

**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.

## **Cheques**

Section 6 of the Act defines "A cheque is a bill of exchange drawn on a specified banker, and not expressed to be payable otherwise than on demand".

A cheque is bill of exchange with two more qualifications, namely, it is always drawn on a specified banker, and (ii) it is always payable on demand. Consequently, all cheque are bill of exchange, but all bills are not cheque. A cheque must satisfy all the requirements of a bill of exchange; that is, it must be signed by the drawer, and must contain an

unconditional order on a specified banker to pay a certain sum of money to or to the order of a certain person or to the bearer of the cheque. It does not require acceptance.

### **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.

## **PARTIES TO NEGOTIABLE INSTRUMENTS**

### **Parties to Bill of Exchange**

**Drawer:** The maker of a bill of exchange is called the 'drawer'.

**Drawee:** The person directed to pay the money by the drawer is called the 'drawee',

**Acceptor:** After a drawee of a bill has signed his assent upon the bill, or if there are more parts than one, upon one of such parts and delivered the same, or given notice of such signing to the holder or to some person on his behalf, he is called the 'acceptor'.

**Payee:** The person named in the instrument, to whom or to whose order the money is directed to be paid by the instrument is called the 'payee'. He is the real beneficiary under the instrument. Where he signs his name and makes the instrument payable to some other person, that other person does not become the payee.

**Indorser:** When the holder transfers or indorses the instrument to anyone else, the holder becomes the 'indorser'.

**Indorsee:** The person to whom the bill is indorsed is called an 'indorsee'.

**Holder:** A person who is legally entitled to the possession of the negotiable instrument in his own name and to receive the amount thereof, is called a 'holder'. He is either the original payee, or the indorsee. In case the bill is payable to the bearer, the person in possession of the negotiable instrument is called the 'holder'.

**Drawee in case of need:** When in the bill or in any endorsement, the name of any person is given, in addition to the drawee, to be resorted to in case of need, such a person is called 'drawee in case of need'.

In such a case it is obligatory on the part of the holder to present the bill to such a drawee in case the original drawee refuses to accept the bill. The bill is taken to be dishonoured by non-acceptance or for nonpayment, only when such a drawee refuses to accept or pay the bill.

**Acceptor for honour:** In case the original drawee refuses to accept the bill or to furnish better security when demanded by the notary, any person who is not liable on the bill, may accept it with the consent of the holder, for the honour of any party liable on the bill. Such an acceptor is called 'acceptor for honour'.

### **Parties to a Promissory Note**

**Maker.** He is the person who promises to pay the amount stated in the note. He is the debtor.

**Payee.** He is the person to whom the amount is payable i.e. the creditor.

**Holder.** He is the payee or the person to whom the note might have been indorsed.

The indorser and indorsee (the same as in the case of a bill).

### **1.6.3 Parties to a Cheque**

**Drawer.** He is the person who draws the cheque, i.e., the depositor of money in the bank.

**Drawee.** It is the drawer's banker on whom the cheque has been drawn.

**Payee.** He is the person who is entitled to receive the payment of the cheque.

The holder, indorser and indorsee (the same as in the case of a bill or note).

## 1.7 NEGOTIATION

Negotiation may be defined 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. According to section 14 of the Act, '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 main purpose and essence of negotiation is to make the transferee of a promissory note, a bill of exchange or a cheque the holder thereof.

Negotiation thus requires two conditions to be fulfilled, namely:

There must be a transfer of the instrument to another person;

and

The transfer must be made in such a manner as to constitute the transferee the holder of the instrument.

Handing over a negotiable instrument to a servant for safe custody is not negotiation; there must be a transfer with an intention to pass title.

### **Modes of negotiation**

Negotiation may be effected in the following two ways:

**Negotiation by delivery (Sec. 47):** Where a promissory note or a bill of exchange or a cheque is payable to a bearer, it may be negotiated by delivery thereof.

**Example:** A, the holder of a negotiable instrument payable to bearer, delivers it to B's agent to keep it for B. The instrument has been negotiated.

**Negotiation by endorsement and delivery (Sec. 48):** A promissory note, a cheque or a bill of exchange payable to order can be negotiated only by endorsement and delivery.

Unless the holder signs his endorsement on the instrument and delivers it, the transferee does not become a holder. If there are more payees than one, all must endorse it.

## **ASSIGNMENT**

Bills, notes and cheques represent debts and as such have been held to be assignable without endorsement. Transfer by assignment takes place when the holder of a negotiable instrument sells his right to another person without endorsing it. The assignee is entitled to get possession and can recover the amount due on the instrument from the parties thereto.

Of the two methods of transfer of negotiable instruments discussed, transfer by negotiation is recognised by the Negotiable Instrument Act.

## **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:

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.

It must be made by the maker or holder of the instrument. A stranger cannot endorse it.

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.

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.

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.

It must be an endorsement of the entire bill. A partial endorsement i.e. which purports to transfer to the endorsee a part only of the amount payable does not operate as a valid endorsement.



If delivery is conditional, endorsement is not complete until the condition is fulfilled.

### **Classes of endorsement**

An endorsement may be:

Blank or general.

Special or full.

Partial.

Restrictive.

Conditional.

### **Blank or general endorsement (Sections 16 and 54).**

It is an endorsement when the endorser merely signs on the instrument without mentioning the name of the person in whose favour the endorsement is made. Endorsement in blank specifies no endorsee. It simply consists of the signature of the endorser on the endorsement. A negotiable instrument even though payable to order becomes a bearer instrument if endorsed in blank. Then it is transferable by mere delivery. An endorsement in blank may be followed by an endorsement in full.

**Example:** A bill is payable to X. X endorses the bill by simply affixing his signature. This is an endorsement in blank by X. In this case the bill becomes payable to bearer.

There is no difference between a bill or note endorsed in blank and one payable to bearer. They can both be negotiated by delivery.

### **Special or full endorsement (Section 16)**

When the endorsement contains not only the signature of the endorser but also the name of the person in whose favour the endorsement is made, then it is an endorsement in full. Thus, when endorsement is made by writing the words "Pay to A or A's order," followed by the signature of the endorser, it is an endorsement in full. In such an endorsement, it is only the endorsee who can transfer the instrument.

**Conversion of endorsement in blank into endorsement in full:**

When a person receives a negotiable instrument in blank, he may without signing his own name, convert the blank endorsement into an endorsement in full by writing above the endorser's signature a direction to pay to or to the order of himself or some other person. In such a case the person is not liable as the endorser on the bill. In other words, the person transferring such an instrument does not incur all the liabilities of an endorser. (Section 49).

**Example:** A is the holder of a bill endorsed by B in blank. A writes over B's signature the words "Pay to C or order." A is not liable as endorser but the writing operates as an endorsement in full from B to C.

Where a bill is endorsed in blank, or is payable to bearer and is afterwards endorsed by another in full, the bill remains transferable by delivery with regard to all parties prior to such endorser in full. But such endorser in full cannot be sued by any one except the person in whose favour the endorsement in full is made. (Section 55).

**Example:** C the payee of a bill endorses it in blank and delivers it to D, who specially endorses it to E or order. E without endorsement transfers the

bill to F. F as the bearer is entitled to receive payment or to sue the drawer, the acceptor, or C who endorsed the bill in blank but he cannot sue D or E.

### **Partial endorsement (Section 56)**

A partial endorsement is one which purports to transfer to the endorsee a part only of the amount payable on the instrument. Such an endorsement does not operate as a negotiation of the instrument.

**Example:** A is the holder of a bill for Rs.1000. He endorses it “pay to B or order Rs.500.” This is a partial endorsement and invalid for the purpose of negotiation.

### **Restrictive endorsement (Section 50)**

The endorsement of an instrument may contain terms making it restrictive. Restrictive endorsement is one which either by express words restricts or prohibits the further negotiation of a bill or which expresses that it is not a complete and unconditional transfer of the instrument but is a mere authority to the endorsee to deal with bill as directed by such endorsement.

“Pay C,” “Pay C for my use,” “Pay C for the account of B” are instances of restrictive endorsement. The endorsee under a restrictive endorsement acquires all the rights of the endorser except the right of negotiation.

### **Conditional or qualified endorsement**

It is open to the endorser to annex some condition to his own liability on the endorsement. An endorsement where the endorsee limits or negatives his liability by putting some condition in the instrument is called a conditional endorsement. A condition imposed by the endorser may be a

condition precedent or a condition subsequent. An endorsement which says that the amount will become payable if the endorsee attains majority embodies a condition precedent. A conditional endorsement unlike the restrictive endorsement does not affect the negotiability of the instrument. It is also some times called qualified endorsement.

## **HOLDER IN DUE COURSE**

Section 9 of the Act defines 'holder in due course' as any person who (i) for valuable consideration, (ii) becomes the possessor of a negotiable instrument payable to bearer or the indorsee or payee thereof, before the amount mentioned in the document becomes payable, and without having sufficient cause to believe that any defect existed in the title of the person from whom he derives his title. (English law does not regard payee as a holder in due course).

The essential qualification of a holder in due course may, therefore, be summed up as follows:

He must be a holder for valuable consideration. Consideration must not be void or illegal, e.g. a debt due on a wagering agreement. It may, however, be inadequate. A donee, who acquired title to the instrument by way of gift, is not a holder in due course, since there is no consideration to the contract. He cannot maintain any action against the debtor on the instrument. Similarly, money due on a promissory note executed in consideration of the balance of the security deposit for the lease of a house taken for immoral purposes cannot be recovered by a suit.

He must have become a holder (passessor) before the date of maturity of the negotiable instrument. Therefore, a person who takes a bill or promissory note on the day on which it becomes payable cannot claim rights

of a holder in due course because he takes it after it becomes payable, as the bill or note can be discharged at any time on that day.

He must have become holder of the negotiable instrument in good faith. Good faith implies that he should not have accepted the negotiable instrument after knowing about any defect in the title to the instrument. But, notice of defect in the title received subsequent to the acquisition of the title will not affect the rights of a holder in due course. Besides good faith, the Indian Law also requires reasonable care on the part of the holder before he acquires title of the negotiable instrument. He should take the instrument without any negligence on his part. Reasonable care and due caution will be the proper test of his bona fides. It will not be enough to show that the holder acquired the instrument honestly, if in fact, he was negligent or careless. Under conditions of sufficient indications showing the existence of a defect in the title of the transferor, the holder will not become a holder in due course even though he might have taken the instrument without any suspicion or knowledge.

**Example:**

A bill made out by pasting together pieces of a torn bill taken without enquiry will not make the holder, a holder in due course. It was sufficient to show the intention to cancel the bill. A bill should not be taken without enquiry if suspicion has been aroused.

A post-dated cheque is not irregular. It will not preclude a bonafide purchase instrument from claiming the rights of a holder in due course.

It is to be noted that it is the notice of the defect in the title of his immediate transferor which deprives a person from claiming the right of a holder in due course. Notice of defect in the title of any prior party does not affect the title of the holder.

A holder in due course must take the negotiable instrument complete and regular on the face of it.

### **Privileges of a holder in due course**

**Instrument purged of all defects:** A holder in due course who gets the instrument in good faith in the course of its currency is not only himself protected against all defects of title of the person from whom he has received it, but also serves, as a channel to protect all subsequent holders. A holder in due course can recover the amount of the instrument from all previous parties although, as a matter of fact, no consideration was paid by some of the previous parties to instrument or there was a defect of title in the party from whom he took it. Once an instrument passes through the hands of a holder in due course, it is purged of all defects. It is like a current coin. Who-so-ever takes it can recover the amount from all parties previous to such holder (Sec. 53).

It is to be noted that a holder in due course can purify a defective title but cannot create any title unless the instrument happens to be a bearer one.

### **Examples:**

A obtains Bs acceptance to a bill by fraud. A indorses it to C who takes it as a holder in due course. The instrument is purged of its defects and C gets a good title to it. In case C indorses it to some other person he will

also get a good title to it except when he is also a party to the fraud played by A.

A bill is payable to "A or order". It is stolen from A and the thief forges A's signatures and indorses it to B who takes it as a holder in due course. B cannot recover the money. It is not a case of defective title but a case where title is absolutely absent. The thief does not get any title therefore, cannot transfer any title to it.

A bill of exchange payable to bearer is stolen. The thief delivers it to B, a holder in due course. B can recover the money of the bill.

## **DISHONOUR OF A NEGOTIABLE INSTRUMENT**

When a negotiable instrument is dishonoured, the holder must give a notice of dishonour to all the previous parties in order to make them liable. A negotiable instrument can be dishonoured either by non-acceptance or by non-payment. A cheque and a promissory note can only be dishonoured by non-payment but a bill of exchange can be dishonoured either by non-acceptance or by non-payment.

### **Dishonour by non-acceptance (Section 91)**

A bill of exchange can be dishonoured by non-acceptance in the following ways:

If a bill is presented to the drawee for acceptance and he does not accept it within 48 hours from the time of presentment for acceptance. When there are several drawees even if one of them makes a default in acceptance, the bill is deemed to be dishonoured unless these several drawees are partners. Ordinarily when there are a number of drawees all of them must

accept the same, but when the drawees are partners acceptance by one of them means acceptance by all.

When the drawee is a fictitious person or if he cannot be traced after reasonable search.

When the drawee is incompetent to contract, the bill is treated as dishonoured.

When a bill is accepted with a qualified acceptance, the holder may treat the bill of exchange having been dishonoured.

When the drawee has either become insolvent or is dead.

When presentment for acceptance is excused and the bill is not accepted. Where a drawee in case of need is named in a bill or in any indorsement thereon, the bill is not dishonoured until it has been dishonoured by such drawee.

### **Dishonour by non-payment (Section 92)**

A bill after being accepted has got to be presented for payment on the date of its maturity. If the acceptor fails to make payment when it is due, the bill is dishonoured by non-payment. In the case of a promissory note if the maker fails to make payment on the due date the note is dishonoured by non-payment. A cheque is dishonoured by non-payment as soon as a banker refuses to pay.

An instrument is also dishonoured by non-payment when presentment for payment is excused and the instrument when overdue remains unpaid (Sec 76).

**Effect of dishonour:** When a negotiable instrument is dishonoured either by non acceptance or by non-payment, the other parties thereto can be



charged with liability. For example if the acceptor of a bill dishonours the bill, the holder may bring an action against the drawer and the indorsers. There is a duty cast upon the holder towards those whom he wants to make liable to give notice of dishonour to them.

**Notice of dishonour:** Notice of dishonour means the actual notification of the dishonour of the instrument by non-acceptance or by non-payment. When a negotiable instrument is refused acceptance or payment notice of such refusal must immediately be given to parties to whom the holder wishes to make liable. Failure to give notice of the dishonour by the holder would discharge all parties other than the maker or the acceptor (Sec. 93).

**Notice by whom:** Where a negotiable instrument is dishonoured either by non- acceptance or by non-payment, the holder of the instrument or some party to it who is liable thereon must give a notice of dishonour to all the prior parties whom he wants to make liable on the instrument (Section 93). The agent of any such party may also be given notice of dishonour. A notice given by a stranger is not valid. Each party receiving notice of dishonour must, in order to render any prior party liable give notice of dishonour to such party within a reasonable time after he has received it. (Sec. 95)

When an instrument is deposited with an agent for presentment and is dishonoured, he may either himself give notice to the parties liable on the instrument or he may give notice to his principal. If he gives notice to his principal, he must do so within the same time as if he were the holder. The principal, too, in his turn has the same time for giving notice as if the agent is an independent holder. (Sec. 96)

**Notice to whom?:** Notice of dishonour must be given to all parties to whom the holder seeks to make liable. No notice need be given to a maker, acceptor or drawee, who are the principal debtors (Section 93).

Notice of dishonour may be given to an endorser. Notice of dishonour may be given to a duly authorised agent of the person to whom it is required to be given. In case of the death of such a person, it may be given to his legal representative. Where he has been declared insolvent the notice may be given to him or to his official assignee (Section 94). Where a party entitled to a notice of dishonour is dead, and notice is given to him in ignorance of his death, it is sufficient (Section 97).

**Mode of notice:** The notice of dishonour may be oral or written or partly oral and partly written. It may be sent by post. It may be in any form but it must inform the party to whom it is given either in express terms or by reasonable intendment that the instrument has been dishonoured and in what way it has been dishonoured and that the person served with the notice will be held liable thereon.

**What is reasonable time?:** It is not possible to lay down any hard and fast rule for determining what is reasonable time. In determining what is reasonable time, regard shall be had to the nature of the instrument, the usual course the dealings with respect to similar instrument, the distance between the parties and the nature of communication between them. In calculating reasonable time, public holidays shall be excluded (Section 105).