Negotiable Instruments: Meaning, Types and Legal Aspects

By Meherpuja Mathur

TYPES OF NEGOTIABLE INSTRUMENTS:

1. Negotiable instruments by Statue
   The Act mentions only three types of Negotiable Instruments (Section 13). These are:
   - Promissory Note
   - Bill of Exchange
   - Cheque

2. Negotiable instruments by custom or usage
   There are certain instruments which have acquired the character of negotiability by the usage or custom of trade. For example, Exchequer bill, Bank Notes, Share warrant, Bill of Lading etc.

   A Comparative analysis, advantages and disadvantages of Promissory note, Bill of Exchange and Cheque is given in the tables below:-
<table>
<thead>
<tr>
<th>Basis of Comparison</th>
<th>Promissory Note</th>
<th>Bill of Exchange</th>
<th>Cheque</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Meaning</td>
<td>A promissory note is a <strong>written unconditional promise</strong> made by the debtor to pay a certain sum of money to the creditor at a future specified date.</td>
<td>A Bill of Exchange is an instrument in writing, in the nature of an <strong>unconditional order</strong>, showing the indebtedness of a buyer towards the seller of goods.</td>
<td>A document used to make payments on demand and can be transferred through hand delivery is known as cheque.</td>
</tr>
<tr>
<td>2. Defined in</td>
<td>Section 4 of the NI Act</td>
<td>Section 5 of the NI Act</td>
<td>Section 6 of the NI Act</td>
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<tr>
<td>3. Number of parties</td>
<td>Two parties, i.e. drawer and payee.</td>
<td>Three parties, i.e. drawer, drawee and payee.</td>
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</tr>
<tr>
<td>4. Drawn by</td>
<td>Debtor</td>
<td>Creditor</td>
<td>Debtor</td>
</tr>
<tr>
<td>5. Validity period</td>
<td>Not Applicable</td>
<td>Not Applicable</td>
<td>3 months</td>
</tr>
<tr>
<td>6. Payable to bearer on demand</td>
<td>Cannot be made payable to bearer on demand as per RBI Act, 1934</td>
<td>Yes</td>
<td>Always</td>
</tr>
<tr>
<td>7. Can drawer/maker and payee be the same person?</td>
<td>No</td>
<td>Yes (--when the bill is discounted by the drawer, When cheque is payable)</td>
<td>Yes</td>
</tr>
</tbody>
</table>
the person who discounted the bill becomes the payee. --when the bill is endorsed to a creditor, the endorsee will become the payee.)

<table>
<thead>
<tr>
<th>8. Stamping</th>
<th>Yes</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>9. Notice of dishonour</td>
<td>No notice needs to be given in case of its dishonour</td>
<td>In case of its dishonour, due notice has to be given by the holder to the drawer</td>
<td>In case of its dishonour, due notice has to be given by the holder to the drawer</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Instrument</th>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
</table>
| 1. Promissory Note | • Simple and easily understandable.  
• Beneficial when a loan has simple payment terms.  
• Not very lengthy. | • Isn't as beneficial for complex situations, where there are more terms and conditions and greater protection against borrower default is sought.  
• Cannot be made payable to bearer |
| 2. Bill of Exchange | • Easily transferable  
• Beneficial when a loan has simple payment terms.  
• Not very lengthy.  
• Certainty of terms and conditions  
• Convenient means of credit | • Not binding unless accepted by the drawee  
• Isn’t as beneficial for complex situations |
3. Cheque

- More convenient than carrying cash
- Payment can be stopped, if necessary
- Can be post dated

- Not suitable for small amount
- Valueless if the drawer has no funds in his account
- Depositing a cheque is time consuming
- Payee without a bank account will be inconvenienced because of a crossed cheque

PARITES TO NEGOTIABLE INSTRUMENTS AND THEIR LIABILITY:

According to Section 26 of the Act, Every person capable of contracting, (who has completed 18 years of age and is of sound mind) according to the law to which he is subject, may bind himself and be bound by the making, drawing, acceptance, indorsement, delivery and negotiation of a promissory note, bill of exchange or cheque.

Minor — a minor may draw, indorse, deliver and negotiate such instruments so as to bind all parties except himself. Nothing herein contained shall be deemed to empower a corporation to make, indorse or accept such instruments except in cases in which, under the law for the time being in force, they are so empowered.

1) Maker: The person who makes a promissory note is called a maker.

Liability: In the absence of a contract to the contrary, the maker of a promissory note is bound to pay the amount thereof at maturity according to the apparent tenor of the note or acceptance respectively. In default of such payment, the maker is bound to compensate any party to the note for any loss or damage sustained by him and caused by such default.

2) Drawer: The person who makes a bill of exchange or cheque is called a drawer.

Liability: The drawer of a bill of exchange or cheque is bound in case of dishonour by the drawee or acceptor thereof, to compensate the holder, provided due notice of dishonour has been given to, or received by, the drawer as hereinafter provided.

3) Drawee: The person directed to pay by the drawer is called a drawee.

Liability: The drawee of a cheque having sufficient funds of the drawer in his hands properly applicable to the payment of such cheque must pay the cheque when duly required so to do, and, in default of such payment, must compensate the drawer for any loss or damage caused by such default.
4) **Acceptor:** After the drawee of a bill has signed his assent upon the bill, or, if there are more parts thereof 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”.

**Liability:** In the absence of a contract to the contrary, the acceptor before maturity of a bill of exchange is bound to pay the amount thereof at maturity according to the apparent tenor of acceptance and the acceptor of a bill of exchange at or after maturity is bound to pay the amount thereof to the holder on demand. In default of such payment as aforesaid, the acceptor is bound to compensate any party to the bill for any loss or damage sustained by him and caused by such default.

5) **Payee:** The person named in the instrument, to whom or to whose order the money is by the instrument directed to be paid, is called the “payee”.

6) **Holder:** He is either the payee or the person to whom the instrument may have been endorsed.

7) **Holder in due course:** “Holder in due course” means any person who for consideration became the possessor of a promissory note, bill of exchange or cheque if payable to bearer, or the payee or indorsee thereof, if payable to 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 whom he derived his title.

**Rights:** Under section 36 of the Act, every prior party (i.e the maker, drawer, acceptor or intervening indorser) to the negotiable instrument is liable thereon to a holder in due course until the instrument is duly satisfied.¹

**Indorsement:**

When the maker or holder of negotiable instrument signs the instrument with the intention to negotiate it, it is called an indorsement and the person who signs is called an “indorser”. The signature can be made on the back or face of the instrument or on a slip of paper annexed to it or it may also be a signature on stamped paper. As per section 46, indorsement is complete only after delivery of the indorsed instrument to the indorsee.

Indorsement confers the property in the instrument to the indorsee (transferee) with right of further negotiation.

**LEGAL ISSUES PERTAINING TO NEGOTIABLE INSTRUMENTS:**

**Whether the payment banker or person making the payment gets protection if the banker credits the proceeds received by him to a person who is not the true owner of the instrument**

Section 85(1) and 85 (2) of the Act provides protection to the paying bank against making payments of order cheque and bearer cheque respectively. However, the payment banker does not get statutory protection if he

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¹ Duly satisfied means if the liability of all the parties is extinguished and the instrument is discharged
makes payment of a cheque which is materially altered or signature of drawer is forged.

Payment of cheque payable to order:
Section 85 (1) of the Act states that:
“Where a cheque payable to order purports to be indorsed by or on behalf of the payee, the drawee is discharged by payment in due course.”

Payment of cheque payable to bearer:
Section 85 (2) of the Act states that:
“Where a cheque is originally expressed to be payable to bearer, the drawee is discharged by payment in due course to the bearer thereof, notwithstanding any indorsement whether in full or in blank appearing thereon, and notwithstanding that any such indorsement purports to restrict or exclude further negotiation.

Whether the payment banker or person making the payment is liable upon payment of instrument where alteration is not apparent

As per Section 89(1) of the Act, the payment banker shall be discharged from liability arising out of alteration of an instrument, which is not apparent, if he has made the payment according to the apparent tenor. It states that:-

“Where a promissory note, bill of exchange or cheque has been materially altered but does not appear to have been so altered, or where a cheque is presented for payment which does not at the time of presentation appear to be crossed or to have had a crossing which has been obliterated, payment thereof by a person or banker liable to pay and paying the same according to the apparent tenor thereof at the time of payment and otherwise in due course, shall discharge such person or banker from all liability thereon; and such payment shall not be questioned by reason of the instrument having been altered, or the cheque crossed.”

The situation is different in case of electronic image of a truncated cheque. In such a case, the banker or clearing house, while truncating and transmitting the image, has to ensure the exactness of apparent tenor of such cheque and verify from the party who transmitted the image, that the image transmitted to it and received by it, is exactly the same.[Section 89(1) and (2)]

In case of dishonour of a cheque under section 138, which court shall have jurisdiction to try the case?

According to Negotiable Instruments (Amendment) Ordinance, 2015, Section 142 has been amended.

• A) In case of a cheque delivered for collection through an account:
  ➢ A cheque bouncing case can be filed only in the court at the place where the bank in which the payee has account is located.

For example, if you are based at Delhi and you have an account in a bank in a particular area of Delhi. You receive a cheque from someone in Mumbai. You present your cheque in Delhi in the bank where you have your account. Now, if this cheque is dishonoured, then the cheque bounce case can be filed only in Delhi in the court which has jurisdiction over the area where your bank is located.

2 Inserted by Act 55 of 2002
B) In case of a cheque, presented for payment otherwise through an account:

> The case can be filed only in the court within whose jurisdiction the branch of the drawee bank where the drawer maintains the account, is situated.

In the above example, if you are residing in Delhi and you receive a bearer cheque from someone in Mumbai, you want to get it encashed from the bank branch in Mumbai where the drawee maintains an account. If such a cheque is dishonoured, the cheque bounce case can be filed only in Mumbai in the court which has jurisdiction over the area where the drawee bank is located.3

- Secondly, once you have filed a cheque bounce case in one particular court at a place in this manner, subsequently if there is any other cheque of the same party (drawer) which has also bounced, then all such subsequent cheque bounce cases against the same drawer will also have to filed in the same court (even if you present them in some bank in some other city or area). This will ensure that the drawer of cheques is not harassed by filing multiple cheque bounce cases at different locations. So, even multiple cheque bounce cases against the same party can be filed only in one court even if you present the cheques in different banks at different locations.

- Thirdly, all cheque bounce cases which are pending as on 15 June 2015 in different courts in India, will be transferred to the court which has jurisdiction to try such case in the manner mentioned above, i.e., such pending cases will be transferred to the court which has jurisdiction over the place where the bank of the payee is located. If there are multiple cheque bounce cases pending between the same parties as on 15 June 2015, then all such multiple cases will be transferred to the court where the first case has jurisdiction as per above principle.4

> In cases of complaints filed under section 138, to what extent does the liability of accused lie?

In the case of Somnath Sarkar v. Utpal Basu5, the Supreme Court has capped the liability of compensation to twice the cheque value. Any amount exceeding the cap would be violative of Section 138.

> Whether in a case where a period is fixed within which a person must act, the day on which the cause of action arises (i.e., receipt of notice under Section 138 (b) of the NI Act intimating the drawer of the fact of dishonour of the cheque) should also be counted while computing the limit of 30 days.

Section 142(b) of the NI Act states the period within which a complaint u/s 138 has to be made. It states that:-

“Complaint in writing is made within one month of the date on which the cause of action

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3 Section 142(2) inserted by Negotiable Instruments (Amendment) Ordinance, 2015
4 Section 142-A inserted by Negotiable Instruments (Amendment) Ordinance, 2015
5 CRIMINAL APPEAL NO. 1651 OF 2013
arises under section 138(c) [Provided that the
cognizance of a complaint may be taken by the
Court after the prescribed period, if the
complainant satisfies the Court that he had
sufficient cause for not making a complaint within
such period].”

The Supreme Court in *Econ Antri Ltd v. Rom Industries Ltd.*\(^6\) reconsidered the principle of
limitation explained in *Saketh India Ltd. and Ors. v. India Securities Ltd* (”Saketh”)\(^7\). It held that for
the purposes of calculating the period of one
month, the period had to be reckoned by
excluding the date on which the cause of action
arose.

*Whether the principle of vicarious
liability applies in cases of dishonour of cheques*

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\(^6\) CRIMINAL APPEAL NO.1079 OF 2006
\(^7\) 1999) 3 SCC 1

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\(^8\) CRIMINAL APPEAL No. 813 OF 2013