DEPARTMENT OF COMMERCE (CA)

Banking (SEMESTER-V)

III-UG Non-Major Elective   Sub code-18BCA5EL

Unit-IV

Negotiable Instruments -Bills of Exchange and Promissory notes -Cheque and Bank draft- Endorsement.

NEGOTIABLE INSTRUMENTS

- Negotiable instruments have great significance in modern business world.
- A negotiable instrument is a transferable document which satisfies certain conditions.
- These instruments pass freely from hand to hand and thus form an integral part of the modern business mechanism.
- The law relating to negotiable instruments in India is contained in the Negotiable Instrument Act 1881.

DEFINITION

According to Negotiable Instruments Act (U/S13)

"Negotiable Instruments means promissory note, bill of exchange or cheque payable either to order or to bearer."

Negotiable instrument is a transferable document either by the applicable of the law or by the custom of the trade concerned.

CHARACTERISTICS

Easily Transferable

Title free from defects

Right to sue

No notice to transfer

Presumption

Credit of the party

1.EASILY TRANSFERABLE

The negotiable instruments are easily and freely transferable from one person to another.

The ownership of the property in the instrument may be passed on the mere delivery.

Transferability is an essential feature of negotiable instruments.

2.TITLE FREE FROM DEFECTS

This is the most important characteristic of a negotiable instrument.

A person who takes a negotiable instrument from another person, who had stolen it from somebody else, will have absolute and indisputable title to the instrument provided he receives the same for value and in good faith a person is called the holder in due course and his interest in the instrument is well protected by the law.

3.RIGHT TO SUE

The transferee who is legally called the holder in due course is entitled to sue upon the instrument in his own name. Thus, he can recover the amount of the instrument from the party liable to pay thereon.

4.NO NOTICE TO TRANSFER

A negotiable instrument can be transferred any number of times till the date of its maturity. The holder of the instrument need not give an notice of transfer to the transferor or any other person liable for payment of the instrument

5.PRESUMPTION

A negotiable instrument is always subject to certain presumptions which are applicable unless contrary is proved.

6.CREDIT OF THE PARTY

The credit of the party who signs the instrument is pledged to the instrument. Therefore, such instrument will never be dishonoured normally.

TYPES OF NEGOTIABLE INSTRUMENT

Mainly there are two types of negotiable instruments such as:

I - Negotiable by law

a) Promissory Note

b) Bill of Exchange

c) Cheques

II – NEGOTIABLE BY CUSTOM OF TRADE OR USAGE

a) Government Promissory Notes (GPNs)

b) Dividend Warrants

c) Interest Warrants

I - Negotiable by law

Promissory Note: Promissory note is an unconditional document in which the drawer promises to pay the amount stated in it after a definite period or on demand to payee or on his order to bearer.

Bill of exchange: A bill of exchange is a written document and also a acknowledgement of a debt. The creditor prepares a bill of exchange which is accepted by the debtor.

Cheque: A cheque is a mode of order to the bank by the depositor to make the payment to the person in whose favour the cheque has been issued.

II – Negotiable By Custom of Trade or Usage

Government Promissory Notes (GPNs): GPN are issued by both Central and State government. It is a promise made by the government to pay a certain sum of money to a certain person or his order on a specified date.

Dividend Warrants: The large joint stock company generally distribute dividend to shareholders by issuing dividend warrants. The amount mentioned in the dividend warrant can be drawn from the company's bankers.

c) Interest Warrants: Interest warrants are drafts for the payment of the interest due on Government securities, debentures etc.

CLASSIFICATION OF NEGOTIABLE INSTRUMENTS

- Bearer vs Order Instrument
- Inland vs Foreign Instruments
- Demand vs Future Time Instruments
- Clear vs Ambiguous Instruments
- Complete vs Inchoate Instrument
- Clean vs Documentary Instruments
- Trade vs Accommodation Bill
- Fictitious vs Escrow Bill

1. BEARER VS ORDER INSTRUMENT

a) Bearer Instrument: As per section 11 of negotiable instrument act, negotiable instrument is a bearer instrument when It is expressed to be payable to the bearer. Such cheques (and drafts) are payable to anyone who presents them, usually over the counter of the paying bank. It is also called bearer draft.

b) Order Instrument: As per section 13(1) of the Negotiable Instrument Act, An order instrument is one which is payable to a particular person. The payee can transfer an order cheque to someone else by signing his or her name on the back of it.

2. INLAND VS FOREIGN INSTRUMENTS

a) Inland Instrument: A negotiable instrument is deemed to be an inland one, when

i) It is drawn and payable in India, or

ii) It is drawn upon any person resident in India, irrespective of his place of origin.

b) Foreign Instrument: As per section 12, an instrument which is not an inland instrument is deemed to be a foreign instrument.

3. DEMAND VS FUTURE TIME INSTRUMENTS

a) Demand Instrument: A negotiable instrument is payable on demand when

i) It is expressed to be payable on demand.

ii) No time is fixed for its payment.

b) Future Time Instrument: An instrument is payable at a future time, when

i) It is payable at a fixed period after its date or event which is certain to happen.

4. CLEAR VS AMBIGUOUS INSTRUMENTS

a) Clear Instrument: Instrument which can be clearly identified as bill or promissory note or cheque are called clear instruments.

b) Ambiguous Instrument: Instruments which can be interpreted either as a bill or promissory note are called ambiguous instrument. It’s holder has to elect once for all whether he wants to treat it a as a promissory note or a bill of exchange.

5. COMPLETE VS INCHOATE INSTRUMENT

a) Complete Instrument: When a negotiable instrument is complete in all its particulars, it is called a complete instrument.

b) Inchoate Instrument: When a negotiable instrument is an incomplete one, duly signed and stamped or upto the value covered by the stamp affixed on it, it is called an inchoate instrument. Inchoate instrument means an unregistered, unrecorded instrument that becomes effective to third parties only when the instrument is recorded.

6. CLEAN VS DOCUMENTARY INSTRUMENTS

a) Clean Instrument: If the bills or promissory notes are not accompanied by certain documents like invoice, bills of lading(shipment receipt), etc., are called clean instrument.

b) Documentary Instrument: If the bills or promissory notes are accompanied by certain documents like invoice, bills of lading etc., they are called documentary instrument. They are used in foreign trade.

7. TRADE VS ACCOMMODATION BILL

a) Trade Bill: A trade bill is drawn and accepted by a trader in payment for goods.

b) Accommodation Instrument: An accommodation bill is drawn and accepted without any sale or purchase of goods, with a view to help each other who are in need of money.

8. FICTITIOUS VS ESCROW BILL

Fictitious bill: When the bill is drawn on fictitious person, it is said to be a fictitious bill. Drawer and payee must be definite person, when they are fictitious , then the bill is called fictitious bill.

b) Escrow Bill: A bill is delivered conditionally or for a special purpose is called escrow. In this the transaction may be safely carried out without the risk of losing money.

PARTIES OF THE NEGOTIABLE INSTRUMENT

Broadly, there are three parts in relation to negotiable instrument. They are:

i) Holder

ii) Holder in due course

iii) Holder for value

i) HOLDER:

The holder must be the person whose name is mentioned in the instruments as the payee or bearer of an instrument.

ii)HOLDER IN DUE COURSE:

A holder in due course (HDC) is a person who acquires the negotiable instrument for some consideration, whose payment is still due.

For example: Anyone who accepts a third-party cheque is a holder in due course.

iii)HOLDER FOR VALUE:

If any person is the holder of a negotiable instrument, the value of which has been paid at any time in the past, then he is known as holder of value. Such holder has no right against the person who has actually paid for the value.

The bill of exchange and promissory note are negotiable instruments used for carrying out various economic activities. However, they vary from each other in many ways. The significant difference between them is that a bill of exchange is a written order drafted by the drawer on the drawee to receive the mentioned sum within the specified period. Whereas, a promissory note is a written promise made by the borrower or drawer to repay the amount on a specific date or order of the payee.

According to the traditional concept, cash is an inevitable part of every transaction. But in the present scenario, whether it is trading, banking, financing or any other economic activity, bill of exchange and promissory note make the transactions convenient even in the absence of immediate cash.

Difference and Comparison

BASIS	BILL OF EXCHANGE	PROMISSORY NOTE
Meaning	A bill of exchange is a written order drafted by the drawer on drawee to pay a specific sum within a mentioned time period without any condition.	A promissory note is a written promise made by the drawer to pay a definite amount to the payee on a specified date.
Drawn by	Creditor	Debtor
Parties Involved	Drawer, drawee and payee	Drawer and payee
Order/promise	Order to pay	Promise to pay
Drawn in sets	Yes	No
Need for acceptance	Yes	No
Stamp duty requirement	Yes	No
Payable to bearer	Yes	No

BASIS	BILL OF EXCHANGE	PROMISSORY NOTE
Defined under	Section 5 of Negotiable Instrument Act, 1881	Section 4 of Negotiable Instrument Act, 1881
Liability on drawer	Secondary and conditional	Primary and absolute
Printed form	Not necessary	Compulsory
Protest in case of dishonor	Yes	No
Notice of dishonor	Yes	No
Can the same person be drawer and payee?	Yes	No

Bill of Exchange

A bill of exchange is a negotiable instrument in a written format which orders the drawee or the debtor to pay a certain sum within the given period to the drawer or the creditor or the payee.

Features of Bill of Exchange

A bill of exchange is a unique instrument used for non-cash transactions. The following characteristics differentiate it from other negotiable instruments:

Negotiable Instrument: A bill of exchange is a negotiable instrument which holds legal obligation on the drawee to pay the specified amount.

Written Order: It is a written order drafted by the drawer on the drawee.

Stamped by Drawer: It holds a legal stamp to ensure its validity.

Duly Signed by Drawee: A bill of exchange is duly accepted and signed by the drawee who owes the sum to the payee.

Date of Payment: The date of payment is mentioned on the bill of exchange.

Unconditional Order: The bill is an order which needs to be fulfilled irrespective of the condition prevailing on the date of payment.

Parties Involved in Bill of Exchange

Though a bill of exchange majorly involves only three parties, there are various others whose role is equally important. These parties are classified as follows:

Drawer: The drawer or the creditor is the person who creates the bill of exchange and is entitled to receiving the sum in return of the goods sold on credit.

Drawee: The drawee is the one on whom the bill is drawn and who owes the amount to the drawer or the payee.

Payee: The person who is liable to receive the sum as mentioned in the bill of exchange is known as the payee. The drawer can be the payee if he/she does not endorse the bill to someone else.

Other Parties: Apart from the above mentioned three parties, some more people are also associated with a bill. They are as follows:

Holder: A holder is a person who has the possession of the bill or is the bearer of it and is liable to recover the amount. Both payee or endorsee can be the holder of a bill of exchange.

Acceptor: The person on whom the bill is drawn, i.e. the drawee who owes the amount to the payee and therefore accepts to pay the same by signing the bill of exchange.

Endorser: The holder who transfers the bill of exchange in the name of some other person, making him/her the payee is known as an endorser.

Endorsee: An endorsee is a person on whose name the bill of exchange is transferred by the endorser and who becomes the payee and holder of that bill.

Promissory Note

A promissory note is a debt negotiable instrument written by a borrower (drawer) who promises to pay the lender (payee), a specific sum on-demand or on a particular future date which is predefined.

Features of Promissory Note

What is a promissory note? How is it different from other negotiable instruments? To get the answers, let us go through the following features of a promissory note:

Debt Negotiable Instrument: A promissory note is a debt instrument made at the time of providing loan other than bank loans.

Written Promise: The promise made by the drawer to pay off the sum is in a written format.

Duly Signed by Drawer or Promisor: This note holds the signature of the drawer abiding by all its clauses.

Fixed Date of Payment: The promissory note states a particular date of repayment on which the promise has to be fulfilled.

Parties Remain Same Throughout: The parties to a promissory note unlike a bill of exchange does not change throughout the execution of it.

Fixed Sum or Amount: The amount is mentioned in the monetary denomination on a promissory note.

Legal Currency: The exchange of money while execution of a promissory note is done in legal currency.

Parties Involved in Promissory Note

A promissory note strictly involves two parties, i.e. a drawer and a payee. To know more about each one in detail, read below:

Drawer: The drawer or the maker of a promissory note is the one who borrows the sum and promises to pay a certain amount in return on-demand or a specified date.

Payee: The payee or the drawee is the person who lends the sum to the drawer and is liable to receive a certain amount in return, on his/her demand or the date specified on the promissory note.

Classification of Bill of Exchange

A bill of exchange can be categorized into various kinds, based on the residential status of the parties, date of maturity and purpose of the bill. These types are explained in detail below:

1.Inland Bills: A bill of exchange drawn within the geographical boundaries of a country, when the drawer, drawee and payee resides in that particular country, is known as an inland bill.

2.Foreign Bills: When a drawer makes a bill in one country to be accepted and payable by the drawee in some other country, this bill of exchange is called a foreign bill.

3.Demand Bills: These bills of exchange do not have a specific date or period of repayment; instead, these are payable on demand of the payee or holder.

4.Term Bills: The bills of exchange payable on a specific date or after a definite period are called term bills.

5.Trade Bills: Trade bills are those who are drawn by the seller or creditor at the time of selling goods on credit to the drawee.

6.Accommodation Bills: The bill which is drawn by a lender to provide financial support or aid to the drawee or the borrower is known as an accommodation bill.

Classification of Promissory Note

A promissory note is divided into the following types, based on the residential status of the parties, date of payment, interest and liability:

1.Inland Promissory Note: If the parties involved in a promissory note, i.e. the drawer and the payee belongs to the same country, the draft is referred to as an inland promissory note.

2.Foreign Promissory Note: A promissory note in which the drawer and the payee both belong to different countries is termed as a foreign promissory note.

3.After Date Promissory Note: An after date promissory note is the one on which the drawer states its life or period of repayment. According to this period and the date of issue, the due date can be calculated.

4.Post-Dated Promissory Note: The promissory note which reveals a date of repayment belonging to the next period, i.e. the next month or year, is known as a post-dated promissory note.

5.Demand Promissory Note: The note which is payable on demand of the payee, i.e. the payee can claim the amount on any day as per his/her choice is termed as a demand promissory note.

6.Interest Bearing Demand Promissory Note: As a mutual understanding between the payer and the payee, the interest on the amount is decided which is payable by the drawer along with the principal amount as and when claimed by the payee.

7.Interest Bearing Promissory Note: Again with a mutual understanding a specific rate of interest is decided among the parties, which is payable by the drawer in addition to the principal sum on the due date to the payee.

8.Joint Liability Promissory Note: The joint liability promissory note is the one in which involves two or more drawers unanimously liable to pay the specified amount to the payee on the due date.

CHEQUE DEFINITION:

According to the Negotiable Instrument Act, 1881

“A cheque is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand.”

INTRODUCTION OF CHEQUE

A cheque is a document of very great importance in the commercial world. It is a very safe and convenient method of making payments or withdrawing money from a bank.’

A cheque being a negotiable instrument, can be passed from hand to hand easily and so it has become a popular mode of payment.

FEATURES OF A CHEQUE:

- Instrument in Writing
- An Unconditional Order
- On a Specified Banker
- Payee Must be Certain
- A Certain sum of Money
- Payment on Demand
- Signed by the Drawer
- Date of the Cheque
- Amount

ISSUE OF A CHEQUE

- Use of printed form
- Complete
- Date of cheque
- Payee’s name
- Amount
- Signature of drawer
- Alterations
- Crossing of cheque
- Counterfoil

KINDS OF CHEQUE

1. OPEN CHEQUE

An open cheque is one which is payable across the counter of the bank. It can be encashed at the counter of the bank.

a) Bearer cheque: It is a cheque in which amount is payable to a person named in the cheque or to the bearer there of who present to the bank.

b) Order cheque: This cheque indicate the word ‘order’ rather than ’bearer’. The word ‘bearer’ is struck off by the drawer.

2. CROSSED CHEQUE

A crossed cheque is most secured cheque. In a crossed cheque, two parallel transverse lines with or without the word & co., ”not negotiable” etc are drawn.

A crossed cheque is not payable across the counter of the bank, it must be deposited directly to the bank account and cannot be immediately cashed by bank or any other credit institution.

ADVANTAGES OF CHEQUE

1.Safe method of payment: A cheque provides a safe and convenient method of making payment.

2.Funds easily transferable: The cheque provides the facility of easy and safe transfer of any amount of funds from one place to another and from one country to another.

3.Safety of money: Cheques provide safety to money from robbery, because there is no need of keeping cash in hand when the cheques are frequently used.

4.Serve as a receipt: The cheque serves as a valid proof of receipts. The drawer can get the counterfoil signed on its back, from the person to whom it is issued.

5.Savings in the use of currency: When cheques are frequently used in transaction, it saves the use of currency.

6.Credit: Cheques facilitate credit which helps in the growth of trade, business and commerce of a country

CROSSING:

Crossed cheque means drawing two parallel lines on the left corner of the cheque with or without additional words like “Account Payee only” or “Not Negotiable”. A cheque bearing such an instruction is called a crossed cheque. A crossed cheque cannot be encashed at the cash counter of a bank but it can be credited to the payee’s account. This is a safer way of transferring money than an uncrossed cheque or open cheque.

TYPES OF CROSSING

1. GENERAL CROSSING: The cheque bears across its face an additional of two parallel transverse lines or the addition of words ‘and Co’ or ‘not negotiable’ between them.

2. SPECIAL CROSSING: In the special crossing, the cheque bears across its face an addition of banker’s name, with or without the words ‘not negotiable’.

3. NOT NEGOTIABLE CROSSING: It is when words ‘Not Negotiable’ written between the two parallel transverse lines across the face of the cheque. The amount is to be credited only into the account of intended person.

4. A/C PAYEE CROSSING: If the words, ‘A/C payee’ are added to a crossing it becomes an A/C payee crossing. It directs the collecting banker that he need to credit the amount of cheque only to the account of the payee, or the party named or his agent.

5. DOUBLE CROSSING: When a cheque bears two special crossing, is called double crossing. In this the second bank acts as an agent of the first collecting banker. It is made when the banker in whose favour the cheque is crossed does not have branch where the cheque is paid.

ENDORSEMENT

The word “Endorsement” is derived from a Latin word ‘in dorsum’ meaning at the back. When a negotiable instrument is signed and transferred by one person to another in such a manner that the right to receive the payment is transferred to the other person, it is known as endorsement. In case there is no space on the backside of the instrument for the endorsement, a separate sheet as **“allonge”** is attached to the instrument for the purpose of making endorsement. It means that endorsement may be made at the back of the instrument.

PARTIES OF ENDORSEMENT

There are two parties of endorsement of a negotiable instrument:

1.ENDORSER: The person who signs the instrument for the purpose of negotiation is called the ‘endorser’.

2.ENDORSEE: The person in whose favour instrument is transferred is called the ‘endorsee’.

ESSENTIALS OF A VALID ENDORSEMENT

1. ON THE BACKSIDE OF INSTRUMENT: It should be made on the backside of the instrument.

2. WRITTEN IN INK: It should always be made in ink not in pencil or by a rubber stamp.

3. SIGNED BY ENDORSER: It must be signed by the endorser. The simple signature of the endorser, with or without additional word is sufficient.

4. ENDORSEMENT OF ENTIRE INSTRUMENT: Endorsement must be of the entire document. A partial endorsement does not operate as a valid one.

5. TWO OR MORE PAYEES: When a negotiable instrument is payable to two or more payees or endorsees, they all must endorse unless they are partners, when one of them can sign on behalf of all.

6. NO USE OF HONOURABLE WORDS: While making an endorsement, the use of the words showing respect such as honourable Ram, Ravi etc, should not be used.

7. NAME OF ENDORSER: While signing his name, the endorser should write his name in the same manner, same alphabets and same order as written in instrument.

8. IN CASE OF MARRIED WOMEN: When a married woman endorses a negotiable instrument, she should mention the name of her husband along with her signature.

9. ENDORSEMENT BY ILLITERATE PERSON: If any illiterate person wants to endorse a negotiable instrument, he can do so by imprinting the impression of his left thumb.

10. DELIVERY INSTRUMENT: The endorsement of the instrument is not completed merely by putting one’s signature upon it. The delivery of the instrument is also very important.

GENERAL RULES REGARDING FORM OF ENDORSEMENT

1. Signature of the endorser: The signature on the document for the purpose of endorsement must be that of the endorser or any other person who is duly authorised to endorse on his behalf.

2. Spelling: The endorser should spell his name in the same way as his name appears on the cheque.

3. No Addition or omission of initial of the name: An initial of name should neither be added or omitted from the name of payee or endorser.

4. Prefixes and Suffixes to be excluded: The prefixes and suffixes to the names of the payee or endorsee need not be included in the endorsement. For example, the words "Mr, Mrs, Miss, Shri etc." need not to be given by the endorser.

5. Endorsement By Firms: Endorsement in the case of firms can be either in the name of the firm itself, or by legally authorised person on behalf of the firm, the name of the firm must be mentioned in full.

TYPES OF ENDORSEMENT

1.ENDORSEMENT IN BLANK: If the endorser signs his name only, the endorsement is said to be 'in blank'.

2.ENDORSEMENT IN FULL: If the endorser adds a direction to pay the amount mentioned in the instrument to, or a specified person in addition to his signature it is said to be endorsement in full.

3.CONDITIONAL ENDORSEMENT: If the endorser express words in the endorsement, makes his liability, or the right of endorsee to receive the amount due, such endorsement is called a conditional endorsement.

4.RESTRICTIVE ENDORSEMENT: The endorsement may express words, restrict or exclude the right to negotiate or receive its contents for the endorser such endorsement is called the restrictive endorsement.

5.ENDORSEMENT 'SANS RECOURSE': An endorser of a negotiable instrument may, by express words in the endorsement, exclude his own liability thereon.

6.FACULTATIVE ENDORSEMENT: The endorser remains liable to the endorsee for the non-payment of the instrument/ order/ notice of dishonour.

7.FORGED ENDORSEMENT: If a negotiable instrument is endorsed with forged signature of the endorser, the endorsee acquires not good title to the instrument. Such an instrument is null.

8.PARTIAL ENDORSEMENT: Where the endorsement is made for part of the amount of the instrument. Such an endorsement is not valid or regular

Reference

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