

# Negotiable Instruments

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## 1.0 Applicable Law

- In Sri Lanka, the Law relating to negotiable instruments is governed by English Law from the Bills of Exchange Ordinance No.25 of 1927.

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# 1.1 Introduction

- Negotiable instruments have become the most acceptable way of monetary transactions today.
- The meaning, types and characteristics of negotiable instruments are therefore necessary to look at to ensure a proper understanding of them.
- It is equally important to be able to make a distinction among bills of exchange, and cheques.

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- The documents or the instruments that are used in the business transactions can be divided into two categories.

1) Negotiable instruments

2) Non-Negotiable instruments (Transferable instruments)

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## 1.2 Negotiable Instruments

- Negotiable Instruments are contracts in writing.
- They are transferable by indorsement or by delivery.
- The holder takes title free from any defenses or objections to their validity that might have been good against the transferors.
- Generally, the word negotiable means transferable.
- But the word negotiable has a wider meaning than mere transferability. Because all the negotiable instruments are transferable as well, but all the transferable instruments are not negotiable.
- In order to identify an instrument as a negotiable instrument it should have certain characteristics

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### Examples of Negotiable Instruments (Transferable Instruments)

- 1) Bills of Exchange
- 2) Promissory notes
- 4) Cheques
- 5) Treasury bills
- 3) Bank drafts
- 6) Share Warrants

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# **Examples of Non-Negotiable instruments**

- 1) Money orders
- 2) Share Certificates
- 3) Letters of Credit
- 4) Postal orders
- 5) Bills of lading
- 6) Fixed Deposit Receipts

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## **1.3 Characteristics (features) of a Negotiable Instrument**

1. The title and the rights to the instrument can be transferred by delivery alone or by endorsement and delivery.
2. The holder of the instrument can sue and be sued in his own name.
3. Notice of assignment need not be given to the person liable there on.
4. A negotiable instrument is transferred “free of equities”, i.e. the transferee obtains a better title than the transferor.

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## **1.3 Characteristics (features) of a Negotiable Instrument**

- Bills of Exchange ordinance recognizes three main types of Negotiable Instruments. They are,
  1. Bills of exchange
  2. Cheque
  3. Promissory notes
- While Cheques and Promissory Notes are commonly used in domestic trade, the bill of exchange is mostly used in international trade (import export trade).

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## **1.4 Negotiation**

- A bill is said to be negotiated when it is transferred from one person to another in such a manner as to constitute the transferee the holder of the bill.
- The main feature of a negotiable instrument is that the instruments can be transferred from one person to another.
- That is from the payee it can go to several hands one after the other in a chain.

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## 1.4 Negotiation

A bill of exchange may be negotiated in the following manner:-

1. In the case of bearer bill, by delivery.
2. In the case of an order bill, by endorsement followed by a mere delivery.

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## 1.5 Parties to a Negotiable Instrument

### 1. Drawer

He is the person who draws the bill or making the order to pay money on his behalf.

### 2. Drawee/ Acceptor

The drawee is the person to whom the order is addressed.

i.e. the person who is required to pay money. A drawee is not liable to pay until he accepts the bill, after he accepts the bill he is known as 'acceptor'.

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## 1.5 Parties to a Negotiable Instrument

### 3. Payee

Payee is the person to whom the money is to be paid. The payee can be a named or a specified person for example "Pay Abraham " or he can be a bearer for example "pay bearer".

### 4. Indorser

Indorser is the person who signs his name on the back of an order bill when he transfers it to another person. An indorser can be the payee or any other holder.

### 5 . Indorsee

Indorsee is the person whose name is written on the back of the bill by the indorser.

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## 1.5 Parties to a Negotiable Instrument

### 6. The Holder

The Holder is the payee or indorsee of an order bill or the one who is in possession of a bearer bill. E.g. If A draws a bill as 'pay C or order' and hand over it to C, here C is the payee as well as the holder. When C negotiates the bill to D, D becomes the holder.

### 7. Holder for Value

Holder for Value is a holder who has given or who is deemed to have given value.

i.e.

when the holder takes the bill after giving valuable consideration, he becomes holder for value. According to s. 30(1) 'every holder of a bill is prima - facie deemed to have taken it for value.

- Ex: "A draws a cheque in favor of B. B indorses it for value in favour of C who gives it as a gift to D. D is holder for value ( although he gives no value himself and he can enforce it against A and B but not against C).

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# 1.5 Parties to a Negotiable Instrument

## 8. Holder in Due Course

- A holder in due course is a holder who has received a bill of exchange, in good faith (without knowing the defects) by giving valuable consideration, from a person who does not have any title to it or who has a defective title.
- He takes the bill free from all defects.
- He can therefore, acquire a better title to the bill than that was held by the transferor.
- He should have received that bill without knowing about the lack of title or defective title of the transferor at the time of receiving it. In addition, there are certain other conditions that also should be present to treat him as a holder in due course.
- Section .29 (1) stipulates the requirements to become a holder in due course. They are:-

(1) The bill should be complete and regular on the face of it. An incomplete bill is a bill which is undated, does not state the amount, lacks signature or lacks proper indorsement.

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# 1.5 Parties to a Negotiable Instrument

**Case Law in brief:** Arab bank V. Ross (1952)

**Case Facts:** A bill was drawn in a favour of a firm "Faith and FaysalNabulsy Company" was indorsed as "Faith and FaysalNabulsy".

**Decision:** Held omitting the word "company" from the indorsement made the bill irregular and incomplete on the face of it.

(2) The holder must have taken the bill before it was overdue.

(3) If it had been previously dishonoured, the holder must have no notice of such previous dishonour.

(4) The holder must have taken the bill in good faith.

(5) Holder himself must have given value for the bill.

(6) At the time the bill was negotiated to him, the holder must have no notice of any defect of the title of the person who negotiated it to him.

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## 1.5 Parties to a Negotiable Instrument

- **Example**
- “A” draws a cheque for the value of Rs.20,000/= in favour of “B”. “B” indorsed it and kept in his cupboard. “C” stole the cheque from “B”, gave it to “X”, and bought a T.V. “X” got it in good faith.
- Here “X” is treated as a holder in due course.

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### Important points to note on Holder in Due Course

1. Every holder is presumed to be holder in due course until fraud or illegality is admitted or proved in the acceptance, issue or negotiation of the bill.
2. A person who takes a bill from a holder in due course will also be treated as a holder in due course.
3. The payee of a bill cannot be a holder in due course, because the bill is not negotiated, it is issued to him.
4. A person who took an order bill bearing a forged indorsement cannot be a holder in due course.
5. If a cheque is crossed ‘not negotiable’, it will prevent a holder from becoming holder in due course.

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# Important points to note on Holder in Due Course

**Case Law in brief:** Wilson and Meeson Vs Pickering (1946)

**Case Facts:** W drew a cheque crossed “not negotiable” and gave it to his clerk to fill in the amount and the name of the payee. The clerk inserted a sum in excess of her authority and delivered the cheque to P in payment of a debt of her own.

**Issue:** Whether W is liable for P.

**Decision:** No

**Justification:** The clerk had no title to the cheque, as the cheque is crossed “not negotiable” P does not get a better title. .

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## Rights of the Holder in due Course

1. He can sue in his own name against any prior party to the bill.
2. He takes the bill free from equities. He can defeat any defenses arising from defects of title or from the dealings between prior parties to the bill. He can therefore, acquire a better title to the bill than that held by his transferor.
3. He can transfer his right to anybody (by negotiation)

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## 2.0 Bill of Exchange

- **Definition**
- Section 3 of the Bills of Exchange ordinance defines a bill of exchange is an unconditional order, in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time, a sum certain in money, to or to the order of a specified person or to bearer’.

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- According to the above definition, following elements should be present in a bill of exchange.
  1. It should be an unconditional order made by the drawer to the drawee
  2. It must be an order and not a request There should be a command or order by the drawer to the drawer and not a request. However using the word “Please” has not been held to be a request. Therefore the words “Pay” or “Please pay” can be used.
  3. In writing: According to section 2 the word ‘writing’ includes ‘printing’.
  4. It should be addressed by one person to another. i.e. it should be addressed by the drawer to the drawee.

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5. It should be signed by the person giving it. i.e. it should be signed by the drawer. It can be signed by the drawer himself or by his authorized agent.

6. A sum certain in money should be required to be paid.

That is the amount of money must be clearly indicated. For example, if it is stated that

“pay a reasonable amount” or “About Rs. 20,000/=” will not be valid, because the amount is not certain.

7. The drawee should be required to pay on demand or at a fixed or determinable future time. This refers to the time of payment.

8. To or to the order of a specified person or to bearer. It means money should be paid to the payee. The payee should be named or indicated with reasonable certainty. According to section 3 of the bills of Exchange Ordinance the payee can be:

- a) a specified person for example “Pay Ravi”; or
- b) to the order of a specified person for example “Pay Ravi or order” or
- c) a bearer for example “Pay bearer”

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- Depending on the payee, a bills are two forms

1. Order bill :In an order bill, the name of the payee is found on the bill for example “Pay Kumar”.

2. Bearer bill: In a bearer bill, the name of the payee is not stated but the word bearer is found for example “pay bearer”.

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## **2.1 Requirements of a valid Indorsement - Section 32 of the Bills of Exchange Ordinance**

- A valid indorsement must be written on the reverse of the bill itself and signed by the indorser, it must be an indorsement of the entire bill and where it is payable to the order of two or more payees or indorsees who are not partners all must indorse.
- An indorsement may be special, blank or restrictive.
- A special indorsement specifies the person to whom or to whose order the bill is to be payable.

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## **2.1 Requirements of a valid Indorsement - Section 32 of the Bills of Exchange Ordinance**

- Writing on the reverse of a bill of exchange the name stated in under the title payee along with the signature is known as indorsement.
- When the payee indorses he should write his name as found on the face of the bill.
- If the payee's name is wrongly spelt, he should indorse according to the spelling on the bill.
- An indorsement is irregular where there is a clear and serious difference between the name of the payee or indorser and his indorsement.
- The person who signs his name on the reverse of a bill is known as indorser.
- The person whose name is written on the reverse of the bill by the indorser is known as indorsee.

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## **There are four types of indorsements.**

1. Blank
2. Special
3. Conditional
4. Restrictive.

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- **Blank Indorsement**
- A blank indorsement is effected by the simple signature of the indorser without writing the name of the indorsee.
- After a blank indorsement the bill becomes payable to bearer.

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- **Special indorsement**

- A special indorsement is effected when the payee writes another person's name on the back and signs for example "Pay Ravi" or "Pay Ravi or order". Here the bill is payable to Ravi and not to any other person.
- But Ravi may indorse it either in blank or specially and transfer it to another person.
- If Ravi indorses in blank the bill becomes a bearer bill.
- If Ravi indorses specially for example "Pay Kumari" again it becomes special and it needs Kumari's indorsement for negotiation.
- If a bill has been indorsed in blank, any holder may insert a name above the signature and so convert the indorsement into a special indorsement: (Section 34)

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- **Restrictive Indorsement**

- A restrictive indorsement is one which prohibits further negotiation of the bill (Section 35), for example, "Pay John only".
- Here John has the right to receive payment of the bill, but he has no right to transfer his rights to another person.
- A bill that was initially negotiable continues to be so until it has been;
  - (a) Restrictively indorsed; or
  - (b) Is discharged by payment or otherwise; (section 36)

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- **Conditional indorsement**
- A conditional indorsement is where a condition is attached to the signature.
- This method of indorsement is not much in use.

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## **2.3 Presentment for Acceptance and Presentment for Payment**

After a bill of exchange is issued, it is submitted to the drawee twice

1. for acceptance
2. for payment

But a cheque is submitted to the drawee only once i.e. for payment. Because acceptance is not necessary for a cheque.

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If a bill is either not accepted or not paid after it is presented to the drawee, it is known as dishonor. Therefore a bill of exchange can be dishonored either by;

1. Non - acceptance (Section 43) or
2. Non - payment (Section 47)

- **Presentment for Acceptance**

- After a bill of exchange has been issued, the holder should present it to the drawee for his acceptance.
- By presenting it for acceptance, the holder may find out whether the drawee is willing to carry out the order of the drawer.
- If the drawee agrees to obey the drawer's order he will accept it by signing his name on the bill, with or without the word "accepted" (Section 17).
- After acceptance, the drawee is known as the acceptor.
- By presenting the bill for acceptance, the holder get the assurance for payment.

- On presentment, the drawee may give either a general or a qualified acceptance, or he may refuse an acceptance.
- A general acceptance means accepting the bill without any qualification or condition.
- Such acceptance makes the acceptor liable to pay the bill: Section 54 (1).

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## 2.4 Discharge of a Bill

- When all rights of action on a bill are extinguished, the bill is said to be discharged. A bill is discharged in the following circumstances
  1. By payment in due course -As per Section 59 (1) payment should be made by or on behalf of the drawee or Acceptor at or after the bill's maturity to its holder in good faith without notice that his title to the bill is defective.
  2. By merger (Section 61) - This occur when the acceptor becomes the holder of the bill on negotiation

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## 2.4 Discharge of a Bill

3. By renunciation Section.62 (1) - at or after the bill's maturity, the holder may absolutely and unconditionally renounce (waive) his rights against the acceptor.

4. By cancellation Section .63 (1) - This must be made intentionally and be apparent.

5 By material alternation - The alteration is material if it has the effect of changing the operation or business effect of the instrument or liabilities of the parties. Such alterations include the date, the sum payable or the time of payment.

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## 3.0 Cheques

- Section 73 defines a cheque as “A cheque is a bill of exchange drawn on a banker, payable on demand”.
- According to this definition a cheque has all the features of a bill of exchange.
- But it is always drawn on a bank and payable on only demand.
- But there are certain other differences also to be found between a cheque and a bill of exchange.

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## 3.1 Differences between a Cheque and a Bill of Exchange

Cheques	Bill of Exchange
Drawee is always the bank.	Drawee can be a bank or an individual.
Only a current account holder can draw a cheque	Any person can draw it.
The rules relating to crossings applies	The rules relating to crossing are not applicable
It need not be presented to the acceptance	It should be presented to the drawee for drawee to accept
It is always in a printed format.	Not so
It is payable only on demand.	It is payable on demand or at a fixed or determinable future time

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## 3.3 Crossings of a Cheque

- Crossing occurs when two parallel lines are drawn on the face of a cheque.
- Crossing is a direction to the paying banker that the money should not be directly paid to the holder over the counter.

# Types of Crossing

## 1. Ordinary Crossing

This consists two parallel lines across the face of the cheque, with or without the words “and co”. If a cheque is crossed, it can be paid through a bank account and cannot be paid directly to the holder.

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# Types of Crossing

## 2. Special Crossing

If inside the crossing the name of a bank is written, it is known as special crossing. If a cheque is crossed specially that cheque has to be deposited in an account of the bank whose name is written inside the crossing.

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# Types of Crossing

## 3. Not Negotiable crossing

Where the words not negotiable are added inside a crossing they are known as not negotiable crossing. They deprive the cheque of its negotiability.

Therefore, a person taking a not negotiable crossed cheque cannot give a better title to it than what he has.

That means if a cheque is crossed 'not negotiable', it will prevent a holder from becoming a holder in due course.

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# Types of Crossing

## 4. Account Payee crossing

If the words account payee or account payee only is written inside the crossing it is known as account payee crossing This is actually a direction to the collecting banker that the proceeds of the cheque should be credited to the account of the payee and cannot be cashed at the counter.

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## 3.4 Who may cross a Cheque

According to Section 77, a cheque can be crossed;

1. By the drawer generally or specially
2. If the drawer has not crossed it, the holder may cross it generally or specially
3. Where a cheque is crossed generally the holder may cross it specially
4. Where a cheque is crossed generally or specially the holder may add the words 'not negotiable'
5. Where a cheque is crossed specially, the banker to whom it is crossed, may again cross it specially to another bank for collection
6. Where an uncrossed cheque or a cheque crossed generally is sent to a banker for collection he may cross it specially to himself

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## 3.5 Advantages of a cheque as a means of payment

- i. The cheque dispenses with the need to keep cash with the attendant risks of theft and loss.
- ii. It can be drawn for the exact amount required.
- iii. It can be dispatched by the debtor to the creditor cheaply and safely without the risks of loss and inconvenience which can occur when settling debts in cash.
- iv. Payment by cheque also provides a simple and authentic record of the payment of the debt. Banks retain paid cheques for over six years so that you can always get the bank to produce a cheque to prove your payment.
- v. Payment by cheque is generally equated to payment by cash. The cheque, when given, is a conditional payment, when honoured (by the bank) it is actual payment.

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## 4.0 Promissory Notes

- According to Section 85, a promissory note is an unconditional promise in writing made by one person to another signed by the maker, engaging to pay, on demand or at a fixed or determinable future time, a sum certain in money, to, or to the order of, a specified person or to bearer.

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## 4.0 Promissory Notes

Differences between a Bill of Exchange and a Promissory Note

- a) A bill is an order but a note is a promise
- b) Only two parties are involved in a note, but in a bill, 3 parties are involved
- c) Note does not require acceptance, but bill requires acceptance.

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