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Law Applicable to Negotiable Instruments

AAT Level II

BLA - Business Law

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Law Applicable to Negotiable Instruments

Shanilka Perera

A) Negotiable Instruments

- Negotiable Instruments came into existence with rapidly developing economies and trade.
- It has provided essential benefits for traders.
- Transactions that involve huge sums of money can now be made conveniently, efficiently and with minimum risk thanks to negotiable instruments.
- When the use of negotiable instruments increased, there arose a necessity to govern the use of negotiable instruments by law.

1) What is a Negotiable Instrument?

- Negotiable instruments in Sri Lanka are governed by the Bills of Exchange Ordinance No. 25 of 1927.
- **Crouch v Credit Foncier of England Ltd** (1873) LR 8 QB 374.
- This case famously defined what a negotiable instrument is.

As per the decision of that case;

"where an instrument is by the custom of trade transferable like cash, by delivery, and is also capable of being sued upon by the person holding it, it is entitled to the name of a negotiable instrument, and the property in it passes to a transferee who has taken it for value and in good faith."

2) Elements of a Negotiable Instrument

a) Easy transferability of the document

- delivery alone is sufficient to pass the property and rights of the negotiable instrument, or delivery and endorsement.

b) The transferee obtains a good title to the instrument

- The transferee will obtain the instrument "free of equities". This means although the transferor's title was defective, transferee will still get a good title.

c) The holder of the instrument can sue or be sued in its own name

- The transferee has the right to sue all parties in his own name instead of the transferor's name. Similarly, other parties can sue against the name of the transferee.

d) No notice must be given to the debtor (the person who is liable to pay) at the transfer of the instrument.

e) Valuable consideration is presumed to have been given to the instrument.

3) Negotiable instruments v Non-negotiable instruments

- The negotiable instruments identified under the Bills of Exchange Ordinance No. 25 of 1927 are;

1) Bills of Exchange
2) Cheques
3) Promissory Notes

- The negotiable instruments not in the Act, but identified by practice are;

1) Bank Note
2) Dividend Warrant
3) Treasury Bills
4) Bearer Debenture

- Non-negotiable instruments;

1) Deposit certificate
2) Postal order
3) Money order
4) Letter of credit
5) Share certificate
6) Bill of Lading
7) Fixed deposit certificate

4) Negotiability v Transferability

"All negotiable instruments are transferable but not all transferable instruments are negotiable".

Transferability – process of passing the title of an instrument

Negotiability – the quality of the title in the instrument that is passed.

For example:

If you lost your phone, if someone picks it up in good faith, or if someone steals it, would that person become the owner of the phone?

The answer is No. It is because the phone is **not negotiable.**

But if you decides with intention to give your phone to your friend as a gift or otherwise, would it be possible?

The answer is Yes. It is because the phone is **transferable**

Therefore, a phone is an instrument which is transferable but not negotiable.

However, take money as an example.

If you found a Rs.5000 note in the street in good- faith and you cannot find who it belongs to, you can keep it.

It is because cash is both **transferable** and **negotiable.**

Similarly, the above discussed instruments which are negotiable are anyway transferable, however some instruments though transferable are not negotiable.

B) Bills of Exchange

- According to Section 3 of the Bills of Exchange Ordinance No. 25 of 1927;
- "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."

- Ex:

08/08/2022

To: ABC Perera
No. 45, Colombo Road
Colombo

Pay to Dinushan Fernando a sum of rupees eighty thousand (80,000) for value received

Signature
Dinesh Peiris

1) Parties to a Bill of Exchange

a) Drawer - the person who draws it. Ex: Dinesh Pieris

b) Drawee – the person responsible to make the sum specified in the bill of exchange. It is often addressed to the drawee Ex: ABC Perera.

c) Payee – the person who is eligible to receive the sum specified in the bill of exchange. Ex: Dinushan Fernando.

d) Endorser

- the person who signs on the back of the bill when he transfers it to another person.

e) Endorsee

- the person who receives the transferred bill from the endorser or after endorsement

f) Holder/bearer

- the one who is in possession of the bill of exchange.

- Ex: In the back of the bill of exchange, Dinushan Fernando can sign and endorse the bill to Amanda Gamage. It maybe because Dinushan although is the payee, he owes similar amount of LKR 80,000 to Amanda. So instead of him taking money from ABC Perera, he can endorse the bill to Amanda. Then, Amanda becomes endorsee and holder and is entitled to present it to ABC Perera and obtain the said LKR 80,000

Endorsed by: (Signature) Dinushan Fernando	To: Amanda Gamage

2) Elements of a Bill of Exchange

a) It should be in writing
   - includes type written

b) There should be an unconditional order
   - there should be an order, not a request
   - the said order must be without any condition

Ex: **Baying Junior and Sims v London and South-Western Bank Ltd**

It was held in this case that the statement "make the payment if the receipt is signed" was a conditional order.

c) It should be signed by the drawer (the person issuing it)
- an agent of the drawer may also sign.
- on behalf of a Company an authorized director may sign.
- forged signatures are invalid on a bill of exchange

Koster's Premier Pottery Pty Ltd v Bank of Adelaide (1981) 28 SASR 355

d) The drawee must be mentioned specifically

e) The amount to be paid must be specific.
- ex: pay LKR 80,000 = specific
- pay LKR 80,000-85,000 = not specific
- pay around LKR 80,000 = not specific
- can include a specific interest rate
- can include an order to pay in installments
- can include to pay in a foreign currency

f) Payee must be mentioned clearly.

g) The date of payment must be stated clearly

3) Classification of Bills of Exchange

a) Term Bills – amount of money can be received after the mentioned date or after maturity or at a determinable future time.

b) Demand Bills – the sum of money should be paid on demand

c) Bearer Bills – paid to the person whoever bears it or in possession

d) Order Bills – ordered to pay to a specific person or persons.

Bearer bills can be identified by the following;

a) Bill contains as to "pay for the bearer" of the bill
b) There is a definite payee and next to it "or pay bearer".
c) Instead of payee name it contains "cash"
d) Payee can be fictitious.
e) The endorsement is a blank endorsement.

Order bills can be identified by the following;

a) Name of transferee written on the bill
b) Next to the name of the transferee a phrase "or to order"
c) Having a special or restrictive endorsement on the bill.

4) Acceptance of a Bill of Exchange

- As per section 17 of the Bills of Exchange Ordinance Acceptance of the bill is this signed written acknowledgement by the drawee to pay the value indicated in the bill on the instance when the bill is issued by the drawer ordering the drawee to pay the payee.
-
- When the bill is accepted by a drawee it needs to be indicated by the drawee with or without the words the implication that it was accepted.
- The drawee is not liable to the bill until he or she has accepted it by signing. Prior to signing the acceptance, that drawer will be liable If acceptance cannot be made by the drawee.

5) Rules to follow when accepting a Bill of Exchange (sec 41)

a) The production must be made by the Holder, or any person authorized by him.

b) The bill should be produced for acceptance before expiration.

c) Production must be made at a reasonable hour on a business day.

d) The bill should be produced to the drawee or his authorized representative for acceptance, if the drawee is bankrupt, it should be produced to his lawful trustee.

e) When a bill is addressed to two or more drawees who are not parties, production must be made to all of them unless one has authority to sign it all.

6) Different types of Acceptances in a Bill of Exchange

a) Conditional acceptance

b) Partial acceptance

c) Regional acceptance

d) Acceptance qualified as to time

7) Dishonoring of a Bill

- This occurs when they drawee refuses to accept the bill Or refuses payment.
- The legal consequence of a bill being dishonored is that the holder of the bill has the right to take legal actions for the payment of the bill.
- It must be noted that if the holder fails to follow the procedure when presenting a bill and it was not accepted because of a breach in procedure or failure of the holder to follow such procedure, it will not result in a dishonor.

7.1) Instances of Dishonor

a) If the bill is presented correctly but payment has been refused.

a) If the drawee is bankrupt or dead.

b) If they drawee is a fictitious person.

c) If the drawee is a person not having the capacity to contract.

d) If even after the exercise of reasonable diligence, such bill cannot be produced for acceptance.

e) Although the submission has been irregular, acceptance has been refused for some other reason.

Note: Except for some instances, the notice of dishonor should be given to the drawer.

8) Endorsement of a Bill of Exchange

As per section 32 of the bills of exchange ordinance valid endorsement must include the following;

a) It must be written on the bill itself and be signed and certified by the endorser . Even a signature will be sufficient for a valid endorsement.

b) It must be an endorsement of the entire bill.

c) Where a bill is payable to more than one person, all those persons must sign with regard to that respective endorsement .

d) If somehow, in a bill payable to order, the payee or endorsee is wrongly designated, or his name is misspelled he may endorse the bill as it is and should put his correct signature thereafter.

8.1 Types of Endorsement

a) Blank endorsement
b) restrictive endorsement
c) Special endorsement
d) Conditional endorsement

9) Holders of the Bill

a) Holder for value - the bill is drawn with consideration

b) Holder without value - there is no consideration

c) Holder in due course – as identified under section 29(1)

9.1) Holder in Due Course [section 29 (1)]

a) The bill is complete and regular on the face of it.
b) The bill is not overdue
c) Has taken the bill without notice that it was dishonored previously
d) Has taken it for valuable consideration
e) Has taken in good faith
f) Has taken without the knowledge that the person who negotiated it has no proper title or has a defective title.

9.2) Rights of the Holder in Due Course

a) Get priority to receive the value for bill.

b) Can sue all previous parties to recover the rights on the bill.

c) Can transfer a good title by negotiation.

10) Rules relating to signature on bill of exchange

a) If a person has not signed the bill, then he or she is not liable as a drawer, endorser or acceptor.

b) A person who signs a bill in a representative capacity will not be personally liable if the fact that he had signed as a representative is clearly shown. Example : **Chapman v Semethburst,** held that the party to the bill had signed in a representative capacity therefore they are not liable.

c) If a bill is payable to holder and it is negotiated by delivery, even if the signature is forged it will be paid.

d) If a bill is payable to order, then the forge signature is inoperative and not valid under law

Example: **National Westminster bank v Barclays International**

It was held in this case where a skillfully forged signature was paid money by the bank, they can recover that money, but if the bank had paid with negligence, then they cannot recover.

e) If the payee is fictitious or not existing then that bill is regarded as bill payable to bearer. Therefore, in such instances even a forged signature effectively passes title.

Ex: **Clutton v Attenborough and Son**

In this case plaintiff was induced to issue an instrument to a person called B, who was non-existent. The plaintiff had no idea about this, the court held that this was an instrument held to be payable to bearer. Whether the signatures were forged was irrelevant

C) Cheques

- As per section 73 of the bills of exchange ordinance No. 25 of 1927 , a cheque can be defined as a bill of exchange drawn on a banker payable on demand.
- A cheque is always a document commanded to a bank.
- It has all the features of a bill of exchange.
- It can only be written by a current account holder of a commercial bank
- Therefore, drawee of a cheque is always a bank.
- This is an instrument payable on demand.

1) Crossing of a Cheque

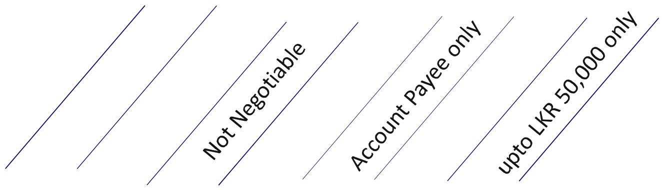
- There are two types of crossing in a cheque;

a) General crossing

b) Special crossing

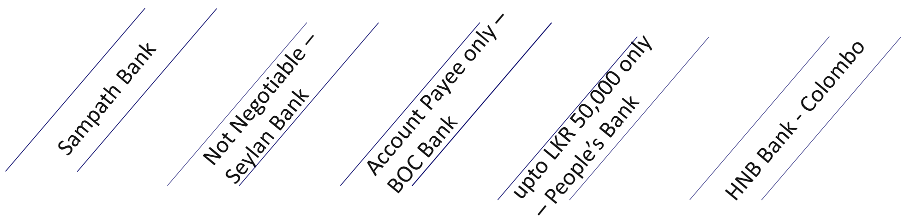
a) General Crossing

- If the cheque has two parallel traverse lines on the face of it, then it is general crossing.
- Apart from the name of a commercial bank anything can be written inside the lines or even kept blank.



a) Special Crossing

- If the cheque has two parallel traverse lines on the face of it, but inside the lines are written the name of a commercial bank, with or without other words.



2) Powers of the parties crossing on a cheque

a) The drawer has power to cross it either generally or specially.
b) The holder can cross the cheque generally or specially, if the cheque is not crossed.
c) The holder can cross the cheque as a special crossing if the cheque is crossed generally.
d) The holder can add traditional words if a cheque is crossed generally or specially.
e) The banker to whom it is crossed can cross it specially to another bank for collection.
f) If an uncrossed cheque or a cheque crossed generally is sent to a Bank of a collection, it may cross it as a special crossing to the name of the bank.
g) Only the drawer can cancel a crossing.

3) Duty of the banker and the duality of cheques

- A cheque serves a dual purpose.
- On one hand it is a negotiable instrument but on the other hand it operates as a mandate issued to the bank by its customer.
- A bank therefore has certain responsibilities or duties regarding cheques
- Some of the duties are as follows;

a) A cheque is an order made to a bank.

- therefore, due payment for cheques on the command of the customer is a duty of the bank.

Prosperity v Lloyd's Bank

The client can file a case against the bank if the bank refuses to pay the order of a check without a reasonable ground this is because if the bank refuses to pay it will tarnish the reputation of the customer.

b) The bank has a duty to facilitate the payment efficiently.

c) Provide notice of dishonor to the client.

d) The bank must follow orders of "stop-payment" / countermand orders.

3.1) Instances in which the bank can refuse payment / dishonor

a) If the client is dead
b) If the client is mentally incapable
c) If the check is damaged
d) If it is postdated
e) Expiration of the cheque.
f) Orders of stop-payment
g) Material alterations made to the check
h) Difference between the amounting figures and in words
i) The signature of the drawer is unclear or suspicious.

4) Protection of the banker

- It is the duty of the bank to pay to the order of the drawer.
- However, there can be situations where they have paid for the wrong person.
- If such payment was made with negligence, then the bank is liable, but if it was made in good faith then they will not be liable.

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a) Section 60

This section provides protection against liability if the bank has paid a bill which has a forged endorsement, however the payment should have been made in;

i) Good faith,

ii) Without any negligence,

iii) During the ordinary course of business of the bank.

If the above are complied with, the bank will not be liable for the payment. It is the person who received the value or amount from the bank that is liable to the true owner of the bill.

b) Section 80

According to this section, if the bank has paid a crossed cheque to an unauthorized person, but if that payment was made;

i) in good faith

ii) without negligence

iii) according to the crossing

iv) in ordinary course of business;

The bank will not be liable if the above are complied with.

c) Section 82

As per this section, if the collecting bank has made a payment for an unauthorized person, but if that payment was made;

i) in good faith
ii) without negligence
iii) according to the crossing
iv) in ordinary course of business;

If the above are complied with, then the collecting bank will not be liable for such payment.

- Case Law

Lad Broke and Co Ltd v Todd

In this case an imposter posing himself as the payee received payment, for a crossed cheque "account payee only".

It was held in this case that the bank had a duty to first check the identity of the payee prior to payment. The bank had failed to do this.

Therefore, they were negligent and thus liable to the client.

5) Difference between a bill of exchange and a cheque

Bill of exchange	Cheque
The drawee does not always have to be a banker	The drawee is always a banker
It is written to be paid on demand either at a specified time or determinable future time	It is written to pay only on demand
Cannot be crossed	Can be crossed
Needs to be accepted	Cheque is a demand, there is no relevancy for acceptance.
Liability exists with the drawee who pays to another person other than owner of the Bill.	Liability is limited to certain instances, so, there is protection for drawee even if paid to a person who is not the owner of the Bill.

D) Promissory Notes

- A promissory note is

i) an unconditional promise
ii) in writing
iii) made by one person to another
iv) signed by the maker
v) engaging to pay on demand or
vi) at a fixed or determinable future time
vii) a sum certain in money to or
viii) to the order of
ix) a specified person or
x) to bearer

- Promissory notes in Sri Lanka are governed by the bills of exchange ordinance

08.08.2022

Promissory Note

I promise to pay eighty thousand rupees (LKR 80,000) to Dinushan Fernando with an interest at five percent (5%) per annum on the value received

Signature
Amanda Peiris
No. 15, Uptown Road,
Gampaha

1) Difference between a Bill of Exchange and a Promissory Note

Bill of Exchange	Promissory Note
There are 3 parties – drawer, drawee and payee	Only 2 parties
There is an order to pay	A promise that a payment will be paid
Drawee has the burden to pay	Promisor has the burden to pay
Acceptance of drawee essential	No need acceptance
If dishonored, notice must be given	No notice of dishonor need to be given
Can be discounted	Cannot be discounted

E) Summary

1) Negotiable Instruments
2) Bills of Exchange
3) Cheques
4) Promissory Notes

THANK YOU