10. Concept and Importance of Negotiable Instruments

10.1 Meaning of Negotiable Instrument

The word 'negotiable' means 'exchangeable' or 'transferable' by delivery and 'instrument' means a written document. 'Negotiable Instruments means a document which can be legally transferred to another party for money.' Negotiable instruments can be identified as "paper money," which is commonly known as commercial paper. Thus, negotiable instrument is a document which is given to another person in exchange for money in the business field. It includes a Bill of Exchange, Cheque, Promissory Note or any other document which is transferable in exchange for money like, Government Promissory Note, Hundi, Share warrants, Dividend warrants, Banker's Draft, Bearer Debentures etc. The word Negotiable means 'transferable by delivery', and word Instrument means 'a written document by which a right is created in favour of some person'.

10.2 Definition of Negotiable Instrument

According to Justice K.C. Wills "*One, the property which is acquired by any one who takes it bonafide and for value notwithstanding any defect of title in the person from whom he took it*".

Nepal Contract Act, 2056 has been silent in this respect but Nepalese Negotiable Instrument Act, 2034 Section 2 has defined as *'Promissory Note and Bill of Exchange are said to be Negotiable Instruments.'* Similarly, Indian Negotiable Instrument Act, 1881 Section 13 has defined Negotiable Instrument as *'A Negotiable Instrument means a promissory Note, a bill of Exchange or a Cheque payable either to an orderer or to a bearer'*. Thus, a negotiable instrument is a certain type of document which can be taken as money in business transaction and money transaction is a document by delivery. In another words we can say; Negotiable instrument is a certain type of document which can be discharged the value of business transaction.

10.3 Characteristics of Negotiable Instrument

The followings are the characteristics of the Negotiable Instrument:

- **Written document:** A Negotiable Instrument is a promise or order that must be made in a formal written document.
- **Right of ownership:** The property in a Negotiable Instrument means a complete right of ownership and not merely a right of possession of the form.
- **Better title to a bonafide transferee:** The legitimate transferee of a Negotiable Instrument is known as 'the holder in due course'. A bonafide transferee for the value is not affected by any defect of the title on the part of the transferer or any of the previous holders of that instrument.
- **It creates the right:** In case of a dishonor of the Negotiable Instrument, the transferee or a holder in due course is entitled to sue in his own name against the transferer.
- **Easy negotiability:** The instrument is transferable from one person to another without any formality in faster way.

- **Legal presumption:** There are some legal presumptions in the Negotiable Instrument. E.g Consideration

10.4 Importance of Negotiable Instrument

Negotiable Instrument is a certain type of document, which transfers the money. It makes easy to carry money one place to another place. So, it is very important for transfer of money in business sector. The following points can grasp as the importance of Negotiable Instrument.

- Negotiable Instrument is easier means of transfer of money.
- It is easy to delivery one place to another place.
- It helps to flourish the business sector.
- It creates the right of property.
- It has the easy negotiability and some where it provides the security.
- It makes the fast transaction of money.
- It makes the security of money as well as personal security in course of transaction of money.

Negotiable Instrument is the easier way of transfer of money one place to another place. It provides the safe way to deliver of money. It has important role to develop the way of money transaction as well as the business realm.

1.1.1 10.4.1 Promissory Note:

A promissory Note is an instrument in writing, except government note or bank currency, containing unconditional undertaking signed by the Maker to pay a certain sum of money only to, or to the order of or to the bearer or to a certain person related to the instrument. (Section 2(f) of Negotiable Instrument Act, 2034

The person, who makes the promissory note or promises, is called a 'Maker' and he has to sign that document as a debtor. The person to whom payment is to be made is called the 'payee'.

1.1.2 10.4.2 Essential Feature of Promissory Note:

The essential features of the Promissory Note are as follows:

- **Must be in a written form:** A Promissory Note must be in a written form but there is not necessary any universal particular form of words and paper. Of course, the message of promissory note must be conveyed.
- **Must contain a promise or an undertaking to pay:** A Promissory Note must have a promise or undertaking to pay. The undertaking to pay must be conveyed but no particular words are necessary.
- **It must be unconditional:** A Promissory Note must be made without any condition.
- It must be signed by the Maker: The sign must be essential which is in the form of writing or mark to represent one's name.
- **The Maker of the note must be a certain person:** The document must indicate person engaging himself for the payment. In case of joint promisors, any of the Promisors may make the note by putting his name clearly.
- **The sum of money must be certain:** The sum of money must be certain in the Promissory Note.
- **The Payee must be certain:** The money must be payable to a definite person or according to his order.

- **The amount payable must be in legal tender money:** A Promissory Note must be in legal tender money and the currency must be as prescribed or of one's own country.
- **It may be made on demand:** The promissory note may be payable on demand or after a certain period of the time.
- **Formalities should be fulfilled:** e.g. signature, date, stamp

10.5 Bill of Exchange

Bill of exchange is another type of Negotiable Instrument. It is also in practice in the business sector. 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 bearer of the instrument. It is defined under the section 2(g) of the Nepalese Negotiable Instrument Act, 2034. Section 2(g) defines as *"A bill of exchange is an instrument in writing containing an unconditional order, signed by maker, directing a certain person to pay a certain sum of money to, or to the order of a person or to a person or to the bearer of the instrument".* On the basis of above definition, there are three parties in the bill of exchange, which are as below:

a. **Drawer:** The maker of a bill of exchange

b. **Drawee:** The person, who is directed to pay.

c. **Payee:** The person who receives the bill of exchange.

1.1.3 <u>10.5.1 Features of Bill of Exchanges:</u>

The essential features of Bill of Exchanges are as follows:

- The Bill of Exchanges must be in written form.
- It must contain an order to pay.
- The order to pay must be unconditional.
- It must be signed by the Drawer.
- Payable sum must be certain.
- The Bill must contain an order to pay money only.
- There must be three parties.
- It must comply with the formalities as regards date, consideration, stamps etc.
- The money must be payable to a definite person.

1.1.4 <u>10.5.2 Difference between Promissory Notes and Bill of Exchanges</u>

The differences between a promissory note and a bill of exchange are as below:

Promissory Note	**Bill of Exchange**
1. It has two parties. e.g Maker of Note and Payee	1. It has three parties. e.g Drawer, Drawee and payee
2. It has a promise to make the payment.	2. It has an order for making the payment.
3. Primary and absolute liability is of the maker on the instrument.	3. Secondary and conditional liability of a drawer on the instrument.
4. No acceptance is necessary because, the liable person signs on the Promissory Note.	4. Acceptance by the Drawee is necessary before it is binding upon him.
5. The Maker stands in an immediate relationship to the payee.	5. The Drawer stands in an immediate relationship with the acceptor and not to the payee.
6. No notice is necessary to the Maker.	6. Notice of dishonour must be given to all prior parties, who are liable to pay.
7. It can not be drawn 'payable to bearer'.	7. It can be drawn 'payable to bearer'
8. In case of dishonour of promissory Note, protest is not necessary.	8. In case of dishonour, a foreign Bill must be protested.
9. It can not be drawn in sets.	9. It can be drawn in sets.
10. Provisions of acceptance are not applicable.	10. Provisions, like presenting for acceptance, are applicable.

10.6 Meaning of Holder and Holder in Due Course

The term Holder means a party of a Bill of Exchange, Promissory Note, or Cheque. In another words we can say, any person who is legally entitled to the possession of the instrument, and to receive or recover the amount due thereon from the parties liable thereto. That is either the payee or the endorsee of the instrument. Section 2(k) of Nepalese Negotiable Instrument Act, 2034 has stated *"A Holder is a person entitled to the possession of the instrument on his own name and to receive or recover the amount due thereon from the parties."* To be legal Holder, the person must satisfy the following two conditions.

- He must be entitled to the possession of the instrument in his own name.

- He must be entitled to receive or recover the amount due thereon from the parties liable thereto.

Besides, being entitled to possession of the instrument, the person must have the right to receive or recover the amount prescribed in the instrument. Any person can hold instrument as a bearer or the payee or an endorser of the instrument, may not be called a Holder. To be legal Holder, the person must persuade the legal right to receive the amount mentioned in the instrument.

1.1.5 10.6.1 Holder in due course:

A holder in due course means the holder who takes the instrument in good faith for value before it is over due. The person who has given consideration is a Holder, but it is not necessary to be adequate. A Holder in due course is an important party to discharge the contract. To be treated as a Holder in due course, a person must prove the following qualifications.

- **He must be a 'Holder':** He must be entitled to the possession of the instrument in his own name under a legal title. Obtained by gift, unlawful means or unlawful consideration, defective title can not create the legal Holder.
- **He must be holder for valuable consideration:** There must be some consideration to which law attaches value. The consideration, however, need not be adequate.
- **He must have become the holder of the Negotiable Instrument before its maturity:** The Holder who acquires a Negotiable instrument after maturity can not be a holder in due course.
- **He must take the Negotiable Instrument complete and regular in the face of it:** A negotiable instrument contains any material alteration, which must be confirmed by the drawer through his signature, or if it is incomplete, drawer's name is not there, or it is not properly stamped, he can not become a holder in due course.
- **He must have become holder in good faith:** This is the most important condition to be satisfied. He must exercise great care and take all necessary precautions in finding out if the transferor's title was defective. Moreover, he must tale the instrument without any negligence on his part.

1.1.6 10.6.2 Difference between Holder and Holder in due course:

The Differences between Holder and Holder in due course are as follows:

Holder	Holder in due course
1. Can not get better title from defective party	1. Get a good title in case of a defect on the prior party.

2. Consideration is not necessary to be done by a Holder.	2. He has acquired the instrument for a consideration process.
3. Can claim against the transferor.	3. Can sue all prior parties, until the instrument is duly satisfied.
4. Acquires the instrument after it becomes due for payment.	4. Acquires the instrument before the amount mentioned in it payable.
5. Possession of instrument to recover money by name.	5. Takes the instrument in good faith, for consideration before it is overdue.
6. Acquires no privileges.	6. Acquires different privileges.

10.7 Discharge of Negotiable Instrument

The negotiable instrument can discharge in two ways. One is discharge of the instrument and another is discharge of parties.

a. **Discharge of the Instrument**: A negotiable instrument is said to be discharged when it becomes completely useless or it can not be negotiated further. After discharge of a negotiable instrument, the rights against all the party comes an end. It is the caused by the presence of disqualification of an instrument. The condition of discharged the instruments are as follows:
   - By the payment of instrument before the prescribed time.
   - When a principal becomes a holder in due course after payment.
   - When the holder cancels the instrument with an intention to release the party, the instrument is discharged.
   - When a liable party becomes insolvent, the instrument is discharged.

b. **Discharge of parties:** A party is said to be discharged from his liability when his liability on the instrument comes to an end. Parties are discharged from liability in the following ways:
   - **By cancellation:** When the holder of a negotiable instrument deliberately cancels the name of any of the party liable on the instrument with an intention to discharge him from liability thereon, such party and all endorsers subsequent to him are discharged from the liability.
   - **By release:** The holder of the negotiable instrument can release any party to the instrument by any method other than cancellation of names, by a separate agreement of waiver, release, or remission.

- **By payment:** The instrument can be discharged by the payment.
- **By not giving notice of dishonour:** Any party to a negotiable instrument to whom notice of dishonour is not sent by the holder is discharged from liability.
- **By material alteration:** Any material alteration of a negotiable instrument renders the same void, e.g. discharges the instrument itself, and all parties thereto at the time of making such alteration are discharged from liability.
- **By termination:** After fulfilling the liability by a party, the instrument is discharged.
- **By expiry of time:** Negotiable instrument is discharged by late presentation or expiry of the prescribed time.