

3. **Ratifier should be *competent* to ratify the act :** The person on whose behalf the act was done should have contractual capacity at the time both when it was done and also when it was ratified. One not competent to authorise an act, cannot give it validity by ratifying it. Thus, when the minor was not in a position to give authority at the date when acts were performed, he cannot subsequently ratify these acts.
4. **The transaction must have been *subsisting* at the time when it is ratified :** Before any act can be ratified, it must exist at date of ratification. To constitute ratification the approval of a transaction must occur before the other party had withdrawn from it and before the agreement has been terminated or discharged.
5. **The principal must have signified his *unconditional acceptance* of the act :** The principal must accept the act of the agent unconditionally. Where the acceptance is qualified or conditional ratification is invalid.
6. **Ratification may be *express* or *implied* :** Ratification may be in express words or in writing and it can also be implied from the conduct of the person on whose behalf the act was done.
7. **Ratification must have been made *with full knowledge* of all the materials facts :** Valid ratification involves knowledge of all material facts on the part of the ratifier. No valid ratification can be made by a person whose knowledge of the facts of the case is materially defective. It is the actual knowledge and not mere opportunity for acquiring actual knowledge which is essential for valid ratification.
8. ***Whole transaction* must be ratified :** A contract cannot be ratified in parts and repudiated in part. If ratified, the whole transaction must be ratified. Once a part is accepted, it is an implied acceptance of the whole. Either you ratify or you do not. For instance if an agent purchases without authority 20 bags of paddy, it is not open to the principal to ratify 12 of them, without approving of the other 8 bags of paddy.
9. Ratification may be of *one act or of a series of acts*;
10. **Ratification must be made *within a reasonable time* :** The ratification of a contract must be made within a reasonable time after the contract is made. Where a time is expressly limited, a ratification after the time has expired will not serve. The time of commencement of performance of the contract was September but the Board ratified the tender in October, when the defendant had already withdrawn his tender. Ratification was held to be too late.
11. **Act to be ratified should *not be void or illegal* :** A contract which is void in law cannot be ratified. An act which is void from the very beginning cannot be ratified. An act considering a criminal offence is incapable of ratification. A voidable contract however, can be ratified. Payment of dividend out of capital is void and cannot be ratified. Similarly, a forgery of signatures being a crime cannot be ratified.
12. **Ratification must be *communicated* :** There can be no valid ratification of an act unless it is communicated to the other party. Ratifier cannot keep his thoughts to himself.
13. **Ratification must *not injure their person* :** Ratification is equivalent to previous authority. An exception to this rule is provided in Section 200, which says that when interest of third parties are likely to be affected, the principle of ratification does not

apply. Ratification cannot relate back to the date of contact if third parties have in the intervening time acquired rights.

14. **Ratification relates back to the date of the act of the agent** : Ratification relates back to the original dating or making of the act or contract. It has a retrospective effect. It teantamounts to previous authority. It places all the parties in exactly the same position as they would have occupied in the case of a precedent authority.

### NATURE OF AUTHORITY OF AN AGENT

An agent is appointed with some authority by which he can bind the principal with third persons. In general , acts of an agent done with his authority, bind the principal (Sec.225). The authority, however, is not unlimited.

**Express and Implied authority:** The authority of an agent may be express or implied (Sec.186). An authority is said to be expressed when it is given by words spoken or written. An authority is said to implied when it is to be inferred from the circumstances of the cases; and things spoken and written or the ordinary course of dealing, may be accounted as circumstances of the case (Sec.187.)

**Acts within the Implied Authority :** The following acts of a (agent) partner are included within the scope of the implied authority of a agent (partner): (The implied powers have not been mentioned in the Act)

1. To purchase goods of the kind that are used in the business of the firm.
2. To sell the goods on behalf of the firm.
3. To engage servants to perform the business of the firm.
4. To receive payment of the debts due to the firm and give receipts for the same.
5. To settle the accounts with the persons dealing with the firm.
6. To draw, accept, endorse bills of exchange or any other negotiable instruments.
7. Pledging the firm's property as security for loan etc.

**Ostensible or apparent authority:** Ostensible or Apparent Authority is the authority of an agent as it appears to others. When an agent is employed for a particular business, the persons dealing with him can presume that he has authority to do all such acts as are necessary or incidental to such business.

**Emergency authority:** An agent has authority, in emergency, to all such acts for the purpose of protecting his principal from loss as would be done by person of ordinary prudence, in his own case, under similar circumstances (Sec.189).

### Distinction between Agent and Servant

<i>Agent</i>	<i>Servant</i>
1. An agent is authorised to act on behalf of his principal and has power to create legal relations between the principal and third persons.	A servant has no representative character. He has no authority to make contract on behalf of his master.
2. An agent is not subject to the direct control and supervision of the principal.	A servant acts under the direct control and supervision of his employer.

- |                                                                                                                                                                                                                   |                                                                                                                            |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------|
| <p>3. An agent may work for several principals.</p>                                                                                                                                                               | <p>A whole time servant serves only one master.</p>                                                                        |
| <p>4. The principal directs an agent "as to what is to be done".</p>                                                                                                                                              | <p>The master has the right to direct not only "what work is to be done" but also "how the work is to be done".</p>        |
| <p>5. An agent may be paid by way of commission on the basis of work done.</p>                                                                                                                                    | <p>A servant is paid by way of salary or wages.</p>                                                                        |
| <p>6. The principal is liable for only those acts of his agent which are done within the scope of authority and is not liable for those acts of the agent which are done outside the scope of such authority.</p> | <p>An employer is liable for the wrongful acts of the servant, if such acts are committed in the course of employment.</p> |

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**Distinction between Agent and Independent Contractor**

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<i>Agent</i>	<i>Independent Contractor</i>
<p>1. An agent represents his principal and has the authority to create contractual relationship between his principal and third parties.</p>	<p>An independent contractor does not represent his employer. And no authority to create contractual relationship between his master and third parties.</p>
<p>2. An agent is not personally liable in ordinary cases.</p>	<p>Independent contractor is personally liable for all acts done by him.</p>
<p>3. The question of authority arises in case of agency.</p>	<p>The question of authority does not arise in the case of independent contractor.</p>
<p>4. An agent is bound to act in the matter of agency subject to the directions and control of his principal.</p>	<p>An independent contractor undertake to perform a certain specified work, the manner and means of performances being left to his discretion.</p>

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**SUB-AGENT AND SUBSTITUTED AGENT**

**Definition of Sub-Agent:** Section 191 defines a sub-agent as "*person employed by and acting under the control of the original agent in the business of the agency*".

**Appointment of Sub-agent:** The ordinary rule of the law is that *an agent cannot delegate his powers or duties to another without the express authority of the principal*. To this rule, there are certain *exceptions* where an agent can appoint a sub-agent;

- (a) where the ordinary custom or usage of trade permits employment of sub-agents;
- (b) where it is necessary because of the nature of the agency;
- (c) where the act to be done is purely ministerial and does not involve any confidence or require any skill;
- (d) where the agent has express authority to appoint sub-agent;
- (e) where in the course of the agent's employment unforeseen emergencies arise which render it necessary to delegate his authority;

to Section 227, where an agent has done more than what he is authorised to do and it is separable, the principal is bound by that part which is within his authority.

3. **Principal bound by notice given to agent (Section 229):** A notice given to the agent is as effectual as notice given to principal as otherwise notice might be avoided in every case by employing agents. Thus, the knowledge of a manager of a bank is knowledge of the bank. Similarly, knowledge of one partner in firm is a knowledge of all the partners. The principal is bound by notice given to the agent in the course of the business. *Knowledge of the agent is the knowledge of the principal.* But where knowledge is not acquired by the agent in course of his employment, it cannot be imputed to the principal. However, the rule contained in this section will not apply if the agent had committed a fraud on the principal.
4. **Liability of principal by estoppel (Section 237):** A principal is liable where he has, by words or conduct, induced a belief in the contracting party that the act of the agent was within the scope of his authority. The liability of the principal under Section 237 is not based on any real authority, but is by estoppel.
5. **Liability for misrepresentation or fraud by an agent (Section 238):** The principal is liable for the fraud of his agent acting within the scope of his authority, and whether the fraud is committed for the benefit of the principal or that of the agent.

### **Agent acting for an Unnamed Principal**

Where an agent disclosed the fact, that he is an agent, but at the same time does not disclose his principal's name, the contract made by the agent is binding on the principal. But the unnamed principal should be in existence at the time of the contract. Where an agent signed the contract as a broker, "to my principal's", but did not disclose the name of the principal, it was held that the broker was not personally liable.

### **Agent acting for an Undisclosed Principal**

The doctrine of the undisclosed principal comes into operation when an agent enters into a contract with a person without disclosing the name and the existence of his principal. Where the agent does not disclose the existence of his principal he is personally liable for the contract. On such contracts he can sue and be sued in his own name because he is then in the eyes of law the real contracting party. But the agent's right to action comes to an end with the intervention of the undisclosed principal. Once the third party knows of the existence of the principal as well as of the agent, he has right to sue both or either of them. Once he elects to sue one and other, it would appear that he exhausts his cause of action.

### **Personal Liability of an Agent**

**General Rule (Section 230) :** In the absence of any contract to that effect, an agent cannot personally enforce contract entered into by him on behalf of his principal, nor is he personally bound by them.

### When the Agent becomes Personally Liable

The circumstances under which an agent becomes personally liable are shown below:

- (a) **In case of Foreign Principal** (Section 230) : Where the contract is made by an agent for the sale or purchase of goods for a merchant residing abroad, in the absence of any contract to the contrary, it is presumed that the agent is personally liable for such contracts.
- (b) **In case of Undisclosed Principal** (Section 230) : Where the contract is made by an agent for an undisclosed principal, in the absence of any contract to the contrary, it is presumed that the agent is personally liable.
- (c) **In case of Incompetent Principal** (Section 230) : Where a contract is made by an agent for a person who cannot be sued. (e.g. minor, lunatic, foreign ambassador), in the absence of any contract to the contrary, it is presumed that the agent is personally liable.
- (d) **In case of Principal not in Existence** : Where a contract is made by the promoter for a company not yet incorporated, the promoters are personally liable.
- (e) **In case of acts not Ratified** (Section 235) : A person untruly representing himself to be the authorised agent of another, and thereby inducing a third person to deal with him as such agent, is liable, if his alleged employer does not ratify his acts, to make compensation to the other in respect of any loss or damage which he has incurred by so dealing.
- (f) **In case of acts in his Own Name** : Where a contract is made by an agent without disclosing that he is contracting as an agent, the agent is personally liable.

**Example** : X took a loan from Y by executing a hundi in Y's favour. X did not sign the hundi as agent of the firm nor did he disclose to Y the name of his principal. The agent was held personally liable. (*Trilok Chand Vs. Rameshwar Lal*).

- (g) **In case of Express Agreement** : Where a contract made by an agent specifically provides for the personal liability of the agent, the agent will be personally liable.
- (h) **In case of Custom or Usage of Trade** : Where there is a custom or usage of trade making the agent personally liable, in the absence of any contract to the contrary, the agent is personally liable.

**Example** : X, a share broker purchased 100 shares @ Rs. 100 per share and sold the same shares @ Rs. 90 per share on behalf of Y who refused to give the difference. X is personally liable because it is a custom that a share broker is personally liable for the contracts entered into by him.

- (i) Where agent acts, *receives or pays money by fraud or by mistake.*
- (j) Where an agent *acts beyond his authority.*
- (k) Where the agent *signs negotiable instruments in his own name.*
- (l) When the agent *appoints sub-agent without authority.*
- (m) Where the agent *is an unauthorised one.*

**1. Where the agency is coupled with interest:** An agency is said to be coupled with an interest when the agency is created for the purpose of securing some benefit over and above his remuneration as an agent. Thus, an agency is coupled with interest when the agent has an interest in the authority granted to him or when the agent has an interest in the subject-matter with which he is authorised to deal. Such an agency cannot, in the absence of any contracts to the contrary, be terminated to the prejudice of such interest.

**Illustration :** A gives authority to B to sell A's land and to pay himself out of the proceeds the debts due to him from A. A cannot revoke this authority nor can it be terminated by his insanity or death.

This rule, will not apply to cases where the interest of the agent arises after the creation of agency. The interest of the agent should have arisen interior to the authority. It is important that the agency is created with the object of securing a benefit or gain to the agent and is not sufficient that it does so incidentally.

**2. Where the agent has incurred a personal liability:** When an agent has incurred personal liability, the agency becomes irrevocable, for the principal cannot be permitted to withdraw, leaving the agency exposed to risk or liability he has incurred.

**Illustration :** A consigns certain wheat to B for sale. Subsequently B advanced some money to A the principal. Held the subsequent advance could not convert the agency into one coupled with interest.

**3. Where the agent had partly exercised the authority:** Section 204 of the Act lays down that the principal cannot revoke the authority given to agent after the authority has partly exercised so far as regards such acts and obligations as arise from acts already done in the agency.

**Illustration:** A authorises B to buy 1,000 bags of paddy on account of A and to pay for it out of A's money remaining in B's hands. B buys 1,000 bags of paddy eg., in his own name, so as to make himself personally liable for the price. A cannot revoke B's authority so far as regards payment for the paddy.

## POWER OF ATTORNEY

**Meaning:** A power of attorney is defined by s.2 (21) of the Stamp Act, as including "any instrument not chargeable with a fee under the law relating to court fees for the time being in force," which empowers "a specified person to act for and in the name of the person executing it". It is the Powers of Attorney Act, 1882, which deals with the subject, but does not define it. In common parlance, a power of attorney is an instrument or a deed by which a person is empowered to act for and in the name of the person executing it. The person executing the deed is known as the *Principal or donor* and the one in which favour it is executed is the agent, or the power agent or the power of attorney agent.

Section 2 of the Powers Attorney Act, 1882, provides the donee may execute any instrument in and with his own name and signature and his own seal, where sealing is required, by the authority of the donor of the power. And such an instrument shall be as effectual in law as if it had been executed by the donor.

As mentioned earlier, no consideration is necessary to create agency. Therefore, the deed of Power of Attorney may stipulate that the agent will not get any remuneration.

**A Power of Attorney may be Special or General:** If the deed conferring power by one to another relates to one single transaction, it is known as *special power of attorney*. If the deed conferring power relates to several transactions it is *general power of attorney*.

**Registration:** As a general rule, registration of power of attorney is not necessary but if it authorises the donee to recover the rents of an immovable property of the donor for the donee's benefit, it would require registration. And so also a power creating a charge in favour of the donee upon an immovable property referred to therein.

Further s.32(c) of the Registration Act, 1908, requires that where a document is presented for registration by the agent of a person entitled to present it for registration, such agent must be duly authorised by power of attorney executed and authenticated in manner as mentioned in s.33 of the Act.

Such a power of attorney is to be executed before and authenticated by a registrar or sub-registrar. Unregistered power executed in a foreign country before a notary public can be used by the agent for presentation of document for registration. The power of attorney, however, executed before a notary public in India will not enable the agent to present any document for registration under the Registration Act, 1908.

The power of attorney is required to be engrossed on non-judicial stamp paper. The amount of stamp duty varies with different types of powers as described in the Stamp Act and varies among different States of India. Section 4 of the Power of Attorney Act, 1882 provides that the original deed of power can be deposited in the High court in whose jurisdiction the principal resides and a certified copy of the deed can be obtained from the High Court. Such certified copies are equal to originals and are binding on all.

Further, s.85 of the Indian Evidence Act provides that the Court shall presume that every document purporting to be a power of attorney and to have been executed before and authenticated by a Notary Public, or any Court, Judge, Magistrate, was so executed and authenticated.

#### REVIEW QUESTIONS

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1. Define the term 'agency'. What are the essentials and legal rules for a valid agency?
2. Briefly explain the various modes by which an agency may be created.
3. What is agency by estoppel? In what way does it differ from an agency by holding out?
4. Mention some important mercantile agents and their functions.
5. 'Ratification is tantamount to prior authority'. Comment and explain the requisites of a valid ratification.
6. What are the different kinds of agents? How they can be classified?
7. State briefly the duties and rights of an agent. What is the degree of skill required of an agent?
8. Discuss the duties of an agent under the Indian Contract Act.
9. Define the term 'substituted agent'. Give a comparison between sub-agent and substituted agent.
10. State the rules relating to the personal liability of an agent for a contract entered into by him on behalf of his principal.
11. Discuss briefly the different modes in which the agency can be terminated. When does the termination take effect?
12. Explain (a) Irrevocable Agency (b) Agency coupled with interest.

**Meaning and Definition of Negotiable Instrument :** A negotiable instrument is a written contract evidencing a right to receive money and it may be transferred by negotiation i.e., either by delivery or by endorsement. The term "*negotiable instrument*", literally means "a document transferable by delivery". In India, the law relating to negotiable instruments is contained in the Negotiable Instruments Act, 1881 which came into force 1st March, 1882. It is more or less a condensation of the English common law rules on the subject. Section 13 (1) of the Negotiable Instruments Act states that, a *Negotiable Instrument means a promissory note, bill of exchange or cheque payable either to order or to bearer.*

The Act applies to the whole of India and to all persons resident in India, whether foreigners or Indians. The provisions of this Act is not applicable to *Hundis* and other native instruments. Special customs and local usages govern instrument. Where no such custom is established, this Act will equally apply to *Hundis*.

### Examples of Negotiable Instruments

- (a) Negotiable Instruments recognised by *statute*: (i) Bills of Exchange, (ii) Promissory Notes, (iii) Cheques.
- (b) Negotiable instruments recognised by *usage or custom* : (i) *Hundis*, (ii) Share warrants, (iii) Dividend warrants, (iv) Banker's drafts, (v) Circular notes, (vi) Bearer debentures, (vii) Debentures of Bombay Port Trust, (viii) Railway receipts, (ix) Delivery orders.

The list of Negotiable Instruments is not a closed chapter. With the growth of commerce, new kinds of securities may claim recognition as negotiable instruments.

**Examples of Non-negotiable instruments :** (i) Money orders, (ii) Deposit receipts, (ii) Share certificates, (iv) Dock warrants, (v) Postal orders.

### Essential Features of Negotiable Instruments

1. **Easy transferability :** They can be transferred from one person to another like cash, i.e., the property (ownership) in the instrument can be transferred by mere *delivery* (if is a bearer instrument) or by *endorsement and delivery* (if it is an order instrument).
2. **Title :** A bonafide transferee for value (known in law as a *holder in due course*) of a negotiable instrument gets a complete, independent and indefeasible title to the instrument even though there was some defect in the title of the transferor.
3. **Right to file Suit :** The transferee of a negotiable instrument is entitled to file a suit in his own name for enforcing any right or claim on the basis of the instrument i.e., there is right of action in itself and he is not dependent upon another's title.
4. **Notice of transfer:** Moreover, it is not necessary to give notice of transfer of a negotiable instrument to the party liable to pay.
5. **Presumption:** Certain presumptions apply to all negotiable instruments e.g., consideration is presumed to have passed between the transferor and the transferee.
6. **Procedure for suits:** In India a special procedure is provided for suits on promissory notes and bills of exchange (order 37-A in the Civil Procedure Code).
7. **Number of transfer:** These instruments can be transferred in infinitum till they are at maturity.



8. **Rule of evidence:** These instruments are in writing and signed by the parties; they are used as evidence of the fact of indebtedness because they have special rules of evidence.
9. **Exchange :** These instruments relate to payment of certain money in legal tender; they are considered as substitutes for money and are accepted in exchange of goods because cash can be obtained at any moment by paying a small commission. The parties to these instruments know for certain (by whom, to whom, how much, when and where) the liabilities or claims will mature.

### Presumptions as to Negotiable Instruments

Section 118 and 119 of the Negotiable Instruments Act provide the following presumptions as to negotiable instruments:

1. **Consideration:** Every negotiable instrument was made or drawn, accepted, endorsed, negotiated for consideration;
2. **Date:** Every negotiable instrument was made or drawn on the date it bears;
3. **Time of acceptance:** Every accepted bill was accepted within a reasonable time after its date and before its maturity;
4. **Transfer:** Every transfer of a negotiable instrument was made before its maturity;
5. **Order of endorsement:** The endorsement on a negotiable instrument were made in the order in which they appear.
6. **Stamping :** A lost promissory note, bill of exchange or cheque was duly stamped;
7. **Holder in due course:** The holder of a negotiable instrument is a holder in due course;
8. **Proof of protest:** In a suit upon an instrument which has been dishonoured, the court shall, on proof of protest, presume the fact of dishonour, unless and until such fact is disproved i.e., counter evidence.

The above presumptions are rebuttable by evidence to the contrary. Moreover, these presumptions would not arise if an instrument has been obtained by means of fraud (or) for unlawful consideration.

### Parties to Negotiable Instruments

The parties to negotiable instrument in case of pro-note, bill of exchange and cheque are stated below.

1. **Drawer:** The maker of a negotiable instrument is called 'drawer'.
2. **Drawee:** He is person on whom the instrument is drawn.
3. **Acceptor:** He is a person who accepts the instrument of bill of exchange. Generally the drawee becomes the acceptor after accepting the instrument (but sometimes a stranger may accept on behalf of the drawee).
4. **Payee:** Payee is a person to whom the sum stated in the instrument is payable. The drawer or any other person may also be the payee. In the latter case, he is called *Payee for Honour*.
5. **Holder:** He is either the original payee or any other person to whom the payee has endorsed the instrument. In case of the bearer cheque, the bearer is the holder.

6. **Endorser:** When the holder endorses the instrument to anyone else, he becomes the endorser.
7. **Endorsee:** The person to whom the instrument is endorsed is known as endorsee.
8. **Endorsee in case of need :** The person to whom resort may be had in case of need (In English law, he is called *refree in case of need*) i.e., when the bill is dishonoured either by non-acceptance or by non-payment.
9. **Acceptor for honour:** Further, any person may voluntarily become a party to a bill as an acceptor. A person who, on refusal by the original drawee to accept the bill or to furnish better security when demanded by the notary, accepts the bill in order to safeguard the honour of the drawer or any endorser is called *acceptor for honour*.
10. **Holder in due course:** According to Section 8 of the Negotiable Instruments Act, a holder of a negotiable instrument is "a person entitled in his own name to the possession thereof and to receive or recover the amount due thereon from the parties thereto". Thus, a person who has obtained the possession of an instrument by theft or under a forged endorsement is not a holder in due course as he is not entitled to recover the amount of the instrument.

**Privileges of a Holder in due course :** A holder in due course is given certain other privileges under the Negotiable Instruments Act, which are not available to a holder.

- (i) A person, who signed and delivered to another a stamped but otherwise *inchoate (incomplete) instrument*, is stopped from asserting, as against a holder in due course, that the instrument has not been filled in accordance with the authority given by him provided the amount filled is covered by the stamp affixed (Section 20).
- (ii) Every prior party to a negotiable instrument, i.e., the maker or drawer, the acceptor, and all the intermediate *endorsers continue to remain liable to the holder in due course* until the instrument is duly satisfied (Section 36).
- (iii) Where a *bill of exchange is drawn by a fictitious person* and is payable to his order, the acceptor cannot be relieved from his liability to the holder in due course. The holder in due course shall, however, have to prove that the instrument was endorsed by the same hand as the drawer's signature (Section 42).
- (iv) Where an instrument is negotiated to a holder in due course, *the parties to the instrument cannot escape liability* on the ground that the delivery of the instrument was conditional or for a special purpose only (Section 46 and 47).
- (v) Not only that the title of the holder in due course is *not subject to the defect in previous holder's title* but once the instrument passes through the hands of a holder in due course, it is a purged of all defects. Any person acquiring it takes it free of all defects, unless he was himself a party to the fraud (Section 53).
- (vi) No maker of a promissory note and no drawer of a bill of exchange or cheque shall in a suit thereon by a holder in due course, be permitted to *deny the validity of the instrument* as originally made or drawn (Section 120).
- (vii) No maker of a note and no acceptor of a bill payable to order is, in suit thereon by a holder in due course, permitted to *deny the payee's capacity* at the date of the note or bill to endorse it (Section 121).

**Difference between Holder in due Course and Holder**

<i>Holder in due course</i>	<i>Holder</i>
1. Takes the instrument for free from all defects	Takes it subject to all defects and equities
2. Acquires the instrument for valuable consideration	Consideration not necessary.
3. Should have acquired possession of the instrument before the amount mentioned in it became payable	Could acquire the possession after the amount mentioned in it became payable.
4. He should not have noticed any defect in the instrument	Can take the instrument with notice of defects.
5. Must have possession of the instrument	It is sufficient if he is entitled to the possession of the instrument-He could be a holder though the instrument is lost.

**Comparison between Negotiation and Assignment**

<i>Negotiation</i>	<i>Assignment</i>
1. Consideration is presumed	Consideration must be proved.
2. The bonafide holder is due course gets better title than the transferor.	The title of the transferee is subject to the same defects as that of transferor.
3. Instruments payable to bearer are negotiated by mere delivery and instrument payable to order are negotiated by endorsement and delivery	Assignment requires a written documents duly signed by the transferor.
4. Notice of transfer to the debtor by the transferee is not necessary	Notice of assignment of a debt, in order to make the assignment complete and effective, must be given by the assignee to the debtor.
5. Negotiation requires no registration	Assignment requires registration.

**Negotiation of a Negotiable Instrument**

The term '*negotiation*' may be defined as the transfer of a negotiable instrument by any person to another so as to constitute the transferee the holder of the instrument. In case of bearer instruments, the negotiation can be made by simple delivery of the instrument. In case of an order instrument, the negotiation can be made only by indorsement on the instrument and its delivery. In other words, a negotiable instrument payable to a particular person or his order, can be transferred by making an indorsement on it and then delivering the same.

**PROMISSORY NOTE**

**Definition :** Section 4 of the N.I Act defines, *A promissory note is an instrument in writing ( not being a bank note or a currency note) containing an unconditional undertaking signed by the maker, to pay a certain sum of money to, or the order of a certain person or to the bearer of the instrument.*

**Parties to a Promissory Note :** The parties to a promissory note include the *maker*, the *payee*, the *holder*, the *endorser*.

### Essential Features of a Promissory Note

1. **The Promissory note must be in writing:** Mere verbal promise or oral undertaking does not constitute a promissory note. The intention of the maker of the note should be signified by writing in clear words on the instrument itself that he undertakes to pay a particular sum of money to the payee or order or to the bearer.
2. **It must contain an express promise or clear undertaking to pay :** The promise to pay must be express. It cannot be implied or inferred. A mere acknowledgment of indebtedness is not enough.

Also, a receipt for money, if it does not contain express promise to pay is not a promissory note. But, if the receipt is coupled with a promise to pay, it shall be a promissory note.

**Example :** "We have received a sum of Rs. 9,000 from Shri R.R. Sharma. This amount will be repaid on demand. We have received this amount in cash". Held, this is a promissory note. [*Surjit Singh Vs. Ram Ratan, A.I.R. (1975) Gan 15*]. However, notice that the use of the word 'promise' is not essential to constitute an instrument as 'promissory note'.

3. **The promise to pay must be definite and unconditional:** A promise to pay contained in the note must be unconditional. If the promise to pay is coupled with a condition it is not a promissory note.
4. **The maker of the pro-note must be certain:** The instrument should show on the fact of it as to who exactly is liable to pay. The name of the maker should be written clearly and ascertainable on seeing the document.
5. **It should be signed by the maker:** Unless the maker signs the instrument, it is incomplete and of no legal effect. Therefore, the person who promises to pay must sign the instrument even though it might have been written by the promisor himself.
6. **The amount must be certain:** The amount undertaken to be paid must be definite or certain and not vague. That is, it must not be capable of contingent additions or subtractions.
7. **The promise should be to pay money:** The promissory note should contain a promise to pay money and money only i.e., *legal tender money*. In India one rupee and above denominations (both notes and coins) are *unlimited legal tender* and fifty paise coin is *limited legal tender*, upto ten rupees and all other subsidiary coins are upto one rupee only. The promise cannot be extended to payments in the form of goods, shares, bonds, foreign exchange, etc.
8. **The payee must be certain:** The money must be payable to a definite person or according to his order. The payee may be ascertained by name or by designation. But it *cannot be made payable either to bearer* (Section 31 of the R.B.I. Act, 1934) or to the maker himself.
9. **Demand or Usance:** The promissory note may be payable on demand or after certain definite period of time.
10. **It should bear the required stamping :** A promissory note should, necessarily, bear sufficient stamp as required by the Indian Stamp Act, 1889.

11. **If should be dated:** The date of a promissory note is not material unless the amount is made payable at particular time after date. Even then, the absence of date does not invalidate the pro-note and the date of execution can be independently proved. However, to calculate the interest or fixing the date of maturity or limitation period the date is essential. It may be *ante-dated* or *post-dated*. If postdated, it cannot be sued upon till the ostensible date.
12. **The rate of interest:** It is usual to mention in it the rate of interest per annum. When the instrument itself specifies the rate of interest payable on the amount mentioned in it, interest must be paid at the rate from the date of the instrument(Sec.79).

### EXAMPLES OF PROMISSORY NOTES

*The following are the illustrations of Promissory Notes :*

A signs instruments in the following terms :

- (a) "I promise to pay 'B' or order Rs. 500".
- (b) "I acknowledge myself to be indebted to 'B' in Rs. 1000, to be paid on demand, for value received".

*But the followings are Not Promissory notes.*

- (i) "Mr. Balu I.O.U. (I owe you) Rs. 1,000".
- (ii) "I am liable to pay you Rs. 500".
- (iii) "I promise to pay B Rs. 500 and all other sum which shall be due to him".
- (iv) "I promise to pay B Rs. 500, first deducting thereout any money which he may owe me".
- (v) "I promise to pay B Rs. 1500 on D's death, provided he leaves me enough to pay that sum".
- (vi) "I promise to pay B Rs. 500 seven days after my marriage with C".
- (vii) "I promise to pay B Rs. 500 and to deliver to him my black horse on 1st January next".

### BILL OF EXCHANGE

According to section 5 of the N.I. Act *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 the bearer of the instrument.*

There are usually three parties to a bill of exchange. The maker of a bill of exchange is called the *drawer*(creditor). The person who is directed to pay is called the *drawee* (debtor); the person who is entitled to receive the money is called the *payee*; when the payee gets the possession of the bill, he is called the *holder*. It is the holder's duty to present the bill for acceptance to the drawee. The drawee signifies his acceptance by signing on the bill. After such a signature, the drawee becomes the acceptor. It is not, however, necessary that three separate persons should answer to the description of drawer, drawee and payee. Sometimes, the drawer and the payee may be one and the same person in which case the drawer directs the drawee to make payment of the sum specified in the bill to himself.

Besides the above parties to a Bill of Exchange, there may be the endorser, the endorsee, Drawee in case of Need, Acceptor for Honour, etc.

place is specified in the instrument for presentment for payment, such presentment can be made to him in person *wherever he can be found* (Section 71).

**Presentment for Payment Excused (Section 76) :** In the following cases no presentment for payment is necessary and the instrument may be treated as dishonoured; 1. Where the acceptor, maker or drawee intentionally *does something so as to prevent the holder from presenting* the bill, eg., where a bill is lost and the drawer refuses to give a duplicate thereof. 2. Where his *business place is closed on a working day* during the usual business hours on the due date. 3. Where there is *no person authorised to make payment* at the place specified for payment. 4. Where it is not payable at any specified place and the *person liable to make payment is not found* after making reasonable search. 5. Where the parties to the bill have *undertaken expressly or impliedly to pay* the instrument in spite of its non-presentment for payment. 6. Where the *drawee would not suffer and damage* for non-payment, any holder can make the drawer liable without presentment, e.g., where the *drawer of a bill and the drawee is the same person*. 7. Where *drawee is a fictitious person*. 8. Where a person to the bill is *incompetent to contract*. 9. Where the bill is *dishonoured by non-acceptance*. 10. When it is *impossible to present* the instrument, e.g., declaration of war between the countries of the drawee and the holder.

**Accommodation Bill :** Usually the bills are drawn, accepted or indorsed for consideration. When a bill is drawn, accepted or indorsed without any consideration, it is called an *accommodation bill*. Such bills are drawn to provide financial help to another. When the bill is accepted, it is discounted with the bank and proceeds are shared by the parties. In case of accommodation bills the relationship between the drawer and the drawee is not that of a creditor and a debtor. The party accommodating is called the '*accommodation party*' and the party accommodated is called the '*accommodated party*'.

**Ambiguous Instruments :** Where an instrument owing to its faulty drafting may be construed either as a bill of exchange or a promissory note, such instruments are known as *ambiguous instruments*. In such a case, the holder may treat it either as a bill or a promissory note. Once the holder elects at it in a particular manner, later on he cannot change and cannot treat it in a different manner. The cases where an instrument may be treated as an ambiguous one are- Where in a bill the drawer and the drawee are the same person, or where the drawee is a fictitious person or a person incompetent to contract, the instrument is an ambiguous one.

**Inchoate Instrument :** An instrument which is incomplete in some respect is called an inchoate instrument. Section 20 provides that where one person signs and delivers to another a paper stamped in accordance with the law relating to negotiable instruments then in force in India, either wholly blank or incomplete in some respect, he thereby gives prima facie authority to the holder thereof to make or complete it, for any amount not exceeding the amount covered by the stamp. The person so signing shall be liable upon such instrument, in the capacity in which he signed the same, to any holder in due course for such amount. But a person other than the holder in due course cannot recover from the person delivering the instrument anything in excess of the amount intended by him to be paid thereunder. This rule is based on the principle of estoppel. The person who delivers any incomplete instrument is estopped from denying the authority of the person who has completed it.

**Negotiation back or Circuity of Action :** The general rule is that a holder in due course may sue all prior parties to the instrument. However, when a bill or note is negotiated back to

a prior party, the prior party goes back to his former position, and he cannot enforce payment of the instrument against any intermediate party to whom he was previously liable because of his prior endorsement.

An indorser is liable to all parties who come after him but not to prior parties. Similarly all prior parties are liable to him. Every subsequent party can sue the prior party. There is an exception to this rule.

An indorser who negotiates an instrument may again become the holder by subsequent indorsements. Now, the instrument is negotiated back to a prior party. That party is remitted to his former position. He becomes the holder of the instrument.

A the holder of a bill indorses it to B. B indorses it to C, then C to D; then D to E and finally E to A.

A - B - C - D - E - A

Now, is A a prior party or subsequent party? As a subsequent party he can sue E. If he is allowed to sue E, E can sue D, D can sue C and C can sue B. But B can now sue A as a prior party. This circuity of action is prohibited. A can further negotiate the bill only if he cancels or strikes off the indorsements of B, C, D and E. This is called *Taking up of a Bill*.

**Payment for Honour :** When a bill has been noted or protested for non-payment, any person including a party already liable under the instrument may pay the same *supra protest* for honour of any party liable to pay the same. Such payment is called *payment for honour* and the person so paying is called *payer for honour*. No consent of the holder is necessary. A declaration should be made before a Notary Public by him, indicating the party for whose honour he accepts and such a declaration should be recorded by the Notary Public (Section 113). Payment should precede protest by the Notary Public. On payment, the payer for honour can recover the amount of the bill he has paid with interest thereon plus all expenses properly incurred (e.g., the notarial charges) in making such payment (Section 114). In case there are two or more offers for payment, the holder should generally accept payment of the person who will discharge the largest number of persons liable on the bill.

*The protest is a condition precedent for payment for honour and protest is a strong evidence of dishonour.* In India noting alone is sufficient to enable a person to pay it for honour.

*Acceptance for honour* has to be made before the bill is overdue and by a person who is not already liable on the bill; a payment for honour is made after maturity, after default by the drawer or the acceptor. The payment for honour need not necessarily be by a person who is not already liable on the bill.

In the case of acceptance for honour, the consent of the holder is necessary and the holder has got the option either to accept or reject an acceptance for honour. There is no such necessity in the case of payment for honour. Formalities to be made in the case of payment for honour the party proposing to make such payment must appear before a notary personally or through an agent declaring his intention to pay the bill for honour of the person for whose honour the payment is made, the declaration must be got recorded by the notary, otherwise the payment will not amount to a payment to honour *supra protest* that a mere voluntary that a mere voluntary payment.

**Dishonour by Non-Acceptance:** A bill is said to be dishonoured if it is not accepted (*within 48 hours from the time of presentment*) or it is not paid. A bill is said to be dishonoured by

<i>Bill of Exchange</i>	<i>Promissory Note</i>
4. <b>Acceptance:</b> A bill needs to be accepted to make it valid. The drawee put his signature as acceptor (Bills payable on demand do not require acceptance).	No such acceptance is required; a pro-note is signed by the maker only.
5. <b>Nature of liability:</b> The liability of the drawer of a bill is secondary and conditional; The drawee or the acceptor is primarily liable.	The liability of the maker of a pro-note is primary and absolute because he himself is the main debtor.
6. <b>Immediate relation:</b> The drawer (Maker) of an acceptance bill stands in immediate relation with the acceptor and the payee.	The maker of a note stands in immediate relation with the payee.
7. <b>Notice to prior parties:</b> When a bill is dishonoured either by non-payment, due notice of dishonour must be given by the holder to all prior parties (including drawer and intermediate endorsers).	Notice of dishonour need not be given to the maker of a pro-note.
8. <b>Sets:</b> Foreign bills are drawn in sets (of three or four).	Pro-notes are not so drawn.
9. <b>Protest:</b> Foreign bills must be protested for dishonour when such protest is required by the law of the place where they are drawn.	No such protest for dishonour is required for foreign Pro-Notes.
10. <b>Conditional acceptance:</b> A bill may be accepted conditionally.	The maker of the pro-note cannot attach any such condition to it.
11. <b>Acceptor for Honour:</b> The acceptor for honour can even make the payment of a bill	It cannot be paid for honour.
12. <b>Payable to the maker himself:</b> A bill may be payable to the maker (drawer) himself when the drawer and the payee are one and the same person.	A note cannot be made payable to the maker himself.

#### Distinction Between a Cheque and a Bill Exchange

<i>Cheque</i>	<i>Bills of Exchange</i>
1. <b>Drawee:</b> A cheque is always drawn on a specified banker only.	A bill may be drawn on any one, including a banker.
2. <b>Payable on demand:</b> A cheque is always payable on demand.	A bill may be drawn payable on demand or on the expiry of a certain period after date or sight.



<i>Cheque</i>	<i>Bills of Exchange</i>
3. <b>Payable to the bearer on demand:</b> A cheque is always payable on demand and may be made payable to bearer or order.	A bill cannot be drawn payable to the bearer on demand.
4. <b>Acceptance:</b> A cheque requires no acceptance.	A bill must be accepted before payment can be claimed.
5. <b>Days of grace:</b> No days of grace are allowed.	In the case of time bills three days of grace are allowed from the due date for calculating the maturity of the bill.
6. <b>Supposition:</b> It is presumed that the customer is having an account with sufficient credit balance or credit arrangement	In case of a bill, there is no such presumption.
7. <b>Crossing :</b> A cheque can be crossed either generally or specially.	A bill cannot be crossed.
8. <b>Stamping:</b> A cheque does not require any stamp.	A bill must be properly stamped. (except in the case of demand bills).
9. <b>Contermending:</b> A payment of a cheque can be countermanded by the drawer.	The payment of a bill cannot be countermanded by the drawer.
10. <b>Circulation:</b> A cheque is not intended for circulation but for immediate payment.	A bill may be circulated by endorsing it.
11. <b>Discounting :</b> A cheque is not generally discounted.	A bill can be discounted and rediscounted with the banks.
12. <b>Failure to present:</b> If the cheque is not presented for payment on the due date, the drawer is not discharged from liability unless he suffers any damages by delay in presentment, e.g., the liquidation of the bank.	The drawer of a bill is discharged if it is not duly presented to the acceptor for payment or else.
13. <b>Primary liability:</b> The drawer of a cheque is primarily liable for payment.	The drawee or the acceptor of a bill is primarily liable on it.
14. <b>Statutory protection:</b> The banker is protected if he pays a cheque under a forged endorsement.	The drawee of a bill has no such protection.
15. <b>Noting and protesting:</b> A cheque need not be noted and protested when dishonoured.	A bill must be noted and protested when it is dishonoured.
16. <b>Sets:</b> Cheques are not issued in sets.	Foreign bills are generally drawn in sets of three or four.



# **CHEQUE AND DEMAND DRAFT**

## **CHAPTER OUTLINE**

### **CHEQUE**

- **MEANING OF A CHEQUE**
- **ESSENTIALS OF A CHEQUE**
- **CROSSING OF A CHEQUE**
- **ENDORSEMENT IN A CHEQUE**
- **PAYMENT IN DUE COURSE**
- **DISHONOUR OF CHEQUES**
- **BOUNCING OF CHEQUES**
- **PAYING BANKER**
- **COLLECTING BANKER**

### **DEMAND DRAFT/BANK DRAFT**

### **DISCHARGE OF NEGOTIABLE INSTRUMENTS**

instrument, he is said to endorse the same, and is called the "endorser".

The person who signs the instrument with the intention of transferring its ownership to another is called the 'endorser' and the person in whose favour the instrument is transferred is called the 'endorsee' and the procedure is called 'endorsement'.

**Who may endorse:** The following person may endorse a negotiable instrument: (a) the *payee* of the instrument (Section 8); (b) the *holder* of instrument (Section 15); (c) the *maker* signing it otherwise as such maker (Section 15); (d) every sole maker, drawer, payee or *endorsee* or all of several joint makers, drawers, payees or *endorsees* of the instrument (Section 51); and (e) the *holder in due course* of the instrument (Section 53).

### Types of Endorsement

1. **Blank or General endorsement:** An endorsement is said to be blank or general when the endorser merely signs on the back of the instrument without specifying any person to whom the payment is to be made (Section 16).
2. **Full or Special endorsement:** When an endorser signs his name and also specifies a person to whom or to whose order the amount of the instrument is to be paid the endorsement is said to be full or special, and the person so specified is called the "endorsee" of the instrument (Section 16)
3. **Restrictive endorsement:** An endorsement is said to be restrictive when the endorser, by express words, restricts the right of further negotiation of the instrument.
4. **Partial endorsement:** Where only part of the amount of the instrument is transferred, it is called *partial endorsement*. A partial endorsement does not operate as a negotiation of the instrument e.g., the holder of a promissory note for Rs. 2,000 writes on it, "pay B Rs.1,000 " and endorses the note. The endorsement is invalid for the purpose of negotiation. But where an instrument has been partly paid, it can be negotiated for the balance, provided the fact of part-payment is noted on the instrument (Section 56).
5. **Conditional or Qualified endorsement:** Where an endorsement limits or negates the liability of the endorser, it is called *qualified endorsement* (Section 52). It differs from a restrictive endorsement which restricts the negotiability of the instrument but does not in any way limit or negate the liability of the endorser.
6. **San Recourse Endorsement :** An endorsement of a negotiable instrument may by express words in the endorsement exclude his own liability thereon (Section 52). Such endorsement is called 'Endorsement Sans recourse' or '*without recourse to me*'. For example, where X endorses a cheque as :

'Pay Y or order Sans Recourse' or 'Pay Y or order without recourse to me'. 'X' will not be liable on the instrument if it is dishonoured.

7. **Sans Frais :** These words, when added at the end of the endorsement, indicate that *no expenses should be incurred on account of the bill*.
8. **Faculative Endorsement :** Where such words are added to an endorsement whereby the endorser waives his right to receive notice of dishonour, the endorsement is termed as '*Faculative Endorsement*'.

## PAYING BANKER AND STATUTORY PROTECTION

The banker on whom the cheque is drawn viz., the drawee or otherwise known as the *paying banker* has a contractual duty to pay money to the right person according to the customer's mandate. If he pays, by mistake, to a wrong person he would be committing actual breach of his duty towards his customers. The Negotiable Instruments Act gives legal protection to a paying banker, provided the payment is a *payment in due course* (payment according to an established custom and practice of bankers in the country.)

### Payment in due course

The essentials of a payment in due course are:

1. **Payment of Money:** First of all, there should be a payment of money during bank business hours only.
2. **Payment in accordance with the apparent tenor of the instrument:** The payment must be in accordance with either the directions contained in the cheque or the intentions of the parties in the cheque. Payment must be the exact amount mentioned in the cheque. Payment must be made at or after the maturity of the cheque. Payment must be made according to crossing rules, if the cheque is a crossed one.
3. **Payment in good faith and without negligence:** A thing is deemed to be done in good faith with meaning of this Act, where it is in fact done honestly, whether it is done negligently or not. Banks in India are supposed not only to act always in good faith but also without negligence.
4. **Payment to a person having possession of the instrument:** A payment cannot be a payment in due course if it is made to a person not legally entitled to receive it. Possession implies legal possession i.e., entitlement for receiving payment.
5. **Payment under the bonafide circumstances:** The person to whom payment is made, should only be in possession of the instrument, but there should be no such circumstances connected with his possession as to afford a reasonable ground for believing that he is not legally entitled to receive payment of the amount mentioned in the instrument.

**Payment of bearer cheques:** An instrument may be made payable to (i) bearer, or (ii) a specified person or his order. An instrument is payable to bearer which is expressed to be so payable on which is expressed thus "*Pay to Ram or bearer*". It is also payable to bearer when the only or last endorsement on it is an endorsement in blank. Where a cheque is originally expressed by the drawer himself to be payable to the bearer, the paying banker is fully protected if he makes the payment to the bearer or even if there is any forged or restrictive endorsement on the cheque. But the payment must be made in due course. Hence, the rule, *once a bearer cheque always a bearer cheque*. In other words, the original character of the cheque is not altered so far as the paying is concerned, provided the payment is made in due course.

*An instrument is payable to order.* (i) when it is payable to the order of a specified person or (2) when it is payable to a specified person or his order or, (3) when it is payable to a specified person without the addition of the words "or his order" and does not contain words prohibiting transfer or indicating an intention that it should not be transferable. When an instrument, either originally or by endorsement, is made payable to the order of a specified person and not to him or his order, it is payable to him or his order, at his option.

**Penal action for dishonour of the cheque:** Under Section 138 of the Negotiable Instruments Act, introduced by the (Amendment) Act 66 of 1988, has inserted a new chapter XVII in the Negotiable Instruments Act 1988. The Amendment came into force w.e.f. April, 1989, a drawer of a cheque is liable to penalties in case of dishonour of the cheque for *insufficiency of funds in the account*. If a person issues a cheque in payment of any debt or liability and it is dishonoured for lack of funds or if it exceeds the arrangement with the bank, he or she will be deemed to have committed an offence and will be punished with *imprisonment for a term which may extend to one year, or with fine which may go upto twice the amount of the cheque or both*.

*The courts have held the following amounting to dishonour for insufficiency of funds:*

- (i) *stop-payment* instructions to the Payee Bank
- (ii) *request to the payee not to present* the cheque till further intimation [*Modi Cement Ltd. case (1998)*].
- (iii) cheque received back from the Payee bank with the remarks '*Account Closed*' [*G.M. Mittal Stainless Steel Vs. Nagarjuna Investments (1997)* and *N.E.P.C. Micon Ltd. Vs. Magma Leasing Ltd. (1999)*].

However, remarks '*Refer to Drawer*' will not constitute dishonour for insufficiency of funds because a cheque may be referred to a drawer for reasons other than insufficiency of funds.

#### Conditions for Penal Action

- (i) the cheque in question should have been *issued in discharge of whole or part of a legally enforceable debt or liability*; a cheque given as gift will not fall in this frame-work.
- (ii) the cheque in question should have been presented within 6 months of its specific validity period, whichever is earlier.
- (iii) the payee or holder *should give notice demanding payment within 15 days* of his receiving information of dishonour, which should be for no other reason than *insufficiency of funds*.

With respect to post-dated cheques, the Supreme Court in *Anil Kumar Sawhney Vs. Gulshan Rai (1993)*, reversing the decisions of Punjab and Haryana High Court, and the Madras High Court, held that a post-dated cheque remains a mere bill of exchange upto the date shown on the cheque and becomes a cheque only from the date written on it. The period of six month (for banker's validity) is, therefore, to be reckoned from the date of the cheque.

- (iv) *drawer can make payment within 15 days of receipt of the notice* and only if he fails to do so, he is liable to be prosecuted.
- (v) *complaint can be made only by payee or holder in due course-within one month of cause of action arising*.

It may be noted that the holder of a cheque shall be presumed to have received the cheque for discharge, in whole or in part, of any debt or other liability (Sec. 139).

However, no Court shall take cognizance of any offence punishable under Sec. 138 except upon a complaint, in writing, made by the payee, or, the holder in due course of the cheque. Further, no Court inferior to that of a *Metropolitan Magistrate or a Judicial Magistrate of the First Class* shall try any offence punishable under Sec. 138.

However, in the following cases it is not an offence- (a) A cheque given in gift; (b) A cheque not presented within the validity period; (c) The Payee or holder has not given notice demanding

payment within 15 days of dishonour in case of insufficiency of funds; (d) The payee has paid the same within 15 days of receipt of notice; (e) The complaint was made after a month of cause of action (Sec. 142);

### **Amendment to deal with bouncing of cheques strictly**

With over five lakh cases relating to bouncing of cheques pending disposal all over the country, the Govt. has amended Section 138 of the Negotiable Instruments Act to deal sternly with the growing menace. The amendment will enable the '*Certificate of bouncing*', issued by the banks - where the cheques bounce - to be treated as a concrete evidence in the court of law. As the law exists, the alleged defaulter has to prove his case in the court beyond reasonable doubt despite the bank issuing a 'certificate of bouncing' and it takes a long time for the courts to dispose of the case.

The changes include doubling of the punishment for dishonour of cheques from one year to two years, and a provision to legalise transactions through electronic cheque. The amendments have also set a *time limit of six months for the disposal of such cases from the time of filing of the cases, raise the time ceiling for issue of notice by the victims from 15 days to 30 days, and do away with the existing condition that courts must take cognisance of the cases within one month.*

### **Statutory Protection to the Collecting Banker**

Section 131 of the N.I. Act 1881 affords limited protection to the collecting banker (bank who collects the cheque through the bankers' clearing house) against the liability for conversion of cheques. Section 131 runs as follows :

*"A banker who has in good faith and without negligence received payment for a customer" of a cheque crossed generally or specially to himself shall not, in case the title to the cheque proves defective, incur any liability to the true owner of the cheque by reason only of having received such payment".*

A collecting banker can claim *protection against conversion* under this section only if the following conditions are satisfied: 1. Protection for collection of *crossed cheques* only; 2. Collection on behalf of *customers*; 3. Collection *as an agent* of the customer; 4. Received payment in *good faith* and *without negligence*.

*In the following instances, the collection bankers are held negligent:* (1) Collecting an order cheque without verifying the endorsement thereon; (2) Collecting order cheque without *making enquiries*, where the endorsement should have aroused the banker's suspicion; (3) Collecting a cheque crossed *account payee* for the account of a person other than a payee; (4) Collecting a cheque payable to a company for the *personal account of a director* or official of the company; (5) Collecting for the account of a company, a cheque payable to another company; (6) Collecting a cheque payable to a public official for personal account of an official; (7) Collecting a cheque payable to a partnership firm for the personal account of the partner; (8) Collecting for the personal account of an employee, or his wife a cheque payable to this employer; (9) Collecting a cheque for a very large amount for an account in which sufficient balance has never maintained. In general, the collecting banker will have to be cautious when collecting a third party cheque for a customer.

the instrument stand discharged, because the instrument as such is discharged by such payment.

4. *By allowing drawee more than 48 hours to accept* (Sec. 83) If the holder of a bill of exchange allows the drawee more than forty eight hours, exclusive of public holidays, to consider whether he will accept the same, all previous parties not consenting to such allowance are thereby discharged from liability to such holder.
5. *By taking qualified acceptance* (Sec. 86). If the holder of a bill agrees to a qualified acceptance all prior parties whose consent is not obtained to such an acceptance are discharged from liability.
6. *By not giving notice of dishonour* : Any party to a negotiable instrument (other than the party primarily liable) to whom notice of dishonour is not sent by the holder is discharged from liability as against the holder, unless the circumstances are such that no notice of dishonour is required to be sent.
7. *By non-presentment for acceptance* of a bill (Sec. 61) When a bill of exchange is payable certain period after sight, its holder must present it for acceptance to the drawee within a reasonable time after it is drawn. If he makes a default in making such presentment the drawer and all endorsers who were liable towards such a holder are discharged from their liability towards him.
8. *By delay in presenting cheque* (Sec. 84). It is duty of the holder of a cheque to present it for payment within reasonable time of its issue. If he fails to do so and in the meanwhile the bank fails causing damage to the drawer, the drawer is discharged as against the holder to the extent of the actual damage suffered by him.
9. *By material alteration* : Any material alteration of a negotiable instrument renders the same void, i.e., discharges the instrument itself, and all parties thereto at the time of making such alteration and not consenting to the change are discharged from liability thereon (Sec. 87). But, persons who become parties to the instrument after the alteration are liable under the instrument as altered. In other words, those who take an altered instrument cannot complain (Sec. 88).  
It is worth noting that the material alteration of the instrument discharges all the parties liable thereon at the time of making such alteration, and it makes no difference whether the alteration is for the benefit or detriment to any party to the instrument or whether it is made by the holder of the instrument or by a stranger while the instrument was in the custody of the holder, because the party in custody of the instrument is bound to preserve it in its entirety (*Davidson Vs Cooper*). But alteration made by a stranger without any negligence on the part of the holder does not affect the liability of the parties thereto. (*Guoroachandra Vs Krushna Charana*).
10. *By negotiation back* : When a bill of exchange comes back to the acceptor by process of negotiation and he becomes its holder, it is called '*negotiation back*' and all rights of action thereon are extinguished [Sec. 90].
11. *By Operation of law* : (a) By an order of the insolvency court, discharging the insolvent. (b) By merger-when a judgement is obtained against the acceptor, maker or indorser, the debt under the bill is merged into the judgement debt. (c) By lapse of time, i.e. when the remedy becomes barred by limitation.



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**REVIEW QUESTIONS**

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1. What is a cheque? What are its requisites?
2. Distinguish between (a) Cheque and Bill of exchange. (b) Cheque and Promissory Note.
3. What do you mean by 'crossing' on a cheque? Explain with suitable illustrations the various types of crossing.
4. Define the term 'Holder' of a negotiable instrument. What are his rights?
5. Give definition of 'Holder in due course' as defined under N.I.Act. What are his rights and privileges?
6. Define 'endorsement'. Explain with suitable illustrations the different types of endorsements. Also state the significance of each.
7. What is material alteration? Give examples. State also the legal effects of material alteration and forgery?
8. When can the payment of the cheque be refused by a bank?
9. Explain the conditions to be fulfilled for penal action for dishonour of a cheque on account of insufficiency of funds?
10. Distinguish between
  - (a) General Crossing and Spacial Crossing
  - (b) General Crossing and Restrictive Crossing.
  - (c) Special Crossing and Double Crossing.
  - (b) Special and Restrictive endorsement.
11. State the rules regarding the protection of bankers against forgery regarding (i) Cheques drawn on them and (ii) Cheques which they collect for their customers.
12. Z drew a cheque in favour of Y which in turn endorsed it to X for consideration. The cheque was dishonoured by the bank on the basis of instructions from Z as there was failure of consideration undertaken by Y. Is X entitled to recover the amount of cheque?

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**PRACTICAL PROBLEMS**

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**Attempt the following problems giving reasons for your answers:**

1. A Payee of a cheque informs the bank on which it is drawn that the cheque drawn in his favour is lost and requests the bank to stop payment of the cheque pending an advice from the drawer. But before the stop payment instructions are received from the drawer, the cheque is presented throughout clearing. How should the drawer bank act?  
[Hint - The drawee bank should immediately try to get confirmation from the drawer of the cheque and pending that should send back the cheque with remarks "Reported Lost, drawer's confirmation awaited".]
2. A cheque drawn by A and payable to B passed by indorsement through the hands of several persons and was ultimately indorsed in favour of E the cheque was dishonoured on account of want of funds. Advise E.  
[Hint - E can hold all prior parties liable to him provided he gives them a notice of dishonour.]
3. A's wife forged his signature on 40 cheques drawn on M bank and cashed them. Upon his discovery of the forgeries, A did not at once inform the bank but some months later when his wife informed him that she wanted more money for the purpose for which the previous cheques had been drawn and cashed by her, he stated his intention of notifying the bank, with the result that the same night his wife committed suicide. A brought an action against the bank, claiming to be credited with the amounts of the forged cheques will he succeed?

[Hint - No, A will not succeed as he did not inform the banker at once after coming to know about the forgeries. He is guilty of gross negligence. His continued silence operated to prevent the bank from taking its remedies against the wife.]

4. A cheque is drawn payable to 'B or order'. It is stolen and B's indorsement is forged. The banker pays the cheque in due course. Is the banker discharged from liability? Would it make any difference if the drawer's signatures were forged?

[Hint - Yes, the paying banker is discharged from liability despite the forged indorsement in favour of the payee, because of special protection granted by Section 85 (1). Of course, where the drawer's signature is forged, a banker remains liable to the drawer even by a payment in due course and cannot debit the drawer's account.]

5. X and Y, husband and Y wife, have a joint account in a bank. The account is such as can be operated upon by either of them. The deposits in the account are usually made by X, the husband, although the withdrawals are usually made by Y the wife. The banker comes to know that a 'garnishee order' attaching X's money in the bank has been issued by the court X and Y order the banker to transfer the amount standing in their joint account to the current account of Y, the wife, in the same bank. Discuss the liability of the banker to abide by the order if the order is served on him before/after the account is transferred.

[Hint - If the garnishee order is served on the banker before the transfer is applied for by X and Y, the banker is bound to follow the order and refuse the transfer to the account of Y. But if he receives the order after the amount is transferred to the account of Y, the banker is not bound by the garnishee order and will, therefore, be not liable in that case.]

6. A banker pays a cheque crossed generally over the counter. Is he liable to the drawer or to the payee of the cheque?"

[Hint - The banker is liable to the payee of the cheque and not to the drawer. (Sec. 129)].

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# **PRINCIPLES OF INSURANCE**

## **CHAPTER OUTLINE**

**LAW OF INSURANCE**

**CONTRACT OF INSURANCE**

**TYPES OF INSURANCE**

**PRINCIPLES OF INSURANCE**

- **INSURABLE INTEREST**
- **GOODFAITH**
- **INDEMNITY**
- **RISK**
- **PREMIUM**
- **CAUSA PROXIMA**
- **CONTRIBUTION**
- **DOUBLE INSURANCE**
- **REINSURANCE**

**RETURN OF PREMIUM**

The law of insurance is a branch of the Law of Contract. Like a contract in the law of contract the parties to the contract of insurance also have the duties and rights against each other. The contract of insurance creates rights and duties on both of them. The insurance business in India is governed by the following Acts :

1. The Insurance Act, 1938 (as amended up-to-date)
2. The Life Insurance Corporation Act, 1956.
3. The Marine Insurance Act, 1963.
4. The General Insurance Business (Nationalisation) Act, 1972.

The Insurance Act, 1938 contains provisions regarding matters like definition of insurer and insured, commission payable to agents, licensing of agents, appointment of staff, register of policies and register of claims, powers of the Controller of Insurance, acquisition of surrender value by policy, actuarial report, deposits, investment and loans, valuation of the assets and liabilities, accounts and balance sheet, re-insurance, etc. The Act also contains provisions relating to the constitution, management and winding up of insurance companies but since all types of insurance business have been nationalised, these provisions (i.e., regarding constitution, management and winding up of insurance companies) have become redundant. The provisions of the Insurance Act, 1938 are applicable to both Life and General Insurance business in so far as these are not inconsistent with those contained in the special Acts governing them. In addition to this Act (i) life insurance business is also governed by the General Insurance Business (Nationalisation) Act, 1972, and (iii) marine insurance business is also governed by the Marine Insurance Act, 1963, and the General Insurance Business (Nationalisation) Act, 1972.

### Contract of Insurance

Contract of Insurance is a contract whereby one person, called the *insurer*<sup>1</sup> undertakes to make good the loss of another, called the *insured*<sup>2</sup> by payment of a sum of money to him on the happening of a specified event. The consideration for which the insurer undertakes to indemnify the assured is called the *Premium*. The instrument in which the terms of contract of insurance is generally embodied is called the *Policy*. The insurance policy is not the contract; it is the evidence of the fact of insurance and proof of insurance contract. The thing or property insured is called his *subject-matter* of insurance, and the interest of the assured in the subject-matter is called his *insurable interest*. The risk which is insured against is the loss arising from uncertain events or casualties, i.e., destruction of or damage to the property or the death or disablement of a person and these are called perils insured against or *insurable risk*.

**Insurable Risk :** Insurance is the device which has now assumed the form of a business of a dealing in risk. But this does not imply that each and every business risk can be insured against. *Whether or not a particular business risk can be insured against, depends on the fulfilment of the following criteria:*

1. There must be a sufficiently large number of homogeneous exposure units to make the losses reasonably predictable. Insurance is based on the operation of the law of large numbers. Unless we are able to calculate the probability of loss, we cannot have a financially sound programme.
2. The loss produced by the risk must be *definite*.