BLOGS

Negotiable Instruments: Understanding Cheques, Bills of Exchange, and Promissory Notes

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Introduction

Negotiable instruments are foundational to commercial transactions, serving as substitutes for money and facilitating the smooth flow of trade and finance. They are written documents that promise to pay a specific sum of money, either on demand or at a future date.

The key characteristic of a negotiable instrument is its negotiability, meaning it can be freely transferred from one person to another, and the person who receives it in good faith and for value (a holder in due course) obtains a title free from any defects in the title of the previous holder.

This transferability and the protection afforded to a holder in due course make these instruments highly reliable and essential tools in modern commerce. The law governing negotiable instruments in India is primarily codified in the Negotiable Instruments Act, 1881, which defines and regulates the various types of these instruments and the rights and liabilities of the parties involved.

Cheques

A cheque is one of the most common types of negotiable instruments, defined under Section 6 of the Negotiable Instruments Act, 1881. It is essentially a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand.

In simpler terms, it is a written order to a bank to pay a stated amount of money from the drawer’s account to the person or entity named on the cheque (the payee), or to the bearer of the cheque.

The parties involved in a cheque are the drawer (the person writing the cheque), the drawee (the bank on which the cheque is drawn), and the payee (the person to whom the payment is to be made).

Cheques are payable on demand, meaning they can be presented for payment immediately upon issue. They are widely used for making payments, withdrawing money from bank accounts, and transferring funds.

Features like crossing (marking two parallel lines across the face of the cheque) can restrict its negotiability, for instance, by requiring the payment to be credited only to the payee’s account.

Bills of Exchange

A bill of exchange is a more general form of a negotiable instrument compared to a cheque. As defined in Section 5 of the Negotiable Instruments Act, 1881, a bill of exchange is an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a certain sum of money only to, or to the order of, a specified person, or to the bearer of the instrument.

The parties typically involved are the drawer (the person who writes the bill and orders payment), the drawee (the person on whom the bill is drawn and who is ordered to pay), and the payee (the person to whom the payment is to be made).

Unlike a cheque, which is always drawn on a bank, a bill of exchange can be drawn on any person or entity. Bills of exchange are frequently used in trade to facilitate credit transactions, allowing a seller to draw a bill on a buyer for the price of goods, with the buyer accepting the bill and promising to pay at a later date.

The acceptance by the drawee is crucial, as it signifies their agreement to the order and makes them primarily liable for the payment.

Promissory Notes

A promissory note is another fundamental type of negotiable instrument, defined under Section 4 of the Negotiable Instruments Act, 1881. It is an unconditional undertaking in writing, signed by the maker, to pay a certain sum of money only to, or to the order of, a specified person, or to the bearer of the instrument.

The key difference from a bill of exchange or a cheque is that a promissory note is a promise to pay, made by the person who signs it (the maker), rather than an order to a third party to pay.

The parties involved are the maker (the person who promises to pay) and the payee (the person to whom the promise is made). Promissory notes are often used in loan transactions, where the borrower (maker) issues a promissory note to the lender (payee) promising to repay the loan amount with interest on a specified date or on demand.

They serve as written evidence of a debt and the maker’s commitment to repay. Like other negotiable instruments, a promissory note can be transferred by endorsement and delivery, allowing the payee to transfer their right to receive payment to another person.

Conclusion

Cheques, Bills of Exchange, and Promissory Notes are distinct yet related types of negotiable instruments, each playing a vital role in facilitating financial transactions and commerce.

While a cheque is specifically an order to a bank payable on demand, a bill of exchange is a more general order to pay, and a promissory note is a direct promise to pay. Their negotiability, governed by the principles of the Negotiable Instruments Act, 1881, provides certainty and ease of transfer, making them indispensable tools in the economic landscape.

Understanding the characteristics and legal implications of each of these instruments is crucial for anyone involved in commercial activities, from individuals writing cheques to businesses engaging in complex trade finance.