

Negotiable Instruments

NI ACT 1881 · CHARACTERISTICS · HOLDER & HOLDER IN DUE COURSE · PROMISSORY NOTE · BILL OF EXCHANGE · CHEQUE

Comprehensive Exam Revision Handout

1 CORE CONCEPT — NEGOTIABLE INSTRUMENTS

Governing law: **Negotiable Instruments Act, 1881** (**S. 1, 1A**) — whole of Pakistan, in force from **1 March 1882**; applies **regardless of any contrary usage or custom**. *Negotiable* = transferable by delivery; *instrument* = written document creating a right.

Promissory Note · **Bill of Exchange** · **Cheque** → **payable to ORDER or BEARER** (**S. 13**)

Delivery (**S. 3(d)**)

Transfer of possession, **actual or constructive**.

Issue (**S. 3(e)**)

First delivery of an instrument, complete in form, to a person who takes it as holder.

Negotiation (**S. 14**)

Transfer so as to **constitute the transferee the holder**.

2 CHARACTERISTICS

Order or bearer (**S. 13**)

Order: "Pay Azam", "Pay Azam or order", "Pay Azam or Babar" — no words prohibiting transfer.
Bearer: "Pay bearer", "Pay Azam or bearer", or **last indorsement in blank** (signature only).

"Pay bearer whenever he asks for" → not valid.

Easy transferability

Bearer → by mere **delivery**. **Order** → by **indorsement + delivery**.

Title of holder in due course (**S. 9**)

In the hands of a holder in due course the instrument becomes **free from all defects**.
Finder of a lost note can't recover; an innocent HDC from him can sue maker and all prior parties.

3 PARTIES, HOLDER & HOLDER IN DUE COURSE

Maker — makes a promissory note

Drawer — maker of a bill or cheque

Drawee — on whom bill/cheque is drawn, directed to pay; **Acceptor** once he signs assent

Payee — named person to whom/to whose order money is paid

Holder (**S. 8**)

(i) Entitled to **possession in his own name** (not a beneficial owner through a benamidar), and (ii) entitled to **receive/recover** the amount. If lost/destroyed, the person in possession at that time continues as holder.

Holder in due course (**S. 9**)

Possessor (bearer) / payee or indorsee (order) who took it **for consideration, before it became overdue, without notice of defect in transferor's title**.

✓ Conditions to become a Holder in Due Course

1. Is a holder

2. Valuable consideration gift ✖

3. Before maturity on demand: within reasonable time

4. Complete & regular no unconfirmed material alteration

5. Good faith no negligence / suspicion

*Material alteration (**S. 3(f)**): change of date, sum, time or place of payment; adding a place of payment to a generally accepted bill without acceptor's assent.*

Basis	Holder	Holder in due course
Consideration	Not necessary	Necessary
Right to sue	May not sue all prior parties	Can sue all prior parties
Good faith	May or may not	Must
Title	May not be free from defects	Better title than transferor
Maturity	Before or after	Only before maturity

4 PROMISSORY NOTE (**S. 4**)

An instrument **in writing** (not a bank/currency note) containing an **unconditional undertaking, signed by the maker**, to pay on demand or at a fixed/determinable future time a **certain sum of money only** to, or to the order of, a **certain person**, or to the bearer.

Date: September 15, 20XX
Rs. 10,000/- only
Three months after the date I promise to pay Ashraf or to his order the sum of Rupees Ten Thousand, for value received.
To: Ashraf (**Payee**) Sign: Zahid (**Maker**)

7 Essentials

- In writing**
- Promise** to pay (not mere acknowledgment)
- Definite & unconditional**
- Signed** by maker (thumb mark OK)
- Certain parties**
- Certain sum**
- Legal tender** (money only)

✓ Valid

- "I promise to pay B or order Rs. 500"
- "I acknowledge myself to be indebted to B in Rs. 1,000 **to be paid on demand**, for value received"
- "...seven days after **Saleem's death**" (certain to happen)
- Payable to the **principal of a college** (ascertainable)
- Sum with **interest**, at an indicated exchange rate, or in instalments with default acceleration

✖ Invalid

- Oral promise on telephone
- "I owe you Rs. 1,000" / "I am liable to pay" — **mere acknowledgment**
- "...after my marriage" / "as soon as I can" / "at my convenience" — **conditional**
- "Rs. 500,000 and all other sums due"; "with interest calculated at quarterly rests"; "and all applicable interest" — **uncertain sum** (per study-text solutions)
- Money + horse/shares; **foreign currency** (USD) — not legal tender
- "to you or your successors" — **uncertain payee**; unsigned note

Not conditional: payable at a particular place, after a specified time, or on an event certain to happen. Adjustment for the maker's business **profit or loss** does not make the sum uncertain.

5 BILL OF EXCHANGE (**S. 5**)

An instrument **in writing** containing an **unconditional order**, signed by the maker, **directing a certain person** to pay on demand or at a fixed/determinable future time a **certain sum of money only** to, or to the order of, a certain person or the bearer. Usually drawn by a **creditor on his debtor**.

Date: September 15, 20XX
Rs. 10,000/- only
Three months after the date pay to Yaseen or to his order the sum of Rupees Ten Thousand, for value received.
Accepted — **Aslam**
To: Aslam (**Drawee**) Sign: Mohsin (**Drawer**)
Payee: **Yaseen**

Parties & liability

- Drawer** — principal debtor **until acceptance**
- Drawee** — not liable until acceptance; then liable as **acceptor** after maturity
- Payee** — receives payment

*Essentials mirror the note, but with an **order** (not a request) and signed by **drawer and drawee**. Fictitious payee → may be treated as payable to bearer.*

✓ **Order (even if polite)**: "Babar, **please pay** Rs. 50,000 to Ehsaan or order"; "Bilal will much oblige me by paying Dawood Rs. 30,000".

✖ **Mere request / defective**: "please let Jazib have Rs. 50,000 ... and oblige"; "highly obliged if you make it convenient"; "as early as possible"; no drawee named; money + wheat.

6 CHEQUE (**S. 6**) & COMPARISON BLOCKS

A **bill of exchange drawn on a specified banker** and not expressed to be payable otherwise than **on demand**. Drawer = account holder; drawee = **banker**; payee. A bearer cheque is valid for **six months** (study-text example).

Basis	Promissory Note	Bill of Exchange
Parties	2 (maker, payee)	3 (drawer, drawee, payee)
Maker = payee?	Not possible	Possible ("pay to me or my order")
Nature	Promise	Order
Acceptance	Not required	Required from drawee
Liability	Maker: primary & absolute	Drawer: secondary & conditional
Bearer	Cannot be drawn "payable to bearer"	Can, but not "to bearer on demand"
Dishonour notice	Not required to maker	To all prior liable parties

Basis	Cheque	Bill of Exchange
Drawee	Always a banker	Any person, incl. banker
Payable	Only on demand	On demand or after a period
Acceptance	Not required	Required
Stamp	Not required	Must be stamped
Stop payment	Drawer can countermand	Cannot be countermanded

7 APPLICATION — WHICH INSTRUMENT?

Debtor pays creditor directly

No third party involved → issue a **promissory note** ("Five months after date I promise to pay Zain or order...").

Settling two debts at once

A owes Kamran and Abdullah owes A → A draws a **bill of exchange** on Abdullah, payable to Kamran, accepted by Abdullah.

Accepting an endorsed bill

Check: unconditional order, stamped, signed by drawer & drawee, certain parties/sum, alterations confirmed, proper indorsement and delivery.

8 COMMON EXAM TRAPS

! "...after X's **death**" is **valid** — death is certain; "after **marriage**" is **conditional**.

! Bill received **as a gift** or **after maturity** → holder, **not HDC**.

! "Please pay" can still be an **order**; "I shall be obliged if convenient" is a **request**.

! Negotiable instruments **need not be registered**.

! "Pay Afshan only" → **not negotiable** (transfer restricted).

! Note for **USD / goods** → invalid; money (legal tender) only.

! Blank indorsement converts an order instrument into a **bearer** instrument.

! Drawee of a cheque is **always a banker**; cheque needs **no acceptance, no stamp**.

9 QUICK REVISION BOX

1881

NI Act (in force 1 March 1882)

3

Instruments: note · bill · cheque

7

Essentials of Rs. 1,000 / bill

5

HDC: holder · value · pre-maturity · regular · good faith

• **S. 3** Definitions (bearer, delivery, issue, material alteration) · **S. 4** Note · **S. 5** Bill · **S. 6** Cheque

• **S. 7** Parties · **S. 8** Holder · **S. 9** Holder in due course · **S. 13** Negotiable instrument · **S. 14** Negotiation