

3. Negotiable Instruments

3.1. Negotiable Instruments

All negotiable Instruments are governed by the provisions of our Bills of Exchange Ordinance of 1927. This Ordinance is a verbatim reproduction of the English Bills of Exchange Act of 1882 which is globally regarded as one of the best drafted statutes.

Legal nature of the Negotiable Instrument

The following is a famous definition of a negotiable instrument as given in the English case of *Crouch v Credit Foncier of England Ltd* (1873) LR 8 QB 374.

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

From the above judicial definition, it will be seen that the following are essential features of a negotiable instrument.

- i. The property and rights in the negotiable instrument passes by delivery alone, or by delivery and endorsement. No further evidence of transfer is required.
- ii. The holder of the instrument can sue on it in his own name.
- iii. No notice need to be given to the debtor (that is the person who is liable to pay) in respect of the instrument.
- iv. Valuable consideration is presumed to have been given for the instrument. Since English law applies, “Valuable consideration” which is not a requirement in Roman Dutch Law, is a requirement in negotiable instruments. However, the law presumes it in the case of a negotiable instrument.
- v. A negotiable instrument is transferred “free of equities”. This means that a transferee obtains a good title to the instrument although the transferor’s title may have been defective. For example, the transferee is not affected by defenses such as fraud. However, it is only a transferee who has received the instrument in good faith for value who enjoys this privilege.

Negotiability contrasted with Transferability

The term ‘negotiability’ and ‘transferability’ are often regarded as being synonymous. This is a common misunderstanding. In fact, to appreciate the concept of negotiability, it may be contrasted with transferability. All negotiable instruments are transferable but not all transferable

instruments are negotiable. While transferability refers to the process of passing title in an instrument, negotiability usually refers to the quality of the title of the instrument that is passed.

As previously noted, 'negotiability' has a strict legal meaning and the difference between negotiation and transfer may be illustrated by considering the examples of a watch and a banknote. The ownership of the watch can only pass from one person to another if there is the element of intention. Possession is not sufficient and, if the watch is lost or stolen and passed on through several hands, the original true owner of the watch at no time loses ownership and may claim possession from the present holder. The watch is a non-negotiable article; title does not transfer by delivery alone; nor does it pass 'free of equities'.

A banknote on the other hand, is a negotiable instrument. If the note is lost or stolen and comes into the possession of a person who takes it in good faith and for the value and is innocent of the defect in title of the transferor, he or she becomes the true owner of the banknote and no amount of effort on the part of the person who lost the banknote will avail. *Miller v Race* (1758) 1 Burr 425. Both the watch and banknote are transferable, but only the banknote has the quality of negotiability.

Examples of Negotiable Instruments

The following instruments have been recognized as negotiable instruments by statute or by business usage or custom.

1. Bills of Exchange
2. Cheques
3. Promissory notes
4. Bank Drafts
5. Dividend Warrants
6. Bearer Debentures
7. Treasury Bills

Example of Non-negotiable Instruments

Although they look like negotiable instruments the courts have refused to recognize the following as negotiable.

1. Money Orders
2. Postal orders
3. Fixed Deposit Receipts issued by Banks
4. Certificates of Deposit
5. Share Certificates
6. Letter of Credit
7. IOUs
8. Bills of Lading

Bills of Exchange

Definition of Bills of Exchange

According to Section 3 of the Bills of Exchange Ordinance No. 25 of 1927,

1. A bill of exchange is an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand, or at a fixed or determinable future time, a sum certain in money to or to the order of a specified person, or to bearer.
2. An instrument which does not comply with these conditions, or which orders any act to be done in addition to the payment of money, is not a bill of exchange
3. An order to pay out of a particular fund is not unconditional within the meaning of this section, but an unqualified order to pay, coupled with –
 - a. An indication of a particular fund out of which the drawee is to reimburse himself, or a particular account to be debited with the amount; or
 - b. A statement of the transaction which gives rise to the bill, is unconditional.
4. A bill is not invalid by reason –
 - a. That it is not dated;
 - b. That it does not specify the value given or that any value has been given therefore; or
 - c. That it does not specify the place where it is drawn, or the place where it is payable.

Unconditional Order

There must be an “order”, that is something in the nature of a command, such as “Pay” or “Please pay”. A document reading “I should be pleased if you would pay” would not be a bill of exchange because those words would constitute not an order but a request. Further, the order must be “unconditional”, that is unqualified. Therefore, an order to pay out of a particular fund—such as “Pay B Rs. 500/- out of my number 2 account” – is not unconditional. The reason is that payment is made to depend upon the number 2 account having a minimum of Rs. 500/- to its credit. But if the order were to read – “Pay B Rs. 100/- and charge to my number 2 account” – it would constitute an unconditional order even though it would include an “indication” of the particular account to be debited because that indication would not be a condition precedent to the operation of the order. See Section 3(3)

The following judicial decisions further illustrate this requirement that “the order be unconditional”.

A simple request will not satisfy the requirements of an order. The phrase “we hereby authorize you to apply on our account to the order of” was held not to be an order in *Hamilton v*

Spottiswoode (1849) E Exch 200. That phrase did not create a clear obligation to pay. The words “I should be obliged if you would arrange to pay” will also not qualify as an order.

The order must unconditional. An order to a banker to pay “provided the receipt form at foot hereof is duly signed” will not be a bill of exchange because the banker is ordered to pay only if a condition is fulfilled by the payee, namely signing the form before the banker can pay. It is not an unconditional order to pay (*Bavins Junior and Sims v London and South Western Bank Ltd* [1900] 1 QB 270)

If the drawer has requested the payee to do something without addressing such request to the drawee, it will not make the bill a conditional order. For instance the words “the receipt as the back hereof must be signed, which signature will be taken as an endorsement of this cheque”, were held to be compatible with the characteristics of a bill of exchange (*Nathan v Ogdens* (1905) 93 LT 553)

Roberts and Co v Marsh (1915) 1 KB 42, provides a good illustration. In that case a person drew a cheque on a blank sheet of paper and wrote on it the words, “to be retained.” This was given to the payee asking him not to present it for payment, and promising that a proper cheque would be sent to replace it. As the promise was not kept the payee presented the cheque for payment, and it was dishonored. When the payee sued the drawer on the cheque, it was held that the order for payment was unconditional. The words “to be retained” were held to be a condition imposed by the drawer on the payee and not on the drawee, the banker.

In writing

The whole of the order in the instrument must be in writing. The word “in writing” includes what is typed, printed or written. Either ink or pencil will be sufficient. Section 2.

Signed by the person giving it

This means that the bill of exchange must be signed by the drawer (issuer). It is sufficient, however, if the bill is signed by some duly authorized person on behalf of the drawer. A bill is not signed by the drawer if his signature is forged or placed on the bill by someone without authority. So, forged cheques are not bills of exchange. *Koster’s Premier Pottery Pty Ltd v Bank of Adelaide* (1981) 28 SASR 355

Requiring the drawee to pay on demand

This requirement refers to time of payment. The term used is pay on “demand”, which means “pay when asked or requested” (demanded)

According to section 10 (1) of the Bills of Exchange Ordinance a bill is payable on demand

1. Which is expressed to be payable on demand, or sight, or on presentation, or
2. In which no time for payment is expressed.

Or at a fixed or determinable future time

Apart from using the term “pay on demand”, the instrument can say that it should be paid at a fixed or determinable future time. A “determinable future time” may be a stipulated period after a date, or after sight, or after the occurrence of some event which is certain to happen. But payment cannot depend on contingency, even if the event should occur. So a document expressed to be payable “six days after the ship named “Sea Lion” leaves “Colombo Harbour” is not a good bill of exchange because the specified event might not happen. *Banker v Efford* (1873) 4 All AJR 161.

Section 10(2) says that where a bill is accepted or endorsed when it is overdue, it shall, as regards the acceptor who so accepts, or any endorser who so endorses it, be deemed a bill payable on demand.

Section 11(1) says that a bill is payable at a determinable future time within the meaning of the Bills of Exchange Ordinance which is expressed to be payable

1. At a fixed period after date or sight, or
2. At a fixed period after the occurrence of a specified event which is certain to happen, though the time of happening may be uncertain.

A bill which is payable on or before a given date is bad, because the date of payment may be any date between the date of drawing and the last day for payment. *Williamson v Rider* [1963] 1 QB 89

An instrument expressed to be payable on a contingency is not a bill, and the happening of the event does not cure the defect. Section 11(2). Therefore, “when I marry X” will not satisfy the requirement of a determinable future time, even if in fact the drawer gets married. *Pearson v Garrett* (1689) 4 Mod. 242

A sum certain in money

Section 9(1) of the Ordinance says that the sum payable is certain although it is required to be paid:

1. With interest;
2. By stated installments;
3. By stated installments, with a provision that upon default in payment of any installment the whole shall become due;
4. According to an indicated rate of exchange or according to a rate of exchange to be ascertained as directed by the bill.

An order to pay a fixed sum “and all bank charges” or “and costs” is not a “sum certain”:
Standard Bank of Canada v Wildey (1919) 19 SW (NSW) 384.

To or to the order of a specified person or to bearer

The bill must be payable to:

1. A specified person; for example “Pay X”; or
2. The order of a specified person; for example, “Pay X or order”; or
3. Bearer, for example, “Pay bearer” or “Pay X or bearer”

Of the above (1) and (2) are “order bills” and (3) is a “bearer bill”.

A bill may be drawn payable to, or to the order of the drawer himself. Here the payee and drawer are one and the same person, as happens when a person draws a cheque payable to “self”. Again, the bill may be drawn payable to or to the order of the drawee. This might occur where a person indebted to his banker pays the bank by a cheque drawn on the bank. Payee and drawee are here the same person.

Capacity of Parties

Capacity to incur liability as a party to a bill is coextensive with capacity to contract, Where such capacity is to be determined by the law of Sri Lanka, it shall be determined by Roman Dutch law as administered in Sri Lanka, subject to the provisions of the statute law. Section 22(1) and (2).

Consideration

Valuable consideration for a bill may be constituted by-

- a) Any consideration which by the law of England is sufficient to support a simple contract;
- b) An antecedent debt or liability. Such a debt or liability is deemed valuable consideration whether the bill is payable on demand or at a future time. Section 27(1)

Generally the nature of the consideration is not mentioned on the fact of the bill. However, the absence of the mention that value was given does not render the bill invalid. Section 3(4)(b)

In this context, consideration means that a person issuing a bill of exchange or a cheque must receive something in return for issuing such bill of exchange or cheque. The decision of the Sri Lankan Supreme Court in *Letchime v Jamison* (1913) 16 NLR 286 is a good illustration. In that case the plaintiff was the defendant’s brother’s mistress and had two children by him. When the defendant’s brother was leaving Sri Lanka the defendant as a favour, gave a promissory note to the plaintiff to maintain the children. The defendant did not receive any consideration from his brother for making this arrangement, and gave the note of his own accord and not at his brother’s request.

The question before the Court was whether the plaintiff could sue the defendant on the promissory note. For the defendant it was argued the since no valuable consideration passed between the plaintiff and the defendant for the note, no action could be filed on the promissory note for lack of consideration. This view was in accordance with the principles of English law.

On the other hand it was argued for the plaintiff that the defendant's liability had to be determined according to the principles of Roman Dutch law and not English law and that under Roman Dutch law the plaintiff need not prove that there had been valuable consideration for the note.

The Supreme Court held that since this was an action based on a promissory note (a bill of Exchange) the English Law applied and under English law consideration was a requirement. Therefore, the plaintiff could not sue on the note because it was not given for valuable consideration.

Different types of persons that get involved in a Bill of Exchange

When a bill of exchange is drawn several parties come into existence who acquire legal rights and liabilities on the bill.

I. Drawer of the bill of exchange

The person who drew it. Under Section 55, the drawer of a bill by drawing it;

- a) Engages that on due presentation it shall be accepted and paid in accordance to its tenor, and that if it be dishonoured he will compensate the holder or any endorser who is compelled to pay it, provided that the requisite proceedings on dishonor be duly taken;
- b) Is precluded from denying to a holder in due course the existence of the payee and his then capacity to endorse.

II. Drawee

A drawee is the person on whom the bill is drawn. Under Section 53 a bill of exchange, by itself, does not operate as an assignment of funds in the hands of the drawee available for the payment thereof. Therefore, the drawee of a bill who does not accept a bill (as provided for in the Ordinance) is not liable on it. On the other hand, if the drawee accepts the bill, the law implies that he will pay it according to the method of his acceptance. Therefore, a drawee who accepts the bill is called an acceptor and is liable on the bill. As acceptor he is also precluded from denying to a holder in due course the existence of the drawer, the genuineness of his signature and his capacity and authority to draw the bill. Section 54.

Endorsement of Bills of Exchange

The term 'indorser' comes from the word 'indorsement' or 'endorsement'. To endorse means to write one's signature or to sign on the back of a document and therefore give your approval or sanction to that document.

Bills of Exchange and cheques can be negotiated by the payee endorsing them by writing his name on the back and transferring them.

Section 2 states 'indorsement' means indorsement completed by delivery. So merely signing the bill of exchange on its back will not constitute legal endorsement, In addition, there must be a delivery of the bill of exchange after endorsing it.

How 'endorsement' of a bill occurs

Afer a bill is drawn other persons beside the drawer, may decide to make use of it an thereby incur .liabilities on it. The payee of a bill drawn to order may wish to transfer it to some other person, and thereby this is done by an "endorsement". The person endorsing is he "endorser". There can be no endorser of a bearer bull because such bills are transferred by simple delivery.

Section 55(2) outlines the liabilities of an endorser.

Different types of 'Holders' of Bills of Exchange'

A 'holder' of a bill of exchange is the payee or endorser of a bill who is in possession of it or the bearer thereof. Section 2. Any person in possession of a bearer bill is a holder of it, but to be a holder of an order bill, the person in possession must also either be (i) the original payee or (ii) a person to whom the bill has bee endorsed.

A holder in due course. Section 29(1)

Before it was overdue – Section 36(2)

In good faith and for value – Section 92

Defective title – Secion 29 (2)

Presumption that 'holder of a bill' is a 'holder in due course' –Section 30

Holder for value – Section 27 (2)

Importance of the signature for liability on a bill of exchange

Section 23

Section 93(1)

Section 26

Negotiation of Bills of Exchange

The whole purpose of a bill of exchange is that it could be transferred from person to person in settlement of debts.

A bill is negotiated when it is transferred from one person to another in such a manner as to constitute the transferee the holder of the bill. While in the case of a bill payable to order, negotiation is by endorsement of the holder completed with delivery, a bill payable to bearer is transferred by delivery alone. Section 31.

Requisites of a valid endorsement – Section 32

1. The indorsement must be written on the bill and be signed by the endorser
 2. It must be an endorsement of the entire bill.
 3. When the bill is payable to more than one person all must indorse, unless the one indorsing has authority to indorse for others;
 4. Where the payee or indorsee is wrongly designated or his name is misspelt, he may indorse it as the name wrongly appears and add his proper signature.
- The payer may disregard any condition attached to the indorsement. – Section 33
 - An indorsement in blank makes the bill payable to bearer. A bill with a blank indorsement can be converted by a subsequent holder to a specially indorsed bill – Section 34
 - A restrictive indorsement prohibits the further transfer of the bill. Example : “Pay D only” – Section 35
 - The acceptor for honour is liable to pay if it is not paid by the drawee on due presentation – Section 66
 - When a bill is dishonoured by the acceptor for honour it must be protested for non-payment by him. –Section 67

Today, apart from its importance in the finance of international trade, the use of bills of exchange is not very common in domestic banking. Rather in domestic retail banking, the popular negotiable instrument bankers have to deal with on a daily basis is the cheque. Basically a cheque is a bill of exchange drawn on a banker.

Promissory Notes

Promissory notes are a type of negotiable instruments. Although a promissory note is defined in our Bills of Exchange Ordinance and certain parts of that statute is made applicable to them, strictly speaking, promissory notes are not bills of exchange. This is because promissory note involves only two parties, the maker of the note and the payee/bearer, while a normal bill of exchange involves three parties, namely, (i) the drawer (ii) the drawee/ acceptor and (iii) the holder.

A promissory note must also be distinguished from a cheque. A cheque must always be drawn on a banker, while a promissory note need not involve a bank at all.

Part IV of the Bills of Exchange Ordinance of 1927 deals with promissory notes.

Section 85 defines a promissory note as follows;

A promissory note is –

- a) An unconditional promise in writing by one person to another signed by the maker
- b) Engaging to pay
- c) On demand or at a fixed or determinable future time
- d) A sum certain in money
- e) To or to the order of a specified person or bearer.

- A promissory note is complete only upon delivery. –Section 86
- Where a note is payable on demand, it must be presented for payment within a reasonable time. –Section 88(1)
- Where it is payable at a particular place, it must be presented for payment there. In any other case, presentment for payment is not necessary. Presentment for payment is necessary to make the indorser of a note liable. Section 89

The following provisions in the Bills of Exchange Ordinance do not apply to promissory notes, namely provisions relating to:

- a) Presentation for acceptance
- b) Acceptance
- c) Acceptance supra protest
- d) Bills in a set.