**Chapter Three**

**Negotiable Instrument**

**Introduction**

The law of commercial paper is important to anyone who writes checks or borrows money. Historically speaking, however, commercial paper is a relatively new development. In early human history, people lived on whatever they could hunt, grow, or make for themselves. Imagine what your life would be like if you had to subsist only on what you could make yourself. Over time, people improved their standard of living by bartering for goods and services they could not make themselves. But traders needed a method for keeping account of who owed how much to whom. That was the role of currency. Many items have been used for currency over the years, including silver, gold, copper, and cowrie shells. These currencies have two disadvantages—they are easy to steal and difficult to carry.

Paper currency weighs less than gold or silver, but it is even easier to steal. As a result, money had to be kept in a safe place, and banks developed to meet that need. However, money in a vault is not very useful unless it can be readily spent. Society needed a system for transferring paper funds easily. Commercial paper is that system.

Exchange of goods and services is the basis of every business activity. Goods are bought and sold for cash as well as on credit. All these transactions require flow of cash either immediately or after a certain time. In modern business, large numbers of transactions, involving huge sums of money, take place every day. It is quite inconvenient as well as risky for either party to make and receive payments in cash. Therefore, it is a common practice for businessmen to make use of certain documents as means of making payment. Some of these documents are called ***negotiable instruments***. In this lesson let us learn about these documents.

**Meaning of Negotiable Instruments**

To understand the meaning of negotiable instruments let us take a few examples of day-to-day business transactions. Suppose Petros, a book publisher, has sold books to Philipos for Br. 10,000 on three months credit. To be sure that Philipos will pay the money after three months, Petros may write an order addressed to Philipos that he is to pay after three months, for value of goods received by him, Br.10,000/- to Petros or anyone holding the order and presenting it before him (Philipos) for payment. This written document has to be signed by Philipos to show his **acceptance** of the order. Now, Petros can hold the document with him for three months and on the due date can collect the money from Philipos. He can also use it for meeting different business transactions.

For instance, after a month, if required, he (Petros) can borrow money from Samrawit for a period of two months and pass on this document to Samrawit. He has to write on the back of the document an instruction to Philipos to pay money to Samrawit, and sign it. Now Samrawit becomes the owner of this document and she can claim money from Philipos on the due date. Samrawit, if required, can further pass on the document to Alem after instructing and signing on the back of the document. This passing on process may continue further till the final payment is made.

In the above example, Philipos who has bought books worth Br. 10,000 can also give an undertaking (promise) stating that after three months, he will pay the amount to Petros. Now Petros can retain that document with himself till the end of three months or pass it on to others for meeting certain business obligation (like with Samrawit, as discussed above) before the expiry of that three months’ time period.

You must have heard about a cheque. What is it? It is a document issued to a bank that entitles the person whose name it bears to claim the amount mentioned in the cheque. If s/he wants, s/he can transfer it in favor of another person. For example, if Abera issues a cheque worth Br. 5,000 in favor of Birhan, then Birhan can claim Br. 5,000 from the bank, or she can transfer it to Chaltu to meet any business obligation, like paying back a loan that she might have taken from Chaltu. Once she does it, Chaltu gets a right to Br. 5,000 and she can transfer it to Dawit, if required. Such transfers may continue till the payment is finally made to somebody.

In the above examples, we find that there are certain documents used for payment in business transactions and are transferred freely from one person to another. Such documents are called ***Negotiable Instruments***. To elaborate it further, an instrument, as mentioned here, is a document used as a means for making some payment and it is negotiable i.e., its **ownership can be easily transferred.**

Thus, negotiable instruments are documents meant for making payments, the ownership of which can be transferred from one person to another many times before the final payment is made. They may be defined as *“Promissory note, Bill of exchange, or Cheque, payable either to order or to bearer”.*

**Types of Negotiable Instruments**

There are just three types of negotiable instruments i.e., promissory note, bill of exchange and cheque. In the following sections, we shall study about Promissory Notes (popularly called Pronotes), Bills of Exchange (popularly called bills), and Cheques.

* 1. **Promissory Note**

Suppose you take a loan of Br. Five Thousand from your friend Rahel. You can make a document stating that you will pay the money to Rahel or the bearer on demand. Or you can mention in the document that you would like to pay the amount after three months. This document, once signed by you, duly stamped and handed over to Rahel, becomes a negotiable instrument. Now Rahel can personally present it before you for payment or give this document to some other person to collect money on her behalf. She can endorse it in somebody else’s name who in turn can endorse it further till the final payment is made by you to whosoever presents it before you. This type of a document is called a *Promissory Note*.

A promissory note is a promise made by the borrower (maker) to pay the lender a definite sum of money on a specified date. It is drawn and signed by the debtor, who promised to pay the creditor a certain sum of money. A promissory note may be drawn by more than one person, who may undertake to pay the amount both in their individual capacities as well as jointly.

A promissory note may also be defined as ‘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 only to or to the order of a certain person or to the bearer of the instrument’.

|  |
| --- |
| Br. 10,000/- Mekelle September 25, 2002On demand, I ***promise*** to pay Rahel or order a sum of Br. 10,000/- (Birr Ten Thousand only), for value received.To Rahel BerhanuAddress…….. Stamp |

**Parties to a Promissory Note**

There are primarily two parties involved in a promissory note. They are**:**

1. **The Maker or Drawer –** the person who makes the note and promises to pay the amount stated therein. In the above specimen, Berhanu is the maker or drawer.
2. **The Payee –** the person to whom the amount is payable. In the above specimen it is Rahel.
* In course of transfer of a promissory note by payee and others, the parties involved may be -
1. **The Endorser –** the person who endorses the note in favor of another person. In the above specimen if Rahel endorses it in favor of Rahwa and Rahwa also endorses it in favor of Bereket, then Rahel and Rahwa both are endorsers.
2. **The Endorsee –** the person in whose favor the note is negotiated by endorsement. In the above, it is Rahwa and then Bereket.
* **Features of a promissory note**

Let us know the features of a promissory note.

1. A promissory note must be in writing, duly signed by its maker and properly stamped.
2. It must contain an undertaking or promise to pay. Mere acknowledgement of indebtedness is not enough. For example, if someone writes ‘I owe Br. 5000/- to Mohammed’, it is not a promissory note.
3. The promise to pay must not be conditional. For example, if it is written ‘I promise to pay Sumeya Br. 5,000/- after my sister’s marriage’, is not a promissory note.
4. It must contain a promise to pay money only. For example, if someone writes ‘I promise to give Sultan a Volvo car’ it is not a promissory note.
5. The parties to a promissory note, i.e. the maker and the payee must be certain.
6. A promissory note may be payable on demand or after a certain date. For example, if it is written ‘three months after date I promise to pay Haile or order a sum of Birr Five Thousand only’ it is a promissory note.
7. The sum payable mentioned must be certain or capable of being made certain. It means that the sum payable may be in figures or may be such that it can be calculated. (See specimen below).

**Illustration**: The specimen of a P/N is given below

|  |
| --- |
| AksumMay,18/2011 No 14Ninety days after date, we promise to pay to the order ofAwash company thirty thousand birr payable at CBE; valuereceived plus interest at the rate of 10% per annum.Due date --------------------- Aksum University Model Bank President |

***Required:***

1. Record the entry for the note signed on the issue date.
2. Determine the due date, interest and maturity value

Solution

1. Feb. 18,2006

**On the book of Awash Company On the book of Aksum University**

N/R -------------------30000 Cash or other Assets ------30000

 Cash receivable ----------30000 N/payable -----------------------30000

1. Determine due date( maturity date)

Term of the note------------------------------------ 90 days

Days in May. -------------------31

Issue date Feb. ----------------18-----------------13

Remaining days

June --------------------------------------------------- 30

July-----------------------------------------------------31

August------------------------------16

* Therefore, due date is on August 16, 2011

***Interest Computation:***

Interest = 30000 x 10% x 90/360

 = Br 750

Maturity value = Face value (principal) + interest

 = 30000+ 750

 = 30750

* 1. **Bill of Exchange**

Bills of exchange were originally used for payment of debts by traders residing in one country to another country with a view to avoid transmission of coin. Now-a-days they are used more as trade bills both in connection with domestic trade and foreign trade and are called inland bills and foreign bills respectively.

 A bill of exchange is an inland instrument if it is (i) drawn or made and payable in Ethiopia, or (ii) drawn in India upon any person who is a resident in India, even though it is made payable in a foreign country. But a promissory note to be an inland should be drawn and payable in Ethiopia, as it has no drawee.

Suppose Redwan has given a loan of Br. Ten Thousand to Samuel, which Samuel has to return? Now, Redwan also has to give some money to Tariku. In this case, Redwan can make a document directing Samuel to make payment up to Br. Ten Thousand to Tariku on demand or after expiry of a specified period. This document is called a ***bill of exchange***, which can be transferred to some other person’s name by Tariku.

Bill of Exchange may be defined as ‘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’.

**Acceptance of a bill of exchange**

The drawee of a bill of exchange, as such, has no liability on any bill addressed to him for acceptance or payment. A refusal to accept or to pay such bill gives the holder no rights against him. The drawee becomes liable only after he accepts the bill. The acceptor has to write the word 'accepted' on the bill and sign his name below it.. Thus, it is the acceptor who is primarily liable on a bill.

The acceptance of a bill is the indication by the drawee of his assent to the order of the drawer. Thus, when the drawee writes across the face of the bill the word "accepted" and signs his name underneath him becomes the acceptor of the bill.

An acceptance may be either general or qualified. A general acceptance is absolute and as a rule, an acceptance has to be general. . Where an acceptance is made subject to some condition or qualification, thereby varying the effect of the bill, it is a qualified acceptance. The holder of the bill may either refuse to take a qualified acceptance or non-acquiescence in it. Where he refuses to take it, he can treat the bill as dishonored by non-acceptance, and sue the drawer accordingly.

Acceptance for Honour

When a bill has been noted or protested for non-acceptance or for better security, any person not being a party already liable thereon may, with the consent of the holder, by writing on the bill, accept the same for the honour of any party thereto. The stranger so accepting, will declare under his hand that he accepts the protested bill for the honour of the drawer or any particular endorser whom he names.

The acceptor for honour is liable to pay only when the bill has been duly presented at maturity to the drawee for payment and the drawee has refused to pay and the bill has been noted and protested for non-payment. Where a bill has been protested for non-payment after having been duly accepted, any person may intervene and pay it *supra protest* for the honour of any party liable on the bill. When a bill is paid *supra' protest,* it ceases to be negotiable. The stranger, on paying for honour, acquires all the right of holder for whom he pays.

**Presentment for Acceptance**

It is only bills of exchange that require presentment for acceptance and even these of certain kinds only. Bills payable on demand or on a fixed date need not be presented. Thus, a bill payable 60 days after due date on the happening of a certain event may or may not be presented for acceptance. But the following bills must be presented for acceptance otherwise; the parties to the bill will not be liable on it:

(a) A bill payable *after sight.* Presentment is necessary in order to fix maturity of the bills; and

(b) A bill in which there is an express stipulation that it shall be presented for acceptance before it is presented for payment.

The presentment for acceptance must be made to the drawee or his duly authorized agent. If the drawee is dead, the bill should be presented to his legal representative, or if he has been declared an insolvent, to the official receiver or assigner.

The following are the persons to whom a bill of exchange should be presented:

1. The drawee or his duly authorized agent.
2. If there are many drawees, bill must be presented to all of them.
3. The legal representatives of the drawee if drawee is dead.
4. The official receiver or assignee of insolvent drawee.
5. To a drawee in case of need, if there is any. This is necessary when the original drawee refuses to accept the bill.
6. The acceptor for honor. In case the bill is not accepted and is noted or protested for non-acceptance, the bill may be accepted by the acceptor for honor. He IS a person who comes forward to accept the bill when it is dishonored by non-acceptance.

The presentment must be made before maturity, within a reasonable time after it is drawn, or within the stipulated period, if any, on a business day within business hours and at the place of business or residence of the drawee. The presentment must be made by exhibiting the bill to the drawee; mere notice of its existence in the possession of holder will not be sufficient.

 When presentment is compulsory and the holder fails to present for acceptance, the drawer and all the endorsers are discharged from liability to him.

**Presentment for Acceptance when Excused**

Compulsory presentment for acceptance is excused and the bill may be treated as dishonored in the following cases:

(a) Where the drawee cannot be found after reasonable search.

(b) Where drawee is a fictitious person or one incapable of contracting.

(c) Where although the presentment is irregular, acceptance has been refused on some other ground.

**Presentment for Payment**

All notes, bills and cheques must be presented for payment to the maker, acceptor or drawee thereof respectively by or on behalf of the holder during the usual hours of business, and if at bankers within banking hours.

**Presentment for Payment when Excused**

No presentment is necessary and the instrument may be treated as dishonored in the following cases:

(a) Where the maker, drawer or acceptor actively does something so as to intentionally obstruct the presentment of the instrument, e.g., deprives the holder of the instrument and keeps it after maturity.

(b) Where his business place is closed on the due date.

(c) Where no person is present to make payment at the place specified for payment.

(d) Where he cannot, after due search be found.

(e) Where there is a promise to pay notwithstanding non-presentment.

 (f) Where the presentment is express or impliedly waived by the party entitled to presentment.

(g) Where the drawer could not possibly have suffered any damage by non-presentment.

(h) Where the drawer is a fictitious person, or one incompetent to contract.

(i) Where the drawer and the drawee are the same person.

(j) Where the bill is dishonored by non-acceptance.

(k) Where presentment has become impossible, e.g., the declaration of war between the countries of the holder and drawee.

(I) Where though the presentment is irregular, acceptance has been refused on some other grounds.

# Dishonor by non-acceptance

A bill of exchange is said to be dishonored, by non-acceptance in the following cases:

1. When the drawee or one of the several drawees (not being partners) makes default in acceptance upon being required to accept the bill (48 hours required).
2. Where the presentment for acceptance is excused and the bill is not accepted.
3. Where the drawee is incompetent to contract.
4. Where the drawee makes the acceptance qualified.
5. If the drawee is fictitious person or after reasonable search cannot be found.

# Dishonor by Non-payment

A promissory note, bill of exchange or cheque is said to be dishonored by non-payment when the maker, acceptor of the bill or drawee of the cheque makes default in payment upon being duly required to pay the same.

Also, a promissory note or bill of exchange is dishonored by non-payment when presentment for payment is excused expressly by the maker of the note or acceptor of the bill and PN or BE remains unpaid.

Effect of Dishonor

* As soon as a negotiable instrument is dishonored (either by non-acceptance or by non-payment) the holder becomes entitled to sue the parties liable to pay thereon.
* The holder MUST, however, give notice of dishonor to all the parties against whom he intends to proceed.

Notice of Dishonor

* Notice of dishonor means formal communication of the fact of dishonor.
* Such a notice also serves the purpose of enabling the person so notified to protest himself against the prior parties.

Notice By Whom

* Notice of dishonor must be given by the holder or by some party to the instrument who remain liable thereon;
* Any party receiving the notice of dishonor must also transmit the same to all prior parties in order to make them liable to him.
* No suit can be filed against the prior party if he has not transmitted the fact of dishonor of instrument.
* One person can give the notice only.
* Duly authorized person can also give notice.

Notice to Whom

* Notice of dishonor must be given to all parties (other than the maker of note, acceptor of a bill or drawee of a cheque) to whom the holder seeks to make liable or other duly authorized agents.
* In case of death of a person, notice must be given to his legal representative and were he has been declared insolvent to his Official Assignee.
* In case after dispatch of notice and before it receipt the person dies, it will be treated as if the notice has been served. (Not knowing the fact).

Mode of Giving Notice

* It may be oral or in writing. If it is in writing it must be sent by post
* It should be given in reasonable time.

What is Reasonable Time?

In determining what reasonable time is the consideration is to be given: -

1. Nature of the instrument
2. The usual course of dealing with respect to similar instruments
3. Distance between the parties
4. While calculating public holidays shall be excluded.
5. In case a party received the notice of dishonour is to transmit the same to his prior parties, the transmission should be done in reasonable time.

When Notice of Dishonor is Unnecessary

1. Where the endorsee while signing in that capacity adds the words ‘notice of dishonor waived’.
2. Where the drawer of a cheque countermanded payment.
3. Where the party charged could not suffer damage for want of notice such as bank account closed or in case of accommodation bill.
4. Where the party to whom the notice is to be given not traceable or the party who has to give notice is unable to give notice like death, accident or serious illness.
5. When the drawer also happens to be acceptor.
6. In case the Promissory Note which is not negotiable
7. When the party entitled to receive notice promise to pay unconditionally the amount as due after due date.

Consequences of not giving notice of dishonor

Any party to negotiable instrument (other than maker of a note, acceptor of a bill or drawer of cheque) is discharged from his obligation under the instrument unless circumstances are such where no notice is required to be sent.

Noting

* In case a promissory note or bill of exchange has been dishonored by non-acceptance or non-payment notice, the holder may cause such dishonor to be noted by Notary Public.
* Noting must be made within reasonable time after dishonor and must specify (i) the date of dishonor (ii) the reason assigned for dishonor and (iii) the notary’s charges.

Protest

“Protest” is a formal certificate issued by the notary public to the holder of the bill or note on his demand (noting is merely a record of dishonor on the instrument).

Contents of Protest

1. The instrument itself or a literal transcript of the instrument and of everything written or printed thereon,
2. The name of the person for whom and against whom the instrument has been protested.
3. The fact and reason for dishonor
4. The place and time of dishonor
5. The signature of notary public
6. In case of acceptance for honor or payment for honor, the names of the persons by whom and for whom it is accepted or paid.

Discharge of the Instrument

* A negotiable instrument is said to be discharged when it becomes completely useless.
* In the following cases the instrument is deemed to be discharged: -
	1. When the party liable to make payment on the instrument makes the in due course to the holder.
	2. When the acceptor in his own right at or after maturity, holds the bill of exchange, which has been negotiated,, the instrument is discharged.
	3. When the party primarily becomes insolvent.
	4. When the holder cancels the instrument with an intention to release the party primarily liable thereon from liability.

Discharge of One or More Parties.

* A party is said to be discharged from his liability when his liability on the instrument comes to an end.
* Discharge of one or more party does not discharge the instrument and rights under it can be enforced against those parties who continue to be liable thereon.

One or more parties to a negotiable instrument is/are discharged from liability in the following ways:-

1. By cancellation-When the holder of a negotiable instrument *deliberately* cancels the name of any of the party liable on the instrument with intent to discharge him from liability.
2. By release – If the holder of a negotiable instrument releases any party to the instrument by any method other than cancellation of names.
3. By payment
4. By allowing drawee more than 48 hours to accept
5. By taking qualified acceptance
6. By not giving notice of dishonor
7. By non-presentment for acceptance of bill
8. By delay in presenting cheque
9. By material alternation like:
	* 1. Any alteration of the date, the sum payable, the time of payment and place of payment
		2. Alteration by the addition of a new party.
		3. Alteration of the rate of interest.
		4. Tearing off the material part of the instrument

Alteration not vitiating the instrument

1. Alteration made for the purpose of correcting a mistake or clerical error
2. Alteration made to carry out the common intention of the original parties
3. Alteration made before the instrument is issued
4. Alteration made with the consent of the parties liable on the instrument
5. Conversion of bearer cheque into order
6. Filling blanks in the case of inchoate or incomplete instrument
7. Conversion of blank endorsement into an endorsement in full.
8. Making qualified acceptance
9. Alteration which result of the accident.

**Specimen of a bill of exchange:**

|  |
| --- |
| Br. 10,000/- Mekelle May 2, 2001Five months after date, pay Tariku or (to his) order the sum of Birr Ten Thousand only for value received. To Accepted StampSamuel Samuel Address Redwan |

**Parties to a bill of exchange**

There are three parties involved in a bill of exchange. They are:

1. **The Drawer** – The person who makes the order for making payment. In the above specimen, Redwan is the drawer.
2. **The Drawee –** The person to whom the order to pay is made. S/He is generally a debtor of the drawer. It is Samuel in this case.
3. **The Payee –** The person to whom the payment is to be made. In this case it is Tariku.

The drawer can also draw a bill in his own name thereby s/he himself becomes the payee. Here the words in the bill would be Pay to us or order. In a bill where a time period is mentioned, just like the above specimen, is called a Time Bill. But a bill may be made payable on demand also. This is called a Demand Bill.

* **Features of a bill of exchange**

Let us know the various features of a bill of exchange.

1. A bill must be in writing, duly signed by its drawer, accepted by its drawee and properly stamped.
2. It must contain an order to pay. Words like ‘please pay Br. 5,000/- on demand and oblige’ are not used.
3. The order must be unconditional.
4. The order must be to pay money and money alone.
5. The sum payable mentioned must be certain or capable of being made certain.
6. The parties to a bill must be certain.
	1. **Cheque**

**Definition**

A cheque is defined as a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand. To understand this definition, it is necessary to know the definition of a bill of exchange.

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.

**Essentials of a cheque**

From the above definition it follows that an instrument to be called a cheque must fulfill certain conditions. They are:

1. **Instrument in Writing:** A cheque or a bill of exchange is an instrument in writing.

Legally speaking the writing may be done by means of printed characters, type-writer, or by a pen or pencil. But bankers do not generally honour cheques drawn in pencil, unless confirmed by the drawer. This is because; it is easy to make unauthorized alterations when a cheque is drawn in pencil.

2. **Contains Unconditional Order:** The instrument must contain an unconditional order. For instance, if the banker is ordered to pay a certain sum provided the payee fulfils certain conditions, it cannot be considered a cheque as the order is a conditional one. However, if such instruments are addressed to the payee and not to the banker, the order to pay may be regarded unconditional.

3. **Drawn by the Drawer:** A cheque is to be drawn or taken out only by the drawer or the account holder. The account holder being a customer of the bank has an account wherein he has deposited his funds. He is the rightful or authorised person to draw the cheques for making payments and for that he has to sign the cheques himself.

4. **Drawn Upon a Specified Banker:** The account holders, whenever they desire to make payments, are expected to draw cheques on a banker and not on an individual.

Further, the banker should be specific, i.e., his name and address should be definite.

5. **To Pay a Certain Sum of Money:** The order of the drawer of a cheque must be payed a certain sum of money and not anything else e.g., securities or goods etc. The amount of money to be paid must be certain and specified both in words and figures.

6. **Payable on Demand:** When the instrument does not specify for payment, it is always payable on demand. Unless and until a demand is made, the amount in respect of the cheque would not be paid. Demand is necessary to make the banker liable to pay the amount of the cheque.

7. **Payable to a Certain Person or his Order or to the Bearer of the Instrument:**

The amount mentioned in the cheque should be paid to a specific person or payee or according to his order. Or it may be made payable to the bearer. Or it may be made payable to the bearer of the instrument.

8. **It is signed by the Maker:** The maker must sign the instrument. In order to be a valid cheque, the instrument must contain the signature of the drawer. In the case of an illiterate person, his thumb impression will suffice. Though legally permissible, pencil signatures are discouraged by bankers. So also signatures impressed on the cheque by means of a rubber stamp is not permitted generally.

**Specimen of a Cheque**

|  |
| --- |
| ………......20.......Pay……..............................................................................................................……....................................................................................................... or Bearer.Br.\_\_\_\_\_\_\_\_\_\_\_Birr ……………………………………………………………………………………………………**COMMERCIAL BANK OF ETHIOPIA**Aksum University, Aksum – 110067MSBL/97**6 5 3 0 0 3 1 1 0 0 0 2 0 5 6 1 0** |

**Types of Cheques**

1. **Order Cheque:** A cheque which is payable to a particular person or his order is called an order cheque.

2. **Bearer Cheque:** A cheque which is payable to a person whosoever bears, is called bearer cheque.

3. **Blank Cheque:** A cheque on which the drawer puts his signature and leaves all other columns blank is called a blank cheque.

4. **Stale Cheque:** The cheque which is more than six months old is a stale cheque.

5. **Multilated Cheque:** If a cheque is torn into two or more pieces, it is termed as mutilated cheque.

6. **Post Dated Cheque:** If a cheque bears a date later than the date of issue, it is termed as post dated cheque.

7. **Open Cheque:** A cheque which has not been crossed is called an open cheque. Even if a cheque is crossed and subsequently the drawer has cancelled the crossing at the request of the payee and affixes his full signature with the words “crossing cancelled pay cash”, it becomes an open cheque.

8. **Crossed Cheque:** A cheque which carries too parallel transverse lines across the face of the cheque with or without the words “I and co”, is said to be crossed.

9. **Gift Cheques:** Gift cheques are used for offering presentations on occasions like birthday, weddings and such other situations. It is available in various denominations.

10. **Traveller’s Cheques:** It is an instrument issued by a bank for remittance of money from one place to another

**Uses of a Cheque**

1. If payment is made by means of a crossed cheque, receipt need not be obtained.

2. It is also convenient to receive money.

3. Payment can be made to a particular person by drawing up crossed “Account payee”

cheques.

4. The cheque is ‘near money’ and hence is endorsable from one person to another to settle the effects.

5. It minimises the operation of legal tender money and the bankers can operate with a less amount of cash reserves.

6. No need of counting cash while making payment.

7. If a crossed cheque is lost, only a piece of paper is lost, i.e., the amount remains intact.

8. If payments are made by cheques an automatic record of the account is also maintained in the banker’s books.

**Parties to a Cheque**

Basically there are three parties to a cheque viz., (1) Drawer (2) Drawee, and (3) Payee.

1. **Drawer:** A drawer is the person who has an account in the bank and who draws a

cheque for making payment. He is the customer or account holder.

2. **Drawee:** A drawee is the person on whom the cheque is drawn. He is liable to pay the amount. In case of a cheque, the drawee happens to be the banker on whom the

cheque is drawn, he is also called the Paying-Banker.

3. **Payee:** A payee is the person to whom the amount stated in the cheque is payable.

It may be either drawer himself (self cheques) or only other third party states in the

cheque.

**Differences between bill of exchange, promissory notes and cheques**

**Distinction between a Promissory Note and a Bill of Exchange**

|  |  |  |
| --- | --- | --- |
|  No. | Promissory Note | Bill of Exchange |
|  | It contains an unconditional promise | It contains an unconditional order |
|  | There are two parties- the maker and the payee  | There are 3 parties-Drawer, drawee, and payee |
|  | It is made by the debtor | It is made by the creditor |
|  | The liability of the maker/drawer is primary and absolute | The liability of the maker/drawer is secondary and conditional upon non-payment by the drawee. |

**Distinction between a Cheque and a Bill of Exchange**

|  |  |  |
| --- | --- | --- |
|  No. | Cheque | Bill of Exchange |
|  | It is drawn only on a banker | It can be drawn on anybody including a banker |
|  | The amount is always payable on demand | The amount is payable on demand or after a specified period |
|  | It can be crossed to end its negotiability | It cannot be crossed |

**Crossing of Cheques**

Crossing first originated in England when cheques were sent from one bank to another. There was the possibility that a cheque might fall in the hands of wrong or unauthorized parties and thereby the original holder was likely to be put to a loss or inconvenience. To avoid this disadvantage, the bankers introduced this new system of crossing of cheques. Crossing automatically means that a cheque should be presented for payment through a bank.

**Meaning of Crossing**

Crossing of cheques means drawing two parallel transverse lines on the left hand top corner of a cheque. Sometimes, it is also done in the centre of the cheque.

The Negotiable Instruments Acts recognise crossing of cheques. A crossing is a direction to the paying banker that the cheques should be paid only to a banker and if the banker is named in the crossing, only to that banker.

This ensures the safety of payment by means of cheques. The holder of the cheque is not allowed to cash it across the counter.

**Types of Crossing**

Cheques can be crossed in two ways (1) General Crossing (2) Special Crossing.

1. **General Crossing:** It can be as follows:

“Where a cheque bears a cross its face an addition of the words ‘& company’ or any abbreviation thereof, between two parallel transverse lines, or of two parallel transverse lines simply either with or without the words ‘not negotiable’ that addition shall be deemed a crossing and the cheque shall be deemed to be crossed generally.”

The drawing of two parallel transverse lines on the face of the cheque constitutes “General Crossing.” The lines must be (a) on the face of the cheque, (b) parallel to each other, and (c) in cross direction (*i.e.,* transverse). Inclusion of words ‘and company’ is immaterial and of no special consequence.

The effect of general crossing is that the cheque must be presented to the paying banker through any other banker and not by the payee himself at the counter. The collecting banker credits the proceeds to the account of the payee or the holder of the cheque. The latter may thereafter withdraw the money.

* 1. **Special Crossing**

“Where a cheque bears a cross its face, an addition of the name of a banker, either withor without the words ‘ not negotiable’, that addition shall be deemed a crossing, and thecheque shall be deemed to be crossed specially, and to be crossed to that banker.” Followingare given specimens of special crossing:

The Special Crossing on the cheque is a direction to the paying banker to honor the cheque only when it is presented through the bank mentioned in the crossing and no other bank. The cheque crossed specially thus becomes safer than the generally crossed cheque. The banker, to whom a cheque is specially crossed, may appoint another banker as his agent for the collection of such cheques.

***Specimen of* a *general crossing***

 ***& Specimen of a special crossing***



****

* 1. **Other Types of Crossing**

Besides the above two types of crossing, in recent years, the following types of crossing have been developed:

i. **“Not Negotiable” Crossing:** A cheque may be crossed either generally or specially with the words “not negotiable.” The impact of these words is given as states, “A person taking a cheque, crossed generally or specially, bearing in either case the words “not negotiable” shall not have and shall not be capable of giving a better title to the cheque than that what the position from whom he took it had.” Whereas the cheque is crossed with the words “not negotiable,” the bank must be careful in paying such cheques. In such a case, the payment must be made only after the bank is satisfied that the person demanding payment is the person entitled to get it in reality.

ii. **Restrictive Crossing or Account Payee Crossing:** Restrictive or Account Payee

Crossing means “a direction to the collecting banker that the proceedings of the cheque are to be credited only to the account of payee named, written or mentioned in the cheque. It is to be noted here that the words “Account Payee” are not recognized by the Negotiable Instruments Acts. The words ‘Account Payee Only’ constitute an instruction to the collecting banker that he should collect the amount of the cheque for the benefit of the payees only (Nobody can get any benefit except payee).

3. **Double Crossing:** A cheque is crossed specially to more than one banker, except when crossed to an agent for the purpose of collection; the banker on whom it is drawn shall refuse payment thereon. This type of crossing may be used only when the banker in whose favor the cheque is specially crossed does not have any branch at the place where the cheque is to be paid.

**Significance of Crossing**

In the case of general crossing, the addition of the words “& Co.” does not have any legal significance; but the words “not negotiable” have legal significance. By crossing a cheque generally the person who is not entitled to get its payment, is prevented from getting the cheque cashed at the counter of the paying banker. While in the case of special crossing, the name of the banker must be written on the face of the cheque, to whom or to whose collecting agent, payment of cheque is to be made. It is to be noted that the lines are not essential for a special crossing. By crossing a Cheque specially, it is quite safer than the generally crossed cheque. In such a case the banker to whom a cheque is crossed specially, may appoint another banker as his agent for the collection of such cheques. Such cheques may be sent through ordinary post.

In short, a cheque can be crossed by the drawer, holder or banker. Some of the Negotiable Instruments Act states, “Whereas a cheque is crossed generally or specially, the holder may add the words ‘not negotiable.’” In the case of a banker, the above Section further states: “whereas a cheque is crossed specially, the banker to whom it is crossed may again cross it especially to another banker as his agent for collection.” While in the case of a drawer, he has the right to cancel the crossing by putting his full signature and writing the words “Pay Cash.”

|  |
| --- |
| ***Activity 3.1****Are all the types of negotiable instruments being applicable in CBE and other commercial banks in Ethiopia? You need to take a visit…….* |

**Endorsement**

Endorsement literally means “writing on the back of the instrument.” But under commercial code, it means “writing of a person’s name on the back of the instrument or on any paper attached to it for the purpose of negotiation.” The person who signs the instrument for the purpose of negotiation is called the “endorser.” The person to whom the instrument is endorsed or transferred is called the “endorsee.” Mere endorsement is not sufficient unless the instrument is delivered to the endorsee. The endorsement is completed by delivering the signed instrument to the endorsee. The purpose or object of endorsement is negotiation or transfer of the instrument.

**Essentials of a Valid Endorsement**

The following are the essentials of a valid endorsement:

(a) Endorsement must be on the back or face of the instrument. If no space is left on the instrument, it must be made on a separate paper attached to it.

(b) It should be made in ink. An endorsement in pencil or rubber stamp is invalid.

(c) It must be made by the marker or holder of the instrument. A stranger cannot endorse it.

(d) It must be signed by the endorser.

(e) It must be completed by delivery of the instrument.

(f) It must be an endorsement of the entire bill. A partial endorsement does not operate as a valid endorsement.

**Kinds of Endorsement**

Endorsement may be of any of the following kinds:

1. **Blank Endorsement:** It is also called “general endorsement.” An endorsement is said to be blank if the endorser signs his name only on the face or back of the instrument. Endorsement in blank specifies no endorsee. It simply consists of the signature of the endorser on the endorsement. A negotiable instrument even though payable to order becomes a bearer instrument if endorsed in blank. Thus, a blank endorsement converts an order instrument into a bearer one. It is negotiable by delivery of the instrument.

**Example:** A bill is payable to the order of Swaroop. Swaroop signs on the back of the bill. This is an endorsement in blank by Swaroop. The bill becomes payable to bearer and is negotiable without any further endorsement.

2. **Special Endorsement:** It is also called “full endorsement.” In this type of endorsement, the name of the endorsee is specifically stated. If the endorser adds direction to pay the amount mentioned in the instrument to, or to the order of a specified person, the endorsement is said to be special. In other words, it specifies the person to whom or to whose order the cheque is to be payable. A blank endorsement can be easily converted into a special endorsement by any holder of negotiable instrument.

**Example:** (a) “Pay to x or order”, (b) Pay to the order of x

3. **Partial Endorsement:** If an instrument is endorsed for a part of its amount, such an endorsement is said to be partial. Similarly, if an instrument is endorsed to two or more endorsees separately and not jointly, the endorsement becomes partial. Such an endorsement does not operate as a negotiation of the instrument. No right of action arises under a partial endorsement. It is invalid.

**Example:** The holder of a promissory for Br. 1,000 writes on it pays B Br. 500 and endorses the note. The endorsement is invalid for the purpose of negotiation.

4. **Restrictive Endorsement:** An endorsement is said to be restrictive when it prohibits or restricts the further negotiability of the instrument. It merely gives the holder of the instrument the right to receive the amount on the instrument for a specific purpose. It does not give power to him to transfer his rights in endorsement to anyone else. “Pay X only” or “pay X for my use” are examples of restrictive types of endorsement.

5. **Conditional Endorsement:** It is also called “qualified endorsement.” An endorsement where the endorser limits or negatives his liability by putting some condition in the instrument is called a conditional endorsement. If for instance, the endorser endorses an instrument with the words “pay A or order on his marrying B,” the endorsement becomes conditional. A conditional endorsement, unlike the restrictive endorsement, does not affect the negotiability of the instrument. It does not invalidate the instrument. An endorsement may be made conditional in any of the following forms:

(a) *‘Sans recourse’ Endorsement:* An endorser may, by express words, exclude his own liability thereon to the endorsee or any subsequent holder in case of dishonor of the instrument. Such an endorsement is called an “endorsement sans recourse” (without recourse). “Pay to A or order without recourse to me” is an example of this type of endorsement. The endorser “sans recourse” is however, liable to the previous endorsers.

(b) *Facultative Endorsement:* An endorsement where the endorser extends his liability or gives up some rights under a negotiable instrument is called a “facultative endorsement.” “Pay A or order, notice of dishonor is waived” is an example of facultative endorsement. Thus, endorser makes himself liable to subsequent endorsees of the cheque even though no notice of dishonor is received by him from the holder. In this type of endorsement, the holders’ duties towards the endorser are waived.

(c) *‘Sans Frais’ Endorsement:* Where the endorser does not want the endorsee or any subsequent holder to incur any expenses on his account, on the instrument, the endorsement is called “sans frais” endorsement.

Summary

There are certain documents used for payment in business transactions and are transferred freely from one person to another.

Negotiable instruments are documents meant for making payments, the ownership of which can be transferred from one person to another many times before the final payment is made. They may be defined as “Promissory note, Bill of exchange, or Cheque, payable either to order or to bearer”. There are just three types of negotiable instruments i.e., promissory note, bill of exchange and cheque.

A promissory note may also be defined as ‘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 only to or to the order of a certain person or to the bearer of the instrument’

A bill of exchange is an inland instrument if it is (i) drawn or made and payable in Ethiopia, or (ii) drawn in India upon any person who is a resident in India, even though it is made payable in a foreign country.

A cheque is defined as a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand.

Crossing of cheques means drawing two parallel transverse lines on the left hand top corner of a cheque. Sometimes, it is also done in the centre of the cheque. Cheques can be crossed in two ways (1) General Crossing (2) Special Crossing.

Endorsement literally means “writing on the back of the instrument.” But under commercial code, it means “writing of a person’s name on the back of the instrument or on any paper attached to it for the purpose of negotiation.”

***Review Questions***

*DISCUSSION QUESTIONS:*

1. *Define the negotiable instruments?*

*\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_*

1. *Describe the promissory note, bill of exchange and cheque as negotiable instruments.*

*\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_*

1. *Differentiate the types of endorsement.*

*\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_*

1. *Identify the general crossing and special type of crossing.*

**\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_**

***Self check table for students assessment***

|  |  |  |  |
| --- | --- | --- | --- |
| ***No.*** | ***Do students grasp objectives/competencies*** | ***Yes***  | ***No.***  |
| *1* | *Explain the meaning of negotiable instruments* |  |  |
| *2* | *Identify the various features of negotiable instruments* |  |  |
| *3* | *Describe the various types of negotiable instruments, and* |  |  |
| *4* | *Differentiate between bills of exchange, promissory notes, and cheques.* |  |  |