**Unit 4: Negotiable Instrument**

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**4.0 Aims and Objectives**

At the end of this unit the student is expected to:

* Identify Negotiable Instruments
* Define and distinguish the difference between Negotiation, assignment, and discounting
* Define Alteration and types of alterations that could be made
* Discuss about certain concepts related with negotiable instruments such as:
* Holder and Holder in due course
* Endorsement
* Crossing of cheques
* Precautions regarding payment of cheques
* Collection of cheques etc,

**4.1 INTRODUCTION**

Negotiable instruments have acquired an important place in the modern structure of business. Negotiable instruments play an important role for making payments and discharging businesses obligations. The modern commercial banks, which are engaged in making and receiving payment on behalf of their customers, deal in these instruments. However, these documents must be used in a proper manner so as to eliminate unnecessary liabilities of any party.

Therefore, in this unit we will discuss first about the meaning of negotiable instruments, their characteristics, conditions and presumptions about issuance of negotiable instruments. There after we will discuss about types of negotiable instruments, their respective characteristics, parties to these instruments, their similarities and differences. Finally, we will discuss about the basic concepts of negotiable instruments such as; holder and holder in due course, endorsement, crossing, payment in due course, precautions to be taken in payment of these instruments, collections of cheques, and legal protections given to a collecting bank.

**4.2 Meaning of Negotiable Instruments and Negotiation**

**4.2.1 Meaning of Negotiable Instruments**

A negotiable instrument is one which is by a legally recognized custom of trade or law, transferable by delivery, or by endorsement and delivery, in such circumstance that, the holder of it for the time being may sue on it in his own name and the property in it passes, free from equities, to a bona fide transferee for value, not withstanding any defect in the title of the transferor.

A negotiable instrument is that piece of paper which when transferred by delivery or by endorsement and delivery passes to the transferee a good title irrespective of the title of the transferor provided the transferee is a bona fide holder for value and does not have knowledge of any defect in the title of the transferor. Thus mere transferability of the instrument by delivery or by endorsement and delivery is not sufficient to make it negotiable. In addition to this, it must give the transferee the right of action in his own name and without defenses, which could have been set up against the transferor.

**4.2.2 Meaning of Negotiation**

Negotiation means the transfer of the right, title and interest of the holder of a negotiable instrument, so as to give the transferee good little, if he be a holder in due course, even though the transferor has a bad or defective title, except in the case of forgery of the holder’s signature if the instrument is payable to order, or in the case of an instrument is void or except in the case of an instrument completed and transferred after it is stolen and which was not at all delivered by the maker or drawer to any body.

One of the important characteristics of a negotiable instrument is hat it is freely transferable from one person to another. The ownership of a negotiable instrument can be transferred in any of the two ways:

**Modes of Negotiation**

Negotiation may take place in either of the two ways: By delivery and by endorsement and delivery.

**a) Negotiation by delivery**

Negotiable instruments payable to bearer are negotiable by mere delivery. There is no need of endorsement in such cases. By delivery, we meant that, the transfer of the physical possession of the instrument. An instrument is said to be bearer instrument, if the instrument is expressed to be payable to bearer and if it is endorsed in blank as follows:

i). Pay to A or bearer

ii). Pay to the bearer

iii). If the last endorsement bear only the endorser’s name

Transfer by delivery of a bearer instrument is a sale of the instrument just like a sale of the goods and the transferee becomes the holder of the instrument. A person who steals or finds a bearer instrument is not the holder because it has not been delivered to him. Thus, delivery is essential to make the transferee the holder of the instrument.

For example;

* Ato Alemayehu, the holder of a negotiable instrument payable to bearer, delivers it to Ato Megersa’s agent to keep for Ato Megersa
* Ato Hogos and Ato Zeberga have an account at Dashen Bank. Ato Hogos, the holder of a negotiable instrument payable to bearer directs Dashen Bank to transfer the instrument to Ato Zeberga’s account. The banker (Dashen Bank) does so, and accordingly now possessed the instrument as Ato zeberg’s agent.

In both cases, the instruments are negotiated and Ato Megersa and Ato Zeberga becomes the holder of the instrument.

**b) By endorsement and delivery**

A negotiable instrument payable to order is negotiable by the holder through endorsement and delivery. Thus, in case of on order instrument, the holder must first endorse it and then deliver it to the endorsee. Endorsement can be done by signing his name by the endorser on the back of the instrument. Mere endorsement does not account to negotiation of the instrument payable to order, it must be delivered to the endorsee to make him the holder. An instrument is said to be an order instrument, if the instrument is expressed to be payable to a particular person: the payee or endorsee, and if the instrument does not contain words prohibiting transfer or indicating an intention that it shall not be transferable: -

For example: - i) Pay to A

ii). Pay to A or order

iii). Pay to the order of A

The payee mentioned in the instrument is the rightful person to make the first endorsement. After this, any party who has become the holder of the instrument can make endorsement. Such a holder may be even the drawer or maker of the instrument and if this happens, the drawer or maker of the instrument can endorse it in his capacity as the holder.

Delivery of the instrument is an essential formality to complete negotiation whether the instrument is payable to bearer or to order. The property in the instrument does not pass unless it is delivered to the desired person i.e. to the bearer, incase of bearer instrument, and to the endorsee, in case of an order instrument. For example, If Ato Suleman endorse (write his name on the instrument) an instrument for the benefit of Ato Gemechis but deceased before delivery, the instrument is not said to be negotiated and Ato Gemechis, the endorsee, in the instrument, has no right to claim the amount in the instrument. Delivery of a negotiable instrument may take place in any of the following three ways:-

* **Actual Delivery:** - This exists when the change of physical possession of the instrument takes place from one person to another
* **Constructive Delivery**: - This takes place without change of actual physical possession of the instrument. A person is said to have constructive possession of the instrument when it is in the actual possession of his agent, clerk, or servant on his behalf.

For example, Ato Amare holds a bill on his won account subsequently endorses it in favorer of Ato Migbaru and holds it as to Ato Migbaru’s agent. This is a case of constructive delivery.

* **Conditional Delivery**: - where a negotiable instrument is delivered continually, property in the instrument does not pass until the condition is fulfilled. In case of conditional delivery, if the holder transfers the instrument to some body else and does not fulfill the condition attached to delivery, plea of conditional delivery will be available only against the person who takes it with the notice of the condition and not against the holder in due course.

For example, W/o Zewditu, the holder of a negotiable instrument, delivered it to Ato Yigermal, on condition that Ato Yigermal is to provide something in return within ten days. Ato Yigermal further delivers the instrument to W/o Zeritu without notifying the condition that exists between himself and W/o Zewditu. If Ato Yigermal, fail to provide what he agrees within ten days, W/o Zeritu can claim the amount of the instrument only from Ato Yigermal not from W/o Zewditu.

**4.3 Certain Concepts Related With Negotiable Instruments**

**4.3.1** **Presumption of Negotiable Instruments**

Negotiable instruments are written contracts entered between and among parties. However it is different from other forms of contracts in certain characteristics**.** The following are some of the characteristics of Negotiable Instruments, which distinguish them from other forms of written contracts.

1. **Transferability.** The basic feature of a negotiable instrument is that it is easily transferable from person to another person and the ownership of property in the instrument can be transferred by mere delivery, if the instrument is bearer instrument, and by endorsement and delivery, if the instrument is an order instrument. No formalities are necessary in transferring the right in a negotiable instrument.
2. **Good Title of the Transferee**

The person who takes a negotiable instrument in good faith and for value gets it free from all defects and thus is entitled to recover the amount of money mentioned in the instrument. The transferee of a negotiable instrument is known as a “holder in due course”. His title is not affected by any defect of title on the part of the transferor or of any of the previous holders of the instrument (see other privileges of a holder in due course under its section.)

**iii) Right of Action**:-

The holder of a negotiable instrument who is also the holder in due course gets the right to sue upon the instrument in his own name and without making the transferor a part to the suit.

**iv) Presumption as to consideration**:-

It is presumed that consideration has been given for the negotiable instrument. Besides, there are other presumptions, which will be discussed later.

**V) No need to give notice of transfer to the party liable to pay**.

It is not necessary to give to the party, liable on the instrument, notice of its transfer to ensure that he makes payment only to the transferee.

**4.3.2 Presumption as to Negotiable Instruments**

The following legal presumptions are made in respect of a negotiable instrument until the contrary is proved.

i) **Consideration: -**Every negotiable instrument was made or drawn for consideration and that every such instrument, when it has been accepted, endorsed, negotiated or transferred; was accepted, endorsed, negotiated or transferred for consideration. Consideration means payment given as reward.

ii) **As to date**. The date that a negotiable instrument bears is presumed to be the date it was made or drawn, though, the issuance date and the date written on the instrument may be different. The instrument may be post dated or ante dated.

**iii) As to time of acceptance: -**. Every accepted instrument (a bill of exchange) must be accepted within a reasonable time after it is being made and before its maturity.

**iv) As to time of transfer: -**Every transfer of a negotiable instrument is made before its maturity. An instrument transferred after maturity does not grant the holder of it a better title.

**v) As to order of endorsement: -** The endorsements appearing up on a negotiable instrument are made in the order in which they appear. Their liability also falls in the order that it appears.

**vi) As to stamp.** Negotiable instruments are assumed to be properly stamped as they are issued.

**vii) Holder as a holder in due course**: - The holder of a negotiable instrument is a holder in due course; provided that, the instrument has been obtained from its lawful owner, or from any person in lawful custody, by means of an offence or fraud, or has been obtained from the maker or accepter by means of an offence or fraud or for unlawful consideration, the burden of proving that the holder is a holder in due course lies upon him.

viii**) In a suit upon a dishonored instrument,** the court shall on proof of the protest, presume that it was dishonored until this fact is disproved.

**4.3.3 Alterations of Negotiable Instrument**

Normally, a written contract cannot be unilaterally altered. If a contract in writing has been executed, it can only be altered by a voluntary act by both parties as evidenced by their signatures to the alterations. This rule applies equally to Negotiable Instruments. In the case of Negotiable Instruments, alternations may be divided in to the following three categories: Material Alterations, Immaterial Alterations, and Unilaterally Allowed Alteration

**1. Material Alteration**

It is an alteration, which makes significant variations in the rights and liabilities of the parties. The parties who have not agreed to such an alteration are absolved from liability on the instrument. Therefore, material alterations cannot be made by one party without the consent of the other party. These material alterations include:

1. Alteration of the date of the instrument
2. Alteration of the sum payable
3. Alteration in the time of payment
4. Alteration of the place of payment
5. Alteration of the rate of interest
6. Alteration of the name of the parties
7. Addition or omission f a new or an existing parties to or from the instrument
8. Tearing an instrument in a material part

**2. Immaterial Alterations**

It is an alteration, which does not have a significant effect on the position of the parties. Any party without the consent of the other party may make it. I t includes:-

* 1. Alterations made before the issue of the instrument
  2. Alteration made to carry out the common intention of the parties to the instrument
  3. Alteration made for correction of a mistake in date or of a clerical error like: Crossing a “t”, dotting an “i”, correcting spelling errors.
  4. Alteration made with the consent of all the parties
  5. Alteration which have resulted from an accident, e.g. mutilation by washing and ironing of a garment
  6. Correcting other obvious error in the body of the instrument

**3. Unilaterally Allowed Alteration**

There are certain alterations to an instrument, which are allowed to be made by one party without the consent of the other party. These include**;**

a. Crossing uncrossed instrument

b. Conversion of a blank endorsement in to endorsement in full and vice versa

c. Filling a blanks in inchoate instruments

d. Altering a general crossing to a special crossing

Presumtion of Negotiable Instruments

An instrument to be a negotiable instrument, it should fulfill the following conditions

a. The transferee should be a holder in due course

b. The instrument should not be completed after stolen.

c. The instrument should be delivered by the maker or drawer to any body

d. Signature should not be forged in case of order instrument

e. The title of the transferor may be bad or defective.

**4.3.4 Presentment and Dishonor of Negotiable Instruments**

***4.3.4.1. Presentment of Negotiable Instruments***

Presentment of a negotiable instrument means placing the instrument before the drawee or maker for any of the following purposes:

1. Presentment for acceptance
2. Presentment for sight
3. Presentment for payment

**i). Presentment for Acceptance**

Acceptance is defined as the signification by the drawee of his assent to the order of the drawer. After acceptance, the drawee is known as the accepter. It is only a bill of exchange, which may have to be presented for acceptance. Presentment of a bill is not necessary for acceptance in all the cases. Bill of Exchange payable on demand or at sight or on a certain date need not be presented by the holder for acceptance; however, presentment of a bill for acceptance is desirable in order to:

* 1. Obtain additional security of the acceptor’s name on the bill
  2. Obtain an immediate right of recourse against the drawer and the other parties in case the bill is dishonored by non-acceptance.

Presentment for acceptance of a bill is, however, necessary in the following cases:

a. When a bill is payable at a given time after acceptance or sight, presentment for acceptance is necessary to fix the maturity of the instrument

b. When a bill expressly stipulates that it shall be presented for acceptance; it must be presented for acceptance before it is presented for payment.

The essentials of a valid acceptance are:

1. Acceptance must be in writing and must appear on the bill
2. Acceptance must be signed by the drawee or his duly authorized agent
3. The bill must be delivered to the holder

**Types of acceptances**

The acceptor is the drawee or any person who has signed his assent up on the bill and delivered it to the holder or has given notice of his so doing to the holder. He can be only the drawee or a person named as drawee in case of need or an acceptor for honor or an agent to the drawee. Acceptance may be general or qualified.

1. **General Acceptance.**

When the drawee of a bill accepts the order of the drawer to pay the amount in full without any condition or limitation, acceptance is said to be general or absolute. It is affected when the drawee signs his name on the bill with the word “accepted.” thereby signifying his assent to the bill. No addition must be made on the instrument.

**b. Qualified Acceptance.**

In case of qualified acceptance, the drawee accepts the bill subject to certain qualifications or conditions. Acceptance is qualified in various ways i.e. as to time, place, event, amount, drawee, etc. may be added to the acceptance.

**ii) Presentment for sight**

The Negotiable Instrument Act sec. 63 deals with the necessity to presentment for sight of promissory note payable at certain period, after sight. A promissory note, payable at a certain period, after sight, must be presented to the maker for sight by a person entitled to demand payment, within a reasonable time after it is made and in business hours on a business day. If the holder fails to present in such case, no party in the instrument is liable to the person making such default.

**iii) Presentment for payment**

According to sec.64 of the negotiable instrument act, promissory notes, bill of exchange and cheques must be presented for payment to the maker, acceptor or drawee respectively, by or no behalf of the holder. In case of the death of these parties, presentment should be made to his legal representative or assignee. It can be presented for payment either by the holder or his authorized agent or in case of his death or insolvency, by his legal representative or official assignee. If the holder fails to present, the other parties to the instrument are not liable to the holder.

**Rules Regarding Presentment for payment**

The following rules are applicable as to presentment of a negotiable instrument for payment.

Presentment for payment must be made during the usual hours, of business. In case of a banker, presentment must be made within banking hours.

* A promissory note or a bill of exchange which is payable at a specified period after date or sight must be presented for payment at maturity.
* A promissory note, bull of exchange, or a cheque made, drawn or accepted payable at a '' specified place and not elsewhere'' must be presented for payment at that place in order to charge any party. In case the holder fails to present the bill at the specified place, all parties will be discharged from their liability,
* A promissory note or a bill of exchange made, drawn or accepted payable at a specified place must be presented for payment at that place in order to charge the maker or drawer. Failure to present will discharge all the prior parties, drawer and endorsers but not the acceptor.
* If no specific place is mentioned in the bill or the note, it must be presented for payment at the place of business, or at the usual residence of the drawee (acceptor) or the maker, as the case may be. If the latter has no known place of business or fixed residence, such presentment may be made to him in person wherever he can found.
* A negotiable instrument payable on demand must be presented for payment within a reasonable time after it is received by the holder.
* Presentment for payment may be made to:-

a) the duly authorized agent of the drawee, maker or acceptor

b) his legal representative in case of his death

c) his assignee, if he has been declared insolvent

* A presentment through the post office by means of a registered letter is sufficient, if authorized by agreement or usage.

Delay in presentment may be excused if the delay is caused by circumstances beyond the control of the holder and not imputable to his default, misconduct or negligence. When the cause of delay ceases to operate, presentment must be made within a reasonable time.

**Presentment for payment is excused when:**

**There is intentional prevention of presentment**: - When the holder of a negotiable instrument lost the same, he has to report to the maker and the maker is required to give a copy of the original instrument. But, when a bill of exchange is lost and a duplicate is not supplied, presentment is not necessary, as it is considered the existence of an intentional prevention of presentment.

**Place of Business Closed: -** When the instrument is payable at the maker, acceptor and drawees place of business and that is closed during normal business hours, no presentment is necessary.

**Payer absents from place of payment**. When the instrument is payable at a specified place on the due date but there is no person authorized to refuse or make payment at that place.

**Payer is not found after due search.** When the instrument is not payable at any specified place and the person liable to make payment is not found after making reasonable search.

**Waiver of presentment**. This is when the parties to the negotiable instrument have undertaken to pay the instrument in spite of its non-presentment for payment. Presentment for payment in this case is waived either expressly or impliedly.

When the drawer could not suffer damage for non-payment, any holder can make the drawee liable without presentment, e.g. where the drawer draws the bill on himself or when the drawee is a fictitious person.

**When the bill is dishonored by non-acceptance**

**When presentment has become impossible** e.g. by declaration of war between the countries of the holder and the drawee.

# *4.3.4.2. Dishonor of Negotiable Instrument*

## A bill of exchange is said to be dishonored when either it is not accepted by the drawee or payment is request by the drawee or acceptor. A promissory note or a cheque is said to be dishonored when the maker of the note or the drawee banker refuses payment. Thus negotiable instrument may be dishonored either by non-payment or non-acceptance.

## a. Dishonor by non-acceptance

Only a bill of exchange can be dishonored by non-acceptance. It shall be dishonored by non-acceptance in the following cases:-

1. The drawee has refused to accept the bill when it is presented to him for acceptance or he does not accept the bill within 48 hours from the time of presentment for acceptance.
2. When acceptance of bill is not given in those case where presentment for acceptance is excused.
3. When the drawee is incompetent to contract
4. When the drawee gives a qualified acceptance (if the holder wish to consider as accepted, it can be treated as accepted).

In these cases an immediate right of recourse against the drawee and endorser accrues to the holder without waiting until the maturity date.

### b. Dishonor by Non-payment

All types of negotiable instruments may be dishonored by non-payment in the following cases: -

1. If the maker of the pronote, acceptor of the bill or drawee of the cheque refuses to pay or
2. When payment is excused and the bill is overdue unpaid.
3. When they cannot be obtained at maturity day.

When a bill is dishonored by non-payment, an immediate right of recourse against the drawer and the endorser accrues to the holder. Notice of dishonor should be given on the dishonor of a negotiable instrument.

Notice should be given by the holder or some party thereto who remains liable on the instrument. The agent of any such party may also give notice. A notice by a stranger is invalid. When the holder has given the notice to any of the parties liable on the instrument and the party has in turn given due notice of dishonor to all other prior parties, the holder can treat it as notice given by him.

No notice is necessary to the maker of a note or acceptor of a bill of exchange or drawee of a cheque as they are the principal debtors and they themselves have dishonored the note or the bill. Notice must be given to other parties to whom the holder wants to make liable. Notice of dishonor must be given as follows.

* When there are two or more persons jointly liable as drawees or endorsers, notice to any one of them is taken as notice to all.
* In case of death of a person, notice may be given to his legal representative.
* In case of his insolvency, it may be given to the official Assigner or receiver.

### Effect of the Omission to give notice

Omission to give notice of dishonor to parties entitled to such notice will discharge them from their liability. Therefore, holder must give notice to all the prior parties to enforce his right against them.

#### **Mode of Giving Notice**

Notice of dishonor may be given to a duly authorized agent of the person to whom it is required to be given or when he has died, to his legal representative, or where he has been declared an insolvent, to his assignee; may be oral or written; may, if written, be sent by post; and may be in any form; but it must inform the party to whom it is given either in express terms or by reasonable intendment, that the instrument has been dishonored and in what way, and that he will be held liable; and it must be given within a reasonable time after dishonor, at the place of business or, at the residence, incase such party has no place of business, of the party for whom it is intended.

Thus notice of dishonor may be oral or written. If written, it may be sent by post. If the notice is dully directed and sent by post and miscarries, such miscarriage does not vender the notice invalid. Any party receiving notice of dishonors must, in order to render any prior party liable to him self, give notice of dishonor to such party within a reasonable time, unless such party has received.

### 4.3.5 Maturity of Negotiable Instruments

The maturity of a promissory note or a bill of exchange is the date at which it falls due. A bill or note payable at sight or on demand or a cheque becomes payable at once and so three is no question of these being matured.

Every promissory note or bill of exchange which is not expressed to be payable on demand, at sight or on presentment is presented at maturity, on the third day after the day on which it is expressed to be payable. These additional three days are called the days of grace.

Rules for the determination of the maturity date

**1.**If a negotiable instrument has been made payable after a stated number of months ''after date’’ or after sight '' or after a certain event'' the period stated shall be held to terminate on the day of the month which corresponds with the day on which the instrument is dated, presented for acceptance or sight or the event happens.

**Illustration**

a). A negotiable instrument, dated 30th April 1991 is payable three months after date. It matures for payment on 3rd August. 1991.

b). A bill, dated 30th April 1991 is payable two months after sight. It is presented for acceptance on 4th May 1991. It s date of maturity will be 7th July 1991.

c). A bill dated 30th April 1991, is payable one month after the death of A. A dies on 15th May, 1991. Its date of maturity will be on 18th June 1991.

**2.** If the month in which the specified number of months (the period) will terminate has no corresponding date. Bill of exchange will mature on the last day of the month.

**Illustrations**

A bill drawn on 29th December 1991, and payable two months after date shall mature on 3rd March 1991.

**3.** Where bill of exchange is drawn payable after a certain number of days after the date or after sight or after a certain even, the day on which it was drawn or presented for sight or acceptance or on which the event happens shall not be counted towards the number of days for which the bill has been drawn.

**Illustrations**

1. A bill drawn on 1st January 1991 and payable thirty days after date shall fall due for payment on 3rd February 1991.
2. A bill drawn on 1st January 1991 and payable thirty days after sight is presented for acceptance on 3rd January. The instrument will mature on 5th February.

**4.** If the maturity day of a negotiable instrument comes out to be a public holiday, the instrument shall be deemed to be due on the preceding business day. In case the holiday is an emergency holiday, the instrument shall fall due for payment on the next succeeding business day.

**Illustrations**

1. A bill of exchange dated 23rd December is payable one month after date. The instrument shall due for payment on 25th January (26th January being a public holiday).
2. A bill falls due for payment on 25th January. The government declares the day as a holiday. The instrument shall fall due for payment on 27th January. (If 26th January is a public holiday).

* The expression “public holiday” includes Sundays and any other days declared by the government to be a public holiday.

**4.4. Kinds of Negotiable Instruments**

There are two broad categories of Negotiable Instruments. They are:

**Negotiable Instruments by statue:** The Negotiable Instruments Act states three instruments: cheque, bill of exchange and promissory note as Negotiable Instruments. These are, there fore, called negotiable instruments by statute.

**Negotiable Instruments by custom:-** The Transfer of property Act states that instruments may be negotiated by custom and their negotiability will be recognized by courts. Instruments falling in this category are: Bank draft, Notes, etc. However, it is nowhere stated that these are the only documents that are negotiable instruments. Other instruments may also be added to this list of negotiable instruments provided they fulfill the following two conditions.

1. They are transferable by mere delivery or by endorsement and delivery; and
2. The holder in due course can sue in his own name.

Therefore, every instrument which entitles a person to receive money and which possesses the characteristics of negotiability is a negotiable instrument. In other words, it can be said that a negotiable instrument is an ordinary chose-in-action clothed with the feature of negotiability.

**4.4.1. Bills of Exchange**

The Negotiable Instruments Act defines a bill of exchange as an instrument in writing containing unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of, certain person, or to the bearer of the instrument. Thus a bill of exchange is a written acknowledgment of debt, written by the creditor and accepted by the debtor.

**a. Essential Characteristics**

The essential characteristics of bill of exchange are:

1. It must be in writing
2. It must be signed by the drawer
3. The drawer, drawee and payee must be certain.
4. The sum payable must also be certain
5. It should be properly stamped
6. It must contain and express order to pay money and money alone

A mere request to pay on account, will not amount to an order. But an order expressed in courteous words or polite language will not be taken to be mere request.

Example: -

I shall be highly obliged if you make it convenient to pay Birr 100.00 to Alemu.

Ato Amare, please let the bearer have Birr 100.00 and place it to the debit of my account.

Please pay Birr 100.00 to the order of A.

Mr. A will oblige Mr. B by paying to the order of Mr. C.

The 1st and 2nd are not order to pay but only a request to pay. The 3rd and 4th are order to pay. Hence, the 1st and 2nd are not termed as a bill of exchange but the 3rd and 4th are bills of exchange.

**7.** The order must be unconditional

It should not be attached with uncertain future events. It must not order any act to be done in addition to the payment of money. **Specimen of bill of Exchange**

1. **Order bill payable on demand**

|  |
| --- |
| **Br 400.00 Addis Ababa. Feb. 6.2001**  **On demand pay. To Ato Abera or order the sum of Birr 400.00 for value received.**  **To Yitayew Legeta Abebayehu Yetemen**  **stamp** |

1. **Bearer bill payable at a future fixed time /on the expiry of a specified period of time**

|  |
| --- |
| **Br 100.00 Bahir Dar, March 1,2001.**  **Three months after date pay bearer the sum of Br1000.00 for value received**  **Alemayehu Techane**  **To: Amare Gemechu**  **Address Stamp** |

1. **Bill payable 90 days after acceptance**

|  |
| --- |
| **Br 200.00 Merkato, January 7,2001**  **Ninety days after sight pay to my order Br 200.00 for value received.**  **Abebayehu Yetemegn**  **To : Yitayew Legeta**  **Address Stamp.** |

* The word “value received” though usually written in a promissory note and a bill of exchange, it is not legally compulsory.
* The drawer and the drawee and the drawer and payee may be the same person.
* If the drawer and the drawee are the same or the drawee is a fictitious person, the instrument may be treated as a bill of exchange or a promissory not at the holder’s option.
* The holder is the payee or endorsee that is in possession of the bill, or the in case of order bill bearer in the case of a bearer bill.
* **A bill is payable to order when**

a. It is expressed to be payable to order

* 1. It is payable to a particular person and does not contain words prohibiting transfer.

Ex. “to pay AB Br 500.00”

“Pay AB only” or “pay AB personally Br 500.00” is not an order bill

* 1. It is payable to the order of a particular person.

Ex. A bill payable to “the order of AB” is payable either to AB or to AB’s order.

* **A bill is payable to bearer: -** When it is expressed to be so payable or when the only or last endorsement is an endorsement in blank.

**a. Classifications of Bills of Exchange.**

Bills of exchange can be classified as follows:

**1. Inland and Foreign Bills.**

**a) Inland Bill**

An inland bill is one, which is: -

* Both drawn and payable within the same country, or
* Drawn within the country upon some person resident therein whether payable in or outside the country
* Drawn in the country on a person residing outside the country but payable in the country

**b) Foreign Bills**

A Bill, which is not an inland bill, is a foreign bill. A foreign bill is one, which is:

* Drawn in a country on a person residing outside the country and payable outside the country.
* Drawn outside the country and made payable either in or outside the country.
* Drawn outside the country on a person residing in the country
* Drawn outside the country and payable outside the country.

**2. Time and Demand Bills**

* + - * 1. **Time bill**: A bill payable after a fixed time is termed as a time bill. A bill payable “after date” is a time bill. In case a bill payable “after date”, the maturity date is to be reckoned from the date as mentioned in the bill but in case of bill ‘payable after sight”, the date of maturity is to be calculated from the date of presentment for acceptance.
        2. **Demand bill:** A bill payable at sight or on demand is termed as a demand bill. Demand bills are also referred as “sight bills” and they require no acceptance. All clean and documentary bills which are payable upon presentation, at sight or on demand, are demand bills because they are payable on demand.

**3. Trade and Accommodation Bills**

* 1. **Trade Bill:** A bill drawn and accepted for a genuine trade transaction is a “trade bill”. It is drawn in the course of a trade transactions.
  2. **Accommodation bill:** A bill drawn and accepted not for a genuine trade transaction but only to provide financial help to some party is termed as an accommodation bill”. It is a bill which does not originate in pursuance of a commercial transaction like sale of goods or lending of money, and is drawn, accepted or endorsed without consideration merely to help the business associate.

**Illustration: -**

“A” is in need of money for three months. He induces his friend “B” to accept a bill of exchange drawn on him for Br 100.00 for three months. The bill is drawn and accepted by A and B respectively and A becomes the accommodated party and B becomes the accommodating party.

The following are the rules regarding accommodation bills.

1. In case the accommodated party continues to hold the bill till maternity, the accommodating party shall not be liable to him for payment of the bill since the contract b/n them is not based on any consideration.
2. The accommodating party is liable to a holder of the instrument for value even though the holder may have known that the party was only an accommodating party.

The accommodating party can, in turn, claim compensation from the accommodated party for the amount it has been asked to pay the holder for value.

**4. Clean and Documentary Bill**

* + 1. **Clean Bills:** A bill drawn and accepted with out support of documents is a clean bill,
    2. **Documentary Bills: -** It contains such documents as bill of lading or railway receipt, certificate of origin, consular invoice, insurance, policy, carriers invoice.
    3. **Parties to a bill of Exchange**

**Drawer:** He is the maker of a bill of exchange. He is the one who order some other person or institution to pay money to some specified person. He must sign it. Though there is no objection to its being accepted before the drawer places his signature on it, it remains incomplete and cannot be issued.

**The Drawee/Acceptor.** He is the person ordered by the drawer to pay money. He can be a person or an institution. He becomes the “acceptor” after he has signified his assent to the order of the drawer by writing the word “accepted” right across the face of the bill with his signature and date.

**Payee:** He is the person to whom or to whose favor the money is directed by the instrument to be paid. The drawer may make the bill payable to him or may name another person in the bill to whom it has to pay.

**Holder:** He is any person entitled in his own name to the possession of the instrument and to receive or recover the amount thereon from the parties. He may be the original payee named in the bill or one to whom the bill is endorsed over the original payee. If the instrument is a note payable to bearer, the bearer is the holder otherwise the endorsee will be the holder.

**Endorser:**When the holder transfers or endorses the instrument to any one else he becomes the endorser.

**Endorsee** The person to whom the bill is indorsed. He can be again a person or an institution.

**Drawee in case of need:** When, in the bill or in any other instrument, the name of any person is given, in addition to the drawee, to be resorted to in case of need, he will be the drawee in case of need. If the original drawee refuses to accept the bill, the bill must be presented to such a drawee in case of need. In other way he is a guarantor at the time of issuance.

**Acceptor for honors:** In case the original drawee refuses to accept the bill or to furnish better security when demanded by the holder, any person who is not liable on the bill may accept it with the consent of the holder for the honor of any party liable on the bill. To be valid, an acceptance for honor can only take place after the bill has been protested for non-acceptance and is not overdue.

**Discounting A Bill**

When a banker discounts a bill, he buys it out right for a sum less than its face value or maturity value. The amount received by the discounter is the proceed i.e. the discounted balance. The difference between the face value or maturity value of the note and the proceed amount is termed discount. The rate applied to determine the discount is termed as a discount rate. The discount rate is again determined based on the remaining dates of the note and the banks policy.

Recording method: - Dr Cash xxx (by the amount received)

The customer account xxx (by face value or maturity value)

When the banker buys trade bills, there are points to be considered in order to avoid unmarketable bills, which may eventually produce endless trouble.

For example: - If a bill drawn by A on B brought to be discounted

* The banker should consider the position of the acceptor –B.
* The banker should obtain opinion about B from the banker if his account is held at another bank.
* The banker should consider
* How many other bills accepted by B are in the bill case?
* Have any of B’s acceptances ever been dishonored?

A bill is a genuine trade bill if

* + - 1. The bill is accepted by B because he has received value for it from A.
      2. ‘B’ accept it merely for the accommodation of ‘A’ on the understanding that ‘A’ he must meet it at maturity.

A banker who discounts a bill is “holder for value” and at maturity he obtains the full proceeds.

**4.4.2.** **Promissory Notes**

According to the Negotiable Instruments Act, a promissory note is an instrument in writing (not being a bank 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 promissory note is drawn and signed by the debtor (called the “maker”). Who promises to pay the creditor (called the “payee”), a certain sum of money. The note may be drawn in any form, but the words used must clearly bring out a promise to pay.

* A promissory note may be payable on demand or after the expiry of a fixed time after date or sight.

**A specimen of a promissory note payable on demand.**

|  |
| --- |
| **Amount Place: Addis Ababa**  **Br 10,000.00 Date: Sept.,15, 2003**  **On demand, I promise to pay to Ato Yigermal or his order a sum of birr Ten Thousand, value received.**  **To: Ato Yigrmal Stamp**  **Address maker** |

A specimen of a promissory note payable after the expiry of a fixed time after date

|  |
| --- |
| **Amount Place: Addis Ababa**  **Br 5,000.00 Date: Nov.,3, 2003**  **Thirty days after date, I promise to pay to Ato Geremew or his order a sum of Birr Five Thousand, value received.**  **To: Ato Geremew stamp**  **Address maker** |

A specimen of a promissory note payable after the expiry of a fixed time after sight

|  |
| --- |
| **Amount Place: Arussi**  **Br 20,000.00 Date: Nov.,1, 2003**  **Ninety days after sight, I promise to pay to Ato Habtamu or his order a sum of Birr Twenty Thousand, value received.**  **To: Ato Habtamu stamp**  **Address maker** |

* A promissory note may be payable to either the bearer or to the order.

A specimen of a promissory note payable to the order.

|  |
| --- |
| **Amount Place: Wollaita**  **Br. 15,000.00 Date: Oct. 15, 2003.**  **I promise to pay Ato Kebede or his order a sum of Birr Fifteen thousand, value received.**  **To: Ato Kebede Stamp**  **Address maker** |

N.B: This form of a promissory note can be prepared by any one.

Specimen for a promissory note, payable to the bearer.

|  |
| --- |
| **Amount Place: Arba Minch**  **Br. 9,000.00 Date: Nov. 6,2003**  **I promise to pay to the bearer a sum of Birr Nine Thousand, value received.**  **Stamp**  Maker |

N.B: This can be prepared only by the government or National Bank.

Currency or Bank notes are bearer promissory notes, which are issued by the National Bank. They are promises made by government. But, in actuality they are not promissory notes. Because, as you promise, it implies that you enter in to an understanding to pay money in the future time, but when you give money now, even though it is a promise, the payment is actually made and no payment is expected in the future. However, one thing must be made clear; that government is always ready to redeem these currency notes.

**a. Essential features of promissory note**

A promissory note must possess the following essential characteristics. They are:

* 1. **It must be in writing.** A mere verbal promise or oral promise to pay does not constitute as a promissory note.
  2. **It must contain an expressed promise or clear undertaking to pay**: - A mere/simple acknowledgment of a debt is not a promissory note. The promise to pay money must be stated in express words and not implied. However, the use of the word “promise” in the instrument is not necessary.

The following are promissory notes:

If Ato Akloge writes:-

i). “I promise to pay Ato Geremew or order Br.500.00.”

ii) “I acknowledge myself to be indebted to Ato Chanyalew for Br.1, 000.00 to be paid on demand, for value received.”

The following are not promissory notes.

If Ato Alemayehu writes:-

i). “Ato Abate I owe you Br.100.00.”

ii). “I have taken from Ato Zerihun one thousand only. The amount to be repayable after one year along with interest at the rate of 8 percent per annum,”

iii). “Ato Alemu I am liable to pay you Br. 100.00.”

These are not promissory notes because: the first one is a simple acknowledgment of a debt, the second is simply an implied, not expressed, and the third one is expressing only being indebted, not the obligation to pay.

In the second case the banker, deputed to collect the amount of the cheque from another banker, is called the collecting banker. He presents the cheque for encashment to the drawee banker and on its realization it credits the accounts of the customer with the amount so realized.

* 1. **The undertaking to pay is unconditional.** Conditions can be certain or uncertain condition. Therefore payments should not be attached with uncertain conditions.
* The following documents are not promissory notes.
* I promise to pay to Mr. B Br 1,000.00, if he marries Ms C
* I promise to pay as soon as possible a sum of Br 1,000.00

* The following documents are promissory notes.
* I promise to pay Br 1,000.00 seven days after the death of Mr. D.
* Sixty days after sigh, I promise to pay A’ Mr. Z or order a sum of Br 1,000.00 value received.
  1. **It must be signed by the maker:** It may be signed on any part of the instrument. It may be signed with pencil or ink or thumb mark or initials. An agent can sign the promissory note but the agent must expressly state as to on whose behalf he is signing, otherwise, he himself may be held liable as a maker.
  2. **The maker must be certain:** He may be described by name or by his designation. In case two or more persons promise to pay, they may bind themselves jointly or jointly and severally, their liability cannot be in the alternative.
  3. **The payee must be certain:** The payee may be ascertained by name or by designation. In case there is a mistake in the name of the payee or his designation, the note is valid, if the payee can be ascertainable by evidence. Even when the name of a dead person is entered as payee in ignorance of his death, his legal representative can enforce payment.
  4. **The promise should be to pay money and money only:** Money means legal tender money. If the promise to pay includes other items with money, it will not be deemed as a pronto. It may be discussed as follows.

“ I promise to pay to Mr. A Birr 1,00.00 and one Cow.”

This document is not a promissory not, because it includes money with cow.

* 1. **Amount should be certain:** The amount to be paid should be either expressly or impliedly stated and it should be specific
* The following are not promissory notes.

-I promise to pay to W/t Nigist Birr 500.00 and all other sums, which become due.

-I promise to pay to W/t Azalch Birr 1,000.00 first deducting there from any amount, which, she owes to me.

The following are promissory notes.

* 1. Thirty days from date, I promise to pay to Mr. A Birr 1,000.00 with an interest rte of 10%.
  2. Thirty days from date, I promise to pay to Mr. A Birr 1,000.00 with the prevailing interest rate.
  3. Three months from date, I promise to pay to Mr. B USD 1,000.00 with an exchange rate of Br 8.5216.
  4. Three months from date, I promise to pay to Mr. B USD 100.00 with the prevailing exchange rate.
  5. **The Instrument must be properly stamped:** The promissory note must be stamped or signed to ascertain who the issuer is. Therefore, if the issuer is an individual, he can put his signature and stamp it. However, if the issuer is an institution, it can only stamp it.
  6. **Other formalities**
* The date of the instrument is not material unless the amount is made payable at a certain, time after date. Even in such a case, omission of a date does not invalidate the instrument if the date of execution can be independently ascertained and proved.

“ I promise to pay Birr 1,000.00 to Mr. C on the first day of the first month colander year”

* Number, place, date and consideration though usually found in the promissory notes but are not essential in law.
* The words “Value received” are also unnecessary.

**b. Presentation of promissory Notes**

Negotiable Instruments are presented for three causes: for acceptance, for sight and for payment. But presentation of a promissory note for acceptance is not needed i.e. presentation is not necessary for fixing the liability on the maker because it is already done as he/she writes the promissory note. But presentation is necessary under the following conditions.

1. When it is payable after a certain period “after sight”, it must be presented with in a reasonable time and during business hours on a business day.
2. It must be presented for payment, if it is a demand note within a reasonable time, after it has been received by the holder, and in other cases within a reasonable time after maturity.

However, delay in presentation owing to unavoidable cause can be condoned. The instrument to be presented just at the end of the unavoidable cause.

3.A promissory note, which is payable in installments, must be presented on the due dates of installments.

4. A promissory note, which is payable at a specified place, must be presented for payment at that place.

**Difference between a bill of exchange and a promissory note.**

**1. Number of parties**

**Bill of exchange**: - There are three parties: drawer, drawee and payee. The drawer may also be the payee. In bill of exchange, drawer and payee and drawer and drawee can be one and the same person

**Promissory note**: -There are only two parities maker and payee. Maker cannot be payee

**2. Promise and order**

A bill contains an order to pay certain sum of money, whereas a promissory note contains a promise to pay a certain sum of money to the payee.

**3. Acceptance**

Bill payable after sight requires acceptance of the drawee before it is presented for payment while a pronto does not.

**4. Nature of Liability**

The liability of the maker of a note is primary and absolute but that of a drawer of a bill of exchange is secondary and conditional. The drawer can be liable only on the default of the acceptor in payment of the money due and provided the fact of dishonor has been notified to him.

**5. Maker’s Position**

The maker of a promissory note stands in an immediate relationship with a payee.

The maker in a promissory note being the originator of the note cannot make it conditional.

The drawer in a bill of exchange stands in immediate relationship with the acceptor and not the payee. The drawee (acceptor) in a bill of exchange can accept the bill conditionally because his contract is only supplementary. Being super imposed on that of the drawer.

**6. Notice in the case of dishonor**

Notice of dishonor must be submitted to all prior parties, in case of dishonor of a bill either by non-acceptance or non-payment.

In case of dishonor of a promissory note no notice is necessary to the maker as the maker is the one who dishonor it by non-payment.

7. **Who may draw the instrument**?

A creditor always draws a bill on the debtor. Promissory note is drawn by the debtor and given to the creditor.

8. **Bearer or order**. A bill can be drawn payable to bearer, provided it is not payable on demand. A promissory note cannot be made payable to bearer.

**4.4.3. Cheque**

According to the Negotiable Instruments Act. “A cheque is a bill of exchange drawn on a specified bank and not expressed to be payable otherwise than on demand.” It is unconditional order in writhing, signed by the drawer requiring the banker to pay on demand a sum certain in money to, or to the order of a specified person or to the bearer.

* It is always drawn on a specified banker
* It is always payable on demand
* It is a bill of exchange.

Thus, all cheques are bill of exchange but all bills are not cheques.

**A. Essentials /Characteristics of a cheque.**

An instrument to be called a cheque must fulfill the following conditions

**i. The instrument must be in writhing.**

The instrument to be referred as a cheque, it must be in writhing. It can be written in different forms such as: printed characters, type written, pen or pencil or engraved characters. There is no legal restriction as to the form of writing. However, banks do not generally honor cheques drawn in pencil, unless confirmed by the drawer, because it is easy to make unauthorized alterations when a cheque is drawn in pencil.

**ii. The instrument must contain an unconditional order.**

The order to pay must be unconditional, that is, no condition should be attached to the payment of the cheque. If the banker is asked to do something else besides payment of money on the cheque, the order will be conditional order. Thus it will not be called a cheque. But if the condition is communicated only to the payee but not the banker, the order to pay may be regarded unconditional.

**iii. 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/her thumb impression is necessary. Pencil signatures are discouraged by banker, but legally permissible. Rubber stamp impression is not permitted generally.

**iv. Drawn on a Specified Banker**.

It should be drawn on a banker only. The name of the banker must be specified or stated. Fortunately, the name of the bank and the name of the specific branch where the account is maintained is printed on the face of the cheque.

**v. The order must for a certain sum of money only.**

The order must be for the payment of money only. The money means legal tender-currency. The amount must be certain or definite; when the cheque is drawn in any foreign currency and when it is payable with interest at a given rate up to the date of happening of a fixed future event, it is believed the amount is certain.

**vi. Payee to be certain.**

The person to whom the amount is to be paid must be certain. It may be made payable to a certain person or to his order or to the bearer. If not payable to barer;

-The payee must be named of other wise indicated therein with reasonable certainty.

-The payee need not be a human being; it can be a legal person.

**vii. Payable on demand**.

The instrument must be payable to or to the order of a certain person or to his bearer on demand. Cheques are always made payable on demand at sight or at presentment.

vii. **Other Characteristics of cheques.**

1. A cheque drawn to cash or bearer can be paid to the presenter. It should be endorsed by the bearer at the time of encashment or crediting to his/her account.
2. Only the drawer should endorse a cheque drawn to self.
3. A cheque drawn in the name of corporation, Co-operatives or legal bodies in general cannot be paid in cash. Such cheques shall be credited to the payee’s or endorsee’s account. The cheque should bear a seal whenever possible.
4. A cheque drawn to specific person shall be paid to such person or credited to his/her account upon endorsement. He can transfer to another person by endorsement.
5. A cheque drawn to joint account holder (or in the name of two persons) shall be paid against their endorsement.
6. A cheque drawn to the order or alternative individuals can be paid by the endorsement of one of the individuals.
7. Unlike a bill of exchange, a cheque does not require any acceptance.

**B. Dating of cheques.**

There are two ways of dating a cheque.

**1. Ante-dated cheque**.

It is one that bears a date earlier than the date of issue; It is a negotiable instrument and payable on demand.

**2. Post –dated Cheque**

It is one that bears a date later than the date of issue. It is a negotiable instrument but not an instrument payable on demand. A cheque is not invalid merely on the ground that it is antedated or post-dated, or that it bears a date on Sunday (holiday).

A bank is not bound to honor an undated cheque. It is an inchoate cheque. But it is still a valid cheque. Hence, the holder of such a cheque is authorized to fill in the date within a reasonable time.

The holder of a cheque must present it for payment within a reasonable time of its issue, and failure to do this will discharge the drawer to the extent of any damage he may suffer from the delay.

**Differences between a Cheque and Bills of Exchange**

1. A cheque is always drawn on a banker, while a bill of exchange may b e drawn on any person or institution, including banker.
2. A cheque is always payable on demand whereas a bill of exchange may be payable on demand or on the expiry of a fixed period. When a bill is payable after a specified period, three days of grace are allowed for payment. No grace day is allowed in case of a cheque.
3. A cheque maybe crossed but there is no such provision in case of a bill of exchange.
4. A cheque does not require acceptance, whereas a bill of exchange, unless payable on demand, requires acceptance.
5. A bill payable on demand can never be drawn to bearer whereas a cheque drawn to bearer payable on demand is valid.
6. A bill of exchange, except in certain cases, must be stamped, whereas a cheque does not require any stamp.
7. The payment of a cheque may be countermanded by the drawer, but payment of a bill, after acceptance, cannot be countermanded.
8. Notice of dishonor is essential in case of a bill whereas no notice of dishonor is necessary in case of a cheque.

**Summary**

|  |  |
| --- | --- |
| Cheque | Bill of Exchange |
| 1. Order on a specified bank | 1.Order on any person or institution |
| 2. Always payable on demand | 2. Payable either on demand or after a specified period of time or at sight. |
| 3. Drawn in home currency only | 3. May be drawn in home currency or any foreign currency. |
| 4. No acceptance is required | 4. Acceptance is a must in case of time bills. |
| 5. No days of grace are allowed to the bank | 5. Three days of grace allowed to the acceptor |
| 6. Bearer cheques can be issued | 6. A bill of exchange can be made payable only to order. |
| 7. Can be crossed | 7. Cannot be crossed |
| 8. the liability of the drawer is primary for payment | 8. the liability of the drawee or acceptor is primary and that of drawer is or acceptor is primary and that of drawer is secondary |

**Crossing of cheques**

In actual practice, there are two types of cheques. Namely open cheques and crossed cheques.

**Open cheques:** are those, which can be directly presented to the bank for payment over the counter and those which doesn’t bear any crossing over their face. They may be either bearer cheque or an order cheque.

**Crossed cheques**: where a cheque bears across its face two parallel transverse lines, the cheque is said to be crossed. The lines are generally drawn on the top corner of the left hand side of the cheque though there is no hard and fast rule regarding this.

Crossing is a direction to the paying banker that the cheque should be paid only to a banker and if the banker is named in the crossing, only to the banker. Crossing prevents the paying banker from paying the value of the cheque at the counter. Whenever two parallel transverse lines appear on the cheque, the bank will not make payment to its holder at the counter of the bank. The payment of a crossed cheque can only be obtained through the bank of the holder. This ensures the safety of payment by means of cheques. Thus, crossing affords security and protection to the true owner of the cheque. The holder of the cheque is not allowed to cash it across the counter but he can deposit it in his account and can withdraw by his won cheque, there after.

Crossed cheques are negotiable by delivery, incase they are payable to bearer and by endorsement and delivery when they are payable to order. But when words “Not negotiable” are added to the crossing, the cheque is not negotiable, though transferable.

**Advantages of Crossing**

A crossed cheque offers the following advantages

i) Crossing protects payment of cheques to the wrong full holder.

ii) Crossing cautions the bank not to pay the amount of cheque at the counter. Payment of a crossed cheque must be collected through a bank. This reduces the risk of fraud.

iii) If a cheque is crossed, it is easy to trace the person for whose benefit the payment was collected.

**Bearer cheque:-** In case of a bearer cheque, the liability of the paying bank is over, after making payment to the bearer of the cheque. If it is lost or stolen, the bank will not be responsible, if the payment is made to an unauthorized person or a thief. The bank cannot refuse to make the payment of a bearer cheque if it is in order and there is sufficient balance in the concerned account. If an instrument is issued originally expressed to be payable to bearer, it will always be treated as bearer and the bank will be discharged from liability by making payment across the counter to the bearer.

###### Order Cheque:- In case of an order cheque, the bank makes payment across its counter to the person or payee named in the cheque. The bank must ensure that payment is made only to the payee. In other words, the identity of the payee of the cheque must be verified before making the payment.

Since open cheques are not required to go through a bank before being presented to the drawee bank for payment, there are certain risks attached to such cheques. When an open cheque is lost or stolen, the finder or thief may get it encashed at the drawee bank. If the cheque is payable to order and the drawee bank makes payment in due course, it will be discharged from its liability. Thus, open cheques are liable to risks in the course of circulation. In order to avoid such risks and protect the holder of the cheque, crossing has been introduced.

**Type of Crossing**

The Negotiable Instruments Act provided two types of crossing: Generals crossing and Special crossing. In Addition the commercial usage adopted a third type of crossing: Restrictive Crossing.

**General Crossing:-** When a cheque bears across its face two transverse parallel lines with or with out any words, such us “and company “or “and co”, “not negotiable” it is called generally grossed and the process is known as general crossing. These, two transverse lines across the face of the cheque are essential for general crossing.

A cheque bearing general crossing cannot be enchased at the counter of the bank. It must be presented for collection through the bank of the payee to the drawee bank. After collection, the collecting bank will credit the account of the customer with the amount of the cheque. The customer can then withdraw the amount.

The addition of the words “account payee” or “payee’s account” to the crossing increases the safety of the cheque. However, they cannot be strictly considered as addition to the crossing, the paying banker’s position remains practically the same and they are intended to warn the collecting banker that the amount should not be collected except for the benefit of the payee’s account. But the addition of the word “not negotiable” has significant legal effect.

**Significance of general crossing**

General crossing provides the following meaning:-

1. Cash will not be paid across the counter.
2. The cheque is deposited in the holder’s account, if he has an account in that particular bank/ branch.
3. The cheque is instructed to be deposited in another bank/ branch, if he has no account in the collecting bank/ branch.
4. He can withdraw from his account through a cheque, if it is deposited in a correct account.
5. He can withdraw from his account through withdrawal slip, if it is deposited in saving account.
6. He can withdraw (collect) it through a person having an account in the same bank or any other bank.

* Specimen forms of general crossing
  + 1. And company
    2. & Company
    3. Not Negotiable
    4. Not negotiable & com.

**Special Crossing:-** The Negotiable Instrument Act states that “where a cheque bears across its face an addition of the name of a banker, either with or without the word “not negotiable”, that addition shall be deemed a crossing and the cheque shall be deemed to be crossed specially and to be crossed to that holder,” Here, the name of the banker through whom the cheque can be collected appears on the face of the cheque.

A special crossing warns a paying banker that the amount should be paid only to the banker whose name mentioned in the 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 is safer than the generally crossed cheque. The banker to whom a cheque is crossed specially may appoint another banker as his agent for the collection of such cheque.

**The specimen forms of special crossing are**:-

* + - 1. Commercial Bank of Ethiopia
      2. Not Negotiable, Dashen Bank
      3. Account payee, AIB

Significance of Special Grossing

The paying banker should pay the amount only to the banker whose name is stated on the face of the cheque or to its agent for collection.

**Illustration**

Mr. ‘A’ issued a cheque on Awash International Bank, Arada Branch, in favor of Mr.’ B’ for Br 10,000.00 with the name of Awash International Bank, Bole Branch, written on it. It means the paying banker AIC, Arada branch, must pay the amount to AIC-Bole branch or to its agent. This type of crossing is very safe. Because a bank (AIC-Bole branch) will not collect the cheque unless the person on whose behalf the cheque is to be collected is its customer.

**Restrictive Crossing:-** Restrictive crossing is only a direction to the collecting banker that the proceeds of the cheque are to be credited only to the account of the payee named in the cheque. In case the collecting banker allows the proceeds to be credited to some other account, it may be held liable for wrongful conversion of funds. In restrictive crossing, the lines of crossing contain the words “Account payee only” or “Payee’s account only”. Restrictive crossing does not affect the negotiability of the cheque, if it is negotiable to its origin. Thus, the payee mentioned in the cheque is entitled to transfer the cheque to any one. But the transferability of such a cheque renders difficulty because the bank will not like to receive payment on behalf of any person other than the payee. The words “Account payee only” constitute a direction to the collecting banker that the proceeds of the cheque are to be credited to the account of the payee only.

Thus, in practice restrictive crossing hinders the negotiability of the cheque; such a crossing does not in any way affect the paying banker. It is not the duty of the paying banker to ascertain that the cheque is being collected on behalf of the person named as payee.

A cheque may be crossed either generally or specially with the words “not negotiable” on it. A person taking cheques 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 which the person from whom he took it had.

“Not negotiable” crossing does not make the instrument “non-transferable”. But the person holding a crossed cheque bearing the words ‘not negotiable’ does not get better title than that of his transferor and he can not convey a better title to his own transferee. Thus “not negotiable” crossing takes away the negotiable value of the cheque because the person taking it will only get the rights of the transferor. He will not become the holder in due cause.

Specimen of Restrictive Crossing is:-

1. Account payee only

2. Payee’s account only

**Double Crossing:-** Special crossing is meant for giving direction to a particular bank to collect payment. But such a cheque can be crossed specially again to another bank, by the bank in whose favor the cheque is originally crossed specially, acting as an agent for collection.

A cheque can be specially crossed only once except when the second crossing is to a banker as agent for collection. It is necessary to specify in the second special crossing that the banker in whose favor it is made is an agent for collection on behalf of the first bank.

**A specimen of such a Valid crossing is given below:-**

Bank of Abyssinia

To

Commercial Bank of Ethiopia

As an agent for collection

The phrase as “agent for collection” is very important. When the second special crossing to a bank is not done as agent for collection, the payee banker must refuse the payment of the cheque. In short, the payee banker is under an obligation to dishonor the cheque crossed specially to more than one banker except when the second crossing is to an agent for the purpose of collection.

**What is not crossing?**

Two transverse lines on the face of the cheque are essential in case of general crossing, whereas the name of a bank on the face of the cheque is also a must for special crossing.

The following cases do not constitute crossing:

i) A cheque bearing the words “not negotiable” or “account payee only” without two parallel lines or the name of any bank.

ii) A cheque bearing single line across its face

iii) A cheque bearing “X” mark on its face.

**Persons Authorized to Cross a Cheque**

A cheque can be crossed by any of the following parties:-

i) **The drawer**: -The drawer of the cheque can make a general, special or restrictive crossing on cheque before issuing it.

ii) **The Holder**: - He can cross a cheque delivered to him under the following condition:-

* 1. Where the cheque is uncrossed, the holder may cross it generally or specially.
  2. Where a cheque is crossed generally, the holder may cross it specially.
  3. Where a cheque is crossed generally or specially, the holder may add the word “not negotiable”.

iii) **The banker**: -Where a cheque is crossed specially, the banker to whom it is crossed may again cross it specially to another banker as his agent for collection. A cheque can be crossed especially only once except where the second crossing is to a banker a s agent for collection.

**Liability of paying Banker on Crossed Cheques**

The banker on whom a cheque is drawn is known as the “paying bankers”. In case cheques are crossed generally, the paying banker should make the payment to a banker only, but where the cheque is crossed specially, the paying banker should pay it only to the banker to whom it is crossed or his agent for collection. Any banker paying a cheque crossed generally, otherwise than to a banker, or a cheque crossed specially otherwise than to the banker to whom the same is crossed, or his agent for collection, being a banker, shall be liable to the true owner of the cheque for any loss he may sustain owing to the cheque having been so paid. If 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 should refuse payment therefore. If the paying banker makes payment of a crossed cheque in violation of the direction of the drawer conversed through the crossing, the banker shall be liable to the true owner of the cheque for any loss sustained by him as a result of such payment.

If the bank fails to follow the instruction given by the drawer on a crossed cheque, the payment by the bank is not treated as “payment in due louse”. If the payment is made to a wrong person, the banker will not be entitled to debit the account of the customer with the amount of payment. The banker will also lose the protection granted to him by the law.

**Opening of Crossing**

Cancellation of crossing of a cheque is known as opening of crossing. When the crossing is cancelled, it becomes an open cheque. Cancellation can be done only by the drawer of the cheque. For canceling the crossing, the drawer should write the words “pay cash “and then affix his full signature twice for both cancellation of crossing and the new instruction. When this is done, the cheque becomes eligible for payment at the counter of the bank. When the crossing on the cheque is opened, the bank should verify the signature of the drawer carefully. If the drawer’s signature is forged by the holder in order to cancel the crossing, and the banker makes payment at the counter, the banker will be held liable to the true owner of the cheque.

**Obliteration of Crossing**

Obliteration of crossing is a crime. Crossing on a cheque may be obliterated or erased by dishonest person so cleverly and skillfully that the paying banker is not able to detect such obliteration despite utmost care on his part. If it is not possible for a man of ordinary prudence to detect such obliteration, and the banker makes payment at the counter, he will be protected by the Negotiable Instruments Act (section 89) as if he has made the payment in due course

**4.5. Certain Concepts Related with Cheques**

**4.5.1. Holder and Holder in Due Course**

**A) Holder**

According to the Negotiable Instrument Act, "holder of a promissory note, bill of exchange or cheque means any person entitled in his own name to the possession of an instrument and to receive or recover the amount due thereon from the parties in the instrument. A person is called the holder of a negotiable instrument if the following conditions are satisfied.

**1) He must be entitled to the Possession of the instrument in his own name and under a legal title.**

A holder may be the payee or endorsee or the bearer. If the instrument is payable to the order: the payee, if the instrument is not negotiated and the endorsee, if the instrument is negotiated. If the instrument is payable to the bearer, the holder is the one who actually /physically possess the instrument. Actual possession is necessary if the instrument is payable to the bearer and it is not necessary if it is payable to the order- being either payee or endorsee is suffice. The holder must have the legal right to possess the instrument in his own name - It means that the title to the instrument is acquired lawfully and in a proper manner. But, if a person acquires a cheque or bill by theft, fraud, or forged endorsement or finds it laying some where, he does not acquire in his own name legal title thereto and hence, he cannot be called its holder.

**2) He must be entitled to receive or recover the amount from the parties concerned in his own name.**

A person can be entitled to receive or recover the amount in his own name if he is a payee or endorsee, in the instrument payable to the order and the bearer, in the instrument payable to the bearer. The holder is competent to require payment or recover the amount by filing a suit in his own name against other parties, to negotiate the instrument and to give a valid discharge. In case the instrument is lost or destroyed, its holder is the person who was entitled at the time of loss or destroy.

**B) Holder in due course**

According to the Negotiable Instrument Act. "Holder in due course means any person who, for consideration, became the possessor of a negotiable instrument, if payable to bearer, or the payee or endorsee if payable to order, before the amount mentioned in it became payable, and without having sufficient cause to believe that defect existed in the title of the person from whom he derived his title."

The essential qualifications of a holder in due course are summarized as follows:

1. He must be a holder for valuable consideration.

He must receive the instrument as a reward for some legal and genuine activity.

2. He must become a holder (possessor) of the instrument before the maturity date of the instrument

3. He must become holder of the negotiable instrument in good faith i.e. without having sufficient cause to believe that defect existed in the title of the person who transfers the instrument.

4. A holder in due course must take the Negotiable Instrument complete and regular on the face of it. Complete refers that all the necessary information is filled. Regular also refers that the endorsement, the form of the cheque, and other components of a cheque are in order.

If the contrary is proved, the person who becomes the possessor of the instrument cannot be a holder in due course.

**C. Privileges of a Holder in due course**

A holder in due course enjoys all the rights of a holder. In addition he enjoys the following privileges.

**1. He/she possesses better title from all defects**

Whatever the title of the transferor, the holder in due course will have a better title. This is to mean that, if the transferor or any prior party possesses the instrument unlawfully or, without consideration, or found a lost instrument and transfer the instrument for consideration to an endorsee, an endorsee can further negotiate, transfer or claim the amount in suit of law by his own name. His title is not affected by the fact that the person from whom he has taken the instrument had defective or no title to the instrument. He can recover the amount of the instrument from all previous parties although there was a defect in the title of the party from whom he took it.

**2. His rights are not affected in case of an inchoate instrument**

Assume that the drawer (A) delivers a blank instrument to the payee (B) for birr 10,000.00. However the payee writes Br 12, 000.00 on the instrument and negotiates to an endorsee (C), then C further negotiates the instrument to D. Finally, D claims the amount Br 12,000.00 not Br 10,000.00 and the drawer (A) has no right to decline/refuse to pay the claimed amount.

3**. All prior parties liable to a holder in due course.**

Every prior party to a negotiable instrument, that is the maker or drawer, acceptor or endorser is liable to a holder in due course until the instrument is duly satisfied.

**4. He can enforce payment of a fictitious bill.**

If the drawer issues a fictitious bill and negotiates the bill, the holder in due course will have the right to claim the amount stated in the instrument from the drawer himself or any other prior party, severally or jointly, wholly or partially.

**5. Transfer of better title.**

Once an instrument passes through the hands of a holder in due course, it is purged of all effects. A holder of a negotiable instrument who drives title from a holder in due course gets the right thereon of that holder in due course.

**6. Estoppels against denying original validity of instrument.**

The maker or drawer or acceptor of an instrument will not be allowed to deny the original validity of the instrument if it is in the hands of the holder in due course.

**7. Estoppels against denying capacity of payee to endorse.**

No maker of a promissory note and no acceptor of a bill of exchange payable to order shall, in a suit thereon by a holder in due course, be permitted to deny to payee’s capacity, at the date of the note or bill, to endorse the same.

**8. Estoppels against denying signature or capacity of prior parties**.

No endorser of a negotiable instrument shall, in a suit thereon by a subsequent holder, be permitted to deny the signature of capacity to contract of any prior party to the instrument.

**9. No effect of conditional delivery.** If the drawer issues an instrument on condition that the payee satisfies certain obligations and the payee further negotiates the instrument, even without satisfying the obligation, the last holder can claim the balance in the instrument from all prior parties including the drawer.

**10. No effect of absence of consideration or presence of an unlawful consideration or purging of prior defects.** A person liable on a negotiable instrument cannot defend himself against a holder in due course on the ground that the instrument was lost or obtained from him by means of an offence or fraud or for an unlawful consideration.

**D. Differences between Holder and Holder in due course**

Holder and holder in due course of a negotiable instrument differ in regard to the following.

**1. Consideration**: The existence of consideration is not essential in case of a holder, but a holder in due course must obtain the instrument after paying its full value. Consideration should be lawful and should not be forbidden by law, or fraudulent or immoral or opposed public policy and should not involve any injury to the person or property of another. But it need not be adequate when the transaction is a bona fide one.

**2. Possession**. The person entitled to be called holder in due course must become the possessor of the instrument before it become payable. In case of a holder, neither actual possession nor any time limit with in which it must be acquired is important. For example, a bill of exchange payable on 31st March 2004; the person must get it before this date for becoming the holder in due course. However, the person can get the bill even after 31st march 2004 to be a holder. If a person receives an instrument after its due date, the person receives it at his own risk because it may turn out to be a stolen one. Therefore, the holder in due course must prove that he became the holder of the instrument before it became payable.

**3. Transferor’s Title**: - A holder in due course must acquire an instrument with out suspicion in the title of the transferor. This condition is not essential in case of a holder. The holder in due course must obtain the instrument after taking all possible care about the transferor’s title. There should be no cause to believe that any defect exists in the title of the transferor. In other words there should be an absolute good faith in the part of the person receiving the instrument.

**Summary**

**Holder Vs Holder in Due Course**

|  |  |
| --- | --- |
| Holder | Holder in Due course |
| 1.Consideration is not essential | 1. The instrument must be obtained by paying its full value. |
| 2. The holder must be entitled to the possession of the instrument in his own name. Actual possession of the instrument is immaterial | 2. The holder in due course must become the possessor of the instrument before it becomes payable. |
| 3.The holder has the right to recover the amount in his own name | 3.The holder in due course must obtain the instrument with out any suspicion to the title of the transferor |
| 4. The holder does not enjoy the privileges available to a holder in due course. | 4.The holder in due course enjoys certain privileges such as better title, purging of prior defects in the instrument, right of estoppels, etc |

**E. Rights of a holder**

The rights of a Holder of a negotiable instrument are as follows;

1. He can claim payment of the instrument and can sue in his own name on the instrument
2. He can obtain a duplicate instrument; if he loses the original.
3. He can negotiate the instrument to a third person and can also convert the endorsement in blank in to endorsement in full.
4. He is entitled to cross the cheque either generally or specially and also with the word ‘Not Negotiable”

**4.5.2 Payment in Due Course**

According to a Negotiable Instruments Act, "Payment in due course means payment in accordance with the apparent tenor of the instrument in good faith and without negligence to any person in possession thereof under circumstances which do not afford a reasonable ground for believing that he is not entitled to receive payment of the amount mentioned in the instrument." Payment should be made to the right person, and according the tenor of the instrument by the paying banker, the acceptor of the bill. Otherwise the latter shall be responsible for the beneficiary. Payment is an effective discharge only if it is “payment in due course”.

**The essential features of a payment in due course are**:-

* + 1. **The payment should be made in accordance with the apparent tenor of the instrument**, that is, according to the true intention of the parties as apparent from the document itself.

For example;

* If the cheque is postdated - It means pay only after the future stated date
* If the cheque is crossed - It is ordering the paying banker not to pay cash at the counter but to credit an account.

The payment should be made at or after maturity. A payment before maturity is not a payment according to the apparent tenor of the instrument and so, not a payment in due course. If an instrument is paid before maturity and is subsequently endorsed to a bone fide endorsee, it remains valid. When the instrument is payable on demand, its payment will not be effective discharge unless it is cancelled. A payment by the drawee or acceptor before maturity operates as a purchase of the instrument, he may endorse the bill to any person and then all the parties to the instrument will remain liable.

**2. The payment should be made in good faith and with out negligence.** In good faith, means honestly and not fraudulently. The paying bank should effect payments to suspicious or doubtful payees or presenters after making proper inquires from the drawer, otherwise, the paying bank will be liable. The banker should not make payment negligently. He should take all the necessary precaution and act as a reasonable person will act in a particular circumstance of a case. Therefore, he should ascertain that the cheque is complete, all alterations are duly confirmed and the endorsements are regular.

3. **Payment must be made to the person in possession of the instrument in circumstances**, which do not arouse suspension about his title to possess the instrument and to receive payment. In other words, payment should be made to the rightful holder who can give a valid discharge. If the instrument is made payable to bearer, the rightful holder is the person who has received it by delivery. The maker or drawee while making the payment to the possessor of the instrument must see that there is nothing to show that he is not entitled to recover it. However, when the instrument is payable to a particular person or order and is not endorsed by him, payment to the possessor of such an instrument will not amount to payment in due course. Further, the payment must be made by the maker or drawee of the instrument or on his behalf.

Examples of payments, which are not, deemed payment in due course can be shown as follows;

1. A cheque bearing a special crossing in the name of Abyssinia Bank is paid when presented through Dashen Bank

2. The banker pays a cheque containing forged signature of the drawer.

3. A cheque dated 30th October 2002 is presented for payment on 20th of October 2002 and is paid on the same date.

4. A cheque having alterations in the name of a payee or the amount of the cheque (material alteration), not confirmed by the full signature of the drawer, is paid by the banker.

5. The drawer of a cheque countermands its payments, but the banker pays the cheque.

6. An agent or a prone of a company presents a cheque for big amount on behalf of the company, which is contrary to the past practice and the banker pays the cheque without any enquiry.

**4.5.3. Endorsement**

According to The Negotiable Instruments Act, "When the maker or holder of a negotiable instrument signs the same, otherwise than as a maker, for the purpose of negotiation, on the back or face of the instrument, usually on the back, or on a slip of paper annexed there to, or signs for the same purpose a stamped paper intended to be completed as negotiable instrument, he is said to have endorsed the same and is called the endorser." Endorsement means signing a negotiable instrument for the purpose of negotiation.

Negotiable instruments can be negotiated in two different ways

a). By delivery only - if the instrument is payable to bearer. Here no need of endorsement

b). By endorsement and delivery - if the instrument is payable to order i.e. before delivery the drawer or any holder signs the instrument for the purpose of negotiation.

The person who signs the instrument for the purpose of negotiation is called the "endorser" and the person in whose favor the instrument is transferred is called the "endorsee". The endorser may sign either on the face or on the back of the negotiable instrument. But the common usage is on the back of the instrument. If the space on the back of the instrument is not sufficient for additional endorsement, a piece of paper known as "allonge” may be attached with the instrument.

**A. General Rules regarding the form of Endorsement**

The appropriateness or otherwise of a particular form of endorsement depends upon the practice amongst the banker. However, in general, endorsement must be regular and valid in order to be effective. The following rules are followed in this regard.

**1. Signature of the endorser: -**The signature on the instrument for the purpose of endorsement must be that of the endorser or any other person who is duly authorized to endorse on his behalf. If a cheque is payable to two or more persons, both or all of them should sign in small letters, in their own handwriting. If endorser signs with block letters, it will not be considered as a regular endorsement.

**2. Spelling: -** The endorser should spell his name in the way his name appears on the instrument as its payee or endorsee. If his name is misspelt or his designation has been given incorrectly, he should sign the instrument in the same manner as given in the instrument. However, if he likes to do, he may put his proper signature thereafter; but in the same hand writing. For example, if Ato Asamere’s name is mis spelt as a payee as “Asemare “, he should write his name in the endorsement as “Asemare / Asamere/”.

**3. No addition or Omission of initial of the name: -** An initial of the name should neither be added nor omitted from the name of the payee or endorsee as given in the cheque. For example, a cheque payable to Habte Georgics should not be endorsed as H/Giorgis because it will be doubtful for the paying banker to ascertain who the true owner is i.e. whether H/Giorgis is Habte Giorgis or Haile Giorgis.

**4. Prefixes and Suffixes to be excluded.** The prefixes and suffixes to the name of the payee or endorsee need not be included in the endorsement. For example, the words "Ato" W/ro, W/t, Major, Dejazamach, Captain, M.D, etc” need not be included in the endorsement given by the endorser; otherwise, the endorsement will not be regular. However, an endorser may indicate his title or rank, etc after his signature. For example, Meles Zenawi (Prime Minister), Fanta Belay (Major General) etc.

**5. Maker or Holder**:-The endorsement must be made by the Maker or holder of the instrument. A stranger cannot endorse it.

**6. Delivery**:-Endorsement is completed only by delivery-actual or constructive. The endorser himself must make the delivery. If the delivery is conditional, the endorsement is not complete until the condition is fulfilled.

**7. Special cases**

**Illiterate person**: - If the payee of a negotiable instrument is an illiterate person; he/she may endorse the instrument by fixing his/her thumb impression on the instrument. However, it should be duly witnessed or attested by some body that would give his fall address as follows.

Thumb impression of A

Attested or witnessed by ABC, Lawyer

P.O. Box ---- Tel. Res. ---- office ---

City ---------- Country --------

**2. Partnership firm**

In case of a partnership firm, the name of the firm must be signed by a person (partner, manager etc) who is duly authorized to sign on behalf of the partnership firm. But if the two partners sign without showing that they are the partners in the firm, the endorsement will not be a regular one.

**3. Agent: -**

A person may duly authorize his/her agent to endorse the cheque on his/her behalf. The agent should, therefore, use the words 'for", for and on behalf of ', 'on behalf of ', 'pre-pro' etc in the endorsement. This indicates that he signs the instrument only on his agency authority.

**B. Kinds of Endorsement**

According to the Negotiable Instrument Act, the following forms of endorsement are presented. They are discussed as follows: -

**1. Blank endorsement or General endorsement:** An endorsement that bears only the name of the endorser is deemed as a blank endorsement. The name of the endorsee is not included in the endorsement and hence the instrument becomes payable to bearer even if it is originated as order instrument. Then it can be negotiated by simple delivery and the holder is entitled to this payment.

**i. Blank Endorsement**.

|  |  |
| --- | --- |
| Name of bank Account Number Date -------  Name of branch Name of Account Holder  Pay Ato Zemedhun  To Ten Thousand only (Br 10,000.00)  \_\_\_\_\_\_\_\_\_\_  Serial number \_\_\_\_\_\_\_\_\_\_\_\_ Signature------ | Front page of a cheque |

|  |  |
| --- | --- |
| 1. Zemedhun 2. pay to Tarik  Signature Zemedhun  Signature  3. Pay to Abera  Tarik. | Reverse page |

Any subsequent holder can convert an endorsement in blank into an endorsement in fall. For example, in the first endorsement above, which is a blank endorsement, Ato Gemechu becomes the holder of the instrument (cheque), which is the bearer. Then Ato Gemechu can further endorse it by simply writing the name to whom the instrument is endorsed (an endorsee), as can be shown under the second endorsement Ato Gemechu, then, endorse the instrument to Tarik without making himself party in the instrument i.e. he avoids the liability that may arise in the instrument. The second endorsement is a full endorsement made by Zemedhun to Tarik? The Third endorsement is a full endorsement made by Tarik to Abera.

**2. Full Endorsement/ Special Endorsement**

If the endorser, in addition to his name, writes the name of the endorsee or adds a direction to pay the amount mentioned in the instrument to or to the order of a specified person, the endorsement is full endorsement. A Blank endorsement can be converted in to full endorsement by writing the name of the endorsee on top of the name of the previous endorser. Then, the last endorser will be free from any liability that may arise. In such an endorsement, it is only the endorsee that can negotiate the instrument by endorsement. Thus, the instrument retains its order character.

**3. Partial Endorsement**

It is one, which purports to transfer to the endorsee a part only of the amount payable under the instrument. A partial endorsement does not operate as a negotiation of the bill. The law lays down that an endorsement must relate to the whole instrument. Thus, a partial endorsement is invalid.

For instance, if A, the payee of bill for Birr 10,000.00 endorses it in favor of B for Birr

5, 000.00 and C, for the remaining Br 5,000.00. Since the endorsement is partial, it is invalid and no right of action will arise. But when amount of the instrument has been partly paid, a note to that effect may be endorsed on the instrument, which may then be negotiated for the balance.

**4. Restrictive Endorsement**

A restrictive endorsement gives the endorsee the right to receive payment of the cheque and to sue any party thereto that his endorser could have sued, but gives him no power to transfer his right to an endorsee unless it expressly authorizes him to do so. Hence the instrument will be transferable but not negotiable. The endorser restricts further negotiation of the instrument, in express words and excludes the right to negotiate. Here, the endorsee acquires all the rights of the endorser except the right of negotiation. The endorsement must in express words restrict or exclude the right of the endorsee.

E.g. pay the contents to C only

Pay C for the account of B

The within must be credited to C, etc

**5. Conditional Endorsement/ Qualified Endorsement**

The liability of the endorser dependent on the happening of a contingent event or may make the right of the endorsee to receive payment in respect of the instrument dependent on the happening of such an event. Such conditions may be either conditions precedent or conditions subsequent. However, it does not restrict or prohibit the negotiability of the instrument as in the case of restrictive endorsement. The endorser gets the following rights under such endorsements.

1. **In the case of a condition subsequent**, the right of the endorsee is defeated on the fulfillment of the condition.

E. g. “Pay A or order unless before payment, it is countermanded.”

The endorser may make his liability on the instrument conditional on the happening of a particular event. He will not be liable to the subsequent holder if the specified event does take place before payment. The endorsee in such a case can sue other parties to the instrument even after the particular event takes place.

b**) In case of a condition precedent**, the right to recover the amount does not pass on to the endorsee until the condition is fulfilled. The endorser may make the right of the endorsee of the instrument conditional on the happening of a particular event.

E.g. "Pay on his marrying X". The endorsee gets title only if he marries X. If the event does not take place or if he cannot marry x, the endorsee can not sue any of the parties.

c) However, such an endorsement is generally used, and it does not make the instrument non-transferable. A conditional endorsement may take place in any of the following ways.

**Endorsement "Suns Recourse"**

An endorser of a negotiable instrument may by express words in the endorsement, exclude his own liability in the instrument. For example, if ‘A’ endorses a cheque as follows.

i. Pay to ‘B’ or order at his own risk

ii. Pay to ‘B’ without recourse to me

‘A’ will not be liable to ‘B’ or any of the subsequent endorsees, if the bank dishonors the cheque subsequently. Subsequent endorsees will have the right to sue any prior party except such an endorser. But if an endorser who so excludes his liability after wards becomes the holder of the instrument (If there is negotiation back to ‘A’), all intermediate endorsers are liable to him. For example, ‘X’ issue the instrument in favor of ‘Y’, then ‘Y’ endorses it to ‘A’, ‘A’ transfer it to B’s favor with ‘suns recourse endorsement’. ‘B’ again endorses it to ‘C’, ‘C’ to ‘D’ and ‘D’ back to ‘A’. Here all parties i.e. X, Y, B, C and D will be liable to the last holder; A.

**Facultative Endorsement**

When the endorser waves some of his rights or increases his liabilities intentionally in the instrument, it is said to be facilitative endorsement. For example,” pay Alemu or order, notice of dishonor waived “, is a facilitative endorsement. In this case, the endorser has waived notice of dishonor, but will remain liable for non-payment.

**‘Sans Fraise' Endorsement**

The endorser does not want any expenses to be incurred on his account on the bill by the endorsee or subsequent holder of negotiable instrument.

**Liability dependent upon a contingency**

When an endorser makes his liability dependent up on the happening of a specified event, which may or may not happen, the liability of the endorser will take place only on the happening of that event. For instance, an endorser may write, “pay A or order on his marriage” or “pay A or order on the arrival of goods safely”. Here, the endorser will not be liable to make payment until the marriage takes place or the said goods arrived safely, as the case may be.

**C. Effect of Endorsement**

The endorsement of a negotiable instrument followed by delivery transfers to the endorsee the property therein with right to further negotiation; but the endorsement may, by express words, restrict or exclude such right, or may merely constitute the endorsee an agent to endorse the instrument or to receive its contents for the endorser, or for some other specified person.

Illustration

Ato Kemal signs the following endorsements on different negotiable instruments payable to bearer:-

1. “Pay the contents to Chaltu only.”
2. “Pay chaltu for my use”
3. “Pay chaltu or order for the account of Kemal.”
4. “The within must be credited to Kemal.”

These endorsements exclude the right of further negotiation by Chaltu

1. “Pay Chaltu.”
2. “Pay Chaltu value in account with CBE.”

These endorsements do not exclude the right of further negotiation by Chaltu.

**D. Endorsement of cheques payable to: fictitious, impersonal or imaginary persons**.

Cheques made out in the names of impersonal payees have been held not to be cheques, as they do not satisfy the essential requisites of a cheque. The bank in case makes the payment, should obtain a duty stamped receipt from the receiver of such payment. It is customary to treat such cheques as bearer cheques, and, therefore, no endorsement is required in such cases.

**E. Endorsement; by legal representative.**

The legal representative of a deceased person cannot negotiate by delivery only, a negotiable instrument payable to order and indorsed by the deceased but not delivered. He will have to re-indorse the instrument and deliver it there after.

**F. Effect of an intentional Cancellation of Endorsement**

When the holder of a negotiable instrument intentionally strikes off the endorsement with the object of discharging the person liable to make payment from liability, such a party will be discharged from liability to holder and to all parties claiming title under such holder.

E.g.’ A’ indorses to ‘B’.’B’ indorses to ‘C’ and ‘C’ indorses to ‘D’. ‘D’ by his own intention cancels the name of ‘B’ as an endorsee. The liability of ‘B’ as well as that of ‘C’ comes to an end.

**G. Negotiation Back**

It may sometimes happen during the course of negotiation that the instrument comes back to the same person who had, indorsed it previously. The process under which an endorser comes again to the endorser is known as “negotiation back”.

In such a case, none of the intermediate endorsers are liable to him. But when an endorser excludes his liability and afterwards becomes the holder of the instrument, all intermediate endorsers are liable to him.

E.g. A indorses the instrument to B. ‘B’🡪 C 🡪D 🡪E🡪’B’.

‘B’ can recover the amount of the instrument from C, D, or E or from all of them jointly and severally, but he himself being a prior party, is liable towards all of them. Thus, ‘B’ comes to his original position and he can only sue ‘A’ or any party prior to him. ‘B’ can cancel the endorsements of C, D and E and negotiate the instrument further-such a transaction is called “taking up of a bill”.

If B at the first endorsement expressly excludes his personal liability, by ‘suns recourse’ endorsement, he is not liable to C, D and E rather they will be liable to him. He can recover the amount from all or any of them.

**4.5.4 Payment of Cheques**

One of the stationary obligations of a banker towards his customer is to honor the cheques drawn by the latter on the former. The paying banker is responsible to his customer and is under a duty to make payments to the right person in accordance with the instructions of the drawer. If he honors the cheques carelessly and negligently in a manner inconsistent with the instructions of a drawer, he subjects himself to heavy liability. Not only shall he lose the money so paid, but he shall be liable to pay damages or compensation to his customer and also to the true owner of the cheque. The duty of a paying banker is of great responsibility and calls for great care, caution, prudence and presence of mind on his part.

***4.5.4.1 Precautions to be taken by the paying banker***

The paying banker should ensure that the cheque is regular in all respects and should take the following precautions while making payment of his customer's. However, if the banker pays cheques with out proper identification, it will take all the liabilities associated with the payment.

**A. Precaution regarding the form of the cheque**

No law prescribes the form of a cheque. The banker should, therefore, not dishonor a cheque drawn on a piece of paper provided that it carries an unconditional order to the banker and fulfils other requisite of a cheque. However, the banking practice requires that a cheque drawn on a baker to be on a printed format supplied by the concerned bank. The printed forms used by a banker are desirable because of the following advantages.

* It is convenient for the drawer to draw a cheque. He\She need not take necessary precautions while drafting a cheque as per the requirements of the act. The chances of dishonor of the cheques, due to this case, are thus minimized.
* The counterfoils of the cheques (check stabs) serve the purpose of record for future reference.
* Countermanding will be convenient. He can use the date, amount, name of payee, and serial number from the check stub.
* Chances of forgery can be minimized, if the customer keeps the cheque book safely and carefully. The serial numbers of cheque forms issued to a customer are recorded by the banker, who verifies at the time of presentation, that the cheque is drawn by a person to whom the relevant cheque book is issued.

**B. Precaution Regarding Date;**

The banker must refuse payment of undated cheque. Because the mandate of the customer to the banker given in the cheque becomes legally effective on the date mentioned on the cheque and expires as six months pass from same date.

The drawer of a cheque fills in the date before the cheque is issued, but if he has not done so, the instrument does not become invalid. The payee of the cheque or any subsequent holder thereto may fill in the date. But if an undated cheque is presented for payment, the baker must refuse its payment. The date should not be incomplete, that is, it must include besides the year, the name of the month and the number of the day. For example, a cheque bearing “January 2004” or “December 31, 200-.” is not a complete dated cheque; as such the banker must refuse its payment. If a cheque dated March 15, 2004 is presented on March 15 and after, must be paid.

**i) Stale cheques (Cheques presented after the expiry date).**

If the drawer mentions a date earlier to the date of writing the cheque, it is called antedated cheque. For example, a cheque issued on 15th November 2003 may bear the date of 10th November 2003. The banker shall have no objection in making payment of such cheques. But if a cheque is not presented for payment within a reasonable period after the date it bears, it is called a stale cheque. The expiry date is usually after six months from the date of the cheque

**ii) Post-dated cheques**.

If the drawer (or any holder) mentions a date on the cheque, which is subsequent to the date on which it is drawn, it is called a post-dated cheque. For example, if a cheque drawn on 30th November 2003 bears the date of 20th December 2003, it is a post-dated cheque. Such a cheque though not invalid, becomes effective only on the date mentioned there in (20th December 2003).

The banker should, therefore, not make payment of the post-dated cheque before the date mentioned therein, otherwise he will be liable as follows:-

1. If the drawer instructs the banker, before the date mentioned in the cheque, not to make payment of the post-dated cheque, the banker can not debit his account with the amount of the cheque. In case the banker had honored the cheque before the receipt of the countermand order. Such payment is deemed as payment made without the authority of the drawer.
2. If, as a consequence of payment of a post-dated cheque by the banker, any other cheque issued by the drawer is dishonored on the ground of insufficiency of funds, the drawer will be entitled to clime damages for its dishonor.
3. If the customer dies, becomes insolvent, or insane after the banker has made the payment but before the date mentioned in the cheque, the amount can not be debited to the customer’s account because the latter’s mandate becomes ineffective on the occurrence of any of these events.
4. Payment of a post-dated cheque, before the date of the cheque, is not considered as payment in due course. The banker, therefore, can not avail of the statutory protection. But its payment on or after the date of the cheque shall be valid and the banker will bear no liability in this regard.

**iii) Precaution Regarding Amount of the Cheque;**

The amount of the cheque must be certain and expressed both in words and figures. In case of discrepancy between the amount expressed in words and figures, the amount in words shall be the amount undertaken or order to be paid. The banker may, therefore, pay the amount written in words without incurring any liability for the same. However, in practice the banker send back the cheque to the drawer with the remark “amount in words and figures differ.” And ask for necessary rectification by the drawer.

If the amount is written in words only, the banker may pay the cheque. But if the amount is written in figures only, it should send back to the drawer for necessary correction because there is every possibility of manipulation of the amount stated in figures.

**D. Precaution regarding “Funds” of the customer;**

The banker is under an obligation to pay his customer’s cheques, if the customer’s account shows sufficient credit balance. But if the fund in the customer’s account is insufficient to pay the cheque, the banker is not bound to honor the cheque or even to pay the balance in the amount to the presenter of the cheque. Cheques are to be paid in full and not in part. For example, if a cheque for Birr 10,000.00 is presented for payment to a banker while the drawers account has the credit balance of Birr 9,999.00 only, the banker is not bound to honor the cheque or to make part payment to the extent of Birr 9,999.00 because the cheque contains the order of the drawer to pay a specified sum of money.

While considering sufficient funds in the drawer’s account, the following points should be borne in mind by the banker.

If the banker has already agreed to grant a loan or overdraft to the customer up to a certain account, cheques in excess of the credit balance in the account but within the limit of the loan of the overdraft must be honored by the banker in the usual course. For example, if the banker agrees to grant Mr. X an overdraft facility up to Birr 50,000.00 he should honor cheques issued by Mr. X till the debit balance reaches the limit of 50,000.00. If, subsequently, the banker decides to reduce the overdraft limit, say only Birr 20,000.00, he should not stop honoring the customer’s cheques immediately. For this purpose he should give due notice to the customer and cheques drawn thereafter in excess of debit balance of Birr 20,000.00 be dishonored after the service.

If a number of cheques are received by a banker in a day, the banker generally must pay in the chronological order of their receipt. It means that the cheque first received by the banker on an account will be paid first, and so on. Serial number and date of issue are not significant for this purpose. When a number of cheques are received by the banker simultaneously for payment through mail or clearing house, but there is no sufficient fund in his account, the banker has the following options. For example, three cheques of Birr 1,000.00, Birr 4,000.00 and Birr 500.00 are received by a banker for payment while the drawer’s account shows a credit balance of Birr 5,000.00 only. There may be the following options in such a situation:

* The banker may treat all the cheques as constituting one demand and hence dishonor all for short of fund. But this is not fair to the drawer because it affects his reputation greatly while funds are sufficient to honor at least two of them.
* A cheque for a bigger amount is paid first, in practice. ‘The highest first and the lowest last’ principle works.
* If the cheque with smaller amount is paid to the tax authorities etc. it may be honored first.
* If all cheques are of equal amounts, the banker is free to honor any of them.

**E. Precaution Regarding Material Alterations.**

Any alteration or correction on a cheque, to be valid, must be made by, or with the consent of the drawer and confirmed by his full signature. The banker should be very careful in this regard and should not pay for cheques that bear an alteration especially, material alterations, without confirmation by the drawer. An alteration is considered as material alteration if; a) it affects the operation of the instrument substantially; and b) the liability of the parties concerned is changed significantly.

**Examples of material alterations**

* + - 1. Alteration of the date of cheque. A fraudulent holder can secure payment of a post-dated cheque or a stale cheque, which a banker is not authorized to make. Alteration of amount of cheque.
      2. Alteration in the names of the parties.
      3. Substituting the word “bearer” in place of ‘order’ in the cheque.
      4. Alteration of the crossing on a cheque.

A material alteration makes a material or significant change in the mandate given in the cheque. If an addition or alteration does not affect the mandate of the drawer or the position of the parties materially or significantly, it will not be called a material alteration. Examples of immaterial alterations or alterations that do not significantly change the position of the parties in the instrument.

* 1. Conversion of an endorsement in lank into an endorsement in full.
  2. Grossing of an open cheque by the holder.
  3. Conversion of general into special crossing
  4. Conversion of bearer in to order.

F. Precaution regarding drawer’s signature

The paying banker is not given any protection under law if he pays cheques with a forged signature of the drawer, however, cleverly the forgery is made and it was difficult to detect it with reasonable degree of care and scrutiny. He cannot debit the balance of his customers account for such types of cheques and suffer all the loss himself. Therefore, he has to ascertain the genuinety of the signature on the cheque, by comparing the signature on the cheque against the signature on the specimen signature card, given by the customer while opening the account. The cheque must be signed by the drawer on its face and not on its back. The account holder may change his specimen signature any time and supply to the banker his fresh specimen signature. The banker is bound to accept the new specimen signature with effect from a specified date.

If the signature on the cheque differs from the specimen signature of the drawer or the former is a forged one, the banker must refuse payment of the cheque. Because a cheque with forged signature of the drawer is a nullity and it gives no mandate to the banker to make any payment. Payment of a cheque with forged signature of the drawer is deemed as payment without the authority of the customer and hence a breach of the implied contract between a banker and his customer.

However, the customer is under an obligation to protect the banker in this regard. The customer should not be negligent in observing the necessary precautions to save the banker from the losses, which may arise because of his won acts. The customer may under certain cases personally a loser, if it fails to do its part correctly.

Example:

1. If a banker is in doubt about the signature of the drawer and seeks confirmation of the drawer and the customer expressly states that the signature is his own. Later on the customer has no right to deny the validity of his signature on the cheque.
2. If the signature on the cheque differs from his specimen signature, but he writes to the banker about his issuing a cheque bearing his different signature, the customer will have no right to deny the validity of the signature on the cheque, even if, the consecutive cheques bear a different signature. Because such information will amount to confirmation of his signature on the cheque.
3. If the customer fails to inform the banker that his signature, on a cheque has been forged, and the banker loses his right of action against the forger, the customer is stopped from denying the genuiness of his signature.

Example: If serial No 0101 cheque leaf is stolen and forged and serial No 0102 cheque leaf is written by the customer without notice of such lose of a cheque by the customer, will eliminate his right against the banker’s action.

1. In case of joint account, both or all the signatures on the cheque must be signed by every drawer and must be genuine. If one of the signatures is a forged one, the banker should not make payment. Otherwise he can not debit his customer’s account. If one of the joint account holder forces the signature of the other one and the banker makes payment of the cheque, he will be liable to the other one.
2. If the customer comes to know or has reasonable ground to believe that a cheque with his forged signature is going to be presented for payment, he is under duty to inform the banker immediately to avoid loss to the banker. In such a case he is stopped from denying the validity of the cheque.

**G. Precaution regarding mutilated cheques**

A mutilated cheque is one, which is torn into two or more pieces. The banker should examine it carefully to ascertain if the cheque was mutilated with the intention to cancel it, just before making payment for mutilated cheque. If such intention is evident or if the main contents of the cheque are illegible, the banker should not pay the cheque, without customer’s confirmation. He may pay a cheque, which is torn at the corner, and no material fact is erased or cancelled.

**H. Precaution regarding banking hours.**

A cheque must be presented to the paying banker for payment within the banking hours. Banking hours mean the period of time when a banker transacts banking business with the public. Such hours are fixed by the banker and notified to the customers by a general notice. Different banking hours may be fixed by different banks and by the same bank in different cities or localities to suit the conveniency of the local people. The banker should make payment of the cheques presented to him during the banking hours only. Actual payment might be made after the banking hours of the day, if it could not be finished within the banking hours. For example, cheque received at 3:55 P.M (that is five minutes before the close of banking hours at 4:00 P.M) might be made, say at 4:15 P.M. But a cheque presented after the banking hours are paid say, 4:20 PM, such payment will not be considered as payment in due course.

If the banker pays a cheque presented to him after the banking hours, he shall incur a great risk. In fact, the amount of such a cheque cannot be debited to the drawer’s account till the opening of the bank on the next day. In the meantime, if any of the following events happen payment will be invalid.

* 1. if the customer countermands payment of such a cheque
  2. If garnishee order is served on the banker restraining him from making payment out of the drawer’s account.
  3. if death of the drawer is reported
  4. If insolvency of the drawer is reported.

**I. Precaution Regarding Endorsement**

Regularity and validity of endorsement are important aspects from the view point of paying banker. The paying banker should see whether the cheque is a bearer cheque or an order one. He need not require the presenter’s endorsement on an open cheque payable to bearer and presented over the counter. However, in practice, banks ask the presenter to sign on the back of the cheque in order to be useful later in identifying the person to whom the payment was made. In case of order cheque, he should see whether the endorsements on the cheque are regular or not; but need not dilate with the verification of the genuineness or validity of the endorsement, as he does not have the specimen signature of endorsers. So he is granted statutory protection in case of forged endorsements.

**J. Precaution regarding crossing**

A paying banker should always observe not to pay cash for a generally crossed cheque, accept a specially crossed cheque to another bank or the restrictive endorsement made to payee. Therefore, the banker should confirm the nature of the crossing and effect according to its true intention. Other wise such payment is not a payment in due course.

**When the banker must refuse payment of cheques?**

The banker must refuse payment of cheques under any of the following conditions. If he pays violating these conditions, he will incur liability by himself.

**A. When the drawer countermands payment**

A cheque is an unconditional order of the drawer to the banker. The drawer is competent to cancel or withdraw his order of payment at any time before its payment is made. He need not explain the reason for stopping payment of a cheque. The banker has to comply with the countermand order issued by the drawer without inquiring the reason. The following points worth discussion in this connection:

**I) The right to countermand payment of a cheque is vested in its drawer only**, not to the payee or the endorsee, as there is no contractual obligation on the banker toward the payee or the holder. However, the payee or the endorsee may report to the banker that the cheque has been lost by him. Such notice is deemed sufficient to put the banker on enquiry about the validity of the title of the person presenting the cheque. This report made by the payee or endorsee should be supported by a stop payment order issued by the drawer. If in the mean while, the cheque is presented for payment, the banker must postpone its payment till the instruction of the drawer is received.

**II. The stop payment order may be given verbally, through telephone, or in writing**. If the drawer communicates such notice through telegram and verbal the banker should postpone payment till he gets its confirmation from the customer in writing. If the notice is given verbally to any officer of the bank outside the bank premises, the notice will be effective only if the said officer communicates it to the bank before the cheque is presented. In such circumstances the officer is deemed to be the agent of the drawer till the notice is communicated in a proper manner to the concerned official or clerk.

**III. The stop payment order must be signed by the drawer of the cheque**. In case of a firm, joint account or joint stock company, any of the persons authorized to sign on the cheque may stop payment. It is not necessary that the countermand order must be signed by all those persons who had signed the cheque concerned. But, if the countermand is to be cancelled, all the persons authorized to operate the account must sign such letter. For example, if any two directors of a company are authorized to sign cheques along with secretary of a company, the countermand order way be issued by any two of the directors, not necessarily the same two who had signed the cheque if question

**IV. The stop payment order must contain full and correct details of the cheque to be countermanded.** Full and correct means, the order should contain the number and date of the cheque, name of the payee and the amount. If the drawer informs the banker wrong number of the cheque even by mistake, and as a consequence the cheque intended to be stopped is paid by the banker, the banker cannot be held liable for the payment which was made because of the mistake on the part of the drawer.

**V. The stop payment order to be served before payment**. To bind the banker, the stop payment order must be duly served to the banker before the payment of the cheque is made. The time of receipt of such order is very important. It must be received by the banker before he actually makes payment of the cheque. Any such order given after payment will have no effect. If due to oversight the payment is made after the receipt of the countermand order, the banker shall be liable to the drawer. Even if such a cheque is dishonored after the receipt of the stop payment order for want of sufficient funds, the banker will be held liable.

Payment of a cheque is deemed as made when money is actually laid on the counter of the cashier and the person receiving it extends his hand over it. If a banker receives a stop payment order after the cheque is entered in the book and it is passed for payment but before money could actually be handed over, the order shall be binding on the banker. If the cheque is presented through clearing, the countermand order shall be binding if it is received by the banker within the time allowed or returning back the dishonored cheques; but not there after. But if a cheque is presented through the post and its payment has been sent by draft, the stop payment order shall not be binding on the banker if the remittance draft has actually been mailed.

**VI. The banker shall be liable to the drawer if he pays the cheque even by over sight after the receipt of countermand order**. If the banker has made the payment of the cheque after or before the banking hours of any working day and in the mean while the customer countermands such payment, the banker shall be liable for the same amount, as the amount of such cheque cannot be debited for the customer’s account.

Moreover, if another cheque of the customer is dishonored as a result of the payment of the countermand cheque, the banker shall, in addition, be liable to the drawer for the damages in respect of the wrongful dishonor of the normal cheque. The notice to stop payment may be served to the banker anytime and not necessarily within the banking hours only. It shall be binding if it is actually received by the banker.

**VII. The stop payment order remains effective until it is revoked by the drawer or there is an agreement limiting its period.** Generally banks take all the necessary precautions up to a period of six months from the date of the cheque. Thereafter, the cheque becomes stale (out of date) and its payment is refused on that base. If the cheque is an open cheque, all mechanisms should be employed to safe guard the interest of the customer.

Note that, the banker, as soon as receiving the countermanding, he should put a note on the ledger by writing all the details. This could help the banker to follow the countermanded cheque and as well it helps the employees of the banker to take necessary precautions.

**B. Death of the drawer**

On the receipt of reliable information or notice about the death of the customer, the banker must stop payment of the cheques singed by him because the order of the customer to the banker ceases to operate on the occurrence of his death. The notice of death of the customer should be served on the same branch where the customer has an account and not to any other branch. The bank should make sure that the news about customer’s death is reliable.

**C. Insolvency of the drawer**

If a debtor commits an act of insolvency as defined in the insolvency law; either he or any of his creditors may present a petition in the court of law, for an order of adjudication. When the court issues an order of adjudication, the whole property of the insolvent person vests in the court or an official receiver and becomes available for distribution among the creditors.

The banker must stop payment from customer’s account as soon as he receives the information that an insolvency petition has been filed by or against the customer. Payments made before such time are protected under the law but if the banker pays cheque, after being aware of the insolvency petition, such payment will be made at his own risk and shall have to make such amount available to the official receiver. After an order of adjudication has been passed by the court, the banker must close the account of the insolvent customer and communicate to his official receiver the balance to the credit of the customer.

**D. Insanity of the customer**

The banker is not bounded to honor his customer’s cheques on receipt of notice that the customer has become absolutely insane or of unsound mind. But as long as the customer acts rationally and understands properly, his cheques should not be refused. The banker must have confirmed information from reliable sources about the insanity of the customer before he refuses payment on this base. The banker can insist on formal information and certification to the effect that his customer has gone insane.

**E. Notice of assignment of credit balance**

The credit balance on the account of a customer may be assigned or transferred by him to another person or purpose. On receipt of a notice of such assignment, the banker must stop payment of the cheques drawn by an assignor, as the latter cases to be the owner of such funds. However, if the credit balance is greater than the amount assigned for another person or purpose, the banker can honor cheques up to that amount.

**F. Receipt of Garnishee Order**

A banker is bound to comply with the order issued by the court refraining him from paying the money from a customer’s account. He must refuse payment of the cheque presented after the receipt of a Garnishee order or any other order of the court attaching the customer’s money. If the court’s order attaches a part of the credit balance of the customer, the banker can utilize the remaining balance to honor the cheques issued by the customer.

**G. Breach of trust**

If the banker comes to know that the customer, who is operating a trust account, contemplates to use the funds of the trust account in breach of trust, the banker must stop payment of the cheques drawn on such account.

**H. Defective title of the party**

If any person presenting a cheque has defective title to the cheque and the banker is aware of this fact, he can refuse to honor such a cheque without any risk, because if he makes payment to such person, it will not be made in good faith and the payment will not be deemed as payment in due course.

**I. The bank will also be justified in refusing payment of the cheques for other valid reasons too, like**

* + - * When the credit balance of the customer’s account is insufficient to meet the cheque issued by the customer and he has no overdraft arrangement with the banker.
      * When the customer closes the account before the cheque is presented for encashment.
      * When the cheque bears forged signatures of the drawer.
      * When the banker has a claim of or the set off on the funds of the customer and the cheque is in excess of the balance above the claim.
      * When the cheques are issued against the cheques sent for clearance.
      * When some discrepancy appears on the face of the cheque which creates suspicion as to the its genuineness
      * When a cheque is not properly drawn i.e. it is irregular, ambiguous, drawn in a form of doubtful legality, signature on the cheque does not tally with the specimen signature given to the banker, or the account in words differs from the account in figures. In practice, the banker makes payment of the account in words when there is difference in the amount shown in words and figures.
      * When the funds are not properly applicable to the payment of a cheque. Example, personal cheques cannot be paid out of out of trust accounts.
      * When the customer informed the bank about the loss of the cheque.
      * When the cheque is post –dated and is presented for payment before its ostensible date

In general, to protect forgery and fraud, customer’s attention is necessary on the following points:

* 1. All blank cheques should be kept in a safe place under lock and key.
  2. All cheques should be written in ink
  3. The amounts in words and figures should begin closer to the printing
  4. Any alteration on the cheque should be confirmed by the full signature of the drawer.

***4.5.4.3. Answers given by the banker in case of dishonored cheques***

In case a cheque is dishonored, the bank should return it with a slip disclosing the reason for dishonor. Generally, banks keep a printed slip called “Return memo” which contains a list of reasons for dishonoring the cheque. The relevant reason is tick-marked on the slip and the slip is attached with the cheque returned.

Some of the reasons for dishonor and the abbreviations used by the bankers are:

**a. Refer to drawer (R.D)**

The banker puts such a note in those cases where; a) the drawer does not have sufficient funds with bank, or b) there is reasonable ground for suspecting that a cheque has been tempered with (it is more appropriate for the second reason). When a bank does not wish to reveal the current position as to why a cheque has been dishonored, it may tick this mark.

**b. ‘Not sufficient’, ‘No effects’ or ‘No funds’ (N.S., N.E., or N.F.)**

Used in those cases where the drawer does not have sufficient funds with the bank.

**c. Not arranged for (N.A.)**

This phrase is used in a case where payment of cheque will result in an overdraft which has not been approved by the bank. The customer may apply for an overdraft facility and assuming that it is approved writes a cheque. In such cases, the banker uses this response.

**d. Endorsement Irregular (E.I.)**

This phrase is used in those cases where endorsement is not in order. E.g. the spelling of the payee’s name as given on the face of the cheque differs from that in the endorsement.

**e. Effects not cleared (E.N.C.) Please present again**

This phrase is used in those cases where the drawer has given certain cheques, drafts, etc., for collection and the same have not been collected yet and, therefore the banker is not in a position to meet the cheque drawn on account of insufficiency of funds in the drawers’ account at the moment.

**f. Drawer Deceased (D.D)**

Where the banker receives information that the drawer has expired and, therefore, it has stopped payment of cheques. His account will be stopped until legal representatives or hairs apply to the bank with the necessary evidence that may be given by the court.

**g. Words and figures differ (W. & F.D.)**

This is used on cases where the reason for dishonor is differing of amount of cheque in words and figures. If the banker wants to pay such cheques, he can pay only the amount written in words. He will not be liable thereafter. However, banks usually return such cheques unpaid.

**4.5.5. Collection of Cheques**

A banker is under no legal obligation to collect his customer’s cheques but collection of cheques has now-a-days become an important function of a banker with the growth of banking habit and with a wider use of crossed cheques, which are invariably to be collected through a banker only. One of the most important services provided by the commercial banks to their customers is the collection of cheques, bills of exchange, and other instruments on behalf of their customers. When a customer or a banker receives a cheque drawn on any other banker he has two options of collection.

1. To receive its payment personally or through his agent at the counter of the drawee bank, drawers bank or paying bank.
2. To send to his banker for the purpose of collecting from the drawee bank.

Here the banker which receives cheques for collection will be referred as a collecting bank and the banker that pays the value of the cheque is known as the paying bank or drawee bank or drawer’s banker. In other ways this bank is the bank where the drawer’s account is maintained.

While collecting his customer’s cheques, the collecting banker acts either, (1)As a holder for value or (2) As an agent of a customer

**i. A collecting banker as a holder for value**

If the collecting banker pays to the customer the amount of the cheque or credits such amount to his account and allows him to draw it, before the amount of the cheque is actually realized from the drawee banker, the collecting banker is deemed to be its ‘holder for value’. The banker receives an undertaking from the customer in return’. A banker becomes its holder for value by giving its value to the customer in any of the following ways:

* 1. By lending further on the strength of the cheque.
  2. By paying over the amount of the cheque or part of it in cash or in account before it is cleared.
  3. By agreeing either then or earlier, or as a course of business, that customer may draw before the cheque is cleared.
  4. By accepting the cheque for reduction of an existing overdraft.
  5. By giving cash over the counter for the cheque at the time it is paid in for collection.

**ii. Collecting banker as an agent of a customer**

If the banker credits the customer's account with the amount of the cheque after the amount is realized from the drawee banker and allow the customer to draw the amount only thereafter. The banker thus acts as an agent of the customer and charges from him a commission for collecting the amount from outstation banks.

As an agent of his customer, the collecting banker does not possess title to the cheque better than that of the customer. If the customer has no title, or his title is defective, the collecting banker can not have good title to the cheque. In case the cheque collected by him did not belong to his customer, he will be held liable for 'conversion of money', that is, illegally interfering with the rights of the true owner of the cheque. The bank incurs a fiduciary responsibility to account for and pay the amount to his principal or to any one else according to his direction.

***4.5.5.1. Statutory Protection to the Collecting Banker***

The Negotiable Instruments Act provides statutory protection to the collecting banker against the risk of conversion involved in the collection of cheques because otherwise no banker will be prepared to provide the service of collecting cheques on behalf of his customer unless he is very sure that the customer is the true owner of the cheques. Conversion is a legal term signifying wrongful interference with another person’s right of property, which is inconsistent with the right of possession. Conversion applies only to tangible property and not to debts.

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, incase the little to the cheque proves defective, incur any liability to the true owner of the cheque by reason only of having received such payment. The statutory protection provided to the collecting banker is very valuable, but is available only when the following conditions are fulfilled:-

**1. Payment must be received in good faith and without negligence.**

The collecting banker must act in good faith and without negligence. By good faith we mean that the bank should act honestly and by negligence, we mean that the bank has failed in its duty to take care. The bank should act honestly and must take reasonable degree of care to protect the interest of the true owner. The degree of care that a banker should take will depend up on the circumstances of each case. If the bank does not take the required degree of care, it will be held negligent and will lose the statutory protection. A thing is deemed to be done in good faith when it is in fact done honestly whether negligently or not. An important test of negligence is whether the payment considered in the light of the circumstances antecedent and present, so much out of ordinary course that ought to have arrived doubt in banker’s mind and caused him to make enquiries.

For instance, the banking history of a customer creates suspicion. In such a case, a cheque collected on behalf of a customer who had forged the endorsement of the real owner**;** the banker made some enquiries. But, not as much as the past history of the customer, whose cheques had been frequently dishonored, required. Hence, the bank was guilty of negligence.

Other examples of the banker’s negligence could be determined and depend on the banking practices of other banks and circumstances. Some of them can be discussed as follows:

* + - * Opening of an account without proper introduction: If the person opens an account without proper introduction; only for the purpose of cheque collection and if his title on the cheque is found absent or defective the banker will not get the legal protection.
      * Not verifying the correctness of endorsements.
      * No proper inquiry being made in doubtful case.
      * Failure to take note of not negotiable crossing”
      * Collection of “account payee” cheque for person other than payee mentioned there in, etc.

**2. The payment must be received for a customer**:-

The Negotiable Instrument Act requires that the banker should collect the cheque on behalf of a customer. If a bank allows the facility of collection to a person who is not its customer, it will do so at his own risk, A customer means a person who has an account with the bank and his dealings with the bank are in the nature of banking business.

It is equally significant that the bank should receive payment as the agent of the customer and not in any other capacity. The protection is restricted to the case where the collecting banker acts only as an agent for collection of the customer and will not extend to the case where the bank is a holder for value. If a banker becomes the holder of the cheque and receives payment in its capacity as the holder, it will lose the protection granted for a collecting banker as an agent. A bank will not become the holder of a cheque if it credits the customer account after receiving the crossed cheque but does not allow him to withdraw the amount till the proceeds are collected.

**3. The cheque must be a Crossed one.**

The statutory protection is available to the banker only in case of crossed cheques only and the crossing must have been done before the cheque come into the hands of the collecting banker. He cannot avail himself of this protection in case of an uncrossed cheque or an uncrossed cheque which is crossed by the collecting banker himself after receiving it. Therefore, it is essential that the cheque is crossed one before it is deposited with the bank for collection, otherwise the banker will be liable for collection, if the title of the customer proves to be defective or the endorsement thereon is forged.

**4. Receipt of Payment.**

The statutory protection granted is limited to the receipt of payment which takes place at the time of clearing when the amount is credited in the books of the clearing house. The collecting banker does not lose the statutory protection, if he credits his customer’s account with the amount of the cheque its actual realization and the customer is allowed to draw the amount only after its realization.

***4.5.5.2. Duties of a Collecting Banker***

A collecting banker has certain responsibilities in the collection of cheques for his customers. As his customer’s agent, the collecting banker is expected to act with due care and diligence in the collection of cheques given to him. If he fails in his duty, he will be liable to the customer for any loss that may arise as a direct consequence of his negligence. The duties of a collecting banker may be disused as below**:-**

**1. Presentment of cheques for payment within a reasonable time**

The collecting banker should prove due-care and diligence in the collection of cheques within a reasonable time. The collecting banker should present the cheques received for collection to the drawee banks within a reasonable time. He must use only the recognized channels for collection; presentment need not be made at the premises of the drawer bank but may be made through the clearing house. Payment through post is also recognized.

If the collecting banker does not present the cheque for collection through proper channel within a reasonable time, customer, may suffer losses. The customer may also suffer damages owning to dishonor of certain cheques issued by him in anticipation of the realization of the cheques paid in. Reasonable time for presentment depends upon the facts and circumstances of each case.

1. When the cheque is drawn on a bank in the same place, the banker should present it the day after he receives it.

2. When the cheque is drawn on a bank in another place, it should be presented or forwarded in the day after receipt.

3. When the collecting branch is also the drawer branch, then it is a mere question of fact whether the cheque is presented for payment or deposited for collection. However, the banker may not credit the customer’s account on the very same day he receives it for collection.

After the expiry of a reasonable time the customer paying in the cheque for collection is entitled to presume that the cheque has been collected and the proceeds thereof have been credited to his account.

The customer can, therefore, draw a cheque for an amount not exceeding the amount to be collected. If the bank has failed to collect the cheque in the meantime, it cannot dishonor the cheque on the ground of shortage of funds, if he dishonors the cheque on this ground, the customer can recover damages for wrongful dishonor.

**2. Serving Notice of Dishonor**

In case a cheque is dishonored and returned back by the paying banker without payment for one reason or the other, the banker must serve a notice of dishonor on his customer to enable the latter to claim the amount from previous parties including the drawee. If the banker fails to serve notice of dishonor to the customer it will be liable to the customer for any loss that the customer might have suffered on account of such failure. It is to be noted that a cheque is deemed to be dishonored, when the paying banker refuses its payment. In case a cheque is returned by the drawer bank for confirmation of endorsement, it is not dishonored. In such a case also the notice should be given to the customer. If such notice is not given and the cheque is returned for the second time and the customer suffers a loss, the collecting banker may be held liable for the loss.

The bank generally conveys the notice of dishonor by returning the cheque to the customer along with the reason of dishonor. The bank can also debit the account of the customer with the amount of the cheque if it had already given credit prior to collection.

**3. Agent for Collocation**

If the cheque is drawn on a place where the banker is not a member of the clearing house, he may employ another banker who is a member in it for the purpose of collecting the cheque. In such a case, the latter banker becomes a substituted agent.

**4. Remittance of Proceeds to the Customer**

When a cheque is realized by a collecting banker, he should pay the proceed to the customer as soon as practicable in accordance with the customers directions. Usually, the amount is credited to the customer’s account. At the request of the customer, the proceeds of the cheque collected may be remitted to him by a demand draft. As soon as the draft for the proceeds of the cheque collected is forwarded in accordance with the customer’s instructions, the relationship of principal and agent comes to an end and that of debtor and creditor commences.

**Check Your Progress Questions**

1. What is meant by negotiable instrument? Explain its characteristics.

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1. Discuss about the presumptions as to negotiable instruments.

**………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………..**

1. Identify and define negotiable instruments.

**………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………..**

1. Discuss the similarities and difference between and among promissory notes, bills of exchange and cheque

**………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………..**

1. What is negotiation? How is it effected and how does it differentiate from assignment and discounting.

**………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………..**

1. What is an endorsement? Explain and illustrate the different kinds of endorsements.

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1. Explain the precautions, which the paying banker should take before making payment of a cheque.

**………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………..**

1. State and explain the statutory protections available under the negotiable instruments act to the paying banker.

**………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………..**

1. When must a bank reject the payment of a cheque? Discuss.

**………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………..**

1. What are the duties and responsibilities of a banker in the collection of a cheque? Explain.

**………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………………..**

**4.6. SUMMARY**

Every document which entitles a person to a sum of money and which is transferable by delivery is a negotiable instrument. It is one the property in which is acquired by any one who takes it bona fide and for value, notwithstanding any defect of title in the person from whom he took. It includes promissory notes, bills of exchange and cheques.

Easy transferability is one of the important characteristics of a negotiable instrument. An instrument may be transferred through; a) Assignment, and b) Negotiation.

Banks take different precautions in accepting negotiable instruments. They have to treat them in a right manner so as not to affect the benefits of parties in the instrument. One of he important modern services of banks to their customers is collection of cheques and as the collector of customer’s cheques; they take either a holder in due course or an agent for collection position. The collecting banker should take the necessary precautions so as to get legal protection.

**5.8 Answers to Check Your Progress Questions**

1. Refer section 4.2 5. Refer section 4.3(b)

2. Refer section 4.3.1 6. Refer section 4.5.3

3. Refer section 4.4 7. Refer section 4.5.4.1

4. Refer section 4.4 8. Refer section 4.5.5.1

9. Refer section 4.5.4.2

10.Refer section 4.5.5.2.