8

KENYA SCHOOL OF LAW

COUNCIL OF LEGAL EDUCATION
THE ADVOCATES TRAINING PROGRAMME

COMMERCIAL TRANSACTIONS

NEGOTIABLE INSTRUMENTS

by

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INTRODUCTION

The history of negotiable instruments in Kenya is closely tied to that of Europe and Great Britain.

Among the early merchants, the most acceptable and more universal mode of payment for merchandise was precious metals, e.g. gold, silver, copper, bronze etc.

For large transactions this meant that traders were compelled to transport vast quantities of these precious metals or currencies across borders often through robber-infested territories.

Introduction... *contd.*

Merchants in Europe required a payment system that avoided the dangerous and difficult transportation , over long distances, of large sums of cash needed to pay off debts owed to foreign creditors.

Yet creditors insisted on cash.

Introduction... *contd.*

This led merchant-debtors to create written *orders to pay* or authorities that were much safer to convey and less attractive to highway robbers.

In time, the orders became known as bills of exchange.

The passing of the bill among traders came to be known as "negotiation", hence the term negotiable instrument.

Introduction... *contd.*

A negotiable instrument is a form of commercial paper used for purposes of payment or credit or as security.

It is essentially a document embodying a right to the payment of money that may be transferred from one person to another.

Such documents developed out of the need by traders to make credit instruments transferable among them to facilitate commerce.

Thus documents held by one person showing or proving that somebody was in his debt could be used to meet his own liabilities: see *Encyclopaedia Britannica.*

SOURCES OF LAW

The principal sources of the law relating to negotiable instruments in Kenya are: -

- the Bills of Exchange Act (chapter 27) (also referred to as 'BEA');
- the Cheques Act, (chapter 35);
- English common law; and
- English rules of equity.

The genesis of the last two is well known.

The Bills of Exchange Act

The BEA largely is a copy work of the English statute of 1882, which largely codified the then existing case-law, which in turn had developed from comprehensive rules created by merchants earlier.

It provided, and continues to provide, a code for the creation of bills and cheques.

It came into effect here on 14.05.1927.

BEA applies to bills, cheques and promissory notes.

BEA... *contd.*

By s.2, "bill" means bill of exchange and "note" means a promissory note (see definition at s.84); and, by s.73, a cheque is a bill of exchange drawn on a banker payable on demand.

NB: (1).BEA does not apply to other negotiable instruments; but its principles are often used by courts in cases involving other types of instrument.

BEA... *contd.*

(2). All cheques are by law bills but not all bills of exchange are cheques.

(3). Bills are relatively quite uncommon.

(4). The most common commercial document known today is the cheque.

(5). Promissory notes, other than bank notes, are mainly used in medium-term export credits today.

Cheques Act

The Cheques Act came into effect on 28.07.1968.

It is borrowed also, from English Act 1957 of the same name, and is mainly a procedural statute.

It was enacted to reduce the endorsement on cheques.

In practice cheques were almost wholly issued to payee who presented the same to bank for encashment or collection.

They had long ceased to be instruments of transfer.

Under this Act banks are not required to examine endorsements and need not dishonour cheques for irregularities in endorsements.

Personal Property

The law recognizes people's rights in respect of real or personal property.

Out of the latter, there are two (2) kinds of property:

(a) **Choses in Possession**

-i.e. corporeal property (tangible, exist in material form - cash, jewellery, goods) which may be physically possessed or transferred.

-Can be protected physically.

Personal property... *contd.*

(b) Choses in Action

-i.e. incorporeal property comprising rights like copyrights, shareholders' rights and contractual rights.

These may be transferred by assignment.

Negotiable instruments are specialized types of chose in action.

They are transferred by negotiation.

They may be protected by means of legal action.

DEFINITIONS

No legislation in Kenya defines the term "negotiable instrument".

The word "negotiable" is a derivative of the word "negotiate".

To 'negotiate' here means to transfer (a commer-cial paper) in return for value received: p.762 *Collins English Dictionary and Thesaurus.*

"Negotiable" thus means-

- able to be negotiated; or
- (in relation to bill of exchange, cheque, promissory note etc.) legally transferable from one party to another.

Definitions... *contd.*

Taken together the two words denote a **writing or record that can be exchanged or transferred as or for money.**

One definition:

"Negotiable instrument" is a chose in action, the full and legal title to which is transferable by mere delivery of the instrument (possibly with the transferor's endorsement) and on such transfer the complete ownership of the instrument and **all the money that it represents** is capable of passing, free from equities, to the transferee.

Definitions... *contd.*

Second definition:

Another is that it is "one the property in which is acquired by anyone who takes it *bona fide* or in good faith and for value notwithstanding any defect of title in the person from whom he took it".

Definitions... *contd.*

From definitions of negotiable instruments above, they operate as proxies for money.

They become, like money, the media of exchange.

Definitions... *contd.*

Generally, a negotiable instrument is one which is, by a legally recognized custom of trade or by law,

(a) transferable by delivery or by endorsement and delivery;

(b) without notice to the party liable, in such a way that the holder of it for time being may sue upon it in his own name; and

(c) the property in it passes to a bona fide transferee for value free from equities and free from any defect in the title of the person from whom he obtained it.

Definitions... *contd.*

In each case, the transferee must take the instrument-

-for value,

-in good faith, and

-without notice of conflicting claims or defences, if any.

Definitions... *contd.*

"Value" is co-extensive with contractual concept of consideration.

Anything which in the law of contract would be treated as consideration is 'value'.

E.g. goods, money, services or in remission of an existing liability as the 'purchase price' of the transfer.

NB: Value given need not be adequate; but it must be something recognized by the law as capable of being consideration.

Definitions... *contd.*

What is 'good faith'?

-A state of mind consisting in honesty, in belief or purpose;

- faithfulness to one's duty or obligation;

- observance of reasonable commercial standards of fair dealing in a trade or business;

- or absence of intent to defraud.

A thing is deemed to be done in good faith, within the meaning of the BEA, where it is in fact done honestly, whether it is done negligently or not.

Definitions... *contd.*

When a bill of exchange, or cheque or promissory note is transferred to any person, so as to constitute that person the holder thereof, the instrument is said to be **negotiated.**

There are two methods of negotiation: -

1. *Negotiation by delivery*
   If an instrument is payable to bearer, it is negotiable by delivery thereof.
2. *Negotiation by endorsement and delivery*
   If an instrument is payable to order, it is negotiable by the holder by endorsement and delivery thereof.

Delivery & Endorsement

Delivery

Refers to the actual handing over of the document (negotiable instrument) by way of transfer of possession, actual or constructive, from one person to another.

Endorsement

It means writing of a person's name on an instrument for the purpose of negotiation.

Endorsement .... *contd.*

The person who endorses the instrument is called the "endorser" and the person to whom it is endorsed is called the "endorsee".

This refers to the signature of transferor on the back of the document/instrument.

CLASSES OF NEGOTIABLE INSTRUMENTS

Instruments are classified as negotiable either by-

-statute, or

- usage, or

-custom.

TYPES OF NEGOTIABLE INSTRUMENTS

Instruments negotiable by Statute.

The BEA mentions only three kinds of negotiable instruments. These are

(a) bills of exchange,

(b) cheques and

(c) promissory notes.

Bill of exchange

A bill of exchange is simply a written promise of payment from one person to another that is legally binding.

More technically, it is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a sum certain in money only to, or to the order of, a certain person, or to the bearer of the instrument: Section 3 (1) BEA.

Bill of Exchange (form)

(Ligisa Street, Chweya Town)
Kenya
5th September 2008
Kshs. 10,000/-

ON DEMAND [*(or)* AT SIGHT *(or)* ON PRESENTATION] pay to NIT NDEKLE *(payee)* or order (or) *(payee)* or bearer *(or)* my order] the sum of [shillings ten thousand] for value received.
K. KEKO

(Signature of drawer)
To MINO DUGU LTD *(drawee's)* of *(drawee's' full address)*

Bill of Exchange Payable on Demand

Dalavilla,
Kandito
5th September 2008
Kshs. 100,000/-
On demand pay to A. DUODI or order the sum of Kenya Shillings One Hundred Thousand.

(Signature of drawer.....................)
For and on behalf of MINO DUGU LIMITED

To PESOLITH BANK LIMITED *(drawee)*
Koko Road

Parties to a bill

The person who makes the bill is called the *drawer*. The person who is directed to pay is called the *drawee*. He becomes the acceptor when he/she signs the bill.

The person to whom the payment is to be made is called the *payee*.

Should the bill be negotiated (i.e. transferred) then anyone holding or endorsing it becomes a party to the bill and liable upon it.

Cheque

A cheque is a bill of exchange drawn on a specified banker and payable on demand: section 73 (1) BEA.

It is a species of a bill of exchange with two additional qualifications:

(a) It is always drawn on a specified banker; and

(b) It is always payable on demand.

NB: Crossed cheques will be dealt with below.

Promissory note

A 'promissory note' is an instrument in writing (not being a bank note or a currency note) containing an unconditional undertaking or promise signed by the maker, to pay on demand a sum certain in money only to, or to the order of a specified person, or to the bearer of the instrument : section 84 BEA.

"Promissory notes are promises to pay, the object of which is to prevent disputes relating to the amount due to by enabling the holder of the note to enforce payment when it becomes due": See *Kanji v. Agriquip Agencies (E.A) Ltd.* (1983) KLR 549.

Promissory notes ...*contd.*

The person who makes the promissory note is called the *maker*; the person to whom the payment is to be made is called the *payee*.

NB: 1. Bills and cheques are **orders** to pay; promissory notes are promises to pay.

2. A bank note or a currency note is not a promissory note.

Promissory note (basic form)

PESA BANK LTD
Ligisa Street, Chweya Town

5th September 2008
I promise to pay to NIT NDEKLE of Dalavilla [or order (or) of bearer] on demand (or) [three] months after date (or) on sight] the sum of Kenya Shs. Ten Thousand (Kshs. 10,000/-) for value received.

(Signature of maker)
K. KEKO

OTHER TYPES OF NEGOTIABLE INSTRUMENTS

Instruments negotiable by custom or usage.

There are certain other instruments, which have acquired the character of negotiability by the usage or custom of trade.

Examples:
- -treasury bills,
- -bank draft,
- -bearer securities, etc
- -bank notes,

Other types of negotiable instruments... *contd.*

- -share warrants,
- -bearer debentures,
- -dividend warrants,
- -share certificates with blank transfer,
- -deeds, etc.

NB: A traveller's cheque is not really a negotiable instrument. It has a condition attached, i.e., drawer must sign in front of the payee.

Non-negotiable instruments

The following documents of title to money or security for money are some examples of non-negotiable:

(a) bills of lading;
(b) postal orders;
(c) money orders;
(d) registered share certificates;
(e) IOUs;

Non-negotiable instruments...*contd.*

(f) receipts;
(g) dock warrants or receipts;
(h) delivery orders;
(i) insurance policies;
(j) travellers' cheque; and
(k) registered debentures.

TRANSFERABILITY AND NEGOTIABILITY

Transferability

- A transferor transfers whatever title in the instrument he has to the transferee.
- If transferor has defective title (such as a stolen cheque), he can only transfer the defective title.
- i.e. the transferee will obtain a defective title.
- Transferring a bad title will result into the receiver acquiring a bad title.

Transferability and Negotiability.... *contd.*

-Depending on the case, a transferee may acquire a good title, although the transferor transfers defective title;

I.e. the receiver may acquire good title which was bad at time of transfer.

Thus, all negotiable instruments are transferable; but not all transferable instruments are negotiable.

Transferability and Negotiability.... *contd.*

Negotiability

-A transferee acquires a better title to the instrument than that possessed by the transferor through negotiation:

-i.e., in order to obtain value, negotiate.

Test of negotiability

A person taking an instrument *bona fide*, and *for value*, known as a holder in due course, gets title even though the title of the transferor may be defective.

A rough and ready test of negotiability in case of bearer instruments is:

Can a good title be acquired through a thief? If yes, the instrument is negotiable.

In other words, the principle of *'nemo dat quod non habet'* does not apply to negotiable instruments.

HOLDERS

(a) Holder

A holder is any payee or endorsee or bearer in possession of a bill.

A holder must have possession of the bill

However, the possessor may not be the owner of the bill.

Impliedly, every holder is prima facie *holder in due course* (see below) unless one or more of the above conditions - good faith and value - are absent.

Holders... *contd.*

Consequently, a payee of a cheque cannot be a holder in due course – because the cheque was *issued* and not negotiated to him.

The cheque was merely transferred to him.

He is just a holder of that cheque.

Holders... *contd.*

(b) Holder for value

This is a person who has given value or valuable consideration for the bill.

'Valuable' means:

(a) any valuable consideration;

(b) settlement of debt;

(c) that the holder has a lien on the cheque.

Once a bill/cheque is given for value, all subsequent holders are holders of value.

Holders... *contd.*

(c) Holder in due course

This is someone who takes the bill complete and regular on the face of it (on both sides of the bill/cheque), which means that:

(a) there has been no forgery of essential endorsement;

(b) the cheque is complete, without any missing sections; and

Holders... *contd.*

(c) the cheque must not be overdue and must be taken without notice of previous dishonor.

Rights of holder in due course

(i) He is an absolute legal owner of bill/cheque.

Holder in due course... contd.

(ii) His title cannot be disputed and is not affected by any defect in the previous title or by any counterclaims (e.g., claims of set-off).

(iii) He can enforce against any prior parties, sue all prior parties, if necessary, in his own name if bill/cheque is not paid/honoured.

(iv) He can pass a perfect title.