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## UNDERSTANDING THE NEGOTIABLE INSTRUMENTS ACT, 1881

~ *Shubhika Dutta*

### INTRODUCTION

In any modern economy, trust in financial transactions is essential. Whether it's a local trader extending credit or a corporate house issuing post-dated cheques, there's a shared assumption that the promise to pay will be honoured. For over a century, the Negotiable Instruments Act, 1881 (herein referred to as the NI Act), has provided the legal foundation for that assurance in India. Though colonial in origin, it remains central to the regulation of financial instruments that symbolise money but circulate more freely than cash ever could.<sup>1</sup>

### CHEQUES, NOTES, AND BILLS: WHAT THE LAW COVERS

A negotiable instrument is a written document guaranteeing the payment of a specific sum to its holder. Its hallmark is transferability: it can pass from one person to another either by simple delivery or by endorsement and delivery.<sup>2</sup> Unlike most forms of property, a bona fide transferee of a negotiable instrument obtains a clean title, even if the transferor's title was defective.<sup>3</sup> The Act recognises three types of instruments: promissory notes, bills of exchange, and cheques.<sup>4</sup> These are not mere formalities; they form the legal skeleton of Indian credit and trade. A promissory note (Section 4) is a written, unconditional promise made by one person to another to pay a specified sum.<sup>5</sup> It represents a direct debtor-creditor relationship and does

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<sup>1</sup> The Negotiable Instruments Act, No. 26 of 1881, § 1, INDIA CODE (1881).

<sup>2</sup> Id. § 14.

<sup>3</sup> M.S. Parthasarathy, *Negotiable Instruments Act* 54 (LexisNexis 2021).

<sup>4</sup> The Negotiable Instruments Act, §§ 4–6.

<sup>5</sup> Id. § 4.

not require acceptance by the payee. A bill of exchange (Section 5) is more layered. It is a written instrument in which the drawer directs the drawee to pay a certain amount to a third party (the payee).<sup>6</sup> It is common in business dealings, especially where delayed payments are involved. A cheque (Section 6) is a kind of bill of exchange, but it is always drawn on a banker and payable on demand.<sup>7</sup> Cheques are deeply embedded in commercial usage, especially in formal sectors such as leasing, real estate, and institutional finance.<sup>8</sup>

## **WHY THE ACT STILL MATTERS**

The NI Act does not stop at classification. It builds a legal framework governing issuance, transfer, endorsement, and enforcement. This structure allows financial instruments to circulate confidently in a commercial ecosystem that depends on delayed payments and third-party transfers.<sup>9</sup> Sections 118 and 139 are particularly notable; they establish a presumption in favour of the holder.<sup>10</sup> Unless rebutted, courts will assume that the instrument was issued for consideration and is valid. In practical terms, this shifts the burden of proof onto the drawer, giving the payee a procedural advantage.<sup>11</sup>

## **THE LEGAL VOCABULARY IN PRACTICE**

The Act also introduces key legal concepts. A holder is someone legally entitled to possess the instrument and claim payment.<sup>12</sup> A holder in due course enjoys stronger protections: if they acquired the instrument for value, in good faith, and without notice of defects, their title is considered unassailable.<sup>13</sup> Endorsement involves signing the instrument to transfer it to another person, and negotiation is the broader process of such transfer by endorsement, delivery, or both.<sup>14</sup> These features give negotiable instruments their cash-like fluidity, enabling them to move swiftly across hands while retaining enforceability.<sup>15</sup>

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<sup>6</sup> Id. § 5.

<sup>7</sup> Id. § 4.

<sup>8</sup> M.S. Parthasarathy, *Negotiable Instruments Act* 54 (LexisNexis 4th ed. 2021).

<sup>9</sup> P. Kandasamy, *Law Relating to Negotiable Instruments* 23 (EBC 5th ed. 2020).

<sup>10</sup> The Negotiable Instruments Act, §§ 118, 139.

<sup>11</sup> Id. § 139.

<sup>12</sup> Id. § 8.

<sup>13</sup> Id. § 9.

<sup>14</sup> Id. § 15.

<sup>15</sup> Parthasarathy, *supra* note 3, at 63.

## **CHEQUE BOUNCE AND SECTION 138: THE MOST LITIGATED CLAUSE**

No provision in the Act has received as much judicial attention as Section 138, which criminalises cheque dishonour due to insufficient funds or amounts exceeding arrangements. Introduced in 1988, it was intended to restore confidence in the cheque system amid rising defaults.<sup>16</sup> For liability to arise, the cheque must be presented within three months of issue. If dishonoured, the payee must send a written demand within 30 days of learning about the dishonour.<sup>17</sup> If payment isn't made within 15 days of receipt of the notice, a criminal complaint may be filed.<sup>18</sup> Punishment under Section 138 includes up to two years' imprisonment, a fine up to twice the cheque amount, or both.<sup>19</sup> This provision has led to a flood of cases in magistrate courts, effectively making Section 138 a debt enforcement mechanism in many instances.<sup>20</sup>

## **CASE LAW AND LEGISLATIVE DEVELOPMENTS**

Judicial interpretation has refined the operation of Section 138. In *Dashrath Rupsingh Rathod v. State of Maharashtra* (2014), the Supreme Court held that jurisdiction lies where the drawee bank is located.<sup>21</sup> This ruling was later superseded by the 2015 Amendment, which placed jurisdiction in the court where the payee's bank is located, facilitating easier access to justice for complainants.<sup>22</sup> The 2018 Amendment added Section 143A, allowing courts to award interim compensation up to 20% of the cheque amount during the pendency of proceedings.<sup>23</sup> This was introduced to mitigate the impact of procedural delays on genuine creditors. Technological changes have also influenced the Act. Electronically generated cheques and those signed digitally are now covered.<sup>24</sup> Despite the growth of UPI, NEFT, and other digital systems, post-dated security cheques remain common in business, employment contracts, and real estate dealings.<sup>25</sup>

## **IS IT STILL RELEVANT?**

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<sup>16</sup> The Banking, Public Financial Institutions and Negotiable Instruments Laws (Amendment) Act, No. 66 of 1988.

<sup>17</sup> The Negotiable Instruments Act, § 138(b).

<sup>18</sup> *Id.* § 138(c).

<sup>19</sup> *Id.* § 138.

<sup>20</sup> Ministry of Finance, *Statement on Pending Cases under Section 138 of the N.I. Act*, RAJYA SABHA UNSTARRED QUESTION NO. 2045 (July 2021).

<sup>21</sup> *Dashrath Rupsingh Rathod v. State of Maharashtra*, (2014) 9 SCC 129.

<sup>22</sup> The Negotiable Instruments (Amendment) Act, No. 26 of 2015.

<sup>23</sup> The Negotiable Instruments (Amendment) Act, No. 20 of 2018, § 143A.

<sup>24</sup> The Negotiable Instruments Act, § 6 Explanation II (as amended).

<sup>25</sup> Reserve Bank of India, *Annual Report 2022–23*, <https://www.rbi.org.in>.

Given the rise of instant digital payments, one might wonder whether the NI Act is outdated. But cheques continue to play a critical role in India's formal economic sector. They are traceable, formally accepted, and can be backed by statutory presumptions that make recovery easier.<sup>26</sup> Most importantly, the legal framework under the NI Act gives cheques an enforceable presumption of validity that no current digital payment mechanism provides.<sup>27</sup> Until a comparable digital statute emerges, cheques retain unique legal and commercial relevance.

## **CRITIQUE AND NEED FOR REFORM**

That said, the Act, particularly Section 138, has been subject to criticism. While meant to deter wilful default, it is often used to pressure debtors through criminal prosecution.<sup>28</sup> The quasi-criminal nature of the provision has raised concerns about misuse, especially in civil disputes. Further, the judicial backlog is considerable. Cheque bounce cases contribute significantly to the congestion in lower courts.<sup>29</sup> Recognising this, the Ministry of Finance, in a 2020 policy paper, proposed decriminalising minor economic offences, including Section 138.<sup>30</sup> The idea is to treat such issues as civil wrongs rather than crimes, thereby lightening the burden on the criminal justice system. However, this proposal remains under debate.

## **CONCLUSION**

Despite being over 140 years old, the Negotiable Instruments Act, 1881, remains a cornerstone of India's commercial legal system. It creates accountability where otherwise there might be none, and provides remedies that are both preventive and punitive.<sup>31</sup> As India transitions towards a fully digital economy, the Act will need further reform to remain relevant. But until then, its role in maintaining commercial discipline, particularly through the cheque system, is far from over.

A written promise to pay is not merely symbolic under this law; it is a commitment with legal consequences, and that is why the Act continues to endure.<sup>32</sup>

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<sup>26</sup> Law Commission of India, *248th Report on Amendment to Section 138 of the N.I. Act* (2014).

<sup>27</sup> *Id.*

<sup>28</sup> *Id.*

<sup>29</sup> Ministry of Law and Justice, *Report of the Expert Committee on Decriminalization of Offences* (July 2020).

<sup>30</sup> *Id.*

<sup>31</sup> Singh, *supra* note 8, at 105.

<sup>32</sup> Parthasarathy, *supra* note 3, at 187.