# NEGOTIABLE INSTRUMENTS LAW

**NEGOTIABLE INSTRUMENTS LAW (Act No. 2031)**

## I. General Concepts

**Negotiable Instrument** (*2005 Bar Exam*) – a written contract for the payment of money which complies with the requirements of Sec. 1 of the NIL, which by its form and on its face, is intended as a substitute for money and passes from hand to hand as money, so as to give the holder in due course (HDC) the right to hold the instrument free from defenses available to prior parties. (*Reviewer on Commercial Law, Sundiang and Aquino*)

**Functions of Negotiable Instrument**:
1. Substitute for money
2. Medium of exchange
3. Credit instrument which increases credit circulation
4. Increase purchasing medium in circulation
5. Evidence of transaction

**Two Distinctive Features/Characteristics of NI**: (*2005 Bar Exam*)

1. *Negotiability* - it is that attribute or property whereby a bill or note or check may pass from hand to hand similar to money, so as to give the holder in due course the right to hold the instrument and to collect the sum payable for himself free from defenses.

2. *Accumulation of Secondary Contracts* - secondary contracts are picked up and carried along with Negotiable Instruments as they are negotiated from one person to another; or in the course of negotiation of negotiable instruments, a series of juridical ties between the parties thereto arise either by law or by privity. The indorsers become secondarily liable to the holder.

### Negotiable Instruments and Non-Negotiable Instruments

| NEGOTIABLE INSTRUMENTS | NON-NEGOTIABLE INSTRUMENTS |
|---|---|
| Must contain all requisites of Sec.1 | Does not contain all requisites of Sec.1 |
| Transferable by negotiation and assignment | Transferable by assignment only |
| HDC can have rights better than his transferor | A transferee acquires no better right than his transferor |
| Prior parties warrant payment. | Prior parties do not warrant payment but merely the legality of his title |
| Governed by NIL | NIL only applies by analogy |
| Transferee can be a HDC | Transferee is assignee only and cannot be HDC |
| HDC takes the NI free from personal defenses | All defences available to prior parties may be raised against the last transferee |

Kinds of Negotiable Instruments: (*2002 Bar Exam*)

1. *Promissory Note (PN)* – an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay on demand, or at a fixed or determinable future time, a sum certain in money to order or to bearer (Sec. 184).

2. *Bill of Exchange (BE)* - an unconditional order in writing addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a sum certain in money to order or to bearer (Sec. 126).

3. *Check* - a bill of exchange drawn on a bank payable on demand (Sec. 185).

   Kinds:
   - Manager's / Cashier's Check – drawn by a bank on itself and therefore, it is a primary obligation of the bank.
     - It is accepted in advance by the act of its issuance and is not subject to countermand by the payor after indorsement.
     - The bank's manager signs manager's check while cashier's check is signed by the bank cashier.
   - Memorandum Check – it is like an ordinary check except that the word "memorandum," "mem" or "memo" is written upon the face of the check, signifying that the drawer engages to pay the bona fide holder absolutely, and not upon a condition to pay upon presentment at maturity and if due notice of the presentment and non-

payment should be given. This check is not to be presented for payment, but will be redeemed by the drawer himself.

- Certified Check – one drawn by a depositor upon funds to his credit in a bank which a proper officer of the bank certifies will be paid when duly presented for payment
- Traveler's check – one upon which the purchaser's signature must appear twice – at the time he buys it and also at the time he uses it. It has the characteristics of a cashier's check of the issuer.
- Crossed check (1995, 1996, 2004, 2005 Bar Exams) – when 2 parallel lines are drawn across its face or across a corner thereof. If the name of a bank appears between the parallel lines, the check is said to be specially crossed, and payment should be made only if presented by the named bank. If no name appears between the parallel lines, the check is said to be generally crossed, and payment should be made only upon presentment by some bank.
  - Effects of crossing a check:
    a. That the check may not be encashed but only deposited in the bank;
    b. That the check may be negotiated only once to one who has an account with a bank; and
    c. That the act of crossing the check serves as a warning to the holder that the check has been issued for a definite purpose so that he must inquire if he has received the check pursuant to that purpose.
- Stale check – one which has not been presented for payment within a reasonable time after its issue.

**Iron Clad Rule**: Prohibits the countermanding of payment of certified checks (Republic of the Philippines v. PNB. GR No. 16106. December 1, 1961). But the holder must be a HIDC (Mesina v. IAC, 145 SCRA 497)

**Bills in Set**: one composed of several parts, each part numbered and containing a reference to the other parts, the whole of the parts constituting but one bill.

Rights of holders where parts are negotiated separately:

1. If both are HIDC, the holder whose title first accrues is considered the true owner of the bill.
2. But the person who accepts or pays in due course shall not be prejudiced.

Obligations of holder who indorses 2 or more parts of the Bill in Set:

1. The person shall be liable on every such part.
2. Every indorser subsequent to him is liable on the part he has himself indorsed, as if such parts were separate bills.

**Distinctions between a Negotiable Instrument and a Negotiable Document of Title** (2005 Bar Exam)

| NEGOTIABLE INSTRUMENTS | NEGOTIABLE DOCUMENTS OF TITLE |
|---|---|
| Subject is money | Subject is goods |
| Is itself the property with value | The document is a mere evidence of title – the things of value being the goods mentioned in the document |
| Has all the requisites of Sec. 1 of NIL | Does not have these requisites |
| A holder of NI may run after the secondary parties for payment if dishonored by the party primarily liable | Intermediate parties are not secondarily liable if the document is dishonored |

| PROMISSORY NOTE | BILLS OF EXCHANGE |
|---|---|
| Unconditional promise | Unconditional Order |
| Involves 2 parties on its face | Involves 3 parties on its face |
| Person who issues is the maker | Person who issues is the drawer |
| Party primarily liable is the maker | Party primarily liable is the acceptor |
| One presentment only: for payment | Could be two presentments: for acceptance and for payment |

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**When a BILL may be treated as a NOTE**:
1. Drawer and drawee are the same person.
2. Drawee is a fictitious person.
3. Drawee has no capacity to contract.
4. When instrument is so ambiguous, the holder may treat it either as a BILL or a NOTE.

| BILLS OF EXCHANGE | CHECK |
|---|---|
| Not necessarily drawn on a deposit. The drawee need not be a bank | Not necessarily drawn on a deposit. The drawee need not be a bank. |
| Death of a drawer of a BOE, with the knowledge of the bank, does not revoke the authority of the drawee to pay | Death of the drawer of a check, with the knowledge of the bank, revokes the authority of the banker to pay |
| May be presented for payment within a reasonable time after its <u>last negotiation</u> because it may be further negotiated | Must be presented for payment within a reasonable time after its <u>issue</u>. |
| May be payable on demand or at a fixed or determinable future time | Always payable on demand |
| Presentment for acceptance may be required (Sec. 143) | Need not be presented for acceptance |

**Other Forms of Negotiable Instruments**
1. Certificate of deposit issued by banks, payable to the depositor or his order, or to bearer
2. Trade acceptance
3. Bonds, which are in the nature of promissory notes
4. Drafts, which are bills of exchange drawn by one bank upon another

- All of these must comply with Sec. 1, NIL

**Note**: Postal Money Order, Treasury Warrant, Certificate of Stock, Letter of Credit, Bill of Lading and Warehouse Receipts are not negotiable instruments.

**Legal Tender**
That kind of money that the law compels a creditor to accept in payment of a debt when tendered by the debtor in the right amount. Under Sec. 52 of RA 7653, all notes and coins issued by the BSP shall be legal tender in the Philippines.

Legal Tender Power of:
Notes – no limit as to amount
Coins –
a. P1, P5 & P10 – up to P1,000
b. P0.25, P0.10, P0.05 & P0.01 – up to P100
(BSP Circular No. 537, Series of 2006)

**Note**: A negotiable instrument (including check) although intended to be a substitute for money, is not legal tender.

SEC. 60. *Legal Character.* _ Checks representing demand deposits do not have legal tender power and their acceptance in the payment of debts, both public and private, is at the option of the creditor: *Provided*, however, That a check which has been cleared and credited to the account of the creditor shall be equivalent to a delivery to the creditor of cash in an amount equal to the amount credited to his account. (RA 7653)

**Incidents in "Life" of Negotiable Instrument**
1. Preparation and signing
2. Issue
3. Negotiation
4. Presentment for acceptance, in certain kinds of bills of exchange
5. Acceptance
6. Dishonor by non-acceptance
7. Presentment for payment
8. Dishonor by non-payment
9. Notice of dishonour
10. Protest, in some cases
11. Discharge

*Issue* - the first delivery of the instrument, complete in form, to a person who takes it as a holder.

*Delivery* - transfer of possession, actual or constructive, from one person to another
Holder – refers to the:
a. If ORDER instrument - The payee or indorsee of a bill or note who is in possession of it, or
b. If BEARER instrument - The bearer thereof (sec.191)

*Bearer* - the person in possession of a bill or note which is payable to bearer.

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## II. NEGOTIABILITY

**Requisites of Negotiability (Sec. 1, NIL)** *(1996 Bar Exam)*

a. It must be in writing and signed by the maker or drawer;
b. Must contain an unconditional promise or order to pay a sum certain in money;
c. Must be payable on demand, or at a fixed or determinable future time;
d. Must be payable to order or to bearer; and
e. Where the instrument is addressed to a drawee, he must be named or otherwise indicated therein with reasonable certainty.

Note: Do not be confused with the word “order” under “b” and “d”

*1. Must be in writing, signed by the maker or drawer;*

- Otherwise it cannot be a substitute for money.
- Signature may be in any form like initial or mark. No particular location.

*2. Must contain an unconditional promise or order to pay a sum certain in money;*

*Certainty of sum payable*

The sum payable is a sum certain although it is to be paid:

a. With interest; or
b. By **stated** installments; or
c. By **stated** installments, with a provision that, upon default in payment of any installment or of interest, the whole shall become due; or
d. With exchange, whether at a fixed rate or at the current rate; or
e. With costs of collection or an attorney's fee, in case payment shall not be made at maturity. (sec. 2)

- Interest stipulated but not specified – legal interest.
- Interest not stipulated – legal interest will be paid when the debtor incurs in delay (Art. 2209, NCC)
- Interest due shall earn legal interest from the time it is judicially demanded (Art. 2212, NCC)

**Note**: NI need not be payable in legal tender.

*When promise or order unconditional*

An unqualified order or promise to pay is unconditional though coupled with:

a. An indication of a particular fund out of which reimbursement is to be made or a particular account to be debited with the amount; or
b. A statement of the transaction which gives rise to the instrument.

- Mere acknowledgment insufficient.

An order or promise to pay out of a particular fund is not unconditional because, in effect, it is subject to the condition that the fund is sufficient.

| FUND FOR REIMBURSEMENT | PARTICULAR FUND FOR PAYMENT |
|---|---|
| Drawee pays the payee from his own funds; afterwards, the drawee pays himself from the particular fund indicated. | There is only one act- the drawee pays directly from the particular fund indicated. Payment is subject to the condition that the fund is sufficient. |
| Particular fund indicated is NOT the direct source of payment but only the source of reimbursement. | Particular fund indicated is the direct source of payment. |

*3. Payable on demand or at a fixed or determinable future time;*

*Certainty of time of payment*

An instrument is payable at a determinable future time which is expressed to be payable:

a. At a fixed period after date or sight; or
b. On or before a fixed or determinable future time specified therein; or
c. On or at a fixed period after the occurrence of a specified event which is certain to happen, though the time of happening be uncertain.

- After sight means after the drawee has seen the NI upon presentment for acceptance.
- The event must necessarily happen. If conditional, not negotiable.
- An instrument payable upon a contingency is not negotiable, and the happening of the event does not cure the defect. (Sec. 4)
- A promise to pay “when able,” “as soon as I can”, etc., without specification of an absolute date is not negotiable. However, there is a difference of opinion as to whether it is a conditional promise or an absolute promise to pay at an unreasonable time:
  a. Under the first view, negotiability is destroyed both by the condition and by want of a fixed time for payment;
  b. Under the second view, by the general principle that a promise to pay within a reasonable time is not so certain as to render an instrument negotiable.

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<u>*Aftersight Draft*</u> - payable only after the expiration of the stipulated period from acceptance (legal sight).

**<u>Acceleration Notes</u>**
- provisions which make it possible for the maker to pay the NI at an earlier date or make it possible for the holder to require payment of the NI at an earlier date.

1st Class – On or before a certain date
2nd Class –

a. renders whole debt due and demandable upon failure of obligor to comply with certain conditions (*Acceleration Clause*)
b. Maker shall supply additional collateral in case of depreciation of the value of the original deposit, and upon default, the note shall become due.
c. Contains provisions for acceleration where holder deems himself insecure (*Insecurity Clause*)

**<u>Extension Clause</u>**
- Clause in NI that extend the maturity dates. "An instrument is payable at a definite time if by its terms it is payable at a definite time subject to extension at the option of the holder, or to extension to a further definite time at the option of the maker or acceptor or automatically upon or after a specified act or event." (Subsection 3-109(1)(d) of the Uniform Commercial Code of the United States; Aquino, Timoteo B., Notes and Cases on Banking Law and Negotiable Instruments Law Vol. I, 2009, p. 50.)
- Different from Sec. 120(f)

*When payable on demand* (Sec. 7)*:*

a. When it is so expressed to be payable on demand, or at sight, or on presentation; or
b. In which no time for payment is expressed.

**Note:** Where an instrument is issued, accepted, or indorsed when overdue, it is, as regards the person so issuing, accepting, or indorsing it, payable on demand.

*4. <u>Payable to order or to bearer</u>*

a. *When payable to order* (Sec. 8)

The instrument is drawn payable:

a. To the order of a specified person or
b. To him or his order.

- The payee must be named or otherwise indicated therein with reasonable certainty.
- It may be drawn payable to the order of:

a. A payee who is not maker, drawer, or drawee; or
b. The drawer or maker; or
c. The drawee; or
d. Two or more payees jointly ("AND"); or
e. One or some of several payees ("OR"); or
f. The holder of an office for the time being.

*When payable to bearer* (Sec. 9)

a. When it is expressed to be so payable; or
b. When it is payable to a person named therein or bearer; or
c. When it is payable to the order of a fictitious or non-existing person, and such fact was known to the person making it so payable; or
d. When the name of the payee does not purport to be the name of any person; or
e. When the only or last indorsement is an indorsement in blank.

*Fictitious Payee Rule*

- If an actual, existing and living payee is not the intended recipient of the proceeds of the check, the payee is considered a "fictitious" payee and the check is a bearer instrument. Hence, even if the signature of the payee was forged, the collecting bank and drawee bank are relieved of liability.
- Theory: One cannot expect a fictitious payee to indorse. Hence, the issuer must have intended for the NI to be negotiated by mere delivery.
- The loss falls on the drawer.
- Burden: The check is presumed to be an order instrument and it is up to the person making the contrary allegation to prove otherwise.

(*PNB v. Rodriguez*, *et al.* G.R. No. 170325, 26 September 2008)

- In the US, the rule is used to counteract the effect of forged indorsements on the right of the holder to enforce payment against the drawer or maker.
- The rule intends to remove the group of cases involving a dishonest employee from the tradition "forged indorsement doctrine" and imposes the loss on the employer who hires and fails to properly control the dishonest agent, rather than on banks which collect and pay checks with forged indorsement.
- *Bad Faith Exception*: A showing of commercial bad faith on the part of the drawee bank, or any transferee will work to strip it of this defense.

*5. <u>Identification of the drawee</u>*