

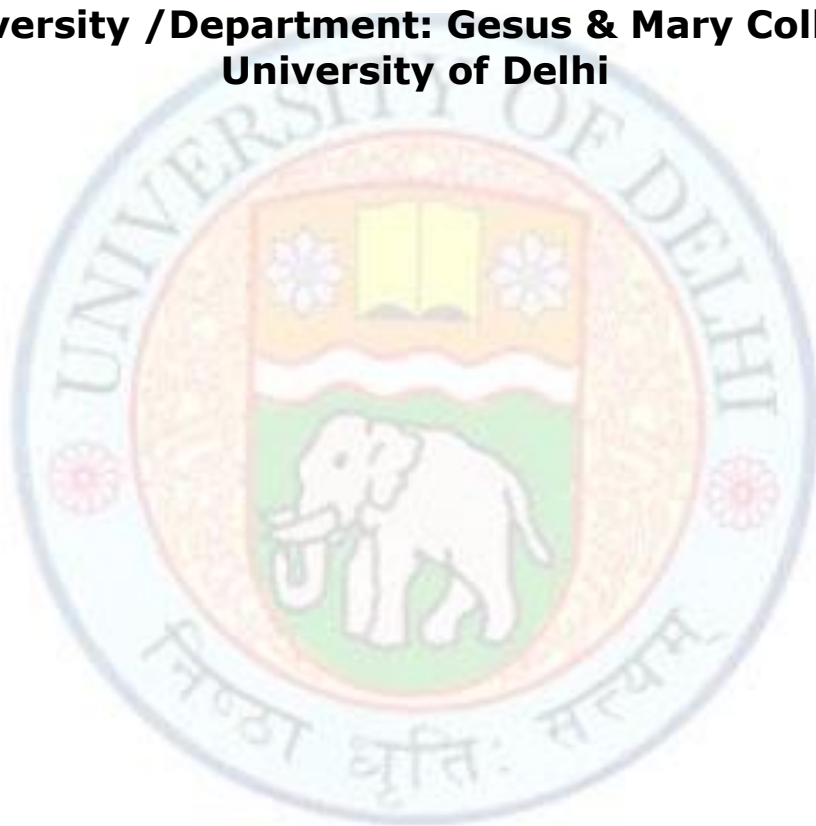
## **3 (B) Holder and Holder In Due Course**

**Subject : Commerce**

**Lesson : Holder and Holder In Due Course**

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University of Delhi**



## 3 (B) Holder and Holder In Due Course

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## **3 (B) Holder and Holder In Due Course**

### **Chapter 3 (B) Holder and Holder In Due Course**

The scope of the Unit is given below:

- 21.1 Holder
- 21.2 Holder in Due Course
- 21.3 Distinction between Holder and Holder in Due Course
- 21.4 Privileges of a Holder and Holder in Due Course



## 3 (B) Holder and Holder In Due Course

### 21.1 Holder

Section 8 of the Negotiable Instruments Act, defines a holder as "any person entitled in his own name to the possession thereof and to receive or recover the amount due thereon from the parties thereto". The person whose name is in the bill of exchange / promissory note / cheque or to whose order, the specific amount on it is payable, is the **payee**. The payee, therefore, is the original party to the negotiable instrument. Under the Bills of Exchange Act, 1882, it is essential to have possession of the instrument, but under the Indian Law it is not necessary to possess it but the payee should have an entitlement to the possession of the instrument even if he does not have actual possession of it. This means that he requires de jure and not de facto possession of the instrument. The payee has two options:

- To be entitled to keep in his possession the instrument and to receive the money specified on it. In this case, he has the rights of being a holder of the instrument.
- To negotiate the instrument to another person to whom he has to pay money in discharge of his liability. In this case, the rights of the holder will be transferred to the person on whose name the instrument has been negotiated and endorsed.



**Figure 21.1 Payee and Holde**

In order to be a holder, two conditions must be satisfied. These are the following:

- He should be entitled to possess the instrument in his own name.
- He should be entitled to receive or recover from the parties that are liable.

### 3 (B) Holder and Holder In Due Course

#### Check your Progress



- **21.1.1 He should be entitled to possess the instrument in his own name.**
  - i. **Identity of Holder:** A holder should identify himself with a legal or a valid title. Entitlement to the possession of an instrument is not a sufficient proof of identity. If it is a bearer instrument, the holder must be the person who is the original payee or the person to whom the instrument has been endorsed.
  - iii. **Possession by Gift or Inheritance:** A person who has in his possession an instrument because of receiving a gift or by inheritance becomes a holder due to operation of law. He is entitled to possess the instrument in his own name.
  - iii. **Possession as Assignee:** In case of an assignment, an assignee of a bill / promissory note does not become a holder, unless it has been endorsed in his favour or it is payable to order. However, the assignee has a right to sue on the instrument. According to the English Law, an endorsee, who is making a collection on behalf of another, can become a holder, but according to the Indian Law, this is not allowed.
  - iv. **Identity by English and Indian Law:** A person, who finds a lost instrument, or a thief, who forges the instrument, cannot acquire a legal title thereto, and he is not entitled to have possession of this instrument in his own name. A person, who claims to be a trustee or a guardian in whose favour the instrument is drawn in place of the beneficiary, does not have the right to be a holder because he is not entitled to possess the instrument in his name.

### 3 (B) Holder and Holder In Due Course

**Check your Progress**

**Identity of Holder**

1. Select whether the given statement is true or false by clicking the radio button.

**According to the English Law, an endorsee, who is making a collection on behalf of another, can not become a holder**

True

False

2. Type the correct answer for the given question.

**In case due to any form of \_\_\_\_\_ of the negotiable instrument, the entitlement to the instrument will be that of the holder who was entitled.**

\_\_\_\_\_

3. Select whether the given statement is true or false by clicking the radio button.

\_\_\_\_\_

Attempt the questions and scroll down to click the Submit button for results.

#### Illustration

Raju finds a promissory note and forges it by putting his signature. He does not become entitled to the rights of a holder as he is a forger, and he cannot acquire legal title to it. Therefore, he cannot claim any funds on it.

#### **21.1.2 He should be entitled to receive or recover from the parties that are liable**

**Clear Title:** The person should be legally and lawfully entitled to receive or recover money. The instrument should have a clear title. Only in that condition will the holder be able to give a valid discharge to the payer. If the instrument is under a legal process and the right to recover money is not possible because of legal problems, the person cannot be called a holder.

1. **Title in Case of Losses and Natural Calamities:** In case of a fire, earthquake, storm or any form of destruction of the negotiable instrument is lost or destroyed, the entitlement to the instrument will be that of the holder who was entitled to the instrument. A person, who finds this instrument and wrongfully decides to keep it, cannot be a holder
2. **Title of Agent:** This rule also applies to an agent who holds an instrument for his principal. He cannot be called a holder, even though he may have the powers to receive payment on behalf of the lawfully entitled holder. A person who is an employee or an agent can receive a negotiable instrument on behalf of his employer, but he cannot sue in his own name for the instrument. Therefore, he cannot be a holder of the instrument.



## 3 (B) Holder and Holder In Due Course

### Illustration

Latika receives a cheque from Karan for Rs 23000/-. She is entitled to recover the money as payee. When she wants to recover the amount, she finds that there is a dispute and is under consideration in the court. Only after it is cleared, would it be possible for her to receive the money. In such a state her legal entitlement is questionable, and she cannot be called a holder.

A holder has a premium position in the case of negotiable instruments. Only he has the right to become a holder in due course. According to Sections 46 and 48, the holder possesses the right to negotiate the instrument further to another person, and under Section 78, to give a valid discharge to the acceptor of the instrument.

### 21.2 Holder In Due Course

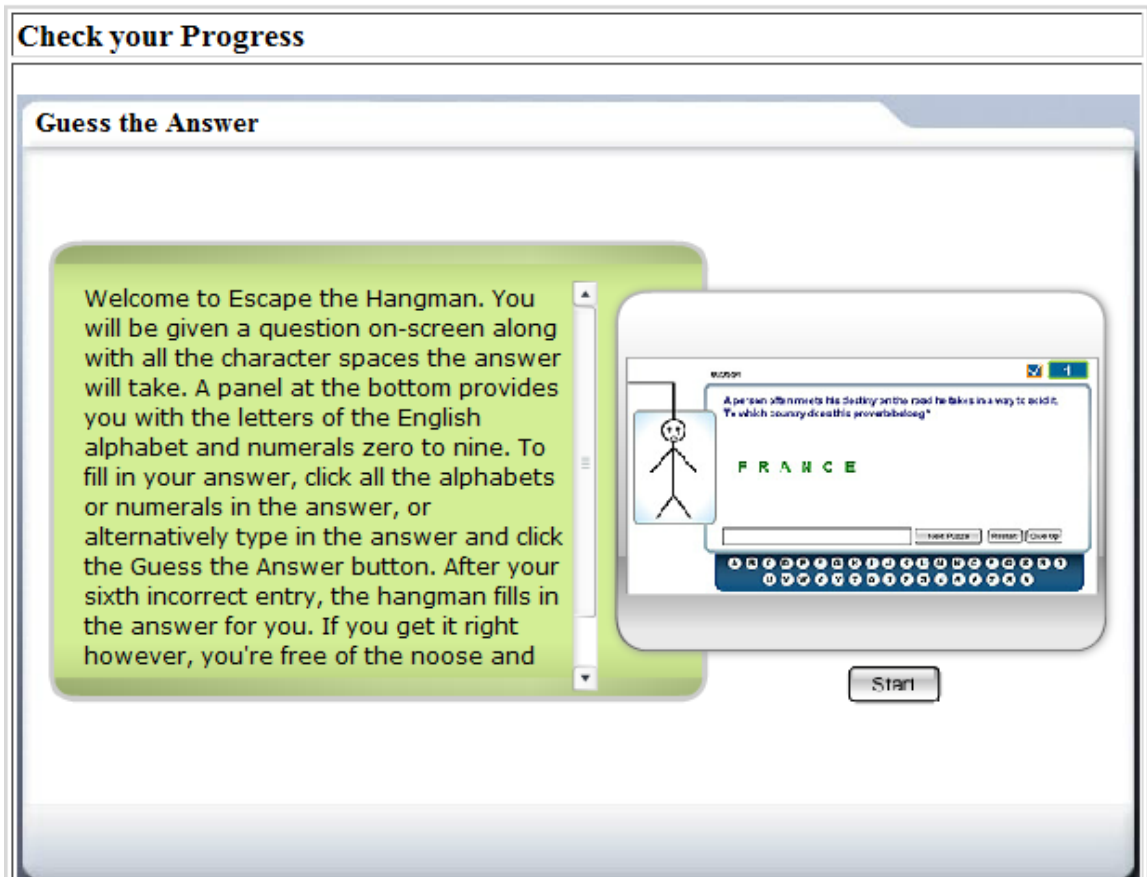
A negotiable instrument has the benefit of easy transferability. According to Section 9 of the Negotiable Instrument Act, "**a holder in due course** is a person who possesses for some consideration a bill of exchange, promissory note or cheque payable to bearer or the payee or the endorsee in good faith, and without any reason to believe that there is any defective title in the instrument in his possession". If the following conditions are satisfied the person will become the holder in due course:



Figure 21.3 Holder and Holder in Due Course

- i. **He must be a Holder:** A holder in due course is a person who is entitled to possess a negotiable instrument in his own name and under a legal title. He should be able to recover the amounts from the parties legally. In other words, the holder in due course should actually have the qualities of a holder of the instrument.
- i. **Lawful Consideration:** The holder in due course should have obtained the negotiable instrument by some consideration for acquiring it. The consideration may not be completely adequate, but it must be lawful and fulfill the conditions under Section 2 (d) of the Indian Contract Act. This means that if he has received the instrument as a gift or donation and there is no consideration attached to it, he cannot be called a holder in due course, even though he is a holder of the instrument.

### 3 (B) Holder and Holder In Due Course



1. **Acquisition before Maturity:** The date of acquiring the negotiable instrument is important for a person to become a holder in due course. If it is obtained before the maturity date by a person, then he is entitled to become a holder in due course. If however, he receives it on the date of maturity or after the payment has been attained, then the possessor of the instrument cannot become a holder in due course. The justification for it is that on an over due instrument, the possession is taken with the defects that are attached to it. However, if acquisition is of an accommodation bill, it can be acquired after the date of maturity with all the benefits of being a holder in due course. A cheque, however, should be taken only within six months because legally after that date, the validity of the cheque expires.
2. **Technically Complete Instrument:** A negotiable instrument should be complete in all respects. It should be clear without any changes through overwriting or cutting. In case of alterations, the drawer should have signed the instrument. If the instrument is not technically sound, the person, who receives it, cannot become a holder in due course.



### 3 (B) Holder and Holder In Due Course

#### Case Law 1

#### In Arab Bank Ltd. v Ross (1952) 2 Q B 216

The payee of the promissory note was identified as F and F. N. & Co. The endorser omitted the words 'and company', and endorsed it as F and F. N. This was a technical flaw. The endorser could not become a holder in due course because the endorser and the payee were different on the instrument.

- v. **Received in Good Faith:** To become a holder in due course, the person should have received the instrument in good faith. If he has received a defective title or a stolen instrument, but is not aware of it, he gets a valid title. However, he has to enquire about the title of the instrument and be sure of its legality before accepting it. In other words, he has to prove that he took all kinds of precaution, and did not suspect any defective title of the instrument accepted by him.

### 21.3 Distinction between Holder and Holder In Due Course

The discussion of holder and holder in due course brings out certain important differences between them. Table 21.3 shows the differences between them.

	Holder	Holder in due course
<b>Nature</b>	A holder is a person, who is entitled to possess a negotiable instrument, as well as, recovers and receives the amount on it from the parties.	A holder in due course is a holder, who has accepted a technically correct instrument before maturity and in good faith.
<b>Consideration</b>	The holder can receive an instrument with or without consideration.	A holder in due course must receive the instrument with some consideration. Although consideration may not be adequate.
<b>Title</b>	A holder can only have a good title on an instrument, if the previous parties do not have a defective title.	A holder in due course, who has acted in good faith can acquire a good title, even if the previous parties had a defective title.
<b>Privileges</b>	A holder does not get any privileges.	A holder in due course has some special privileges.

#### Illustration

Shruti receives a gift cheque from her father. She is interested in knowing whether she is a holder or holder in due course. Her friend Supriya advises her that since she has not received the bill by any consideration she has acquired the status of a holder. In such a case Shruti cannot become a holder in due course because she has not acquired the instrument with adequate or inadequate consideration.

#### Illustration

Sanyogita acquires a bill before maturity. She carefully scrutinizes the technical details on the instrument, and when she is sure that the title is not defective, she accepts it. Later on it is found that the title is defective. She requires certain advice to

### 3 (B) Holder and Holder In Due Course

find out whether she can be called a holder in due course. What would be her status? Sanyogita has acted in good faith, and the technical details, according to her, were in order. If she can prove that she was unaware of the defective title, she will be able to acquire the status of holder in due course.

#### Illustration

Suman gives a valuable consideration for a negotiable instrument to her friend Pankaj knowing that the instrument is defective. She has acquired it before maturity. Will the court accept her as a holder in due course?

Suman cannot be called a holder in due course because she has acquired the instrument knowing that it had a defective title.

#### Illustration

Namrata lost her cheques and bills in the Gujrat earthquake. Murarilal found one bill which was payable to bearer. What would be the rights of Murarilal as he has found the bill in good faith and due to natural calamity? Namrata continues to be the holder of the bill found by Murarilal. He cannot become a holder in due course even though he acquired the bill before maturity and in good faith. It does not belong to him and he must return it.

#### Check your Progress

##### Difference between Holder and Holder in Due course

Holder	Holder in due course
<ul style="list-style-type: none"> <li>● A holder is a person, who is entitled to possess a negotiable instrument, as well as, recovers and receives the amount on it from the parties.</li> </ul>	<ul style="list-style-type: none"> <li>● A holder in due course is a holder, who has accepted a technically correct instrument before maturity and in good faith.</li> </ul>
<ul style="list-style-type: none"> <li>● The holder can receive an instrument with or without consideration.</li> </ul>	<ul style="list-style-type: none"> <li>● A holder in due course must receive the instrument with some consideration. Although consideration may not be adequate.</li> </ul>
<ul style="list-style-type: none"> <li>● A holder can only have a good title on an instrument, if the previous parties do not have a defective title.</li> </ul>	<ul style="list-style-type: none"> <li>● A holder in due course, who has acted in good faith can acquire a good title, even if the previous parties had a defective privileges title.</li> </ul>
<ul style="list-style-type: none"> <li>● A holder does not get any privileges.</li> </ul>	<ul style="list-style-type: none"> <li>● A holder in due course has some special privileges.</li> </ul>

## 3 (B) Holder and Holder In Due Course

### 21.4 Privileges of a Holder In Due Course

A holder in due course is considered to be in a superior position having certain special privileges, which the holder does not have. He has the following rights:

- He has a better title than that of the transferor.
  - He has certain special privileges in case of inchoate stamped instruments.
  - He has rights against the prior parties.
  - He has privileges in case of fictitious bills.
  - He has rights against conditionally delivered instruments.
  - He has the right of estoppel in case of validity of the instrument.
- 
- He has the right of estoppel against the denying capacity of payee to endorsee.



**Figure 21.4 Privilege of A Holder In Due Course**

Each one of these rights is discussed below:

**1. Better Title than that of the Transferor:** A holder has the same title as a transferor, but a holder in due course acquires a better title than the transferor. This means that if a transferor has a defective title, the holder will also have the same title, but a holder in due course gets a better title than the transferor. Thus, according to Section 58, if an instrument is acquired in good faith and without any knowledge of the defects of the instrument, the holder in due course is in a privileged position. Therefore, if there is a defence on the part of a person liable thereon that the instrument is lost or acquired by fraud or unlawful consideration, it cannot be pleaded against a holder in due course. More privileges of a holder in due course are cited in section 53. According to it, "A holder of a negotiable instrument who derives the title from a holder in due course has the rights thereon of that holder in due course". Accordingly, a holder in due course is cleansed of all the defects of the previous holders in due course. He serves as a channel to protect all previous holders in due course. A transferee from a holder in due course is like a holder in due course, and can recover the amount from prior parties, even if he knew of the defects such as fraud or defective title. The exception to this case is when the transferee is a party to a fraud with a previous holder in due course he cannot recover the amount as is cited in the case law *Guildford Trust V Goss*<sup>60</sup>. A forged instrument is not a defect but a lack of title.

#### **Illustration**

Karan drew a bearer cheque for Manhar and gave it to Kusam to deliver it. Kusam wrote her own name and indorsed it to Asif. Since Asif was a holder-in due course, who acquired the instrument for some consideration, he was interested in knowing his privileges and asked for advice.

Asif can collect the money from Karan as he is a holder in due course. He is entitled to

### 3 (B) Holder and Holder In Due Course

recover the amount.

#### Illustration

Sanjana draws a bill on Kala and makes it payable to herself and gets Kala's acceptance by fraud. Sanjana's rights on the bill against Kala will be identified as defective. If she indorses the bill in favour of Raju, the transferee will have full rights against Kala as holder in due course. However, if Raju indorses the bill in favour of Navneet without consideration what type of rights would he acquire? Navneet's position is that he cannot become a holder in due course, but he would have a good title on the bill, even if he knew that the title was defective.

#### Illustration

Rajiv drew a bill on Reena, and made it payable to himself, taking her acceptance by fraud. Now, Rajiv indorses it to Ramesh, who becomes a holder in due course. Ramesh indorses it further to Rakesh, who indorses it back to Rajiv. Is Rajiv able to collect the money? What are his rights as holder in due course? Rajiv cannot acquire a good title because he is a party to the fraud. A forged instrument cannot be cured of its defects.

**2. Special Privileges in Case of Inchoate Stamped Instruments:** An inchoate stamped instrument is one, which is not complete in all respects. Under section 20, the original payee should fill in an amount that he / she is authorized to enforce. If the amount filled in is more than the authorized amount, he cannot recover the excess amount on it. If an incomplete instrument is transferred to a holder in due course, exceeding the authorized amount, he would be entitled to recover the entire amount on the instrument if the stamp affixed on it covers the amount.

#### Illustration

Rajni signed a blank stamped instrument and gave it to Munish authorizing him to fill in a promissory note for Rs 7,200 to take an advance from Meenu. Munish fills it as a note for Rs 11000/- payable to Meenu, who in good faith advances Rs 11000/- to Munish. Meenu is entitled to receive the money from Rajni.

**3. Rights Against the Prior Parties:** Under Section 36, a holder in due course has a right against all prior parties, including drawer, acceptor and endorsees before him. They are liable to him both jointly and severally. He can hold any of the parties individually or jointly liable for payment of the instrument. Until the instrument is completely discharged by the person who is primarily liable, they continue to remain liable.

#### Illustration

Kavi drew a bill of exchange on Mattu payable to Somu. It is accepted by Somu and endorsed by him to Dara, who in turn endorses it to Sukhmani. Since Sukhmani becomes the holder in due course, she can realize the amount on the bill not only from Mattu, who accepts the bill, but also from Kavi and Dara. All the prior parties remain liable to Sukhmani, until she is satisfied that the bill is duly discharged.

**4. Privileges in Case of Fictitious Bills:** A person who accepts a bill that is drawn in a fictitious name and is payable to the order of the drawer, does not get relieved from his responsibility towards the holder in due course because the bill is in a fictitious name.

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However, according to Section 42, the holder in due course has to prove that the signature of the first endorsee and the drawer are the same.

#### Illustration

Priya accepted a bill of exchange for Rs 5200/- drawn by Veeru and payable to the fictitious person Meera. The bill was returned to Veeru after Priya accepted the bill. Later, Veeru indorsed the bill to Rekha by signing as Meera, the endorser. During the course of negotiation, the bill came in the hands of Mattu, a holder in due course. How can Mattu recover the money as holder in due course? Mattu can recover the amount on the bill from Priya by showing that the signatures of the drawer Veeru and the first endorser Meera are in the same handwriting.

**5. Rights Against Conditionally Delivered Instruments:** If an instrument which is prepared for a special purpose or delivered conditionally as a collateral security or for the safe custody, and not with the idea of transferring the rights of the property to the endorser, is negotiated to a holder in due course and a valid delivery is presumed, then under section 46, the holder in due course acquires a good title to it.

#### Illustration

Amir is the holder of a bill. He indorses it to Bali. Bali endorses the bill to Kavita. She becomes a holder in due course and acquires a good title to the bill and has the right to claim the money from the prior parties. As a holder in due course, Kavita can also sue all the prior parties to the instrument.

**6. Right of Estoppel in Case of Validity of the Instrument:** The drawer and the acceptor of a bill or cheque are liable to the holder in due course. If a holder in due course sues any of those parties, they will not be permitted by court to deny that the instrument was not valid. The drawer/maker are the prior parties responsible to the holder in due course. They have prepared the original documents so they do not have the right to deny the validity of the instrument due to the right of estoppel of the holder in due course. However, if the drawer can prove that the instrument is forged, then under Section 12, he can get relief.

#### Illustration

Amul draws a cheque in favour of Cheenu who endorses it to Mani for some consideration. On the due date it is dishonoured. Mani gives a notice to Cheenu. He cannot deny that he endorsed it.

Amul, as the drawer of the cheque, can also not deny that the instrument is valid. However, if he can prove that it is a forged instrument, then Mani will not get relief.

**7. Right of Estoppel Against the Denying Capacity of Payee to Endorsee:** Under Section 121, the maker of a promissory note or an acceptor of a bill are not permitted to state to the holder in due course that the payee did not have the capacity to endorse the bill or cheque. Therefore, if the holder in due course files a suit against the acceptor of a bill, he will not be permitted to state that he was a minor when he accepted the bill. However, the maker of the note or the acceptor can reject the instrument by bringing out the fact that the bill was not genuine or the payee's endorsement was not valid.



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#### Illustration

Abhay is the maker of a promissory note, which is payable to Bani, who is a minor. Bani endorses it to another person by the name of Sanjay, who becomes the holder in due course. Abhay cannot state that Bani did not have the capacity to make an endorsement. The holder in due course, Sanjay, can recover the money from Abhay, who is the drawer of the promissory note. Unless Sanjay's claim is discharged, he remains liable to him.

To conclude, a holder is a person who will eventually become a holder in due course. A holder is entitled to receive and recover amount against the negotiable instrument that he is entitled to possess. When he transfers the instrument for some consideration before the maturity date, and the instrument is technically complete, the person taking the instrument acquires the rights of a holder in due course. The holder in due course has certain special privileges. Therefore, it is important to analyze the differences between the holder and the holder in due course to understand their rights and obligations.

Check Your Progress





## 3 (B) Holder and Holder In Due Course

### Summary

#### Definition of a holder

- The person whose name is in the bill of exchange / promissory note / cheque or to whose order the specific amount on it is payable, is the payee or the holder.
- He must be entitled to the possession of the instrument in his own name.
- He must be entitled to receive or recover the amount due thereon from the parties

#### Entitled to possession requires the following necessary details.

- The holder should have a legal title
- A gift entitles a person to become a holder.
- A person can also become a holder by operation of Law.
- An assignee of a bill is not a holder.
- A thief or a forger cannot become a holder as he does not have a legal title to it.

#### Entitlement to receive or recover the amount due thereon from the parties requires the following conditions.

- The holder should have the legal right to recover the money.
- In case of natural calamities or losses continues to have the right to be called the holder.
- The agent of the holder can collect money on his behalf but cannot become the holder.

#### Who is a holder in due course?

- A holder in due course is a person who possesses the bill of exchange, promissory note or cheque if payable to bearer or the payee or the endorsee .
- He should receive the instrument in good faith.
- It should be received with some consideration.
- It should be without any reason to believe that there is any defective title in the instrument in his possession.
- He should receive the instrument before the maturity date.
- The instrument must be technically complete in all respects.
- There should be no alterations and if there is any cutting on the instrument the requisite signatures should be made.

#### Distinction between holder and holder in due course

- A holder is entitled to receive possession and recover the amount on the instrument. A holder in due course acquires an instrument with some consideration, before maturity, and in good faith without belief of any defective title.
- Holder may receive instrument without consideration but holder in due course must possess it with some consideration.
- Holder can have a good title only if the previous parties do not have defective title but holder in due course can have a good title even if the previous parties do not have a good title.
- A holder does not have the privileges that a holder in due course enjoys.

#### Privileges of a holder

- He has a better title than that of the transferor.
- He has certain special privileges in case of inchoate stamped instruments.
- He has rights against the prior parties.
- He has privileges in case of fictitious bills.
- He has rights against conditionally delivered instruments.

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- He has the right of estoppel in case of validity of the instrument.
- He has the right of estoppel against the denying capacity of payee to endorsee.



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