



THE NEGOTIABLE INSTRUMENTS LAW

Instructor: Mr. Ballad **FINALS | 2nd Semester | Jules**

Historical background of our Negotiable Instruments Law

1. **U.S. Uniform Negotiable Instruments Act.** — Our law is patterned with very slight modifications after the Uniform Negotiable Instruments Act of the United States of 1896 drafted by the National Conference of Commissioners on Uniform State Laws.

The Conference was appointed in 1895 to revise and codify the law merchant in the United States as there was much confusion and lack of uniformity then in the court decisions on the subject resulting from the variety of statutes pertaining to commercial paper enacted by various state legislatures. This law, in turn, is based upon and largely copied from the English Bill of Exchange Act of 1882, a codification of the laws in England governing bills of exchange, promissory notes and checks. Most state legislatures adopted the Act as the main law for regulating commercial paper

2. **U.S. Uniform Commercial Code.** — The Uniform Negotiable Instruments Act has been replaced in part by Article 3 and in part by other articles of the Uniform Commercial Code (U.C.C.) prepared under the auspices of the National Conference of Commissioners on Uniform State Law and the American Law Institute. Proposed for adoption by the legislatures of the states, the first draft of the Code was finished in 1952 although the Code is revised periodically, (see 11 Am. Jur. 2d 64.) The Code seeks to simplify and modernize the law of commercial transactions. Each state has adopted part or all of the Code.
3. **Act No. 2031.** — Our Negotiable Instruments Law was enacted as Act No. 2031 on February 3, 1911. It took effect 90 days after its publication on March 4, 1911 in the Official Gazette of the Philippine Islands was completed. (Sec. 198.) The Act, therefore, took effect on June 2, 1911. Since then, our Congress has not seen fit to amend any of its provisions.

The evident purpose of the Act is to facilitate transactions in commercial paper and to promote free flow of credit. Since then, our Congress has not seen fit to amend any of its provisions. (4)

4. **Code of Commerce.** — Prior to the passage of Act No. 2031, the law then existing and in force as to negotiable instruments could be found in Book II of the Code of

Commerce, from Articles 443 to 556. All these articles, with the exception of those on crossed checks, have been repealed. (Sec. 197.)

Application and purpose of the Negotiable Instruments Law

(1) The Act applies only to negotiable instruments (Arnold vs. Jordan, 215 Ala. 693, 112 So. 305.) or to those instruments which meet the requirements laid down in Section 1 of the law. It is designed to describe fully the law of negotiable instruments. It "covers the entire subject of negotiable instruments and must be, treated as a complete body of law upon the subject and controlling in all cases to which it is applicable/" (Bank of Italy, etc. vs. Symmes, 118 Cal. App. 716, 5 P. [2d] 956.) It is decisive as to all matters comprehended within its terms.

(2) Any case not provided for by the Act shall be governed by the provisions of existing legislation or in default thereof, by the rules of the law merchant. (Sec. 196.) The Civil Code has no effect on its provisions except to supply any deficiency in cases not covered by the Act. (see Art 18, Civil Code.)

(3) The law was enacted for the purpose of facilitating, not hindering or hampering transactions in commercial paper. Thus, the said statute should not be tampered with haphazardly or lightly nor should it be brushed aside in order to meet the necessities in a single case. (State Investment House, Inc. vs. Court of Appeals, 217 SCRA 32 [1993].)

Function and importance of negotiable instruments.

Negotiable instruments play an important role in the business world.

(1) As a substitute for money. — Although they do not constitute legal tender (Art. 1249, *ibid.*), and are not money, they are used as a substitute for money. One of the distinctive characteristics of a negotiable instrument is its negotiability which allows it to pass freely from hand to hand in the commercial markets and to take the place of money in commercial transactions free from all personal defenses (see Sees. 57-58.) available against the original owner. A negotiable instrument differs from money, however, in that the former is valuable or worthless depending upon the financial ability of the parties to them. The purpose of the law is to place negotiable instruments on such footing that it would be



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freely accepted without question in commercial transactions and thereby facilitate trade.

(2) As a medium of exchange Jbr most commercial transactions. — Negotiable papers, particularly checks, constitute, at present, the media of exchange for most commercial transactions. They thus increase the purchasing medium in circulation. Without them circulating among business houses and individuals, more money either in coins or bank bills would be needed in circulation to take care of the ever increasing everyday business transactions. It would be very difficult for the economy to prosper.

(3) As a medium of credit transactions. — Negotiable instruments also serve as a medium of credit transactions." A man does not always have property, or valuable property rights which he can turn into cash at any moment. These tilings, however, measure his credit and he avails himself of his credit by executing his note to his creditor who, in turn indorses this to a third person. Thus, men, in this way, without cash in hand are enabled by means of credit to conduct and carry to completion business and commercial enterprises. The purpose of negotiability then is to allow men of undoubted credit to carry on a business enterprise upon their promissory notes, bills of exchange and checks knowing that other businessmen will treat these promises as cash/' (Ogden, Negotiable Instruments [5th ed.], p. 50.) The check is primarily used for immediate payment (i.e., as a substitute for money), while the ordinary bill of exchange and the promissory note are intended for the circulation of credits (i.e., primarily as a credit transaction). It is used more than any other instrument of credit as a means of making payment. The use of checks automatically provides a receipt for payment and serves as convenient records of financial transactions, (see Sec. 185.)

EXAMPLE: *S sells goods to B who gives a check or a promissory note payable until a future date. Since S would have to wait until maturity date to collect, this is a form of extending credit to a buyer. Now S may wish to sell the instrument to a bank (or a third person) for immediate cash. In order to induce the bank (indorsee) which would have to wait for the maturity before receiving payment, to buy the instrument, S accepts a discount of say, 10% of the face amount. In the above example, the bank, in effect, pays less than the amount it will eventually collect as a way of charging S (seller) interest in advance as compensation for its role in the transaction.*

Characteristics or features of negotiable instruments.

- Negotiable instruments have two important features, namely: negotiability and accumulation of secondary contracts as they pass from one person to another.

(1) Negotiability. — This is that quality or attribute of a bill or note whereby it 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 collect the sum payable for himself free from any infirmity in the instrument or defect in the title of any of the prior parties, or defenses available to them among themselves, (see Secs. 52,57.) In other words, the rule that one can pass no better title to personal property than he himself has, does not apply to negotiable instruments, (see Sec. 30, re-distinctions between negotiation and assignment) A negotiable instrument is analogous to money, for one who honestly takes coin or currency from a thief or finder without knowledge of loss or theft, giving value for it, can hold it against the world, including the true owner. Without this rule, negotiable instruments could not perform their peculiar functions. When transferability is limited or restricted, the paper may be said to be non-negotiable.

EXAMPLE: *Suppose S sells and delivers goods to B who later refuses to pay for them as they, in fact, are not as ordered. In a suit by S against B for the price, B can successfully raise breach of contract by S as a defense. If S assigns the account to X, B can interpose the same defense against X notwithstanding the fact that X did not know of any dispute between S and B when X bought B's account. As assignee X stands in the shoes of S, his assignor. Assume now that B had issued to S his promissory note for the price of the goods. If S sues B on the note, the defense of breach of contract is available to B. But if S negotiates the note to Y who takes the note under such circumstances as to make him a holder in due course (see Sec. 52.), B can no longer interpose such defense against Y.*

A bona fide holder, however, while free from personal defenses available to prior parties among themselves, is subject to real defenses that might have obtained between them, (see Sec. 58.)

(2) Accumulation of secondary contracts. — The most important feature of negotiable instruments is the accumulation of secondary contracts as they are transferred from one person to another. Once an instrument is issued (see Sec. 191.), additional parties can become involved.

EXAMPLE: *Suppose A issues a promissory note payable to the order of B for the sum stated therein. Here, the contract is only between A and B. A is primarily liable. If*



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B transfers his right to the instrument to C, B thereby enters into a new contract with C whereby B binds himself to pay in C in case A, the maker, does not pay the note. Here, B is secondarily liable. The primary contract is that between A and B. The transfer of the note to C makes a secondary contract between B and C. If D buys or discounts the note from C, a similar contract is entered into and so on as it passes from hand to hand. It is obvious that the more debts are added, the more advantageous it will be to the holder as he can proceed not only against the "maker but also against all transferors.

The theory of negotiable instruments.

The theory of negotiable instruments, and of their currency from hand to hand, rests upon the proposition that they appear to belong to the person having them in possession and to no one else. By sending a negotiable instrument into the world, the maker is estopped from urging, as against a bona fide holder who has received it from anyone in possession, a defect of title. The holder, though without title, has capacity to give a title because he is the apparent owner of the instrument. (Manhattan Sav. Inst. v. New York Nat. Ex. Bank, 62 NE1079.)

Forms of negotiable instruments.

(1) Common forms. — The most common forms of negotiable instruments in commercial transactions are the promissory note (Sec. 184.), bill of exchange (Sec. 126.), and bank check. (Sec. 185.) Actually, the Negotiable Instruments Law deals only with two kinds or types of instruments, namely:

(a) promissory notes or those in which the issuer has promised to pay; and
(b) bills of exchange or those in which the issuer has ordered a third person to pay. Checks are also discussed in the law but they are really a special form or kind of bill of exchange.

(2) Special types. — There are, to be sure, many various forms of negotiable instruments. An analysis of the many variations will reveal, however, that they belong to one or the other of the types mentioned.

Some other instruments that have been held negotiable under the Negotiable Instruments Law are: certificates of deposits, bank notes, due bills, bonds, drafts, trade acceptances, and banker's acceptances. The first four are special types of promissory notes (see Sec. 184.) while the others are types of bills of exchange, (see Sec. 126.)

Doubt resolved in favor of negotiability. Negotiable paper, representing as it does in almost all civilized nations a very large proportion of the commercial operations, and serving to a great extent as the representative of money, is justly a favorite of the law, and enjoys immunities and privilege which are extended to no other species of contracts. (Winston v. Westfeldt, 22 Ala. 760.) Where the meaning is doubtful, the courts have thus adopted the policy of resolving in favor of the negotiability of the instrument. The purpose obviously is to encourage the free circulation of the negotiable papers because of the admittedly indispensable function they perform in mercantile business transactions in any given country and the world at large.

Contracts and negotiable instruments compared.

(1) Assumability and negotiability. — Bills of exchange and promissory notes in their various forms are written contracts, and the fundamental rules governing the law of contracts are applicable to the determination of the legal questions which may arise over such instruments. However, bills and notes are capable of being cast in such form as to have the quality of negotiability, and instruments having this quality, while their nature as contracts is unimpaired, are distinguished from ordinary contracts by incidents having their foundation in the law merchant (see Sec. 196.), which, so far as it has been codified by statute, is now known as the Negotiable Instruments Law.

Between ordinary contracts and negotiable instruments there is the difference between "assignability" and "negotiability." (11 Am. Jur. 2d 29-30; see Sec. 30.) Unlike other contracts, a negotiable instrument is not in force until it is delivered: (see Sec. 16*)

(2) Negotiability of various types of commercial papers. — While it has been said that there is no middle term between negotiability and non-negotiability, the courts sometimes use the term "quasi-negotiability," and "negotiability" may vary with various types of commercial papers and their various purposes and functions. An instrument may possess some, but not all, of the elements of negotiability, or be negotiable in a limited sense rather than in the true sense. True negotiability may be confined to commercial contracts which represent and, in a measure, pass as money, such as bills of exchange and promissory notes (11 Am. Jur. 2d 33-35.) and their special forms.

(3) Rules of law applicable. — The peculiarities of the Negotiable Instruments Law, distinguishing such instruments from other contracts, relate, of course, to a holder who has taken by negotiation, and not as an original party. (Vander Plaeg v. Van Zuuk, 112 NW 807.)



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Bills and notes, while usually negotiable, are not necessarily so, and non-negotiable instruments generally are governed by the rules of law applicable to ordinary contracts, except as there is applicable to them, by analogy or by express provisions, the Negotiable Instruments Law. (11 Am. Jur. 2d 30.) Instruments which are negotiable in the true sense are governed by said Law

Commercial papers with limited negotiability. There are certain instruments with limited negotiability which are also widely used in commercial transactions but they have been held to be non-negotiable in the technical sense because they do not have the requisites that are essential under the Negotiable Instruments Law. They are beyond the scope of the Law and are, therefore, governed by other laws.¹

¹Also not governed by the NIL are:

Among such commercial papers are the following: (1)

Document of title. — It is a receipt or order for the delivery of goods, (see Part II.) It includes any bill of lading, dock warrant, "quedan" or warehouse receipt. Although it is termed "negotiable" when the goods are deliverable to the bearer or order, it is without an unconditional promise or order to pay a sum certain in money;

(2) Letter of credit. — It is in favor of a specified person and not to order. (Art. 568, Code of Commerce; see Part III-A.) But drafts (see Sec. 126.) issued in connection with letters of credit are negotiable instruments. (Lee vs. Court of Appeals, 375 SCRA579 [2002].)

(3) Trust receipt — It is a document of security pursuant to which a bank acquires a "security interest" in the goods under trust receipt, (see Part III-C.) Under a letter of credit-trust receipt arrangement, a bank extends a loan covered by a letter of credit with the trust receipt as a security for the loan. The transaction involves a loan feature represented by a letter of credit and a security feature which is in the covering trust receipt which secures an indebtedness. (Lee vs. Court of Appeals, supra.)

(4) Certificate of stock. — It is a muniment of title to a given share in the assets of a corporation. It is also without an unconditional promise or order to pay a sum certain in money; and

(5) Pawn ticket. — It is not a negotiable instrument under the Negotiable Instruments Law nor a negotiable document of title under Articles 1507, et seq. of the Civil Code. (Part II-A.) A

(1) Treasury warrant. — It is a government warrant for the payment of money such as that issued in favor of

public officer or employee covering payment or replenishment of cash advances for official expenditures. It is payable out of a specific fund or appropriation (Abubakar vs. Auditor General, 81 Phil. 359 [1948]; Metropolitan Bank & Trust Company vs Court of Appeals 194 SCRA169 [1991]) and

(2) Postal money order. — It is an order for the payment of money to the payee named therein drawn by one post office upon another under authority of law. (see 11 Am. Jur. 2d 55.) It is subject to restrictions and limitations under postal laws and regulations (only one indorsement is allowed) inconsistent with the character of negotiable instrument. (7 Am. Jur. 921.) Moreover, in establishing and operating a postal money order system, the government is not engaged in commercial transactions but merely exercises a governmental power for the public benefit. (Phil.

pawnbroker who has been notified by the owner of the thing (jewelry) pledged by another that the thing pawned to it was either stolen or involved in an embezzlement of the proceeds of the pledge, has the duty (see Art. 21, Civil Code.) to hold the thing and to give notice to the owner and the police of any effort to redeem the same. The circumstance that the pawn ticket states that the pawn is redeemable does not exempt him from that duty. (Serrano vs. Court of Appeals, 196 SCRA107 [1991].)

CHAPTER I

FORM AND INTERPRETATION

Section 1. Form of negotiable instruments. — An instrument to be negotiable must conform to the following requirements:

- (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.

Commercial paper defined.

Commercial paper, in its broadest sense, refers to written promises or obligations that arise out of commercial transactions from the use of such



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instruments as promissory notes and bills of exchange. All such paper is either negotiable or Non-negotiable.

Formal requirements of negotiability in general.

A negotiable instrument, briefly stated, is a contractual obligation to pay money. However, whether or not an instrument is negotiable or non-negotiable depends entirely on its form and content. In determining the negotiability of an instrument, the following must be considered:

- (1) the whole of the instrument;
- (2) only what appears on the face of the instrument; and
- (3) the provisions of the Negotiable Instruments Law especially

Section 1 thereof which gives the requirements of negotiability. A valid instrument is not necessarily negotiable. Every negotiable instrument is presumed to be a contract but not every contract is a negotiable instrument.

Negotiable instrument defined.

Section 1, in effect, gives a definition of a negotiable instrument. It is an instrument which possesses all the elements of negotiability provided in Section 1 of the Negotiable Instruments Law. It does not cover other types of negotiable documents involving the sale or transfer of goods, (see Part II.)

The requisites enumerated in Section 1 are deemed essential for the security of commercial transactions as they enable one to tell at a glance whether or not an instrument is negotiable and accordingly, to gauge the risks involved in taking it as security. The Negotiable Instrument Law cannot' come into operation unless the document in existence is of the character described in Section 1 of the law. (Kauffman v. National Bank, 12 Phil. 182 [1908].)

Formal requirements explained.

All kinds of negotiable instruments are either promises or orders to pay money which meet the formal requirements set forth in the law.

The requirements indicated in subsections (a), (b), (c), and (d) are necessary in order that a promissory note may be negotiable while all the sub sections from (a) to (e) are necessary in order that a bill of exchange may be negotiable.

Under subsection (a), the maker refers to the person issuing a promissory note, while the drawer, to the person issuing a bill of exchange.

In subsection (b), the instrument must contain an "unconditional promise" if it is a promissory note and "an unconditional order" if it is a bill of exchange.

Subsections (c) and (d) are both applicable to each of the two kinds of instruments, but subsection (e) is applicable only to bills of exchange.

(1) The instrument must be in writing.—The term "instrument" indicates a writing. The instrument must be in writing or reduced in tangible form; otherwise, nothing could be negotiated or passed from hand to hand.

(a) Writing includes not only that which has been written on paper and with a pen or pencil but also that which is in print. (Sec. 191.) or has been typed. The writing may be made upon leather, doth or any other substitute for paper as long as it is movable in nature. Such materials, however, are no longer used in the usual exercise of business. The usual way is to have the instrument written or printed in durable paper. There is no such thing as an oral negotiable instrument. An oral promise can make it difficult to determine liability and create the danger of fraud.

(b) The accepted rule is that the negotiability or non negotiability of an instrument is determined from the writing that is from the face of the instrument itself. While the writing may be read in the light of surrounding circumstances in order to more perfectly understood the intent of the parties, yet as they have constituted the writing to be the only outward expression of their meaning, no other words are to be added to it or substituted in its stead. The duty of the court in such case is to ascertain not what the parties may have secretly intended as contradistinguished from what their words express, but what is the meaning of the words they have used. (Caltex [Phils.], Inc. vs. Court of Appeals, 212 SCRA 448 [1992].)

(2) The instrument must be signed by the maker or drawer. — Although the signature of the maker or drawer as a general rule is placed at the lower right hand corner of the instrument, it may appear in any part thereof whether at the top, middle or bottom or at the margin.

(a) A handwritten statement on the body of the instrument, such as "I, Juan dela Cruz, promise to pay Maria dela Cruz . . ." will be considered as Juan's



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signature. It will be valid and binding as long as it appears that a person intended to make the instrument his own. His signature is prima facie evidence of his intention to be bound as either maker or drawer. However, if the signature is so placed upon the instrument that it is not clear in what capacity the person intended to sign, he is deemed an indorser (Sec. 17[f].) and not a maker or a drawer.

(b) The signature of the maker or drawer is usually written in longhand. It is preferable that the full name or at least the surname should appear. But initials or any mark will be sufficient, provided that such signature be used as a substitute and the maker or drawer intends to be bound by it. The name may be written in script or Roman letters with a pen or pencil, or made by rubber stamp by one having authority. It may be printed, type-written, engraved, photographed or lithographed. What is important is that the signer has intended to adopt the signature on the instrument as his own and to obligate himself for its payment. However, an unusual signature may limit the acceptability of an instrument. The use of a pencil is undesirable as it is easy to tamper the writing.

(c) Where the genuineness of the signature of the maker or drawer is denied, the signature is nevertheless presumed valid. The maker or drawer must provide some evidence of the signature's invalidity

(3) The instrument must contain an unconditional promise or order to pay. — See comments under Section 3.

(4) The instrument must be payable in a sum certain in money. — The promise or order must call for the payment of a sum certain in money.

(a) The reason for the requirement that negotiable instruments must be payable in money is that money is the one standard of value in actual business. All other commodities may rise and fall in value but in theory, at least, money always measures this rise and fall, and remains the same. The chattel which is used as means of payment may fluctuate in value. (Norton on Bills and Notes, 4th ed., p. 66.) But the promise or order may designate "a particular kind of current money in which payment is to be made." (Sec. 6[e].) With the requirement, negotiable instruments acquire a uniform standard of value enabling them to pass freely in lieu of money in the business world.

(b) The term money properly includes all legal tender, (see Sec. 6[e].) Legal tender is that sort of money in which a debt, or other obligation calling for money, may

be lawfully paid, if the contract does not specify the medium of payment. (18 R.C.L. 1276-1278; Ballentine's Law Dictionary, p. 738.) Thus, gold and silver and bank notes are not money. See comments under Sections 2 and 6.

(5) The instrument must be payable at a fixed or determinable future time or on demand. — See comments under Sections 4 and 7.

(6) The instrument must be payable to order or bearer. — See comments under Sections 8 and 9.

(7) The drawee must be named. — This provision applies only to bills and checks. Obviously, an order which is not addressed to any person cannot be a bill, (see Sec. 14.) A bill is an order. But the bill would be insufficient if the drawee is indicated therein with reasonable certainty though he is not named. Thus, where a bill is addressed to the "treasurer" of a corporation, the drawee is sufficiently indicated, (see Secs. 128,129,17[e].) The trade name may be used as in the case of the payee. The reason for this last element of negotiability is to enable the payee or holder to know upon whom he is to call for acceptance or payment. A promissory note has no drawee. Like the drawee, the payee must be named with reasonable certainty, (see Sec. 8, par. 2.

Non-negotiable instrument defined.

- A non-negotiable instrument is, of course, an instrument which is not negotiable, that is, an instrument which does not meet the requirements laid down to qualify an instrument as a negotiable one, or an instrument which in its inception was negotiable but has lost its quality of negotiability. (11 Am. Jur. 2d, 37.)
- A typical example is a check payable only to a specified person, as when it reads merely "Pay to Pedro Cruz/" A negotiable instrument ceases to be negotiable if the indorsement prohibits the further negotiation of the instrument, (see Sec. 36[a]; also Secs. 32 and 41.)
- An instrument which is non-negotiable is covered by the general provisions of the Civil Code, not by the Negotiable Instruments Law. It is merely a simple contract in writing and is evidence of such intangible rights as may have been created by the assent of the parties. (Garcia vs. Llamas, 417 SCRA 292 [2003].)



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- A non-negotiable instrument may not be negotiated but it may be assigned or transferred (see Sec. 30.), absent an express prohibition against assignment or transfer written on the face of the instrument. The legal consequences of negotiation, as distinguished from assignment of a negotiable instrument, are different. (*Sesbreno vs. Court of Appeals*, 222 SCRA 466 [1993].) Persons who transfer or assign contractual or non-negotiable rights pass only the rights that they had.

Money defined.

- Specifically, money means what is coined or stamped by public authority and has its value fixed by public authority. In a literal sense, the term "money" means cash, (see 11 Am. Jur. 2d 40.) It is a medium of exchange authorized or adopted by a government as part of its currency, (see [U.S.] Uniform Commercial Code 1-201 [24].) It includes all legal tender, \ {supra;see Sec. 6[e].}

Money not governed by Act.

- Paper money is, of course, a negotiable instrument, but the Negotiable Instruments Law has no application to money as such
- While negotiable instruments approach money in character and use, and are a temporary substitute therefor, the question whether for any particular purpose such an instrument constitutes money, payment, or proper tender, is not governed by the Act.' (see 11 Am. Jur. 2d 40.)

Promissory note defined.

- A negotiable promissory note is 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. (see Sec. 184.)
- A promissory note, briefly stated, is a promise to pay a sum of money. It is commonly referred to as note. It may be a demand instrument (Sec. 7.) but is normally a time instrument. (Sec. 4.)
- A mere contract to pay money which is not a promissory note is a mere chose in action. (*Steward v. McIntosh*, 9 NE 2d 407.)

Original parties to a promissory note.

This class of negotiable instrument is a promise paper, or two-party paper. There are originally two parties in a promissory note. The one who makes the promise and signs the instrument is called

- the maker and the party to whom the promise is made or the instrument is payable is called the payee.

- The payee may be specifically designated by name or by office or title (e.g., treasurer of X Corporation). It may be unspecified * (e.g., "bearer"). He may seek payment personally or further . negotiate (see Sec. 30.) the instrument/Thus, the maker assumes liability to pay to the payee or to the holder.
- The maker's signature must appear on the face of the note for him to be liable thereon. After an Instrument, promissory note or bill of exchange —is issued, additional parties can also become involved.

NOTE: Every person to whom an instrument is delivered, is a holder, (see Sec. 191.) Such holder may be the payee or any subsequent person receiving the promissory note or bill of exchange (infra.) by delivery or by delivery and indorsement, (see Sec. 30.)

EXAMPLES:

The foregoing illustrations show the general outline and principal features of a negotiable promissory note:

(1) Payable to order:- payable only to a specific person or anyone they authorized/order.requires endorsement (signature of the payee) and deliver to transfer.

August,30,2010

Manila

P10,000.00

For value received, I promise to pay to the order of Alfredo M. Almada the sum of Ten Thousand (P10,000.00) Pesos on or before September 30, 2010 at

his house at Pateros, Metro, Manila.

(Sgd.) Arsenio F. Flores

(2) Payable to bearer: - payable to whoever holds or possesses the instrument. Can be transferred by mere delivery.

August30,2010

Manila

P10,000.00

Two months after date, I promise to pay to Alfredo M. Almada or bearer the sum of Ten Thousand (P10,000.00) Pesos.

(Sgd.) Arsenio F. Flores

(1) The figures "P10,000.00" at the upper left hand corner of the instrument indicate the amount of the note. This is not essential but it is convenient because the amount in figures is more quickly grasped than if written in words, (see Sec. 17[a].)

(2) The word "Manila" at the upper right corner indicates the place where the contract is executed, while the date "August 30,2010," the date of execution. The place and the date are not essential to the negotiability of the



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instrument except in certain cases when the date is necessary to determine when the note is due (see examples [b]/ [c], and [d].) or the interest is to run when the payment of interest has been stipulated or whether the holder is barred by the statute of limitations from enforcing the note, (see Sees. 144,186.)

(3) The words "for value received" indicate the consideration given for the note which may be specified. As consideration is presumed (Sec. 24.), the words "for value received" may be omitted. (Sec. 6[b].)

(4) The words "I promise to pay" signify an absolute and unconditional promise to pay the payee, or to a holder. This is essential to the negotiability of the instrument. Instead of "promise," however, any other set of words of equivalent meaning may be substituted, "I agree to pay," "I will pay," "good to Alfredo Almeda or order" (Hussey v. Winslow, 59 Me. 170.) "due to Alfredo Almeda or order" (Smith v. Allen, 5 Day [Conn.] 337; Shimmerl v. Williams, 240 NY Suppl. 161.), "I acknowledge to be indebted to Alfredo Almeda or order" and the like. But mere acknowledgement of a debt without the use of the words "order" and "bearer" which are usually referred to as words of negotiability does not satisfy the requirements, "Due to Alfredo M. Almeda P10,000.00," because it does not imply a promise to pay. (see Sec.

3.) Neither the words "will agree to pay" satisfy an unconditional promise to pay.

(5) The words "to the order of (example [a].) and "or order" (example [b].), indicate a promise to pay as ordered or commanded by the payee. But the instrument may be payable to bearer, (examples [c] and [d].) The above examples show four different ways usually adopted in making an instrument payable to order or bearer.

(6) The words "on or before September 30,2010" (example [a].) indicate the date of maturity or the time when the promise to pay is to be fulfilled. Not all instruments are payable at a fixed future time. They may be payable after date or after the expiration of a certain period, (examples [b], [c], and [d].) Others may be payable on demand. Where no time for payment is expressed, an instrument is payable on demand. (Sec. 7[b].)

(7) The name "Alfredo M. Almeda" indicates the payee, the person to whom the promise is made or the

instrument is payable. But the payee need not be specified if the promise made to "bearer." (example [d].)

(8) The amount "Ten Thousand Pesos" as the figures "P10,000.00" do indicate the amount which the maker binds himself to pay. The figures "P10,000.00" are not essential, (see Sec. 17[a].)

(9) The words "at his house at Pateros, Metro Manila" indicate the place where the note is to be paid. The place of payment, however, is not essential as an instrument may be made payable at any other place agreed upon by the parties.

(10) The signature "Arsenio F. Flores" is the maker of the note. He is the one who promises to pay at the first instance. A note may be signed by several persons either jointly, or jointly and severally, (see Sec. 17[g].)

Bill of exchange defined.

A negotiable bill of exchange is 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.) From the foregoing, it will be seen that a bill of exchange is essentially an order made by one person to another to pay money to a third person. For brevity, a bill of exchange is usually called a "bill." If drawn on a bank and payable on demand, the order bill is, by definition, called check. (Sec. 185.) The check is the most common form of order paper, (infra.)

Original parties to a bill of exchange.

This class of negotiable instruments is known as order paper, or three-party paper. A bill of exchange requires in its inception at least three parties — the drawer, the drawee, and the payee — to fill the legal roles involved. The holder of the instrument may be the payee or, when there has been a negotiation thereof, a party subsequent to the payee, (supra.)

(1) The person who issues and draws the order bill is called the drawer. He gives the order to pay money to a third party. He does not pay directly.

(2) The party upon whom the bill is drawn is called the drawee. He is the person to whom the bill is addressed and who is ordered to pay. He becomes an acceptor when he indicates a willingness to accept responsibility for the payment of the bill. (Sec. 62.) The drawee is a bank in the case of a check.



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(3) The party in whose favor the bill is originally drawn or is payable is called the payee. Up to the time of acceptance by the drawee, the payee looks exclusively to the drawer. Again, the payee, as in a promissory note, may be specifically designated, or may be an office or title, or unspecified. The parties need not all be distinct persons. Indeed, a bill will be valid where there is only one party to it, for one may draw on himself payable to his own order (see Sec. 8.), that is, the two parties to the bill can be the same person (drawer-drawee or drawer-payee).

EXAMPLE:

December 30, 2010

Manila

P10,000.00

Thirty days after date, pay to Alfredo M. Almeda or order the sum of Ten Thousand (P10,000.00) Pesos. Value received and charge the same to the account of (Sgd.) Jovencio F. Cinco To Domingo M. Lantican College, Los Bafios Laguna

As may be seen from the above example, a bill of exchange has the following general characteristics not found in the promissory note:

(1) The words "pay to" indicate an unconditional order to pay instead of an unconditional promise to pay a promissory note.

(2) The name "Jovencio F. Cinco" indicates the drawer, the one who signs the bill of exchange. He corresponds to the maker in the case of a promissory note.

(3) The name "Domingo M. Lantican" indicates the drawee, the one to whom the bill is addressed. In a promissory note there is no drawee. The drawee is not really a party to the bill. He assumes liability only when he accepts the bill usually by writing the word "accepted" and signing his name on the face thereof (see Secs. 132 and 133.) in which case he ceases to be a drawee and becomes known as an acceptor.

By accepting, the acceptor becomes primarily liable like the maker of a note (see Sec. 62.), the drawer becoming only a surety, (see Sec. 61.)

(4) The words "charge the same to the account of" means that the amount to be paid by the drawee is to be charged against the funds of the drawer. But these may be omitted.

Idea and purpose of a bill of exchange.

(1) **Drawer's funds in hands of drawee.** — The original and fundamental idea and purpose of a bill of exchange is that the drawer has funds in the hands of the drawee of which the drawer wishes to avail himself, the drawer being the party primarily interested in, and benefited by, the transaction. By this instrument, the drawer,

appropriates the fund, actual or anticipated, in the drawee's hands and receives the consideration for the appropriation from the payee to whom the instrument is delivered. The office of the instrument is to collect for the drawer from the drawee money to which the former may be entitled, (see 11 Am. Jur. 2d 42.)

(2) **Liability of drawee for non-payment.** — If the drawee refuses to accept when he has funds for the purpose, he becomes liable to the drawer for the resulting damages and the harm done to his credit. If the drawer has no funds in the hands of the drawee, it is at least presumed that the former must have made arrangements with the latter so that he will honor the bill. In such a case, the drawee must look to the drawer for reimbursement and not to a bona fide holder.

In short, in order for the drawee to be liable to the drawer, there must be some kind of agreement obligating the drawee to honor the order of the drawer or an existing debtor-creditor relationship between them, that is, the drawee must owe the drawer a debt, in which case the drawer simply orders the drawee to pay the debt or a portion of it to a third party. A drawee-bank is not liable for its refusal to pay a check on account of insufficient funds notwithstanding the fact that a deposit may be made later in the day.

Where the deposit is sufficient, the failure of a bank to pay the check of the drawer entitles the drawer to substantial damages without any proof of actual damages. (Moran vs. Court of Appeals, 230 SCRA 799 [1994].)

Sec. 2. Certainty as to sum; what constitutes. — The sum payable is a sum certain within the meaning of this Act, 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.

Certainty of sum payable.

The promise or order must call for the payment of a sum certain in money. This is a requisite for the negotiability of the instrument (Sec. 1[b]);, to assure clarity and certainty in determining the value of the instrument. The "sum certain" requirement is met if the holder can determine from the instrument itself the amount he is



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entitled to receive at maturity. If the instrument calls for an act other than the payment of money, it is not negotiable because a negotiable instrument is intended as a substitute for money.

(1) Payment of a fixed amount of money. — Since a negotiable instrument is a device intended as a substitute for money, it is, therefore, essential that it represents a fixed amount to be paid wholly in money. The amount to be paid must be stated plainly on the face of the instrument or at least, may be ascertained upon its face by computation, independent of any extrinsic evidence. If an instrument be for a specified sum of money, and also for the payment of something else, the value of which is not ascertained but depends upon extrinsic evidence, it would not be negotiable. Accordingly, the following do not express a sum certain:

(a) "To pay \$1,000.00 or what may be due on my deposit book/" (National Savings Bank v. Cable, 79 Conn. 68,48 Atl. 428.)

(b) "To pay \$1,000.00 and also all other sums which may be due to him." (Smith v. Nightingale, 2 Stardie, 375.)

(c) "To pay \$1,000.00 and the value of four days labor/" (Iowe v. Bliss, 24111.168.)

(2) Permissible clauses or stipulations. — The sum is not rendered uncertain by a clause in the instrument that it is to be paid with interest, by stated installment, with exchange, with costs of collection, or with attorney's fees. Neither is the certainty of the sum affected by an acceleration provision in an installment note. The basic test is whether the holder can determine by calculation or computation the amount payable when the instrument is due. But a promissory note giving the maker the right to ascertain the amount rightly payable thereunder is non-negotiable.

Sum to be paid with interest.

(1) Interest at fixed rate. — A provision for the payment of interest is a mere incident; it does not render the instrument non-negotiable because it does not make uncertain the sum payable.