UNITED NATIONS

GENERAL ASSEMBLY

Distr.
GENERAL

A/CN.9/261
28 January 1985

ORIGINAL: ENGLISH 22265

UNITED NATIONS COMMISSION
ON INTERNATIONAL TRADE LAW
Eighteenth session
Vienna, 3 - 21 June 1985

REPORT OF THE WORKING GROUP ON INTERNATIONAL NEGOTIABLE INSTRUMENTS ON THE WORK OF ITS THIRTEENTH SESSION (New York, 7 - 18 January 1985)

CONTENTS

V.85-21698

INTRODUCTION

1. The United Nations Commission on International Trade Law, at its seventeenth session (New York, 25 June-10 July 1984), considered the draft Convention on International Bills of Exchange and International Promissory Notes as prepared by the Working Group and contained in document A/CN.9/211. As regards its future course of action, the Commission decided that further work should be undertaken with a view to improving the draft Convention and entrusted this work to the Working Group on International Negotiable Instruments. 1/

2. The mandate of the Working Group was to revise the draft Convention on International Bills of Exchange and International Promissory Notes in the light of decisions and discussion at the seventeenth session of the Commission, 2/ and also taking into account those comments of Governments and international organizations in documents A/CN.9/248 and A/CN.9/249/Add.1 which were not discussed at that session.

3. The Working Group held its thirteenth session at United Nations Headquarters in New York from 7 to 18 January 1985. The Working Group consists, according to the decision of the Commission at its seventeenth session, 3/ of the following 14 members of the Commission: Australia, Cuba, Czechoslovakia, Egypt, France, India, Japan, Mexico, Nigeria, Sierra Leone, Spain, Union of Soviet Socialist Republics, United Kingdom of Great Britain and Northern Ireland and United States of America. With the exception of Sierra Leone, all members of the Working Group were represented at the thirteenth session. The session was also attended by observers of the following States: Argentina, Austria, Canada, Chile, China, Democratic Yemen, Ecuador, El Salvador, Germany, Federal Republic of, Greece, Hungary, Iran (Islamic Republic of), Iraq, Italy, Ivory Coast, Netherlands, Norway, Oman, Paraguay, Portugal, Qatar, Republic of Korea, Romania, Sweden, Switzerland, Syrian Arab Republic, Thailand, Turkey and Yugoslavia, as well as by observers from the following international organizations: Hague Conference on Private International Law, International Bar Association and International Chamber of Commerce.

1/ Report of the United Nations Commission on International Trade Law on the work of its seventeenth session, Official Records of the General Assembly, Thirty-ninth Session, Supplement No. 17 (A/39/17), para. 88.

2/ The discussion and conclusions on major controversial and other issues are set forth in the report of the United Nations Commission on International Trade Law on the work of its seventeenth session, Official Records of the General Assembly, Thirty-ninth Session, Supplement No. 17 (A/39/17), paras. 21-82.

3/ Ibid., para. 88.

4. The Working Group elected the following officers:

Chairman: Mr. Willem Vis (Netherlands)*

Rapporteur: Mrs. G. O. Adebanjo (Nigeria)

5. The Working Group had before it the following documents:

A/CN.9/WG.IV/WP.28 - Provisional agenda;

A/CN.9/211 - Draft Convention on International Bills of Exchange and International Promissory Notes: Text of draft articles as adopted by the Working Group on International Negotiable Instruments: note by the Secretariat;

A/CN.9/213 - Commentary on draft Convention on International Bills of Exchange and International Promissory Notes: Report of the Secretary-General;

A/CN.9/248 - Draft Convention on International Bills of Exchange and International Promissory Notes and draft Convention on International Cheques: analytical compilation of comments by Governments and international organizations;

A/CN.9/249 - Draft Convention on International Bills of Exchange and International Promissory Notes and draft Convention on International Cheques: major controversial and other issues;

A/CN.9/249/Add.1 - Draft Convention on International Bills of Exchange and International Promissory Notes and draft Convention on International Cheques: major controversial and other issues - Addendum: summary of the comments of Romania and Switzerland;

Report of the United Nations Commission on International Trade Law on the work of its seventeenth session (1984), Official Records of the General Assembly, Thirty-ninth Session, Supplement No. 17 (A/39/17).

---

* The Chairman was elected in his personal capacity.

DELIBERATIONS AND DECISIONS

6. The Working Group took note of the mandate conferred upon it by the Commission, namely to revise the draft Convention on International Bills of Exchange and International Promissory Notes in the light of the decisions taken and the discussion held at the seventeenth session of the Commission and also taking into account those comments of Governments and international organizations contained in documents A/CN.9/248 and A/CN.9/249/Add.1 which were not discussed at that session.

7. The Working Group commenced its review of the draft Convention on International Bills of Exchange and International Promissory Notes by considering the major controversial issues, as set forth in document A/CN.9/249 and as discussed by the Commission at its seventeenth session, 4/ and some related questions.

8. The Working Group decided, subject to approval by the Commission, to hold its next session (the fourteenth session) at Vienna from 9 to 20 December 1985.

DRAFT CONVENTION ON INTERNATIONAL BILLS OF EXCHANGE AND INTERNATIONAL PROMISSORY NOTES: CONSIDERATION OF MAJOR CONTROVERSIAL ISSUES AND SOME RELATED QUESTIONS

I. The concept of holder and protected holder

A. Definition of protected holder

9. The Working Group considered whether a person who had taken an incomplete instrument and had completed it in accordance with the agreement between the payee and the drawer or the maker could qualify as a protected holder. The Working Group, after deliberation, was of the view that the mere fact that the instrument was incomplete should not prevent a person from becoming a protected holder provided he complied with the provisions of article 11.

10. Various suggestions were made to effect that result. Under one proposal, the words in article 4 (7) "when he became a holder, was complete and regular on its face" would be deleted. Under another proposal, the word "complete" would be retained but would be qualified by the following addition "or was incomplete but which could be completed in accordance with article 11 (1) and was completed in accordance with an agreement entered into".

11. It was agreed that the point of time at which it should be determined whether a person had protected holder status was not the time when the person took the incomplete instrument but when he completed it.

4/ Ibid. paras. 21 - 38.

12. Opinions were divided on the question whether a holder who took an instrument that was irregular on its face could qualify as a protected holder. Under one view, the requirement that the instrument be regular on its face should be retained in view of the fact that an instrument showing apparent defects should put the holder on notice that a claim to or a defence upon the instrument might exist. Under another view, the criterion that the instrument be regular on its face should be deleted because: (a) it was difficult to determine exactly what was meant by regular or irregular, and (b) the concerns of those who favoured denying protected holder status to a holder taking an instrument that was irregular on its face were met by the rule that knowledge of a particular irregularity would amount to knowledge of a particular claim or defence. The reference to regularity was thus not indispensable.

13. The Working Group considered the following revised version of article 4 (7), prepared by the Secretariat:

> "(7)'Protected holder' means the holder of an instrument which, when he obtained it, was [regular on its face and] complete or, if incomplete as referred to in article 11 (1), was completed by him in accordance with an agreement entered into, provided that, when he became a holder:
>
> (a) He was without knowledge of a claim to or defence upon the instrument referred to in article 25 or of the fact that it was dishonoured by non-acceptance or non-payment; and
>
> (b) The time-limit provided by article 51 for presentment of that instrument for payment had not expired."

14. The Working Group adopted this text of article 4 (7), subject to the deletion of the words between square brackets "regular on its face and". The Working Group was of the view that these words could be deleted since it was clear from other provisions in the draft Convention, particularly article 5 on the definition of knowledge, that the holder who took an instrument on which there was, for instance, visible evidence of forgery or material alteration could not qualify as a protected holder. With respect to sub-paragraph (a) of article 4 (7), see the discussion and decision of the Working Group in the context of article 26 (below, para.26).

B. Defences and claims that may be set up against a holder (article 25)

15. The Working Group discussed whether the fact that a holder took an instrument with knowledge of a particular claim or defence should make him vulnerable to other claims or defences of which he had no knowledge. The following examples were given:

(a) The payee C of an instrument obtains it from the drawer A by fraud; in turn, D obtains the instrument from C by fraud; D has no knowledge of the fraud perpetrated by C on A. There was general agreement that, under the draft Convention, D should not be a protected holder and he should be subject to the claim by A to the instrument or to the defence by A on the instrument based on fraud;

(b) If A had a defence against C not based on fraud of which D, who defrauded C, had no knowledge, D should not be a protected holder and would be subject to the defence of A;

(c) If D transferred the instrument to E who knew of the fraud committed by D, E would be subject to the defence of fraud set up by A in an action by E against him;

(d) If A had a defence against C based on the delivery of defective goods and D obtained the instrument from C by fraud, E, to whom D transferred the instrument, would be subject to the defence of A if E had knowledge of the fraud committed by D against C.

16. The Working Group, after deliberation, concluded that the draft Convention should not give protected holder status to a holder who took the instrument by fraud or by theft or who knew that fraud or theft had been committed by a prior party. On the other hand, the mere fact that the holder had knowledge of a defence not based on fraud or theft should not necessarily deprive him of protection against defences of which he had no knowledge. Thus, the holder who had knowledge of defence X of the drawer against the payee should cut off defence Y of the drawer against the payee if he had no knowledge of that defence. It was suggested that that result could be achieved by modifying article 25 concerning the rights of a holder.

17. The Working Group set up an ad hoc working party composed of the representatives of Austria, Canada, the Union of Soviet Socialist Republics and the United States of America and requested it to prepare a draft proposal.

18. The ad hoc working party submitted the following proposal:

"Add to article 25 a new paragraph (4):

A holder is subject to a defence under paragraph (1) (b) or to a claim under paragraph (2) of this article only if he took the instrument with knowledge of such defence or claim or if he obtained it by fraud or participated at any time in a fraud concerning it."

19. The Working Group adopted the draft provision, subject to the following modifications. After the words "A holder" should be inserted the words "who is not a protected holder", and the words "concerning it" shall be replaced by the words "affecting it". The new paragraph is to follow paragraph (2) of article 25 and, for the time being, labelled as paragraph (2 bis).

C. Defences and claims that may be set up against a protected holder (article 26)

20. It was noted that article 26 (1) (c) referred to two defences, namely that based on incapacity and that based on fraud in the factum. The Working Group discussed the question whether other defences such as duress,

misrepresentation or impossibility should be added as defences available against a protected holder. The prevailing view was that only the two defences referred to in sub-paragraph (c) should be available.

21. The Working Group considered the proposal that the words in paragraph (2) "or arising from any fraudulent act on the part of such holder in obtaining the signature on the instrument of that person" be deleted. It was stated that this particular provision could apply in the case where a protected holder obtained fraudulently an acceptance from the drawee or a signature from a guarantor. The Working Group noted that the preparatory work on the draft Convention, as reflected in the reports of the Working Group, did not set forth any specific reason why the above wording had been added to an earlier version of paragraph (2). It was thought likely that the wording had been added in order to align paragraph (2), which was concerned with a claim to the instrument, with the provision of paragraph (1) (b), which contained similar wording in respect of defences.

22. While some representatives expressed doubts as to the usefulness of such wording in paragraph (2), the Working Group decided to retain the present text of article 26 (2).

23. With particular regard to article 26 (1) (b), the proposal was made that the protected holder, in addition to the defences listed in article 26 (1), should also be subject to defences to contractual liability based on a transaction, not related to the issue or the transfer of the instrument, between himself and the party from whom he claimed payment. Therefore, as between a protected holder and the party he had dealt with, even those defences that did not derive from the underlying transaction, which gave rise to the issue or the transfer of the instrument, could be set up. The following example was given: the maker A issues a note to the payee B; B transfers the note to C; because of a previous transaction between B and C, unrelated to the transfer of the note, C is indebted to B; upon dishonour by non-payment, C demands payment from B. B should be able to raise, as a defence to his liability on the note, the fact that C is indebted to him, in spite of the fact that C is a protected holder.

24. The proposal was opposed on the ground that defences to liability on the instrument should be derived only from the transaction which gave rise to the issue or the transfer of the instrument to a protected holder. The indebtedness of C could be the subject of a set-off or counter-claim off the instrument which, under some legal systems, was governed by general rules, in particular those on civil procedure, which in turn reflected different attitudes in this respect. Another ground on which the proposal was opposed was that it diminished the rights of a protected holder and that this was undesirable.

25. A more limited proposal was to enlarge the present wording of article 26 (1) (b) so as to cover not only defences derived from the underlying transaction itself but, at least, also defences deriving from agreements which were related to such transaction. Special reference was made to agreements for prolongation.

26. In the context of these proposals, it was noted that the definition of protected holder as set forth in article 4 (7) required, in its sub-paragraph (a), that the holder be without knowledge of a defence upon the instrument referred to in article 25, which, in its paragraph (1) (c), included any defence to contractual liability based on a transaction between the holder and an immediate party. The Working Group requested the Secretariat to reconsider the definition of protected holder in article 4 (7), in particular the appropriateness of the reference in sub-paragraph (a) to all defences listed in article 25. The Secretariat should further consider which defences should be available to an immediate party of a holder or a protected holder (under articles 25 and 26), with particular regard to the provisions of article 25 (1) (c) and article 26 (1) (b). The text to be submitted by the Secretariat should be accompanied by explanatory notes in which the various possible solutions should be tested at the hand of concrete examples.

27. The Working Group decided to postpone to its next session consideration of the following suggestion which had been made during the discussion at the Commission's seventeenth session: it ought to be considered whether the draft Convention should protect a holder only in those cases in which he took the instrument in good faith, and whether the shelter rule (article 27) should enable a holder to have the rights of a protected holder even though he had taken the instrument in bad faith. 5/

II. Forged endorsements and endorsements by agent without authority (article 23)

A. Basic policy issues concerning forged endorsements

28. The Working Group noted that article 23 (1) was the result of a compromise between common law and civil law systems in that it followed the Geneva approach under which a forged endorsement would not prevent the endorsee and a subsequent transferee from being a holder and, at the same time, reached the result obtaining in common law jurisdictions which placed the risk of loss consequent upon the forged endorsement ultimately on the person who took the instrument from the forger.

29. It was also noted that, according to paragraph (2), the liability of a party or the drawee who paid, or of an endorsee for collection who collected, an instrument on which an endorsement was forged was not regulated by the Convention and was thus left to the applicable national law. Doubts were expressed whether it was acceptable to leave important matters regarding negotiable instruments to national laws which differed considerably.

B. Liability of endorsee for collection

30. Under one view, article 23 should state that the endorsee for collection was not liable for any damages which a party or the person whose endorsement was forged would suffer because of the forgery. In support of this view, it was stated that the endorsee for collection was usually a bank which provided

---

5/ Ibid., para. 32.

a service to its customers and was not in the best position to conduct extensive investigations as to whether the endorser had title to the instrument or authority to sign it.

31. On the other hand, it was pointed out that some legal systems placed the ultimate liability in the collection process upon the person or bank which took the instrument from the forger. If this liability were taken away, the person whose endorsement was forged would be left without the remedies which he would have under national law. This was a particularly serious matter in that, since under article 23 a forged endorsement was a good endorsement for purposes of transfer and would result in the transferee being a holder, payment of the instrument would, under the draft Convention, be payment to a holder and would thus lead to a discharge of liabilities on the instrument. In such a case, the person from whom the instrument was stolen and whose endorsement was forged would not have a cause of action for conversion which he would have, at least under some systems, against the drawee who paid.

32. The Working Group, after deliberation, accepted a compromise solution under which the endorsee for collection who took the instrument from the forger under a forged collection endorsement should not be liable under article 23 (1) if he was without knowledge of the forgery, provided that such absence of knowledge was not due to his negligence.

33. Divergent views were expressed as to the relevant time at which knowledge of the forgery would trigger liability. The Working Group considered in this respect the time at which the endorsee for collection received the instrument from the forger, the time at which he collected the amount of the instrument from the drawee or a party, and the time at which he transferred the funds he collected to the forger. The Working Group was agreed that the endorsee for collection should be liable if, up to the time at which he accounted to his principal, he acquired knowledge of the forgery. However, he should also be liable in the case where he credited the account of his principal before collecting the instrument and learned about the forgery after crediting his principal's account.

C. Liability of a party or the drawee paying the instrument

34. It was noted that the drawee who had not accepted the bill of exchange was not liable on the instrument and that the question whether payment by the drawee was proper payment and whether the drawee who paid could debit the account of the drawer, and in what circumstances, could depend on the contractual arrangements between the drawer and the drawee. It was suggested that, since the liability of the drawee for payment and non-payment was a liability off the instrument, the draft Convention should not deal with these issues.

35. Under another view, however, payment by the drawee of an instrument on which an endorsement was forged could affect the rights of the person whose endorsement was forged. Consequently this issue should be addressed by the

draft Convention. In this connection, reference was made to article 73 (2) according to which payment by the drawee resulted in the discharge of all parties of their liabilities on the instrument.

36. The Working Group, upon analysis of the various issues involved, decided to adopt the same régime as the one it had agreed upon in respect of the endorsee for collection (see above, para. 32) also for the acceptor, the maker and the drawee who paid the instrument directly to the forger of an endorsement. Thus, if such payment resulted in damages suffered by a certain party or the person whose endorsement was forged, the payor was not liable if payment was made to the forger without knowledge of the forgery, provided that such absence of knowledge was not due to his negligence.

D. Persons entitled to compensation

37. The Working Group noted that, under article 23 (1), "any party" had the "right to recover compensation for any damages that he may have suffered because of the forgery". It was agreed that this right should, on the one hand, also be accorded to "the person whose endorsement was forged". On the other hand, not every party to the instrument who suffered damage because of the forgery should be given the right for compensation under article 23 (1) but only those parties who signed the instrument before the forgery. Such limitation was justified because the rationale underlying article 23 was that a remedy should be given in first instance to the person whose endorsement was forged and in second instance to the party who was dispossessed of the instrument. For example, if an instrument was stolen from the post before it reached the payee, the drawer or the maker should be entitled to compensation under article 23 (1). On the other hand, a party who signed the instrument after the forgery was protected sufficiently by his right of recourse against a prior party or, in the absence of an endorser's liability, by his right of action under article 41.

E. Conclusions and decisions on forged endorsements (article 23 (1),(2))

38. The Working Group considered the following draft proposal prepared by an ad hoc working party composed of the representatives of France and the United Kingdom and the observers of Canada and Switzerland:

"(1) If an endorsement is forged, the person whose endorsement is forged or any party who signed the instrument before the forgery has the right to recover compensation for any damage that he may have suffered because of the forgery against:

(a) the forger,

(b) the person to whom the instrument was directly transferred by the forger,

(c) a party or the drawee who paid the instrument directly to the forger.

(2) However, an endorsee for collection shall not be liable under paragraph (1) if, at the later of:

(a) the time he receives the proceeds of the instrument and

(b) the time at which he accounts to his principal for them,

he was without knowledge of the forgery, provided that such absence of knowledge was not due to his negligence.

(3) Also, a party or the drawee who pays an instrument shall not be liable under paragraph (1) if, at the time he paid the instrument, he was without knowledge of the forgery, provided that such absence of knowledge was not due to his negligence.

(4) Except as against the forger, the damages recoverable under paragraph (1) may not exceed the amount of the instrument, plus interest calculated at the rate of ...."

39. The Working Group, after deliberation, adopted the draft proposal, subject to the following modification in paragraph (4). The Working Group was agreed that the amount recoverable under paragraph (1) from a person other than the forger should not exceed the amount referred to in article 66 or 67. One representative stated his reservation to this rule, with particular regard to the rate of interest provided for in article 66 (2). Some representatives and observers expressed the view that the reference to article 66 or 67 may be questionable in view of the fact that these articles also covered matters which were not relevant in the context of article 23. The Working Group requested the Secretariat to consider whether a more appropriate wording than the mere reference to these articles could be found.

40. It was noted that the above régime would generally impose strict liability on the person who dealt directly with the forger, unless he was an endorsee for collection or a party or the drawee who paid the instrument. One representative, in stating his reservation, and one observer expressed the view that holding such a person, who received the instrument from the forger in good faith, liable for damages was unacceptable and would thwart the circulation of the international instrument.

F. Endorsement by agent without authority (article 23 (3))

41. It was noted that article 23 (3) equated an endorsement, which was placed on an instrument by a person in a representative capacity without authority, with a forged endorsement. Divergent views were expressed as to whether such equation was justified.

42. Under one view, the equation was not justified since the bulk of the cases covered by article 23 (3) were of a different nature. While it was true that it should make no difference whether, for example, a thief forged the signature of the payee or whether he signed his own name but falsely presented himself as agent of the payee, most cases of endorsements by an agent without authority should be distinguished from cases of forgery for the following reasons. An agent without authority was not necessarily a stranger to the person who received the instrument from him and may even be a person who previously had full authority or was merely exceeding a still existing authority. In such cases there was less reason for the person receiving the instrument to be on guard and it was inappropriate to require from him extensive investigations into the details of the organizational set-up or other circumstances relating to the possible authority. It was pointed out that this was particularly true in cases of endorsements for collection in view of the fact that the collecting bank was merely providing a service to its customer. Some proponents of this view pointed out that it was equally unjustified to hold a person liable for taking an instrument which the agent without authority had endorsed, not for collection, if the endorsee had no knowledge of the lack of authority.

43. The prevailing view was that it was justified to treat the case of an endorsement by an agent without authority on the same footing as a forged endorsement. In support of this view, it was pointed out that the policy considerations which had been accepted in regard of article 23 (1) and (2) applied with equal force to paragraph (3). It was therefore justified to place the risk ultimately on the person who dealt directly with the unauthorized agent. It was further pointed out that it was well-nigh impossible to draw a precise line between forged endorsements and endorsements by an agent without authority in all cases. Moreover, it was noted that the provision would only apply in those cases where the agent did indeed not have the power to bind his principal. Thus it would not apply where, for example, the agent had apparent or implied authority under the applicable national law.

44. The Working Group requested an ad hoc working party composed of the representatives of Czechoslovakia, Mexico and Nigeria and the observers of Norway and Qatar to prepare a draft provision, if deemed appropriate by it as a separate article, which would deal exclusively with endorsements by an agent without authority and possibly contain features not contained in the rules governing forged endorsements.

45. The proposal of that working party was as follows:

"Replace article 23 (3) by the following new article 23 bis:

(1) If an instrument is endorsed by a person as an agent but without authority, any party or the person whom the unauthorized agent purports to represent has the right to recover compensation for any damage that he may have suffered because of such endorsement against:

(a) the unauthorized agent, and

(b) the person to whom the instrument was directly transferred by the unauthorized agent, or

(c) a party or the drawee who paid the instrument directly to the unauthorized agent,

provided, however, that the person against whom compensation is sought shall not be liable unless, at the time when the instrument was transferred or paid, he had [or ought to have had] knowledge of the lack of authority.

(2) Except as against the unauthorized agent, the damages recoverable under paragraph (1) may not exceed the amount referred to in article 66 or 67."

46. The Working Group, after consideration of this draft proposal, concluded that the final decision on the crucial issue of whether endorsements by an agent without authority should be equated with forged endorsements was possible only after the rules on forged endorsements had been agreed upon. Therefore, it requested the ad hoc working party which was entrusted with revising the rules on forged endorsements (see above, para. 38) to prepare a revised draft of article 23 bis.

47. The revised draft prepared by this ad hoc working party, composed of the representatives of France and the United Kingdom and the observers of Canada and Switzerland, was as follows:

"(1) If an endorsement is made by an agent without authority or power to bind his principal in the matter, the principal or any party who signed the instrument before such endorsement has the right to recover compensation for any damage that he may have suffered because of such endorsement against:

(a) the agent,

(b) the person to whom the instrument was directly transferred by the agent,

(c) a party or the drawee who paid the instrument directly to the agent.

(2) However, an endorsee for collection shall not be liable under paragraph (1) if, at the later of:

(a) the time he receives the proceeds of the instrument and,

(b) the time at which he accounts to his principal for them,

he was without knowledge that the endorsement did not bind the principal, provided that such absence of knowledge was not due to his negligence.

(3) Also, a party or the drawee who pays an instrument shall not be liable under paragraph (1) if, at the time he paid the instrument, he was without knowledge that the endorsement did not bind the principal, provided that such absence of knowledge was not due to his negligence.

(4) Except as against the agent, the damages recoverable under paragraph (1) may not exceed the amount of the instrument, plus interest calculated at the rate of ...."

48. The Working Group, after deliberation, adopted this revised draft text, subject to improvement of its drafting and to the alignment of its paragraph (4) with the corresponding provision relating to forged endorsements (see above, para. 39). One representative maintained the view that the equation of endorsements by an agent without authority with forged endorsements was not justified and stated his reservation with regard to paragraph (1)(b).

III. Liability of a transferor by mere delivery (article 41)

49. The Working Group considered article 41 in the context of the following issues: (a) whether the draft Convention should recognize a liability on the part of persons who transferred the instrument by mere delivery, i.e. without endorsing it; (b) if so, what should be the nature and the extent of such liability, and in what circumstances could the liability be relied upon by a holder who received the instrument by mere delivery; and (c) should the liability for certain infirmities attaching to the instrument be imposed also upon endorsers.

A. Retention of provision on liability of transferor by mere delivery

50. It was noted that the negotiable instruments law of common law countries recognized that, in certain instances, a person who transferred an instrument by mere delivery warranted that the instrument was free from certain defects. It was also noted that under civil law systems the liability of the transferor by mere delivery in such cases was dealt with under the general law of contracts or under the law of sale of goods.

51. In view of the fact that, if the Convention were silent on this issue, the national laws, which differed in their approach, would govern, there was general agreement that the Convention should set forth rules regulating such liability. The substantive reason for giving the holder who obtained an instrument by mere delivery a right of action against his transferor was that, in the absence of such an action, the holder could be without a remedy in cases when the instrument he took was not the instrument he legitimately expected to have received.

B. Nature and extent of liability

52. The Working Group was agreed that a holder, who took an instrument by mere delivery and in good faith, should be able to rely on the fact that the signatures on the instrument were genuine or authorized and that no material alteration had been made on it. Such reliance should be fully protected and it was irrelevant in this respect whether the person who transferred the instrument by mere delivery was with or without knowledge of such infirmities. On the other hand, the liability of the transferor by mere delivery should not be strict as regards the matters set forth in paragraph (1) (c) and (d) of article 41, namely that no party had a valid claim or defence against the transferor and that the instrument had not been dishonoured by non-acceptance or non-payment. Consequently, the liability in respect of the matters covered by paragraph (1) (c) and (d) should be conditioned upon knowledge of the transferor. One representative and one observer maintained the view that the liability of the transferor should be conditioned upon knowledge also in respect of those matters covered by paragraph (1) (a) and (b), namely forged or unauthorized signatures and material alteration.

53. The Working Group was agreed that the liability under article 41 should be incurred by a transferor by mere delivery only to his immediate transferee. One observer expressed the view that if the transferor had knowledge of an infirmity attaching to the instrument and he failed to inform his transferee thereof he was guilty of fraud and in such case his liability should extend to all subsequent transferees.

54. It was stated that the liability of the transferor by mere delivery could be defined in terms of damages and in terms of rescission of the contract between the transferor and the transferee. If the liability were for damages, the holder would have to prove the damages which he suffered because of an infirmity and would, at least under some legal systems, be obliged to mitigate those damages. Consequently, it could be held that where recourse was available to the holder against parties to the instrument, such recourse should be had in first instance before the right under article 41 could be exercised. Conversely, if the right of action under article 41 were conceived of in terms of rescission of the contract, the holder could proceed immediately against his transferor and, in such a case, would receive back the amount he paid for the instrument and any interest, against surrender of the instrument to the transferor.

55. The Working Group, after deliberation, was of the view that article 41 should not espouse either approach but should be drafted in such a way that the holder would be given an immediate right of action against his transferor but would leave open the option of proceeding against parties liable on the instrument. It was noted that if the holder elected to proceed in first

instance against a party liable on the instrument, he would still retain his right to proceed under article 41 if he had not obtained the full amount he was entitled to. The following example was given: the maker A issues a note for 1,000 Swiss francs to the payee B; B fraudulently alters the amount from 1,000 to 2,000 Swiss francs, endorses the note in blank and transfers it to C; C delivers the note to D who has no knowledge of the alteration and is a protected holder. The prevailing view was that D had a right to recover from C 2,000 Swiss francs from the moment he learned about the alteration and it was in this respect irrelevant whether C, when he delivered the note to D, was with or without knowledge of the alteration, while under another view this result was doubtful since article 41 dealt with the issue of damages. Alternatively, at maturity of the note, D could enforce the note for 1,000 Swiss francs against the maker A and then recover, under article 41, 1,000 Swiss francs from C.

56. The Working Group considered the following revised draft of article 41 prepared by the representative of France:

"1. Any person who transfers an instrument by mere delivery shall, in the absence of agreement to the contrary, warrant to the holder to whom it transfers the instrument that:

(a) The instrument does not bear any forged or unauthorized signature;

(b) The instrument was not materially altered;

(c) No party has a valid claim to this instrument or defence against him;

(d) The bill has not been dishonoured by non-acceptance or non-payment and the note has not been dishonoured by non-payment.

2. The warranty referred to in paragraph 1 (a) and (b) shall be due only if the defect concerning the instrument was not known to the holder to whom the instrument was transferred, regardless of any consideration of knowledge on the part of the person who transferred the instrument by mere delivery.

It shall be due on account of the defects listed in paragraph 1 (c) and (d) only if the defect concerning the instrument was, on the one hand, known to the person who transferred it by mere delivery and, on the other hand, not known to the holder to whom this instrument was transferred.

3. The holder has the possibility either of exercising, before or after the maturity of the instrument, the claim under the warranty referred to above or of exercising, up to the due amount, against the parties obligated under the instrument and to the extent of their commitment, the recourse referred to in articles 55 et seq. or of claiming damages against the person responsible for the forgery or alteration or unauthorized signature.

Except in respect of a claim against the person responsible for the forgery or alteration or unauthorized signature, the holder, particularly where multiple claims are exercised, may not receive a total sum which exceeds that of the amount of the instrument, plus interest on this amount at the rate of ...."

57. The Working Group, after deliberation, adopted the revised draft text, subject to improvement of its drafting and the following modification of its paragraph (3). The Working Group was agreed that the amount which the holder may recover from a transferor by mere delivery under article 41 should be limited to the amount he paid, or the value he gave, for the instrument plus interest which, in a given case, may be less than the amount of the instrument. It was noted in this context that, as provided for in paragraph (1) of article 41, the transferor by mere delivery could exclude or limit his liability by agreement with the holder.

58. As regards the rate of interest, a proposal was made that the relevant rate should be the London inter-bank offered rate (LIBOR). The Working Group was agreed that the issue of the rate of interest should be dealt with at its next session.

59. The view was expressed that the liability of the transferor by mere delivery under article 41 should be conceived of in terms of damages and not in terms of warranties given by him. The Working Group requested the Secretariat to review the above draft article 41 with a view to improving, in general, its wording and in particular to avoiding any reference to the concept of warranty since this term was not used in all legal systems.

C. Extension of article 41 to endorsers

60. Divergent views were expressed on the question whether the liability under article 41 should be extended to endorsers. Under one view, the undertaking of an endorser on the instrument was that he would pay the instrument in case of dishonour by non-acceptance or non-payment, provided that due presentment and protest had been made. Therefore, if the instrument was not accepted or not paid on one of the grounds listed in article 41 (1), the holder would obtain payment from the endorser because of the latter's undertaking. Thus, it was not necessary to extend the liability under article 41 to endorsers since, even without such remedy, the holder would be getting what he expected to receive when he took the instrument.

61. Under another view, if article 41 were not extended to endorsers, the liability of a transferor by mere delivery could in certain instances be more onerous than that of an endorser. Although it was true that a transferor by mere delivery did not warrant the solvency of prior parties, the transferee's right of action under article 41 was an immediate right which was available even before maturity, if he learned about the infirmity before maturity, and was moreover not conditioned by certain procedural steps which were necessary for the liability of an endorser to materialize. In addition, considerations of policy which had been accepted in respect of the liability of a transferor by mere delivery, namely that the disparity of approaches in different legal systems would give rise to uncertainty, also applied to the liability of an endorser off the instrument for the infirmities listed in article 41 (1). In this connection, a view was expressed that the liability of an endorser who had signed the instrument "without recourse" was similar to the liability of a transferor by mere delivery.

62. The Working Group, after deliberation, failed to reach a consensus on this issue. In the light of this situation, a proposal was made that, if the draft Convention, following the prevailing view, would not deal with the liability of an endorser for the infirmities listed in article 41 (1), it should contain an express provision according to which such liability was left to the applicable national law.

63. The Secretariat was requested to submit to the Working Group's next session a study examining the advantages and disadvantages of a rule in the Convention which would impose liability for the matters set forth in article 41 (1) upon an endorser. The Secretariat was also requested to prepare, if deemed appropriate, alternative draft provisions in this respect.

IV. Definition of knowledge (article 5)

64. Different views were expressed on the definition of knowledge set forth in article 5. Under one view, the notion that a person is considered to have knowledge of a fact not only if he had actual knowledge of it but also if he could not have been unaware of its existence was unacceptable. The draft Convention should provide certainty and this could only be achieved by laying down that only actual knowledge constituted knowledge for the purposes of the Convention. Under another view, the provision of article 5 should be retained in its present wording since it would enable courts to deduce from the circumstances surrounding the case that a person should have had knowledge of a fact despite his denial of having knowledge of it. There could indeed be situations where ignorance of a fact was inexcusable. Furthermore, if the definition of knowledge were restricted to actual knowledge, it would, in certain circumstances, be extremely difficult to prove knowledge.

65. The view was expressed that even if knowledge were restricted to actual knowledge courts would still have discretion to draw certain inferences from objective factors and to conclude that a person had knowledge though he denied having it. On the other hand the phrase "could not have been unaware of its existence" would permit a court to impute knowledge to a person who did not have actual knowledge because he had wilfully closed his eyes to relevant factors.

66. The Working Group considered a drafting proposal prepared by the representatives of Australia, Czechoslovakia and the United States. The proposal was to replace, in article 5, the words "or could not have been unaware of its existence" by the words "or if he does not have actual knowledge because he unjustifiably disregarded facts or circumstances known to him". One observer expressed the view that the definition of knowledge should accommodate the possibility of presumed knowledge.

67. The Working Group, after an exchange of views, was agreed that, for the purposes of the Convention, knowledge should in principle be actual knowledge; this should include the power of courts to deduce from the circumstances of the case that a person, despite his denial, had actual knowledge of a fact. However, the definition should go beyond that, without covering negligence, in that it should allow imputing knowledge to a person who did not have actual knowledge because he had wilfully disregarded relevant facts. The Working Group requested the Secretariat to prepare for its next session a revised draft of article 5 which would implement this understanding.

* * *