I. INTERNATIONAL PAYMENTS

International negotiable instruments

1. Report of the Working Group on International Negotiable Instruments on the work of its fifteenth session (New York, 17-27 February 1987) (A/CN.9/288)[a]

CONTENTS

[a]For consideration by the Commission, see Report, chapter II, (part one, A, above).

INTRODUCTION

1. The United Nations Commission on International Trade Law, at its nineteenth session, held in New York, from 23 June to 11 July 1986, considered the articles of the draft Convention on International Bills of Exchange and International Promissory Notes as revised by it at its seventeenth session and by the Working Group at its thirteenth and fourteenth sessions as contained in document A/CN.9/274.[1] As regards its future course of action, the Commission requested the Secretariat to transmit to all States for comment the draft Convention as revised by the Commission at its nineteenth session and as set forth in annex I to its report.[2]

2. The mandate of the Working Group was to revise the draft Convention on International Bills of Exchange and International Promissory Notes for the consideration of the Commission at its twentieth session.[3] At its nineteenth session the Commission was agreed that the Working Group, at its fifteenth session, should consider the comments received from Governments on the draft Convention and should make recommendations to the Commission as to how any concerns expressed in those comments might be satisfied. It should examine the draft Convention with a view to discovering any inconsistencies among its provisions or any lacunae. The Working Group should also be at liberty to suggest improvements to the draft Convention.[4]

3. The Working Group on International Negotiable Instruments was established at the fifth session of the United Nations Commission on International Trade Law.[5] The Working Group held its fifteenth session at New York from 17 to 27 February 1987. The membership of the Working Group was expanded, at the nineteenth session of the Commission, to include all States members of the Commission.[6] These are: Algeria, Argentina, Australia, Austria, Brazil, Central African Republic, Chile, China, Cuba, Cyprus, Czechoslovakia, Egypt, France, German Democratic Republic, Hungary, India, Iran (Islamic Republic of), Iraq, Italy, Japan, Kenya, Lesotho, Libyan Arab Jamahiriya, Mexico, Netherlands, Nigeria, Sierra Leone, Singapore, Spain, Sweden, Union of Soviet Socialist Republics, United Kingdom of Great Britain and Northern Ireland, United Republic of Tanzania, United States of America, Uruguay and Yugoslavia. All members of the Working Group attended the session except: Brazil, Central African Republic, Iran (Islamic Republic of), Kenya, Lesotho, Libyan Arab Jamahiriya, Sierra Leone, United Republic of Tanzania and Uruguay. The session was also attended by observers from the following States: Bahrain, Bangladesh, Bulgaria, Burma, Burundi, Canada, Côte d'Ivoire, Democratic People's Republic of Korea, Finland, Germany, Federal Republic of, Guatemala, Holy See, Malta, Morocco, Oman, Peru, Poland, Republic of Korea, Romania, Rwanda, Saudi Arabia, South Africa, Switzerland, Thailand, Turkey, Venezuela, Yemen and Zaire, as well as observers from the following international organizations: International Monetary Fund, United Nations Industrial Development Organization, Hague Conference on Private International Law, International Chamber of Commerce and Latin-American Federation of Banks.

4. The Working Group elected the following officers:

Chairman: Mr. Willem VIS (Netherlands)

Rapporteur: Mr. Victor MOORE (Nigeria)

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

(*a*) Provisional agenda (A/CN.9/WG.IV/WP.31);

(*b*) Draft Convention on International Bills of Exchange and International Promissory Notes: comments of Governments and international organizations: note by the secretariat (A/CN.9/WG.IV/WP.32 and Add.1 to 6);

(*c*) Draft Convention on International Bills of Exchange and International Promissory Notes: draft final clauses: note by the secretariat (A/CN.9/WG.IV/WP.33);

(*d*) Report of the United Nations Commission on International Trade Law on the work of its nineteenth session, *Official Records of the General Assembly, Forty-first Session, Supplement No. 17* (A/41/17).

DELIBERATIONS AND DECISIONS

6. The Working Group considered the comments submitted in regard to articles 1 to 32 and adopted new texts in respect of those articles where it deemed it appropriate. The revised articles adopted by the Working Group are contained in the annex to this report.

[1] *Official Records of the General Assembly, Forty-first Session, Supplement No. 17* (A/41/17), paras. 15-211.

[2] *Ibid.*, para. 223.

[3] *Ibid.*, paras. 212-224.

[4] *Ibid.*, para. 222.

[5] *Ibid., Twenty-seventh Session, Supplement No. 17* (A/8717), para. 61.

[6] *Ibid., Forty-first Session, Supplement No. 17* (A/41/17), para. 221.

7. As a result of in-depth discussions on some of the key features of the draft Convention, the Working Group was not able to consider the comments made by Governments and international organizations on articles other than articles 1 to 32. The Working Group was however of the view that the remaining comments on the draft Convention could appropriately be discussed by the Commission in plenary session and that no further session of the Working Group was required.

DRAFT CONVENTION ON INTERNATIONAL BILLS OF EXCHANGE AND INTERNATIONAL PROMISSORY NOTES: CONSIDERATION OF COMMENTS BY GOVERNMENTS AND INTERNATIONAL ORGANIZATIONS

In general

8. One representative expressed the view that, although the current text of the draft Convention was the result of prolonged efforts, in its present state it was not acceptable. It was noted that the Commission, at its nineteenth session, had called on the Working Group to examine the draft Convention with a view to suggesting improvements. There were two separate types of improvement needed by the present draft Convention: those related to form and those related to substance. The draft still contained serious lacunae in that it did not envisage endorsement in pledge, sets of identical parts of an instrument, or the establishment of copies. The representative concluded his observations by stating that it was imperative for the draft Convention and the Geneva Convention to be made compatible. The present tendency in the draft in favour of the common law legal system should be corrected into a fair compromise between civil law and common law. The Working Group and the Commission should take all the time that was necessary to achieve this end.

Article 1

Paragraphs (2) and (3)

9. The view was expressed that the reference to the words "International bill of exchange (Convention of . . .)" both in the heading and in the text of an international bill of exchange and similar wording in the heading and text of an international promissory note, as provided in articles 1(2)(*a*) and 1(3)(*a*), was unnecessary and repetitive and that a single reference to those words in the first paragraph of the text of an instrument was preferable. This view was not accepted. The current draft, by requiring the words both in the heading and in the text, increased the likelihood that the international instruments would be recognized as such by personnel handling them in banks.

10. The view was expressed that, although articles 1(2)(*b*) and 1(3)(*b*) qualified the order or promise to pay contained in an international instrument as "unconditional", the authority to stipulate on a bill that it must not be presented for acceptance before a certain date or before the occurrence of a certain event given by article 46(1) and the use of an acceleration clause in a case of default permitted by article 6(*c*), constituted conditions to the order or promise to pay contained in the instrument. The prevailing view, however, was that these provisions did not make the order or promise conditional.

11. A proposal was made to delete subparagraph (*c*) from articles 1(2) and 1(3) as being potentially misleading and unnecessary since article 8(1)(*b*) provides that an instrument is deemed to be payable on demand if no time for payment is expressed. It was stated, in reply, that the requirement expressed in subparagraph (*c*) was necessary in order to exclude, in particular, instruments payable at an indefinite stage. An alternative proposal was that the two paragraphs should read "contains the indication of maturity", which would bring them closer to the Geneva system. The Working Group decided to retain the current text.

Paragraph (4)

12. The view was expressed that paragraph (4), which provides that proof that the statements referred to in articles 1(2)(*e*) or 1(3)(*e*) are incorrect does not affect the application of the Convention, raised problems when read in connection with the preceding paragraphs of article 1. It was recalled that those problems had been discussed at the seventeenth session of the Commission in 1984 and that, at that time, it had been concluded that "there was a need to revise the criterion contained in article 1(4) so as to limit the application of the Convention to genuinely international instruments".[7] It was stated that the above-mentioned paragraph could be interpreted in two ways: (*a*) by keeping strictly to the letter of the provision and reading it only in conjunction with paragraphs (2)(*e*) and (3)(*e*); (*b*) by interpreting the paragraph as directly affecting paragraph (1), which would then give the drawer or maker of an instrument freedom to exclude a purely domestic instrument from the régime of the applicable national law. It was stated that the second interpretation was contrary to the aim of the draft Convention and that the first interpretation, which was suggested to be the correct one, should be expressly stated in the draft Convention by means of a proposal that would read as follows:

> "Proof that the statements referred to in paragraphs (2)(*e*) or (3)(*e*) of this article are incorrect does not affect the application of this Convention, provided the international character of the negotiable instrument, as defined in the preceding paragraphs of this article, is maintained."

13. On the one hand, this proposal was supported in so far as it reduces the possibility of a fraud on the law. On the other hand, it was resisted in so far as it forces parties to inquire whether the statements on the instrument as to the places indicated were accurate or not and, if not, whether the instrument retained its international character because of contacts with places not mentioned on the instrument. It was suggested by way of

[7] *Ibid., Thirty-ninth Session, Supplement No. 17* (A/39/17), para. 41.

compromise that no proof that the statements were incorrect should be possible against a protected holder. The Working Group decided to maintain the current text.

Paragraph (5)

14. A proposal was made that the words "this Convention does not apply to cheques" should be qualified by the words "although in some countries cheques are regarded as a type of bill of exchange". Although the proposal was found to be correct, it was not adopted by the Working Group on the ground that the countries concerned had no objection to the current text.

Division of article 1

15. A proposal was made by France and the United States to divide article 1 into two or three articles so as to separate the requirements needed to make an instrument international in character from the formal requisites of a bill of exchange or a promissory note. The Working Group agreed to this proposal. The new text of articles 1, 1 *bis* and 1 *ter* is set forth in the annex to this report.

Article 2

16. The Working Group considered various proposals which aimed at limiting the scope of application of the Convention as envisaged in article 2. One proposal was to require that two of the places listed in article 1, paragraph (2)*(e)* or (3)*(e)*, be situated in Contracting States. Another proposal was to require that the place where the bill is drawn, or the note is made, and the place of payment be situated in Contracting States. Yet another proposal was to allow any Contracting State to introduce this latter requirement by way of a reservation.

17. In support of these proposals, it was stated that the current article 2 was exorbitant in that it declared the Convention to be applicable irrespective of whether the places indicated on the instrument were situated in Contracting States. The courts of Contracting States would thus apply the Convention even to acts or situations in non-Contracting States. Moreover, parties who issued or took an instrument purportedly governed by the Convention ran the risk in any forum of a non-Contracting State that another legal régime would regulate their rights and obligations. Above all, the wide scope envisaged in article 2 was contrary to the rules of private international law as found, for example, in the 1930 Geneva Convention for the Settlement of Certain Conflicts of Laws in Connection with Bills of Exchange and Promissory Notes or the Inter-American Convention on Conflict of Laws Concerning Bills of Exchange, Promissory Notes, and Invoices (Panama, 1975). It was stated that no State adhering to any such Convention could ratify or accede to the Convention under consideration if article 2 remained unchanged.

18. The prevailing view in the Working Group was not to adopt any of the proposals for limiting the scope of application envisaged in article 2. In support of this view, it was stated that the idea expressed in article 2 was an integral part of the philosophy underlying the system of the draft Convention. The introduction of any of the limitations proposed would unduly restrict the use and usefulness of the new optional instrument created by the Convention. There was not only the formal effect of restricting the application to instruments made and payable in Contracting States but also the more far-reaching practical obstacle to circulation arising from the need to inquire whether certain countries were parties to the Convention. Significant difficulties would be created if the proposed reservation were allowed. All this would be contrary to the important principle of negotiable instruments law that parties should be able to gain certainty from what is between the four corners of the instrument. It was more appropriate in this field where a network of rights and obligations was created by the circulation of the instrument to have one legal régime, originally chosen and expressed in the instrument, follow that instrument. While the present system was not free from possible difficulty or uncertainty as to what would happen in the forum of a non-Contracting State, there was similar doubt as to whether any of the proposed restrictions would lead to a higher degree of certainty.

19. The Working Group, after deliberation, adopted the prevailing view and decided to retain article 2 in its current form, without a reservation clause. As regards the possible conflict between the draft Convention and the 1930 Geneva Convention, the Working Group was agreed that it could not, at this stage, usefully consider this issue, which was essentially one for the States Parties to that Convention.

Article 3

20. A proposal was made to delete the words "the observance of good faith in international transactions". It was stated that the meaning of the words was not clear. They were a criterion for the behaviour of the parties without any significance when addressed to a judge who had to interpret legal provisions that were formal in character and that demanded certainty and uniformity of interpretation. Uniformity could not be obtained with concepts that had a different meaning in different legal systems. According to another view, the words should be maintained in the text of article 3 since they were to be found in other conventions on international trade law, in particular in article 7(1) of the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980).

21. The Working Group decided to retain the current text of article 3.

Article 4

22. It was suggested that the list of definitions might be supplemented for the sake of comprehensiveness by the concepts mentioned in articles 8 and 12. The Working Group decided to keep the current list of definitions in article 4 without any additions.

Paragraphs (6) and (7)

23. The view was expressed that the definitions of "holder" and "protected holder" were still not satisfactory. In particular, the technique of drafting by reference to other articles raised considerable uncertainties of interpretation. It was suggested that the definition in article 4(7), apart from being incomprehensible, was misplaced. A proposal was made that the requirements for being a protected holder should be contained in a new article 25 *bis* and that article 4(7) should provide that "'Protected holder' means a holder who meets the requirements of article 25 *bis*". It was suggested that with such a proposal the concept of "protected holder" would logically appear in the part of the Convention where the rights of the holder and the protected holder were regulated.

24. The Working Group agreed to the proposed organizational change.[8]

Paragraph (10)

25. A view was expressed that the draft Convention should contain a clear definition of the word "signature" to include the name of the signer. It was observed that under articles 1(2)(*f*) and 1(3)(*f*) the signature of the drawer or maker was an indispensable element for the Convention to apply to an instrument. Without a clear definition of signature there was no certainty that a signature would be valid in States where the instrument might be negotiated or sued upon. A second suggestion was to insert after the words "handwritten signature" in paragraph (10) the words "even if it is illegible but corresponds to that of its author". It was stated that the proposed addition would obviate the need for the courts to decide whether an "illegible signature" was a signature. The prevailing view was that both of these problems could be easily decided by the courts by reference to the words "handwritten signature". It was noted that other international instruments such as the Geneva Uniform Law for Bills of Exchange and Promissory Notes contained no definition of "signature".

26. A third suggestion was that categorizing "any other means of effecting the equivalent authentication" as a signature was superfluous and the words should be deleted. It was stated that they permitted too wide a range of potential means of authentication, including authentication by symbols or by electronic means. It was suggested that the latter category, in particular, should not be included in the draft Convention since that might imply that an instrument need not be on paper.

27. However, the prevailing view was that these words reflected the practice of several countries to authenticate an instrument by means of symbols and that they provided flexibility in regard to future means of authenticating commercial documents. As a result, the Working Group decided to maintain the current text without change.

[8]The discussion and decision on new article 25 *bis* are set forth below, paras. 130-137.

Article 5

28. It was suggested that the words "or could not have been unaware of its existence" could be deleted or, if not deleted, at least clarified. It was difficult to prove that a person could not have been unaware of the existence of a certain fact. The wording implied a presumed knowledge, which might lead to the objectionable conclusion that the person concerned had the burden of proving his ignorance. Furthermore, that wording, and in fact the entire article 5, was not necessary in view of the fact that the element of knowledge or lack of knowledge was qualified by the concept of negligence in all those provisions where that was appropriate. The concept of negligence, although different interpretations might be given to it in civil law and in common law countries, certainly embraced the idea that the person "could not have been unaware of the existence of a fact".

29. The prevailing view, however, was to retain article 5 in its current form. While the wording of its second part was not as felicitous as it might be, no better wording had been found after extensive discussions. For those provisions where the element of negligence for good reasons was not added, it was necessary to define knowledge as covering somewhat more than actual knowledge so as to allow a court to imply knowledge where cogent reasons led to the conclusion that a person, despite his denial, had knowledge or had deliberately closed his eyes. Accordingly, the Working Group retained article 5 without change.

Article 6

Subparagraph (c)

30. The Working Group considered a proposal to delete article 6(*c*). The reasons advanced by the proponents of that proposal included the following. A stipulation on the instrument that upon default in payment of any instalment the unpaid balance became due was inconsistent with the requirement of an unconditional order or promise to pay as laid down in article 1, paragraphs (2)(*b*) and (3)(*b*). If the sole purpose of article 6(*c*) was to declare that an instrument bearing an acceleration clause met the requirement of "definite sum", there was no need to retain this provision in view of the existence of article 6(*b*), which covered all instruments payable by instalments at successive dates.

31. Above all, the envisaged sanction for default that the full unpaid balance became due was too harsh and was objectionable in certain circumstances, such as intervening events beyond the control of the debtor, e.g. imposition of foreign exchange controls. If the deletion of article 6(*c*) was not acceptable, one should at least restrict the provision to certain types of default, such as non-payment due to insolvency. In more general terms, the concern was expressed that acceleration clauses might operate unfairly against debtors and that, therefore, article 6(*c*) would not be in the best interest of countries with large foreign debts.

32. The prevailing view was in favour of retaining article 6(*c*). It was stated in support of that view that the

Convention should not disregard current practices in many countries reflecting commercial needs. To exclude instruments with acceleration clauses would not necessarily be to the advantage of countries in need of foreign capital since it might adversely affect the availability of long-term credit or lead creditors to require, for example, a series of demand instruments instead. Above all, it was felt that the above concerns and any possible response to them lay outside the scope of article 6(*c*), which merely dealt with the issue whether an instrument bearing an acceleration clause could be a negotiable instrument. On that point, it was desirable to provide certainty as regards such clauses.

33. Article 6(*c*) was viewed as neutral in that it merely took into account the possibility of two parties agreeing on an acceleration clause and in that it did not pre-empt the application of any rule that might come to the relief of the debtor. In appropriate circumstances, relief might be obtained, for example, through article 72 of the Convention or from any mandatory provisions of public policy designed to protect weaker parties.

34. The Working Group, after deliberation, adopted the prevailing view and decided to retain article 6(*c*) in its current form. It was noted that the question of provisions preventing abuse and protecting parties was an issue of wider application, which the Commission might wish to consider thus in a wider context.

*Subparagraphs (*d*) and (*e*)*

35. The Working Group referred to a future drafting group the proposal to add the substance of subparagraph (*d*) to the provision of subparagraph (*e*).

Article 7

Paragraph (1)

36. It was pointed out that the amount on an instrument might be expressed more than once in figures or in words and that there might be a discrepancy between those figures or words. It was suggested that the draft Convention should contain a rule similar to that contained in article 6 of the Geneva Uniform Law that in case of such a discrepancy the lower amount would be deemed to be correct. In case of conflict between the amount expressed in words and the amount expressed in figures as so determined, the current rule in article 7(1) that the amount in words would be deemed to be correct would govern. It was suggested that that proposal would lead to an excessively rigid rule since the intention of the parties on a different amount might be clear. The Working Group noted, however, that the rule would have its primary effect when an instrument had circulated, since the intention of the parties could always be shown between immediate parties. Therefore, the Working Group decided to add the following sentence:

> "When the amount payable by an instrument is expressed more than once in words or more than once in figures, and there is a discrepancy, the smaller amount is the relevant one."

Paragraph (5)

37. A view was expressed that there should be no limitation in the Convention on the type of variable interest rate that would qualify under article 7(5). The prevailing view was that the compromise reached in the Commission was appropriate, but the drafting of the provision was too complicated. In that regard it was suggested that the end of article 7(5) should be redrafted as follows:

> ". . . each such reference rate must be published or otherwise available to the public and not be subject to determination influenced by any person who might improperly take advantage of it in connection with the instrument."

38. Although there was some support for the view that the current text more clearly set out the parties who were not to have the power to determine the variable rate, the prevailing view was that the proposed text should be adopted. It was stated that the word "improperly" was not needed since the holder had the right to charge interest.

39. The Working Group, after deliberation, decided to adopt the proposed text without the word "improperly".

Article 8

Paragraph (1)

40. A proposal was made to delete, in subparagraph (*a*), the words "or if it contains words of similar import" on the ground that they were superfluous and might create difficulties of interpretation. The Working Group did not accept the proposal for the reason that the words served a useful purpose by covering the various other possible expressions that banks and businessmen might use to indicate that an instrument was payable on demand.

Paragraph (2)

41. A proposal was made to delete paragraph (2). A second proposal was to restrict its application to endorsement after maturity by deleting references to acceptance and guarantee after maturity. It was stated in support that the maturity date was an important cut-off date after which only payment or dishonour with any consequent right of recourse should be envisioned. It was neither current practice nor of practical value to accept overdue instruments or to give a guarantee after maturity. Moreover, it was inappropriate to allow such acts after maturity without clearly regulating their legal consequences. It was, for example, not clear whether presentment or protest was necessary with regard to an endorser after maturity, whether such endorser was liable to parties subsequent to himself, and what the date was from which the time-limit for presentment for payment or the limitation period would run.

42. The proposals were opposed on the ground that the Convention should regulate the effects of such acts as endorsement, acceptance and guarantee after maturity. It was stated that those actions occurred in practice in

certain countries, including countries following the Geneva Uniform Law which prohibits acceptance after maturity. The fact that the practice was not known or not regarded as useful in all countries did not justify its exclusion from the Convention.

43. As regards the questions concerning the legal consequences of such acts, it was felt, after deliberation, that the Convention provided answers in an appropriate way. In particular, it was agreed that the general rule requiring presentment for payment and protest in case of dishonour would apply to an instrument that had been endorsed after maturity. That solution was adequate since otherwise the liability of such an endorser would come close to that of a guarantor of the drawee. As regards other legal consequences, it was understood that article 8(2) by its very terms did not convert the instrument into a demand instrument in all respects but made it payable on demand merely as regards the person who accepted, endorsed, or guaranteed it after maturity.

44. After deliberation, the Working Group decided to retain article 8(2) in its current form and concluded that there was no need to add further provisions on the legal consequences of an acceptance, endorsement or guarantee after maturity.

Paragraph (5)

45. A proposal was made to add at the end of this provision the words "or the date on which the instrument is presented for acceptance and is dishonoured". The purpose of this addition was to cover the case where a bill was not accepted, since even for that case it was necessary to determine the maturity date of a bill payable at a fixed period after sight.

46. Doubts were expressed as to whether there was a real need to determine the maturity date in the case of dishonour since in that case the holder had no right against the drawee but had an immediate right of recourse. It was noted, however, that the maturity date was needed to determine the amount of interest due in accordance with article 66(1)(*b*).

47. As regards the substance of the proposed addition, it was stated that the date of presentment for acceptance might be less certain than the date of protest and that the latter date was the one used in that context by article 35(1) of the Geneva Uniform Law. Where protest was dispensed with, the relevant date should be that of dishonour. The same solution was provided in article 80(1)(*d*) of the draft Convention for the purpose of calculating the limitation period.

48. Accordingly, the Working Group decided to add to paragraph (5) the words "or, where the bill is dishonoured, by the date of protest for dishonour by non-acceptance or, where protest is dispensed with, by the date of dishonour".

Paragraph (7)

49. In considering the case where the maker refuses to sign the visa, it was noted that the Convention, while containing a set of rules on non-acceptance of bills payable at a fixed period after sight and on its consequences, contained no comparable provisions dealing with refusal of visa for notes payable at a fixed period after sight. The question was raised how presentment could be proven in view of the fact that the Convention did not require protest in such circumstances.

50. In the light of this situation and based on the view that notes payable at a fixed period after sight were not used in practice, a suggestion was made to delete paragraph (7). It was stated, in reply, that such notes were sometimes used in certain countries and that proof of refusal to sign the visa was secured there, for example, by some public verification procedure or by requiring protest in an analogous application of the rules on after-sight bills.

51. The Working Group, after deliberation, decided to retain paragraph (7) in its current form. In the context of the discussion of the rules on refusal to accept an after-sight bill, consideration would need to be given to the appropriateness of special rules for refusal of visa or, possibly, of a general rule to the effect that the rules on refusal to accept would apply accordingly.

Article 9

52. The view was expressed that more than one person were rarely, if ever, found on instruments as drawer, maker or drawee. Even plurality of payees was not common. It was therefore suggested that article 9 should be deleted or, at least, restricted to payees. The view prevailed, however, that since the practice of multiple drawers, drawees, makers and payees was known in some countries it should be reflected in the draft Convention.

53. It was stated that the draft Convention provided no answers to the various legal questions arising from the plurality of drawers, makers, drawees or payees. For example, as regards obligors it was unclear whether they were jointly or separately liable on the instrument. It was noted in that connection that the draft Convention, in articles 47(*b*) and 51(*b*), regulated the presentment for acceptance or for payment of bills drawn on two or more drawees. As regards payees, it was asked, for example, whether they could individually transfer the instrument and whether their protection could differ in that only one was a protected holder.

54. In general, it was suggested that the answers would depend on the relationships as reflected on the instrument and that satisfactory solutions could be found in most cases by way of a reasonable construction of the rules of the Convention. If a need were felt for adding special rules relating to such issues as liability, presentment, protest or recourse, this could be considered during the discussion on the provisions dealing with those issues.

55. With that understanding, the Working Group decided to retain article 9 in its current form.

Article 10

56. No comments were made on this article.

Article 11

57. A proposal was made to amend paragraph (1) of this article as follows:

"(1) An incomplete instrument which satisfies the requirement set out in subparagraph (*a*) of paragraph (2) of article 1 and bears the signature of the drawer or the acceptance of the drawee, or which satisfies the requirements set out in subparagraphs (*a*) and (*f*) of paragraph (3), but which lacks other elements pertaining to one or more of the requirements set out in paragraph (2) or (3) of article 1 may be completed and the instrument so completed is effective as a bill or a note."

58. It was noted that different meanings were given to the term "incomplete instrument" in article 11 and in article 38(1). Under article 11, an incomplete instrument was one that satisfied the requirements of subparagraph (*a*) of article 1(2) or 1(3) that the instrument contained in its text the words of internationality, and of subparagraph (*f*) that it be signed by the drawer or maker, but that failed to satisfy one or more of the other requirements set out in article 1(2) or 1(3). Under article 38(1), however, a bill of exchange that satisfied only the requirements of article 1(2)(*a*) was regarded as an incomplete instrument that might be accepted by the drawee. It was pointed out that the Commission, after deliberation at its nineteenth session, had amended article 38(1) by adding a new sentence that provided that, in such case, the provisions of article 11 applied accordingly to the signing of the drawer and any further completion by the drawer or another person.

59. The current proposal was to delete the sentence that had been added and to amend instead article 11(1) to introduce that concept into it. The proposal was found to be satisfactory and was adopted by the Working Group.

60. A view was expressed that the article should state that the completion of an incomplete instrument was lawful only if there was agreement between the parties, since that agreement alone could legitimize the completion. The proposal was not accepted on the ground that a subsequent holder could not know whether the instrument had been completed in accordance with authority or not.

61. Finally, a proposal was made to add to article 11 the idea that a holder may complete an instrument only before the instrument had matured. It was stated that if, at the date of maturity, an instrument was not complete in accordance with article 1, it could not be regarded as covered by the Convention. It was noted, however, that the Convention provided for an instrument to be transferred after maturity. Thus, it should be possible to complete an instrument after maturity. For those reasons the proposal was not adopted.

Article 12

62. No comments were made on this article.

Article 13

63. After noting that comments had been submitted on this article, the Working Group retained the article unchanged.

Article 14

64. In connection with article 14, a proposal was made to introduce provisions governing instruments issued in a set of two or more identical parts. It was pointed out that such instruments were used in some countries and were found in those countries to be of value. The Working Group agreed in principle to the proposal; it did not consider the possible content and drafting of such provisions.

65. The Working Group decided to retain, for the time being, article 14 unchanged.

Article 15

66. No comments were made on this article.

Article 16

67. After noting that comments had been submitted on this article, the Working Group retained the article unchanged. In connection with article 16, a proposal was made to add to the draft Convention a new article 20 *bis* covering endorsements in pledge (see below, paras. 72-75).

Article 17

68. It was observed that paragraph (2) used the expression "is deemed not have been written" while article 35(2) used the expression "is without effect". It was agreed that the inconsistency in formulation, together with the many other drafting suggestions made by Governments in their comments, should be considered by a drafting group in conjunction with the twentieth session of the Commission.

Article 18

69. After noting that comments had been submitted on this article, the Working Group retained the article unchanged.

Article 19

70. No comments were made on this article.

Article 20

71. The Working Group decided, for the sake of clarification, to modify paragraph (1)(*c*) as follows: "(*c*) Is subject only to the claims and defences which may be set up against the endorser".

New article 20 bis

72. It was proposed to add to the draft Convention a new article 20 *bis* as follows:

"When an endorsement contains the statements 'value in security' (*"valeur en garantie"*), 'value in pledge' (*"valeur en gage"*), or any other statement implying a pledge, the endorsee:

"(*a*) Is a holder by virtue of article 4(6) and (7) and article 28;

"(*b*) May exercise all the rights arising out of the instrument;

"(*c*) May only endorse the instrument for purposes of collection;

"(*d*) Is subject to claims and defences which may be set up against the endorser only in the cases specified in articles 25 and 26.

"Such an endorsee, having endorsed for collection, is not liable upon the instrument to any subsequent holder."

73. It was stated, in support of the proposal, that the draft Convention would be incomplete if it did not cover endorsements in pledge, which were used in practice and served a useful purpose. Although such endorsements were not known in all countries and were no longer used in certain countries, the Working Group decided to include them in the draft Convention so as to accommodate the practice where it existed.

74. Various questions were raised relating, in particular, to the legal status of an endorsee in pledge in comparison with that of other endorsees covered by the Convention. After discussion, it was understood that the endorsee in pledge was a holder in his own right like any other transferee except the endorsee for collection, who was essentially an agent of his endorser. The endorsee in pledge could be a protected holder or a holder who was not a protected holder or a holder in whom the rights of protected holder were vested pursuant to article 27. Accordingly, he was subject, and subject only, to those claims and defences specified in article 25 or 26, whichever the case may be, unlike the endorsee for collection, who was subject to all the claims and defences available against his endorser (see article 20(1)(*c*)). Like the endorsee for collection, however, he was not entitled to transfer the instrument except for purposes of collection.

75. Accordingly, the following suggestions for modifying the proposed draft text were made and adopted. Subparagraph (*a*) should state that the endorsee is a holder as referred to in article 14. As proposed by an *ad hoc* working party composed of the representatives of Egypt, France, Netherlands and United Kingdom and the observers of Canada and Switzerland, subparagraph (*d*) should read as follows: "(*d*) Is subject only to claims and defences specified in article 25 or 26". The text of new article 20 *bis* as adopted by the Working Group is set forth in the annex to this report.

Article 21

76. After noting that comments had been submitted on this article, the Working Group retained the article unchanged.

Article 22

77. After noting that comments had been submitted on this article, the Working Group retained the article unchanged.

Article 23

Paragraph (1)

78. A proposal was made to redraft subparagraph (*b*) as follows: "The person who received the instrument directly from the forger, having knowledge thereof". The addition of the requirement of knowledge, which was also proposed for the parallel provision in article 23 *bis*, was said to be necessary for the following reasons. It was wrong to presume, as the current text apparently did, that there was collusion between the forger (or the agent without authority) and the person to whom the instrument was directly transferred. The policy of this provision contradicted the rule in article 14(1)(*b*), according to which the transferee became a holder even if the last, or any previous, endorsement was forged. Above all, the effect of this provision would be to impede the negotiability and thus the circulation of instruments.

79. The Working Group did not adopt this proposal for the following reasons. The provision of paragraph (1)(*b*) constituted a vital part of a basic compromise solution, which had been agreed upon after extensive deliberations during various sessions of the Working Group and the Commission. The compromise essentially consisted in combining the Geneva rule as laid down in article 14(1)(*b*) of the draft Convention with the common law rule that a forged endorsement is not an endorsement for purposes of negotiation. There was no evidence to suggest that the operation of this rule in common law countries had in any way impeded the circulation of negotiable instruments.

Paragraphs (2) and (3)

80. As regards paragraph (2)(*a*), it was stated that the expression "He pays the principal" was not wholly felicitous in that the same verb was used here as in other cases of payment which were different in substance (e.g., payment by acceptor, maker or a party secondarily liable). It was realized, however, that no better expression had been found which was easily translatable into all six official languages.

81. A proposal was made to delete in paragraphs (2) and (3) of article 23, and of article 23 *bis*, the words "provided that such absence of knowledge was not due to his negligence". It was stated, in support of this proposal, that the concept of negligence was a subjective one which was inappropriate in the context of negotiable instruments law and was difficult to apply. The

difficulties were aggravated by the fact that the relationship to article 5 was not absolutely clear, due to the uncertain scope of that article. Moreover, there was a need for simplifying the system of the draft Convention, which in some of its provisions used the element of lack of knowledge without qualifying it by negligence and in others with that qualification. Above all, retention of the element of negligence in respect of acts by bankers would place too heavy a burden on them by requiring, for example, inquiries or investigations or, at least, the keeping of records about the state of knowledge at the time of the acts in question. This in turn would impede the circulation of instruments.

82. The prevailing view was that liability should not be excluded in all cases of lack of knowledge. The additional requirement of non-negligence, or a similar notion, was the result of a compromise found after extensive discussions and was an appropriate solution. It would be wrong to take into account only the interests of endorsees for collection or parties or drawees who paid the instrument and to disregard the interests of the other persons involved. As regards any fear of imposing too heavy a burden on banks, it was stated that banks in common law countries had long operated under the less favourable rule of strict liability and that, under the draft Convention, the burden of proof was on the plaintiff claiming compensation.

83. The Working Group was agreed, however, that it was not necessary to retain the term "negligence" itself. Instead, other expressions were suggested for establishing appropriate standards, e.g., "normal diligence", "reasonable commercial standards" and "ordinary banking practice". It was noted, in particular, that the ICC Uniform Rules for Collections (1979), which were followed by banks around the world, provided in article 1 that "banks must act in good faith and exercise reasonable care".

84. An *ad hoc* working party, composed of the representatives of Australia, Austria, Germany, Federal Republic of and United States of America, proposed the following wording: "unless the absence of knowledge is due to his failure to act in good faith or exercise reasonable care". The Working Group decided to substitute this wording in paragraphs (2) and (3) of articles 23 and 23 *bis* for the words "provided that such absence of knowledge was not due to his negligence".

Article 23 bis

85. A proposal was made to add to article 23 *bis* the following new paragraph:

"(3 *bis*) Also, the person to whom the instrument was directly transferred by the agent shall not be liable under paragraph (1) towards the principal if, at the time of the transfer, he was without knowledge that the endorsement did not bind the principal, provided that such absence of knowledge was not due to his negligence."

86. It was stated in support of that proposal that the situation dealt with in article 23 *bis* differed considerably from that covered by article 23 and that it was unjust to subject, as the draft Convention did, both situations to the same legal régime. The person to whom the instrument was directly transferred by an agent without authority should be liable to the purported principal only if he had, or ought to have had, knowledge of the lack of authority. The risk of loss should not be shifted from the purported principal to an endorsee in good faith since, in most cases where the transferee was in good faith, there existed some kind of relationship between the purported principal and the unauthorized agent. Moreover, it was often difficult for an outsider to ascertain precisely the existence and scope of authority, in particular in an international context.

87. The prevailing view, however, was not to adopt the proposal. The current text, which treated the case of an endorsement by an unauthorized agent like that of a forged endorsement, was the result of extensive discussions and provided an appropriate solution. It was often difficult to draw a precise dividing line between the two cases, in particular since the relevant legal rules differed from one legal system to another. It was further stated that the scope of application of article 23 *bis* was narrower than might appear at first sight since it would not apply in cases of apparent or implied authority which all legal systems, although using differing concepts, recognized in substance.

88. The Working Group, after deliberation, decided not to alter the legal régime laid down in article 23 *bis*. It retained the text of the article, except for the modifications of the last part of paragraphs (2) and (3) referred to in paragraph 84 above.

Article 24

89. No comments were made on this article.

Article 25

90. The view was expressed that the current text contained equivocal and ambiguous cross-references, that some of its provisions were inconsistent with one another and that other provisions were duplications. As a result, the article needed to be completely restructured.

91. A proposal for a new text of article 25 was presented to the Working Group by France. It was stated that, while the proposal eliminated some of the original text as being inconsistent with or a duplication of other text, no change in substance had been intended or was thought to have occurred. The proposed text is as follows:

"*Article 25*

"A party may set up or assert against a holder who is not a protected holder:

"(*a*) Any defence available under this Convention;

"(*b*) The exceptions set out in article 26(1)(*a*);

"(*c*) Any defence based on the underlying transaction between himself and the drawer or

between himself and the party subsequent to himself, but only if the holder took the instrument with knowledge of such defence or if he obtained the instrument by fraud or theft or participated at any time in a fraud or theft concerning it;

"(*d*) Any defence arising from the circumstances as a result of which he became a party, but only if the holder took the instrument with knowledge of such defence or if he obtained the instrument by fraud or theft or participated at any time in a fraud or theft concerning it;

"(*e*) The claims which may be validly made on the instrument by any other person, but only if the holder took the instrument with knowledge of such claims or if he obtained the instrument by fraud or theft or participated at any time in a fraud or theft concerning it;

"(*f*) Any defence resulting from the underlying transaction between himself and the holder;

"(*g*) Any other transaction between himself and the holder that would be available as a defence against contractual liability;*

"(*h*) Any defence based on incapacity of such party to incur liability on the instrument or on the fact that such party signed without knowledge that his signature made him a party to the instrument, provided that such absence of knowledge was not due to his negligence."

92. The Working Group acknowledged the necessity of having a new text for the article. It expressed its gratitude to the French delegation for its efforts. It recognized that the French draft was an improvement in terms of presentation, but that it also introduced some substantive changes.

93. Inspired by the French drafting approach, another proposal was made by the United States of America. It was suggested that this text did not contain any substantive changes or any omissions with regard to the current draft of the article. The text proposed by the United States reads as follows:

"Article 25

"(1) A party may set up against a holder:

"(*a*) Any defence available under this Convention;

"(*b*) Any defence based on the underlying transaction between himself and the drawer or between himself and the party subsequent to himself, but only if the holder took the instrument with knowledge of such defence or if he obtained the instrument by fraud or theft or participated at any time in a fraud or theft concerning it;

"(*c*) Any defence arising from the circumstances as a result of which he became a party, but only if the holder took the instrument with knowledge of such defence or if he obtained the instrument by fraud or theft or participated at any time in a fraud or theft concerning it;

"(*d*) Any defence based on incapacity of such party to incur liability on the instrument or on the fact that such party signed without knowledge that his signature made him a party to the instrument, provided that such absence of knowledge was not due to his negligence;

"(*e*) Any defence upon the instrument to which his transferor is subject, if the holder took the instrument after the expiration of the time-limit for presentment for payment;

"(*f*) Any defence resulting from any transaction between himself and the holder;

"(*g*) Any defence resulting from any transaction between himself and the holder not referred to in paragraph (1)(*f*) that would be available as a defence against contractual liability.

"(2) The rights to an instrument of a holder who is not a protected holder are subject to any valid claim to the instrument on the part of any person, but only if he took the instrument with knowledge of such claim or if he obtained the instrument by fraud or theft or participated at any time in a fraud or theft concerning it. However, a holder who takes the instrument after the expiration of the time-limit for presentment for payment is subject to any claim to the instrument to which his transferor is subject.

"(3) A party may not raise as a defence against a holder who is not a protected holder the fact that a third person has a claim to the instrument unless:

"(*a*) Such third person asserted a valid claim to the instrument; or

"(*b*) Such holder acquired the instrument by theft or forged the signature of the payee or an endorsee, or participated in such theft or forgery."

94. The Working Group decided to consider both the French and the United States proposals with a view to formulating a new text for article 25.

Reference to defences available under article 26(1)(a)

95. It was noted that the French draft contained the addition of the words "the exceptions set out in article 26(1)(*a*)". Such an addition was said to be justified on the ground that a party may set up against a holder who was not a protected holder also any defence specified in article 26(1)(*a*) that could be set up against a protected holder. Since the current text of the article was equivocal and did not clarify whether defences available under article 26(1)(*a*) were also available against a holder who was not a protected holder, a special reference to them was found to be necessary. According to another view the addition of such words was superfluous since the general statement contained in article 25(1)(*a*) of the current draft was broad enough to include the proposed addition. However, one might consider redrafting subparagraph (*a*) as follows: "(*a*) Any defence available against a protected holder and any other defence available under this Convention".

*The limitation concerning transactions between the party claiming payment and the holder which could serve as defences against contractual liability is open to criticism and should be restricted."

Underlying transaction between obligor and drawer or subsequent party

96. The Working Group noted that the two versions were identical, except for a minor discrepancy in French, and that they were based upon paragraph (1)(*b*) and the first sentence of paragraph (3) in the original text. The Working Group agreed to the formulation.

Circumstances of becoming a holder

97. The Working Group noted that the two versions were based upon the remaining portions of paragraph (1)(*b*) and the first sentence of paragraph (3) in the original text, and contained the same minor discrepancy in French. The Working Group agreed to the formulation.

Claims to the instrument

98. The Working Group considered subparagraph (*e*) of the proposal of France which was intended to replace paragraph (2) of article 25 of the current draft Convention and the rule of exception laid down in paragraph (3). It was noted that the second sentence of paragraph (3) concerning a transferee after maturity was not incorporated in the French proposal while it was set forth twice in the proposal of the United States, namely in paragraph (1)(*e*) relating to defences and in paragraph (2) relating to claims.

99. In support of the French proposal, it was stated that the second sentence of paragraph (3) had not been retained since it was incompatible with article 4(7)(*b*), which prevented the transferee of an overdue instrument from becoming a protected holder. Moreover, the drafting approach of the United States was said not to be convincing since it led to duplication and repetition by distinguishing between defences and claims—a distinction which was unnecessary in view of the fact that a valid claim to the instrument constituted a defence against the holder.

100. The prevailing view, however, was that the rule laid down in the second sentence of paragraph (3) should be retained. There was no inconsistency between this rule and article 4(7)(*b*), which merely regulated the question whether the transferee could become a protected holder in his own right. Not only was there room for the shelter rule of article 27 to apply, but there was also a need to regulate the rights of the holder who took an overdue instrument and was not a protected holder. It was recalled that this additional rule had become necessary when the Commission introduced the requirement of knowledge as a restriction to the availability of claims and certain defences. It was noted that the rule correctly reflected the policy of treating the transferee of an overdue instrument in substance as an assignee.

101. As regards the distinction between claims and defences, the Working Group was agreed that it was sound and that it would facilitate the understanding if it were made throughout the article. As reflected in the United States proposal, the first part would set forth the defences, followed by a second part dealing with claims. On the basis of this organizational agreement, a suggestion was made to regulate the rights of a transferee after maturity in a separate paragraph covering both defences and claims.

Underlying or other transaction between obligor and holder

102. The Working Group retained the rule laid down in paragraph (1)(*c*)(i) of article 25, which allows any defence resulting from the underlying transaction between the holder and the party from whom payment is sought. This rule was incorporated without change in the proposals of France (subparagraph (*f*)) and the United States (paragraph (1)(*f*)).

103. It was noted that the rule laid down in paragraph (1)(*c*)(ii) of article 25, which allows defences resulting from any other transaction between these persons which would be available as defences against contractual liability, was incorporated in both proposals (subparagraph (*g*) of the French draft and paragraph (1)(*g*) of the United States draft). However, as indicated in the comments of France, there were doubts as to the appropriateness of the restriction to "defences against contractual liability". Various views were expressed on this point.

104. Under one view, the rule was too narrow in that it did not allow the obligor to invoke by way of a set-off any claim he may have against the holder, whether or not based on contract. It was felt that the draft Convention should clearly recognize this right, which legal systems tended to grant to any person obliged to pay a sum of money.

105. Under another view, the draft Convention should not allow any defences arising from transactions other than the underlying one. Accordingly, the entire paragraph (1)(*c*)(ii) should be deleted. It was stated that it was contrary to the purpose of a negotiable instrument, which should be similar to "cash", to allow defences that were unrelated to the issue or transfer of the instrument. Moreover, one should distinguish between the question whether under negotiable instruments law there should be a defence to liability, taking into account the possible consequences for other parties, and the question whether payment could in fact be avoided or substituted by a set-off, which was normally governed by the general law of obligations and often subject to special procedural rules.

106. Yet another view, which the Working Group adopted after deliberation, was to modify somewhat the current rule by expressly recognizing any set-off of a contractual nature. Thus, the party from whom payment was sought could raise this defence to his liability if the claim to be set-off originated in a transaction, i.e., a contractual relationship, between himself and the holder.[9]

[9]As to the drafting of this rule, see below, para. 128.

Incapacity and "non est factum"

107. The Working Group noted that the proposals by France and the United States were identical to one another and to paragraph (1)(*d*) of the original text.

108. The Working Group agreed to the portion of the provision dealing with incapacity. Different views were expressed about the remaining portion of the provision allowing a defence that the party signed without knowledge that his signature made him a party to the instrument, provided that such absence of knowledge was not due to his negligence.

109. Under one view, this portion of the provision should be deleted. It was stated that this was a defence that was unknown in a number of legal systems and that it would be dangerous to permit it against instruments that were intended to circulate internationally. Even if this defence was deleted, between the original parties the obligor could raise the defence as one arising out of the underlying transaction. For those cases where fraud was involved or where the holder had knowledge of the defence, i.e., the ignorant signing, there was no need for a special rule since this was already covered by the rule of paragraph (1)(*b*) of article 25, which allowed any defence arising from the circumstances as a result of which the obligor became a party. It was stated that this provision contained the appropriate limitations, namely knowledge or fraud.

110. Under another view, the defence was widely known. It was stated to be of particular importance in international transactions where a party may be requested to sign papers in a foreign language he cannot read and whose characters he may not recognize. Those papers may be international instruments even though he had no reason to believe they were. In most cases where negligence was not involved, the signing was induced by fraud.

111. As regards the possible coverage under paragraph (1)(*b*) of article 25, it was stated that no comparable provision existed in article 26 and that, therefore, the defence of *non est factum* should be treated on its own in both articles. If this defence was deleted from article 25 as a defence available against a holder who was not a protected holder, it would also have to be deleted from article 26 as a defence available against a protected holder. It was pointed out, however, that the availability of this defence against a protected holder had been part of a compromise by which two of the common-law "real" defences were available under the draft Convention.

112. It was suggested that the occurrence of the facts on which this defence was based was rare, in particular, since the rule excluded instances of negligence. To that extent it was not very important whether the provision was retained or deleted. Since it had been stated that the facts leading to the defence which were worthy of being covered would normally arise out of fraud, it was agreed that the defence be limited to such cases.

"Ius tertii"

113. It was noted that the proposal of France, unlike that of the United States (paragraph (3)), did not incorporate the *"ius tertii"* rule laid down in paragraph (4) of article 25.

114. In support of the French proposal, it was stated that paragraph (4) of current article 25 had not been retained since it was redundant and in part incompatible with other provisions. It was redundant in that the assertion of a valid claim (paragraph (4)(*a*)) was already covered by subparagraph (*e*) of the French proposal, which incorporated the substance of current paragraph (2) of article 25, and in that the instances of forgery or theft (paragraph (4)(*b*)) were already covered by subparagraph (*d*) of the French proposal, which incorporated the substance of current paragraph (1)(*b*) of article 25 (i.e., defences arising from circumstances as a result of which he became a party). Paragraph (4)(*a*) was not consistent with paragraph (2) of article 25 and articles 68(3) and 73(2), all of which incorporated the requirement of knowledge.

115. It was stated in reply that the provision laying down the *ius tertii* rule was not redundant. Paragraph (2) of article 25 dealt with the question whether a claim to the instrument could be made against the holder and not whether a party could raise as a defence the assertion of a claim by a third party. Paragraph (1)(*b*) of article 25 did not cover those instances of forgery or theft commited by a holder who was not a party, for example, where a person stole a note from the payee and, after forging the payee's signature, demanded payment from the maker. As regards the comparison with articles 68(3) and 73(2), it was pointed out that the knowledge required there was that of the person paying and not that of the holder. However, as regards the comparison with paragraph (2) of article 25, there was some support for the view that the requirement of the holder's knowledge of the claim could usefully be incorporated into paragraph 4(*a*) of article 25.

116. While the Working Group was agreed on the need for retaining a *ius tertii* rule, divergent views were expressed as to what the content of such a rule should be. Under one view, the rule as laid down in article 25(4) should be retained unchanged, although it was realized that the words "asserted a valid claim" in subparagraph (*a*) were not abundantly clear and precise. However, no other formulation had been found to date which was clearer and provided a more acceptable solution balancing the interests of the holder and those of the party from whom payment was sought.

117. Under another view, there was a need for more certainty, taking into account the interests of the holder and the dilemma of the obligor who was faced at the same time with a demand for payment by a holder and the assertion of a claim by a third party. It was stated that the difficulties of the obligor related not only to the question whether the third party had in fact a valid claim but also to the question whether or not the holder was a protected holder. Various proposals were made in this respect.

118. One proposal was to prevent the obligor from paying the holder if the third party had notified him and demanded that he not pay the holder. Since the obligor in such case was willing to pay but did not know whom to pay, it was inappropriate to speak of a defence to liability. However, based on the law and practice in some countries, it was suggested to add to the Convention a new article 54 *bis* which would admit garnishment to stop payment only in the case of loss or theft of the instrument or the legally established insolvency or legally established incapacity of the holder. The proposal was opposed on the ground that, despite this limitation, the rule was too rigid in that a mere notification by a third party operated as an automatic blocking of payment and that this would unduly weaken the position of the holder of a negotiable instrument.

119. Various other suggestions were aimed at securing in one way or another judicial protection. For example, it was proposed to provide for payment into court, as was done in the similar case of a lost instrument in article 74(2)(*d*) of the draft Convention. It would then be up to the holder and the adverse claimant to obtain a court decision as to who is entitled to payment as the true owner. The proposal was opposed on the grounds that the draft Convention should not contain any more procedural rules or indirectly require adhering States to establish new procedural rules and that the solution to the obligor's dilemma of depositing the amount with the court was in any event available in practice in most countries even if the draft Convention did not provide therefor.

120. Another proposal was to require, instead of an informal assertion of a valid claim, the assertion of a claim in proceedings before a court or another competent authority. It was stated in support of that proposal that it would provide a greater degree of precision and of the likelihood that the assertion was not fraudulent or frivolous. The proposal was supplemented by a second instance which would entitle the obligor to refuse payment, namely where the holder had been requested, but had refused, to issue a guarantee against the asserted claim. It was stated that the device of requesting a guarantee under these circumstances was often used in practice and that the holder could obtain payment by providing such security.

121. While there was considerable support for this proposed modification of subparagraph (*a*) of paragraph (4), the Working Group, after deliberation, did not adopt it. It was felt that the assertion in judicial proceedings did not provide certainty about the validity of the claim and that the other part of the rule concerning refusal of a guarantee weakened the position of the holder. From a more general point of view, it was felt that the proposed rule did not provide the flexibility needed in a commercial context and that it created difficulties concerning questions of liability for delay in payment, in particular as regards the interest payable under article 66(1)(*b*).

122. Accordingly, the Working Group decided to retain paragraph (4) of article 25 unchanged.

123. In connection with the discussion on article 25(4), the Working Group considered the appropriateness of the parallel *ius tertii* rule in the article on discharge, i.e. article 68(3). A proposal was made to reword this provision along the following lines:

> "(3) A party is discharged of liability even if he knows at the time of payment that a third person has asserted a claim to the instrument, unless the third person has asserted the claim to the instrument in judicial proceedings or before another competent authority or unless the third person has provided indemnity satisfactory to the obligor."

124. It was stated in support of this proposal that it was not necessary and in fact wrong to maintain parallelism between article 25(4) and article 68(3). While the former dealt with the ability of the obligor to defend a refusal of payment, the latter was concerned with the duty of the obligor and, in this context, it was necessary to restrict considerably the exceptions to the principle so as to protect the obligor. In this vein, one could restrict the above proposal even further by requiring a court order instead of assertion in judicial proceedings, and by leaving out the instance of sufficient indemnity by the adverse claimant. It was stated that the proposal did not distinguish between a protected holder and a holder who was not a protected holder since this determination was normally difficult and often impossible for the obligor to make.

125. The proposal was opposed on the following grounds. It was not consistent with the principle that payment to a protected holder constituted discharge. It was not easily reconciled with the provisions setting forth the defences and claims available against a holder. In particular, it did not limit the exception from discharge to those cases where the obligor knew that the holder was not a proctected holder and, thereby, it neglected the impact of the presumption in article 28; it was stated in reply to this point that article 28 addressed the question as to who had the burden of proof. The policy underlying the second part of the proposed rule, i.e., sufficient indemnity by the adverse claimant, was not regarded as convincing. Moreover, the proposal omitted the instance of payment with knowledge of a forgery or theft on the part of the holder.

126. After noting that there was not sufficient time left for a detailed consideration of, and possible amendments to, the proposal, the Working Group decided not to adopt the proposed modification.

Adoption of revised text of article 25

127. Following the discussion, a new draft text, based on the proposal set out in paragraph 93, was submitted by an *ad hoc* working party.

128. It was noted that the provision covering defences resulting from non-underlying transactions between the holder and the party from whom payment was sought was worded as follows: "Any other defence resulting from a contract between himself and the holder". This

wording was opposed on the grounds that it did not expressly mention set-offs, that the qualification of a claim as contractual differed from one legal system to another and that it was not immediately clear whether claims for breach of contract were covered. It was stated in reply that an express reference to set-offs would equally raise the problem of different qualifications in different legal systems and that the requirement of a contractual origin of the defence was intended to exclude defences or set-offs originating, for example, from tort (or delict). The Working Group, after deliberation, adopted the following wording: "Any defence which may be raised against an action in contract between himself and the holder not referred to in paragraph 1(*e*)".

129. The text of article 25 as revised by the Working Group is set forth in the annex to this report.

New article 25 bis

130. In its discussion of article 4(7) the Working Group had agreed that a new article 25 *bis* should be drafted based upon the current text of article 4(7) (see above, paras. 23-24). The Working Group had before it two proposals. The first proposal was submitted by France as follows:

Proposal 1

"The holder may be a protected holder or a holder who is not a protected holder.

"The expression 'protected holder' means the holder of an instrument which, when he took it, was complete or, if an incomplete instrument within the meaning of paragraph (1) of article 11, was completed in accordance with authority given:

"(*a*) Provided that, when he became a holder:

— He was without knowledge of a defence available under this Convention (article 25(1)(*a*));

— He was without knowledge of a defence based on an underlying transaction between the party from whom payment is claimed and the drawer, or between the party from whom payment is claimed and the party subsequent to himself, or arising from the circumstances as a result of which he became a party (article 25(1)(*b*));

— He was without knowledge of any defence based on incapacity of the party from whom payment is claimed to incur liability on the instrument or on the fact that such party signed without knowledge that his signature made him a party to the instrument, provided that such absence of knowledge was not due to such party's negligence (article 25(1)(*d*));

— He was without knowledge of valid claims to the instrument of any other person (article 25(1)(*d*));

— He was without knowledge of any non-acceptance or non-payment (article 4(7)(*a*));

"(*b*) And provided that, when he became a holder:

— The time-limit provided by article 51 for presentation of the instrument for payment had not expired;

"(*c*) And provided that:

— He did not obtain the instrument by fraud or theft or participate at any time in a fraud or theft concerning it.

"A holder who does not fulfil these conditions shall be a holder who is not a protected holder."

131. A second proposal was submitted by the United States as follows:

Proposal 2

"'Protected holder' means the holder of an instrument which was complete when he took it or which was incomplete within the meaning of article 11(1) and was completed in accordance with authority given, provided that when he became a holder:

"(*a*) He was without knowledge of a defence upon the instrument referred to in article 25, paragraphs (1)(*a*) through (1)(*f*);

"(*b*) He was without knowledge of a valid claim to the instrument of any person;

"(*c*) He was without knowledge of the fact that it was dishonoured by non-acceptance or non-payment;

"(*d*) The time-limit provided by article 51 for presentment of that instrument for payment had not expired; and

"(*e*) He did not obtain the instrument by fraud or theft or participate at any time in a fraud or theft concerning it."

132. The Working Group noted that the cross-references to article 25 in the first proposal referred to the paragraphs in the current text and those in the second proposal referred to the paragraphs in the United States draft proposal (see above, para. 93).

133. The Working Group discussed which of the two proposals to follow in terms of their basic structure. In favour of the French proposal, it was pointed out that it set forth in more detail the elements that would keep a holder from being a protected holder. This was stated to have the advantage that it was not necessary to refer to another article in order to determine whether a holder was a protected holder, as it was in both the United States proposal and the current definition of protected holder in article 4(7). Furthermore, as a matter of principle, it was inappropriate to define a protected holder in terms of a holder.

134. In favour of the United States proposal, it was stated that it was more concise and easier to read. Setting forth in full the elements necessary for the holder to be a protected holder as in the French proposal was repetitious and unnecessary. It was stated that the reference to consecutive subparagraphs in the article immediately preceding this article did not cause the same

problems as occurred in article 26, which cross-referenced to a series of non-consecutive articles. After discussion, the Working Group decided to adopt this approach to the drafting of the article.

135. As regards subparagraph (*a*) of the proposed draft of article 25 *bis*, it was decided to delete the words "upon the instrument" since some of the defences referred to here were defences outside the instrument. It was noted that knowledge of a defence resulting from a transaction between the holder and the party from whom payment was sought prevented the holder from becoming a protected holder if the transaction was the underlying one but not if it was any other transaction. The Working Group, after deliberation, decided to retain this solution, which was taken over from the previous definition of protected holder in article 4(7).

136. The Working Group adopted subparagraphs (*b*) through (*e*), subject to the deletion in subparagraph (*e*) of the words "at any time". This deletion was intended to make it clear that, in line with the principle that the status of protected holder was determined at the time at which he became a holder, any act of fraud or theft committed after that decisive point of time would not take away from the holder the protected holder status. It was understood that a party from whom payment was sought may set up a defence resulting from such act against such protected holder (article 26(1)(*b*)).

137. The text of new article 25 *bis* as adopted by the Working Group is set forth in the annex to this report.

Article 26

138. The Working Group was presented two proposals by France and by the United States for a new wording of the current draft of article 26. It was noted that the French proposal avoided the eight cross-references by setting out the defences that could be set up against a protected holder. The United States proposal followed the style of the French proposal in that each defence was listed separately with a summary description of it. It followed the style of the current text in that article 26 incorporated the defences by cross-references.

139. According to one view, the French proposal was not satisfactory in that it was too detailed, to the point of duplicating the articles dealing with defences set out in other parts of the draft Convention. It was also pointed out that the proposal did not reproduce in its entirety the complete text of the provisions to which it referred and that this disparity of texts could create problems of interpretation for the courts. According to another view, the United States proposal would be satisfactory only with some drafting improvements, while according to still another view the proposal was not presented in a form compatible with other provisions in the draft Convention.

140. The prevailing view was in favour of retaining the current structure of article 26.

Paragraph (1)(a)

141. The view was expressed that article 68 should be added to the list of defences available against a protected holder. This defence would then be available when an instrument was paid to a protected holder, the party paying failed to obtain the instrument and the party paid, being a protected holder, presented it again for payment. It was noted that paragraph (1) of article 68 provided for a discharge of liability on the instrument when a party paid the holder, and that paragraph (4)(*e*) provided that a discharge could not be set up as a defence against a protected holder if payment was made but the person paying failed to obtain the instrument. The view was expressed that neither of these provisions clearly resolved the example under consideration.

142. Various views were expressed in regard to the proposal. All were agreed that the party paid, whether or not a protected holder, should not be able to present the instrument a second time for payment. According to one view, that result was already stated in article 68(1). It was also suggested that the fact of payment was not a defence to liability; the liability had been discharged. According to another view, a protected holder who was paid was no longer a protected holder. However, it was noted that the status of protected holder was acquired, if at all, when receiving the instrument and that that status was not lost by subsequent events. According to still another view, it was appropriate to adopt a drafting change of one form or another to make the desired solution clear, and several suggestions were made. The prevailing view was that it was not necessary to change the text to achieve the desired result.

Paragraphs (1)(b) *and (2)*

143. Suggestions were made to delete the words "or arising from any fraudulent act on the part of such holder in obtaining the signature on the instrument of that party" from both paragraph (1)(*b*) and paragraph (2). It was stated that a party who received an instrument by fraud would not be a protected holder. While this was recognized, it was pointed out that a protected holder might by fraud induce a person to sign an instrument as guarantor. Therefore, it was useful to keep the words in paragraph (1)(*b*).

144. In regard to paragraph (2), the Working Group could think of no example where a person could be a protected holder and be subject to a claim to the instrument, as distinguished from a defence on the instrument, arising out of such a fraudulent act. Although there was some support for retaining the words for the eventuality that some such example might exist, the prevailing view was to delete the words from paragraph (2).

Paragraph (1)(c)

145. The Working Group decided to add the words "and provided that he was fraudulently induced so to sign" to the end of the subparagraph in the light of the decision to add them to the equivalent provision in article 25 (see above, para. 112).

146. The text of article 26 as revised by the Working Group is set forth in the annex to this report.

Article 27

147. A proposal was made to reintroduce a former paragraph which the Working Group had deleted at its fourteenth session in 1985, as follows:

> "If a party pays an instrument in accordance with article 66 and the instrument is transferred to him, such transfer does not vest in that party the rights to and upon the instrument which any previous protected holder had."

148. The Working Group noted that it had deleted the paragraph as unnecessary by reason of the fact that an instrument is not transferred to a party who pays it and such party does not become a holder of it.

149. A proposal was made to amend paragraph (2)(*a*) by adding the words "if, when the instrument was transferred to him, he had knowledge of a transaction which gives rise to a claim to, or defence upon, the instrument". The Working Group decided not to accept this proposal on the ground that a restriction of the shelter rule of article 27 in respect of persons who had knowledge of a claim or defence when they took the instrument, but who themselves had not participated in the events leading to that claim or defence, would unduly impair the transferability of the instrument.

Article 28

150. No comments were made on this article.

Article 29

151. No comments were made on this article.

Article 30

152. A proposal was made to add to the end of article 30 the words "according to the terms of such acceptance or representation". The proposal was intended to recognize that a person whose signature had been forged may accept the forged signature or represent that it was his own only towards particular holders. The Working Group did not adopt this proposal since it would weaken the protection of other holders and might thus adversely affect the transferability of the instrument.

153. The Working Group retained article 30 unchanged, subject to replacing in the English-language version the words "has accepted to be bound" by the words "has consented to be bound".

Article 31

154. After noting that comments had been submitted on this article, the Working Group retained the article unchanged.

Article 32

Paragraph (5)

155. A proposal was made to delete paragraph (5). In support of this, it was stated that the paragraph would give an undue benefit to an agent who signed without authority or who exceeded his authority at the expense of the person he purported to represent.

156. In response, it was stated that an agent who signed an instrument without authority or who exceeded his authority in signing, and not the party he purported to represent, was responsible to pay the instrument under paragraph (3). Paragraph (5) completed the scheme by placing such an agent who was required to pay the instrument in the same position as the person he purported to represent. This view prevailed and the paragraph was retained.

157. It was suggested that article 32 should not refer to an agent in those cases in which he had signed without authority or had exceeded his authority, since such a person was not an agent. The Working Group did not have the time to consider this question and decided that the matter should be raised in the Commisson if, on further reflection, such consideration seemed appropriate.

Annex

Text of articles as revised by the Working Group at its fifteenth session

Article 1

(1) This Convention applies to an international bill of exchange when it contains the heading "International bill of exchange (Convention of . . .)" and also contains, in the text thereof, the words "International bill of exchange (Convention of . . .)".

(2) This Convention applies to an international promissory note when it contains the heading "International promissory note (Convention of . . .)" and also contains, in the text thereof, the words "International promissory note (Convention of . . .)".

(3) This Convention does not apply to cheques.

Article 1 bis

(1) An international bill of exchange is a bill of exchange which specifies at least two of the following places and indicates that any two so specified are situated in different States:

(*a*) The place where the bill is drawn;

(*b*) The place indicated next to the signature of the drawer;

(*c*) The place indicated next to the name of the drawee;

(*d*) The place indicated next to the name of the payee;

(*e*) The place of payment.

(2) An international promissory note is a promissory note which specifies at least two of the following places and indicates that any two so specified are situated in different States:

(*a*) The place where the note is made;

(*b*) The place indicated next to the signature of the maker;

(*c*) The place indicated next to the name of the payee;

(*d*) The place of payment.

(3) Proof that the statements referred to in paragraph (1) or (2) of this article are incorrect does not affect the application of this Convention.

Article 1 ter

(1) A bill of exchange is a written instrument which:

(*a*) Contains an unconditional order whereby the drawer directs the drawee to pay a definite sum of money to the payee or to this order;

(*b*) Is payable on demand or at a definite time;

(*c*) Is dated;

(*d*) Is signed by the drawer.

(2) A promissory note is a written instrument which:

(*a*) Contains an unconditional promise whereby the maker undertakes to pay a definite sum of money to the payee or to his order;

(*b*) Is payable on demand or at a definite time;

(*c*) Is dated;

(*d*) Is signed by the maker.

Article 2

This Convention shall apply without regard to whether the places indicated on an international bill of exchange or on an international promissory note pursuant to paragraph (1) or (2) of article 1 *bis* are situated in Contracting States.

Article 4(7)

(7) "Protected holder" means a holder who meets the requirements of article 25 *bis*.

Article 7(1), (5)

(1) If there is a discrepancy between the amount of the instrument expressed in words and the amount expressed in figures, the amount of the instrument is the amount expressed in words. When the amount payable by an instrument is expressed more than once in words or more than once in figures, and there is a discrepancy, the smaller amount is the relevant one.

. . .

(5) A rate at which interest is to be paid may be expressed either as a definite rate or as a variable rate. For a variable rate to qualify for this purpose, it must vary in relation to one or more reference rates of interest in accordance with provisions stipulated in the instrument and each such reference rate must be published or otherwise available to the public and not be subject to determination influenced by any person who might take advantage of it in connection with the instrument.

Article 8(5)

(5) The maturity of a bill payable at a fixed period after sight is determined by the date of the acceptance or, where the bill is dishonoured, by the date of protest for dishonour by non-acceptance or, where protest is dispensed with, by the date of dishonour.

Article 11(1)

(1) An incomplete instrument which satisfies the requirements set out in paragraph (1) of article 1 and bears the signature of the drawer or the acceptance of the drawee, or which satisfies the requirements set out in paragraph (2) of article 1 and subparagraph (*d*) of paragraph (2) of article 1 *ter* but which lacks other elements pertaining to one or more of the requirements set out in articles 1 *bis* and 1 *ter* may be completed and the instrument so completed is effective as a bill or a note.

Article 20(1)(c)

(1) When an endorsement contains the words "for collection", "for deposit", "value in collection", "by procuration", "pay any bank", or words of similar import, authorizing the endorsee to collect the instrument (endorsement for collection), the endorsee:

. . .

(*c*) Is subject only to the claims and defences which may be set up against the endorser;

Article 20 bis

When an endorsement contains the words "value in security", "value in pledge", or any other words indicating a pledge, the endorsee:

(*a*) Is a holder as referred to in article 14;

(*b*) May exercise all the rights arising out of the instrument;

(*c*) May only endorse the instrument for purposes of collection;

(*d*) Is subject only to claims and defences specified in article 25 or 26.

Such an endorsee, having endorsed for collection, is not liable upon the instrument to any subsequent holder.

Article 23(2), (3)

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

(*a*) He pays the principal or advises the principal of the receipt of the proceeds of the instrument, or

(*b*) He receives the proceeds of the instrument,

whichever comes later, he is without knowledge of the forgery, unless the absence of knowledge is due to his failure to act in good faith or exercise reasonable care.

(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, unless the absence of knowledge is due to his failure to act in good faith or exercise reasonable care.

Article 23 bis *(2), (3)*

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

(*a*) He pays the principal or advises the principal of the receipt of the proceeds of the instrument, or

(*b*) He receives the proceeds of the instrument,

whichever comes later, he is without knowledge that the endorsement does not bind the principal, unless the absence of knowledge is due to his failure to act in good faith or exercise reasonable care.

(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, unless the absence of knowledge is due to his failure to act in good faith or exercise reasonable care.

Article 25

(1) A party may set up against a holder who is not a protected holder:

(*a*) Any defence that may be set up against a protected holder;

(*b*) Any defence based on the underlying transaction between himself and the drawer or between himself and the party subsequent to himself, but only if the holder took the instrument with knowledge of such defence or if he obtained the instrument by fraud or theft or participated at any time in a fraud or theft concerning it;

(*c*) Any defence arising from the circumstances as a result of which he became a party, but only if the holder took the instrument with knowledge of such defence or if he obtained the instrument by fraud or theft or participated at any time in a fraud or theft concerning it;

(*d*) Any defence based on incapacity of such party to incur liability on the instrument or on the fact that such party signed without knowledge that his signature made him a party to the instrument, provided that such absence of knowledge was not due to his negligence and provided that he was fraudulently induced so to sign;

(*e*) Any defence resulting from the underlying transaction between himself and the holder;

(*f*) Any defence which may be raised against an action in contract between himself and the holder not referred to in paragraph 1(*e*);

(*g*) Any other defence available under this Convention.

(2) The rights to an instrument of a holder who is not a protected holder are subject to any valid claim to the instrument on the part of any person, but only if he took the instrument with knowledge of such claim or if he obtained the instrument by fraud or theft or participated at any time in a fraud or theft concerning it.

(3) A holder who takes the instrument after the expiration of the time-limit for presentment for payment is subject to any claim to or defence upon the instrument to which his transferor is subject.

(4) A party may not raise as a defence against a holder who is not a protected holder the fact that a third person has a claim to the instrument unless:

(*a*) Such third person asserted a valid claim to the instrument; or

(*b*) Such holder acquired the instrument by theft or forged the signature of the payee or an endorsee, or participated in such theft or forgery.

Article 25 bis

"Protected holder" means the holder of an instrument which was complete when he took it or which was incomplete within the meaning of article 11(1) and was completed in accordance with authority given, provided that when he became a holder:

(*a*) He was without knowledge of a defence upon the instrument referred to in subparagraphs (*a*) through (*e*) and (*g*) of paragraph (1) of article 25;

(*b*) He was without knowledge of a valid claim to the instrument of any person;

(*c*) He was without knowledge of the fact that it was dishonoured by non-acceptance or non-payment;

(*d*) The time-limit provided by article 51 for presentment of that instrument for payment had not expired; and

(*e*) He did not obtain the instrument by fraud or theft or participate in a fraud or theft concerning it.

Article 26

(1) A party may not set up against a protected holder any defence except:

(*a*) Defences under articles 29(1), 30, 31(1), 32(3), 49, 53, 59 and 80 of this Convention;

(*b*) Defences based on the underlying transaction between himself and such holder or arising from any fraudulent act on the part of such holder in obtaining the signature on the instrument of that party;

(*c*) Defences based on the incapacity of such party to incur liability on the instrument or on the fact that such party signed without knowledge that his signature made him a party to the instrument, provided that such absence of knowledge was not due to his negligence and provided that he was fraudulently induced so to sign.

(2) The rights to an instrument of a protected holder are not subject to any claim to the instrument on the part of any person, except a valid claim arising from the underlying transaction between himself and the person by whom the claim is raised.

Article 38(1)

(1) An incomplete instrument which satisfies the requirements set out in paragraph (1) of article 1 may be accepted by the drawee before it has been signed by the drawer, or while otherwise incomplete.[10]

Article 74(2)(a)*(i)*

(2) (*a*) The person claiming payment of a lost instrument must state in writing to the party from whom he claims payment:

(i) The elements of the lost instrument pertaining to the requirements set forth in paragraph (1) or (2) of articles 1, 1 *bis* and 1 *ter;* for this purpose the person claiming payment of the lost instrument may present to that party a copy of that instrument;

[10]The decision to delete the second sentence of this paragraph was taken in connection with the amendment of article 11(1) (see above, paras. 58-59).