BILLS OF EXCHANGE AND OTHER NEGOTIABLE INSTRUMENTS

A handbook of effective practice

H. Paul Shovlin

BILLS OF EXCHANGE AND OTHER NEGOTIABLE INSTRUMENTS

A handbook of effective practice

H. PAUL SHOVLIN

Woodhead-Faulkner
New York London Toronto Sydney Tokyo

Published by Woodhead-Faulkner Limited,
Simon & Schuster International Group,
Fitzwilliam House, 32 Trumpington Street,
Cambridge CB2 1QY, England

First published 1988

British Library Cataloguing in Publication Data
Shovlin, H. Paul
Bills of exchange and other negotiable instruments : a handbook of effective practice.
1. Negotiable instruments
I. Title
332.5'5

ISBN 0-85941-452-3

Designed by Geoff Green
Typeset by Hands Fotoset, Leicester
Printed in Great Britain by A. Wheaton & Co. Ltd, Exeter

TO
Mary, Catherine and Brigid

PREFACE

This book has been written in response to the needs of those actively involved in both domestic and international business and banking, finance and treasury.

Negotiable instruments and particularly bills of exchange have been surrounded by a mystique which often conceals their importance in business practice. The book seeks to dispel this by taking a practical approach to the various principles underlying the subject, dealing directly with real applications. The book does not seek to deal in detail with the legal aspects of bills of exchange which are already adequately covered in other texts. Though not specifically aimed at the student of business or banking to whom more comprehensive texts may be available, I hope nevertheless that it may have some value in combining essential knowledge of bills of exchange with their practical application. A glossary of terms is provided to assist the reader.

ACKNOWLEDGEMENTS

I would like to acknowledge the assistance I received from a number of people and organisations in writing this book. The level of support and encouragement I received from colleagues and friends was greatly appreciated. Their offers of criticism of the text helped me fashion the final outcome. Of course any errors which may have occurred are solely my own responsibility. I would also like to thank those colleagues and friends who helped me assemble the various exhibits.

In the course of this project I received the assistance and encouragement of the Institute of Bankers in Ireland for which I am grateful. A debt of gratitude is also owed to Hilary Higgins who patiently typed the manuscript.

I have written this book as a private individual but I would like to particularly thank my employer, Barclays Bank PLC, without whose support this book would not have been possible.

Formal acknowledgement is due to the following organisations for their kind permission to reproduce various exhibits:

Bank of England
Barclays Bank PLC
Blue Star Line Limited
The Controller of Her Majesty's Stationery Office
The De La Rue Company PLC
Food Industries PLC
Ulster Bank Limited.

CONTENTS

Part 1

INTRODUCTION

Negotiable instruments are a highly flexible and well-established form of title document. A negotiable instrument embodies a legally binding promise to make payment. It possesses the unique feature of its title being transferable from one party to another by means of a straightforward procedure of either simple physical transfer or endorsement combined with physical transfer.

Negotiable instruments have widespread practical application in commercial, financial and banking transactions. The ready transferability aspect of these instruments particularly facilitates their use in the above type of transaction. Unlike other documents of title which require other actions such as the serving of notice, negotiable instruments are much less cumbersome to deal with as they are stand alone documents.

Examples of negotiable instruments are bills of exchange, promissory notes, treasury bills, cheques, etc. Their usage categories are in international and domestic trade as well as banking and finance.

The Bills of Exchange Act 1882 is the principal legal code which applies to negotiable instruments. This Act is augmented by a body of case law.

1

INTRODUCTION

The origins of negotiable instruments can be traced back to English mercantile practice in the thirteenth century. One of the earliest examples of a negotiable instrument is the goldsmith's receipt for money lodged with him. Traffic in these receipts soon developed to the extent that they circulated freely as the currency of commerce. Unlike other legal instruments no notice was required to be given to the goldsmith when this receipt was transferred from person to person. The receipt eventually developed into what we now know as the 'bank note'. It was, therefore, one of the earliest forms of negotiable instrument and provided the basis for later development of negotiable instruments. Subsequently other documents developed into negotiable instruments as a result of their usage becoming recognised in commerce.

Negotiable instruments are widely used in commercial and financial transactions. Their use is firmly established as acceptable business practice among banks and trading and other companies and they enjoy the confidence which derives from well-established rules of law and practice. Their purpose is to secure payment and they have become increasingly used by companies for creating, transferring and procuring satisfaction of various financial liabilities. The handing over of the instrument is often accepted as being equivalent to payment. Unlike cash, a negotiable instrument is not 'legal tender'. Legal tender is defined as that which can always be used in transactions at face value; legal tender is that form of money which constitutes *at law* a valid tender of payment, i.e. a creditor is bound to accept payment made in legal tender.

Negotiable instruments enjoy many advantages but the most outstanding is their ready negotiability or transferability between various parties. Unlike other instruments, which are not negotiable but which can be transferred, the negotiable instrument enjoys a special status which makes it a most useful tool in finance and commerce.

A typical example of a commercial transaction is one where a manufacturer supplies materials to a wholesaler on 60 days credit terms. The manufacturer will draw a bill of exchange on the wholesaler who will accept liability on the bill by signing his name on the face. He will then return it to the manufacturer. The manufacturer will then normally present it through his bank to that of the wholesaler on the maturity date (i.e. at the end of 60 days).

A unique feature of the development of negotiable instruments is that practice preceded the law. In other words negotiable instruments became widely used among bankers and businessmen without any prior recognition in law. The law was subsequently developed to reflect a business practice already in existence.

A promise to pay, usually but not necessarily money, is embodied in every negotiable instrument. The promise is legally binding and the document may be transferred or 'negotiated' from one person to another each time conferring on the latest transferee a right to have the promise enforced for his own benefit. A negotiable instrument is particularly useful in commercial transactions. Anyone who gives value for it, taking the document in good faith, can enforce the promise unaffected by any previous fraud (short of a forged signature), which has been perpetrated without his knowledge and of which he could not have been expected to be aware.

There are many other instruments used in business which do not enjoy negotiable status. While useful in themselves, such documents of commerce do not possess the unique features of a negotiable instrument. They are often referred to as quasi-negotiable or non-negotiable instruments; a common example is a ship's Bill of Lading.

2

DEFINITION OF NEGOTIABLE INSTRUMENTS

General Definition

The following definition may be applied to a negotiable instrument. It is a written contract in which a *full and legal title is transferable* by either *simple delivery* of the instrument or *endorsement and delivery* of the instrument. In this transfer the instrument and all the property it represents passes to the transferee *free from any prior claims* provided that the transferee takes it in *good faith* and *for value.*

From the definition it is clear that:

1. Full and legal *title passes on delivery;* in essence this means that the transferee can sue in his own name in respect of the rights under the instrument.
2. No notice of transfer has to be given to the liable party on the instrument as title passes on delivery to the transferee.
3. Title passes *free from equities* or defects in title of any previous holder.
4. *Good faith* must always be present. By doing something in good faith is meant that it is done honestly. For example, if A *was aware* that B, the person who transferred an instrument to him had stolen the document from C and ignored the fact and attempted to transfer it for value to E, A would *not* be acting in good faith. Consequently the instrument would not enjoy the status of negotiability as far as A is concerned. The key point is that A was aware of the previous theft and transferred knowingly to E in bad faith. On the other hand E will enjoy negotiability of the instrument as he will have acted in good faith and have given value. Whether it is done negligently or not

or, sensibly or not, is beside the point. For example, something negligently but honestly done is deemed to be done in good faith.

5. *For value* means that the transferee must give consideration which is of some value to the transferor. Examples of value are money, goods, services or a promise to deliver value after say 30 days, e.g. a 30-day bill of exchange. A gift is a case where value is not given, but in the example of a gift, negotiability is exceptionally not lost because of the absence of value (or consideration).

   It is important to realise that value given may be inadequate but provided it is done in good faith there is no problem. For example A may give B only £10,000 for a consignment of goods when market value could be determined to be £12,000. Provided A acted in good faith this is a perfectly valid transaction. In summary the adequacy of value is not an issue.

Definition of 'Negotiable'

The word 'negotiable' is regularly used outside the strict bounds of the meaning it assumes in the subject of negotiable instruments. Indeed it is a word which has several interpretations depending on the context in which it is used. For the purpose of understanding negotiable instruments it is useful firstly to look at the concept of a 'transferable' instrument. For example both a bill of exchange and a bill of lading are transferable instruments. However, a bill of exchange is negotiable whilst a bill of lading is not negotiable; the difference is that even though both are transferable, the bill of lading cannot be transferred free from any prior claims unlike the bill of exchange. An instrument which is 'negotiable' can therefore be simply defined as being capable of being transferred by negotiation.

All negotiable instruments are connected with financial obligations. They often take the place of cash and therefore have some of the attributes of cash. For example, they are easily transferable and the person receiving them has confidence that he is receiving full value. As with cash, a person giving value for it and receiving it in good faith obtains good title to it even though it may earlier have been stolen or acquired by fraud. It should however be remembered that a forged signature, for example, invalidates the title of subsequent holders.

The transferee receives good title to the document and the right to sue on the promise contained in it. Of course he must satisfy himself that the person who made the promise or some person who is party to it is able to pay. The kernel of negotiability is the power to transfer free from equities, i.e. free from prior claims.

Definition of 'Instrument'

In law the word 'instrument' is defined as any written document under which any right or liability exists. Such a document is not just evidence of a right or liability but it *is* the instrument by which the right or liability is created. A typical example of a document which constitutes an instrument is a building contract where all the terms and conditions are agreed in writing. An invoice, in contrast is a good example of a written document which is not an instrument but mere evidence of a contract to supply goods.

Negotiation v. Assignment

For a fuller understanding of negotiability it is helpful to compare negotiation with assignment. Both are used to represent a change of ownership but they are quite different. A contractual 'right' is transferred from one person to another normally by way of 'assignment'. A typical example is the assignment of a life insurance policy by the customer ('assignor') to his bank ('assignee') as a pledge of security in return for a loan facility. If, however, the 'right' is embodied in a negotiable instrument it can be transferred by 'negotiation'. Compared with a negotiation, an assignment has disadvantages for the transferee:

1. Depending on the type of assignment an assignee may not be able to sue to enforce his right in his own name but must persuade the assignor to lend his name to the action or have him compelled to do so through a particular legal process.
2. The right being assigned is accepted by the transferee (assignee) subject to any defects in title the assignor had at the time of the assignment. The legal maxim, 'no one can give that which he does not have' applies. Therefore if a person has a right which is void because it was obtained by fraud he cannot give the transferee perfect title. He takes the right subject to equities,

e.g. subject to the right of set off of another existing debt or counterclaim by whomsoever.

3. The assignor must send notice *in writing* to the liable party of his intention to assign a contract.

   It is therefore evident that assignment compared with negotiation is a less satisfactory method for the transfer of contractual instruments in business transactions. The unreliability of this method in particular circumstances suggested the need for a more efficient and flexible approach which would create confidence in the business community. The development of negotiable instruments was the result.

Table 2.1 Negotiation v. assignment

	Negotiation	Assignment
Transferable by delivery or endorsement and delivery	Yes	No
Good title despite previous theft	Yes	No
Right of action by transferee in own name	Yes	Yes (but not always)
Notice of transfer to liable party required	No	Yes
Must be in writing	No	Yes
Validity of counterclaim or set off against the transfer	No	Yes

Key Characteristics of Negotiable Instruments

1. Negotiation may be effected by mere *delivery* or *endorsement and delivery*. If a negotiable instrument such as a bill of exchange, cheque, promissory note etc. is made out to 'bearer' then simple delivery to another person with the intention to pass those rights will suffice. There is no limit to the number of times such an instrument may be negotiated to other parties.

   If on the other hand, the instrument is made out to a specified person, that person may transfer the right by endorsing the instrument with a written order to pay another person and by signing the endorsement. It is noteworthy that the words 'or order', which are generally used on the face of cheques and bills of exchange for example, are not necessary if the instrument is negotiable. Where these words are written on a cheque, e.g. 'pay H. Jackson or order', they mean pay H. Jackson or according to his order. Indeed the words 'or order' are superfluous on a negotiable instrument as the very essence of negotiability is H. Jackson's ability to transfer. In the case of bills of exchange, cheques and promissory notes a simple signature of the holder by way of endorsement will make the instrument payable to bearer; the process is completed by delivery.

2. Negotiation gives the transferee a *right of action in his own name* against the original promissor or acceptor on his promise even though notice of transfer has never been given to that person. The promissor or acceptor of the instrument is liable to any person to whom the instrument has been negotiated. Other prior persons who become parties to the instrument by endorsement are also liable to the party to whom it has been negotiated.
3. Negotiation gives a transferee *good title* to the instrument even though the transferor had defective title or no title at all. However, the transferee must have taken the instrument in *good faith* and *for value*. Value means that consideration must exist (same requirement as for any other contract). However, the person who receives the instrument with prior knowledge of cirumstances which would arouse suspicion or have knowledge of facts which should have put him on enquiry but to which he turned a blind eye will not obtain good title. Such prior knowledge also includes irregularities in the instrument itself, e.g. being out of date.