EARLY IMPLEMENTATION OF THE 1988 UNCITRAL BILLS AND NOTES CONVENTION

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I. The Problem.

Negotiable instruments are the most common forms of payment in a modern commercial economy. A debt may be evidenced by a promissory note.[2] Goods may be bought and paid for with a bill of exchange.[3] These instruments can be handwritten, typed, typeset or a combination of all three.[4]

A negotiable instrument's primary benefit is that it restricts the defenses a debtor can raise against certain creditors (commonly called the "holder" of the instrument).

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[2] A promissory note is a written promise to pay a fixed sum to the order of a person. It is called a two party instrument because there are two parties (the maker, who owes the money, and the payee, the person who is to be paid the money). The most simple example of a promissory note is "Pay to the order of the Organization of American States $1,000,000 (signed) Houston Putnam Lowry."

[3] A Bill of Exchange is a three party instrument, meaning there are three parties to it. The most common type of bill of exchange is a check. The drawer is the person who signs the bill of exchange. Payee is the person who is to be paid by the bill of exchange. The drawee is the person who will normally pay the bill of exchange (the bank, in the case of the check). There is usually a special relationship between the drawee and the drawer (such as a bank account in the case of a bank and its customer).

[4] It is common for checks to be issued in pre-printed forms (which contain the names and addresses of the drawer and drawee). Some information is typed (such as the payee's name). Some information may be stamped (such as the amount, which may be stamped by a check writing machine). Some information is handwritten (such as the signature).

These creditors (often called “holders in due course” or “protected holders”) can require payment even if a defense to payment exists to the underlying transaction (such as a defect in the goods purchased). However, certain requirements must be met before a holder may acquire this special status.

These requirements are governed by local law[5] and can sometimes vary significantly. Two of the most common requirements can present a significant obstacle to modern commerce.

Instruments often must be denominated in a country’s currency. As international trade expands, international currencies have become popular. The most common of these international currencies is the Special Drawing Right (“SDR”).[6] Some national laws would have trouble determining an instrument payable in SDRs was negotiable. Given the importance of these currencies (particularly to various development agencies), this acts as an unnecessary impediment to trade.

The other problem is interest rates. Instruments may accrue interest at the rate specified with them. Modern commercial practice allows variable interest rates. These variable rates are usually fixed by third parties (or are based on rates fixed by third parties).[7] As the index goes up, the interest due under the instrument goes up. If the index goes down, the interest due under the instrument goes down.

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[5] In Canada, negotiable instruments are governed by the Bills of Exchange Act (based on the 1882 United Kingdom Bills of Exchange Act). In New York, South Carolina, Guam and the US Virgin Islands, negotiable instruments are governed by the old Uniform Commercial Code Article 3. In the rest of the United States, the District of Columbia and Puerto Rico, the 1990 revision of Uniform Commercial Code Article 3 governs negotiable instruments. The 1932 Law of Credit Instruments and Transactions governs negotiable instruments in Mexico.

[6] Issued by the World Bank.

[7] Such as a central bank.

While the rate cannot be determined from the four corners of the instrument, it can be determined with a minimal investigation (such as contacting a central bank or consulting a public newspaper). However, many national negotiable instrument laws prevent instruments with a variable interest rate from being considered negotiable instruments.

A promissory note denominated in SDRs based upon LIBOR[8] is not considered a negotiable instrument under many national laws. This means there can be no "holder in due course", which (in turn) restricts the transferability of the note and acts as an impediment to trade.

The difficulty of making an instrument negotiable is an impediment for trade and increases transaction costs without any social benefit. These types of rules can only be described as unnecessarily discouraging international trade.

II. CONVENTION PROVIDING A UNIFORM LAW FOR BILLS OF EXCHANGE AND PROMISSORY NOTES[9]

This convention was drawn up in Geneva, in 1931. While it went into force on January 31, 1943, it never attracted much interest from the Americas. It was perceived as a product of the European civil law system. While Columbia, Ecuador and Peru signed it, they never ratified their signatures. The sole party from the Americas is Brazil.

There were no new state parties to the convention since the 1960s (other the former states of the Union of Soviet Socialist Republics which wished to continue having the convention applied within their territory after the USSR dissolved).

The Uniform law contained a number of restrictions that would not meet present commercial and banking needs. For example, installment payments were not allowed (forcing the parties to use multiple instruments instead of a single

[8] London Interbank Borrowing Offered Rate.

[9] League of Nations Treaty Series, vol. 143, p. 257.

instrument with multiple payment dates). This old text will not accommodate modern commercial needs and is generally considered obsolete.

III. 1975 PANAMA CONVENTION ON THE CONFLICT OF LAW CONCERNING BILLS OF EXCHANGE, PROMISSORY NOTES AND INVOICES

The 1975 Inter-American Convention on the Conflict Of Law Concerning Bills of Exchange, Promissory Notes and Invoices ("OAS Convention") was issued in Panama as part of the CIDIP process.[10] Fourteen countries are parties to the OAS Convention. While the OAS Convention clarifies what law will govern a transaction (or parts of a transaction),[11] it does not modernize the underlying law. As such, it is a classical conflicts of law treaty rather than a substantive legal regime treaty.

This means the currency and interest rate problems described above may (or may not) still exist, depending on local law. If local law has fixed these legal problems and the OAS Convention's conflict of laws rules point to local law, then there is no problem. If local law has not fixed these legal problems and the OAS Convention's conflict of laws rules point to local law, then the problem exists.

A trap for the unwary occurs when local law has fixed these legal problems and the OAS Convention's conflict of laws rules point to a foreign law which has not fixed the problem. Then the foreign law governs and the problem still exists despite a modern local law. Local parties who are not aware of this problem will find their relationship is not governed by the legal rules they expected.[12]

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[10] The text of the OAS Convention (B-33) can be found at http://www.oas.org/juridico/english/treaties/b-33.htm.

[11] *See* Article 3 "All obligations arising from a bill of exchange shall be governed by the law of the place where they are contracted." It is assumed the parties cannot contract for another law to apply, which is commonly allowed in other kinds of contracts.

[12] *For example*, the parties may specify promissory note is payable in New York City without specifying where the

A conflicts of law Convention simply does not address the necessity of modernizing a national negotiable instruments law. While sophisticated attorneys and scholars may understand the problem after doing considerable research, the people handling such transactions are often rushed and without legal training. The result is increased transaction costs and unintended consequences.

IV. 1988 UNCITRAL BILLS AND NOTES CONVENTION.

The UNCITRAL Convention governs bills of exchange and promissory notes (collectively "instruments").

It is important to note what the UNCITRAL Convention does not apply to. It does not apply to checks, which remain governed by local law.[13] This means the normal check processing procedures adopted by local banks will not have to be changed in light of the UNCITRAL Convention. Depository contracts between banks and their customers will not have to be changed either.

Likewise, the UNCITRAL Convention does not apply to admittedly domestic instruments (instruments that are purely domestic on their face). Such instruments will continue to be governed by local law.

The UNCITRAL Convention adopted the "opt-in" philosophy expressed during negotiations. The UNCITRAL Convention does ***not*** apply to any instrument unless the instrument refers to the UNCITRAL Convention in its heading, as well as the body of the instrument. This means the UNCITRAL Convention will only apply to a transaction

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obligation was entered into. Pursuant to Article 5, this means the laws of New York.

[13] And possibly the Inter-American Convention on Conflict of Laws Concerning Checks (B-34), which is available at http://www.oas.org/juridico/english/Treaties/b-34.html. There are nine state parties to this convention. Argentina, Dominican Republic, El Salvador, Mexico and Venezuela are parties to OAS Convention (B-33), but not the checks convention (B-34).

when the parties intended to apply it. Banks will be able to easily determine an instrument is governed by the UNCITRAL Convention rather than local law simply from the "four corners" of the instrument. This enables banks to easily separate such instruments from their ordinary work.[14]

Building on a well recognized contracting principle, the UNCITRAL Convention essentially allows parties to "contract into" it. While the UNCITRAL Convention requires either the place of payment or the place of issuance to be in a contracting state,[15] incorrectly stating this information does not remove the instrument from the scope of the UNCITRAL Convention. For example, the parties to an instrument could incorrectly indicate one of them is from a foreign country, even though both of them are from the same country. Such an instrument would still be governed by the UNCITRAL Convention.

If the instrument looks like an international instrument, the UNCITRAL Convention will govern it. This position is in accord with the venerable adage of not looking beyond the "four corners" of the instrument (such as making an independent factual investigation). People should be able to rely upon what is printed on the instrument to determine the applicable law.

The UNCITRAL Convention does not prohibit local laws from penalizing such practices. [16] The only requirement is the UNCITRAL Convention must still govern the transaction. Local law could even make such behavior a criminal offense, but what *appears* to be governed by the UNCITRAL Convention

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[14] For example, a simple note under the UNCITRAL Convention could read:

International Promissory Note (UNCITRAL Convention)

Pay to the order of Barclays Bank of Buenos Aires, Argentina US$1,000,000. This instrument is an international promissory note (UNCITRAL Convention).
(signed) Houston Putnam Lowry
At: Meriden, Connecticut USA
Dated: February 27, 2002

[15] UNCITRAL Convention Article 2(1) and Article 2(2).

[16] UNCITRAL Convention Article 2(3).

must actually *be* governed by it. The instrument cannot be invalidated.

The UNCITRAL Convention allows negotiable instruments to be denominated in international currencies.[17] This means instruments payable in SDRs are fully negotiable and can have a protected holder.

Likewise, instruments containing variable interest rates are allowed.[18] However, variable interest rates must be set by a third party. Variable interest rates cannot be unilaterally set by one party to the instrument. This means a bank will not be able to set an instrument's interest rate by their "base rate" or "prime rate"; a rate which they unilaterally control. They may use a central bank's base rate (as long as it is publicly available). Failure to abide by this restriction means the UNCITRAL Convention will not consider the instrument negotiable (and therefore the instrument cannot have a protected holder).

This will not be a significant restriction for most large transactions (which already use variable interest rates set by third parties, such as LIBOR). In the case of small business enterprises dealing with financial institutions (where the reference is traditionally *to the financial institution's base rate* – which is entirely within the control of the financial institution), the method for determining the variable interest may have to be changed (or their instruments would not be negotiable under the UNCITRAL Convention).

Under the UNCITRAL Convention, an instrument can be transferred to a protected holder even if it is part of a larger transaction. For example, a bank may wish to transfer a pool of loans evidenced by a series of negotiable instruments. Under some local laws,[19] this means the purchaser does not acquire protected holder status.

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[17] UNCITRAL Convention Article 5(l).

[18] UNCITRAL Convention Article 8(6).

[19] Such as the Revised Uniform Commercial Code in the United States.

A purchaser under such facts under the UNCITRAL Convention becomes a protected holder. Such a distinction will promote further transferability of instruments and securitization of instruments (which, in turn, further promotes international trade by making more capital available). Instruments are often sold into the capital markets so the original lender can acquire further liquidity. If this can't be done at a reasonable price, local lenders will be unable to lend further (or can only lend at higher rates).

Another difficult problem is completing incomplete instruments.[20] Under the UNCITRAL Convention, the answer is clear. Incomplete instruments can (by and large) be completed.[21] There is no need to try to figure out the applicable law (which traditionally depended on where the instrument was completed) to determine if the instrument can be completed. For example, an instrument might be properly completed in Argentina. The same information being completed in Brazil may not be properly inserted.

It can be very difficult to determine after the fact if an instrument was properly completed (especially since it is not common to write on the instrument the locality of where the missing information was inserted).[22] How can the parties determine who inserted the information? When was the missing information inserted? Where did the act of inserting the information take place? Such information can be very hard to figure out.

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[20] An instrument may be delivered with important information missing, such as:

1. the amount to be paid (the proverbial "blank check").
2. the name of the payee.
3. the date of the instrument.
4. or any other required information.

[21] UNCITRAL Convention Article 13.

[22] *See, for example,* Crawford, *Montage v. Irvani: Conflicts or Harmonization of Laws,* 7 Banking & Finance Law Review 85 (1992). It should be noted this case took ten years to resolve (with significant related expense). The author argues it probably would not have been brought if the UNCITRAL Convention was the governing law.

However, some things cannot be completed even under the UNCITRAL Convention, such as adding the magic words "International bill of exchange (UNCITRAL Convention)" or "International promissory note (UNCITRAL Convention)." The drafters wanted the parties to properly invoke the UNCITRAL Convention on their own.

Likewise, the literal language of the UNCITRAL Convention does not allow a maker's or drawer's signature to be completed.[23] Virtually any other information can be completed. Even an unauthorized completion may still be effective in some cases (such a later ratification of the unauthorized act).

There is no doubt commerce is becoming more and more electronic. In 1988, not very many people had email. The worldwide web protocol was not developed until 1991.[24] Yet the UNCITRAL Convention was drafted so it would not be bound by existing technology. A signature was not limited to a handwritten signature. Article 5(k) defined "Signature" as "a handwritten signature, its facsimile ***or an equivalent authentication effected by any other means***; "forged signature" includes a signature by the wrongful use of such means". This language suggests there is no legal reason (although there may be technological reasons) an instrument cannot be electronic.[25]

The UNCITRAL Convention also introduces the concept of an "aval." This legal concept does not exist in the common law. It is a special type of guarantee that does not include the intricate common law background of suretyship (which can become quite complex).

The aval guarantee is a way of enhancing the credit worthiness of certain instruments. A third party agrees to pay the instrument if the person normally liable does not

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[23] Local agency law outside of the UNCITRAL Convention may allow this.

[24] http://www.zakon.org/robert/internet/timeline/.

[25] The United States has enacted federal legislation specifically allowing instruments to be in electronic form; *see* P.L. 106-229.

pay. While an instrument issued by an individual may be carefully scrutinized by a recipient, the same instrument carrying an aval guarantee by a solvent multinational bank will be more readily accepted.

The defenses to payment that can be raised by such a guarantor are very limited.[26] This type of guarantee almost has the effect of creating a protected holder even though the holder is not otherwise eligible to be a protected holder.

If the local law has no concept of an aval, it is uncertain how the court will interpret such a guarantee. By providing for such a guarantee, the UNCITRAL Convention makes it available to those who whish to use it.

There is one possible trap for the unwary under the UNCITRAL Convention. Under Article 88, it is possible to make a reservation that a country "will apply the [UNCITRAL] Convention only if both the place indicated in the instrument where the bill is drawn, or the note is made, and the place of payment indicated in the instrument are situated in Contracting States." It can be very difficult for private parties to accurately determine what reservations a country has made to a treaty (although this is becoming less and less true as such information becomes available on the internet).

For certain instruments, such a reservation means local law will be applied instead of the UNCITRAL Convention *if the case is brought in a certain country's courts* (the country has made the reservation). A contrary result occurs in countries that have not made such a reservation. Under such conditions, there may well be a race to judgment by the parties in their preferred courts. Making such a reservation would not promote uniformity.

While the UNCITRAL Convention requires ten state parties before entering into force,[27] it is possible to have

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[26] UNCITRAL Convention Article 47(4)(c).

[27] Three countries are currently parties to the UNCITRAL Convention: Guinea (23 January 1991), Honduras (8 August 2001) and Mexico (11 September 1992). Three countries have signed, but have not yet ratified: Canada (7 January 1989), Russia (30 June 1990) and the United States of America (29

an implementing protocol[28] which would allow it to enter into force early between contracting states. This is currently being considered by the United States, Canada and Mexico. Considering the objectives of the Organization of American States, such a protocol would be advantageous to its members to bring the UNCITRAL Convention into force early.

IV. Conclusion.

A robust economy has benefits for everyone. Placing barriers to the transfer of funds creates a cost to every transaction. This drives up the costs of each and every good bought. A barrier to the transfer of funds acts as a brake to an economy without any social benefit.

The costs for implementing the UNCITRAL Convention will be fairly modest. The instruments are clearly labeled so bank personnel can recognize them. The rules are fairly clear and UNCITRAL has done an excellent job of publishing cases[29] that interpret their legal documents. In the end, the costs of implementation will be more than offset by the decreased transaction costs.

June 1990). This shows a strong interest in the UNCITRAL Convention within the Americas because the Russia is the only state involved which not in the Americas.

[28] An example of such a protocol is attached to this paper. The United Nations was designated as the depository for the protocol because it already is the depository for the UNCITRAL Convention. Nothing would be gained by requiring private parties to check two depositories to very which countries are parties to the UNCITRAL Convention (or even determine if the UNCITRAL Convention was in force). In the alternative, the OAS Secretary-General could send some kind of notice to the United Nations, but it is uncertain if this would be accepted by the United Nations. The acceptability of this procedure could be determined by consultation.

[29] Such cases are available on-line at http://www.uncitral.org/english/clout/index.htm.

For the foregoing reasons, the 1988 UNCITRAL Convention should be brought into force early within the Americas. This would be done with a special implementing protocol (see attached proposal). Once ten states were parties to the UNCITRAL Convention, the protocol would no longer be necessary. In the meantime, the UNCITRAL Convention would be in force between those states even though the Convention's requirement of ten states before it came into effect[30] had not been met.

[30] UNCITRAL Convention Article 89.

Proposed Implementing Convention

AGREEMENT ON THE IMPLEMENTATION OF THE
1988 UNCITRAL BILLS AND NOTES CONVENTION

ARTICLE 1. The States Parties to this Agreement agree the 1988 UNCITRAL Bills and Notes Convention shall be immediately effective between them, notwithstanding Article 89 of that Convention.

ARTICLE 2. Becoming a State Party to this Agreement shall have the effect of an accession to the 1988 UNCITRAL Bills and Notes Convention if the State Party is not otherwise bound by that Convention.

ARTICLE 3. This Agreement shall be open for signature by any member in the Organization of American States.[31]

ARTICLE 4. This Agreement is subject to ratification.[32]

ARTICLE 5. This Agreement shall remain open for accession by any State.[33]

ARTICLE 6. No reservations to this Agreement are permitted.[34]

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[31] This allows the most number of states to participate. If desired, the reference to the Free Trade in the Americas can be deleted.

[32] *See, for example,* 1975 Inter-American Convention on the Conflict of Laws concerning Bills of Exchange, Promissory Notes and Invoices, Article 13 and 1975 Inter-American Convention on International Commercial Arbitration, Article 8.

[33] *See, for example,* 1975 Inter-American Convention on the Conflict of Laws concerning Bills of Exchange, Promissory Notes and Invoices, Article 14 and 1975 Inter-American Convention on International Commercial Arbitration, Article 9.

[34] Vienna Convention on the Law of Treaties, Article 19(a).

ARTICLE 7. The Secretary-General of the United Nations is hereby designated the depository for this Agreement.[35]

In witness whereof, the undersigned Plenipotentiaries, being duly authorized thereto, have signed this Agreement.

Done at _____, _____ this ___ day of June 2002.

[35] If the Secretary-General of the United Nations isn't designated, then the public will have to check two places to determine who are the parties to the UNCITRAL Convention. In the alternative, the OAS Secretary-General could send some kind of notice to the United Nations, but it is uncertain if this would be accepted by the United Nations. The acceptability of this procedure could be determined by consultation.