

Principles of Commercial Law

Lecture Title: Credit Instruments and Bills of Exchange

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Diploma in Law (Malta)



CAMILLERI PREZIOSI
ADVOCATES

What is Credit?

- Credit is a **future payment obligation** i.e. a right to obtain or receive a payment (this also comprises repayment) at a future date
 - This is coupled with the duty of the debtor to make the payment at the said future date
- Credit is an **Actionable Right**
- Credit is an **Assignable Right**
- Credit plays a crucial role when a new business is being founded - most businesses need some form of credit as it enables traders to transact without cash flow



Important Distinction

It is important to distinguish between:

1. **Credit Instrument or Agreement**

- Examples: Bill of Exchange, Loan Agreement

2. **Security**

- Examples: Guarantee, Suretyship

3. **Priority**

- Examples: Pledge, Hypothec



Development of Credit Instruments

- Credit Instruments were developed out of necessity by traders in order to facilitate trade and the exercising of acts of trade
- Credit is a form of incorporeal right and therefore traders needed to develop a way to record and document this 'right' onto some tangible material and as a result the *instrumentum* of credit was developed
- Bills of exchange were amongst the earliest forms of credit instruments to be developed and this was followed by Promissory Notes
- Eventually Cheques were developed – these were the result of the formation of banks and the practice of banking

- According to Professor Caruana Galizia – Credit Instruments form a *sui generis* kind of wealth
 - They involve the *exchange of present wealth for future wealth*
- There are credit instruments in the ‘proper’ sense of the word such as bills of exchange, promissory notes, cheques (which deal with money).
- However, there are also ‘Improper’ instruments of credit such as documents of title in respect of goods & other movables, bills of lading etc

Definition of Credit Instruments

- The term 'Credit Instrument' is not defined in the Commercial Code
- Definition found in the draft Commercial Code (1926): *'Documents in virtue of which the issuer gives to the lawful holder the right therein literally described which is not issuable or assignable without the document itself'*
- *Cesare Vivante* stated that a credit instrument is a necessary document for exercising the literal and autonomous right included therein
- Various writers have sought to define credit instruments → a number of key characteristics have emerged



Characteristics of Credit Instruments

The five main characteristics are the following:

1. Necessary
2. Literal
3. Autonomous
4. Negotiable
5. Fungible



1. Necessary

- Vivante has referred to a credit instrument as 'un documento necessario'
- This refers to the necessity of the physical document itself, in order to be able to exercise the rights described within the instrument or that emanate therefrom
- A credit instrument can not be transferred without the document itself
- To exercise his/her rights – the holder must be able to produce the document

2. Literal

- This denotes the concept that the right contained within the credit instrument is said to be, so to speak, literal
 - Implies that the right itself exists and must be understood in light of the tenor of the document and the specific wording utilised
- Simply stated, the rights that are granted by the credit instrument are those which are described and included in the document itself



3. Autonomous

- The right contained within a credit instrument is deemed to be autonomous
 - Through the credit instrument a **new, distinct obligation is created**
- The holder of the credit instrument exercises a right which:
 - is deemed to be his own and
 - consequently is not dependent upon what may have taken place between the issuer and the person to whom it was first issued
- The element of autonomy – acts to facilitate the negotiability aspect



4. Negotiable

- Credit instruments are transferable – the right of payment is transferred by endorsement and delivery
- There is no need to notify the debtor when such a transfer occurs
- Debts are generally transferred by *assignment* – where the assignee would step into the shoes of the assignor, acquiring rights and liabilities
 - There is an obligation for the debtor to be notified
- When a transfer occurs – prior claims are not transferred

5. Fungible

- The credit instrument is essentially a *res fungibilis*
- This implies that it can be substituted by another instrument of the same tenor
- Credit instruments can be replaced with another document of the same nature/wording

Credit Instruments vs Cash

- Credit instruments do not constitute 'cash' but are nevertheless effective means of payment
 - Due to the elements of autonomy and negotiability
 - Bills of exchange and promissory notes issued in terms of the Commercial Code may constitute executive titles (Article 253 of the COCP)
- Delivery:
 - Cash: Payment acts in such a way as to extinguish the obligation
 - Credit Instr.: Encompasses the right to receive payment at a later date
- Legal Tender:
 - Cash: Yes
 - Credit Instr.: No legal tender – this is dependent upon the will of the parties involved

Credit Instruments in Practice

- Bills of exchange are not as commonly used nowadays as in the past – however are still occasionally utilised by traders in certain types of transactions
- Promissory Notes – Not very commonly used
- Cheques are a common form of payment but there has been a decrease in their usage due to the rise of more advanced methods of payment (ex; credit cards)



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Bills of Exchange

- A bill of exchange is a **written order for payment**, by which one party is bound to pay a fixed amount of money to the other party, on a particular date or upon the demand for such payment to be made
 - Facilitates the carrying out of trade and also provides a level of clarity
 - It is similar to a promissory note or cheque
- There is no definition of a 'bill of exchange' in the Commercial Code
 - These are instruments which were developed by usages of trade and are not derived from the wording of the law
- The bill of exchange is arguably the most important type of credit instrument

- Bills of exchange are included in the list of objective acts of trade in Article 5 of the Commercial Code
 - Article 5(c) – *Any transaction relating to bills of exchange*
- A good definition of bills of exchange was provided by *Navarrini*:
 - “*un titolo di credito all’ordine essenzialmente commerciale, **munito di particolare forza processuale**, contenente l’obbligazione **letterale, formale, astratta, incondizionata..**”*
- This sets out some of the fundamental characteristics of bills of exchange and holds that bills are *endowed with a particular procedural force* – which is in line with Maltese law, seeing as bills of exchange constitute executive titles.

Characteristics of a Bill of Exchange

- Since a bill of exchange is a credit instrument – all the characteristics of a credit instrument, as previously discussed, are applicable to bills of exchange:
 - The instrument itself (i.e. the bill) is **necessary**
 - Every lawful holder acquires an **autonomous** right
 - The Bill is at its very essence, **transferable**
 - The Bill is also **negotiable**
- A bill of exchange is '**literal**'
 - This is because the right contained within a bill of exchange exists to the extent of the wording of the document

Who are the Parties to a Bill of Exchange?

- **The Drawer** – The person who issues or creates the bill of exchange
- **The Drawee** – The person delegated by the Drawer to effect payment to the Payee
- **The Acceptor** – The Drawee – once he accepts to pay by signing the bill
- **The Payee** – The person to whom the money is payable
- **The Endorsee** – The person to whom the bill is transferred by endorsement
- **The Holder** – The Payee is the *first* holder of the bill but it can also refer to the Endorsee, if the bill has been endorsed



Form of a Bill of Exchange

- The Commercial Code does not set out a specific format in accordance with which bills of exchange are to be drawn up
 - The bill can take any form and no particular medium is specified, as long as: (i) It is in writing and (ii) The requirements set out in Article 123 are satisfied
- Article 123 of the Commercial Code states:

A bill of exchange must be **dated**, and must **specify the place** where it is drawn, the **sum** to be paid, the **name of the person who is to pay**, and the **name of the person to whom or to whose order payment is to be made**, the **time and place of payment**, and the **value given**, whether in cash, in goods, in account, or in any other manner; and must be **signed by the drawer**.

- The law clearly sets out the formal requirements of bills of exchange:
 1. Date of Issue
 2. Place of Issue
 3. Sum to be paid
 4. Name of the person who is to pay
 5. Name of the person to whom or to whose order payment is to be made
 6. Time of payment
 7. Place of payment
 8. The value given – whether this be in cash, goods, in account or other
 9. Signature of the drawer

- The written form of a bill of exchange is evidently an *ad validitatem* requirement
- Article 123 uses the word '*must*' - various judgements have dealt with whether or not a bill would be rendered invalid or null, if certain requirements, as specified in the Commercial Code, were missing
- In *Martyn Attard noe et vs Alfred Cachia pro et noe (1995)* – The Court held that only the signature of the drawer and the amount were *ad validitatem* requirements
 - However – various judgements have also stated that the absence of other elements would render the bill of exchange null

The Date

- A distinction must be made between the date of *issue* and of *maturity*. The inclusion of the date of issue is important as it may be required in order to determine the relevant date of maturity
- The date of issue – important to ascertain whether the drawer was capable of binding himself by means of a bill
- There is no specific provision in the law which renders the bill invalid if the date of issue is missing.
- Profs Caruana Galizia - the omission of the date of issue does not affect the validity of the bill of exchange

Place of Issue

- The place of issue will determine which law will regulate the bill
- It has been accepted that failure to state the place of issue, will not invalidate the bill
- Profs Caruana Galizia - the omission of the place of issue does not affect the validity of the bill of exchange
- In *Ventur Auto Imports Co. Ltd v Oleg Anatolyevich Skylarov* (2016), the Court stated that the absence of the place where the bills were drawn would render them *invalid* only if the holder would consequently be unable to seek any party (therefore the details of any other party have been omitted).

The Sum to be Paid

- This is a crucial requirement – constitutes the subject of the obligation arising from a bill of exchange
 - Article 183 -> *'A bill of exchange must be paid in the money specified therein'*
- The sum to be paid must be certain with regards to both the (i) amount; and (ii) the currency
- The sum must be ascertainable from the bill itself and not by making reference to something extraneous to the bill itself
- Article 126 - *Where in a bill of exchange the sum payable is expressed in words and also in figures, and there is a discrepancy between the two, the sum denoted by the words is the amount payable*

Name of Drawee

- Must be indicated in the bill of exchange with reasonable certainty
 - Profs. Caruana Galizia states that the bill would be null and void without the name of the drawee
- The law does not require that the bill be *signed* by the drawee
 - The drawee signs the bill when he accepts the order given to him by the drawer (becomes the acceptor)

Name of Payee

- In *Martyn Attard v Alfred Cachia* (1995) – the Court held that if the name of the payee is not included, the name can be added subsequently
- The law does not allow the issuing of a bill to the *bearer* (i.e. that the bill is innominate). Confirmed in *Vincenza Xuereb v Cecil Pace et* (1977)



Time of Payment

- This corresponds to the date of maturity
- Time of payment must be *certain* and *possible*
- According to Article 172, Comm Code – A bill may be expressed to be payable:
 - (a) at sight;
 - (b) at a certain time or on a certain day;
 - (c) at a certain time after sight;
 - (d) at a certain time after date;
 - (e) at usance.
- Absence of time of payment from Bill – Article 180 states that *in the absence of any of the indications mentioned in article 172, the bill shall be payable at sight* - Therefore would not be rendered invalid



Place of Payment

- Failing to include the place of payment will not lead to the invalidity of the bill
 - The Court concluded that the fact that there was no indication of place of payment, does not render the bills automatically null (*Ventur Auto Imports Co. Ltd v Oleg Anatolyevich Skylarov*)
 - Article 224 sets out that *the presentment of a bill for acceptance or payment, the protest, the request for a duplicate of the bill, as well as all other acts against a particular party with regard to a bill, shall be made at such party's place of business or otherwise at his residence*
- This section would seem to apply when the place of payment is not specified and adds to the importance of including the drawee's address



Value Given

- Article 123 requires a bill to specify “*the value given, whether in cash, in goods in account, or in any other manner*”.
- In order to determine the root of the requirement, we need to make reference to some Civil Code Provisions:

987. An obligation without a consideration, or founded on a false or an unlawful consideration, shall have no effect.

988. The agreement shall, nevertheless, be valid, if it is made to appear that such agreement was founded on a sufficient consideration, even though such consideration was not stated.

- In reality rather than specifying a particular consideration, it is the practice for a bill of exchange to simply state “value received” without actually specifying what the consideration consisted of.



Signature of the Drawer

- The **most important and essential requirement** for the validity of the bill – it signifies the intention of the drawer to bind himself thereby
- Without signature of the drawer -> Bill is rendered unenforceable
- In *Phoenix Domestic Appliances Limited v. Joseph Vassallo*, Writ No. 2388/97 (2001), the Court held that according to Article 123 of the Commercial Code, the **signature of the drawer** is listed as one of the essential elements of a bill of exchange and therefore must be signed by the drawer *ad valitatem*

- In *Walter Zammit v Pio Callus* (1981), the Court held that a bill of exchange not signed by the drawer is to be considered as null
- In *John Giordimaina v Joseph Pace* (2006) – the Court of Appeal, applied the doctrine of *ius superveniens* and accepted a bill of exchange which was signed by the drawer during the course of proceedings and deemed it to be valid
- In *Ventur Auto Imports Co. Ltd v Oleg Anatolyevich Skylarov* (2018) – Court concluded that despite the fact that the underlying obligation between the company and the client was not null, the lack of signature on the part of the drawer, on the bills -> rendered them null and void at law (this constituted a grave and valid reason to suspend execution)

Sample of a BOE

Malta, _____ **Exch. for** _____

At _____ **Pay this** _____

of Exchange to the order of _____

the sum of _____

Value _____ **which place to Account**

To _____

No _____

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Endorsement

- The most noteworthy characteristic of a bill of exchange is the fact that it is transferable by endorsement
 - There could be **several endorsements** which take place
- **Article 136, Commercial Code** -> The holder of a bill can transfer the property in it by endorsement
- Where is the endorsement made? – **Article 138**
 - The endorsement is made on the back of the bill, or on a slip of paper called an allonge which, when necessary, is attached to the bill itself

- Equivalent to a fresh issue of the bill of exchange
- Transfer by means of endorsement is the only means through which the autonomous right discussed earlier is created
- This is an *accessory* transaction – the endorsement presupposes the existence of a bill of exchange, which is formally valid.
- Endorsement is completed by the delivery of the bill to the endorsee
- Types of Endorsement:
 - *Special* – Where the (a) name of the person to whom or to whose order, the bill is to be payable, (b) the date of endorsement and (c) other particulars are specified
 - *Blank* – May be made blank, where the mere signature of the endorser is included

- By means of Endorsement – the holder of a bill, who then becomes the endorser -> transfers in favour of another person (the endorsee), the property in the bill itself.
- Another kind of Endorsement -> *Restrictive Endorsement*
 - This is when an endorser has expressly prohibited any further transfer of the bill in his endorsement.
 - Parties to whom the bill is subsequently endorsed, have no right of recourse against the endorser (Article 141)
- Endorsement is the **only** valid method of transferring property in a bill
 - The endorser is rendered liable to each succeeding holder of the bill for the acceptance and payment of the bill (Article 140, Comm Code)



Case Law

Western Company Limited v. Spiridione Muscat (2020)

- This case pertained to the endorsement of bills of exchange
- Facts: Muscat filed an application to reject an application which was filed by the plaintiff, in order to have a number of bills of exchange rendered enforceable. This was based on Article 253(e) of the Code of Organisation and Civil Procedure (COCF).
- Muscat claimed that nothing was owed on his behalf to the company and that the first 59 bills were time-barred in accordance with Article 2156(f) of the Civil Code.
 - He utilised this as being a grave and valid reason as to why the bills were not enforceable

- The Court made reference to another case: Raymond Scerri v Christopher Caruana (2020) - provided an interpretation of Article 253(e) of the COCP
 - Held that there is a **difference between bills of exchange that are endorsed and those that are not.**
 - Those which are endorsed are independent from the underlying obligation with the third party
- In the Muscat case – Court noted that defendant was not claiming that the signature on the bills was not his or that he had not been validly notified
 - Agreed with the defendant by finding that the first 59 bills were in fact time-barred and therefore this qualifies as a grave and valid reason for the bills not to be enforceable
 - However the Court decided that the remaining bills of exchange were enforceable

Acceptance of a Bill

- This signifies the drawee's acceptance of the order given by the drawer, which is to pay the sum on the maturity date to the holder of the bill at that time
- Acceptance must be made on the bill itself, by the signature of the acceptor – with or without the words 'I accept' or 'accepted' (Article 148)
 - A *promise* to accept a bill – does not amount to an acceptance
- Acceptance must be dated and it cannot be conditional

Acceptance ctd.

- When does acceptance take place? -> A bill shall be presented for acceptance: (i) **on presentment** or (ii) **at the latest within 24 hours after presentment**
- Effects of Acceptance:
 - The acceptor is rendered liable for payment on date of maturity and this is *absolute* and *irrevocable*
- Refusal to accept – be proven by means of a protest for non-acceptance
 - Where the bill is not accepted for the whole amount for which it is drawn- protest for non-acceptance of balance is drawn up
 - Acceptance of *only part* of the amount in bill -> permitted

Presentment for Acceptance

- Presentment -> Means to present the bill for Acceptance and/or Payment
- Requires the bill of exchange to be physically presented
- To be made at that particular party's place of business or residence
- A. For Acceptance
 - Comprises that act/those acts carried out by the holder for the purpose of obtaining the drawee's assent to the order of the drawer
 - There is no obligation for the Holder of the bill to present it for acceptance – but if presented, is bound to protest it in the case of non-acceptance.
- B. For Payment
 - Holder of the bill shall present it for payment on maturity (i.e. the day it falls due)

Protesting the Bill

- This is an action against the drawer and/or endorsers in the event of
 - (i) **non-acceptance** – *A refusal to accept shall be proved by means of a protest termed protest for non-acceptance*
 - (ii) **non-payment** - *A refusal of payment of a bill shall be proved by means of a protest termed protest for non-payment*
- The doing of certain acts necessary for the exercise and preservation of rights of recourse under a bill
- Protest –this is drawn up by a Notary
- When is the protest to be made:
 - For non-acceptance: On the day succeeding that on which the bill was presented for acceptance
 - For non-performance: On the day next succeeding that on which the bill becomes due

Executive Title

- Article 253(e) COCP – includes ***Bills of exchange and promissory notes issued in terms of the Commercial Code*** amongst the list of Executive Titles
- Being in possession of a *signed* bill of exchange is an extremely useful tool legally
 - Render the *signed* bill executable by filing a judicial letter
- Standard procedure – A person seeking to enforce a bill or promissory note must send a judicial letter, wait for 20 days to lapse from day of service and if no opposition, then they have the right to enforce the executive title



Executive Title ctd.

- There is a special procedure in place for bills of exchange/promissory notes as set out in the proviso to Article 253(e)
 - A person seeking to oppose the execution of a bill or promissory note may file an application in court, within 20 days from the service of the judicial letter which was sent for the purpose of rendering the same bill/promissory note executable.
 - The parties are then usually heard.
 - The competent court will then issue the decree suspending the execution, in whole or in part, if satisfied that:
 - (a) the signature on the bill/note is not of the said person or his mandatory *or*
 - (b) where grave and valid reasons are raised to oppose enforce

Case: Mark Gaffarena vs Brian Lia (2021)

- Mr Lia was served with a judicial letter, by means of which, Mr Gaffarena sought to render a bill of exchange executable.
- In response Lia had brought an application on the basis of Article 253(e) of the COCP – claiming that there were grave and valid reasons to counter the execution of the bill
- Court noted that the law does not set out what reasons could be considered as *grave* and *valid* and was therefore left up to the interpretation of the Court
- The Court referred to the case: Michael Attard Ltd v Turista Ltd (785/2012)– where the Court held that the grave and valid reasons sufficient to lead to the suspension of the execution of a bill, cannot be wider than the reasons set out by the Commercial Code that prevent a bill from being paid.

- The Court in the *Gaffarena* case referred to another judgement: Daniel Zerafa pro et noe vs 240 Contracting Ltd gia Allfix – which considered what classifies as a grave and valid reason
 - The execution of a bill should not be confused with the question of the validity or the cancellation of the bill, as these do not fall under Art. 253(e).
 - If proven that the bill was issued by means of violence or if it was issued for reasons contrary to the law – such circumstances may be deemed ‘grave’ enough to stop the execution, in so far as the action for cancellation is also brought forward and examined by the court.
 - Other reasons that could be considered as grave are: (i) where the notification of the judicial letter is made to a person who is not mentioned anywhere on the bill itself or (ii) when the bill itself does not mention the creditor

- The Court in the *Gaffarena* case came to the following conclusions:
 - Due to the fact that the bill had never been transferred – it could not be deemed to be independent from the underlying obligations which led to the issuing of the bill.
 - Since the opposition to the execution of the bill brought forward by Lia, was founded upon the underlying obligations at play between the parties and the reasons for the issuing of the bill, the **Court found this to constitute a grave and valid reason, sufficient to permit the suspension of the execution of the bill.**
- **Therefore, the execution of the bill of exchange was suspended**



Promissory Notes

- The Maltese Commercial Code does not define Promissory Notes
- However, the UK Bills of Exchange Act (1882) describes a promissory note as *'an unconditional promise in writing made by one person to another signed by the maker, engaging to pay, on demand or at a fixed or determinable future time, a sum certain in money, to, or to the order of, a specified person or to bearer'*.
- Article 260 of the Commercial Code states that *"The **provisions applicable to bills of exchange**, and relating to endorsement, joint and several liability, aval, time of maturity, payment, payment for honour, protest, duties and rights of the holder, and re-exchange, **shall apply to promissory notes**"*



Contents of a Promissory Note

- **Article 261, Commercial Code:**
 - A promissory note shall state:
 - The date
 - The amount to be paid
 - The person in whose favour or to whose order such note is signed
 - The time when the payment is due
 - The value supplied in cash, goods, in account or in any other manner
 - A promissory note may also be drawn payable to bearer
- Contains an *unconditional promise* to pay at maturity, a sum (money) which is certain or to the order of a specific person

- Fundamental difference between a Promissory Note and a Bill of Exchange is the following:
 - Bill: The drawer draws the bill upon a person, other than himself
 - Promissory: The bill is drawn by a person, upon himself
- The Promissory Note will not be valid if its not signed by the drawer
- They are included in the list of Executive Titles as found in Article 253 of the COCP (Article 253(e))
- Promissory notes can be endorsed, in the same way as bills of exchange
- Promissory notes are not presented for *acceptance* in the same way that bills are



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