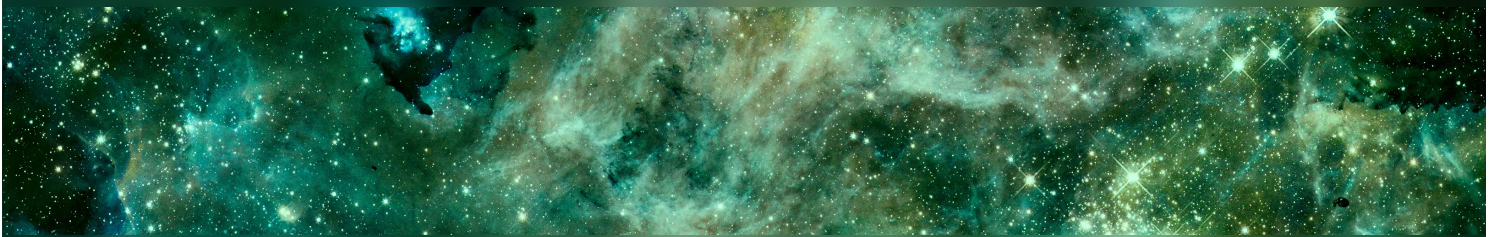


C L I F F O R D

C H A N C E



BILLS OF EXCHANGE – THE NEW LAW

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The Electronic Trade Documents Act 2023 (“**ETDA**”) makes it possible to create electronic bills of exchange, to transform existing bills of exchange from paper to electronic form (and *vice versa*), and to replicate the entire legal structure of obligations on a bill of exchange – including transfer by delivery and the status of holder in due course – within an electronic system. The ETDA received royal assent on the 20 July 2023, and will come into force on the 20 September 2023. Its primary purpose is to facilitate the electronification of trade and trade finance documentation in general, but it also effects a revolution in the law of bills of exchange.

The Bills of Exchange Act 1882 (“**BoEA**”), which has governed the law of bills of exchange, promissory notes and cheques in the UK for the last century and a half, is premised on the fact that a bill of exchange is a physical paper document, possession of which is capable of being transferred from one person to another. The rules relating to liability on a bill of exchange, its transfer and indorsement, the status of holder in due course and the rules relating to presentation and obtaining of payment, are all premised on the idea that a bill of exchange can be and has been physically transferred. By creating the possibility that a bill of exchange can be created, held and transferred electronically, the ETDA upends the traditional legal architecture.

The basis of the ETDA’s approach is that a bill of exchange can be created in electronic form if it is created within an electronic system which is sufficiently robust and can effect a transfer of exclusive control of the document. There is no closed list of such systems – it is for the court in any given case to decide whether a particular system satisfies this requirement. However, the criteria for recognition are set out in the ETDA in some detail, and it is unlikely that the determination of whether a particular system is a system of this kind or not will cause difficulty.

It is of course the case that electronic bills of exchange created within such a system will only be capable of being transferred between members of that system. The ETDA therefore provides for bills of exchange to be capable of being converted from electronic to paper form and vice versa. It will thus be possible for a controller of a bill of exchange within such a system to reduce it to paper for the purpose of being negotiated to a person who is not a member of the system. If that person in turn negotiates that bill of exchange to a person who is a member of a system, it can then be transferred into that system, at which point it will become an electronic bill of exchange. It will also be possible for bills of exchange which as originally created were pure paper bills of exchange to be delivered by a holder into a system, at which point they will become electronic bills of exchange.

There is a little time to prepare, as the ETDA does not apply to documents issued before the date on which it comes into force.

Key points

- From 20 September 2023 bills of exchange can be created, held and transferred electronically
- The electronic system must be a “reliable system”
- Bills of exchange can be dematerialised and rematerialised any number of times

The Scope of the ETDA

The ETDA applies to any document which, in paper form, is a document of a type commonly used in at least one part of the United Kingdom in connection with trade in or transport of goods, or financing such trade or transport, and possession of the document is required as a matter of law or commercial custom, usage or practice for a person to claim performance of an obligation (s.1(1) ETDA). In addition to bills of exchange, the list of instruments which are identified in the ETDA as documents commonly used in this way includes a promissory note, a bill of lading, a ship's delivery order, a warehouse receipt, a mate's receipt, a marine insurance policy and a cargo insurance certificate. The aim of the ETDA is to dematerialise the universe of instruments which are used in international trade. Bills of exchange are caught up in the overall objective, and are not given any separate treatment.

It is important to emphasise that the scope of the ETDA is not confined to documents which actually are used in the context of trade in or transport of goods, but extend to any instrument which is of a kind which is used in this way. Thus, since bills of exchange are used in this way, the ETDA extends to all bills of exchange regardless of how or why they are created.

The core of the ETDA is s.3. This provides that:

- (a) A person may possess, indorse and part with possession of an electronic trade document.
- (b) An electronic trade document has the same effect as an equivalent paper trade document.
- (c) Anything done in relation to an electronic trade document has the same effect (if any) in relation to the document as it would have in relation to an equivalent paper trade document.

This raises the question of what mechanism needs to be used to procure this result. The whole point of the paper bills of exchange regime was to create a mechanism by which it was clear who the holder of a bill of exchange was, how it had been transferred, and to who. The equivalent clarity is provided by s.2 of the ETDA, which states that an electronic document which contains information that, if contained in a document in paper form, would lead to the document being a paper trade document, constitutes an "electronic trade document" only if it exists within a "reliable system".

"Reliable Systems"

The ETDA does not provide (and does not permit any regulator to specify) which systems are "reliable systems" for this purpose. Instead, it provides a series of rules of recognition which are intended to enable a court to identify which systems are "reliable systems".

A “reliable system” is therefore a system which is used to:

- (a) identify the document so that it can be distinguished from any copies,
- (b) protect the document against unauthorised alteration,
- (c) secure that it is not possible for more than one person to exercise control of the document at any one time,
- (d) allow any person who is able to exercise control of the document to demonstrate that the person is able to do so, and
- (e) secure that a transfer of the document has effect to deprive any person who was able to exercise control of the document immediately before the transfer of the ability to do so (unless the person is able to exercise control by virtue of being a transferee).

For these purposes:

- (a) a person exercises control of a document when the person uses, transfers or otherwise disposes of the document (whether or not the person has a legal right to do so), and
- (b) persons acting jointly are to be treated as one person.

Reading or viewing a document is not, of itself, sufficient to amount to use of the document for these purposes.

When determining whether a system is reliable for ETDA purposes, the matters that may be taken into account include:

- (a) any rules of the system that apply to its operation;
- (b) any measures taken to secure the integrity of information held on the system;
- (c) any measures taken to prevent unauthorised access to and use of the system;
- (d) the security of the hardware and software used by the system;
- (e) the regularity of and extent of any audit of the system by an independent body;
- (f) any assessment of the reliability of the system made by a body with supervisory or regulatory functions;
- (g) the provisions of any voluntary scheme or industry standard that apply in relation to the system.

There are a number of such systems in existence – the Law Commission Report on Electronic Trade Documents¹ instances Bolero, essDOCs, CargoX, edoxOnline, e-Title,

¹ Law Com 405

Tradelens, and WAVE BL. However, the aim of this provision is to ensure that any system anywhere in the world which satisfies these requirements should be recognised at English law as a valid mechanism for the dematerialisation and transfer of trade documents.

Under the ETDA, documents are protean – they can change forms multiple times as required. In particular, a paper trade document can be converted into an electronic trade document, and an electronic trade document may be converted into a paper trade document. Where a document has been transformed in this way it is only valid if a statement that the document has been converted is included in the document in its new form, and any contractual or other requirements relating to the conversion of the document are complied with (s.4(1) ETDA). What this means in practice is that when a bill of exchange is put into an electronic system, the electronic record within that system must indicate that the bill of exchange was, as created, a paper bill. Conversely, a bill of exchange which is, as created, an electronic bill, may be converted into a paper bill (and presumably removed from the relevant system), but only if the paper bill created as a result of that removal indicates that it was, as created, an electronic bill (although that fact should be obvious from its form). It seems likely that a bill of exchange which is placed in a system and then removed from it more than once must record on its face each such admission and removal. The effect of the removal is as might be expected – the bill of exchange in its old form ceases to have effect, and all rights and liabilities relating to the bill of exchange continue to have effect in relation to the document in its new form. This clearly means that where a bill of exchange is put into a system and then subsequently removed from it, the old bill of exchange does not revive, but the document created by the system on the removal becomes the bill of exchange.

It is possible for the drawer of a bill of exchange to prohibit that bill from being dematerialised into a system. S.5(1) of the ETDA provides that a bill of exchange cannot be transferred into or out of a system if an intention to that effect appears in, or can reasonably be inferred from, the document or terms that have effect in relation to the document. This of course cuts both ways – a creator of a paper bill can prohibit its being given electronic form, and a creator of an electronic bill can prevent its being transformed into paper form. If a paper bill contains such a prohibition, a purported transfer within a system will not constitute a transfer of possession of the bill, and a purported indorsement within the system will not constitute an indorsement of the bill. It is also not possible to transfer into a system an instrument which is an uncertificated unit of a security that is transferable by means of a relevant system in accordance with the Uncertificated Securities Regulations 2001 (S.I. 2001/3755)².

Transfer of Possession of an electronic document

This takes us to the question of how the specific provisions of the BoEA apply to an instrument which either is, as created, an electronic bill, or which was, as created, a paper bill, but has become electronic at some point during its life.

² The only class of instrument which seems to fit within this exclusion is currently those debt securities which are eligible to be settled in CREST under the Uncertificated Securities (Amendment) (Eligible Debt Securities) Regulations 2003. However, this only applies to instruments where the terms of issue of the security provide that it may only be held in uncertificated form and title to them may only be transferred by means of a relevant system.

S.2 of the BoEA provides that the “bearer” of a bill is the person in possession of the bill, and that a “holder” of a bill means a person who is in possession of it. Since s.3(1) of the ETDA provides that a person may possess an electronic trade document, and s.3(2) provides that an electronic trade document has the same effect as an equivalent paper trade document, it seems clear that a transfer of an electronic bill of exchange within an eligible system has the effect of transferring possession for this purpose. Thus, when a person receives a transfer of an electronic bill within a system, they will be a possessor for this purpose, and may therefore be either a bearer or a holder. In the BoEA, “delivery” is defined as a transfer of possession, actual or constructive, from one person to another. This is important because an “indorsement” for this purpose means an indorsement completed by delivery. Thus, where the system concerned provides for a person to register an indorsement of an electronic bill, that indorsement will not have effect until the instrument has been transferred within the system to another person.

In this regard the question as to whether delivery can be effected by a transfer of constructive possession requires some analysis. This is most likely to occur where two or more users of a system employ the same electronic service provider to access the system on their behalf. In this context it is entirely likely that if one of those users wishes to transfer the bill to another user, the transfer will be recorded only in the books of the service provider, with no actual transfer being recorded in the system itself. In a case of this kind, it seems clear that if the service provider has actual possession, the person on whose behalf they hold must have constructive possession, and if that is the case, then an attornment or transfer by the service provider from one person to another must constitute a transfer of constructive possession.

The essence of a bill of exchange – that it is an unconditional order addressed by one person to another signed by the person giving it, requiring the payment of a sum certain in money to or to the order of a specified person (BoEA s.3(1)) remains unchanged. A conditional order will be as invalid for an electronic bill as it would have been as a paper bill.

Accidental bills?

This raises in some contexts the question of whether the effect of this legislation might be inadvertently to include many existing instruments within the heading of electronic bills of exchange. The point here is that, as regards the position between any payment service provider and their client, the essence of the provision of payment services is that the customer should be able to give the payment service provider an instruction to make a payment to an identified third person of a specified amount. It could be argued that even if this is the case, it is irrelevant – the essence of the law of bills of exchange is in relation to transfers of the bill, and in a conventional payment system such instructions are clearly not transferable. However, there are some provisions of the BoEA which would cause problems if they were applied – for example the rules as to presentment for payment in s.45 which include discharging the obligor from liability if the bill is not presented on the correct day.

The essence of the distinction here is likely to lie in the idea of signature. Cheques are signed, but electronic payment instructions are (generally) electronically authenticated.

Provided that the rules of the relevant system are sufficiently clear that authentication and signature are logically distinct this problem should not arise in practice.

Obligations arising on the bill of exchange

There does not seem to be any good reason why an electronic bill should not be payable to “bearer” – that is, the person in whose account within the system the bill resides, and who has “possession” of it.

An electronic bill which is payable only to a specific person is, by virtue of s.8(5) BoEA, payable to the order of that person – that is, the payee may instruct the drawee to pay to a third person identified by the payee.

The rule set out in s.9(2) of the BoEA to the effect that where the sum payable is set out in both numbers and words, in the event of a discrepancy the words will prevail, will apply to electronic bills. This may in due course create some interesting debate as to what is meant by the term “words” in that context.

Signature of an electronic bill

The essence of the paper bills regime is the physical signature. In particular, s.23 of the BoEA provides that “No person is liable as drawer, indorser or acceptor of a bill who has not signed it”. This rule applies equally to electronic bills.

By s.7 of the Electronic Communications Act 2000 an electronic signature is incorporated into or logically associated with a particular electronic communication is admissible as to the authenticity of the communication. This does not apply to paper bills of exchange, since such bills are not electronic communications for this purpose. However, since it is now possible for a bill to be in electronic form, it must therefore be possible to apply an electronic signature to such an electronic document³. This does not, of course, mean that it is possible to apply an electronic signature to a paper bill which is intended to be subsequently placed into a relevant system – an electronic signature can only be applied to an electronic document.

This logic must extend to acceptance and indorsement. Both of these are effected by a mere signature of the person concerned⁴. Thus, for an electronic bill, a mere signature effected through the relevant system by a drawee will be sufficient to make them an acceptor (provided that the drawee’s obligations are unconditional).

The effect of an electronic indorsement or acceptance⁵ whilst a bill of exchange is in electronic form is equivalent to the physical act of signature as it would apply to a bill in paper form. Thus if a system member “signs” an electronic bill as indorser, they will become liable on the bill in the same way as an indorser of a paper bill. If a bill of exchange which has been accepted and/or indorsed in electronic form is converted to paper form, the liabilities of the acceptor and indorser continue in effect despite the fact that their physical signatures do not appear on the paper bill.

³ This was the conclusion reached by the Law Commission in this respect – see Law Comm 405 – “Electronic Trade Documents = Report and Bill” [9.25] at p. 193.

⁴ BoEA S. 17(2)(a) as regards acceptance, and BoEA s.32(1) as regards indorsement.

⁵ Acceptance is not specified in s.3(1) of ETDA, which relates only to possession and indorsement. However, the effect of s.3(3) of ETDA clearly brings acceptance within its scope.

S.91(1) BoEA provides that where any instrument or writing is required by the BoEA to be signed by any person it is not necessary that they should sign it with their own hand, but it is sufficient if their signature is written thereon by some other person by or under their authority.

It is probably noteworthy that whereas the BoEA regime appears to presume a certain order of things – that the drawer of a bill will create the bill, sign it, send it to the acceptor for acceptance, receive it back, and then transfer it to a holder, there is no requirement that these things should in fact occur in this order. Thus, an acceptor may commence a transaction by providing an acceptance to a client that the client can then convert into an accepted bill (s.20 BoEA). This sequence must therefore be equally valid for electronic bills.

In this regard, s.24 BoEA may have an effect. This section provides that no liability arises on a bill where a person's signature has been placed on a bill in an unauthorised manner. This is particularly important where the signature concerned contains some indication that the person signing has limited authority (conventionally indicated by the inclusion of the letters p.p., per procuracionem).

The Protection of Holders in Due Course

A holder in due course of a bill of exchange takes free from equities provided that they received possession of the bill (a) before it was overdue, (b) without notice that it had been previously dishonoured, and (c) that they received it in good faith and for value. For an electronic bill, the moment of acquisition of possession is clearly the moment when the entry in the books of the relevant system is made which transfers unique control of the bill to the recipient. It seems that where such a recipient receives notice of dishonour, or of bad faith, after they have agreed to receive the bill but before this entry is actually made, they will not be holders in due course, since a person only acquires this status on completion of the transfer of possession.

The moment of transfer of an electronic bill will always be the moment at which the records of the relevant system are amended. This is because a bearer instrument is negotiated by delivery, and that where an acceptor has accepted an instrument, the acceptance is only complete where the bill is delivered (s.31(3) ETDA). Thus, if acceptance within the system is to be legally valid, the system must provide for the bill to be “transferred” to the acceptor for acceptance, and subsequently “transferred” by the acceptor (either to the drawer or to a third party) once accepted.

It should be noted that the original payee of a bill of exchange who retains possession of it is not a holder in due course, since the bill has not been “negotiated” to them⁶. This means that claims made by the payee on the acceptor are subject to equities as against the acceptor or an indorser (for example, fraud).

Payment and discharge

In this context an electronic bill also has the same effect as a paper bill, in that if it is not paid on the due date, a separate action against the drawer arises under the BoEA. This action is entirely separate from the action for the debt in respect of which the bill of exchange was initially tendered, and is not capable of being met with any of the

⁶ Jones (R.E. Ltd) v Waring and Gillow Ltd [1926] A.C. 670 HL

defences which would arise under that contract. Thus, for example, if a buyer wishes to argue that the goods delivered were defective, they will not be able to raise that defence in the face of a claim for non-payment under the bill of exchange.

In general, a bill will be drawn by a customer on a payment provider. Where the payment provider refuses to pay the amount specified (either by non-payment or non-acceptance), the holder must immediately give notice of this fact to all indorsers and to the drawer. The consequences of failure in this regard are drastic – any indorser who is not notified is discharged, as is the drawer (s.48 BoEA). This is an area where the use of a system should be a significant advantage to holders, since the system should be capable of delivering such notifications immediately, provided that all of the indorsers are parties to that system. However, issues may well arise where a bill of exchange which has circulated in paper form outside the system is incorporated within it, since in such a case notice must be given manually to any indorsers who are not system members.

In general, bills of exchange are only discharged by payment. However, the BoEA provides that a holder of a bill at or after its maturity may discharge a bill by absolutely and unconditionally renouncing their rights as against the acceptor, or by cancelling it (ss.62-63 BoEA).

Transfer with and without indorsement

The ordinary method of transferring a bill of exchange is for the transferor to indorse it, thereby becoming liable to the immediate and any subsequent transferee. However, it is entirely possible under the BoEA for a person to receive a bill of exchange and pass it on to another person without indorsing it (s.58 BoEA). In such a case they are not liable as an indorser. It is entirely possible that this may become the main transfer mechanism within a recognised system. In such a case, the transferor is deemed to warrant to the transferee that the bill is valid, that they have a right to transfer it, and that they are not aware of any fact which renders it valueless.

Cheques

It is clear that a cheque is a type of bill of exchange. However, it seems extremely unlikely that cheques fall within the definition set out in s.2 of the ETDA as documents of a type commonly used in at least one part of the United Kingdom in connection with trade in or transport of goods, or financing such trade or transport, and possession of the document is required as a matter of law or commercial custom, usage or practice for a person to claim performance of an obligation. Consequently, it does not seem that cheques fall within the scope of the ETDA⁷.

There have been various attempts over the years to create a statutory regime that would permit the electronic presentation of personal cheques without disturbing the ultimately paper-based system prescribed by the BoEA. The latest of these is contained in Part 4A of the BoEA, inserted by s.13(6) of the Small Businesses, Enterprise and

⁷ This also seems to have been the view of the Law Commission – Law Com [4.4] at p.62.

Employment Act 2015. This provides for electronic presentation of paper instruments for payment by the electronic communication of an image of both sides of the instrument concerned. These provisions are irrelevant to the far more radical regime put forward in the ETDA, and as a result s.89B of the BoEA is amended by the ETDA to provide that these measures do not apply to electronic trade documents.

Other Issues

The use of Distributed Ledger Technology to build “reliable systems” throws up questions around the recharacterisation of electronic bills of exchange (and other electronic trade documents) as cryptoassets both in the UK (see for example the definition of cryptoasset in the Money laundering Regulations 2017 (as amended), the financial promotion regime for cryptoassets and the Financial Services and Markets Act 2023) and in other jurisdictions (see for example the EU Markets in Crypto-Assets Regulation (MiCAR)). Generally, bespoke cryptoasset regimes exclude from their scope, traditional financial instruments such as shares and bonds. However trade documents are specifically carved out from this. This is potentially a significant hurdle to the use of Distributed Ledger Technology in this area.

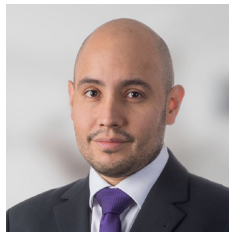
The conflicts of law rules as regards bills of exchange are slightly different from those which apply to ordinary contracts, and are set out in s.72 of the BoEA. The applicability of these rules tend to turn on the identification of the “place of issue” of a bill of exchange. It is unlikely to be entirely clear what the place of issue of an electronic bill might be.

The provisions of s.57 BoEA regarding the quantum of damages against a drawer or indorser (which differ from the ordinary rules for contractual damages) will apply. Liability on an electronic bill may therefore have a different quantum to that arising on a failed payment instruction, even where the facts are otherwise identical.

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