Chapter 60

Validity in General

I. Intrinsic Requirements

THE existing statutes contain only fragmentary conflicts rules, if any, on the subject of essential validity of the contracts in negotiable instruments.[1] There is, however, agreement on the proposition that formal and material validity ought to be subject to the same law.[2] This law also determines what ordinary requirements of contracts are to be modified or abandoned in order to promote the easy negotiation of bills, and what municipal rules are to supplement the special cambial rules.[3]

1. Capacity

The general conflicts rules concerning capacity of contracting are normally also applied to the capacity of signing bills and notes.[4] Capacity thus is governed by the personal law (of nationality or domicil) or the "law of the place of contracting" (better the law of the contract), or a mixed system. In England, the habitual hesitation recurs.[5] Ameri-

[1] Generally speaking, *lex loci contractus* is applied in Argentina, C. Com. art. 738, see 4 Vico 105 § 106; Mexico, law of Aug. 26, 1932, on titles and operations of credit, art. 252-254.

[2] Beale, 23 Harv. L. Rev. 1; Lorenzen 99 ff. and in 30 Yale L.J. 565; Gutteridge, 16 (Ser. 3) J. Comp. L. 62.

[3] *Supra* Ch. 58, pp. 133-134. On the cases: Hugo Fischer, "The Law Governing Capacity with Regard to Bills of Exchange," 14 Mod. L. Rev. (1951) 144, 151.

[4] For a survey see 1 Meyer 646; Veith, 4 Rechtsvergl. Handwörterbuch 491 ff. In Argentina (C. Com. art. 938, *cf.*, 4 Vico § 109), Brazil (Ley Introd. 1942 art. 9, par. 1); in Chile (C.C. art. 14, 15) and many other Latin-American countries, the domicil governs with the reservations for the domestic national law discussed in Vol. I, p. 117 ff.

[5] For domicil Westlake, for *lex loci contractus* Dicey (ed. 6) 682 n. 58.

can courts seldom have resorted to the domiciliary law; they employ the *lex loci contractus*.[6] Thus, a married woman domiciled in Michigan and signing in Michigan a mortgage and note as security for her husband, was not allowed by the Michigan court to raise the defense of coverture or a defense of misrepresentation, according to Michigan law, because the note was delivered to a bank in Ohio.[7]

The Geneva Rules, ignoring the experience of the common law, have established a system no one can ever defend.

In the first place, the Rules base their main provision (article 2, paragraph 1) on the nationality principle, unsuited for such an eminently international commercial matter. A decisive motive was the fear of "fraude à la loi," that eternal preoccupation of older European writers.[8] Else a minor might go to a country where he is regarded as of full age—this was a familiar argument. But what practical importance has such a possibility, and "how can an English banker have all the national laws on capacity in his head?" [9]

The next consequence had to be admission of *renvoi,* to the heartfelt grief of its foes:

> "If this national law declared competent the law of another country, this latter law applies." (Art. 2, par. 1, sent. 2).

An attempt to restrict this unwelcome addition was made by interpreting the reference as meaning exclusively the internal law of the country referred to.[10] This would, illogically, exclude *"Weiterverweisung."*

[6] LORENZEN 63.
[7] State of Ohio, ex rel. Fulton v. Purse (1935) 273 Mich. 507.
[8] DIENA, 3 Tratt. 52; 2 GRUNHUT 570 n. 6; 2 MEILI 327.
[9] GUTTERIDGE, *l.c.* 61.
[10] DIENA, Comptes rendus 347; HUPKA 238; ARMINJON, DIP. Com. 283. An analogous argument in HIRSCH, JW. 1939, 1338.

Illustrations. (i) (Hupka's example of a vicious circle.) An Englishman domiciled in England issues a bill of exchange in Buenos Aires. England refers to Argentine law as *lex loci contractus;* and allegedly Argentina would refer back to England as the domicil. The latter assertion agrees with the usual radical arguments *ad absurdum* but is totally inadequate. There is in fact no further reference. The English conflicts rule itself must be construed, without any help of the Geneva Rules, to refer to the substantive Argentine law. Certainly, England has in this case no reason to make Argentina arbiter of the choice of law. *Lex loci contractus* governs because of the presumption (right or wrong) that the parties know it best. Even the English domicil is not considered in England an obstacle to applying the foreign *lex loci actus.*

(ii) A national of Chile, domiciled in New York, indorses a bill in France. Although Chile refers to the domicil, it would not make sense to apply New York law while the New York courts apply French law. A reference to the *domicil* means entire abandonment to the law at the domicil.

Also the objections that renvoi complicates the task of the judge [11] and needs lawyers to apply it,[12] have no more force here than in general.

Corporations and other legal bodies are not mentioned in the Geneva Rules.[13] Without doubt, their capacity is determined by their personal law, that is, in the eyes of the member states, the law of the principal seat. An American court will evidently apply the law of the state of incorporation; it would not apply the law of the place of acting.[14]

Exceptions. Article 3, paragraph 2, states:

"If, however, the obligations entered into by means of a bill of exchange or promissory note are not valid accord-

[11] G. ARANGIO-RUIZ 178.
[12] GUTTERIDGE, *l.c.* 60.
[13] ASSER, Comptes rendus 347 ff.
[14] *Supra,* Vol. II, 4, 27 ff.

ing to the provisions of the preceding paragraph, but are in conformity with the laws of the territory in which a subsequent contract has been entered into, the circumstance that the previous contracts are irregular in form does not invalidate the subsequent contract."

A signature is valid if given in a territory where the signer would have capacity. This was already conceded by many laws [15] as a needed qualification of the personal law. The exception is more generous than in the French *Lizardi* case and the analogous provisions; also a foreign *lex loci contractus* is a recognized source of capacity.[16]

Yet, again, another proviso, paragraph 3, allows each member state to exclude for its own courts the exception of paragraph 2, if a national of this state has contracted abroad. Thus the Rules turn away from their course and discriminate among territories and nationalities. "The validity of the contract varies according to the court." [17]

Conclusion. The awkward and cumbersome legislation of Geneva has been deservedly criticized.[18] A better solution is furnished by the American practice. The law governing a contract in a bill must also determine the requirements of capacity. Domicil would not be a better test than nationality. The parties cannot be required to examine more than one law to ascertain the value of a signature.

However, the best rule is more liberal. As generally for

[15] Belgium: Law of May 20, 1872, art. 3.
France: C. Com. art. 114.
Germany: WO. (1908) art. 3.
Great Britain: BEA sec. 22.
Scandinavia: Law of 1880, art. 88.
Switzerland: C. Obl. (1911) art. 721.

[16] *Supra,* Vol. I, 188.

[17] MONACO 46; ARANGIO-RUIZ 178.

[18] See, e.g., HUPKA, and G. ARANGIO-RUIZ, *l.c.;* WIGNY, Revue Dr. Int. (Bruxelles, 1931) 784 ff.

contractual obligations,[19] capacity under the personal law deserves to be considered as an optional basis of validity. Although once Lord Esher thought that a "minor," though capable under his domiciliary law, cannot be made liable on a bill in England,[20] the optional validity according to either *lex loci contractus* or *lex domicilii* is winning adherents.[21] Security of commerce, harmed by an unlimited importance of the personal law, is fostered by its auxiliary consideration.

2. Consent

There is no doubt that, like all other "essential requirements," consent to signature and delivery, as distinguished from the "contract giving rise to the issue," is governed by the law of the place of execution.[22]

3. Consideration

The requirement of consideration was introduced into the law of bills of exchange when the common-law courts had assumed jurisdiction over this matter.[23] But the doctrine was modified in several respects;[24] notably, valuable consideration in this field need not come from the promisee,[25] and its existence is presumed.[26] However, the principle was applied in the case of illegality in *Moulis* v. *Owen*,[27] where a foreign check was considered governed by English law because payable in England and its purpose to cover play at baccarat was regarded illicit under English

[19] *Supra* Vol. I, and more recently CHESHIRE, International Contracts. A related proposal is made by FRANKENSTEIN, Projet d'un Code Européen de Droit internat. privé (Leyden, 1950) art. 58 ff.

[20] *In re* Soltykoff [1891] 1 Q.B. 413.

[21] LORENZEN 80.

[22] The former German Wechselordnung, article 85, included this point in 'ts term "essential requirements."

[23] ULMER, Festgabe für Heck (133 Arch. Civ. Prax.) 178.

[24] See LORENZEN 28 n. 72.

[25] BEA sec. 27; NIL sec. 25.

[26] BEA sec. 30; NIL sec. 24.

[27] [1907] 1 K.B. 746. *Cf.*, Lord Mansfield in Robinson v. Bland (1760) 2 Burr. 1077; FALCONBRIDGE, Conflict 311; DICEY (ed. 6) 682, 691.

law; this invalidity of the loan comprised all accessory obligations. The latter may be void also under their own *lex loci contractus*.[28]

In no case is failure of consideration a defense against a holder in due course.[29]

Illustration. In American municipal law, it is controversial whether the maker of a note which he entrusted to a fiduciary payee may set up the defense of failure of consideration against a holder who purchased from the payee in breach of trust and with knowledge thereof.[30] No such defense is given against a holder in good faith.

For conflicts law, there is no reason why lack of consideration, though a defect under the original applicable law, should be strong enough to break the position of a bona fide holder protected by the law of his purchase.

The exceptional option of the most favorable law granted by American courts to creditors attacked on the ground of usury has been discussed before.[31]

Another means to avoid the defense of failure of consideration was sought by the Supreme Court of the United States, when it resorted to the Louisiana law of the place of payment instead of the New York law of the place of delivery,[32] in order to effect the presumed intention of the parties, an inadvisable method of dealing with conflicts rules.

4. Other Incidents

The law of each contract also governs the permissibility of stipulations of interest and conditional indorsements,

[28] Canada: Story v. McKay (1888) 15 O.R. 169; FALCONBRIDGE, Conflict 316.
[29] England: BEA sec. 29 (3).
United States: NIL sec. 28, 58.
France: ARMINJON ET CARRY 475 § 417.
Italy: MONACO 121 ff.
[30] See BRITTON (1943) 487 ff.; PALMER, 48 Mich. L. Rev. (1950) 255, 261.
[31] *Supra* Vol. II, 408.
[32] Pritchard v. Norton (1882) 106 U.S. 124.

mostly identified with questions of form, and, of course, the necessity of delivery of the instrument.

II. Acceptance

The contract of acceptance normally shares the principles of the law of bills of exchange. It consists of presentment for acceptance and the acceptance necessarily written in the bill, plus return, i.e., delivery of the bill. In case of acceptance before issue, the acceptor writes his signature, which again becomes effective by delivery, though this is delivery by the drawer to the payee.

An "anomalous" [33] provision of the American Negotiable Instruments Act,[34] however, allows any form of declaration effective by notification [35] without delivery. On the other hand, the Geneva Convention permits a drawee who wrote his acceptance on the bill to revoke it until he returns the instrument.[36] According to what seems to me the better construction, it is not the unilateral act of the drawer that forms the acceptance (as was the theory of the German Reichsgericht),[37] but the written acceptance plus either return on presentment or delivery to the payee.[38]

Revocation, thus, merely strikes down an incomplete act.

It may be asked whether these requirements of acceptance should not be governed by the law of the place where the bill is returned (delivered) or signed. In fact, the Bill of Exchange Act (art. 72 (1)) expressly treats the form of acceptance on the same footing as the other contracts and calls for the law of the place where the acceptance "contract" is made. But when an American drawee notifies

[33] Hudson and Feller, 44 Harv. L. Rev. (1931) at 356.
[34] NIL sec. 134, 135.
[35] BEA sec. 2; NIL sec. 191.
[36] Geneva Conv. art. 29.
[37] 24 RGZ. 90; 77 *ib.* 141.
[38] Ulmer, Wertpapiere 207; Angeloni 173 § 118.

acceptance by letter sent to Japan without signing the bill, and the recipient takes the bill for value "on the face thereof," the contract is presumably "made" in the United States and therefore binds the drawee, while in the inverse case a Japanese drawee would not be bound wherever the contract would have to be concluded. For this reason and the sake of simplicity, it may be a better solution to extend the law of the place of *payment* to the questions of validity. We shall see that it is now greatly preferred over the law of the drawee's domicil and of the acceptance itself, as respects the effects of acceptance.[39]

III. Special Contracts

1. Accommodation Paper

The English Act (s. 28) and the American Act (s. 29) recognize the liability, to a holder for value, of a party signing as a maker, drawer, acceptor, or indorser, without receiving value and for the purpose of lending his name. The courts hold that an accommodation paper has no legal inception until it is received for value, so as to allow the accommodator until then to revoke his signature.[40] Hence, the conflicts requirement of delivery is not fulfilled until the accommodated party delivers the paper to a holder for a value, and this act determines the law applicable to the issue.[41]

This conflicts problem does not exist in civil law. If someone signs a bill in the interest of another person, though with the understanding between the two that the promisor should not bear a burden, he enters into a serious

[39] *Infra* Ch. 62, I.

[40] Fox v. Cortner (1921) 145 Tenn. 482, 492, 239 S.W. 1069; Dean v. Lyde (1931) 223 Ala. 394, 136 So. 857.

[41] Welsh Co. v. Gilette (Wis. 1911) 130 N.W. 879; Stubbs v. Colt (1887) 30 Fed. 417; 2 Beale 1059.

obligation. Any third holder may avail himself of it, even if he knew of the agreement.[42]

The common-law tradition, indeed, rests upon a confusion, familiar to former jurisprudence, between simulation, which does not bind, and a serious declaration to be bound to any party to the bill except the accommodated person. The Uniform Commercial Code, section 3-415, gives a considered new regulation qualifying the accommodation party as a surety; this sets him in conflicts law at the side of the avalist, presently to be discussed.

2. Aval

The act of guaranteeing an obligation in a bill or note, unknown to the common law of England, is now recognized in all statutes.[43] It is also uniformly agreed that this act has its own law. Most older writers justify such independence by drawing an analogy with the law applicable to suretyship,[44] while the Montevideo Treaty of 1889 upon the same analogy but following the ancient approach to suretyship applies the law governing the "guaranteed obligation." [45]

Nevertheless, an *aval* is not conditioned by the intrinsic validity of the principal debt nor is it restricted to the amount due on the latter.[46]

In consequence, it is now agreed that the admissibility

[42] France: App. Caen (May 30, 1899) D. 1900.2.508; Req. (March 11, 1935) D.H. 210, S. 1935.1.175; 1 PERCEROU ET BOUTERON 36 § 41. On the dangerous position of French banks taking in *"effets de complaisance"* without most strictly examining whether the drawer is really a creditor of the drawee and therefore lacking "bonne foi" and action against the acceptor, see HAMEL, 2 Banques et opérations de banque 750 ff.; *id.*, "L'unification de droit en matières d'instruments negociables" (Int. Bar. Ass., 3rd Int. conf., London, 1950) printed 1950, The Hague, p. 320.

Germany: RG. (Feb. 24, 1928) 120 RGZ. 207; STAUB-STRANZ, art. 17 n. 26.

[43] LORENZEN 32-34.

[44] 4 LYON-CAEN ET RENAULT § 655; STAUB-STRANZ (ed. 6, 1909) art. 86 n. 8.

[45] Montevideo Treaty Com. (1889) art. 31.

[46] 2 GRÜNHUT 579 n. 33; DIENA, 3 Tratt. § 231; 2 MEYER 374; WEISS, 4 Traité 461; LORENZEN 174 n. 420; ARMINJON ET CARRY § 445.

and form of an *aval* are determined by the law of the place where it is "given," that is, signed or delivered, respectively.[47] An Italian decision added a presumption, rebuttable only by the document, that the *aval* is written at the place of the issue of the bill.[48] Another Italian decision,[49] however, examining the question of form, rejected the law of the American state where the *avalist* attached his signature, in favor of the law of Italy to which he sent the bill and where the drawer signed subsequently;[49] insofar as this solution was based on the certain rule that the *aval* did not take effect until the bill was issued, the conclusion was objectionable because form and effect are indistinguishable.[50] But the result agrees with the presumable American conception of the role of delivery in such a case.

3. Acceptance for Honor

In the same manner as for *aval,* it is a constant conclusion that the contract of an acceptor for honor—the now rare "intervention"—is an independent transaction, subject to the law of its own place of making.[51]

In old cases of special contracts, the same conflicts rules respecting form, capacity, and material validity are used as for issue and indorsement.

[47] Montevideo Treaty Com. Terr. (1940) art. 23; *cf.,* ARGAÑA, in Segundo Congreso, Rep. Arg. 223; 4 VICO 95 § 95; Cód. Bustamante, art. 268; Geneva Rules, art. 4, par. 2; MONACO, Rivista (1942) 288 n.l.

[48] Italy: App. Milano (Nov. 25, 1929) Mon. Trib. (1930) 184.

[49] Cass. Ital. (Jan. 14, 1941) Foro Ital. 1941 II. 1055.

[50] MONACO, Rivista (1942) 286.

[51] Treaty of Montevideo, Com. art. 32; Geneva Rules, art. 4, par. 2; DIENA, 3 Tratt. 159; LORENZEN 174; RAISER 89; ARMINJON, DIP. Com. 330 § 174.