Personal Defenses Under the Geneva Uniform Law on Bills of Exchange and Promissory Notes: A Comparison

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This paper has a narrow scope. Its aim is to examine the application of art. 17 of the Uniform Law on Bills of Exchange and Promissory Notes of Geneva (subsequently referred to as U.L.) to a specific situation and to compare it with the legal principles applicable to the same situation under Anglo-American law. As will be seen, art. 17 U.L. involves the question of admissibility of the acceptor's defenses, valid against the drawer or other transferor, of a bill of exchange, in an action brought by the transferee-holder. This article will not examine the distinctions between "personal" and "real" defenses or the various types of these defenses under continental legal concepts, but will confine itself to a discussion of the interpretation of the applicable law, on the assumption of a specific type of defense: non-delivery or defectiveness of merchandise or, expressed in our terms, failure of consideration or breach of express or implied warranty. This defense was singled out specifically in the discussions at the Geneva Conference which led to the adoption of art. 17. By examining the meaning and interpretation of that provision by legal scholars as well as courts of the most important signatories of the Convention and comparing the solutions envisaged by our own law, we may be able to explore a little more that common ground which has to be found if unification of this area of law is desired. But even opponents of unification may find it interesting to examine the approach of a foreign system to a common legal problem. Knowledge of other solutions may help to evaluate our own.

M sells defective goods to X. M issues a bill of exchange drawn on X for the purchase price, payable to M's own order. X, ignorant as to the condition of the goods, accepts. M negotiates the bill to A who takes with notice of the defective character of the goods supplied by M to X. Upon dishonor by X, A brings an action against him in which X interposes the defects of the goods purchased as a defense.

The availability of such a defense to X is governed in those countries which have adopted the Geneva Uniform Law on Bills of Exchange and Promissory Notes (U.L.) by art. 17 of that law.¹

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¹The Uniform Law on Bills of Exchange and Promissory Notes (subsequently referred to as U.L.) of June 7, 1930 is the product of an International Conference held at Geneva, Switzerland, from May 13 to June 7, 1930. It was ratified by Belgium, Denmark, Greece, Norway, Sweden, the Netherlands,
Art. 17 reads: “Persons sued on a bill of exchange cannot set up against the holder defenses founded on their personal relations with the drawer or with previous holders, unless the holder, in acquiring the bill, has knowingly acted to the detriment of the debtor.”

In order to understand the meaning of this provision, it will first be necessary to delimit art. 17 against the preceding art. 16 U.L. which reads:

The possessor of a bill of exchange is deemed to be the lawful holder if he establishes his title to the bill through an uninterrupted series of endorsements, even if the last endorsement is in blank. In this connection, cancelled endorsements are deemed not to be written (non écrits). When an endorsement in blank is followed by another endorsement, the person who signed this last endorsement is deemed to have acquired the bill by the endorsement in blank.

Where a person has been dispossessed of a bill of exchange, in any manner whatsoever, the holder who establishes his right thereto in the manner mentioned in the preceding paragraph is not bound to give up the bill unless he has acquired it in bad faith, or unless in acquiring it he has been guilty of gross negligence. (Official English text)

It thus appears that art. 16 U.L. governs the protection of a holder who acquired the instrument from a person having no title to it. The holder will be protected even against the true owner (and, incidentally, even where one or more endorsements in the chain leading to him have been forged), unless, in acquiring the instrument, he acted in bad faith or with gross negligence. On the other hand, art. 17 will govern where the holder acquired good title but faces personal defenses by the obligor which the latter could validly interpose in an action by the holder’s transferor or other predecessor. The holder will be protected under this article, provided he did not knowingly act to the detriment of the debtor. Hence, in our above example, art. 17 rather than art. 16 would apply.
We thus see a difference in approach with respect to the holder's protection between the U.L. and the Anglo-American law. The protection by the latter is partly more and partly less extensive: 1. The Anglo-American law protects only the bona fide purchaser for value, or the so-called holder in due course. But 2. If he meets the strict test of a holder in due course, (being a “holder” as defined by law and satisfying the requirements of good faith, payment of value, acquisition before maturity, etc.) he will be protected both against equities of ownership and against personal defenses. Gross negligence, generally not considered a sufficient test of bad faith will not deprive him of protection.

On the other hand, the holder under the U.L. never has to qualify as a “holder in due course,” as we define it. In order to keep the instrument as against the claim of the true owner, he must only be free from bad faith and gross negligence. As for personal defenses, the wording of art. 17 seems to imply that such will be cut off against a holder, even if he knew of such defenses, as long as he did not in the acquisition of it act to the detriment of the obligor.

The contrast in viewing the holder’s protection through the unique and single concept of the holder in due course as compared to differentiating such protection depending on the dangers which may threaten the holder (i.e. claim of true owner on one hand and defenses of the debtor on the other) did not always distinguish English law from the continental principles on which U.L. is based. As Professor Eugen Ulmer points out in his historical study, English law at the time of Lord Holt, i.e., at the end of the 17th and beginning of the 18th century, had not as yet fully developed the conception of the “negotiable instrument” and treated the two sides of the holder’s protection separately, much as the European laws did. Not until Lord Mansfield’s decisions in Miller v. Race (1 Burr. 452, 97 E.R. 398), Grant v. Vaughan (3 Burr. 1516, 97 E.R. 957) and Peacock v. Rhodes (2 Doug. 633, 99 E.R. 402) was the character of the negotiable instrument finally defined and the holder’s position circumscribed in one single concept of protection both of his bona fide purchase and from defenses available against prior parties.

It has been strongly asserted that a differentiation between the case of lack of the transferor’s title and a defense based on the personal relationship, outside of the instrument, between the obligor and the holder’s transferor having good title is fully justified. Thus it is maintained

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2 See infra, note 102 et seq.
4 Id. at 192-198. Prof. Ulmer explains at 204-205 that the reasons for such split in the holder’s protection under European laws are historical, since the idea of cutting off defenses had been laid down by statute long before the protection of bona fide purchase was recognized.
5 Id. at 199.
that the very nature of a negotiable paper requires that the holder should not have to inquire into the extrinsic relations of his transferor to the various obligors, because they simply are "none of his business," even if he has notice of them. Only where the motive for the transfer is to cheat the obligor by cutting off a patently well founded defense, this motive being known to the purchaser, such defenses should be preserved against the purchaser as fraud founded in the purchaser's own person. On the other hand, where the transferor did not have title, the purchaser does not deserve the law's protection where he acted in bad faith, or even with gross negligence, in the acquisition of the instrument.

However, the wording of art. 17 is by no means simple of interpretation, especially when it comes to the meaning of the words "unless the holder, in acquiring the bill, has knowingly acted to the detriment of the debtor." From the very beginning, i.e., the time of its discussion and final adoption at the Geneva Conference, it has been considered a vague provision and it has given rise to various and divergent explanations by courts and legal writers alike. That the difficulties were foreseen at Geneva, was illustrated by the following statement by Mr. Giannini, the Italian delegate, who said: "Are you satisfied with this wording? No. Will you vote for it? Yes. I shall vote for it because I do not like it. But since no one likes it, this means without a doubt that this is the only wording which can get all the votes."

The Background of Art. 17 U.L.

The Preliminary Draft of the First Hague Conference of 1910 provided that the party sued on a bill of exchange could interpose, in an action by the holder, defenses based on his (the obligor's) relationship with the drawer or prior holders, if the plaintiff had acted in bad faith (mauvaise foi) in acquiring the instrument. However, the Second Hague Conference of 1912 considered that provision too wide and, in art. 16

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6 Hupka, Das einheitliche Wechselrecht der Genfer Vertraege 6 (1934).
7 Ibid.
8 See e.g. Friedel, De l'inopposabilité des exceptions en matière d'effets de commerce (1951) who states at par. no. 99: "... ont adopté une formule intermediaire, dont le sens exact est encore à déterminer à l'heure actuelle." (They have adopted an intermediate formula, the meaning of which still remains to be determined) See also Koessler, Zur Auslegung des Art. 17 des Genfer Einheitlichen Wechselgesetzes in 1932/33 Schweizerische Juristenzeitung 277: "Es wurde ... der Wechselbalg einer Kautschukformel geschaffen, deren möglicherweise verschiedenartige Auslegung in der Judikatur der einzelnen Laender die einheitliche Anwendung des als einheitlich gedachten, nicht in die Regionen der sog. "Reserven" fallenden Art. 17 zu gefährden geeignet ist." (They created the bastard of a rubber formula, the possibly differing interpretation of which by the courts of the individual countries may endanger the uniform interpretation of art. 17 which was designed to be uniform and not to fall into the area of the so-called "reservations.")
of the Agreement,\textsuperscript{12} changed the wording to the effect that only a fraudulent conspiracy (entente frauduleuse) between the transferor and the transferee of the instrument (to the detriment of the obligor) would expose the transferee to such defenses.

The efforts toward a unification of the law of Bills of Exchange, Promissory Notes and Checks, interrupted by the First World War, were resumed in the early 1920's, mainly through the Comité Économique of the League of Nations. That Committee first appointed a group of 4 experts in 1923, whose findings convinced the Committee that a unification, especially of the continental European laws with the Anglo-American system, could not be expected at that stage. Nevertheless, it resumed its efforts a few years later in the hope of bringing about at least some unification among the laws of the continental system. Again a group of experts, this time consisting of 10 members (among them Mr. Ralph Dawson, Vice President of the Guaranty Trust Co. as the American expert) was appointed in 1926 to study the problem. Their findings\textsuperscript{12} formed one of the important bases for the Geneva Convention.

These experts suggested that art. 16 of the Hague Agreement be changed back to the form given it in the Preliminary Draft of the First Hague Conference, i.e., so as to expose the holder to the defenses good as against the drawer and prior holders, if such holder had acquired the instrument in bad faith (mauvaise foi) rather than making the validity of such defenses dependent on an “entente frauduleuse” between him and his transferor. The reasons given by the experts for the suggested change were: 1. that the notion of an “entente frauduleuse” was too narrow and 2. the desire to harmonize the text of art. 16 with that of the preceding art. 15 which provided for the recovery of an instrument by the dispossessed true owner from a holder who had acquired it in bad faith (mauvaise foi) or with gross negligence from one having no title (eventually adopted in Geneva as art. 16). Thus, the experts paving the way for the Geneva Conference believed that \textit{bad faith} should be the criterion both as to the protection of one acquiring from a person having no title when sued by the true owner and to the question of letting in defenses in the case of acquisition from a legitimate holder.

The experts' suggestions were also submitted to the International Institute for the Unification of Private Law in Rome which, as far as art. 16 was concerned, approved the change suggested, agreeing that the words “entente frauduleuse” were too narrow.\textsuperscript{13}

At Geneva a group of delegates suggested adoption of the text (now to become art. 17) as set out above. This proposal evoked an animated

\textsuperscript{11} \textit{Règlement Uniforme sur la Lettre de Change et le Billet à Ordre}. 1912.
\textsuperscript{13} \textit{Supra}, note 11.
discussion which shows the great difficulties of interpretation that haunted this provision from its inception and the differences of opinion as to the most desirable regulation of this problem which the Swedish delegate Mr. Ekeberg termed "one of the most important practical questions submitted for consideration of the Conference." It therefore seems useful to summarize the views expressed at the Conference on the matter:

1. The fundamental question was, obviously, whether mere notice on the part of the acquirer, at the time of acquisition, of the existence of valid defenses against his transferor would be sufficient to expose the acquirer to the same defenses. The text of the proposed article evidently aimed at excluding this consequence. For that reason the delegate of the Netherlands (Mr. Molengraaff) eloquently opposed the adoption of the proposed article, and favored the formulation framed by the Experts' Committee. He pointed out that the proposed text actually protects the bad faith acquirer who, in acquiring the instrument, is fully aware of the fact that his transferor would be defeated by a valid defense of the obligor against whom the acquirer is bringing the action. He insisted that the law of bills of exchange does not aim at granting someone something that is not due him. The law, he said, is based on the principle of protection of third parties acting in good faith and will not permit a bad faith acquirer to enrich himself unjustly. Such unjust enrichment would be favored if the debtor were refused the right to invoke the acquirer's bad faith and were subjected to the burden of proving that the acquirer had the malicious intent of causing him damage.

The President of the Conference, Dr. J. Limburg, also expressed himself in favor of admitting defenses known to the acquirer.

This view was strenuously opposed by the representatives of Germany (Mr. Quassowski) Switzerland (Mr. Vischer) and Czechoslovakia (Mr. Hermann-Otavsky) who insisted that mere knowledge of existing defenses should not be sufficient to expose the acquirer to those defenses. The Czechoslovakian delegate cited a practical example to illustrate his position, similar to the hypothetical indicated at the beginning of this paper: M supplies defective goods to X and draws on X for the purchase price to his own (M's) order. X accepts. In an action by M against X, X could successfully interpose the defect as a defense. Now, if we assume that the bill has been negotiated to A who has knowledge of the situation at the time of acquisition, is he necessarily exposed to the defense of breach of warranty or fraud? The delegate answers the question in the negative, pointing out that A may have sufficient reasons to believe that the matter would be straightened out

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14 C.R. p. 291.
16 Ibid.
17 Ibid.
peaceably between the parties involved and that the acceptor would suffer no damage as a consequence of the payment of the bill. Thus, A could, in spite of his knowledge of the defenses, be still a purchaser in good faith.

These considerations finally won out and the article was adopted in the form indicated. The Editorial Committee (Comité de Redaction) commented in its summary that the Conference desired to indicate by the wording of the article that it did not suffice that the holder knew the defenses but that, in addition, he had to act knowingly to the detriment of the debtor in acquiring the instrument. The factual circumstances necessary to make this latter formulation applicable (exceptio doli generalis) were left to the discretion of the courts.\(^{18}\)

2. The discussion, moreover, threw some light on how the delegates understood the meaning of the words “acted knowingly to the detriment of the debtor,” which was to become the subject of such conflicting interpretation.

Mr. Vischer, the Swiss delegate, proposed an amendment which would have read: "... unless the holder, in acquiring the bill, acted with the intent to do damage to the debtor, being aware of the defenses which could be interposed against prior holders."

In the ensuing discussion, the Swedish delegate, Mr. Ekeberg, explained that this would mean, in other words, the requirement of "a fact which imparts to the conduct of the acquirer the character of an act contrary to good morals (contraire aux bonne moeurs)."\(^{19}\) The German delegate, Mr. Quassowski, expressed his approval of the Swiss amendment.\(^{20}\) This, however, induced Mr. Asser, a member of the Netherlands delegation, to inquire whether the purpose of the amendment was to indicate that it would not be sufficient for the holder to act knowingly to the detriment of the debtor, but that he would moreover have to have the intent to do damage,\(^{21}\) whereupon Mr. Vischer replied that, in his estimation, the will to do damage was expressed even in the originally proposed formulation of the article, while his amendment merely aimed at expressing the necessity of the holder’s awareness of the defenses which could be interposed against the prior holders.\(^{22}\)

Finally, the Conference rejected the amendment and adopted art. 17 as originally submitted to it and as it now reads.

Art. 17 U.L. in court decisions and literature.

1. France.

In view of the position taken by the Geneva Conference it would seem that 1. mere knowledge of defenses on the part of the acquirer

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\(^{18}\) C.R. p. 133 no. 45.
\(^{19}\) C.R. p. 291.
\(^{20}\) Ibid.
\(^{21}\) Ibid.
\(^{22}\) Ibid.
valid against prior parties would not expose him to such defenses and 2. *a fortiori*, that negligent failure to obtain such knowledge would in no way adversely affect his position.

But, actually, the proposition is far from obvious. The French courts had, prior to the changes made pursuant to the adoption of the Geneva U.L., followed the principle that protection was to be given only to a bona fide purchaser and, at least the majority held that knowledge of the existence of such defenses on the part of the purchaser was sufficient to qualify him as a bad faith holder and expose him to such defenses.\(^2\) They hesitated to depart from that position. It should be pointed out, however, that the prevailing view of the majority was not shared, even before adoption of the U.L., by all French scholars. Thus Lyon-Caen and Renault, to cite the most outstanding ones, declare: "This opinion seems to us to be contrary to the spirit of the law in this area; the debtor is under a direct obligation to the holder and must pay, unless he proves against such holder that he not only knew such a defense as the debtor could have availed himself of, but that he has made himself an accomplice to a veritable fraud designed to obtain payment which could otherwise have been refused."\(^2\) (Translation mine) Thus we find the concept of an "entente frauduleuse" spelled out in 1907 which later became incorporated into art. 16 of the Hague Agreement and which, in the view of many, still governs the differently worded provision of art. 17 U.L. In fact, some French decisions seem to bear out the authors' opinion, but they are in the minority as compared to the ones holding the opposite view.\(^2\)

But the French courts went even further. Both before and after the enactment of the U.L., decisions of French courts, including the Cour de Cassation, held that a holder did not act in good faith where he could


\(^2\) Supra, note 23 at 117.

\(^2\) See cases cited in Lescot et Roblot, *supra*, note 23 at 343 note 5. See also Friedel, *supra* note 8, who states at p. 148 (no. 102) that the greater part of those decisions (i.e. the ones which seem to bear out the views of Lyon-Caen and Renault) "maintain that the establishment of a collusion is sufficient to declare that the holder acted in bad faith but do not say that only such collusion determines bad faith. See also cases cited by Friedel at p. 147, notes 3-8.
have discovered the defect inherent in the instrument, thus exposing him to personal defenses valid against prior holders, on the basis of his gross negligence in failing to discover those defenses. In the light of these decisions, the statement by Professors Lyon-Caen and Renault that "it is, at least, certain that even gross negligence of the holder must not allow him to be treated as a holder in bad faith" does not seem to have been borne out. As late as 1947 the Cour de Cassation allowed personal defenses against a holder based on the latter's gross negligence in acquiring the instrument. In that case the plaintiff had purchased some bills of exchange which had become due almost 12 years before the purchase and the dishonor of which had not been protested. In the meantime the underlying debt had been extinguished. The Cour de Cassation held that the holder should have noticed that the instruments were 12 years old and had not been protested. Hence, even though he did not conspire fraudulently with the drawer, he should have inquired about the reasons of the drawer's inactivity of many years and, at any rate, should have contacted the drawee. His failure to do so meant that he "acted knowingly to the detriment of the debtor."

A more recent French case should be mentioned as significant for our problem. In that case the court declared that the rule that defenses based on the relation between the drawee and the drawer cannot be invoked against the holder becomes inapplicable "if the holder, in acquiring the bill, had knowledge of the damage caused the drawee-acceptor by putting him (the acceptor) through his (the holder's) act to a disability of interposing successfully the defenses based on his personal relations with the drawer." Is this the equivalent of "acting knowingly to the detriment of the debtor?" From the wording it is not clear whether the court means that the holder must have concrete knowledge of the actual damage which would accrue to the debtor or merely knowledge that, by his purchase, the defenses will be cut off, which in itself constitutes damage to the debtor. If the court means the latter, then it comes very close to allowing defenses merely where the holder is aware of their existence.

French legal literature likewise found itself facing a problem the solution of which seemed practically impossible. Somehow the words

26 Supra, note 23.
27 Cass. req. (Cour de Cassation, Chambre de Requêtes) April 29, 1947, J.C.P. 27.II.3602; S. (Sirey) 48.I.113 (cited in Caemmerer, supra note 23 at 131). Note that the question of losing the qualifications of a holder in due course by acquiring an overdue instrument does not have the same significance under the U.L. as under English and American law.
“acting knowingly to the detriment of the debtor” had to be explained. Not only were they there, but the Editorial Committee had itself declared what the words were not supposed to mean, namely mere knowledge of defenses on the part of the purchaser. A European continental legal writer is used to interpreting statutes and will not wait until some court will explain what the words mean. It is frequently the courts which expect the “doctrine” to tell them what a statute means before they are faced with having to hand down an opinion. As was to be expected, each of a number of writers presented his own theory as to what those words should mean, no matter how unconvincing some of those theories seemed to be.

Under one of them, for example, it is conceded that a priori the fact alone that an instrument is acquired with knowledge of the debtor’s valid defenses, is sufficient to let those defenses in against the purchaser, because the acquisition in spite of such knowledge must necessarily cause damage to the debtor. But, if so, then the text means exactly what the Editorial Committee said it must not mean, which cannot be. So, art. 17 means, according to this theory, that the holder will be subject to a personal defense of the debtor only where the acquisition of the instrument would, but for this provision, have had the effect of cutting off a defense which the debtor would have certainly interposed against the transferee. The author admits that it will be almost impossible to prove that the holder really knew that the debtor would have interposed a certain defense in an action brought by the transferee. He, therefore, suggests reliance on presumptions, pointing out that in certain cases the court will assume the holder’s intent to act to the detriment of the debtor because it would, under the given circumstances, be impossible to contend that the holder might have believed the debtor would not have made use of his defense. Where, on the other hand, such presumption should not be warranted, other elements would have to be considered to determine whether or not the holder believed that the debtor would interpose the

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30 Friedel, supra note 8 at 153. Friedel cites (note 3) the remark made by Mr. Giannini, Italy’s representative at Geneva, to the effect that art. 17 aims at the holder who acquired the instrument with the intent to prevent the debtor from availing himself of his defenses (C.R.p. 293) and that this notion was narrower than an intent to harm the debtor, which would spell out fraud. Friedel adds: “It is not apparent why he [the holder] would be interested in having it [the instrument] endorsed to him, if not with the intent to prevent the debtor from availing himself of his means of defense.”

31 Id. at 154. In support of his view the author cites both Staub-Stranz, Kommentar zum Wechselrecht 231, 234 (1934) and Arminjon et Carry, La Lettre de Change et le Billet à Ordre 372 (1938). However, it is submitted that the reference to those two treatises is based on a misunderstanding. Staub-Stranz merely state that the defenses are let in where the purchaser has certain knowledge of the existence of those defenses at the time he acquires the instrument. They do not require knowledge by the transferee that the debtor would have certainly interposed such defenses as a prerequisite for letting them in against such transferee. Arminjon et Carry quote Staub-Stranz for the same proposition.
defense which he (the holder) would be cutting off by his acquisition.\textsuperscript{32}

It is submitted that this interpretation, in addition to being artificial, does not seem to do justice to the intent of the framers and to the wording of art. 17. Its practical applicability seems even more doubtful.

Another author\textsuperscript{33} feels equally reluctant to concede that no significance should be attached to the unworkable formula contained in art. 17. He also suggests a distinction depending on circumstances, particularly on the type of defense involved. Thus he would consider mere knowledge of the existence of the defense sufficient to let it prevail against the holder where such defense arises from the underlying "causa" or is based on a defect of an instrument signed in blank or on discharge by payment, while not allowing it for other defenses (e.g. accommodation or set-off and counterclaim). This approach, while, in this writer's opinion, systematically misconceived, is based on a far better understanding as to the significance of "knowledge of defenses" than other theories and approaches much more closely, at least in the ultimate effect, the viewpoint of the American law.

Professor Houin, after discussing the "hesitations" of French courts in this matter, stated what he believes the statute requires to consider the holder as acting knowingly to the detriment of the debtor: "Knowledge of the defect is not enough. He (the holder) must have been conscious of the fact that he would cause damage to the drawee-acceptor if the latter could not interpose such defect at the time the instrument becomes due."\textsuperscript{34} (Translation mine) However, he adds, quite correctly, that, as a practical matter, it will be a rare instance where the holder's consciousness of damaging the drawee can be proved directly. In most cases, he feels, such proof will result from presumptions drawn from the relationship between the holder and the drawer (or prior holder) and the evaluation of such presumptions by the courts will necessarily be very difficult.\textsuperscript{35} It seems clear that a requirement of intent of "causing harm to the debtor" on the part of the holder has not clarified art. 17 to any appreciable extent. Professor Georges Ripert appears, therefore, quite justified in stating that "the consciousness of damage can hardly be distinguished from the simple knowledge of the defenses."\textsuperscript{36}

2. Switzerland.

While the lower Swiss courts are not quite clear in some of their rare decisions on this point as to the actual meaning of "knowingly acting to the detriment of the debtor," the prevailing view, as expressed by

\textsuperscript{32} Id. at 159.

\textsuperscript{33} Schneider, Essai d'une étude comparative en droit français et en droit allemand du principe de l'inopposabilité des exceptions en matière de lettre de change avant et depuis la Conférence de Genève 224-227 (1937).


\textsuperscript{35} Ibid.

\textsuperscript{36} 2 Traité élémentaire de droit commercial 54 (1960).
the highest Swiss Federal Court, is to the effect that the holder acts in
bad faith where he knew, at the time of the acquisition of the instru-
ment, that the debtor had defenses against his transferor.\textsuperscript{37}

However, one Swiss author disagrees with this interpretation of the
Swiss Supreme Court and, contrary to ideas expressed by himself as
co-author of an earlier work,\textsuperscript{38} he adopts and develops, in a contribution
published in 1955\textsuperscript{39}, the views expounded by Friedel\textsuperscript{40} and Schneider.\textsuperscript{41}
He now considers the provision of art. 17 meaningful as requiring, in
addition to knowledge of the existence of defenses, also the "conscious-
ness of causing a harm to the debtor" on the part of the holder. Such
knowledge will be present, in the author's opinion, where the holder
is not only convinced of the justification of the defenses, but also knows
that the debtor would have certainly interposed them against the trans-
feror, which is the theory developed by Friedel. Using the example
adopted as an illustration at the Geneva Conference and stated above,
he contends that, in the situation described, the holder need not have
acted knowingly to the detriment of the debtor, although he knew that,
for example, the merchandise had not been delivered, since he could
assume that the differences would be amicably settled before the instru-
ment became due. Therefore, he could not be certain that the defense
would have been interposed by the debtor against the claim of the
transferor.

It has already been pointed out above that this theory seems of little
practical value and could be carried into effect only on the basis of high-
ly artificial presumptions. Moreover, as stated by Staub-Stranz,\textsuperscript{42}
the example used merely circumscribes in greater detail the type of knowl-
dge of defenses on the part of the transferee which will or will not
destroy his good faith, but it does not introduce any new element, with-
out which his good faith will be preserved. In other words, where the
holder has knowledge of existing defenses, he usually assumes that such
defenses will still be in existence at the time the instrument becomes due.
If they are not, the holder will prevail, not because he acted in good
faith, but because there are no defenses which can be interposed against
him or against any transferor. If, at the time he acquires the instrument,
his valid reasons to believe that those defenses will disappear at the
time the instrument becomes due, then it might be argued that such is
not "knowledge of defenses" in its true meaning. The evaluation of such
"knowledge" would have to be left to judicial determination in the indi-

\textsuperscript{37} BGE (Entscheidungen des Schweizer Bundesgerichts) 54 II 41, 56 II 294.
\textsuperscript{38} Arminjon et Carry, supra, note 31.
\textsuperscript{39} Aequitas und Bona Fides. Festgabe zum 70. Geburtstag von August Simonius
\textsuperscript{40} Supra, note 8.
\textsuperscript{41} Supra, note 33.
\textsuperscript{42} Supra, note 31 at 232.
individual case. But the factual situation envisaged is certainly not common. It would, therefore, seem unjustified to abolish knowledge of defenses generally as a criterion of good faith only because of the possibility that such a situation might arise.43

3. Germany.

Very few German cases seem to have dealt with our problem since the adoption of the Uniform Law. However, Caemmerer44 cites two cases45 which give some indication of the courts' attitude, even though the opinions may not be conclusive. In the first one the Reichsgericht held that "knowingly acting to the detriment of the debtor" means that the holder must have known the defenses at the time of acquisition of the instrument. Since the defendant could not prove such knowledge, the case was decided for the plaintiff. Thus, the court does not seem to have reached the question as to whether, if proven, such knowledge alone would have been sufficient to deprive the plaintiff of his standing as a bona fide holder. In the other case, decided by an appellate court, our problem was likewise not material to the decision of the case, since knowledge was acquired after the time of acquisition. However, even though dictum, the court's interpretation of art. 17 is interesting. In the court's opinion, art. 17 requires malicious intent ("Arglist") which the court considers present where knowledge of the defenses was obtained at the time of acquisition of the instrument.

With virtually no support from the courts, German legal literature has been fairly eloquent on the interpretation of art. 17. As in the other countries which adopted the Uniform Law, the formula proved extremely vexing to German writers and the usual two opposite lines of approach developed, with some scholars trying to read some sense into the provision and others boldly cutting the Gordian knot and, in effect, admitting its unworkability.

One commentary,46 for example, repeats the standard statement that "mere knowledge, on the part of the acquirer, of the existence of defenses is not sufficient" and adds: "In addition, there must be present the consciousness of damaging the debtor." This is explained by saying that the acquirer must realize that he is depriving the debtor of his defenses through his acquisition of the instrument and must have incorporated this consequence in his intent, either by wanting to bring about such consequence or by taking the risk that such consequence would follow. But, the author continues, if the debtor proves that the holder,
at the time of the acquisition, knew the facts which led to the detriment of the debtor, then "experience in life" (Lebenserfahrung) presumes intent on the part of the acquirer and the latter must rebut such presumption. By way of illustration the authors assert that no intent to inflict damage need be present where the acquirer could expect that the debtor would take successful recourse against another (which is the theory similar to the one advocated by Lenhoff and Valeri) or where the acquirer believed that the debtor would not wish to interpose his defenses.

There is a strange inconsistency in the arguments advanced by the followers of this group. On the one hand it is asserted that the holder should be protected and cannot be expected to pay any attention to the relationships of his transferor to other parties, on the other hand his good or bad faith is made dependent on whether or not he had reason to believe that the debtor would recoup his loss elsewhere or whether he really intended to interpose his good defenses, all of which depends on knowledge of extrinsic circumstances, the obtaining of which might require considerable investigation.

A position similar to the one described above was recently taken in a very thorough doctoral dissertation. The author disagrees with Jacoby's belief that "knowledge of the defense is equal to knowledge of the debtor's detriment" and contends that art. 17 requires that the holder must have drawn the conclusion from his knowledge of the defenses that the debtor would be damaged, even though not requiring an intent on the holder's part to damage the debtor. He concedes that proof of such mental process of the holder will be difficult and admits that the holder will rarely have sufficient legal knowledge to draw a precise conclusion from the principle of "cutting off defenses." Nevertheless, he insists that the holder must have "formed ideas of some kind" as to the damaging effect upon the debtor of his acquisition of the instrument. He also admits that the holder would at least have to be familiar with the principle of "cutting off defenses" (to draw any conclusions at all) and that such principle is by no means widely known. The only solution of these problems is seen in the recourse to presumptions by the courts.

Again the question arises: Would the holder acquire the instrument if he did not believe that the debtor's defenses, of which he is fully aware, will be cut off with respect to him? And, if he does, isn't he just

47 Infra, note 67.
48 [*Infra, note 73. See also Gaehler, Die Einwendungen des Schuldners nach dem neuen Wechsel- und Scheckgesetz 81 (1934).*]
49 Hupka, supra, note 6 and infra, note 62.
51 Infra, note 59.
as aware of the fact that such exclusion of defenses must accrue to the debtor's detriment?

As a consequence, a number of German scholars refused to go along with the unconvincing attempts at an artificial interpretation of art. 17. As early as 1932 one writer stated: "... After protracted discussions, a compromise was reached in the preceding formula which, however, will not fully satisfy the requirements of commerce. It will force him who knows of the existence of defenses which the debtor cannot interpose against him to abstain from the acquisition [of the instrument], because it may be claimed that he had knowledge of the detriment caused the debtor by the transfer. ..." Staub-Stranz agree and state: "... For the acquisition of the bill of exchange in spite of such knowledge contains in itself the intent to cause detriment to the debtor. ..." Subsequently, M. Stranz repeated this statement even more clearly by saying: "In case of certain knowledge of the existence of defenses against his transferor, the purchaser acts with knowledge that the debtor would suffer a detriment through the transfer of the rights arising out of the instrument, if the defense were to be cut off thereby." He adds, however, that such knowledge must be accompanied by the knowledge that such defenses are justified. But the "assumption that the debtor might take recourse elsewhere, does not preclude [the purchaser's] consciousness of causing a detriment."

Staub-Stranz see the significance of the clause only in cases of recourse, when the original transferor becomes a re-acquirer on the basis of his obligation founded in the endorsement. Since, under those circumstances, he does not re-acquire of his own free will, any knowledge of defenses which he may have obtained between the time of the original transfer and that of the re-acquisition, will not affect his position, unless he acts in collusion with the holder and with the fraudulent intent to cut off defenses which the debtor might have had directly against such holder. The same authors, therefore, conclude that "... in the normal case, the intent of the participants in the Conference to add something else to the requirement of knowledge would seem to have remained unfulfilled and the sense of the present version would consist only in a narrow definition of the concept of knowledge, hence in excluding every kind of negligence."

But the most convincing and best stated position with respect to this problem was taken by Professor Jacobi, the leading German scholar in

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52 Michaelis, Wechselrecht 390 (1932).
53 Supra, note 31 at 232.
54 Wechselrecht Kommentar 122 (14th ed. 1952).
55 Id. at 123.
56 Supra, note 54. See also Jacobi, infra, note 59.
57 Supra, note 31 at 232-233.
58 Id. at 232.
this field of law. His interpretation of art. 17 is, in essence, as follows: The intentionally caused detriment provided for by art. 17 is present where the parties to the endorsement consciously deprive the debtor of his existing defenses. Such consciousness on the part of the transferee is sufficient. It may not suffice that this consciousness extend merely to the knowledge that "all unknown personal defenses are cut off" by the transfer, because such is "normal" knowledge, i.e. the regular effect of any endorsement. What art. 17 requires is the "abnormal" knowledge of "a specific defense." What, then, must, according to Jacobi, be the mental process of the holder, in order to expose him to the exception of art. 17? He must have reached the conclusion from the facts known to him that such facts constitute a defense which the debtor will lose through the transfer. But, Jacobi adds, since the holder will not frequently be a lawyer, it must suffice that he believe that, because of the facts known to him, the debtor may have some remedy against the claim, even though he does not understand the significance and effects of such remedy. Hence, Jacobi, too, reaches the conclusion that, in practically all circumstances, "knowledge of the defenses is equal to knowledge of the debtor's detriment."

4. Austria.

Among the decisions of Austrian courts dealing with our problem we again find the familiar "beating around the bush," i.e., dicta to the effect that mere knowledge of existing defenses is not sufficient to make them valid against the transferee and, at the same time, allowing the defenses, even though the facts disclosed no more than knowledge.

In the Austrian literature we see positions at the extremes of the problem discussed. At the one extreme it is asserted that the new formula adopted at Geneva in art. 17 means, when examined in the "light

59 Wechsel-und Scheckrecht unter Beruecksichtigung des auslaendischen Rechts 86 et seq. (1956).
60 See infra, note 73.
61 E.g. the Austrian Supreme Court held for the defendant acceptor who had bought a cow from the drawer and, when sued by the indorsee, interposed defenses based on warranty of the animal's soundness and on the indorsee's knowledge of the defects at the time of acquisition of the instrument. The court, while repeating the standard assertion that mere knowledge on the part of the transferee of the causal relationship existing between the drawer and drawee was not sufficient, reasoned that "acting knowingly to the detriment" consisted in the transferee's knowledge of the detriment accruing to the debtor (through the transfer) plus the transferee's willingness to accept that risk. The court also makes a very interesting distinction between "detriment" and "damage" and explains that it is sufficient if the debtor is to suffer a "detriment to his rights" whereas actual damage is not required: 4 Ob (Oberster Gerichtshof) 44/36, OGZ (Entscheidungen des Obersten Gerichtshofes in Zivilsachen) XVIII 77 (1936). Note also the definition given by OLG Wien (Oberlandesgericht Vienna) 7 R 844/35, Ev.Bl. (Evidenzblatt der Rechtsmittelentscheidungen) 1935 no. 1034 which stated: "Knowingly acting to the detriment of the debtor means not mere knowledge of circumstances which imply that defenses against the bill of exchange might exist (emphasis added), but absolute certainty is required."
of day,” nothing more than the old “entente frauduleuse” (fraudulent conspiracy), since an act knowingly damaging the debtor can hardly be visualized without such collusion between transferor and holder.62 The author adds that, at any rate “the discussion established with full clarity that mere knowledge by the transferee of the existence of the defense does not suffice to render such defense effective against the holder, but that the acquisition must, moreover, appear as a violation of good morals (Verstoss gegen die guten Sitten).63

Another Austrian scholar64 develops a more complex theory, very similar to the one advocated by Georges Friedel65 and Will Schneider.66 According to Stanzl, the holder, in order to be subject to personal defenses valid as against a transferor, must have known of the debtor’s detriment at the time of the acquisition of the instrument and, because of such knowledge, his action is contrary to good morals. However, whether or not the holder realized that he was causing harm to the debtor by the acquisition, cannot be ascertained, since that is a “psychic phenomenon.” Hence, the determination as to whether or not the holder’s action was contrary to good morals under the circumstances, must be made according to views prevailing in the trade. Thus, the application of the formula depends on the type of defense: 1. If the detriment follows naturally from the facts underlying the defense, the circumstances that the holder knew (or should have known) of its existence, will be sufficient to expose him to the defense, e.g. where he knows that the debtor could have interposed the defense of usury against the transferor which he loses through the transfer. 2. On the other hand, where the detriment does not follow as a logical consequence of the facts constituting the defense, additional facts must be present from which the holder can deduce the debtor’s detriment in case of a transfer of the instrument, e.g. where the holder knows only that the debtor has claims arising out of warranty based on the underlying transaction. In such a case, the author feels, knowledge of the defense does not necessarily imply knowledge of the detriment to the debtor which would follow the transfer of the instrument.

It is submitted that the distinction drawn by the author does not seem too convincing. It is not clear why knowledge of one type of defense

62 Hupka, supra note 6 at 52. The same author opposed the substitution of “mauvaise foi” (bad faith) for the Hague formula of “entente frauduleuse” (fraudulent conspiracy). One of the reasons given for his position was that it would be “intolerable” for commerce if mere knowledge of a defense which arose outside of the instrument and which as such should not concern the transferee, could nullify the latter’s claim based on the instrument: Hupka, Zur Revision des Haager Wechselrechtes 11 (1930) Cf. Bigiavi, infra note 78 at 182, 183.
63 Supra, note 6 at 52.
64 Stanzel, Boeser Glaube im Wechselrecht 41 et seq. (1950).
65 Supra, note 8.
66 Supra, note 33.
necessarily implies knowledge of the detriment, while knowledge of another type does not.

Another, rather interesting, interpretation of art. 17 is based on the following reasoning: While mere knowledge of defenses (e.g. defects of the merchandise furnished by the drawer to the acceptor) is not sufficient for the application of the exception, the holder’s good faith will be destroyed where he must reckon with the possibility of the debtor's detriment because, for example, he had reason to believe at the time of the acquisition of the instrument, that the acceptor would not be able to recoup his losses from the drawer because of the latter’s absence of financial responsibility.\(^6\) However, does the holder act less to the detriment of the debtor if he believes that the latter may, at some future time, be able to recoup from the transferor what he had to pay out on the instrument? The detriment is caused by the fact that the debtor loses his defenses as a result of the transfer of the instrument. The distinction made by the Austrian Supreme Court\(^6\) between “detriment” and “damage” seems very much in point in this connection. The law, by its very wording, does not consider only material damages, but rather an infringement of the debtor’s rights. Absent the transfer, he could interpose his defense against the transferor immediately and would not have to bring a separate action against him. The loss of those defenses is the detriment which the holder causes him, since he knows that they will be cut off by the transfer.\(^6\) The succinct statement of the author of a brief German treatise on Negotiable Instruments\(^7\) seems quite applicable. He says: “For all practical purposes the proof of knowledge of the defense will, as a rule, be sufficient, for he who acquires the bill of exchange usually wants to collect it. If, however, he wants to collect it in spite of a defense known to him, he knows that he is damaging the debtor.”

5. Italy.

In the interpretation of art. 17 U.L. (which is art. 21 l.c., i.e. Legge Cambiaria, the Italian law of Bills of Exchange and Promissory Notes) two phases have to be distinguished: 1. The time up to the enactment of the new Italian Civil Code and 2. the period since that enactment. The reason for the distinction is the fact that art. 1993 of the new Civil Code contains a general regulation, applicable to all negotiable instruments, which declares personal defenses available against a holder where

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\(^6\) Lenhoff, Einfuehrung in das einheitliche Wechselrecht 5, 6 (1933).

\(^6\) Supra, note 61.

\(^6\) See also Jacobi, supra note 59 at 87, note 5 who disputes Valeri's theory (infra, note 73) which is quite similar to Lenhoff's. Jacobi points out that the debtor is damaged by the endorsement, at least for the time being. True, he may be able to recoup his damage from the endorser, but “money which the debtor keeps in his pocket is worth more than a claim against the transferor-endorser.”

\(^7\) Hueck, Recht der Wertpapiere 91 (1957).
the latter has acted “intentionally” to the detriment of the debtor, rather than “knowingly,” as used in art. 17 U.L. and art. 21 l.c. There is considerable controversy among Italian legal writers as to whether art. 1993 Cod. Civ. is to be considered as interpretative of art. 21 l.c. We shall subsequently consider that controversy quite briefly. However, the majority of scholars as well as courts believe that the same significance is to be attributed to the two legal provisions and that “knowingly” and “intentionally” have the same meaning.

An examination of the Italian legal literature and decision law reveals the same confusion and absence of unanimity as to the real significance of the clause in question which we find in Germany and in France. We again encounter the difficulty of explaining the true meaning of the nebulous phrase “acting knowingly to the detriment of the debtor.” Every purchaser of an instrument who knows that the debtor has personal defenses against his transferor, also knows that, by acquiring this instrument, he will deprive him of such defenses, hence will act to his detriment. He would not acquire it if he did not expect to recover the amount due, free from such defenses. But if that were so, knowledge of the existence of the defenses would be sufficient to make them available against the holder, which the framers of the U.L. wanted to exclude. It has therefore been contended that the application of the clause under examination requires that the purchaser must, in acquiring the instrument, have had the intent to do harm to the debtor (which seems to go beyond “acting knowingly to the detriment of the debtor”) by depriving him of the only means of avoiding a payment of money he did not owe. It is therefore asserted that the purchaser must have the intent to cause the debtor irreparable damage, knowing that the debtor will be unable to recoup his loss from anyone at any time. If he believes that the debtor can recover the purchase price for the defective merchandise, which he has had to pay to the holder, from the seller or from someone else, he acquires the instrument free from the debtor’s defense and in good faith.

See on this point, supra note 69.

Angeloni, La Cambiale e il Vaglia Cambiario 164-168 (1934), quite similar to the position taken by Valeri, infra, note 73 and Lenhoff, supra, note 67. See also De Semo, Diritto Cambiario, 658, 659 (1953) who requires, for the application of the exception, that there be an intent to harm on the part of the transferee, a disloyal behavior which is contra bonos mores. He relies on art. 1993 Code Civ. (1942) and the change of wording. (“intenzionalmente” replacing “scientemente”) for support of his views. This theory has been stated most precisely by Ascarelli in 5 Novissimo Digesto Italiano, Title “Cambiale” (p. 739, 740) (1958) and may be summarized as follows: 1. Since the transferee acquires a claim independent of any relationship outside of the instrument (which is based on the prevailing theory of the “abstract character of the obligation”) his knowledge of defenses is immaterial, as a general rule. 2. However, the law grants an exception where the purchaser in acquiring the instrument has been conscious of “causing the debtor an irreparable harm, preventing him from recouping the damage from the transferor on the basis of their personal relationship, e.g. because of the latter’s insolvency.” Ascarelli...
Reference should be made at this point to the theory stated by another Italian author, even though it is virtually the same as the one just described, because of a more specifically circumscribed argument which he introduces and which, at first blush, seems rather convincing. He reasons: knowledge by the holder of the debtor's defenses is not sufficient, because the loss of such defenses is the normal effect of any transfer of a negotiable instrument. Hence, what is required is knowledge of the creation of an abnormal effect, viz. of the accrual of an irreparable damage for the debtor, so that such debtor is left with no possibility of recouping his loss from the transferor (e.g. because of the latter's insolvency).

This reasoning appears to be misleading. The author seems to confuse knowledge of a principle of law with knowledge of existing facts. "Knowledge of defenses" obviously does not mean knowledge that the debtor's defenses, if any, will be cut off by the transfer of the instrument to a (bona fide) purchaser. This is knowledge of a principle of law. It means knowledge of specific facts which constitute a defense for the debtor and which, to follow the author's terminology, will produce the "abnormal" effect of destroying the purchasers' good faith.

These theories are contradicted by other writers who reject the idea of an intent to cause irreparable damage as going beyond the context of the law. Instead, it is asserted that it is not the will to do harm to the debtor that is significant, but the desire, on the part of the acquirer, to offer a benefit to the transferor, even if such benefit may result in damage to the debtor. If the agreement between transferor and acquirer rests on the exclusive ground of the latter's wish to save the transferor from a defense which the debtor could have interposed against him, then such agreement is voided by the statute.

The last discussed theory looks very much like the old "entente frauduleuse" which was explicitly rejected at Geneva as a criterion for the application of art. 17. Moreover, it is difficult to see how the holder's mental processes could be as minutely ascertained as this theory seems to require. Furthermore, it is maintained that on the one hand knowledge that the debtor is losing his defenses is not enough and is the "normal" feature of any acquisition of a negotiable instrument, but that on the other hand such knowledge is sufficient where the acquirer desires to give the transferor the benefit of an escape from defenses, even concludes, therefore, that the defenses lost by the debtor must constitute the only means at his disposal to avoid payment which he does not owe and cannot otherwise recoup. For another, excellent exposition of a similar theory see Bracco, La Legge Uniforme Sulla Cambiale 111-114 (1935) Bracco requires "the malicious intent to cause the damage" on the part of the holder.


See Jacobi, supra, note 59 at 87, note 5 and supra, note 69.

Navarrini, La Cambiale e l'Assegno Bancario Secondo la Nuova Legislaione 207 (1937).
though he knows that such benefit will accrue under all circumstances, regardless of what he desires. It is the same knowledge in one case as in the other. This is hardly a satisfactory interpretation.

But, just as in the German literature, there are, among Italian scholars too, those who are not satisfied with these artificial constructions and interpret art. 17 in a much more convincing manner. Thus, one writer points out that, where a defense actually exists (and the acquirer has knowledge of it) the detriment arising to the debtor as a result of the purchase is evident, so that no further peculiar knowledge of the damage is necessary. However, this writer emphasizes that it is not enough that the acquirer merely know the circumstances out of which a defense may arise, for example the defect of the merchandise, because he has the right to expect that the differences between the parties will be settled. But where the controversy has actually arisen and the buyer of the merchandise has, for example, placed it at the seller's disposal, the debtor's defense is manifest and "the indorsee cannot escape by invoking his optimism."7

What seems to this writer the best analysis of the problem, as seen from the Italian viewpoint, has been supplied by another scholar. It is his contention that, while the formula "acting knowingly to the detriment of the debtor" may be more precise, it means exactly the same as "bad faith." As a rule, any holder who knows of the existence of defenses in favor of the debtor acts knowingly to the detriment of such debtor when he acquires the instrument. A requirement of his (the holder's) intent to cause additional damage would go beyond the content of the statute. However, the equivalence of knowledge of defenses with knowingly acting to the debtor's detriment (hence, bad faith) applies only in most, but not in all cases. It does not apply in the case of accommodation parties (where knowledge that the signature was given for accommodation does not affect the purchaser's good faith) or

76 Mossa, Trattato della Cambiale 404, 405 (3rd ed. 1956).
77 Ibid. Compare the very similar analysis by Jacobi, supra, note 59, but observe Jacobi's somewhat more liberal interpretation; Significant for Mossa's approach is the following statement at p. 405 which indicates the author's opposition to the European concept of unrestricted freedom of circulation: "After all, the circulation of negotiable instruments need not at all costs surround itself with mystery or silence, and the indorsee can, without detriment, inform himself with respect to personal relationships." (Translation mine) Accord: Lordi, Ancora sull'opponibilità al giratario di eccezioni opponibili al girante, Riv. Dir. Comm. (Rivista di Diritto Commerciale) 1941.II.353, who emphasizes even more strongly than Mossa that only knowledge by the transferee of the soundness of the debtor's defenses will bring the exception into play. (In the same article Lordi opposes the change of the wording from "scientemente" to "intenzionalmente," subsequently adopted by art. 1993 Cod.Civ. (1942).
in the case of set-off and counterclaim (where knowledge of such claims would not expose the holder to the exception of art. 17).

Professor Bigiavi's views are supported in another contribution\(^7\) which is distinguished by the clarity of its reasoning: Does not, the author asks, the acquisition of an instrument with knowledge that defenses are open against it indicate that the purchaser wanted to deprive the debtor of such defenses? Does not the mere fact that the acquirer knew of such defenses indicate that he wished to interpose himself between the debtor and the transferor and act as a shield to paralyze the debtor's defenses? However, the author, similar to Mossa,\(^8\) and more forcefully than Jacobi,\(^9\) insists that the holder must have known that such defenses were well founded. If he knows that they are unfounded, e.g. where he himself supplied the goods which he knew to be in perfect condition to the transferor who, in turn, sold them to the debtor and the latter now raises the defect of the merchandise as a defense, the holder cannot be charged with knowledge of the defense. However, this raises the question discussed by Jacobi\(^2\) as to the extent to which the holder can be expected to form an opinion as to the sufficiency in law of a defense interposed. Professor Lordi also opposes the views held by such writers as Angeloni and Valeri regarding the concept of "irreparable damage"\(^3\) as contrary to the "clear letter of the law." He points out quite correctly that the debtor suffers damage where he has to pay, be it without hope of recouping the amount from someone else, be it in the presence of such possibility which, however, may never materialize.

The two cases commented on in the notes by Professor Bigiavi and Professor Lordi, respectively,\(^4\) represented the fundamental view expressed by Italy's highest court, viz. that it is sufficient to expose a holder to the defense valid against the transferor, where the former, when acquiring the instrument, knew that the debtor could have successfully interposed defenses against the transferor and that the latter divested himself of the instrument for the purpose of evading such defenses.

However, the same court has radically changed its position, possibly because of the enactment of art. 1993 Code Civ. (1942) which substituted the word "intenzionalmente" (intentionally) for the word "scientemente" (knowingly) in the law governing negotiable instruments. Before discussing the later court decisions, we shall have to turn our

\(^7\) Lordi, Note to Cass. April 3, 1940, n. 1062, Riv. Dir. Comm. 1940.II.277.
\(^8\) Supra, note 76.
\(^9\) Supra, note 59.
\(^2\) Ibid.
\(^3\) Supra, note 72 and note 73.
\(^4\) Cass. March 29, 1940, supra note 78 and Cass. April 3, 1940, supra note 79.
attention to the question as to whether or not art. 1993 Cod. Civ. is to be considered as interpretative of art. 21 l.c.

It has been claimed that art. 1993 of the new Civil Code of 1942 contains an "authentic interpretation of art. 21 l.c." This would mean that the legislator has interpreted the wording of the article to the effect that actual, malicious intent on the part of the holder to cause damage to the debtor is required, in order to subject the former to defenses of the latter directed against the holder's predecessors. However, such a conclusion would violate both a provision of national Italian law and an international agreement to which Italy is a signatory: 1. Art. 2001 Cod. Civ. provides expressly that the rules of Tit. V (which contains the new art. 1993) apply only absent contrary provisions "of this Code or of special laws." The law of Negotiable Instruments being such a special law, there is no foundation for the assumption that art. 1993 is an authentic interpretation of art. 21 l.c. 2. The laws of Negotiable Instruments enacted by the signatories of the Geneva Convention are national laws, but based on an international agreement. If the wording of art. 1993 Code Civ. constitutes a change or abrogation of art. 21 l.c., such would, without a formal rescission of the treaty, amount to a violation of an international agreement.

However, the new wording has nevertheless had a considerable impact on the interpretation of art. 21 l.c., amounting to an "authentic interpretation" de facto if not de jure. This influence is obvious from a study of decisions of the Corte di Cassazione since 1953. The Court now requires for the application of the exception of art. 21 l.c. "a fraudulent program to damage the debtor, with the intent to impede the debtor's defenses by depriving him of such defenses which he could have interposed against the preceding holder and in the knowledge of the resulting damage which such debtor would suffer." The Court recognizes that the debtor will have great difficulties in proving intent on the part of the holder, but asserts that the proof can be obtained through "presumptions derived from objective circumstances which will serve

85 Angeloni, La Cambiale e il Vaglia Cambiario 243 (3d ed. 1949).
86 "Le norme di questo titolo si applicano in quanto non sia diversamente disposto da altre norme di questo codice o di leggi speciali."
88 See Ascarelli, Legge cambiaria e codice civile, supra, note 87.
to ascertain the planned and fraudulent behavior." Yet the same court, only a short time before, considered the test of intent to damage the debtor satisfied where the buyer advised the acquirer, prior to the endorsement of the instrument from the seller to the acquirer, that the merchandise for which the instrument was issued was defective or that the indorser had breached the contract and the holder nevertheless acquired the instrument. Does not that mean that notice of existing defenses alone is sufficient to destroy the acquirer's good faith?

Summary

The conclusion seems justified that the interpretation of art. 17 U.L. by the courts and writers of France, Germany, Austria, Switzerland and Italy is contradictory and, in each of these countries, in a state of confusion. The formula adopted at Geneva (acting knowingly to the detriment of the debtor) was intended as a compromise between an entente frauduleuse and plain, bad faith as criteria for the determination of the holder's position with respect to personal defenses valid against a transferor. The formula did not work satisfactorily, as foreseen at Geneva, if for no other reason than simply because, in the great majority of cases, where the acquirer of an instrument knows that the debtor has valid defenses against a transferor, he also knows that, by cutting off these defenses, he is acting "to the detriment of the debtor" and should refuse to acquire the instrument. In other words, he knows "something is wrong" and, therefore, cannot be acting in good faith. Thus, in spite of various tortured interpretations by courts and writers alike, the basic criterion still remains that of good or bad faith and courts will still, in spite of the various artificial circumlocutions, consider knowledge of existing defenses as incompatible with the requirement of good faith which is essential in both European and Anglo-American law.

The adoption of the formula as a qualification of bad faith was dictated mainly by the desire to preserve the free circulation of the instrument, for which it is designed. But it has never been doubted that somewhere the line had to be drawn to exclude the bad faith purchaser from an over-generous protection. The line was drawn with the words of the formula, mainly with the intent to exclude specifically undesirable effects, e.g. situations where the purchaser is aware of a right of set-off or counterclaim on the part of the debtor against a transferor or where he knows that the obligation was assumed for the accommodation of another party. While the exclusion of a presumption of bad faith in those cases is valid, the purpose could have been accomplished by explicit statutory language. Moreover, it seems likely that the formula was intended to exclude knowledge of the non-fulfillment of an

91 Ibid. citing Cass. October 15, 1954, supra, note 89.
executory contract as a criterion of bad faith, another problem with which the Anglo-American law has dealt adequately, without abandoning the criterion of plain, bad faith.

The balance of this article will be devoted to a brief survey of Anglo-American law on this point, which might provide us with a perspective for evaluation.

**England**

A separate investigation of English law covering our problem could have been omitted, because the Bills of Exchange Act of 1882 (after which our Negotiable Instruments Law was fashioned) and its interpretation do not appear to provide anything substantially different from American law on this point.

However, a brief statement is in order because of a somewhat puzzling remark attributed to Prof. H. C. Gutteridge, the representative of Great Britain at the Geneva Convention. He is quoted as having stated that "the Anglo-Saxon law requires something in the nature of the 'entente frauduleuse.' If he were to be asked what he would wish, he would answer immediately 'entente frauduleuse,' the only thing which could satisfy him, because it is the one which approaches the Anglo-Saxon law most closely."9

This writer does not know whether or not Professor Gutteridge was cited correctly and suspects that his remark is based on a misunderstanding, either on his part or on that of the other members of the conference or of the translator or other person. However, since then numerous European scholars have quoted that statement as authoritatively interpreting English law.94 Nevertheless, nothing could be found to support such an interpretation. Sec. 29 (1) and (2) of the Bills of Exchange Act corresponds to sec. 52 and 55 of the American N.I.L. Both deny the position of a holder in due course to a holder who had notice of a defect in title of the person who negotiated it.95

In fact, English authors and cases indicate that notice which destroys the holder in due course qualification can be either "of the particular facts avoiding the bill"96 or even "General or implied notice where the holder had notice that there was some illegality or some fraud vitiating the bill, though he may not have been apprised of its precise nature."97

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9 C.R. p. 294.
94 E.g. Hupka, supra note 6 at 52, note 1; Bayalovitch, La Loi Uniforme de Geneve et le Droit Uniforme Anglo-Américain 294, note 21 (1935); Friedel, supra note 8 at 158, 159 and many others.
95 §52(4) N.I.L. adds to the words "defect in title . . ." of the BEA the words "any infirmity in the instrument." That both terms mean "all equities and defenses" is convincingly explained by Britton, Law of Bills and Notes 259 (2d ed. 1961).
Or, as another author put it: "'Notice' means actual, though not formal notice, that is to say, either knowledge of the facts, or a suspicion of something wrong, combined with a willful disregard of the means of knowledge."\textsuperscript{98}

Thus, there appears to be no foundation for the assumption that a fraudulent conspiracy between the transferor and the holder comes even near to being the only English criterion for subjecting the latter to personal defenses open as against the former.

United States.

Before discussing the American law dealing with our problem, it seems advisable to restate one proposition: Both the European and the American law of Negotiable Instruments recognize the necessity of free circulation of the paper. Both, therefore, protect the purchaser of such an instrument to a considerable extent. But both agree that only a purchaser in good faith should be protected\textsuperscript{99}. Where they seem to differ is only as to the line of demarcation between good and bad faith.

The experts who prepared the Geneva Convention, considering the words "entente frauduleuse" as too narrow, substituted the words "mauvaise foi" (bad faith)\textsuperscript{100} which, if adopted, would have been left to the interpretation of the courts. Instead, the Geneva U.L. qualified the concept of bad faith through the formula of "acting knowingly to the detriment of the debtor," leaving the interpretation of the formula to the discretion of the courts.\textsuperscript{101}

It is this writer's belief that fewer difficulties would have been encountered if the Committee of Experts' recommendations had been followed, which was, in essence, the way chosen by the American law.

The appearance of difference in approach to our problem between the American and European law vanishes when we realize 1. that, as shown before, many European courts and writers, while paying lip-service to the unworkable formula, still determine our problem on the basis of the holder's bad faith which may be reflected in his acquiring the instrument with knowledge of existing defenses and 2. that the interpretation of "knowledge" and "notice" as evolved in the U.S. gives ample protection to the person whom each legal system wishes to protect, viz. the European bona fide purchaser and the American holder in due course.

1. The N.I.L.

The statutory source governing the question of the acquirer's good or bad faith is found in sec. 52(3) and (4) and sec. 56. In order to qual-

\textsuperscript{98} CHALMERS, Bills of Exchange 90, 91 (12th ed. 1952).
\textsuperscript{99} The distinction between the European bona fide purchaser and the Anglo-American holder in due course is beyond the scope of this article.
\textsuperscript{100} Supra, note 12.
\textsuperscript{101} Supra, note 18.
ify as a holder in due course, the holder must, in addition to fulfilling other requirements, have taken the instrument in good faith and without notice, at the time of acquisition, of any infirmity in the instrument or defect in the title of the person negotiating it. Notice is then defined as "actual knowledge of the infirmity or defect, or knowledge of such facts that his action in taking the instrument amounted to bad faith."

Thus, the N.I.L. does not define good faith, while giving a general, and not very exhaustive, definition of bad faith. Hence, it has been always, before and since the N.I.L., the task of courts and juries to determine under what circumstances the holder acts in bad faith and, as a consequence, loses the protection of freedom from personal defenses.

It took English and American courts more than a century to evolve some concept of bad faith and its varying interpretation shows their concern for the rights of the parties and for the preservation of free circulation of negotiable paper. These variations in interpretation make it rather understandable that the delegates to the Geneva Convention hesitated to adopt the experts' criterion of "mauvaise foi" and attempted to restrict it in some manner. But the "uncertainty as to what facts constitute bad faith cannot be eliminated. And, if certainty could be made to replace uncertainty, the law would probably not be as well off as it is now." However, the historical development of the bad faith rule shows a definite trend in the same direction as that of the European law: toward greater protection of the holder of the instrument. This principle was recognized as early as 1801, overruled by the rule that "suspicious circumstances" at the time of acquisition are sufficient to impute bad faith to the purchaser and restored in England in 1836, when gross negligence ceased to be equated to bad faith. In this country, while at first subject to conflicting decisions, the rule that only factual knowledge of the infirmity or defect of the instrument or the holder's deliberate "shutting his eyes" to facts establishing such infirmity will constitute notice, was firmly entrenched by sec. 52(4) N.I.L. and the decisions interpreting it. "If the facts known to him are sufficient to create the belief or the unavoidable inference that the infirmity exists,

102 Britton, supra, note 95 at 247.
104 Lawson v. Weston /1801/ 4 Esq. 56.
105 Gill v. Cubit /1824/ 3 B & C 466.
106 Goodman v. Harvey /1836/ 4 Ad. & El. 870.
107 Murray v. Lardner, 2 Wall. 110 (1864); Joseph v. Lesnevich, 56 N.J.S. 362, 153 A2d 349 (1959) (suspicious circumstances are of only probative value to prove active bad faith); Henry v. Zachry Co., 92 S.E. 225 (93 Ga. App. 536 (1956) (the mere fact that check had written thereon "car to be free and clear of liens" would not give indorsee notice that consideration had failed or might fail in the future). See also Mutual Finance Co. v. Martin, 63 So.2d 649, 44 A.L.R.2d 1, 97 et seq. (Fla. 1953) and infra, note 109.
his buying is dishonest dealing toward the defendant.”\textsuperscript{108} It is submitted that this statement is by far preferable to “acting knowingly to the detriment of the debtor” and yet expresses approximately the same thought. If the concept of bad faith, even though not rigorously formulated, had evolved in a similar fashion in Europe, the opposition to the adoption of the simpler test of “mauvaise foi” might have been less successful. Between the criterion of gross negligence prevailing in France and that of an “entente frauduleuse” current in Germany, the test of plain, bad faith might have been a far better workable compromise.

How careful some American courts were in emphasizing the limit of knowledge on the part of the holder, might be illustrated by this statement of a number of state and federal courts: “The holder is not bound at his peril to be on the alert for circumstances which might possibly excite the suspicion of wary vigilance. He does not owe the party who puts the paper afloat the duty of active inquiry in order to avert the imputation of bad faith. The rights of the holder are to be determined by the simple test of honesty and good faith, and not by a speculative issue as to his diligence or negligence.”\textsuperscript{109}

Where a note was given in consideration for a sale of cemetery land which required the permission of the town and the holder of the note knew of such restraint and that, at the time of negotiation, it had not been obtained, but had reason to believe that it would be obtained, he was held nevertheless to have acquired in good faith.\textsuperscript{110} This case seems to be very much in point with the hypothetical used at the Geneva Conference, where one of the delegates insisted that personal defenses should not be let in against a holder who had similar reasons to believe that the difficulties between the drawer and drawee would be straightened out by the time of maturity of the instrument.\textsuperscript{111} The American court reached the same result in spite of the apparent difference in legal provisions.

American courts have also consistently held that notice of an executory term of the contract underlying a negotiable instrument would not destroy the holder's good faith where the breach of such term occurred subsequently.\textsuperscript{112}

\textsuperscript{108} Rightmire, \textit{supra} note 103 at 376.


\textsuperscript{110} Markovitz v. Swartz, 264 Mass. 392, 162 N.E. 898 (1928).

\textsuperscript{111} \textit{Supra}, note 15 and 39.

\textsuperscript{112} Thal v. Credit Alliance Corp. 78 F.2d 212, 100 A.L.R. 1354 (1935). The An-
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In yet another case the court held that, where the instrument was negotiated to a holder on May 31, 1957 and he then knew that the contract under which the instrument had been issued contained the words: "Install by May 15, 1957," such knowledge did not preclude him from becoming a holder in due course.\footnote{13}

Again, it may well be that the supporters of the compromise formula at Geneva would have been satisfied with the adoption of a "mauvaise foi" rule, if notice of executory contract terms had been excluded as a criterion of bad faith.

As pointed out previously, one of the motivating factors for the rejection of "knowledge of defenses" as a criterion of bad faith was the fear that knowledge by the purchaser that the debtor was an accommodating party would expose him to the defense based on accommodation. Sec. 29 specifically exempts such knowledge from the consequences of bad faith purchase and American courts have sustained that principle universally.\footnote{14} One state supreme court stated with reference to sec. 29 N.I.L.: "To permit a party who places his name on such paper for the purpose of lending credit to another to interpose want of consideration as a defense against a holder who took it for value would defeat the very purpose for which accommodation paper is usually given. . . ."\footnote{15}

A similar provision in the U.L. would have been a sufficient safeguard to obviate an undesirable result.

On the other hand, the question as to whether set-off and counterclaim may be interposed by the debtor against a holder not in due course, was not clearly answered by the N.I.L. or by the courts interpreting it. The problem of set-off is, generally, governed by state statutes. That the framers of sec. 58 N.I.L., which exposes a holder not in due course to the same defenses as if the instrument were non-negotiable, did not mean to include set-off and counterclaim among the equities interposable against the holder, seems clear.\footnote{16} However, the courts differ widely on the question as to whether set-off and counterclaim are available to the debtor against a holder not in due course.

\footnote{14} See National City Bank v. Parr, 205 Ind. 108, 185 N.E. 904, 95 A.L.R. 958 (1933) and Annotation 964 et seq.
\footnote{15} Grisim v. Live Stock State Bank, 167 Minn. 93, 208 N.W. 805 (1920).
\footnote{16} See Commissioner's Note in BRANNAN, NEGOTIABLE INSTRUMENTS LAW, Part I, p. 142 (a) (7th ed. 1948) and Beutel, Problems of Interpretation under the Negotiable Instruments Law, 27 Neb. L. Rev. 485, 500 (1948).
this question. Some courts state that a right of set-off against the payee of a promissory note by the maker is not an infirmity in the instrument, so that a holder who knew of a set-off at the time of purchase would not thereby lose his standing as a holder in due course. Nevertheless, many courts will allow a claim of set-off against one not a holder in due course, provided such claim had matured before the transfer of the instrument, and will deny interposition of such a claim if it arose subsequent to the transfer. On the other hand, the courts in some jurisdictions refuse to allow a claim of "set-off arising out of collateral and wholly independent matters," even if "the indorsee had notice, gave no consideration for, and took the paper on purpose to defeat the off-set." Moreover, where the holder knows that a set-off or counterclaim may arise before maturity of the instrument, many courts will consider such knowledge immaterial. As one court put it: "Every purchaser of a promissory note knows that, as between the maker and the payee, there may, before the note matures, arise a set-off or counterclaim in favor of the maker, but this will not prevent the purchaser from being a holder in due course, nor is the fact of itself evidence of bad faith in purchasing."

From the above discussion it may be deduced that, under the reign of the N.I.L. the holder not in due course might be exposed to set-off or counterclaim under circumstances under which he would not have to contend with such defenses under the European U.L. The UCC has attempted to clarify the situation and to provide for an implementation of what even the N.I.L. originally intended, namely relief of the holder from such "defenses," even if he knew of their existence.

2. The Uniform Commercial Code

A discussion of the differences between the N.I.L. and the UCC would exceed the scope of this article. However, it may be said, generally, that the UCC clarifies a number of problems connected with the interpretation of "due course holding." Sec. 3-302 and sections 3-304 and 3-305 UCC are the statutory courses dealing with our question. Sec. 3-302(1)(c) makes it clear that a purchaser with notice of any defense against or claim to the instrument on the part of any person is not a holder in due course and will, by virtue of sec. 3-306 be exposed to such defenses, including the defense of failure of consideration mentioned specifically in sec. 3-306(c).


120 Elmo State Bank of Elmo v. Hildebrand, 103 Kan. 705, 177 Pac. 6 (1918); Advance Rumely Thresher Co. v. West, 108 Kan. 875, 196 Pac. 1061 (1921).

121 For such a discussion see Britton, Holder in due course: comparison of NIL provisions with Art. 3 of proposed Commercial Code, 49 Nw. U. L. Rev. 417 (1954).
But the UCC is careful in circumscribing all the terms used with the utmost precision possible. Thus, sec. 1-201(25) provides that a person has "notice" where he has actual knowledge of a fact or has received a notice or notification of it or has reason to know that it exists from all the facts and circumstances known to him. It seems clear that "suspicious circumstances" are not enough to constitute notice under the statute. Sec. 3-304(4) indicates more specifically when knowledge of certain facts does not of itself give the purchaser notice of a defense or claim. Of particular interest for our problem is the provision of subsection (b) of the cited section to the effect that knowledge that the instrument was issued or negotiated in return for an executory promise or accompanied by a separate agreement, does not constitute notice of a defense, unless the purchaser has notice that a defense or claim has arisen from the terms thereof.122

Sec. 3-304(1) (b) would seem to clarify the previously debated question of set-off and counterclaim. The statute provides that the purchaser is considered to have notice of a claim or defense only if the instrument shows certain defects as indicated in subsection (a) or he has notice that the obligation of any party is voidable in whole or in part, or that all parties have been discharged. The official comment to this provision states: "'Voidable' obligation in paragraph (b) of subsection (1) is intended to limit the provision to notice of defense which will permit any party to avoid his original obligation on the instrument, as distinguished from a set-off or counterclaim."123

That knowledge by a holder (for value and before maturity) of the fact that an obligation was assumed for accommodation does not affect the accommodation party's liability, has been reiterated by the UCC in sec. 3-415.

CONCLUSION

Today it is hardly open to question that widest possible uniformity among the legal systems of our shrinking world is desirable. In the area of commercial law such uniformity should encounter fewer obstacles than in other fields, because of the common ground furnished by certain principles of the law merchant. Nevertheless, attempts at unifying the law of Negotiable Instruments have been only partially successful. Even in this narrow area, fundamental differences in concepts of the Civil as compared to the Anglo-American law prevent unification. But this does not mean that unification will never be accomplished. If com-

122 This wording appears to correspond closely to the views held by Mossa, supra note 76 with respect to the interpretation of the formula of art. 17 U.L. Note also that New York has added subsection (7) to sec. 3-304 UCC, the first part of which reads: "In any event, to constitute notice of a claim or defense, the purchaser must have knowledge of the claim or defense or knowledge of such facts that his action in taking the instrument amounts to bad faith."

123 But cf. Britton, supra, note 95 at 437.
plete unanimity cannot be achieved, recent efforts to arrive at an agree-
ment in the creation of an international negotiable instrument, valid only
in international trade and fulfilling the prerequisites on which uniform-
ity could be reached only if such paper did not circulate internally,
might meet with success. In the meantime, comparison will help us
evaluate the advantages and disadvantages of our own legal provisions,
which is one of the aims of Comparative Law.

In this writer's opinion, the wording of art. 17 of the Uniform Law
on Bills of Exchange and Promissory Notes adopted at Geneva does
not compare favorably with the provisions of American law. As has
been shown, the formula "acting knowingly to the detriment of the
debtor" establishing a prerequisite for the opening up of personal de-
fenses against the holder of a negotiable instrument, has not worked
well in the practice of European courts and has been the subject of
much controversy among European legal writers. It appears that ac-
ceptance of knowledge or ignorance of existing defenses as a criterion
of good faith purchase is preferable and has actually been practiced by
many European courts, even though sometimes camouflaged behind the
wording of art. 17 U.L. The apprehension that special situations, such
as accommodation obligations and set-off and counterclaim, might be
solved unsatisfactorily if knowledge of defenses were adopted as a
criterion of bad faith, could have been dispelled by specific provisions,
such as those adopted by the UCC and established, prior to it, by many
American courts.

There are a number of fundamental principles in the Civil and the
Anglo-American law of Bills of Exchange which cannot be reconciled.
This writer believes that the availability of personal defenses against a
holder is not one of them.