

## LESSON 14: OVERVIEW ON TRADE SECURITIES

### SUMMARY:

- 1.-Trade securities: concept and classification
- 2.-Negotiable instruments: bills of exchange, checks and promissory notes
  - a) *Concept and personal elements*
  - b) *Common features*
  - c) *Classification*
- 3.-Bills of exchange
  - a) *Regulation*
  - b) *Acceptance*
  - c) *Endorsement*
  - d) *'Avals'*
  - e) *Maturity*
  - f) *Payment*
  - g) *Recourse for non-acceptance or non-payment*
  - h) *Defenses*
- 4.-Vocabulary

### **1.-Trade securities: concept and classification**

Trade securities can be defined as transferable documents whose possession is needed in order to exercise the right included therein. The right included in the document is abstract and independent, and circulates according to a special regulation that is more flexible and less rigorous than the one which is applicable to ordinary credit assignments.

Trade securities can be classified according to different criteria:

A) According to the way of issuance:

- Documents issued in isolation
- Documents issued en masse. They are issued in one single act and confer the same rights and obligations to their holders. (Shares)

B) *According to the nature of the right included in the document*

- Negotiable documents which include the right to receive a certain amount of money. (Bills of exchange, promissory notes and checks)
- Documents which confer their holders the right to participate in a corporation, determining the rights and obligations of each member. (Shares)

- Documents of title which confer their holders the right to receive goods. (Bills of lading)

C) *According to the way in which the holder of the right can be legitimized*

- Nominative or registered documents, bearer documents and order documents.

## **2.-Negotiable instruments: bills of exchange, checks and promissory notes**

a) *Concept and personal elements*

**BILLS OF EXCHANGE.** A document which includes an unconditional order addressed by one person to another requiring the latter to pay a certain sum of money to a third party.

Personal elements:

*The drawer* is the person who issues the bill and guarantees its payment to any subsequent holder. Regarding the commercial operation underlying the issuance of the bill of exchange, the drawer is the drawee's creditor and holder's debtor at the same time.

*The drawee* is the person who receives the order to pay the holder of the bill. Regarding the commercial operation underlying the issuance of the bill of exchange, the drawee is the drawer's debtor.

*The acceptor.* The drawee becomes the acceptor once he has accepted the bill of exchange. From now on, he will have the obligation to pay the bill.

*The holder* is the person who possesses the document and to whom the drawee has to pay. Regarding the commercial operation underlying the issuance of the bill of exchange, the holder is the drawer's creditor.

The *endorser* is the holder who endorses the bill of exchange.

*The endorsee* is the person who receives the bill and becomes the new holder of the document.

*The bill guarantor* is the person who guarantees the payment of the bill of exchange and is bound in the same manner as the person to whom he has become guarantor.

**CHECKS.** A document which includes an unconditional order addressed by one person to a bank requiring the latter to pay at sight a certain amount of money to a third party. The credit right included in the check is past-due and payable.

*The drawer* is the person who issues the check as a way of payment.

*The drawee* is the bank or other financial institution which receives the order to pay from the drawer. In this context, the drawer usually has, in that bank or financial institution, a current account or checking account where his money has been previously deposited. The drawee will never accept a check.

*The holder* is the drawer's creditor and the person who has to receive the money from the bank.

**PROMISSORY NOTES.** A document which includes an unconditional promise given by one person to another to pay a determinate sum of money.

*Promisor* is the person who makes a promise. In the context of a promissory note, the promisor is the person who is promising to pay the amount of money secured by the note.

*Promisee* is the person to whom a promise is made. In the context of a promissory note, the promisee is the person who is entitled to receive payment for the loan or obligation secured by the note.

#### *b) Common features*

THE POSSESSION OF THE DOCUMENT IS NEEDED TO EXERCISE THE RIGHT INCLUDED IN IT

This means that the person who holds the paper is supposed to be the owner of the right included therein and, therefore is entitled to exercise it. The holder does not need to demonstrate the ownership of the right through means other than presenting the document

DOCUMENTS ARE LITERAL CERTIFICATES

This means that the right included in the negotiable instrument must be defined according to the wording of the document without taking into account the underlying commercial operation where the right comes from. The content of the document provides the following information: personal elements (debtor and creditor), objective elements (the amount of money to be paid) and circumstantial elements (when and where to pay).

#### THE DOCUMENT INCLUDES AN INDEPENDENT AND ABSTRACT RIGHT

When issuing a negotiable instrument, two different relationships arise:

- The economic operation which underlies and justifies the issuance and transmission of the document (causal relationship).
- And the relationship which arises among the drawer, drawee, holder, endorsee, endorser, guarantor, etc., once the document has been issued (trading relationship) according to the specific requirements of the LCCH.

Taking into account these two different relationships, the fact that the document includes an independent and abstract right means that, once the certificate is transferred, the new holder acquires an independent right with no connection with the economic relationships which former holders of the document may have with the debtor, provided that the new holder is a holder in due course.

Nevertheless, it is necessary to make some clarifications

The new holder acquires an independent right, provided that the person who is obligated to pay the bill, the promissory note or the check is not the holder's debtor in the economic operation which underlies the issuance or transmission of the document.

As a consequence, the credit right included in the paper is not independent of the economic relationship which underlies the issuance and transmission of the paper when the creditor and debtor of that relationship are also the creditor and debtor according to the wording of the document.

#### DEBTORS ARE JOINTLY LIABLE

This means that the debtor, according to the wording of the document, must pay the amount of money established in it without being allowed to plead:

- a) That there are former debtors.
- b) That he only has to pay the part of the debt which has not been paid by former debtors who have become insolvent

- c) That the debt must be divided into as many parts as there are debtors

#### DOCUMENTS ARE FORMAL CERTIFICATES

In order to consider bills of exchange, promissory notes or checks to be fully effective, the documents must be completed accurately, including all the information required by the LCCH. If there is a formal defect which cannot be remedied, the documents can only be used as proof of the existence of a legal relationship, but they cannot be considered to be negotiable instruments or circulate according to a specific regulation.

#### DOCUMENTS ARE ENFORCEABLE CERTIFICATES

This means that no previous Court decisions about the existence and content of the debt are required in order to enforce it.

#### DOCUMENTS CIRCULATE ACCORDING TO A SPECIFIC REGULATION

This specific regulation enables credit rights to be transferred according to a process which is faster and more flexible than credit assignments and provides adequate protection for the creditor's interests.

#### c) *Classification*

Negotiable instruments can be classified according to different criteria. The criteria used in this lesson will be the way in which the owner of the credit right can be identified.

a) *Bearer documents*. In this kind of document, the holder is the owner of the credit right and only needs to present the certificate in order to demand the payment of the debt. The transfer of the credit right simply requires the document to be delivered to the new holder.

b) *Nominative or registered documents*. This kind of document includes the name of the owner of the credit right and this fact has a number of consequences. In order to demand the payment of the debt, it will be necessary to present not only the document but also proof that the person who presents the document is the person whose name is written on it. As a consequence, this kind of document cannot circulate.

c) *Order documents*: In this type of document, the owner of the credit right is the person whose name appears on it or the person who the latter or successive holders of the document have designated as the owner. Order documents are, therefore, nominative certificates which can be transferred to other people by endorsement.

In order to demand the payment of the debt, it is necessary that the person who holds the document and the person whose name appears on it are the same. The question is that the person who appears on the document as the owner can be the first holder or the successive endorsees of the certificate who have acquired it through a regular chain of endorsements.

The bills of exchange and checks are order documents by their nature. Nevertheless, these certificates can be issued as non-transferable by endorsement, inserting the words "not to order" in the bill.

### **3.- Bills of exchange**

#### *a) Regulations*

Bills of exchange, promissory notes and checks are regulated in Law 19/85, dated 16 of July, on Bills of Exchange and Checks - LCCH - (*Ley 19/85, de 16 de Julio, Cambiaria y del Cheque*) and in the Convention Providing a Uniform Law for Bills of Exchange and Promissory Notes (Geneva, 1930).

#### *b) Acceptance (arts. 25 to 34 LCCH)*

Until maturity, a bill of exchange may be presented to the drawee for acceptance by the person who is in possession of the bill. By accepting it, the drawee will undertake to pay the bill at its maturity and, in default of payment, the holder will have a direct action against the acceptor.

The drawee is not obligated to accept the bill in the same way that the holder does not have the obligation to present the bill for acceptance. There are only two exceptions. The holder must present the bill for acceptance:

a) When the drawer or any endorser may stipulate that it shall be presented for acceptance with or without fixing a limit of time for presentment.

b) In case of bills of exchange payable at a fixed period after sight, they must be presented for acceptance within one year of their date.

The drawer may also prohibit presentment for acceptance or stipulate that the presentment for acceptance shall not take place before a named date. Nevertheless, the prohibition does not take place in case of bills payable at the

address of a third party or in a locality other than that of the domicile of the drawee or in the case of bills of exchange payable at a fixed period after sight.

*c) Endorsement (arts. 14 to 24 LCCH)*

Every bill of exchange, even if not expressly drawn to order, may be transferred by means of endorsement. Through the endorsement:

1.-The endorsee becomes the new owner of the credit right included in the document

2- The endorser guarantees the acceptance and the payment of the bill.

3- All the rights arising out of a bill of exchange are transferred.

When the drawer has inserted in a bill of exchange the words “not to order” or an equivalent expression, the instrument can only be transferred according to the form and with the effects of the ordinary assignment.

*c) 'Avals'(arts. 35 to 37 LCCH)*

Payment of the bill of exchange may be guaranteed by an 'aval' as to the whole part or part of its amount. This guarantee may be given by a third person or even by a person who has signed the bill as a party.

The giver of an 'aval' is bound in the same way as the person for whom he has become guarantor and, once he pays the bill, he obtains all the rights arising out of the bill against the person guaranteed and against those who are liable to the latter on the bill of exchange.

'Avals' can be included in the bill of exchange at any time between the issuance and maturity.

*d) Maturity (arts. 38 to 42 LCCH)*

A bill of exchange may be drawn payable:

1.-At sight. The bill is payable on presentment.

2.-At a fixed period after sight. In this case, the date of maturity is determined by the date of acceptance or the date of the protest.

3.-At a fixed date.

4.-At a fixed period after date. In this case, the time is calculated taking into account the date of issuance of the bill of exchange.

*f) Payment (arts. 43 to 48 LCCH)*

The holder of a bill of exchange payable at a fixed date or at a fixed period after date must present the bill for payment either on the day on which it is payable or on one of the two business days which follow. In the other cases, the presentment of the bill must be made within a year from its issuance.

When a bill of exchange is not presented for payment within the limit of time fixed by Law, the holder loses his right of recourse against the endorser, the drawer and the other parties liable, but his direct action against the acceptor is preserved.

*g) Recourse for non-acceptance or non-payment (arts. 49 to 66 LCCH)*

The LCCH has provided the holder of the bill of exchange with two different actions:

- a) In case of non-payment, the holder of the bill of exchange has a direct action against the acceptor and its guarantor. Protest for non-payments is not required in order to use this action. The holder retains this action even when he has not presented the bill for payment at its maturity.
- b) The holder also has a right of recourse against the drawer, the endorsers and their guarantors. In order to exercise this right, certain requirements must be met:

*1.- Substantive requirements:*

- Non-payment
- Non-acceptance
- Bankruptcy of the drawee (whether he has accepted or not) or unsuccessful execution against his goods.
- Bankruptcy of the drawer of a non-acceptable bill of exchange.

*2.- Formal requirements:*



-Protest for non-payment or non-acceptance to give evidence of the default of acceptance or payment.

*h) Defenses (arts. 67 to 68 LCCH)*

As a way of protecting the interest of a holder of a bill of exchange, the LCCH has limited the number of defenses which the debtor can use against the payment claim of the holder. It is possible to distinguish two types of defenses:

1.-Personal defenses which can only be used against certain holders. These defenses are founded on the personal relations which the holder may have with the liable parties of a bill of exchange. These defenses can only be used when the holder, in acquiring the bill, has knowingly acted to the detriment of the debtor.

2.-Defenses which can be used against any holder in case of:

- Bills of exchange without some of the formal requirements mentioned in art. 1 of the LCCH.
- Extinction of the credit right included in the bill of exchange

**4.- Vocabulary**

**Credit assignment-** Cesión de créditos

**Bills of exchange-** Letras de cambio

**Promissory notes-** Pagarés

**Checks-** Cheques

**Bill of lading-** Conocimiento de embarque

**Drawer-** Librador

**Drawee-** Librado

**Acceptor-** Aceptante

**Holder-** Poseedor

**Holder in due course-** Poseedor de buena fe

**Endorser-** Endosante

**Endorsee-** Endosatario

**Guarantor-** Avalista

**Past-due** – Vencido

**Promisor-** Firmante del pagaré

**Documents/certificates-** Títulos

**To be jointly liable-** Ser responsables solidarios

**Enforceable certificates-** Títulos ejecutivos

**Bearer documents-** Títulos al portador

**Nominative or registered documents-** Títulos nominativos

**Order documents-** Títulos a la orden

**Issuance-** Emisión del documento (libramiento de la letra)

**To present (the bill) for acceptance-** Presentación de la letra a la aceptación

**Endorsement-** Endoso

**Avales-** Aval

**Maturity-** Vencimiento

- At sight- A la vista
- At a fixed period after sight- A un plazo desde la vista
- At a fix date- A una fecha fija
- At a fixed period after date- A un plazo desde la fecha

**To present (the bill) for payment-** Presentación de la letra al pago

**Direct action-** Acción directa

**Action/ recourse against the drawer,  
endorsers and their guarantors-** Acción en vía de regreso

**Protest for non-payment or non-acceptance-** Protesto por falta de pago o  
aceptación

**Defenses-** Excepciones cambiarias