**Working Group of Officials**

# National Competition Policy Review of the *Bills of Exchange Act 1909*

**July 2003**

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# TERMS OF REFERENCE

1. The Bills of Exchange Act is referred to an Inter-Departmental Working Group (the Working Group) for evaluation and report. The Working Group, which is comprised of officers from the Treasury, the Reserve Bank of Australia and the Attorney-General's Department, is to focus on those parts of the legislation which restrict competition, or which impose costs or confer benefits on business. However, the Working Group may give consideration to a possible broadening of the scope of the Act to encompass financial rights and obligations, whether in the form of a physical instrument or otherwise, which are negotiable in nature, but which are not currently encompassed by the Act.

2. The Act encompasses three types of negotiable instruments, namely, bills of exchange, promissory notes and also cheques drawn before 1 July 1987. The legislation prescribes the form of the instruments, determines many of the rights and obligations of the parties to the instruments and establishes procedures for their drawing up and resale. The Act does not apply to other money market instruments, some of which have come to be regarded as negotiable instruments, such as certificates of deposit, floating rate notes and Commonwealth Government securities, including Treasury Notes and Treasury Bonds.

3. The Working Group is to report on the appropriate arrangements for regulation, if any, taking into account the following objectives:

   a) legislation should be retained only if the benefits to the community as a whole outweigh the costs, and if the objectives of the legislation cannot be achieved more efficiently through other means, including non-legislative approaches. In developing any options, the Working Group will seek to ensure efficiency in the money market in relation to the trading of the instruments to which the Act applies.

   b) compliance costs and the paper work burden on business should be reduced where feasible.

   In assessing these matters, regard should be had, where relevant, to effects on economic development, investor rights, consumer interests, the competitiveness of business including small business, and efficient resource allocation, taking into account rapid technological developments in electronic commerce and trade.

4. In making assessments in relation to the matters in (3), the Working Group is to have regard to the analytical requirements for regulation assessment by the

Commonwealth, including those set out in the Competition Principles Agreement. The report of the Working Group should:

a) clarify and review the objectives of the Bills of Exchange Act in the light of continuing technological developments in electronic trading, clearing and settlement of money market securities;

b) identify the nature and impact of impediments in the Bills of Exchange Act on the development of electronic techniques for the issue of, trading in and transfer of ownership of, negotiable instruments, including bills of exchange and promissory notes, and determine, in the light of technological advances permitting the transfer of money market instruments by electronic means in screen-based or book-entry depository systems, whether the Act should be extended to cover negotiable instruments other than bills of exchange and promissory notes; in addition, determine whether the Bills of Exchange Act should recognise mechanisms for the creation, recording and transfer by electronic means of payment obligations with equivalent characteristics to negotiable instruments;

c) identify whether, and to what extent, the Bills of Exchange Act restricts competition;

d) identify relevant alternatives to the Bills of Exchange Act (including non-legislative approaches) and determine a preferred option for regulation, if any, in light of objectives set out in (3);

e) determine the need to identify Saturdays as non-business days for the purposes of the Act;

f) analyse and, as far as reasonably practical, quantify the benefits, costs and overall effects of the Bills of Exchange Act and alternatives identified in (d);

g) identify the different groups likely to be affected by the Bills of Exchange Act and alternatives identified in (d);

h) list the individuals and groups consulted during the review and outline their views; and

i) examine mechanisms for increasing the overall efficiency, including minimising the compliance costs and paper burden on business (including small business) of the Bills of Exchange Act and, where it differs, the preferred option.

5. In undertaking the review, the Working Group is to advertise nationally, consult with key interest groups and affected parties, and publish a report.

6. Within 6 months of receiving the Working Group's report, the Government intends to announce what action is to be taken, after obtaining advice from the Treasurer and where appropriate, after consideration by Cabinet.

# ABBREVIATIONS

| | |
|---|---|
| ABA | Australian Bankers' Association |
| ACCC | Australian Competition and Consumer Commission |
| AFMA | Australian Financial Markets Association |
| ASCT | Australian Society of Corporate Treasurers |
| ASIC | Australian Securities and Investments Commission |
| ASX | Australian Stock Exchange |
| ATOA | Australian Treasury Operations Association |
| Bills of Exchange Act | *Bills of Exchange Act 1909* |
| CD | Certificate of deposit |
| CHESS | Clearing House Electronic Subregister System |
| CIS Act | *Commonwealth Inscribed Stock Act 1911* |
| CMO | Central Money Markets Office (UK) |
| Corporations Act | *Corporations Act 2001* |
| CP | Commercial paper |
| CRESTCo | Operator of UK settlement systems |
| Electronic Transactions Act | *Electronic Transactions Act 1999* |
| FRN | Forward Rate Note |
| FSR Act | *Financial Services Reform Act 2001* |
| FTR Act | *Financial Transactions Reports Act 1988* |
| ICC | International Chamber of Commerce |
| LCA | Law Council of Australia |
| MMI | Money Market Instrument (UK) |
| NCC | National Competition Council |
| NCP | National Competition Policy |
| NCCUSL | National Conference of Commissioners on Uniform State Laws (US) |
| NCD | Negotiable certificate of deposit |

| | |
|---|---|
| OTC | Over-the-Counter |
| RBA | Reserve Bank of Australia |
| RITS | Reserve Bank Information and Transfer System |
| SFE | Sydney Futures Exchange |
| SIRCA | Securities Industry Research Centre of Asia-Pacific |
| SME | Small and medium sized enterprise |
| T-Note | Treasury Note |
| UCC | Uniform Commercial Code (US) |
| UETA | Uniform Electronic Transactions Act (US) |
| UK | United Kingdom |
| UNCITRAL | United Nations Commission on International Trade Law |
| US | United States |

## Interpretation

Generally speaking, references in this report to 'bills of exchange' should be read as including 'promissory notes'.

The report uses terms such as 'electronic bill', 'electronic note', electronic negotiable security', 'dematerialised negotiable security', dematerialised bill of exchange' and 'dematerialised promissory note' interchangeably.

The term 'dematerialised security' has a special meaning under the rules of the Austraclear System.

The report also uses terms such as 'unchallengeable title', 'better title', 'perfect title', 'guaranteed title', 'free from previous defects in title' and 'title free of defects' interchangeably.

# EXECUTIVE SUMMARY

This report fulfils a commitment made by the Commonwealth to undertake a National Competition Policy (NCP) review of the *Bills of Exchange Act 1909* (Bills of Exchange Act). The focus of the report is on those parts of the legislation which restrict competition and/or impose costs or confer benefits on business, including small business, and investors generally.

The overarching purpose of the Bills of Exchange Act is to codify by statute the common law relating to two types of negotiable instrument - bills of exchange and promissory notes. The Bills of Exchange Act confirms that bills of exchange and promissory notes are negotiable instruments. The particular advantage enjoyed by negotiable instruments over other financial instruments is that of negotiability. Negotiability provides a good faith purchaser of a bill of exchange or promissory note guaranteed title to the financial instrument. The Bills of Exchange Act applies to any person who becomes a party to a bill of exchange or promissory note.

The Bills of Exchange Act plays a significant role in Australia's financial markets, with bills of exchange and promissory notes constituting an important segment of the short-term money market.

The terms of reference of the Review require the Working Group to clarify and review the objectives of the Bills of Exchange Act in the light of continuing technological developments in electronic trading, clearing and settlement of money market securities.

The objectives of the Bills of Exchange Act are to:

- provide uniformity of law in Australia in relation to bills of exchange and promissory notes;
- provide legal certainty by confirming the nature of bills of exchange and promissory notes as negotiable instruments; and
- promote efficiency in the marketplace which utilises bills of exchange and promissory notes through the concept of negotiability.

The Working Group notes that, generally speaking, participants in the Review regarded the Act as achieving its objectives of uniformity, certainty and efficiency. However, participants were almost unanimous in highlighting the substantial compliance costs imposed by the Act's requirements for paper-based financial instruments.

The majority of participants in the Review called for the Act to be retained but modernised to provide for the dematerialisation of bills of exchange, promissory notes and other similar money market instruments, to enable these financial instruments to take advantage of modern developments in electronic commerce.

The Working Group's analysis suggests that the Bills of Exchange Act restricts competition by imposing costs on business and other investors. The complex and prescriptive requirements of the Act relating to the paper form of bills of exchange and promissory notes impose significant costs on participants in relation to producing, trading and settling the instruments. This, in turn, makes bill and note finance less competitive with other sources of finance.

Nonetheless, the Working Group is of the view that the net benefits of the Bills of Exchange Act outweigh the costs of the restrictions to competition it imposes, because the objectives of the Act have allowed it to play an important role in the development of Australia's financial markets through the provision of both legal and commercial certainty and a clear definition of operating parameters.

Pursuant to the terms of reference, the Working Group also examined the nature and impact of impediments to the proposed dematerialisation of bills of exchange and promissory notes arising out of the documentary nature of negotiable instruments.

In addition to issues raised by the terms of reference regarding competition policy matters and the dematerialisation of bills of exchange and promissory notes, the Working Group also considered other issues raised by participants in the Review, including the ramifications of retaining the paper form provisions of the Bills of Exchange Act.

## Recommendations

The Working Group recommends that the Bills of Exchange Act be retained. However, the Working Group considers that the Bills of Exchange Act should be amended to facilitate the dematerialisation of bills of exchange and promissory notes.

The Working Group recommends that the Bills of Exchange Act should retain those provisions that facilitate the continued use of conventional bills of exchange and promissory notes by those investors or traders who need physical bills or notes because of legal requirements.

The Working Group recommends that in providing for the dematerialisation of bills of exchange and promissory notes, a legislative approach would be preferable to a non-legislative approach.

- The Working Group considers that a non-legislative approach could undermine the uniform legal framework established by the Bills of Exchange Act and the Act's

objectives of legal and commercial certainty. The Working Group is of the view that it is in the interests of the public, and the economy in general, to retain uniformity and certainty throughout Australia with respect to the law relating to bills of exchange and promissory notes.

The Working Group also sees scope for the inclusion of negotiable certificates of deposit under the Bills of Exchange Act, given their treatment as negotiable instruments by the market.

- However, the Working Group does not consider that other short-term money market instruments, such as semi-government securities, forward rate notes, perpetual notes or debt instrument issued by trustees should be included within the scope of the Bills of Exchange Act.

## Options for reform

The Working Group has identified three options, derived in part from participants' suggestions and in part though an examination of overseas experience, to assist in reducing the complexity and prescriptiveness of the requirements of the Bills of Exchange Act, so as to achieve the objectives of the legislation in a more cost-effective manner (and facilitate dematerialisation of those instruments that are covered by the Act).

The options are:

- Amend the Bills of Exchange Act to make statutory provision for negotiable instruments in electronic form with equivalent functionality to bills of exchange and promissory notes in paper form. The legislation would specify concepts equivalent to delivery, possession and guaranteed title, so that relevant electronic records of approved trusted record keepers would be treated as equivalent to bills of exchange and promissory notes.

- Rely on the clearing and settlement facilities and electronic transfer of title provisions of the *Corporations Act 2001*, as amended by the *Financial Services Reform Act 2001*.

- Rely on the provisions of the *Electronic Transactions Act 1999* to achieve functional equivalence for electronic bills of exchange and promissory notes with bills and notes in paper form.

The Working Group considers that Options One and Two, adopted in combination, appear to have most potential to reduce costs for participants in the short-term money market. The ensuing efficiencies would be expected to flow into the broader community, resulting in more flexible pricing of negotiable securities, greater

transparency of investment choices and the potential for increased availability of these financial products to investors.

# CHAPTER 1: BACKGROUND TO THE REVIEW

This report fulfils a commitment made by the Commonwealth Government to undertake a National Competition Policy (NCP) review of the *Bills of Exchange Act 1909* (Bills of Exchange Act). In brief, the Working Group is required, within the analytical framework set down in the Competition Principles Agreement of the NCP, to review the Bills of Exchange Act. The focus of the report is thus on those parts of the legislation which restrict competition and/or impose costs or confer benefits on business, including small business, and investors generally (for the purposes of this Review investors include those who issue financial instruments under the terms of the Act and those who use them for investment or trading purposes).

## 1.1 ANALYTICAL FRAMEWORK OF COMPETITION POLICY REVIEWS

An important element of NCP is the Competition Principles Agreement, which contains, inter alia, principles for dealing with reviews of legislation and where appropriate, reform of legislation that restricts competition. The guiding principle is that legislation should not restrict competition unless it can be demonstrated that the benefits of the restriction outweigh the costs, and that the objectives of the legislation can only be achieved by restricting competition.

While restrictions on competition may be necessary to achieve certain economic and social objectives, they can also impose substantial costs through higher prices, reduced choice and impediments to innovation and efficiency. Reflecting these potential costs, the core principle for NCP reviews effectively means that legislative restrictions are to be removed unless they can be shown to confer a net benefit on the Australian community (and unless restricting competition is the only way to achieve the objectives of the legislation).

Under the Competition Principles Agreement, Australian governments have agreed to apply the following principles to their reviews of legislation. A review should:

- clarify the objectives of the legislation;
- identify the nature of the restriction on competition;
- analyse the likely effect of the restriction on competition and on the economy generally;

- assess and balance the costs and benefits of the restriction; and
- consider alternative means for achieving the same result, including non-legislative means.

The terms of reference for the Review for the Bills of Exchange Act, which are stated at the front of this report, reflect the Competition Principles Agreement.

## 1.2 TERMS OF REFERENCE

The terms of reference of the Review directed the Working Group to assess restrictions on competition arising from the legislation. The terms of reference also directed the Working Group to focus on those parts of the legislation which impose costs or confer benefits on business. Any assessment of such benefits and costs for legislation review purposes requires a comparison between the legislation and what would (hypothetically) exist in its absence.

In reviewing individual provisions of the Bills of Exchange Act, the Working Group has identified their contribution to the overall objectives of the legislation. The provisions are then evaluated in terms of the compliance costs they impose in meeting those objectives. Where a particular provision could meet its objectives with less restriction on competition, or in a more cost-effective manner, an alternative to the existing arrangement has been considered.

The terms of reference also required the Working Group to identify the different groups likely to be affected by the legislation and its alternatives. These consist of Commonwealth, State and local governments, Commonwealth, State and local government trading enterprises, private trading enterprises, banks, non-bank deposit-taking institutions, other financial institutions including merchant (or investment) banks, life offices, superannuation and managed funds operators, unincorporated businesses and households.

## 1.3 LEGISLATION UNDER REVIEW

The overarching purpose of the Bills of Exchange Act is to codify by statute the common law relating to two types of negotiable instrument - bills of exchange and promissory notes.

The Bills of Exchange Act confirms that bills of exchange and promissory notes are negotiable instruments, a status evolved at common law. This gives these financial instruments a special advantage over other classes of contracts, as negotiability gives a

good faith purchaser of a bill of exchange or a promissory note guaranteed title to the financial instrument.

The Bills of Exchange Act prescribes the form of bills of exchange and promissory notes, determines the rights and obligations of the parties to the instruments and establishes procedures for their drawing up and resale.

An overview of the Bills of Exchange Act is provided in Chapter 3.

## 1.4 REPORT STRUCTURE

The next chapter, Chapter 2, looks at the market environment that shapes the short-term money market (which is influenced by the Bills of Exchange Act).

Chapter 3 provides an overview of the Bills of Exchange Act, and reviews the objectives of the Act in light of continuing technological developments in the trading, clearing and settlement of money market instruments.

Chapter 4 conveys some of the concerns regarding the Bills of Exchange Act that were raised in submissions to the Review.

Chapter 5 is the core of the Review, analysing the impact of the Bills of Exchange Act on competition via the compliance costs that the prescriptive, paper-form requirements of the legislation impose on participants in the short-term money market.

Chapter 6 considers alternatives (both legislative and non-legislative) to achieving the objectives of the Bills of Exchange Act, and also considers whether the Act should be extended to cover other negotiable instruments.

Chapter 7 discusses legal issues associated with impediments in the Bills of Exchange Act to the development of electronic techniques for the issue, trading and transfer of the negotiable instruments regulated by the Act.

Chapter 8 examines other issues, including legal issues, relating to the Bills of Exchange Act that are of concern to participants in the Review.

Chapter 9 discusses a number of options for reforming the Bills of Exchange Act, which would assist in reducing the complexity and prescriptiveness of the Act, and achieve the objectives of the legislation in a more cost-effective manner.

The appendices list those provisions of the Bills of Exchange Act that relate to the documentary form of the instruments regulated by the Act, provide details of the private depository and settlement system for negotiable instruments in Australia, and examine the measures adopted in various overseas jurisdictions to address issues relating to the creation of electronic negotiable instruments.

# CHAPTER 2: THE SHORT-TERM MONEY MARKET

## 2.1 THE REGULATORY ENVIRONMENT

The short-term money market in Australia is comprised of bills of exchange (bank accepted bills and non-bank accepted bills) and promissory notes, which are governed by the Bills of Exchange Act[1], and certificates of deposit (CDs) and Treasury Notes (T-Notes) issued by the Commonwealth Government, which are not governed by the Bills of Exchange Act.

Bills of exchange and promissory notes are financial instruments, in documentary form, characterised by negotiability. Negotiable instruments are documents of title, the possession of which may confer rights. Thus, a bill of exchange or a promissory note is a document that serves as a unique and transferable physical token of intangible rights and obligations.

The requirement for a bill of exchange or a promissory note to be in documentary form capable of possession represents a fundamental distinction between bills of exchange (and promissory notes) and shares, where registration of changes to ownership are recorded and evidenced in a register of title (which may be in paper form, but which may also be kept in electronic or some other non-paper format). The Bills of Exchange Act reflects the historical treatment of the bill of exchange as a unique physical document.

The statutory requirements of the Bills of Exchange Act governing the issue and transfer of bills of exchange and promissory notes potentially apply to all participants in the short-term money market. More particularly, the Act may apply to any person who is capable (at law) of becoming a party to a bill of exchange or a promissory note by drawing or accepting it, or who becomes a party to a bill or note by way of transfer of ownership. Thus, the Bills of Exchange Act applies to both the primary issue of bills or notes and to any secondary sale of bills or notes.

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1 The Bills of Exchange Act encompasses three types of negotiable instrument: bills of exchange, promissory notes and cheques (which are a form of negotiable instrument) drawn before 1 July 1987.

## 2.2 THE MARKET ENVIRONMENT

The bill of exchange performs a dual function,[2] that of giving credit to the debtor until the bill matures, and of giving the creditor immediate funds by means of its discount. Employed in this way, the bill of exchange is also a means of raising loan finance.[3] The efficacy of such arrangements means that bills of exchange take a number of forms such as accommodation bills, which are issued primarily for the purpose of financial loan transactions and are the basis of the majority of transactions in the short-term money market, and trade bills, which continue to be used in both domestic[4] and international trade.[5]

The financial instruments regulated under the Bills of Exchange Act play a significant role in Australia's financial markets. This is evidenced by the ongoing popularity amongst market participants of bills of exchange and promissory notes, both of which constitute an important segment of the Australian short-term money market.

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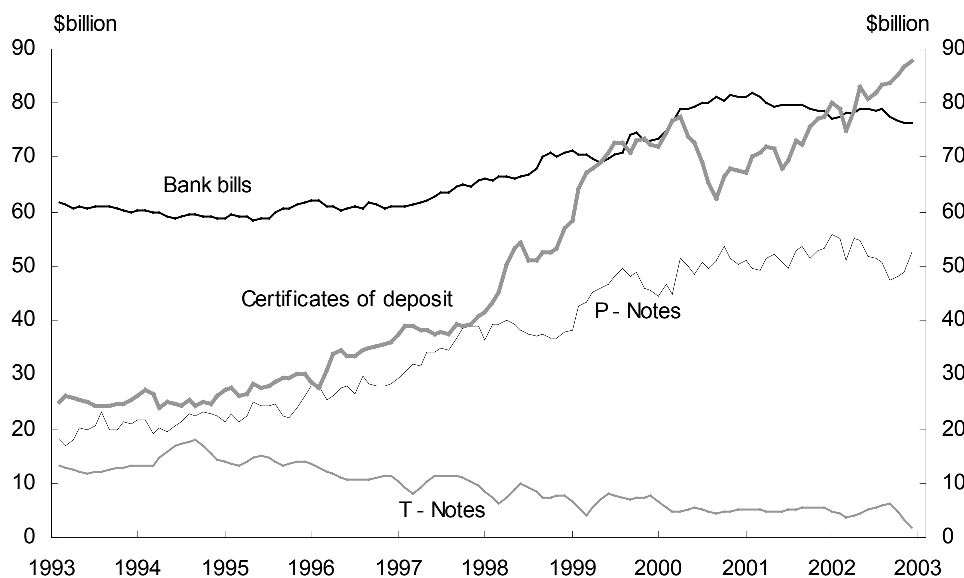
2 WS Weerasooria, *Banking Law and the Financial System in Australia*, 4th edn, Butterworths, Sydney, 1996, p. 164.

3 The most common type of bill of exchange is a bank accepted bill. These bills generally have a company or individual as the drawer or issuer. For a fee, a bank accepts the bill and thereby guarantees that the holder of the bill will receive payment upon maturity of the bill. When the bill matures, the company repays to the bank the full amount borrowed plus the interest or discount. At the same time, the bank repays this amount to the investor. Prior to maturity, however, the investor may on-sell the bill to another investor. When a bill is discounted, the seller indorses the bill on the reverse side with the seller's signature; the buyer becomes the holder of the bill. The first indorser, and each subsequent indorser (each subsequent seller of the bill) establishes a contingent liability against itself, and is thus responsible for the payment of the face value of the bill should the acceptor, and after that person, the drawer, not honour the bill at maturity.

4 For further details on uses of bills of exchange generally, see *Everett & McCracken's Banking and Financial Institutions Law*, 5th edn, by Sheelagh McCracken, LAWBOOK CO., Sydney, 2001, pp. 246-248 and pp. 254-255.

5 For further details on bills of exchange in international trade, see David E Allan, *Trade financing – export transactions*, Chapter 15, in Mallesons Stephen Jaques, *Australian Finance Law*, 4th edn, LBC Information Services, 1999 and Trevor Thompson and Robert Bruce, *Trade Finance,* Chapter 15, in R Bruce, B McKern, I Pollard, & M Skully (eds), *Handbook of Australian Corporate Finance*, 5th edn, Butterworths, Sydney, 1997.




Source: RBA[6].

The Australian short-term money market is dominated by bank bills and CDs (collectively known as 'bank paper'). At the end of March 2003, the total value of securities outstanding in the short-term money market[7] was around $A219 billion, of which bank paper outstanding totalled $A164 billion.[8] Bank paper also accounts for the majority of turnover in the short-term money market. For the year 2001-02, turnover in bank bills and CDs was about $1.6 trillion. For the same period, turnover in promissory notes was $750 billion and turnover in T-Notes was $14 billion.[9]

According to the RBA, the dominance of bank paper in the short-term money market is a result of Australia's strong economic growth during the 1990s, which led to a substantial increase in bank credit (for example, since 1995, the value of CDs on issue has more than tripled, to about $88 billion[10]). In addition, strong government financial positions have resulted in short-term public sector issuance being reduced, with outstandings of Commonwealth

Government T-Notes (see above) declining from around $14 billion at end March 1995 to just under $2 billion in 2003.

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6 Reserve Bank of Australia, *Bulletin Statistics*, May 2003, Tables D.2, D.3 and E.7.

7 Here defined as bank bills, certificates of deposit, promissory notes and Treasury Notes.

8 Reserve Bank of Australia, *Bulletin Statistics*, May 2003, Tables D.2, D.3 and E.7.

9 Australian Financial Markets Association & Securities Industry Research Centre of Asia-Pacific, *Australian Financial Markets Report 2002 (AFMR)*.

10 Reserve Bank of Australia, *Bulletin Statistics*, May 2003, Tables D.2, D.3 and E.7.

## 2.3 BANK BILLS

The bank bill sector of the short-term money market has expanded over recent years. Since March 1995, the value of bank bills on issue has increased by 30 per cent to about $76 billion.[11] This increase is a response to both the underlying growth in the economy (and the associated demand for credit) and the trend for banks to structure a greater share of their liabilities in the form of debt securities.

However, in its submission to the Review, AFMA noted that while the bank bill segment of the short-term market has continued to grow in absolute dollar terms, it is declining in importance as a proportion of total commercial lending. Between the end of March 1995 and the end of September 1997 the volume of bank bills outstanding as a percentage of total commercial lending fell from 49.1 per cent to 39.2 per cent.[12]

This decline probably reflects the fact that there is no longer an incentive to lend via bills in preference to other methods. Previously, the RBA's Statutory Reserve Deposit (SRD) requirements had contributed to the growth in bill financing, since lending via bills was excluded from the calculation of SRD requirements. However, abolition of the SRD requirements, in 1988, removed the bias towards bills.

Although they have declined in *relative* popularity, bank bills are still attractive to banks as a means of providing finance, as they have a reasonably high level of liquidity in the secondary market.

Bank bills issued by the four major domestic banks are benchmarks for the short-dated debt sector. Liquidity in this paper is supported by the high credit quality of the issuing banks and by the fact that the bills of the four major banks are deliverable into the 90-day bank bill futures contract.[13]

According to AFMA's submission to the Review, there is an extremely active market in Australia for bank accepted bills (and promissory notes), both of which are traded in what are regarded as minimum marketable volumes of $10,000,000,[14] comprised of no more than three lines — each being multiples of $1,000,000.[15] Bank accepted bills and promissory notes are commonly in denominations of $100,000, $1,000,000 or $5,000,000, making up each line of identical drawer, acceptor and maturity date in the case of bank bills and identical issuer and maturity date in the case of promissory notes.

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11 Reserve Bank of Australia, *Bulletin Statistics*, May 2003, Tables D.2, D.3 and E.7.

12 AFMA submission.

13 Axiss Australia, Executive Briefing, Section 5 – Short-Term Debt Instruments http://www.axiss.com.au/content/pubs/executive_briefings/debt_security/debt_securities-…(Accessed 27 May 2002).

14 AFMA announced an increase in the size/market parcel from $A10m to $A20m, effective from 1 October 2000.

15 AFMA submission.

The RBA noted in its May 1996 *Bulletin* that, unlike the long-term debt markets, less than 20 per cent of transactions in the short-term money market are among professional market participants, commenting that corporates and fund managers tend to transact a relatively large proportion of business in the short-term markets, using bank bills to meet their short-term investment needs.[16]

## 2.4 CERTIFICATES OF DEPOSIT

CDs are wholesale value deposits that are repayable at a fixed date. They are typically issued in large volumes (of $50-$100 million) and as a result, investments in CDs are usually limited to the larger investment players (although there is a retail market in CDs — see below). CDs are traded at a discount from face value, and bank-issued CDs trade at rates similar to equivalent maturities of bank accepted bills of exchange. CDs usually have a short term (one to three months) with the quoted interest added to the amount of the deposit to establish the redemption amount.

The secondary market in CDs provides these securities with liquidity, because the depositor can sell them prior to their redemption date (that is, trade the promised repayment).

## 2.5 RETAIL MARKET IN BANK BILLS AND CERTIFICATES OF DEPOSIT

The retail market for bank bills and certificates of deposit represents approximately 50 per cent of bank bills and 40 per cent of CDs on issue. It is largely comprised of small business (non-corporates), rural clients and individuals who buy directly from the major banks, which issue bank bills and CDs from their own portfolios and maintain the securities in their own safe custody.

Apart from the large denominations of bank bills issued and (actively) traded in the wholesale market, there is a significant volume of transactions in bank bills issued in denominations between $50,000 and $250,000, as well as non-bank accepted or indorsed bills primarily related to trade transactions (involving small to medium businesses and also import/export finance). Many banks limit retail sales to either over $100,000 or over $500,000, although bills drawn on the Commonwealth Bank may be purchased through Commonwealth Securities (online) for a minimum of $10,000.

As a lending vehicle, a bank will agree to act as 'acceptor' or 'indorser' on a bill of exchange with the client as drawer or the borrower of the funds. Banks will also

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16 RBA, 'Australian financial markets', *Bulletin*, May 1996, p. 7.

purchase other banks' bills (in the wholesale interbank market) for their retail investors.

The majority of bills being issued in the retail market are not on-sold (that is, discounted into the secondary market) except into the inter-bank market or into the non-bank wholesale market. Thus, there is not an active secondary market for these instruments. On the investment side, banks sell bills to retail investors, which are accepted or indorsed by the bank or are purchased from other banks. Buyers tend to retain the investment until maturity. Retail customers selling bills, sell them back to the banks.

## 2.6 PROMISSORY NOTES

According to the Reserve Bank, short-term debt issued by corporations, state central borrowing authorities, other government authorities and finance companies in the form of 'commercial paper' or 'CP' (promissory notes) has increased strongly in recent years, more than doubling since 1995.[17] Turnover in corporate promissory notes has increased sharply as well, quadrupling over the four years to June 2001.[18] The fastest expanding market segment over recent years has been asset-backed commercial paper (ABCP). The ABCP market has grown from $A2 billion in 1996 to $A16.5 billion in December 2002.[19] ABCP now accounts for around 44 per cent of the entire CP market.[20] These instruments have proved very popular with institutional investors in Australia, who are growing increasingly comfortable with the complexity of the structures on offer.

## 2.7 TREASURY NOTES

Treasury Notes (T-Notes) are issued by the Commonwealth Government to meet its cash management requirements. Although historically viewed as negotiable instruments, T-Notes are regulated by the *Commonwealth Inscribed Stock Act 1911,* (the CIS Act) not the Bills of Exchange Act. T-Notes are characterised as discount securities in the context of the short-term money market.

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17 RBA, unpublished data.

18 Australian Financial Markets Association & Securities Industry Research Centre of Asia-Pacific, *Australian Financial Markets Report 2002 (AFMR)*.

19 RBA, *Bulletin Statistics*, May 2003, Table B.16.

20 RBA, unpublished statistics.

There is only a small secondary market for T-Notes, with the main investors in T-Notes being banks. Banks hold about 70 per cent of the T-Notes on issue as the paper is useful for liquidity management.[21]

According to AFMA's submission, the professional short-term money market treats bills, promissory notes, CDs and T-Notes as interchangeable. For example, a bank managing its liquidity requirements, but not having a bill in its portfolio to sell that would match those liquidity requirements, might issue a CD instead. The pricing of CDs and bank accepted bills of a particular bank in the primary and secondary markets is identical.

21 Edna Carew, *Fast Money 4*, Allen & Unwin, Sydney, 1998, p. 136.

# CHAPTER 3: THE BILLS OF EXCHANGE ACT

## 3.1 INTRODUCTION

As previously noted, the Bills of Exchange Act governs the rights and obligations of parties to two types of negotiable instruments — bills of exchange and promissory notes - and is essentially a codification of the common law relating to these financial instruments. The Bills of Exchange Act also applies to cheques drawn before 1 July 1987. Cheques issued since that date are governed by the *Cheques Act 1986*.

The Bills of Exchange Act is long, detailed and prescriptive. It is divided into five Parts and has over 100 sections. The key Parts for the purposes of the Review are Parts II and IV, which deal with bills of exchange and promissory notes, respectively. Part II, which deals specifically with bills of exchange, is divided into a number of Divisions relating to the form and interpretation of bills, capacity and authority of parties to bills, consideration for bills, negotiation of bills, general duties of holders of bills, liabilities of parties to bills, discharge of bills, acceptance and payment for honour of bills, lost instruments, bills in a set and conflict of laws. Part IV of the Act deals with promissory notes, and contains provisions dealing with the delivery of notes, presentment of notes for payment, liabilities of makers to notes, and also with the application of certain provisions of Part II of the Act to promissory notes.

The documentary form requirements of the Bills of Exchange Act relating to bills of exchange and promissory notes form the basis of many of the provisions of the Act. For example, section 8 of the Act sets out the documentary form requirements of bills of exchange. Under section 8, a bill of exchange is not only required to be 'in writing', but it must also be 'signed' by the person giving it and by the acceptor/drawee.[22] If a bill is indorsed, the indorsement must be written on the bill and signed by the indorser.[23] Examples of provisions in the Bills of Exchange Act relating to the documentary form of bills of exchange and promissory notes are set out in Appendix One to the report.

A *bill of exchange* is defined in section 8 of the Bills of Exchange Act as:

An unconditional order in writing, addressed by one person to another, signed by the

22 Bills of Exchange Act, paragraph 22(2)(a).
23 Bills of Exchange Act, paragraph 37(a).

person giving it, requiring the person to whom it is addressed to pay on demand, or at a fixed or determinable future time, a sum certain in money to or to the order of a specified person, or to bearer.

A *promissory note* is defined in section 89 of the Bills of Exchange Act as:

An unconditional promise in writing made by one person to another, signed by the maker, engaging to pay, on demand or at a fixed or determinable future time, a sum certain in money, to or to the order of a specified person, or to bearer.

## 3.2 OBJECTIVES OF THE BILLS OF EXCHANGE ACT

The objectives of the Bills of Exchange Act are to:

- provide uniformity of law in Australia in relation to bills of exchange and promissory notes;
- provide legal certainty by confirming the nature of bills of exchange and promissory notes as negotiable instruments; and
- promote efficiency in the marketplace that utilises bills of exchange and promissory notes through the concept of negotiability.

## Uniformity

The Bills of Exchange Act was introduced into Parliament in 1907 with the stated intention of unifying the law on bills of exchange in Australia in one code:

> Honourable Senators will recognise that it would be of considerable convenience to the trading community of the Commonwealth if they could find the law on this subject in one code, and could be certain that if amendments, no matter how desirable, were introduced, they would be in relation to that one particular code.[24]

The Bills of Exchange Act replaced similar statutes which had previously been enacted by the various Australian colonies.[25] The colonial legislation was in turn based on the 1882 UK Bills of Exchange Act, the enactment of which reduced to statutory form the rules of the common law on negotiable instruments found in more than 2500 judicial decisions.[26]

## Certainty

A key objective of the Bills of Exchange Act is to provide legal certainty in relation to bills of exchange and promissory notes by providing statutory confirmation of their status as negotiable instruments.

There is no simple method of establishing which instruments will be held by the courts to be negotiable instruments,[27]as this matter is determined by taking into account mercantile customs and usages. If evidence is produced of a commercial custom (which is firmly established and long recognised by the mercantile community) that treats certain instruments as negotiable, the courts will treat them as having that quality, although usage over a long period is not essential.[28]

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24 Extract from Hansard, Senator Keating (Minister for Home Affairs), Second Reading Speech on the Bill, Australia, Senate and House of Representatives, *Parliamentary Debates*, 1907, vol XXXVI, p. 653.

25 The Bills of Exchange Act was to supersede all State enactments on the subject. Between 1884 and 1890, all of the Australian colonies had introduced legislation based on the 1882 UK Bills of Exchange Act. By the time the Commonwealth's Bill was introduced into the Parliament in 1907, the State-based legislation regarding bills of exchange was comprised of six principal Acts and six amending Acts.

26 Brian Conrick, *MJL Rajanayagam's The Law of Negotiable Instruments in Australia,* 2nd edn, Butterworths, Sydney, 1989, p. 5.

27 D Everett & S McCracken, *Banking and Financial Institutions Law*, 4th edn, LBC Information Services, Sydney, 1997, p. 194.

28 See WS Weerasooria, *Banking Law and the Financial System in Australia*, 4th edn, Butterworths, Sydney, 1996, p. 161 (and the cases referred to therein).

However, the negotiable status of a particular contract may be determined by statute as well as by the courts. Whereas bills of exchange were recognised by the common law as being negotiable instruments, promissory notes are deemed to be negotiable instruments by the Act,[29] since promissory notes were held not to have enjoyed the attributes of negotiability by the usage and custom of merchants.[30]

In addition to confirming, in statutory terms, their nature as negotiable instruments, the Bills of Exchange Act defines the features and characteristics of bills of exchange and promissory notes, and sets out the rights, obligations and liabilities of parties to bills of exchange and promissory notes. Division 6 of the Act sets out the rights, obligations and liabilities of parties to a bill of exchange, while section 95 designates the rights, obligations and liabilities of parties to a promissory note.[31]

## Efficiency

The bill of exchange, as a negotiable instrument, enjoys two attractive features. It is transferable without formalities, and honest acquisition confers good title (even if the transferor did not have good title).[32]

A bill of exchange (and the rights that it represents) is transferable in principle. That is to say, the rightful possessor of the document can transfer his or her rights to another person simply by delivering the document to that other person. A bill of exchange is capable of being transferred by delivery (in the case of an instrument requiring payment to be made to a named person or its bearer), or by the payee's indorsement and delivery (in the case of an instrument requiring payment to be made to a named person or to the order of that named person). Legal title is vested in the transferee without any further instrument and without the necessity of giving notice of the transfer to the person liable to pay.

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29 In Australia, Senate and House of Representatives, *Parliamentary Debates* , 1909, vol. 1, p. 1932 on the proposed bills of exchange legislation, Mr Glynn, the Attorney-General, noted that:

> 'The negotiability, or power of transfer by mere delivery, which is possessed in the case of bank notes, was challenged in regard to promissory notes, and about 1703 the Chief Justice of the Court of the Queen's Bench declared that they were not transferable, and that it was a piece of impudence for bankers to so regard them. However, a few years later, the Act 3 and 4 Anne (UK) made them equally negotiable with bills of exchange, and ever since they have formed part of the general commercial currency.'

30 D Everett & S McCracken, Banking and Financial Institutions Law, 4th edn, footnote 11, p. 302, citing *Buller v Cripps* (1703) 6 Mod Rep 29, per Holt CJ.

31 The Bills of Exchange Act provides for the protection of holders of bills. The liability for repayment runs from the acceptor, to the drawer, then to the indorsers (last indorser to first indorser). Thus, the first indorser can only make a claim against the drawer or the acceptor. The sole liability established by the issuance of a promissory note is borne by the issuer, since no other party accepts the note; nor is there a series of contingent liabilities established by indorsement, as is the case with bills of exchange.

32 Joanna Benjamin, *The Law of Global Custody,* Butterworths, London, 1996, p. 16.

However, not all instruments that are capable of being transferred are negotiable. In fact, most do not benefit from this attribute.[33] One of the main reasons merchants developed the bill of exchange was to take advantage of the 'guaranteed title' concept of negotiability, which is not enjoyed by other contracts for the transfer of debt, such as, assignments of choses in action.[34] A transferee (or holder) taking a negotiable instrument such as a bill of exchange in good faith, for value and without actual notice of any defect in the transferor's title, can acquire a better title than that possessed by the transferor and is not affected by prior equities (that is, he or she acquires title free from any defect in the title of the prior holder). It is these characteristics which distinguish bills of exchange (and promissory notes) from other contracts.

Under the Bills of Exchange Act, the transferee is known as a 'holder in due course',[35] the legal status of which has been said to promote transactions and encourage the rapid and unimpeded flow of capital.[36] Statutory confirmation of this status by sections 43 and 95 of the Bills of Exchange Act (in relation to bills of exchange and promissory notes respectively) enables the market to rely on the characteristic of negotiability. Arguably, it is the concept of 'guaranteed title' enjoyed by holders in due course of negotiable instruments such as bills of exchange and promissory notes which is the key to the liquidity of these instruments.

## 3.3 CONTINUING RELEVANCE OF THE OBJECTIVES OF THE BILLS OF EXCHANGE ACT

The terms of reference require the Working Group to clarify and review the objectives of the Bills of Exchange Act in the light of continuing technological developments in electronic trading, clearing and settlement of money market securities.

In its submission to the Review, the ASX stated that the Bills of Exchange Act has provided a solid framework for many years, enabling the development of important markets for bills of exchange, promissory notes, and by default, other negotiable type instruments. The ASX commented that:

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33 D Everett and S McCracken, *Banking and Financial Institutions Law*, 4th edn, LBC Information Services, Sydney, 1997, p. 187.

34 Assignments of choses in action, in contrast to negotiable instruments, are 'subject to equities'. This means that the assignee (transferee) has no guarantee that his assignor has a good title to give him. For example, the assignor may have used misrepresentation against the original debtor, and may have no good title to assign to the transferee.

35 The holder in due course of a negotiable instrument takes it free of adverse claims from the issuer (for example, in respect of sums owed to the issuer by previous holders) or third parties (for example, previous holders claiming to be the true owner because an earlier transfer was fraudulent).

36 D Frisch & HD Gabriel, 'Much ado about nothing: achieving essential negotiability in an electronic environment', *Idaho Law Review* , 1995, vol. 31, p. 758.

> Unfortunately, the Act is now outdated and no longer reflects commercial practice and the commercial needs of the money markets. It is therefore imperative that the amended Act continues to provide commercial certainty in respect of the issue, trading and transfer of negotiable instruments.

The ASX also noted that it did not wish to express a detailed view of how these objectives might best be achieved under the Act. However, it noted the importance of the Act in providing market confidence for the growth of negotiable instruments, and stated that the Act should be amended in a manner which allows flexibility and promotes innovation.

The Working Group considers that there are no reasons why the objectives of the Bills of Exchange Act should not remain relevant in the face of ongoing technological developments in the electronic trading, clearing and settlement of money market securities (particularly in light of support amongst market participants for amendments to the Act to better reflect commercial practice in the short-term money market).

However, unless the current impediments in the Bills of Exchange Act, which are grounded in the documentary form of bills of exchange and promissory notes, are overcome, they will prevent the extension of the Act's objectives, (uniformity, certainty and efficiency) to the development of mechanisms for the issue, trading, clearing and settlement of bills of exchange and promissory notes, and related instruments, in electronic form.

The Working Group also considers that the Act's objectives will only continue to operate for the benefit of the economy as a whole, and the short-term money market in particular (as an important facet of the economy), if the Bills of Exchange Act remains relevant in the face of market driven developments, such as the dematerialisation[37] of financial instruments, and if the Act is amended to reflect those developments.

## Issues

Should the Bills of Exchange Act be amended to provide for the issue, recording and transfer of bills of exchange and promissory notes and related negotiable instruments in electronic form and by electronic means?

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37 Dematerialisation has been defined by the Group of Thirty (a New York-based think tank for the securities industry) in its 1989 report, *Securities Clearance and Settlement in the World's Securities Markets,* as 'the elimination of physical certificates or documents of title which represent ownership of securities so that securities exist only as computer records'.

# CHAPTER 4: PARTICIPANTS' VIEWS OF THE BILLS OF EXCHANGE ACT

## 4.1 INTRODUCTION

Participants supported retention of the Bills of Exchange Act and did not propose alternative means of achieving the objectives of the Bills of Exchange Act. A number of submissions considered that the Act had served Australian trade and finance needs well for nearly a century. However, these submissions argued that in recent years, the Act has not been flexible enough to enable instruments issued under the Act to take advantage of developments in electronic trading, clearing and settlement of financial instruments. Most submissions argued that the Act should be retained if it could be amended to allow for technological developments and changes in market practices. A number of participants also pointed to particular provisions, which they considered either limited competition, or added significantly to compliance costs.

Certain issues regarding the impact of the Bills of Exchange Act emerged as common to the majority of submissions to the Review. These were:

- retention of the Bills of Exchange Act;
- restrictions on competition;
- imposition of costs; and
- dematerialisation of bills of exchange and promissory notes.

### Retain the Act

AFMA stated:

> The Act has served Australian trade and financial needs well for nearly a century. More recently, however, it has been found wanting in accommodating technological developments in the electronic trading, clearing and settlement of financial instruments. These shortcomings need to be addressed in the interests of maintaining an efficient and internationally competitive domestic financial sector.

AFMA also stated that:

> The Bills of Exchange Act has played an important role in the development of Australia's financial markets through the provision of legal certainty and the clear definition of operating parameters. In recent years, however, the Act has not been flexible enough to enable market participants to take advantage of electronic commerce to the same extent as other sectors of the economy, and this has resulted in unnecessary costs being incurred and other transaction processes and market inefficiencies.

The ASX submission focussed on the need to retain the concept of negotiable instruments, and in particular, retain a legislative framework that regulates the issue, trading and settlement of all negotiable instruments. The ASX stated that:

> The Act has provided a solid framework for many years, enabling the development of important markets for bills of exchange, promissory notes, and by default, other negotiable type instruments.

The LCA submitted that:

> The primary objective of the Bills of Exchange Act should remain unchanged, notwithstanding continuing technological developments. This objective is to facilitate commerce (both trade and finance) by means of a simple, secure and efficient payment mechanism.

Westpac Banking Corporation stated that:

> We consider that the Act should be retained if it can be amended to recognise that Bills of Exchange can be recorded in electronic format. If the Act cannot be amended to achieve this goal, we consider that government will need to provide some other mechanism to regulate the recording of the obligations and rights of the parties to the transactions characterised as Bills of Exchange but where a written document does not exist.

ATOA commented:

> The Act should not be repealed as continued use of the instruments still plays a significant role in Australia's financial markets.

ATOA also stated that:

> The development of techniques with which the market can move to the electronic trading and transfer of title of negotiable instruments must not in any way compromise or prejudice the obligations attaching to the relevant parties of negotiable instruments under the present modus operandi.

The Department of Industry, Tourism and Resources indicated that the Department would be keen to ensure that existing rights provided under the Act are not diminished.

## Restricts competition

AFMA stated:

> The Act does not in itself restrict competition in the markets for instruments issued pursuant to its provisions to any significant extent. In some circumstances, however, the Act does restrict the ability of instruments issued under it to compete with financial instruments and other sources of finance which fall outside its provisions.

## Imposes costs

The majority of the submissions to the Review commented that significant compliance costs are generated by the form and signature requirements of the Bills of Exchange Act. These costs arise from the obligations imposed on market participants to comply with the particular requirements of the Act to create paper-based securities, which have been signed by the parties to a bill of exchange or promissory note.

Westpac Banking Corporation noted that:

> The requirement that Bills of Exchange be 'in writing' imposes costs on all parties involved in borrowing, investing and accepting bank accepted bills. This requirement limits the application of automated data processing techniques. In most instances, the need to produce a physical (paper) security is imposed by the Act, not by any of the parties to the bank accepted bill.

ASCT [38] submitted that:

> The purpose of producing physical paper revolves around the legal rights of the parties, and now with the advancement of technology, legal rights can be recorded electronically. Therefore, the legislative requirement to produce paper when technology is available is of no benefit, while the associated costs are borne by the end-users.

AFMA stated that:

> The production and processing of physical instruments creates operational inefficiencies, limits the scope to minimise security risks and imposes additional

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38 Now known as the Finance and Treasury Association.

> costs. The inefficiencies and costs result from the requirement to physically produce, process and handle substantial volumes of paper.

### Dematerialisation

The Bills of Exchange Act was considered by most participants to be technologically out of date, and therefore impeding the operation of an optimally functioning market. Participants proposed dematerialisation of bills of exchange and promissory notes as a means of eliminating, or greatly reducing, the costs involved in producing, trading and settling the securities in paper form, and as a way of promoting efficiency in the market place. As previously indicated, dematerialisation is the elimination of physical certificates or documents of title which represent ownership of securities, so that securities exist only as computer records.

ASCT submitted that:

> The Bills of Exchange Act should be amended to allow for dematerialisation of bank bills and promissory notes. It is the absence of the option of dematerialisation which handicaps an optimally functioning bank bill, NCD and promissory note market.

AFMA noted that:

> The advantages of dematerialisation of instruments issued under the Act are greater convenience, increased efficiency, higher levels of security and lower transaction costs.

The ASX supported the need to retain the concept of negotiable instruments, and facilitate the dematerialisation of negotiable instruments to enable the electronic issue, trading and transfer of legal title to those instruments under the Bills of Exchange Act.

Mr Ken Robson submitted that the only reason to codify the clearing rules for negotiable instruments, other than cheques, would be to protect customers and small business.

## 4.2 Conclusion

The majority of participants in the Review supported the retention of the Bills of Exchange Act if it could be amended to allow for technological developments (that would promote market efficiency).

Some participants considered that the Act does not unduly restrict competition. Nevertheless, it was generally considered that the Act does restrict the ability of

instruments issued under it to compete with financial instruments, and other sources of finance, which fall outside the Act's provisions.

Amendment of the Bills of Exchange Act to remove some aspects of these restrictions could lead to reduced operating costs and greater market efficiency, by making the instruments issued under the Act more administratively convenient and more competitive with alternative funding sources.

Participants considered that this could be achieved by moving from paper-based bills of exchange and promissory notes to electronically recorded forms of these negotiable instruments. These matters are discussed in subsequent chapters.

# CHAPTER 5: THE BILLS OF EXCHANGE ACT — RESTRICTIONS ON COMPETITION

## 5.1 INTRODUCTION

This Chapter examines those aspects of the Bills of Exchange Act that may restrict competition. Competition is either directly or indirectly restricted by the Bills of Exchange Act in several ways:

- As a result of the compliance costs generated by the paper form requirements of the Bills of Exchange Act.
- Through the impact of the compliance costs on competing sources of finance.
- By the limited application of the Bills of Exchange Act to negotiable instruments generally, in the context of technological developments.

The following sections:

- describe the restrictions; and
- analyse the likely costs and benefits of the restrictions.

## 5.2 THE GENERAL NATURE OF OPERATING AND COMPLIANCE COSTS

Like all regulation, the Bills of Exchange Act imposes compliance costs. In some areas of the legislation, these costs may be significant and there may be scope to reduce them so that the objectives of the legislation are met in a more cost–effective manner.

The available information suggests that the requirements under the Bills of Exchange Act to produce a physical document and thus to process and handle substantial volumes of paper, create operational inefficiencies, limit the scope to minimise security risks and impose considerable additional costs. It is therefore important to consider whether there is scope to reduce these costs by improving the regulatory framework.

There is only limited quantitative information available with which to undertake an assessment of the magnitude of compliance costs. Most available information consists of anecdotal evidence provided by participants. Some quantitative information on costs was deduced by AFMA from Stage 1 of the Project Report on Benchmarking: The Over-the-Counter Financial Markets.[39]

## Costs associated with the form and signature requirements of the Act

Significant compliance costs are generated by the requirements of the Bills of Exchange Act relating to the documentary nature of bills of exchange and promissory notes. These costs arise from the obligations imposed on market participants to comply with the particular requirements of the Act to create paper-based instruments, which have been signed by the parties to the bill of exchange or promissory note.

Drawing on Stage One of the Benchmarking the Over-the-Counter Financial Markets Project Report, AFMA has estimated that the average cost per short-term securities transaction is $234.40. By way of contrast, the average cost for a cash transaction is estimated to be only $164.85.

AFMA argued that certain costs could be avoided or reduced significantly if instruments issued under the Act could be produced, settled and traded electronically. These include costs associated with:

- drawing up instruments (for example, a drawing of $1,000,000 under a bill facility could involve the production of 10 x $100,000 individual bills);
- checking and signing instruments;
- lodging instruments with a central securities depository;
- checking instruments on maturity;
- storing matured instruments for 7 years (an FTR Act requirement);[40] and
- arranging for the physical security of instruments.

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39 Booth, Peter & Bradley, Graham, *Benchmarking the Over-the-Counter Financial Markets, Stage 1 Project Report: Process, Error Rate and Cost Benchmarks*, Securities Industry Research Centre of Asia-Pacific, in association with AFMA and KPMG, December 1996.

40 A National Competition Policy review of the *Financial Transactions Reports Act 1988* and regulations was conducted by a task force of Commonwealth officials. The taskforce provided its report to the Minister for Justice and Customs on 6 September 2000. Commonwealth National Competition Policy Annual Report 1999-2000. Australia. Dept. of Treasury. Treasury Homepage. http://www.treasury.gov.au/publications/Annual Reports/ (Accessed 27 May 2002).

AFMA also stated that the principal means by which cost savings could be achieved would be by reducing error rates and eliminating process steps (a maximum of 179 steps were identified by the Benchmarking Project).

- Error rates — average errors account for over two per cent of the transaction costs for bank bills. AFMA indicated that savings of up to $3.50 a transaction could be achieved by moving to electronic processes for issuing, trading and transferring bank bills.

- Process steps — if bank bills could be issued, traded and transferred electronically, up to 24 process steps could be eliminated (for example, physical delivery/collection of instruments and forms, physical checking of instruments and physical signing of instruments).

AFMA estimated that cost savings would amount to $34.90 per transaction, a saving of 14.9 per cent on the current cost of $234.40 per transaction. Assuming that each instrument is traded once in the secondary market, AFMA estimated that a saving of $34.90 per transaction would equate to an annual saving for the industry of not less than $8 million.

## Current money-market practices for the creation and custody of paper securities

Current market practices involving the creation and custody of negotiable instruments, including bank bills, promissory notes and NCDs, have gone some way to reducing the transaction costs associated with processing paper-based instruments.

According to ASCT's submission to the Review, the steps involved in issuing paper for a typical roll-over or draw-down where a bank is involved (after negotiation of the interest rate and informing the bank of the maturity date, face value and settlement details) include the following:

- Entry of the details of the bill or other paper into the bank's 'recording system'.

- The paper is then produced with the appropriate details, the details obtained and printed from the bank's 'recording system'.

- The bank bill or promissory note needs to be signed by the drawer, although most bills and promissory notes are now signed by the bank acting as Attorney on behalf of the customer. For bills, the bank also signs as acceptor. With modern technology, the bank's signature can be scanned.

- Most negotiable instruments remain in the physical possession of the bank and evidence of the purchaser's ownership is recorded by the bank. A confirmation is auto-generated with the details of the security, that is, bank bill number, face value,

maturity date, purchase price and the interest rate. The paper is kept in the bank's safe. Thus, from inception to maturity, the physical bill may never leave the bank's premises, and may never be seen by the drawer or investors.

- If the bank has discounted the paper and is on-selling to the secondary market, the paper can either be kept in safe custody with the bank, lodged in the clearing and settlement system, Austraclear,[41] or physically delivered to the purchaser.

- After indorsing and physically delivering the paper to the purchaser, the ownership of the paper is unknown to the bank. On maturity, the paper is delivered to the address on the paper for payment of the face value.

- The delivery of physical paper only occurs in a minority of cases and involves mainly small investors, or non-Austraclear members. The request for paper can occur where the drawer wishes to take delivery of the paper so that they can get it discounted by someone other than the acceptor, or where an investor in the secondary market wishes to hold the paper.

ATOA also noted that the number of negotiable instruments which are actually collected in person by an investor is negligible. It indicated that the majority (in number but not value) of negotiable instruments, once sold outright to investors, are held in custody for investors until maturity. ASCT estimated that this represents 80 per cent to 90 per cent (in number not value) of all negotiable instruments drawn or issued.

ASCT also estimated that between 10 per cent and 20 per cent of negotiable instruments drawn or issued are lodged in, and traded in, Austraclear, which records transfers of title to the instruments. Once lodged, bills generally remain in the physical possession of Austraclear, where they are held in safe custody until maturity.

## 5.3 COMPLIANCE COSTS AS A RESTRICTION ON COMPETITION

Although the Bills of Exchange Act may not in itself restrict competition in the markets for instruments issued pursuant to its provisions to any significant extent (a view supported by AFMA), the Working Group considers that there are elements of the Act which may indirectly restrict the ability of instruments issued under it to compete with financial instruments and other sources of finance which fall outside its provisions.

The compliance costs imposed by the Bills of Exchange Act arguably have an anti-competitive flow-on effect with respect to the economy generally, as they appear

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41 See Appendix Two to the Report.

to affect the competitive aspects of bill finance as an alternative source of funding for business and individual investors, compared to other sources of finance. In its submission to the Review, AFMA pointed to one reason for the decline in the bank bill segment of the short-term market relative to cash advance transactions, as being the significant transaction costs involved in effecting a bank bill transaction. The transaction costs involved in issuing a bill of exchange or promissory note may also be responsible for an apparent decline in bill financing to small business compared to the large business sector.

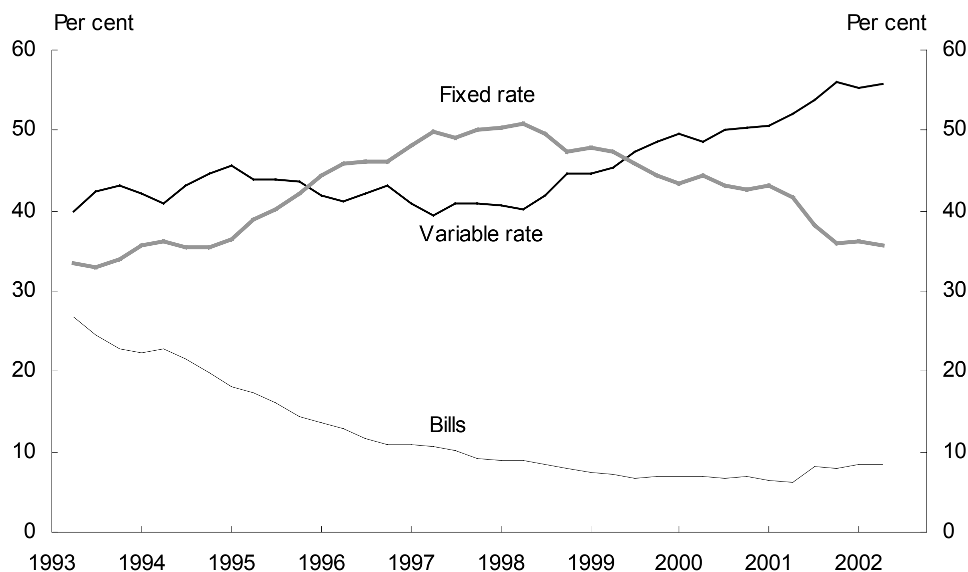
AFMA argued that changes to the Bills of Exchange Act leading to a reduction in transaction costs relating to bills of exchange and promissory notes (for example, by removing the requirements for the production, signing and lodgment of physical instruments) could slow down or stabilise the current decline of the bill market relative to other funding sources.

## Costs of restrictions

AFMA noted that the transactions costs involved in issuing a paper bill of exchange or promissory note (previously noted as being as high as $234.00) may be a disincentive to using these sources of funding when compared with a cash advance (cost per transaction estimated as being $164.85), particularly when the amounts involved are relatively small. AFMA also noted that the transactions costs related to the production, processing and handling of physical instruments under the Bills of Exchange Act alone are a significant disincentive to the drawing of bills for transactions of less than $100,000. The RBA has also commented that banks may have been steering small business away from bill lines because they find it uneconomical to issue small lines of bills.[42]

**Composition of Small Business Loans**
**Share of total — Quarterly**

42 Reserve Bank of Australia, 'Small business lending', *Bulletin,* October 1997, p. 12.




Source: RBA [43].

The RBA indicated that there has been substantial changes in recent years in the types of loans small businesses are taking out, with the use of bill financing falling and fixed-rate financing and variable-rate loans becoming more common. In 2001, bill finance accounted for just over eight per cent of small business finance (defined as loans of less than $500,000) compared with nearly one-third in 1993. [44] The RBA also noted that small businesses were not getting as much access to bill finance as they would like. In contrast, borrowing by

larger business is concentrated in bills (bill financing accounts for 51 per cent of lending to the large business sector).[45]

The relatively high transaction costs associated with the production, processing and handling of paper bills of exchange and promissory notes have also led to the development of market practices and conventions, such as trading in minimum marketable parcels, which may deter SMEs (small and medium sized enterprises), and small businesses in particular, from being able to access bill finance.

In its submission to the Review, RA McGee Pty Limited suggested that bill finance should be able to be accessed from sources other than banks, namely, large corporations. The submission suggested that the afore-mentioned market practices have discouraged the availability of such finance to small business, the practical effect of

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43 Reserve Bank of Australia, *Bulletin Statistics*, May 2003, table D.8.
44 Reserve Bank of Australia, Bulletin *Statistics*, May 2003, table D.8.
45 Reserve Bank of Australia, *Bulletin Statistics*, May 2003, table D.8.

which has been to restrict the use of bills of exchange and commercial paper to large prime-rated industrial corporations.

The submission pointed out that small-denomination trade bills cannot be discounted into the wholesale money market except at relatively high discount rates. This, it is argued, is because the size of marketable parcels of short-dated securities sold into the market has increased to $5 million for large financial institutions and to between $500,000 and $1 million for smaller institutional investors.[46] The submission noted that although a drawer's name on a bill of exchange accepted by a smaller debtor might be categorised by a rating agency as prime or investment grade, the money market no longer wanted to deal in small amounts ('shrapnel').

The submission argued that trade bill programs must therefore depend on the packaging of individual trade bills into composite trade bills. Composite bills could be in parcels of between $500,000 and $10 million with the one corporate drawer of the constituent bills, all of which have been accepted by the various debtors of that drawer.

The submission noted that if a trade bill market is to be developed in Australia, the credit emphasis in negotiated bill transactions must shift from the acceptor to the drawer, thereby allowing SMEs, acting as acceptors, to obtain credit extension from prime corporate suppliers drawing trade bills on them. To achieve this, the submission argued for amendments to the Bills of Exchange Act to eliminate the existing disincentives operating against the use of trade bills by large manufacturing companies.[47]

According to AFMA's submission, there is a significant volume of transactions in bank bills issued in denominations between $50,000 and $250,000, as well as non-bank accepted or indorsed bills, primarily related to trade transactions. This segment of the market is largely comprised of small businesses and rural customers, and the limited number of banks which deal with them. However, the low line volumes, frequent odd denominations and/or lack of an acceptable bank acceptor or indorser, together with relatively high transaction costs, means that after the primary (that is, initial) issue, there is not an active secondary market for these bank bills.

The Working Group notes that it would appear from the majority of submissions to the Review that it is the documentary form provisions of the Act which give rise to the transaction costs associated with bill finance, which in turn, has lead to the evolution of market practices, such as minimum marketable parcels, to offset these costs. The Working Group considers that it is the impact of these provisions which may be discouraging the market from making greater use of low-denominated bills, rather than specific aspects of the Bills of Exchange Act related to the liabilities of acceptors and drawers.

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46 As previously noted, AFMA announced an increase in the size/market parcel from $A10m to $A20m, effective from 1 October 2000.

47 Specifically to sections 22, 29, 35, 36, 64, 67 and 68 of the Bills of Exchange Act.

## Benefits of restrictions

Despite the apparent difficulties of small business in accessing bill finance and the impact on business of the compliance costs imposed by the paper form requirements of the Bills of Exchange Act (which have prompted the use of various operational and market practices designed to avoid or reduce these costs), bills of exchange and promissory notes continue to be utilised by business generally. Turnover in AFMA designated 'Negotiable and Transferable Instruments' (which includes bank bills and bills issued by corporates, CDs and promissory notes) increased by 18.6 per cent in 2000-01 to $2,448 billion.[48]

The underlying objective of the requirement for a bill of exchange or a promissory note to be in paper form derives from historical necessity, since until recently, electronic contracts and electronic securities were not technologically feasible.

As noted previously, bills of exchange and promissory notes are negotiable instruments, the possession of which may confer rights such as access to guaranteed title. The appropriate way of transferring the rights embodied in a negotiable instrument is by transferring the writings themselves (this is done by simple delivery of the instrument or by delivery and indorsement). It has been said that the rule that interests in negotiable instruments can be conferred only by possession of the instrument provides a simple mechanism of title assurance. Thus, possession of the writings, which are the indispensable embodiment of the liabilities of the parties, is essential to transfer and recognition of interests.[49]

It has been suggested, however, that the attributes of easy informal transferability (by simple delivery or by delivery and indorsement) which the market practice attached to negotiable instruments, was a response to the needs of the merchants of an earlier era. The ability to record transactions by computerised electronic means has to a large extent overtaken this need.[50]

## Assessment

The Bills of Exchange Act restricts competition by imposing compliance costs on business and other investors through the requirements in the Act for writing and signatures, which require participants to incur significant costs in producing, trading and settling the instruments in paper form. These costs, in turn, make bill finance less

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48 Australian Financial Markets Association & Securities Industry Research Centre of Asia-Pacific, *Australian Financial Markets Report 2001 (AFMR) An AFMA-SIRCA Joint Study,* 17 October 2001 [Online]. http://www.afma.com.au/afmr/index.html (Accessed 24 May 2002).

49 JS Rogers, 'Negotiability as a system of title recognition', *Ohio State Law Journal*, 1987, vol. 48, pp. 197-224.

50 *Everett & McCracken's Banking and Financial Institutions Law*, 5th edn, by Sheelagh McCracken, LAWBOOK CO., Sydney, 2001, p. 196.

competitive with other sources of finance, and also make bill finance uneconomical for lenders, thus restricting the availability of bill finance to small business.

Nonetheless, the Working Group is of the view that the net benefits of the legislation as a whole outweigh the costs of the restrictions to competition imposed by the Act. This is because the objectives of the Bills of Exchange Act, of uniformity, certainty and efficiency, have allowed the Act to play an important role in the development of Australia's financial markets through the provision of legal certainty and a clear definition of operating parameters.

Submissions to the Review supported retaining the Bills of Exchange Act, but with amendments to allow for technical developments and changes in market practices to promote efficiency, and to provide scope for improvement in the cost-effectiveness of current arrangements. AFMA noted in its submission that this position is strongly supported by consistent feedback from its members (participants in the OTC markets).

# CHAPTER 6: THE BILLS OF EXCHANGE ACT — THE SCOPE FOR IMPROVEMENT

## 6.1 INTRODUCTION

The terms of reference of the Review required the Working party to identify alternatives to achieving the objectives of the Bills of Exchange Act, and to determine a preferred option, if any, in the light of competition policy objectives. In this chapter, both legislative and non-legislative options are identified and assessed.

This chapter also considers whether the Bills of Exchange Act should be extended to cover negotiable instruments other than bills of exchange and promissory notes, such as NCDs.

## 6.2 AMENDMENT OF THE BILLS OF EXCHANGE ACT

A majority of the submissions pointed to dematerialisation of bills of exchange and promissory notes as a way of eliminating or greatly reducing the costs involved in producing, trading and settling the securities in paper form.

One way of achieving this would be to amend the Bills of Exchange Act to provide for the creation, issue and transfer of title by electronic means of payment obligations with equivalent characteristics to bills of exchange and promissory notes. To realise this, the Act could provide legislative recognition for the creation of records of transfers of dematerialised securities with the attributes of negotiability under the operating rules of clearing and settlement facilities regulated under the *Corporations Act 2001* (Corporations Act), or, for example, under contractual arrangements between financial institutions and their customers.

The Working Group notes that Austraclear, the central depository to the wholesale money market and electronic recording system for electronic transfers of government and private sector debt securities, has already provided (under its operating rules) for

transfers amongst its participants of electronically recorded payment obligations with equivalent characteristics to bills of exchange and promissory notes.[51]

Options for amending the Bills of Exchange Act to achieve the objectives of the legislation through the dematerialisation of bills of exchange and promissory notes are discussed in subsequent chapters.

## Benefits of dematerialisation

In its submission to the Review, AFMA suggested that the following benefits should flow from amendments to the Bills of Exchange Act relating to the dematerialisation of bills of exchange, promissory notes and other negotiable instruments:

- Significantly reduced operating costs in processing bills of exchange and promissory note transactions.
- Greater operational effectiveness in processing bills of exchange and promissory note transactions by moving from a physical system to an electronic system.
- Reduced paper burden for business and greater market efficiency, by making instruments issued under the Act more administratively convenient (with fewer and less time-consuming operational steps) and also more competitive with alternative funding sources.
- Reduced operating costs and greater operational effectiveness may lead to an increase in the use of bills of exchange as a source of funding for small businesses and SMEs.
- Availability of a wider range of investment denomination and risk alternatives for investors (particularly those seeking to invest between $50,000 and $250,000) as a direct result of any increase in the use of bills of exchange as a source of funding for small businesses and SMEs.

The AFMA submission also argued that benefits stemming from lower operating costs and greater market efficiency, should flow through to the community as a whole in the form of finer pricing on short-term instruments in general, and hence lead to a lower cost of capital for borrowers.

ASCT maintained that there would be significant cost savings from dematerialisation for the drawer, noting that the benefits would be greater for SMEs than for the 'big end of town'. The submission noted that fees and charges for business banking and Treasury related products are more transparent than retail products, as they are mainly

51 See Appendix Two to the Report.

collected on a user pays principle. Therefore, cost savings to the banking sector, from customers opting to use electronic means, would be identifiable and the relevant savings could be passed onto customers.

The Working Group notes that the majority of submissions to the Review favoured dematerialisation as an alternative mechanism for achieving the objectives of the Bills of Exchange Act, by making the Act more flexible to allow greater scope for efficiencies in the short-term money market through eliminating or greatly reducing the costs involved in producing, trading and settling negotiable instruments in paper form.

## Issue

Should the Bills of Exchange Act be amended to provide for the dematerialisation of bills of exchange and promissory notes as an efficient means of reducing or eliminating the costs associated with handling these instruments in paper form, thereby reducing the scope for the Bills of Exchange Act to restrict competition?

## 6.3 ALTERNATIVE MEANS OF ACHIEVING THE ACT'S OBJECTIVES

Two possible approaches which could provide alternative means of achieving the Act's objectives (that is, uniformity as to the law relating to bills of exchange in Australia, legal certainty as to the nature of bills of exchange and promissory notes as negotiable instruments, and efficiency in the market place through reliance on the concept of negotiability), are:

- private legal arrangements established in accordance with industry standards; and
- private contractual arrangements of a proprietary computer system of the kind established by Austraclear.[52]

### Industry standards

Adoption by participants in the short-term money market of private legal arrangements taking the form of specific contractual terms could achieve negotiability for particular financial transactions in accordance with industry standards.

52 The central depository of the wholesale money market and electronic recording system for electronic transfers of government and private sector debt securities (see Appendix Two to the Report).

However, in the absence of legislation, the confirmation of particular contracts or arrangements as having negotiable status is usually determined by the courts. It is not certain that transactions undertaken in accordance with industry standards would have negotiable status in the absence of an underpinning statute or a court's determination.

### Private contractual arrangements

An alternative mechanism to reliance on the Bills of Exchange Act would be private contractual arrangements of the kind established by Austraclear[53] under its rules and regulations. These provide for the creation, recording and transfer by electronic means of payment obligations with equivalent characteristics to negotiable instruments.

However, direct access to such contractual arrangements is limited to the members of such proprietary computer systems or those who agree to be made subject to their terms and conditions. Under the terms of the Bills of Exchange Act, any person may issue, transfer, buy or sell a bill of exchange or promissory note, subject to the usual limitations as to capacity to contract.

## 6.4 COSTS AND BENEFITS OF ALTERNATIVE ARRANGEMENTS

Reliance on private arrangements undertaken pursuant to industry standards could result in higher overall costs for business and investors generally, compared to compliance with the Bills of Exchange Act. This is because of the possibility that such arrangements would need to comply with State legislative requirements relating to assignments of choses in action.

Under state property laws, generally speaking, debts and other choses in action are assignable by law, provided (i) the assignment is absolute and not merely by way of charge; (ii) it is in writing; and (iii) express notice is given in writing to the debtor, [54] although the rigidity of certain of these formalities, for example, requirements relating to writing and signatures, has in some cases been alleviated by state electronic transactions legislation.[55] However, a particular advantage of the Bills of Exchange Act is that requirements as to the giving of notice, whether required to be in writing or

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53 See Appendix Two to the Report.

54 See WS Weerasooria, *Banking Law and the Financial System in Australia*, 5th edn, Butterworths, Sydney, 2000, p. 115.

55 *Electronic Transactions Act 2000* (NSW); *Electronic Transactions (Victoria) Act 2000*. However, the NSW *Electronic Transactions Regulation 2001* exempts section 23C of the *Conveyancing Act 1919* from section 7(1) and Division 2 of Part 2 of the *Electronic Transactions Act 2000* (NSW). Section 23C requires an assignment of a presently existing equitable chose in action to be in writing and signed by the assignor or his or her agent.

otherwise, imposed by state property laws in relation to the assignment of choses in action, are not imposed by the Bills of Exchange Act.

## 6.5 Assessment

It is not clear to the Working Group that a non-legislative approach, such as the adoption of industry standards, would provide a reliable and long-term basis for meeting the objectives of the legislation of uniformity, legal certainty as to negotiability, and efficiency in reliance on the guaranteed title concept of negotiability. For example, the prospect could arise that if in reliance on these alternative mechanisms, the Commonwealth were to 'vacate the field' of bills of exchange and promissory notes by repealing the Bills of Exchange Act, uncertainty arising from lack of uniformity in the law relating to bills of exchange could provide a real threat to the integrity of the financial markets. Arguably then, it is in the interests of the public and the economy in general to retain uniformity and certainty throughout Australia with respect to the law relating to bills of exchange and promissory notes.

As to the second non-legislative alternative discussed above, the Working Group notes that mechanisms for creating and transferring payment obligations with equivalent characteristics to negotiable instruments, pursuant to the contractual arrangements of proprietary computer systems, rely on market usage and practice to confirm their negotiable status. Moreover, the benefits of such closed systems are usually limited to the members of the proprietary system.

In the view of the Working Group, non-legislative approaches (such as industry standards and private contractual arrangements) would not provide an adequate basis for meeting the objectives of the legislation.

## 6.6 Inclusion of other short-term money market instruments in the Bills of Exchange Act

The terms of reference of the Review call for the Working Group to examine, in the light of technological advances permitting the transfer of money market instruments by electronic means in screen-based or book-entry depository systems, the issue of whether the Bills of Exchange Act should be extended to cover negotiable instruments other than bills of exchange and promissory notes, such as NCDs[56], forward rate notes

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56 A certificate of deposit is an instrument issued by a bank, which records the receipt of money on deposit and an undertaking to repay it with interest.

(FRNs), semi-government securities or Commonwealth Government securities such as T-Notes, perpetual notes[57] and debt instruments issued by trustees.

Submissions received from market participants including AFMA, ASCT and ATOA called for the scope of the Bills of Exchange Act to be broadened to include NCDs and Commonwealth Government securities such as T-Notes, because of the benefits of legal certainty provided by the Act. ATOA also suggested that FRNs and semi-government securities should be covered by the Bills of Exchange Act.

AFMA noted that there is a significant body of support for widening the Bills of Exchange Act to accommodate perpetual notes and debt instruments issued by trustees.

## Restriction

Generally speaking, the Bills of Exchange Act applies to bills of exchange and promissory notes, but not to other money market instruments.

NCDs (as opposed to transferable certificates of deposit[58]) are financial instruments containing evidence of a prior agreement between a depositor and a bank, that the latter will make payment to the holder of the instrument on stated terms. They are treated as negotiable instruments and accepted as such by financial institutions (in its submission to the Review, the LCA noted that there is doubt whether an NCD is a 'negotiable instrument'). As a matter of market practice, however, NCDs are not required to be evidenced in the form of a physical instrument. NCDs are traded in the secondary market alongside promissory notes.

NCDs are not expressly covered by the Bills of Exchange Act. NCDs are not bills of exchange, since they do not embody an order to pay but merely contain or evidence a promise of payment. Equally, they may not fall within the definition of a promissory note under the Bills of Exchange Act, where the terms of their issue import conditions and uncertainties which would take them outside the statutory definition. However, Weaver and Craigie examine various examples of NCDs currently used in Australia and suggest that there is little doubt that the courts would hold these instruments to be fully negotiable.[59]

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57 A perpetual note is an FRN without a set maturity date and having an even interest stream: see Edna Carew, *The Language of Money 3*, Allen & Unwin, Sydney, 1996.

58 According to GA Weaver & CR Craigie, *The Law relating to Banker and Customer in Australia*, The LBC Information Services, Sydney, 1990, Looseleaf, p. 1227, transferable certificates of deposit, as distinct from negotiable certificates of deposit, are registered in the name of the depositor and are transferable by an instrument of transfer in much the same way as company debentures and unsecured notes.

59 Weaver & Craigie, pp. 1224-5.

Where an NCD contains an unconditional promise to pay a sum certain,[60] it would seem to be a promissory note within the meaning of section 89 of the Bills of Exchange Act. Arguably, even if it is not a promissory note as defined in the Act, such an NCD is so similar to a promissory note as to be able to be regulated by the Commonwealth, pursuant to section 51(xvi) of the Constitution.[61]

T-Notes are issued under the CIS Act by the Commonwealth Government to meet its cash management requirements. They are characterised as discount securities in the context of the short-term money market. Historically, T-Notes, or to be more precise, the receipts for T-Notes, were regarded by custom and usage as negotiable instruments.

With the exception of a small number of mainly long-term bonds in paper form (which are transferred by completing a Transfer and Acceptance Form at the RBA Registry in accordance with the CIS Act), T-Notes are now transferred electronically, pursuant to the operating rules of Austraclear. Until February 2002, rights to T-Notes were transferred through the RITS system.[62] The RITS and Austraclear systems are confined to the professional, or wholesale, end of the market.

According to AFMA, NCDs and T-Notes are both regarded as negotiable instruments by the financial markets because of their operational similarities (for example, issue, volumes, denominations, high issuer credit standing). In addition, the professional short-term money market treats bills, promissory notes, NCDs and T-Notes as interchangeable. For example, a bank managing its liquidity requirements but not having a bill in its portfolio to sell which would match those liquidity requirements, might issue a NCD instead. The ASCT submission also pointed out that pricing of the NCDs and the bank accepted bills of a particular bank in the primary and secondary markets is identical. Although the market may treat NCDs and T-Notes as negotiable instruments, the market does not regard FRNs and semi-government securities as negotiable.

AFMA noted in its submission to the Review that provisions in the Act which limit its application to a wider range of financial instruments are the requirements that promissory notes issued under it must be: unconditional, payable on demand or at a fixed or determinable future time, and there must be a sum certain. Examples of

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60 See for example, the certificate set out in Weaver & Craigie, p. 1225.

61 The Working Group is advised that the Commonwealth does not have a general power to legislate with respect to negotiable instruments in general. The subject matter of the Commonwealth's power under section 51(xvi) is bills of exchange and promissory notes, and not negotiable instruments generally. However, what is a bill of exchange or promissory note for constitutional purposes is not fixed at what were bills and notes in 1900. The Commonwealth's power 'with respect to' bills of exchange and promissory notes probably extends to regulating instruments which are similar to bills and notes by providing that such instruments are to be treated as bills or notes. This includes instruments such as certificates of deposit. The same cannot be said of FRNs and semi-government securities.

62 See SFE News [Online]. http://www.sfe.com.au/Content/news/MediaReleases/2002/mr_20020225_01.htm (Accessed 12 March 2002).

products currently in use in financial markets which do not satisfy these requirements, and hence do not come under the Bill of Exchange Act, are:

- perpetual notes (the debt is not payable at a fixed or determinable future time); and
- debt instruments issued by trustees (the trustee's liability is not usually unconditional, rather it is usually limited to its right of indemnity from the assets of the relevant trust).

AFMA considered that there would be advantages in providing legal certainty and flexibility to issue smaller security denominations without having to issue a prospectus for these instruments. However, AFMA indicated that it did not consider this should be achieved by simply widening the definition of a promissory note[63] under the Bills of Exchange Act (or an overriding Act), as to do so would detract from the current clear definition of instruments issued under the Bills of Exchange Act and the well established markets for them. However, AFMA considered that this would not be a problem in the case of T-Notes and NCDs, as they are already clearly defined by well established market practice.

## Costs and benefits of the restriction

The Bills of Exchange Act limits recognition of financial instruments to bills of exchange and promissory notes. Other financial instruments, such as NCDs and T-notes, which are treated as negotiable instruments by the market, are not included within the scope of the Bills of Exchange Act.

AFMA submitted that the inclusion of NCDs and T-Notes under the Bills of Exchange Act would be beneficial from the perspective of grouping together what are in practice negotiable instruments with similar operational characteristics and supporting them with the Act's legal certainty (that is, statutory confirmation of negotiable status) and definition. However, AFMA noted that the primary and secondary markets for NCDs and T-Notes currently function very effectively and their potential inclusion in the Bills of Exchange Act would relate more to consistency of legal treatment of similar instruments, rather than specific enhancements to these markets.

With regard to other financial instruments such as perpetual notes and debt instruments issued by trustees, as the current provisions of the Bills of Exchange Act provide clear definitions for the instruments issued under the Act, if the scope of the Act was widened to encompass such instruments, this could detract from these clear definitions, and the well established markets for them. AFMA considered that in view of the

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63 Promissory notes with a face value of at least $50,000 are excluded from the definition of 'debenture' in section 9 of the Corporations Act and consequently are excluded from the definition of 'securities' in subsection 700(1) in Chapter 6D of the Corporations Act (and hence are not subject to the fundraising provisions of that Act).

relatively low potential issuance volumes and the risk that they may have a detrimental impact on the markets for other instruments, the Bills of Exchange Act should not be amended to accommodate perpetual notes and debt instruments issued by trustees.

## Possible scope for improvement

While the Working Group sees scope for the inclusion of NCDs under the Bills of Exchange Act, given their treatment as negotiable instruments by the market and their potential for inclusion within the constitutional reach underpinning the definitions in the Act, the same argument does not apply to other short-term money market instruments such as semi-government securities, FRNs, perpetual notes or debt instrument issued by trustees.

The Working Group agrees with the AFMA submission that the Bills of Exchange Act should not be altered to include financial instruments such as perpetual notes and debt instruments issued by trustees.

However, the Working Group considers that NCDs should be included in the scope of the Bills of Exchange Act, as this would allow the instruments to benefit from the Act's certainty. The Working Group sees merit in specifically including NCDs under the Bills of Exchange Act, together with the two negotiable instruments already governed by the Act, to allow these paper-based instruments to benefit from amendments to the Act to enhance the efficiency of the market by taking account of technological advances permitting screen-based depository systems to clear and settle electronic securities.

With regard to technological developments permitting the transfer of T-Notes by electronic means, the Working Group notes that the CIS Act has been amended[64] to provide for the electronic creation, recording and transfer of ownership of Commonwealth Government securities (including T-Notes). Accordingly, the Working Group considers that the legal nature of T-Notes should continue to be determined under the CIS Act where the security is grouped together with the other Commonwealth Government securities, as statutorily-created debt securities of a non-negotiable nature.

# Issue

Should negotiable certificates of deposit (NCDs) be included within the scope of the

64 The *Commonwealth Inscribed Stock Amendment Bill 2002* was passed by Parliament on 14 March 2002 and received the Royal Assent on 4 April 2002 (Act No 21 of 2002).

Bills of Exchange Act, in order to benefit from amendments to the Act to provide for the electronic creation, issue and transfer of the negotiable instruments governed by the Act?

# CHAPTER 7: IMPEDIMENTS IN THE BILLS OF EXCHANGE ACT TO DEMATERIALISATION — LEGAL ISSUES

## 7.1 INTRODUCTION

The terms of reference required the Working Group to identify the nature and impact of impediments in the Bills of Exchange Act to the development of electronic techniques for the issue of, trading in and transfer of ownership of negotiable instruments, including bills of exchange and promissory notes, and to determine whether the Bills of Exchange Act should recognise mechanisms for the creation, recording and transfer by electronic means of payment obligations with equivalent characteristics to negotiable instruments.

The terms of reference also required the Working Group to clarify and review the objectives of the Bills of Exchange Act in light of continuing technological developments in electronic trading, clearing and settlement of money market securities.

## 7.2 NATURE OF IMPEDIMENTS TO A BILL OF EXCHANGE OR PROMISSORY NOTE IN ELECTRONIC FORM

Certain form requirements relating to the documentary nature of bills of exchange and promissory notes are imposed by the Bills of Exchange Act itself, for example, the requirements for writing and signatures. Further, certain other concepts pertaining to bills of exchange and promissory notes such as the concepts of 'delivery' and 'possession', although not necessarily expressly set out in the legislation, are also bound up with the nature of the instruments as documents of title.

If the requirements in the Act relating to the written form of the instruments, together with concepts such as 'delivery' and 'possession', are intrinsic to the nature of bills of exchange and promissory notes as negotiable instruments, then these elements may

prove to be impediments to the development of electronic techniques for the issue of, trading in and transfer of ownership of bills of exchange and promissory notes.[65]

## Writing and signatures

To qualify as a bill of exchange, there must be an order in writing which is signed. Section 4 of the Bills of Exchange Act defines 'writing' as including 'print'. However, section 25 of the *Acts Interpretation Act* provides a broader definition of 'writing' which is to apply in any Commonwealth Act unless the contrary intention appears. The section defines 'writing' to include 'any mode of representing or reproducing words, figures, drawings or symbols in a visible form'.

If this definition of 'writing' is applicable, it could be argued that a bill of exchange may be expressed in an electronic form so long as it is visible, or may be rendered visible by a computer. However, it has been suggested that the narrower definition of 'writing' in the Bills of Exchange Act may indicate sufficient contrary intention to oust the definition of 'writing' in the *Acts Interpretation Act*. On balance, the Working Group considers that the narrower definition in the Bills of Exchange Act applies (this interpretation inhibits the development of electronic bills if relying on the existing provisions of the Act).

However, a bill of exchange is not only required to be 'in writing', it must also be 'signed' by the person giving it and by the acceptor/drawee[66] and, if it is indorsed, the indorsement must be written on the bill and signed by the indorser.[67] Section 28 of the Bills of Exchange Act provides that a person is not liable as drawer, indorser or acceptor of a bill if the person has not signed it as such. Thus, the signatures of the drawer, acceptor and indorsers are necessary, not only for the signed instrument to qualify as a bill of exchange but also to determine the liabilities of the parties signing in those capacities.

While it is arguable that a computer system could provide for individual identification of a kind sufficient to comply with authorities such as *Moreton v Copeland*,[68] namely, that a signature is 'any mark which identifies it as the act of a party', it is doubtful that an identification of a 'document' in such a way would be found to be a signature for the purposes of the Bills of Exchange Act in its present form.

In addition to the requirements for writing and signatures in the Bills of Exchange Act, there are other statutory requirements, such as the definitions of 'bearer', 'delivery' and 'holder' in section 4, and the provisions dealing with forgeries of bills, altered

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65 The following comments apply, generally speaking, to both bills of exchange and promissory notes.

66 Bills of Exchange Act, paragraph 22(2)(a).

67 Bills of Exchange Act, paragraph 37(a).

68 (1885) 16 C.B. 517 at 535.

bills, lost or destroyed bills and inchoate instruments, which contemplate the documentary form of bills of exchange and promissory notes.

## Delivery and possession

The concepts of 'delivery' and 'possession' are also bound up with the documentary nature of bills of exchange and promissory notes. A bill of exchange or promissory note is a document of title, the possession of which may confer rights. The rightful possessor of the document can transfer his or her rights to another simply by delivering the document to the other person, in the case of a bearer bill, and in other cases, by delivery and indorsement of the document. In the case of bills and notes, 'delivery' means transfer of possession, actual or constructive, from one person to another. Sections 36 and 37 of the Bills of Exchange Act provide for transfer by delivery, and transfer by delivery together with indorsement, respectively.

Possession of the document of title is necessary before a holder can transfer title to the instrument. It has been suggested that property is always with the holder, or the person in possession, and that for this reason, a negotiable instrument must be capable of possession. Indeed, it has been argued that if it were incapable of possession, the negotiable instrument could not confer upon its possessor (the holder) the status of a 'holder in due course'. [69] The 'holder in due course' of a negotiable instrument enjoys a favoured legal position as a bona fide purchaser for value, who can take and enforce negotiable instruments free from most claims and defences. The status of the 'holder in due course' is confirmed by section 43 of the Bills of Exchange Act, which provides for transfer of title free from previous defects.

This characteristic of a negotiable instrument, that it is transferable so as to give the holder a 'guaranteed title' to the underlying obligation, is what makes the instrument *negotiable* rather than merely *transferable*. As negotiable instruments, bills of exchange and promissory notes differ from other contracts in that they are negotiable, not merely transferable. In contrast to the concept of 'transferability', the essence of 'negotiability' is the ability of the bona fide purchaser to acquire a better title to the instrument than that enjoyed by his or her vendor. The concept of 'transferability' denotes the legally recognised right to assign whatever title one holder has in an article to another holder and the necessity of giving notice of the transfer to the original debtor.[70]

It was because of these limitations that merchants evolved the bill of exchange with the attributes of easy transfer between trading parties (that is, by simple delivery or delivery with an indorsement, and no requirements for notice to be given to previous debtors), together with transfer of a title free from the defects of previous parties.

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69 See Joanna Benjamin, *The Law of Global Custody,* Butterworths, London, 1996, p. 18.

70 A second meaning of 'transferability' (as opposed to 'negotiability') is the sense of being transferable to all the world.

However, it has been suggested that with the advent of electronic means of dealing, it may be that the first of these attributes (that is, delivery) is no longer appropriate, and that the expectations of market participants would be best served by a re-appraisal of the mode of transfer of negotiable instruments to take account of electronic dealings as practised in the market. [71]

The form requirements of the Bills of Exchange Act and the related concepts of 'delivery' and 'possession', on the face of it, have the potential to impede the development of electronic techniques for the issue of, trading in and transfer of ownership of bills of exchange and promissory notes. This is so, particularly if these elements are seen as essential to the nature of bills of exchange and promissory notes as negotiable instruments and to the transfer of the rights and obligations of the parties to the instruments. Unless these impediments can be overcome, they may prevent the replication of bills of exchange and promissory notes in electronic form.

## 7.3 IMPACT OF IMPEDIMENTS ON THE DEVELOPMENT OF ELECTRONIC TECHNIQUES IN RELATION TO BILLS OF EXCHANGE AND PROMISSORY NOTES

In its submission to the Review, the LCA suggested that consideration should be given to whether 'possession' and the related concepts of 'delivery', 'presentment', 'bearer' and 'holder' could be reformulated for electronic bills and notes without upsetting the existing certainty for paper-based documents. In examining various approaches to facilitating the issue, trading and transfer of ownership of bills of exchange and promissory notes in electronic form,[72] there are a number of issues to be considered.

If the paper form of a bill of exchange is an essential incident of its negotiability, a key issue is whether the underlying policy reasons for requiring a bill of exchange to be in paper form can be satisfied by the use of an electronic document. Thus, the question arises whether, in order to be able to transfer the rights and liabilities encapsulated in the negotiable instrument, including title free from previous defects, a unique document of title capable of possession is essential.

To obtain or transfer the right or title incorporated in a negotiable instrument, it is necessary to obtain or transfer the ownership of the original document. The original document is unique because it is prima facie evidence of ownership of the right or title bound up in the negotiable instrument. Thus, it would appear that a unique document

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71 D Everett & S McCracken, *Banking and Financial Institutions Law*, 4th edn, LBC Information Services, Sydney, 1997, p. 199.

72 The issue of extending the scope of the Bills of Exchange Act to include NCDs, for example, to benefit from amendments to provide for electronic creation, issue and transfer of the negotiable instruments governed by the Act, is discussed in Chapter 5 of the Report.

capable of possession is necessary to transfer the rights and liabilities bound up in the negotiable instrument. The question then is whether such a unique document of title can be replicated by the use of electronic documents.

Looking to overseas experience, it appears that some take the view that it may not be possible to create a unique electronic record (since most electronic records can be perfectly copied, there is no discernible difference between the original and a copy). This creates significant problems for documents or situations where an original is required, such as with negotiable instruments and certain documents of title.[73]

The National Conference of Commissioners on Uniform State Laws (NCCUSL), Uniform Electronic Transactions Act Task Force on State Law Exclusions Report of September 1998 noted that:

> At this point, it is not clear whether or not it will be possible to have a true negotiable instrument in an electronic environment . . . In the paper world, two of the hallmarks of negotiability have been delivery and possession of the original document and transfer by indorsement on the document itself. In the electronic world, it does not appear that either of these two attributes has been adapted into practice as of this date, though members of the Task Force are aware of new technologies in development that may be capable of doing so.[74]

The UNCITRAL (United Nations Commission on International Trade Law) Secretariat has suggested that:

> There is generally no statutory means in place by which commercial parties, through the exchange of electronic messages, can validly transfer legal rights in the same manner possible with paper documents. That conclusion is also essentially valid for rights represented by negotiable instruments such as bills of exchange or promissory notes. Moreover, the legal regime of negotiable instruments is in essence based on the technique of a tangible original paper document, susceptible to immediate visual verification on the spot. In the present state of legislation, negotiability cannot be divorced from the physical possession of the original paper document.
>
> The development of electronic equivalents to documents of title and negotiable instruments would therefore require the development of systems by which transactions could actually take place using electronic means of communication. That result could be achieved through a registry system, where transactions would be recorded and managed through a central authority, or through a technical device based on cryptography that ensures the singularity of the

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73 Commission on Electronic Commerce and Crime. *Illinois Electronic Commerce Security Act with Comments*, Final Version, 16 January 1998. www.mbc.com (Accessed 28 May 2002).

74 National Conference of Commissioners on Uniform State Laws. *Uniform Electronic Transactions Act Task Force on State Law Exclusions Report*, 21 September 1998. http://www.webcom.com/legaled/ETAForum/docs/report4.html (Accessed 28 May 2002).

> relevant data message. In the case of transactions that would have used transferable or quasi-negotiable documents to transfer rights that were intended to be exclusive, either the registry system or the technical device would need to provide a reasonable guarantee as to the singularity and the authenticity of the transmitted data.[75]

Thus, it appears that a unique document of title capable of possession is essential to the transfer of the rights and liabilities encapsulated in a negotiable instrument, including title free of defects, and furthermore, a unique document may not be able to be replicated by the use of electronic documents.

However, these issues may be resolved by taking a different approach from confining the issues to be resolved to the questions of whether the paper form is an essential incident of negotiability (title free of defects) and whether negotiability can be replicated in electronic form. As the NCCUSL Task Force Report noted:

> It should be stressed that the issue here is not the existence of an electronic payment instrument; methods of electronic payment already exist, and no doubt new methods will be developed. Rather*,* the question is one of adapting the defining characteristics of negotiability to an electronic record.[76]

Arguably, the paper form required by the Bills of Exchange Act, and the related concepts of 'delivery' and 'possession', are not essential elements of negotiability unless negotiability cannot exist without them. Taking into account the chief characteristics of bills of exchange and promissory notes as negotiable instruments, namely the paper form of the instrument (possession of which equals ownership), together with the key attribute enjoyed by these instruments, namely negotiability (that is, title free of defects), two points may be made:

- bills of exchange have of necessity taken the form of pieces of paper because until recently electronic contracts and electronic securities were not technologically possible; and

- it is the nature of the particular contractual terms which constitute them a bill of exchange, and not the form of the contract.[77]

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75 See note prepared for the thirty-ninth session (March 2002) of the Working Group on Electronic Commerce (Working Group IV) by the United Nations Commission on International Trade Law Secretariat, A/CN.9/WG.IV/WP.94, 14 February 2002, http://www.uncitral.org/en-index.htm (Accessed 4 June 2002), referring to an earlier note A/CN.9/WG.IV/WP.90, 20 December 2000.

76 National Conference of Commissioners on Uniform State Laws. *Uniform Electronic Transactions Act Task Force on State Law Exclusions Report,* 21 September 1998. http://www.webcom.com/legaled/ETAForum/docs/report4.html (Accessed 28 May 2002).

77 Arguably, the form requirement is not an essential element of a bill of exchange or promissory note; rather it is the rights and obligations arising between the parties which constitute the bill or note as a negotiable instrument or security.

Thus, there is no reason why the substance of a bill of exchange could not be created electronically, as long as the electronic security had attached to it the characteristic of negotiability (that is, title free of defects). If the paper form is not essential to the formulation in contractual terms of the key characteristic of the negotiable instrument (title free of defects), then the issue becomes one of adapting the particular defining characteristic of negotiability to an electronic record.

## 7.4 ADAPTING THE ATTRIBUTES OF NEGOTIABILITY TO ELECTRONIC SECURITIES

For electronic securities to be negotiable, the parties involved would need to possess the same rights and obligations as the parties to transactions in the corresponding paper securities. The capacity to transfer an electronic record would depend on access to a computer system creating and recording the electronic securities. In the case of paper bills of exchange, delivery is essential and means transfer of possession, actual or constructive, from one person to another. In the case of an electronic bill of exchange, provision could be made in contractual terms for the transfer of the electronic record and the rights and obligations created by it (including the right to a title free from defects).

Evidentiary provisions with respect to the substance of the electronic securities would be required to establish the liabilities attaching thereto, together with provision for electronic authentication to establish the identity of the relevant parties to the electronic transaction and to determine their intention to be bound by the electronic record.[78] In the absence of any law preventing this, there is no reason why contractual

78 The method of authentication used would need to be reliable, but at the same time, appropriate to the information technology requirements of the particular computer system used to record the contractual arrangement. One element of a computerised business system which supports the use of embodied rights systems is cryptography. What cryptography can establish, almost irrefutably, is the evidence necessary to establish chain of title to ownership rights embodied in electronic records. Control of ownership rights embodied in an electronic record as the analogue of possession of a negotiable instrument or document cannot be guaranteed though the use of cryptography alone, but rather it can only be guaranteed if the electronic record is maintained under conditions of controlled access within a secure environment in which cryptography is used for such functions as establishing chain of title to the record or the integrity of the electronic record. See American Bar Association (ABA) Science and Technology Section, Electronic Commerce Division, Committee on Electronic Commercial Payments and ABA Business Law Section, Cyberspace Law Committee, Working Group on Negotiability and Electronic Commerce (Task Force on Transferability of Electronic Assets). *Joint Report to the UETA Drafting Committee on the UETA Provisions governing Transferable Records, January 25, 1999 draft.* http://www.abanet.org/buslaw/cyber/ecommerce/groups.html (Accessed 3 June 2002).

terms of which the only proof is an electronic record could not be enforced where proof of terms could be given.[79]

On the basis of the above analysis, it appears that it may be possible for the attributes of negotiability, rather than the form of negotiable instruments, to be adapted, though not necessarily replicated, by electronic means. In this regard, theoretical and practical consideration has already been given, both in Australia[80] and in overseas jurisdictions,[81] to the provision of electronic records used as substitutes for transactions normally requiring a unique original document when conducted on paper. This relies on electronic records, utilised in a manner that does not require a unique original electronic document. They include electronic transactions where the legal validity of the electronic record is not established solely by reference to possession of the document, but by reference to a central data base or repository which tracks the validity of ownership, and the authorising of rules of particular computer systems which replicate the benefits of negotiability by contractual means.

For example, it has been suggested that a business information system which controls access to records and also controls access to a central registry of ownership interests could guarantee a degree of control which effectively mimics or surpasses the control achieved through possession of a paper negotiable instrument or document of title. By relying on both an electronic record which represents the commercial asset and a secure environment to prevent unauthorised copying, an electronic embodied rights system could track ownership of non–fungible assets more efficiently and more accurately than an account-based system (for example, a credit card system). It is thus considered by some that advances in technology now permit embodied rights systems of managing ownership of commercial assets to be located within computerised business systems.[82]

From an examination of the various approaches to dematerialising negotiable instruments or adapting the characteristics of negotiability to electronically recorded

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79 The enactment of evidentiary provisions applicable in all proceedings in relation to electronic records of dematerialised bills of exchange and promissory notes would be desirable.

80 See Appendix Two to the Report, which includes reference to dematerialised securities under the Austraclear System.

81 The relevant international experience is summarised in Appendix Three to the Report.

82 It has been suggested that unlike traditional doctrines of negotiability, which define the requirements of negotiable instruments or documents exclusively with regard to the piece of paper which embodies the rights, the corresponding definition of an electronic instrument or document would need to specify not just characteristics of the electronic record but also the functional attributes of the information system within which the record is stored, because only within a secure environment can potential transferees be guaranteed that they are receiving the authoritative copy of an electronic record. See American Bar Association (ABA) Science and Technology Section, Electronic Commerce Division, Committee on Electronic Commercial Payments and ABA Business Law Section, Cyberspace Law Committee, Working Group on Negotiability and Electronic Commerce (Task Force on Transferability of Electronic Assets). *Joint Report to the UETA Drafting Committee on the UETA Provisions governing Transferable Records, January 25, 1999 draft.* http://www.abanet.org/buslaw/cyber/ecommerce/groups.html (Accessed 3 June 2002).

securities, which have been developed or considered in Australia and in overseas jurisdictions, it is clear that, generally speaking, there is scope to legislate for electronic records which would be negotiable instruments if they were brought into existence in paper form.

However, the Working Group considers that it may not be possible for Australian legislation to achieve consistency with international developments in this area, especially given the differences in overseas approaches to achieving electronic negotiable securities (these differ markedly from jurisdiction to jurisdiction and even within jurisdictions). Nonetheless, the Working Group considers that there are elements in overseas approaches, which may usefully be adopted in developing options for dematerialising bills of exchange within the Australian legal and constitutional framework.

Having identified the nature and impact of impediments in the Bills of Exchange Act on the development of electronic techniques for the issue of, trading in and transfer of ownership of negotiable instruments, including bills of exchange and promissory notes, the Working Group considers that the Bills of Exchange Act should be amended to recognise mechanisms for the creation, recording and transfer by electronic means of payment obligations with equivalent characteristics to negotiable instruments — in other words, to provide for the dematerialisation of bills of exchange and promissory notes and related negotiable instruments.

Options for amending the Bills of Exchange Act to provide for statutory recognition of negotiable instruments in electronic form are discussed Chapter 9.

# CHAPTER 8: OTHER ISSUES RAISED BY THE TERMS OF REFERENCE AND SUBMISSIONS TO THE REVIEW

## 8.1 INTRODUCTION

Earlier chapters focussed on those provisions of the Bills of Exchange Act which have been identified as imposing restrictions on competition or significant compliance costs.

Chapter 8 discusses a number of other issues raised by the terms of reference, which the Working Group considers merit attention as specific, stand-alone issues, rather than as issues to be addressed in the broader context of restrictions on competition (discussed in Chapter 5 of the report), or in the particular context of legal impediments in the Bills of Exchange Act to the dematerialisation of negotiable instruments (discussed in Chapter 7 of the report). These issues include:

- retention of provisions in the Bills of Exchange Act relating to the paper form of bills of exchange and promissory notes;
- encumbrances over dematerialised negotiable securities under the Corporations Act;
- the impact of the revised debenture and prospectus provisions of the Corporations Act;
- Saturday as a non-business day; and
- modernisation of the Bills of Exchange Act generally.

## 8.2 RETAINING BILLS OF EXCHANGE AND PROMISSORY NOTES IN PAPER FORM

The Working Group considers that there may be a number of reasons for retaining the provisions in the Bills of Exchange Act relating to conventional bills of exchange and promissory notes, despite the fact that market pricing mechanisms might ultimately

determine the extent to which paper form bills of exchange and promissory notes remain viable.

The ASX submission queried whether negotiable instruments should be able to be held in either certificated or dematerialised form or whether efficiencies associated with electronic systems might ultimately require an eventual transition to dematerialisation.

The ASCT submission suggested that if bank bills and promissory notes were to become totally dematerialised, market participants who wanted physical delivery of the paper would most probably not be able to be accommodated, unless banks introduced registries (similar to finance company debenture registries) which tracked ownership of the securities.

According to the ASCT submission, a better solution would be for dematerialisation to be at the option of the drawer or investor, and to let the market decide whether or not delivery of physical paper continued or not. The submission suggested that an approach similar to CHESS would be appropriate, where the option to use CHESS rests with the investor and it is left to the market, namely the ASX and its members, to sell the benefits of the system.

The Working Group considers that while market pricing mechanisms might ultimately determine the extent to which paper form bills of exchange and promissory notes remain viable, the Bills of Exchange Act should facilitate the continued use of conventional bills of exchange and promissory notes by those investors or traders who require physical bills or notes because of legal requirements, other than the Bills of Exchange Act itself, or who prefer them for other reasons.

The Working Group considers that the provisions of the Bills of Exchange Act underlying the paper form of bills of exchange and promissory notes should be retained for use in circumstances such as those set out below.

- Trust deeds requiring paper bills of exchange and promissory notes.
- Delivery under deliverable bank accepted bill futures contracts.
- Use by import/export companies in international trade.
- The UNCITRAL Convention on International Bills of Exchange and International Promissory Notes.
- State and Territory legislation with references to bills of exchange and promissory notes.
- Convertibility between electronic and paper forms.
- Evidence law issues.

## Trust deeds requiring a physical bill or note

AMFA recommended that amendments be made to the Bills of Exchange Act to allow for electronic issuing, trading and transfer of instruments on the basis that physical instruments could still be produced and that there would be convertibility between physical and electronic instruments.

This would ensure that flexibility is maximised, for example, providing for fund managers who are bound by a trust deed that requires them to purchase conventional bills of exchange, such as funds managers or trustees supervising investments on behalf of religious organisations and other community groups.

## Delivery of physical bills under Sydney Futures Exchange contracts

Unlike most contracts traded on the SFE, bank accepted bill futures are deliverable contracts, with delivery occurring through Austraclear.[83] Until recently, only physical bills were eligible for delivery against bank accepted bill futures contracts. However, 'Electronic Bills of Exchange' or 'EBAs' and 'Electronic Certificates of Deposit' or 'ECDs' (as defined within the definition of 'Dematerialised Securities' in the regulations of the Austraclear System) are now also eligible for delivery against the SFE's bank accepted bill futures contracts.

The market by-laws of the SFE provide that if the buyer wants delivery of a physical bill of exchange or an NCD, the seller must arrange for a bill compatible with the Bills of Exchange Act, or an NCD, to be uplifted for delivery from the Austraclear System, in accordance with the procedure set out in Austraclear's regulations.

The Working Group considers that bills of exchange in paper form should continue to be available for such purposes as delivery under futures contracts.

## Use of bills of exchange and promissory notes in international trade

The Working Group understands that paper form bills of exchange and promissory notes are used in international trade[84] and will continue to be used for this purpose for

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83 See Appendix Two to the Report.

84 For further detail on bills of exchange in international trade, see David E Allan, *Trade financing – export transactions*, Chapter 15, in Mallesons Stephen Jaques, *Australian Finance Law*, 4th edn, LBC Information Services, 1999; and Trevor Thompson and Robert Bruce, *Trade Finance,* Chapter 15, in R Bruce, B McKern, I Pollard, & M Skully (eds), *Handbook of Australian Corporate Finance*, 5th edn, Butterworths, Sydney, 1997.

some time to come. Bills of exchange are used with other documentation such as bills of lading, collectively called documentary bills of exchange, and documentary letters of credit. The procedures regarding these documentary mechanisms are standardised and applied through adherence to the rules of the International Chamber of Commerce (ICC).

The Working Group considers that to the extent that paper-based bills of exchange continue to be used by international counterparties involved in trade with Australian importers and exporters, the provisions in the Bills of Exchange Act providing for the traditional paper form should be retained for both legal and commercial certainty reasons, especially where the domestic laws of Australia's trading partners continue to include conventional bills of exchange legislation based on the UK 1882 Act. The Working Group notes that one submission argued that it is difficult to see how changes to the legislation could be justified unless the suggested changes had the purpose of bringing Australia into line with international practices.

The LCA's submission expressed concern that the primary objective of the Bills of Exchange Act should remain unchanged, notwithstanding continuing technological developments, namely to facilitate commerce (both trade and finance) by means of a simple, secure and efficient payment mechanism. The LCA's submission also urged that consideration be given to the fact that bills of exchange are used in these two different contexts, namely, for international trade payments and as a means of financing in money markets, and that the Review should consider the possible benefits of differentiating between these two applications of bills of exchange.

The Working Group considers that for the time being at least, the continued availability of bills of exchange in both conventional and electronic forms may be a necessary consequence of the different contexts in which bills of exchange are utilised.

## UNCITRAL Convention on International Bills of Exchange and International Promissory Notes

Several submissions to the Review expressed concern that changes to Australian legislation to dematerialise bills of exchange and promissory notes should be made in the context of the need to harmonise the world's commercial laws, particularly in the light of UNCITRAL's work on, amongst other things, the Convention on International Bills of Exchange and International Promissory Notes.

### Australia's response to the Convention

The Office of International Law in the Attorney-General's Department has advised the Working Group regarding Australia's response to the Convention:

> In 1991 the Attorney-General's Department undertook broad ranging consultations with the States, the Territories and stakeholders from the legal and business sectors on whether Australia should adopt the UN Convention on International Bills of Exchange and International Promissory Notes 1988 (the 1988 Convention). Whilst there was some cautious support for accession, it was clear from the consultations that no one felt it was essential for the 1988 Convention to be adopted by Australia at that time. Accordingly, the Attorney-General's Department recommended to the then Attorney-General that active consideration of accession to the 1988 Convention be deferred until such time as more countries (particularly our major common law and civil law trading partners) have become party to the Convention or there is active interest within Australia to adhere to the Convention. Since then, little has changed. As at 8 August 2001, only Guinea, Honduras and Mexico have acceded to the Convention. Canada, the United States and the Russian Federation all signed the Convention more than ten years ago, in each case without further treaty action.[85] The prospects for the Convention entering into force are unlikely given that the Convention requires ten parties to enter into force and, as far as we are aware, no other countries are currently considering ratification.[86]

The Working Group understands that UNCITRAL has recently commenced work on legal barriers to the development of electronic commerce that might result from international trade law instruments, including international conventions.

As part of a survey of possible obstacles to electronic commerce in international instruments relating to international trade, the UNCITRAL Secretariat considered the UN Convention on International Bills of Exchange and International Promissory Notes in a Note prepared for the thirty-ninth Session (11-15 March 2002) of the UNCITRAL Working Group on Electronic Commerce. The Secretariat noted that in view of the particular nature of the issues raised by using electronic substitutes for negotiable instruments, it appears that a comprehensive new legal framework might be required in order to allow for the international use of data messages in lieu of paper-based negotiable instruments.

The UNCITRAL Secretariat submitted that developing such a comprehensive legal framework might go beyond the scope of the UNCITRAL's efforts to remove obstacles to electronic commerce in existing international trade law instruments. The Secretariat further submitted that an analysis of the specific requirements for such a comprehensive legal framework might best be undertaken in the course of

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85 International Trade Law Branch, United Nations, Office of Legal Affairs, *Status of Conventions and Model Laws*. http://www.uncitral.org/en-index.htm 28 March 2002. (Accessed 29 May 2002).

86 The Office of International Law, Attorney-General's Department.

UNCITRAL's consideration of wider legal issues relating to the transfer of rights, in particular, rights in tangible goods, by electronic means.[87]

The Working Group also notes that several UNCITRAL member States have adopted the UNCITRAL Model Law on Electronic Commerce as a basis for domestic economic commerce laws.[88]

## References to bills of exchange in State and Territory legislation

If the Bills of Exchange Act were to be amended to provide functional equivalence for electronic bills of exchange and promissory notes and the definitions of 'bill of exchange' or 'promissory note' expanded to encompass an electronic equivalent of the paper form, it may nonetheless be considered preferable to deal with references in State and Territory legislation to 'bills of exchange' and 'promissory notes' on a case by case basis.

As long as paper bills of exchange and promissory notes are kept alongside their electronic equivalents, users should be able to rely upon the notion that a reference in a State or Territory law to a bill of exchange or promissory note relates to the traditional form as well as the electronic form, although this may need to be expressly stated.

## Convertibility from the electronic form to a paper bill of exchange

One reason for retaining the provisions of the Bills of Exchange Act relating to the paper form of the instrument is to accommodate the need for the electronic form of a bill of exchange or a promissory note to be converted to the paper form.

Westpac Banking Corporation indicated that it envisages that the amendments to the Bills of Exchange Act would provide for a bill of exchange or a promissory note to be recorded electronically by the acceptor or issuer or their agent. However, where any subsequent party to the bill required the paper security to be created, the acceptor would be required to bring the paper security into existence.

AFMA recommended that amendments be made to the Bills of Exchange Act to allow for electronic issuing, trading and transfer of instruments on the basis that physical

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87 United Nations Commission on International Trade Law, Working Group on Electronic Commerce, A/CN.9/WG.IV/WP.94, 14 February 2002, http://www.uncitral.org/en-index.htm (Accessed 29 May 2002).

88 See Appendix Three to the Report.

instruments could still be produced and that there would be convertibility between physical and electronic instruments.

The Working Group considers that it may be useful and indeed necessary to retain the option of being able to convert 'electronic' bills of exchange into their paper equivalents for the following reasons:

- to emphasise the similarities in law between the paper-based security and the electronic equivalent;
- to cater for cases where the rules of a trusted record keeper or licensed clearing and settlement facility provided the capacity to convert an electronic record into the paper-based equivalent; and
- to facilitate the capacity for conversion of dematerialised securities for use in court actions in jurisdictions not recognising the electronic record for evidentiary purposes.

## Equivalence of dematerialised bills with paper bills

In its submission to the Review, the LCA identified a number of disadvantages if the electronic version was made subject to conceptually different regulation from traditional instruments, suggesting that this would:

- introduce a regulatory divergence and possible bias, hindering the maximisation of market efficiencies;
- undermine legal and commercial certainty, hence minimising the relevance of existing case law to electronic instruments; and
- inhibit the ability for bills, notes or other instruments to adopt hybrid electronic/paper forms, or to change form during their currency, which would reduce product flexibility.

The LCA's submission also queried whether a stored electronic copy of a negotiable instrument could be used where a physical bill or note had been lost or destroyed.

The Working Group considers that the option of being able to convert 'electronic' bills of exchange into their paper equivalent should be retained to emphasise the equivalence of the electronic form with the paper form. This would encourage the application of the legal principles governing the traditional form of the instrument to the electronic form, and would also avoid the creation of a separate, second class market in either form of the security.

The Working Group is also keen to ensure that parties to electronic negotiable instruments are entitled to proprietary rights in separate and distinct securities which are separately recorded as such.[89] Confirming the electronic form's equivalence with the paper form through the capacity to convert the electronic security to the paper form would protect the status of the electronic negotiable security as a non-fungible proprietary interest.

## Option to convert in rules of trusted record keeper

Some submissions considered that amendments to the Bills of Exchange Act should allow for the person recorded as the holder of an instrument in the records of a trusted record keeper to require a physical instrument to be produced and delivered to it by the custodian upon request.

The Working Group recognises that there may be a number of good reasons for giving consideration to the inclusion in the rules of the trusted record keeper of a requirement for a trusted record keeper, or a licensed clearing and settlement facility, of an option to convert 'electronic' bills of exchange into their paper equivalents in accordance with their rules, for example, to assist enforcement under current evidence laws (see below), or to attach the rights and obligations of non-member drawers or holders in relation to the electronic record to the security in the re-materialised form.

The Working Group therefore considers that for the sake of flexibility in the early stages of development of dematerialised negotiable securities, consideration should be given to the provision in the rules of record keepers for parties to such securities to be able to agree to the conversion of the security to paper form, as long as this could be accomplished in such a way that it was clear which form would determine the liabilities of the parties operating under the rules of the relevant record keeper.

Alternatively, the parties could agree that the dematerialised negotiable security would not be converted to the physical form without the express agreement of parties concerned, based on an agreed mutual understanding of the possible consequences of this action. For example, the relevant parties could agree that once a dematerialised negotiable security had been re-materialised in physical form, the paper form would have paramountcy over the rights and obligations in respect of the same security in dematerialised form. The agreement could include provisions for the discharge of the security in the re-materialised form.

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89 See Greg Hammond and Craig Wappett, 'Dematerialised and immobilised Securities', Chapter 7, in *Securities over Personal Property*, CC Wappett and DE Allan (eds), Butterworths, Sydney, 1999, p. 178. The authors point out that Austraclear physically segregates and allocates Paper Securities and maintains appropriate records allocating Non-Paper Securities so that a member of the Austraclear System has a proprietary interest in the relevant debt securities as well as contractual rights against Austraclear.

However, the Working Group notes that allowing dematerialised securities to continue to trade in paper form, once re-materialised in that form, could lead to uncertainty and possible unintended consequences for third party issuers of securities initially transferred amongst members of the computer system of a trusted record keeper or a clearing and settlement facility in dematerialised form. While the rules of the system could determine the rights and liabilities of the member parties involved (and the liabilities of non-member issuers as agreed between themselves and members), these rules would not be applicable to trades involving unknown parties, which occurred following the re-materialisation of the security.

On balance, the Working Group considers that the practice of allowing a security, once re-materialised, to continue to circulate freely in the market until maturity, amongst parties not bound by the rules of the trusted record keeper (with the ability of the one permutation to convert and re-convert to the other), should not be encouraged. The Working Group doubts that such a practice would be in the best interests of achieving legal and commercial certainty in the market.

While it acknowledges market practice may be the best way of determining these issues, the Working Group notes that these practices, generally speaking, would be difficult to implement and control and could reduce potential costs savings associated with dematerialisation.

### Issues

Are there circumstances in which dematerialised negotiable securities should be able to be re-materialised in accordance with the rules of trusted record keepers?

Should such dematerialised securities be able to circulate freely in the market until maturity in a re-materialised form amongst parties who are not members of the system recognising the security in its dematerialised form, and who are not subject to the rules of the trusted record keeper of the system?

## Evidence law issues

Currently, a number of provisions of the Commonwealth Evidence Act are relevant to the admissibility of electronic bills of exchange and promissory notes as evidence in legal proceedings in federal and Australian Capital Territory courts. New South Wales has enacted similar legislation, however, in other States and Territories, legislative provisions covering admission of electronic material are generally more limited.[90] The Working Group considers that if the Commonwealth legislates to provide for electronic

90 See also Lief Gamertsfelder, 'Electronic bills of exchange: will the current law recognise them?' *UNSW Law Journal*, vol. 21, no. 2, 1998, pp. 566-577.

bills of exchange, it would be undesirable to have different evidentiary provisions applying, depending on where proceedings are brought or other circumstances of particular litigation. Hence, irrespective of whether or not some States have more 'favourable' evidentiary laws than others, the Working Group considers that the particular evidence laws should be consistent and be determined by the Commonwealth.

Provisions of this kind would only deal with admissibility of electronic bills of exchange as evidence. The weight given to particular evidence must still be determined by the courts. Consequently, the integrity of the electronic record and the means for proving this would need to be assured for the securities to be enforceable.

One of the consequences of an instrument being negotiable is that a court action may be maintained on the basis of the document alone. However, the right to sue for the underlying obligation comes from possession of the document. This would seem to require that a document be printed and verified by signature, rather than verifiable by reference to computerised or other records.[91] However, Benjamin[92] notes that in the case of dematerialised securities, for example, in the UK Central Money Markets Office, the right of the investor to sue the issuer does not arise under an instrument, but is merely contractual.[93]

As previously noted, in the absence of any law preventing it, there seems no reason why contractual terms, of which the only record is an electronic one, cannot be enforced where proof of terms can be given. However, legislation providing for recognition of an electronic record of ownership of, and transfers of title to, electronic securities equivalent to a bill of exchange could serve to assist the holder of a security denoted by the electronic record to rely on that record as proof of the relevant rights and liabilities recorded therein as a basis for commencing a legal action.

The Working Group considers that until uniformity of evidence laws is achieved in relation to electronically recorded obligations mirroring bills of exchange and promissory notes, the enforceability of such records may depend on the jurisdiction in which the relevant action is contemplated. Thus, there may be a need to provide for conversion of a dematerialised negotiable security into its equivalent paper form in jurisdictions without evidence laws recognising the electronically recorded obligation.

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91 Tony Shea, 'Report on Negotiable Instruments' in Appendix A to *Banking Services: Law & Practice, Report by the Review Committee,* by RB Jack, CM 622, Her Majesty's Stationery Office, London, 1989. ('The Jack Committee Report'), p. 215.

92 Joanna Benjamin, *The Law of Global Custody,* Butterworths, London, 1996, p. 18.

93 The regulations of the Austraclear System currently make provision for dematerialised securities in that System to be enforced in the same manner as the equivalent physical securities by providing for the securities to be 'uplifted' in the manner prescribed in the Austraclear System's regulations.

## 8.3 ENCUMBRANCES OVER DEMATERIALISED SECURITIES UNDER THE CORPORATIONS ACT

### Submissions

The LCA, ABA and AFMA submissions called attention to the impact of the Part 2K.2 (Registration of Charges) provisions of the Corporations Act on security interests created in respect of electronic bills of exchange, noting that if such interests constituted a charge[94] under that Act, this would be a significant impediment to the efficiency of any proposed system for dematerialised negotiable instruments.

### Section 262 of the Corporations Act

Section 262 of the Corporations Act requires certain security interests to be registered with the Australian Securities and Investments Commission (ASIC). Security interests required to be registered include a charge on a negotiable instrument other than a 'marketable security'.[95] Charges that do not require registration include charges created in relation to a negotiable instrument by way of pledge, deposit, letter of hypothecation or trust receipt.[96]

Failure to register a registrable charge will mean that the charge is void against the liquidator in a winding up. However, the Working Group notes that while the fundamental purpose of the charges provisions of the Corporations Act is to protect lenders, the rationale for certain exclusions from the charges provisions is to facilitate

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94 A legal mortgage arises when there is a formal transfer of legal title to the secured property from the debtor, who is known as the mortgagor, to the creditor, who is known as the mortgagee. The mortgagor retains an equity of redemption in the property, and frequently retains possession and use of the property. Typically, a document exists which details the terms of the mortgage. Such terms will include, when the mortgage can be enforced, what powers the mortgagee will have and how the mortgage can be discharged.
An equitable mortgage arises where there is a transfer of title which is not recognised at common law but is recognised, and enforced, in equity. There are three instances when equitable mortgages occur: there may be a formal transfer of title to property recognised only in equity (equitable property); or if there has been an agreement to create a legal mortgage but the formal transfer of title has not taken place; or if there is an informal transfer of legal title. This typically arises when the mortgagor gives the mortgagee the means or power of creating a legal mortgage.
A charge, in contrast to a mortgage, does not involve any transfer of ownership from the chargor to the chargee. Instead, a charge operates by designating a fund or asset out of which the chargee is entitled to have his/her claim satisfied. The creation, discharge and terms of a charge are a matter for agreement between the parties.
As to mortgages and charges generally, see Gregory Burton, *Australian Financial Transactions Law*, Butterworths, Sydney, 1991, Chapter 11.

95 See paragraph 262(1)(j) of the Corporations Act.

96 See subsection 262(2) of the Corporations Act.

short-term financing arrangements. To require such charges to be registered would unduly hamper commerce.[97]

It is also said that a pledge of bearer securities or a pledge of paper securities held in the Austraclear System would not ordinarily require registration.[98]

## Security interests in the Austraclear System

Members of the Austraclear System grant security interests to each other over securities lodged or recorded in the System. The Austraclear regulations do not provide for the registration of security interests created by a member over debt securities held by it in the Austraclear System, nor do they provide a procedure for the giving of notice of any such securities to Austraclear.[99] However, the fact that a security is affected by an 'encumbrance' can be recorded by members as a dealing in the relevant security. Although the security remains in the Security Record of the party who granted the encumbrance, it is separately identified in such a way as to indicate the encumbrancee, and it is 'locked' so that it cannot be dealt with except in accordance with the regulations of the Austraclear System.

The regulations of the Austraclear System provide that Austraclear is entitled to treat a member in whose securities account debt securities are recorded, as the sole and absolute owner of the securities for all purposes.[100] However, under the Austraclear regulations, entitlements to security interests are dealt with on the basis that interest payments are to be paid to the encumbrancer, while maturity proceeds are held at the disposal of the encumbrancee.

The Austraclear regulations relating to encumbrances do not prescribe the form or nature of the arrangements between members or of the encumbrance, and leave it to members to determine the terms of the dealings between an encumbrancer and encumbrancee, including the consequences of those dealings under, for example, the Corporations Act.

However, if the only evidence of the agreement between two members of the Austraclear System is the recording of an encumbrance in the System, and if the relevant security is a paper security (as defined in the Austraclear regulations), the nature of the encumbrance is deemed to be a pledge (that is, a security arising by transfer of possession to the encumbrancee with a power of sale on default). In the case of an encumbrance over a dematerialised security (as defined in the Austraclear

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97 The charges provisions impose strict formal requirements in relation to the notification of charges and in relation to the discharge or release of property from a charge.

98 Mallesons Stephen Jaques, *Australian Financial Law*, 4th edn., Law Book Company, Sydney, 1999, p. 577.

99 Mallesons Stephen Jaques, p. 568.

100 Mallesons Stephen Jaques, p. 568.

regulations), the terms of the deemed agreement are taken to be an equitable mortgage of the relevant dematerialised security by the encumbrancer in favour of the encumbrancee.

### Amendment of section 262 of the Corporations Act

The Companies and Securities Advisory Committee (CASAC), in its April 2001 *Report to the Minister for Financial Services and Regulation on charges over uncertificated securities*, recommended that charges over uncertificated securities be removed from the application of the charges provisions. In order to accommodate this, CASAC recommended that a third exclusion be included in section 262(1)(g), that being a charge created over an electronically recorded share. CASAC considered that an amendment along these lines would be consistent the exemption for certificated securities in subparagraph 262(1)(g)(i).

Section 262(1)(g) was subsequently amended as part of the *Corporations Legislation Amendment Act 2003*. This relieves companies from the administrative burden of having to comply with the charges provisions in relation to uncertificated securities, and facilitates the use of uncertificated securities as collateral.

## 8.4 Impact of the definition of debenture in the Corporations Act

Dematerialised securities (as defined in the Austraclear System's regulations) are not currently included in the definition of 'bill of exchange' or 'promissory note' in the Bills of Exchange Act, nor in the definition of 'negotiable instrument' in the Corporations Act. They may, however, be caught by the 'new' definition of 'debenture' for the purposes of the fundraising provisions of the Corporations Act.[101]

Pending the outcome of the Review of the Bills of Exchange Act and any relevant legislative amendments, ASIC granted relief to Austraclear Limited, its members who trade in dematerialised securities as defined in the Austraclear regulations, and subject to certain conditions, non-member drawers of electronic bank accepted bills of exchange, from the application of the prospectus provisions of the Corporations Act by Class Order 99/1206.

ASIC subsequently issued a new Class Order, CO 00/186 as a consequence of the enactment of the *Corporate Law Economic Reform Program Act 1999*. Amongst other things, that Act amended the fundraising provisions of the Corporations Act and also

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101 Inserted by the *Corporate Law Economic Reform Program Act 1999* (Act No 156 of 1999).

the definition of 'debenture' in the Act to refer to a bundle of rights rather than to a document of title.

The Working Group takes the view that if the Bills of Exchange Act were to be amended to give negotiable securities in electronic form functional equivalence to conventional bills of exchange and promissory notes, consideration would need to be given to amending the Corporations Act to exclude such electronic securities from the definition of 'debenture' in the same way that paper-based bills of exchange and promissory notes, with a face value of not less than $50,000, are currently excluded from the definition.

## 8.5 SATURDAY AS A NON-BUSINESS DAY

The terms of reference require the Working Group to determine the need to identify Saturday as a non-business day for the purposes of the Bills of Exchange Act.

### Background

Subsection 98(3) of the Bills of Exchange Act provides that for the purposes of performing various actions in relation to bills of exchange such as presenting and paying them, Christmas Day, Good Friday, Sundays and 'bank holidays' are non-business days for the purposes of the Act. The effect of this provision is that if a bill falls due for payment on any of these days, it should be presented or paid, or otherwise dealt with, on the next business day.

A 'bank holiday' is a day declared to be a bank holiday under a law of the Commonwealth or a State or Territory. The Bills of Exchange Act in subsections 98(4) and (5) then adopts the declared bank holiday (or bank half-holiday) to be a non-business day for the purposes of the Bills of Exchange Act. Some States have declared the Saturday in each week to be a bank holiday throughout the whole of the state for the purposes of the Bills of Exchange Act.

### Submissions

The ABA submission proposed that the Bills of Exchange Act be amended to remove the concept of bank holidays altogether. This would obviate the need to rely on states to declare Saturdays to be non-business days specifically for the purposes of the Bills

of Exchange Act and would allow banks to offer limited trading on Saturdays without having to undertake bills of exchange services.[102]

In its submission, the ABA indicated that banks wished to provide a limited range of banking services to retail customers (including home loan approvals) to meet established community needs, but at the same time wished to avoid the need to provide a full range of commercial services on Saturdays, including certain services in relation to bills of exchange.

In its submission to the Review, AFMA contended that there is no need to specifically identify Saturday as a non-business day for the purposes of the Bills of Exchange Act. It argued that the market convention and practice for market activity (for example, issuing, discounting, trading and settlement) involving bills of exchange and promissory notes is that it is conducted on a business day.

According to AFMA, for OTC financial markets, a business day in Australia is a day on which the Australian payments system is open for business in Sydney or in any other centre mutually agreed by the parties. This market convention is provided for in the *AFMA Guide to OTC Documents*, which reflects standard international practices and is the source of standard documentation for Australia's OTC financial markets.

The AFMA submission argued that with increasing competition and advances in electronic banking services, this approach would provide flexibility in the event that Saturdays, or even Sundays, generally became accepted as business days in the Asia-Pacific region. It noted that in Hong Kong, for example, Saturdays are business days for Hong Kong Dollar transactions.

## Assessment

The Working Group notes that the effect of inserting a reference to 'a Saturday' in subsection 98(3) of the Bills of Exchange Act would be to make Saturday a non-business day for the purposes of the Bills of Exchange Act. While the Act could be amended at a later time to remove a specific reference to a Saturday if and when it became usual business practice in the Asia-Pacific region for Saturday to be a business day in relation to banking services in general, the Working Group is concerned at the inflexibility of such an approach in the face of the changing needs of the market.

On the other hand, the Working Group notes that if a specific reference to a Saturday was not inserted in subsection 98(3) of the Act, and the section was amended to

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102 Banks in some states are able to trade on Saturdays and Sundays. For Example, in New South Wales (where Saturdays and Sundays are bank holidays), a bank may apply to the New South Wales Department of Industrial Relations to open the bank, or one or more branches of the bank, in New South Wales on Saturdays or Sundays, or both. This follows amendments to the Shops and Industries Act 1962 (NSW) and the Banks and Bank Holidays Act 1912 (NSW).

remove the references to a 'bank holiday', this could have the effect that if a State or the Commonwealth declared a Saturday (or any other day) to be a bank holiday under state legislation, the day so declared would not be a bank holiday for the purposes of the Bills of Exchange Act (unless specifically so declared for that purpose).

### Conclusion

The Working Group considers that a direct reference to Saturday as a non-business day should not be included in the Bills of Exchange Act. Such an amendment would prevent business from adopting flexible practices in relation to the presentment and payment of bills of exchange and also restrain business' ability to compete with other financial players in the region in the provision of financial services to the short-term money market. It could also have an anti-competitive impact on the activities of the short-term money market in the long-term.

Leaving section 98 of the Act unamended would appear to provide the greatest degree of flexibility in the event that Saturdays, and any other day currently accepted as a non-business day, became accepted as a business day in the future.

### Issues

Should the Bills of Exchange Act be amended to include Saturday in subsection 98(3) as a non-business day and the reference to 'bank holiday' in subsection 98(3) be deleted?

Should subsections 98(4) and (5), which also refer to 'bank holiday', be left unamended?

## 8.6 MODERNISING THE BILLS OF EXCHANGE ACT GENERALLY

The LCA submission indicated that it would welcome changes to the legislation to facilitate presentment, protest and notice of dishonour of physical bills and notes in novel ways, such as by facsimile, electronic imaging and email, pending the development of fully electronic bills of exchange and promissory notes.

The Working Group notes that proposals such as those mooted by the LCA could be examined in the event that amendments to modernise the Bills of Exchange Act generally are considered in the future. In that context, the Working Group also considers that the opportunity should be taken to remove Part III, Cheques on Banker,

and to update the reference to 'Australasia', which is relevant to the distinction between inland and foreign bills.

## Issues

Should the provisions in the Bills of Exchange Act providing for paper bills of exchange and promissory notes be retained in some or all of the circumstances discussed?

Should the Bills of Exchange Act be modernised insofar as it applies to paper-based bills of exchange and promissory notes?

# CHAPTER 9: OPTIONS FOR REFORM

## 9.1 INTRODUCTION

The terms of reference require the Working Group to consider options for reform of the Bills of Exchange Act against a number of criteria (see terms of reference, paragraphs 3(a) and (b) and 4).

The Working Group identified three options, in part derived from participants' suggestions, which would assist in reducing the complexity and prescriptiveness of the Bills of Exchange Act, and achieve the objectives of the legislation in a more cost–effective manner.

The options are:

- Amend the Bills of Exchange Act to make statutory provision for negotiable instruments in electronic form with equivalent functionality to bills of exchange and promissory notes. The legislation would specify concepts equivalent to delivery, possession and guaranteed title, so that relevant electronic records of approved trusted record keepers would be treated as equivalent to bills of exchange and promissory notes.

- Rely on the clearing and settlement facility and electronic transfer of title provisions of the Corporations Act, as amended by the *Financial Services Reform Act 2001* (FSR Act).

- Rely on the provisions of the *Electronic Transactions Act 1999* (Electronic Transactions Act) to achieve functional equivalence for electronic bills of exchange and promissory notes with bills and notes in paper form.

These options are discussed in detail below.

## 9.2 Option 1 — Electronic bills of exchange and promissory notes to be created by statute; statutory support for transfer of title to electronic bills of exchange and promissory notes

Under this Option,[103] there would be statutory provision for dematerialised securities in the form of electronic bills of exchange and promissory notes.[104] For example, it would be possible to amend the Bills of Exchange Act by adding a new Part to deal specifically with electronic bills and notes using functionally equivalent terminology to replace concepts such as possession, delivery and guaranteed title.[105]

It would be necessary to provide in the legislation that, by means of entries in the accounts of members of a particular computer system, rights and obligations equivalent to those attaching to bills of exchange could be created or recorded. It would also be necessary to put parties to transactions in those rights and obligations in the same position as equivalent parties to transactions in conventional bills of exchange. The contractual arrangements of the system would provide that as between members of the system, any transfer of an obligation would confer on the transferee the same rights and obligations as the member would have had as a holder in due course of a conventional bill of exchange. Thus, any transfer of rights and obligations would confer good title on the transferee, free of equities, and the transferor would be placed in the same position as an indorser. These arrangements would be recognised by the legislation.[106]

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103 In this Option, the Working Group has drawn on the various drafts of the 1999 Uniform Electronic Transactions Act adopted by the US National Conference of Commissioners on Uniform State Laws (NCCUSL), *Uniform Electronic Transactions Act* (various drafts) http://www.law.upenn.edu/bll/ulc/ulc_frame.htm (Accessed 30 May 2002) and the proposals in the Jack Committee Report, *Banking Services: Law & Practice, Report by the Review Committee*, Cm 622, Her Majesty's Stationery Office, London, February 1989, Chapter 8 (Negotiable Instruments), pp. 72-73.

104 The following comments apply, generally speaking, to both bills of exchange and promissory notes.

105 In its submission to the Review, the LCA identified the following disadvantages if electronic negotiable securities were to be subject to conceptually different regulation from traditional instruments, suggesting that this would:

- introduce a regulatory divergence and possible bias, hindering the maximisation of market efficiencies;
- undermine legal and hence commercial certainty, minimising for electronic instruments, the relevance of existing case law; and
- inhibit the ability for bills or notes or other instruments to adopt hybrid electronic/paper forms, to change form during their currency, reducing product flexibility (as to the third point, see discussion in Chapter 7 of the Report).

106 This would mean that the rights and obligations of a person deemed to be the drawer, maker, acceptor or indorser in relation to relevant records of the trusted record keeper, would be

In the legislation, the transferee or 'holder' would be taken to be in 'control' of an electronic record which could be known as a 'transferable record' (or alternatively, be defined as an electronic bill of exchange or electronic promissory note). 'Control' of the transferable record could be treated as the functional equivalent of 'possession' of a written instrument, so as to establish the rights of the holder as equivalent to those of a 'holder in due course' to whom a negotiable document of title had been duly negotiated. 'Delivery' could be redefined as the 'transfer' of the control of the electronic record, which would provide evidence of the relevant rights and obligations.

For such transactions across the electronic records of a trusted record keeper to qualify as an electronic bill of exchange or electronic promissory note under the Bills of Exchange Act, the rules of the system or facility would need to reflect the substance of the statutory concepts established under the Bills of Exchange Act, which would underpin the creation of electronic bills and notes.

The system or facility would need to employ mechanisms for recording and evidencing the transfer of interests in the electronic bill, so that it could be reliably established that the person to whom the electronic bill has been issued or transferred is the person having 'control' of a bill. The system or facility would also need to ensure that the interests of holders transferred across its electronic records were separately recorded as distinct proprietary interests.

The relevant systems or facilities on which electronic bills could be created and transferred would be identified by means of a statutory approval process.[107] Such a process could be set out as part of the proposed amendments to the Bills of Exchange Act.

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equivalent to those to which that person would be entitled or subject to in relation to the equivalent negotiable instrument.

107 A statutory approval process is also desirable as the credibility and integrity of the proposed electronic bills will be heavily dependent on the reliability and competence of the operator of the system within which the bills are created and transferred.

The Working Group notes that the Internet[108] is often cited as a paradigm for electronic transactions, particularly in a consumer context. Though encryption and electronic authentication processes may be now considered sufficiently reliable as to permit the use of the Internet as a mechanism for communication with a trusted third party record keeper, it does not automatically follow that the creation of securities enjoying the key characteristic of negotiability is yet possible between unrelated parties without the certainty of pre-existing agreements to transact in such securities (whether pursuant to specific pre-agreed rules of the market, master agreements or otherwise).

The Working Group considers that it is difficult to envisage wholesale adoption by the market of mechanisms for transacting securities in electronic form without recognised protocols, securely maintained records of transactions and reliable identification codes for the communication and transfer of securities recorded in the computer records of a trusted record keeper, which the market would accept as negotiable (that is, in the sense of conferring guaranteed title). For this reason, the option of relying on a trusted record keeper to achieve negotiable status for the securities involved would seem to be the preferable course for the market to adopt at this stage of the development of electronic recording and trading systems.[109]

The Working Group considers that legislative recognition of contractual arrangements amongst participants of the computer system of a trusted record keeper for the creation of records of transfers of dematerialised securities with the attributes of negotiability, underpinned by the amended provisions of the Bills of Exchange Act, may facilitate increased competition in the relevant market by encouraging a variety of providers to establish facilities for the clearing and settlement of dematerialised securities, where the contractual arrangements and operating rules of such facilities reflected the substance of the statutory concepts discussed above.

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108 The Internet is a worldwide group of computers connected by a series of cables, phone networks and satellite links. 'Internet' is literally an abbreviation of the phrase 'International Network'. Common software systems (known as protocols) are used for the transmission of data over this network. See Rhys Bollen, The regulation of Internet banking, *Journal of Banking and Finance Law and Practice*, vol. 12, no. 1, March 2001, pp. 5-17.

109 The adoption by the market of a recognised and widely-accepted mechanism of the kind supplied by the Austraclear System would appear to preclude the likelihood of a spontaneous market in dematerialised negotiable securities for the present, particularly where legislative recognition of such systems was entrenched by law. Referring to the Austraclear System's approach of achieving negotiability through express agreement by all the participants in the system as to what will constitute the passing of clear title, Maria Polczynski, 'Cyberbanking: The Emerging Technology and Legal Issues: Issues of Electronic Commerce relevant to General, Commercial and Finance Law Practitioners', in *Proceedings of the Banking Law Association*, *14th Annual Banking Law and Practice Conference*, Prospect Media, Sydney, 1997, pp. 206-233, argued that such a specific contractual solution is not possible in respect of wholly spontaneous markets and the requirement for a pre-transaction agreement would negate the advantages of electronic commerce between parties who do not regularly transact business together.

The issue of who would be trusted record keepers in relation to electronic bills and notes created under the Bills of Exchange Act, and how such organisations would be regulated, is considered under Option 2.

## 9.3 OPTION 2 — RELIANCE ON THE CLEARING AND SETTLEMENT FACILITY AND ELECTRONIC TRANSFER OF TITLE PROVISIONS OF THE CORPORATIONS ACT, AS AMENDED BY THE FINANCIAL SERVICES REFORM ACT

One possible option is to include both the traditional form of bills of exchange and promissory note and bills and notes in electronic form in the definition of 'financial product' for the purposes of reliance on the clearing and settlement provisions and the transfer of title provisions of the Corporations Act, as amended by the FSR Act.

The effect would be that the provisions of the Corporations Act relating to the transfer of title of both paper and electronic bills of exchange and electronic promissory notes by clearing and settlement facilities prescribed under the Corporations Act for that purpose, would apply instead of, or in combination with, the provisions of the Bills of Exchange Act (including proposed amendments under Option 1). The Bills of Exchange Act would continue to determine the statutory nature of these instruments.

As to bills of exchange and promissory notes in electronic form in particular, there appears to be no reason why a trusted record keeper under either Option 1 or 2 could not be a clearing and settlement facility regulated under the Corporations Act, so long as the facility's rules reflected the substance of the legislative provisions appropriate to Option 1. This would be necessary for the sake of certainty and consistency of approach between electronic records created under the rules of facilities governed by the Corporations Act, and the traditional form of the negotiable instruments created under the provisions of the Bills of Exchange Act.

One approach to achieving such consistency of approach would be to adopt the approach taken in the recent amendments to the CIS Act.[110] This would involve providing for regulations to be made under the Bills of Exchange Act to provide for the transfer of bills of exchange and promissory notes by electronic means (or otherwise) in the records of a trusted record keeper under the Act, or in addition, or alternatively, for regulations to be made under the Bills of Exchange Act which could provide for the transfer of these instruments by applying the provisions of the Corporations Act, with or without modifications, to enable a clearing and settlement facility regulated under that Act to be recognised as a trusted record keeper with respect to bills of exchange and promissory notes in electronic form under the Bills of Exchange Act.

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110 C*ommonwealth Inscribed Stock Amendment Act 2002* (Act No 21 of 2002).

As to which organisations might qualify under the Corporations Act and any relevant regulations to operate as clearing and settlement facilities in relation to bills of exchange and promissory notes in both paper and electronic forms, the Working Group notes that, for example, an authorised deposit-taking institution (ADIs are regulated under the *Banking Act 1959*) could be a trusted record keeper for the purposes of providing for the electronic recording and transfer of bills of exchange and promissory notes in electronic form, in addition to licensed clearing and settlement facilities licensed under the Corporations Act, as amended by the FSR Act.

ADIs could be licensed as clearing and settlement facilities and prescribed under the Corporations Act in relation to the transfer of title to both paper and electronic bills and notes, since arguably, in carrying out such activities, the ADI would not be acting as a banker in the ordinary course of the business of a banker, such as when acting as an acceptor of a bill of exchange. In that regard, the Working Group notes that under the ABA's Code of Banking Practice, providing a 'banking service' does not include providing a service in relation to a bill of exchange. [111]

However, the Working Group notes that currently under the Corporations Act and Regulations (as amended by the FSR Act and Regulations), the provision of credit generally (and in particular through the issuing, indorsing, accepting or otherwise dealing in bills of exchange and promissory notes) is excluded from the operation of the Act, while a credit facility such as a bill facility under which a credit provider provides credit by accepting, drawing, discounting or indorsing a bill of exchange or promissory note is excluded from the definition of a 'financial product' for the purposes of sub-paragraph 765A(1)(h)(i) of the Corporations Act.[112] Further consideration of this Option would necessitate a reconsideration of this exclusion.

There is also a question of whether utilising a bill of exchange or promissory note to make a payment, in paper or electronic form, would fall within the general definition of a 'financial product' as making a non-cash payment. However, this represents only one use of a bill of exchange or promissory note, and the preferable course of action would be to clarify the reach of the Corporations Act with regard to these instruments, were Option 2 to be taken forward.

The Working Group considers that the question of whether and to what extent bills of exchange and promissory notes, in whatever form, should be included within the purview of the Corporations Act is a broader question than the issue of the application of the clearing and settlement and the transfer of title provisions of the Corporations Act, as amended by the FSR Act. This is because any wider application of the Corporations Act to these particular negotiable instruments raises issues such as

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111 An ADI acting in the ordinary course of its banking business is excluded from the definition of a clearing and settlement facility (paragraph 768A(2)(a) of the Corporations Act, as amended by the FSR Act).

112 Corporations Amendment Regulations 2001 (No 4) 8 October 2001: Subregulations 7.1.06(1) and (3).

whether the product disclosure regime of the Corporations Act, as amended by the FSR Act, should also apply to bills of exchange and promissory notes (in both paper and electronic form).

Similar issues might also apply to NCDs, to the extent that these instruments are taken to be a promissory note within the meaning of section 89 of the Bills of Exchange Act,[113] or if they fall into the definition of a 'debenture' for the purposes of the Corporations Act, and are thus taken to be a 'security' within the meaning of section 761A of the Corporations Act, as amended by the FSR Act.[114]

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113 See the discussion regarding NCDs in Chapter 5 of the Report.

114 See Sheelagh McCracken*, Everett & McCracken's Banking and Financial Institutions Law*, 5th edn, LAWBOOK CO, Sydney, 2001, pp. 174-175.

## Issues

Participants are invited to identify issues arising out of the possible application of other parts of the Corporations Act, as amended by the FSR act, such as the product disclosure regime in Part 7.9, to bills of exchange in both paper and electronic form, and also the potential impact of the financial services provider provisions to the supply of services in relation to these financial instruments, if they were to be brought within the definition of a 'financial product' for the purposes of the Corporations Act.

## 9.4 Option 3 — Reliance on the Electronic Transactions Act

The Working Group considered whether the Electronic Transactions Act[115] could provide for functional equivalence between the electronic version of a bill of exchange or a promissory note and the paper form as provided for under the Bills of Exchange Act in its present form.

The Working Group notes that the Electronic Transactions Act is based on two fundamental principles, namely, 'media neutrality', meaning that paper-based commerce and electronic commerce should be treated equally by the law, and 'technology neutrality', which ensures that the law does not discriminate between different forms of technology. The Act has been developed as an interpretation law. It contains provisions to allow electronic communications to satisfy a requirement or a permission under a law of the Commonwealth to provide information in writing, to sign or produce a document, or to retain information or a document, subject to certain conditions.

The ASX noted in its submission that the Review offered an appropriate opportunity to determine whether the requirements in relation to negotiable instruments should be excepted from the (as it was then) proposed electronic commerce legislation. The ASX noted that functional equivalence legislation of the type recommended by the Attorney-General's Expert Group on Electronic Commerce might not adequately address all issues relevant to the issue, trading and settlement of negotiable instruments in an electronic environment.

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115 The *Electronic Transactions Act 1999*, developed by the Attorney-General's Department to enable electronic data messages to satisfy requirements under Commonwealth laws for writing, signatures and originals, was passed on 25 November 1999, received the Royal Assent on 10 December 1999, and came into operation on and from 15 March 2000. Further details and advice on the operation of the Act are available at *The AGD e-Commerce Homepage.* http://www.law.gov.au/publications/ecommerce/ February 2002. (Accessed 31 May 2002).

The ASX indicated that it considered that the requirement for dematerialising negotiable instruments could be addressed in a legislative framework specific to the needs of negotiable instruments. The ASX considered that the relevant issues would need to be addressed in a manner which ensured that the underlying policy of the existing framework for negotiable instruments could be included in an amended Bills of Exchange Act, or a specific Negotiable Instruments Act which facilitated electronic commerce.

For its part, the Working Group considers that it would not be sufficient to rely on the provisions of the Electronic Transactions Act to create electronic negotiable securities, as the effect would be to allow electronic communications to satisfy the form and signature aspects of the Bills of Exchange Act without providing them with the key characteristic of negotiability, namely, guaranteed title — that is, title free of defects. This is determined on the basis (as previously discussed in Chapter 7 of this report) that it is the nature of the particular contractual terms which constitutes them a bill of exchange and not the form of the contract. Accordingly, the Working Group considers that the preferable approach would be to enact specific legislation for electronic negotiable securities, for example, a separate Part of the Bills of Exchange Act dealing with electronic bills and notes, or reliance on the electronic transfer provisions of the Corporations Act, or a combination of these two options.

In the meantime, the Working Group notes that the Bills of Exchange Act in its current form has been specifically excluded from the application of the Electronic Transactions Act by regulations made under that Act.[116]

## 9.5 CONCLUSION

The Working Group does not believe that Option 3 should be adopted for the reasons set out above. It notes that the approach in Option 3, while providing functional equivalence in relation to form and signature requirements, would not provide functional equivalence with respect to the concept of negotiability, the key characteristic and outstanding feature of bills of exchange and promissory notes as short-term money market instruments.

The Working Group considers that a combination of Option 1 and Option 2 is the approach best suited to updating the legal framework applying to negotiable instruments in Australia, in order to meet the demands of a dematerialised environment. This approach would arguably assist in avoiding divergence from the

116 Prior to 1 July 2001, the Electronic Transactions Act only applied to laws of the Commonwealth specified in the Regulations. From 1 July 2001, the Act applies to all laws of the Commonwealth except those specifically excluded from the application of the Act. The Bills of Exchange Act has been specifically excluded from the application of the Electronic Transactions Act by the *Electronic Transactions Regulations 2000*.

existing law on bills of exchange and promissory notes and maintain legal and commercial certainty with respect to bills of exchange and promissory notes in both paper and electronic form.

The Working Group further considers that Options 1 and 2, adopted in combination, would provide a workable mechanism for eliminating the paper burden currently imposed by the Bills of Exchange Act on business, including small business. More generally, these two options, adopted in combination, appear to possess the potential to reduce the costs for participants in the short-term money market arising out of the documentary form requirements and complexities of the current legislation. The ensuing efficiencies would be expected to flow into the broader community, resulting in more flexible pricing of negotiable securities, greater transparency of investment choices and the potential for increased availability of these financial products to investors.

Finally, the Working Group is of the view that these Options provide a way forward to encourage competition in the provision of services in relation to these products and to promote efficiency in the short-term money market, which ultimately impacts on the economy as a whole.

## Issues

Should Options One and Two be adopted separately or in combination?

# APPENDICES

# APPENDIX ONE

*Examples of provisions in the Bills of Exchange Act relating to the documentary form of bills of exchange and promissory notes*

| Section | Provision |
|---|---|
| Section 4 | Interpretation of terms (definitions) |
| Section 8 | Bill of exchange defined |
| Section 9 | Inland and foreign bills |
| Section 11 | Address to drawee |
| Section 12 | Certainty required as to payee |
| Section 13 | What bills are negotiable |
| Section 22 | Definition and requisites of acceptance |
| Section 23 | Time for acceptance |
| Section 25 | Inchoate instruments |
| Section 26 | Delivery |
| Section 28 | Signature essential to liability |
| Section 29 | Forged or unauthorised signature |
| Section 31 | Person signing as agent or in representative capacity |
| Section 33 | Accommodation bill or party |
| Section 34 | Holder in due course |
| Section 35 | Presumption of value and good faith |
| Section 36 | Negotiation of bill |
| Section 37 | Requisites of a valid indorsement |

| Section 39 | Indorsement in blank and special indorsement |
|---|---|
| Section 40 | Restrictive indorsement |
| Section 41 | Negotiation of overdue or dishonoured bill |
| Section 43 | Rights of holder |
| Section 44 | When presentment for acceptance is necessary |
| Section 45 | Time for presenting bill payable after sight |
| Section 46 | Rules as to presentment for acceptance and excuses for non-presentment |
| Section 47 | Non-acceptance |
| Section 48 | Dishonour by non-acceptance and its consequences |
| Section 49 | Duties as to qualified acceptances |
| Section 50 | Rules as to presentment for payment |
| Section 54 | Rules as to notice of dishonour |
| Section 55 | Excuses for non-notice and delay |
| Section 56 | Noting or protest of bill |
| Section 57 | Duties of holder as regards drawee or acceptor |
| Section 59 | Liability of acceptor |
| Section 60 | Liability of drawer or indorser |
| Section 61 | Stranger signing bill liable as indorser |
| Section 63 | Transferor by delivery and transferee |
| Section 68 | Cancellation |
| Section 69 | Alteration of bill |
| Section 70 | Acceptance for honour supra protest |
| Section 74 | Replacement of lost or destroyed bill |

| | |
|---|---|
| Section 76 | Rules as to sets |
| Section 77 | Rules where laws conflict |
| Section 77A | Effect of non-compliance with stamp laws in case of certain bills of exchange |
| Section 89 | Promissory note defined |
| Section 90 | Delivery necessary |
| Section 91 | Joint and several notes |
| Section 93 | Presentment of note for payment |
| Section 95 | Application of Part II to notes |
| Section 97 | Signature |

# APPENDIX TWO

## DEMATERIALISATION IN AUSTRALIA: THE AUSTRACLEAR SYSTEM

On 24 May 1999, Austraclear commenced operating a regime of 'dematerialised securities' under which electronically formatted and recorded debt obligations of similar effect to negotiable instruments may be transferred in the Austraclear System.

### The Austraclear System

Austraclear Limited commenced operation in 1984 and operates the national central securities depository to the Australian money market. Through its proprietary Financial Transactions Recording and Clearance System (FINTRACS) software, Austraclear electronically clears and settles most debt securities trades in the Australian money and fixed interest market.

Austraclear Limited merged with SFE Corporation Limited in December 2000 to form SFE Clearing, which now consists of SFE Clearing Corporation Pty Ltd and Austraclear Limited. The combined operations of the SFE Clearing Corporation Pty Ltd and Austraclear Limited hold more than $A300 billion of securities in safe custody and settle more than $A10 billion in securities every day.[117]

Austraclear caters mainly for (with membership restricted to) the professional money market, which trades (mainly by phone) and pledges these securities. There are more than 600 participants of the Austraclear System (Members) and they are bound to each other and to Austraclear by contract through Austraclear's operating rules and regulations. The outcomes of transactions are recorded in Austraclear. The vast majority of broker deals in relation to bills of exchange are settled through Austraclear, mainly in the interbank bill market.

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117 SFE Corporation Limited, *Clearing & Settlement in Australia*. Brochure available online from SFE Corporation Homepage at http://www.sfe.com.au/site/html/aboutsfe/clearing.pdf (Accessed 31 May 2002). As at June 2003, these figures are now; over $A400 billion worth of securities in custody, and daily settlement values of over $A15 billion.

There are a number of different types of securities eligible for clearance and settlement through Austraclear. These include:

- bills of exchange;
- certificates of deposit;
- promissory notes (commercial paper);
- fixed and floating rate securities;
- securitised assets; and
- government, semi-government and corporate bonds.

## Physical securities

Initially transactions processed through Austraclear were limited to bearer securities such as bills of exchange and promissory notes. In September 1989, its scope was extended to include registered securities issued by semi-government bodies, banks and corporations, and by 1993 its turnover represented over 90 per cent of the national turnover of fixed interest securities issued by these bodies.

Once a bill of exchange has been drawn and discounted, assuming that the transactions are between members and/or associate members of Austraclear, the bill is physically lodged with Austraclear and is maintained in safe custody in its vaults.

Transactions between members of Austraclear are entered into by the parties through their computer terminals using access codes. Each successive rediscounting of the bill, and change in its ownership, is recorded electronically by Austraclear.

Austraclear holds all negotiable instruments deposited with it in safe custody as bailee for the owner or as bailee for any pledgee of the instrument. On recording the transfer, Austraclear then holds the negotiable instrument as bailee for the transferee. It is this constructive delivery of possession which actually effectuates the change of title to a negotiable bearer instrument.[118]

There is generally no physical indorsement of the bills processed by Austraclear, however the computer system records changes of ownership. This serves as evidence of the line of contingent liability until the bill is honoured and retired at maturity. It is only if the instrument is dishonoured on presentation that actual indorsement is

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118 D Everett & S McCracken, *Banking and Financial Institutions Law*, 4th edn, LBC Information Services, Sydney, 1997, p. 198.

required.[119] However, Austraclear's regulations provide for ex-post facto indorsements in certain circumstances.

Where the bill transaction is between an Austraclear member and a non-member, the transaction is handled outside the System and involves the pre-electronic recording practice of physical indorsement and delivery of the bill from seller to buyer.

## Dematerialisation

The negotiable instruments traded using the Austraclear System are bank accepted bills of exchange, non-bank promissory notes, non-bank negotiable certificates of deposit and bank negotiable certificates of deposit. The electronic equivalent of these securities are Electronic Bank Accepted Bills of Exchange ('EBAs'), Electronic Promissory Notes ('EPNs') and Electronic Certificates of Deposit ('ECDs'). EBAs, EPNs and ECDs are electronically recorded debt obligations as defined within the definition of 'Dematerialised Securities' in the Operating Manual of Austraclear Limited. Dematerialised securities can be traded in the Austraclear System in substantially the same manner as their physical counterparts by virtue of contractual relationships established between the parties by the terms of issue of the dematerialised securities and Austraclear's regulations.

The Austraclear System regulations are intended to bind members to the effect that the rights (including the benefits of negotiability) and obligations of members issuing, accepting, notionally indorsing[120] and holding dematerialised securities are identical to the rights and obligations which would have been applicable if physical-form instruments had been used in the transactions, providing the member has acquired the security on good faith, for value and without notice of dishonour of the security or any defect in the title of the transferor.

For each issue and trade, there is an identical security or securities, albeit recorded in electronic rather than paper form. These securities are not fungible like money; they do not lose their identity and individual characteristics in a commingled pool.[121] In other words, each dematerialised security is separately recorded in a similar fashion to the physical securities held in the Austraclear System.[122] The terms of issue of such

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119 Michael McGrath, *Financial Institutions, Instruments and Markets in Australia*, McGraw-Hill Book Company, Sydney, 1994, p. 179.

120 When making a transfer, each member must include in the terms of the transfer an agreement to indorse the dematerialised security, after which Austraclear may record the transfer in each member's security record. This agreement to indorse is incorporated into the keystrokes required to record the transfer. Austraclear's regulations provide that any member agreeing to indorse attracts the same liabilities as if the indorsement had actually taken place.

121 See generally Joanna Benjamin, *The Law of Global Custody,* Butterworths, London, 1996, Chapters 4 and 5.

122 Greg Hammond and Craig Wappett point out that Austraclear physically segregates and allocates Paper Securities and maintains appropriate records allocating Non-Paper Securities, so that a

dematerialised securities include a requirement to produce the relevant physical instruments in certain circumstances.

The issuer of an ECD and the maker of an EPN must be a member of Austraclear or must be a participating bank. The drawer of an EBA need not be a member, but the EBA must be accepted by a member of Austraclear in order for the EBA to be lodged into the Austraclear System. If the drawer of an EBA is not a member, the member who is the acceptor of an EBA drawn by a non-member must enter into a separate agreement with the non-member drawer that the latter will comply with relevant Austraclear regulations. The Austraclear regulations require a member who lodges an EBA drawn by a non-member to indemnify Austraclear and other members of Austraclear against losses or claims connected with the dematerialised security or in respect of breaches of certain warranties required to be made by the member by Austraclear's regulations.

Austraclear's dematerialised securities have gained relatively widespread industry acceptance in the short time they have been available. There are now more 'dematerialised' bills of exchange and certificates of deposit held by Austraclear than their physical counterparts.

member of the Austraclear System has a proprietary interest in the relevant debt securities as well as contractual rights against Austraclear. See Chapter 7 'Dematerialised and Immobilised Securities' in *Securities over Personal Property*, CC Wappett and DE Allan (eds), Butterworths, Sydney, 1999.

# APPENDIX THREE

## INTERNATIONAL EXPERIENCE

Various approaches have been taken in overseas jurisdictions to facilitating the electronic trading and transfer of negotiable instruments. These include:

- treating the transaction records of third party repositories as the equivalent of 'possession' (United States);
- examining the principles of negotiability in the context of electronic commerce (United States);
- creating, by legislative means, an electronic record which would be a negotiable instrument had it been brought into existence in paper form under negotiable instruments legislation (United States);
- excluding traditional negotiable instruments from the application of electronic commerce legislation (Australia, Singapore, Canada);
- immobilising[123] securities (both debt and equity) (United States);
- legislating for an electronic record representing a debt security backed up by a physical certificate in the possession of the depositor (Canada);
- replicating the benefits of negotiability contractually (United Kingdom); and
- integrating money market instruments with government stock and equities in a dematerialised, fungible form (United Kingdom).

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123 Immobilisation involves depositing 'jumbo' physical certificates or 'master certificates' representing thousands or millions of shares with third party depositories such as the Depository Trust Corporation of New York. According to the September 1998 Report of the National Conference of Commissioners on Uniform State Laws (NCCUSL) Task Force on State Law Exemptions, the beneficial interests of the true owners are recorded through a series of intermediaries, each of which is aware only of the ownership of its immediate predecessor in the chain. The master certificate ultimately becomes irrelevant, and serves a symbolic purpose only. See National Conference of Commissioners on Uniform State Laws. *Uniform Electronic Transactions Act Task Force on State Law Exclusions Report*, 21 September 1998. http://www.webcom.com/legaled/ETAForum/docs/report4.html (Accessed 28 May 2002).

## United States

There have been various attempts in the United States to accomplish the equivalent of negotiability in an electronic environment. For example, the United States Department of Agriculture (USDA) uses a central registry for electronically-generated cotton warehouse receipts, with the registered owner of the receipt being treated as 'in possession' of the receipt for all legal purposes.

The National Conference of Commissioners on Uniform State Laws (NCCUSL) Uniform Electronic Transactions Act Task Force on State Law Exclusions has noted that both the USDA and Uniform Commercial Code (UCC) Article 8 (Investment Securities) schemes[124] share the feature of interposing the transaction records of a trusted third party into the transaction to substitute for possession. According to the Task Force, these alternative arrangements to negotiation of paper documents suggest that it should be possible to provide standards for alternative methods of establishing priority rights to electronic equivalents of negotiable instruments.[125]

In the United States also, a draft model law, the Uniform Electronic Transactions Act (the UETA), was completed by the NCCUSL in 1999.[126] The draft legislation is intended to establish a set of uniform rules, which may be adopted on a nationwide basis to promote electronic commerce throughout the United States. [127] While the primary objective of the Act is to establish the legal equivalence of electronic records and signatures with paper writings and manually-signed signatures, and to remove barriers to electronic commerce, the UETA does make provision for the electronic equivalence of negotiable instruments.

The UETA Draft Prefatory Note and Comments[128] state that:

> Paper negotiable instruments and documents are unique in the fact that a tangible token — a piece of paper - actually embodies intangible rights and obligations. The extreme difficulty of creating a unique electronic token which embodies the singular attributes of a paper negotiable document or instrument,

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124 For detailed information on UCC Article 8 see Sandra M Rocks and Carl S Bjerre, *The ABC of the UCC Article 8: Investment Securities*, American Bar Association, Chicago, 1997.

125 National Conference of Commissioners on Uniform State Laws. *Uniform Electronic Transactions Act Task Force on State Law Exclusions Report*, 21 September 1998. http://www.webcom.com/legaled/ETAForum/docs/report4.html (Accessed 28 May 2002).

126 National Conference of Commissioners on Uniform State Laws. *Uniform Electronic Transactions Act.* (Approved and recommended for enactment in all the States, July 23-30, 1999). http://www.law.upenn.edu/bll/ulc/uecicta/eta1299.htm (Accessed 3 June 2002).

127 The UETA has been enacted in thirty-nine States. Introduction is pending in eight more States, including Illinios. See the following for details of States which have adopted or are intending to introduce the UETA. http://www.nccusl.org/nccusl/uniformact_factsheets/uniformacts-fs-ueta. (Accessed 3 June 2002).

128 National Conference of Commissioners on Uniform State Laws (July 23-30, 1999). *Uniform Electronic Transactions Act*. Draft Prefatory Note and Comments dated 13 December 1999. http://www.law.upenn.edu/library/ulc/uecicta/eta1299.htm (Accessed 3 June 2002).

dictates that the rules relating to negotiable documents and instruments not be simply amended to allow the use of an electronic record for the requisite paper writing. However, the desirability of establishing rules by which business parties might be able to acquire some of the benefits of negotiability in an electronic environment is recognized by the inclusion of this Section on Transferable Records.

The Section referred to above is section 16 of the UETA. Section 16 of the UETA applies to electronic records, known as 'transferable records', which would be, amongst other things,[129] promissory notes under Article 3 of the UCC,[130] if the electronic records were in writing. Transactions governed by Article 3 are excluded from the scope of the UETA. The UETA does not provide for an electronic record which would, if it were in writing, be a draft (equivalent of a bill of exchange) or a check (equivalent of a cheque).[131] Creating an electronic equivalent of a negotiable check was considered to involve important policy decisions concerning payments systems which were seen as outside the proper scope of the UETA. Accordingly, an electronic record which is also a transferable record would not be used for the purposes of a transaction

129 UCC Article 7 warehouse receipts, bills of lading and other documents of title.

130 Article 3 of the UCC governs negotiable instruments, including drafts and notes. A draft (which includes a 'check') is an instrument which is an order. A note is an instrument which is a promise. The term 'bill of exchange' is not used in Article 3. It is generally understood to be a synonym for the term 'draft'. And see Uniform Commercial Code-Article 3 Negotiable Instruments [Online]. http://www.law.Cornell.edu/ucc/3/ (Accessed 22 June 2002).

131 And see Jane K Winn, 'Electronic negotiable instruments', 5:41 *BNA Electronic Commerce & Law Report* 1060 (October 25, 2000), http://www.smu.edu/~jwinn/esig.htm.

governed by Articles 3[132] and 4,[133] for example, but would be an electronic record used for the purposes of a transaction governed by section 16 of the UETA.

The Draft Prefatory Note and Comments indicate that the provisions of the UETA relating to 'transferable records' are intended to operate as free standing rules, establishing the rights of the parties using transferable records under that Act. Thus, although specific provisions in certain Articles of the UCC, including in Article 3, are made applicable rules for the purposes of the UETA, requirements related to notions of possession, which are inherently inconsistent with the idea of an electronic record, are not incorporated into the UETA.

Prior to the completion of the UETA, a number of jurisdictions of the United States (for example, Massachusetts and Illinois) addressed the question of placing negotiable instruments in the electronic commerce context.[134] Massachusetts excepted traditional negotiable instruments from its Electronic Records and Signatures Act, Draft of 14 April 1998.[135]

Illinois[136] provided an exemption for conventional negotiable instruments, taking the view that for policy reasons, the rules authorising the use of electronic records and electronic signatures ought not to apply to such instruments, since in most cases, it was said, there apparently existed no readily available way to create a unique electronic record.

However, it was stated in the Comments accompanying the 1998 Illinois Bill that this exclusion was not intended to apply to certain forms of electronic records which are used as substitutes for transactions which normally require a unique original document when produced on paper, if such electronic records can be utilised in a manner which does not require a unique original electronic document. Examples given included so-called digital cash, which uses a third party repository to verify the validity of digital coins and electronic checks and other similar electronic transactions wherein the legal validity of the electronic record is not established solely by reference to possession of the instrument, but also (or alternatively) by reference to a central data base or repository which tracks the validity of such documents and/or ownership.

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132 Whereas UCC Article 3 governs both drafts (bills of exchange) and checks (cheques), these instruments are governed by separate legislation in Australia.

133 Article 4 of the UCC governs Bank Deposits and Check Collections and Article 4A governs the rights and duties of commercial EFT (ACH, Fedwire and Chips).

134 Both Massachusetts and Illinois are reported as proposing to introduce the UETA in 2002. http://www.nccusl.org/nccusl/uniformact_factsheets/uniformacts-fs-ueta. (Accessed 3 June 2002).

135 Commonwealth of Massachusetts Executive Office for Administration and Finance Information Technology Division. *Uniform Electronic Transactions Act,* http://www.state.ma.us/itd/legal/ (Accessed 6 June 2002).

136 *Illinois Electronic Commerce Security Act* with Comments (Passed by the General Assembly as of May 20, 1998. Effective as of 1 July 1999). http://www.mbc.com/db30/cgi-bin/pubs/iecsawithcomments.pdf (Accessed 28 May 2002).

The American Bar Association noted in its January 1999 Joint Report to the UETA Drafting Committee that the inability of automated computerised business systems to reproduce embodied rights title recognition systems is due to technological limitations inherent in early networked computerised business systems, but that technological advances are eliminating those practical obstacles to embodied rights ownership control systems. The Association also commented that it is possible that the practical relevance of doctrines such as negotiability may increase in the near future, after many years of decline, as a result of innovations in business information systems.[137]

The American Bar Association is also examining the principles of negotiability in the context of electronic commerce through an initiative entitled *Project on Negotiability and Electronic Commerce*.[138] Amongst other things, the project is likely to examine the application of principles of negotiability on traditional and emerging transfer and payment systems and the development of media neutral language for recognising the electronic equivalent of negotiability by contract and by statute.

In the United States, negotiable instruments in the form of commercial paper may be immobilised in paper form in the securities accounts of 'clearing corporations' on behalf of their participants. An increasing proportion of commercial paper is issued in book-entry form in which computerised records of ownership are substituted for physical notes.[139] In particular, the Depository Trust & Clearing Corporation[140] has been active in making more instruments 'eligible' for conversion to book-entry form (where the security can be issued, cleared, settled and redeemed in book-entry form on the computer files of the depository).[141]

The indirect holding system rules in Article 8 of the UCC (Investment Securities) will apply if the negotiable instrument is held through a securities intermediary. According

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137 *Joint Report to the UETA Drafting Committee on the UETA Provisions governing Transferable Records, January 25, 1999 draft* by the ABA Science and Technology Section, Electronic Commerce Division, Committee on Electronic Commercial Payments and ABA Business Law Section, Cyberspace Law Committee, Working Group on Negotiability and Electronic Commerce (Task Force on Transferability of Electronic Assets). http://www.abanet.org/buslaw/cyber/ecommerce/groups.html (Accessed 3 June 2002).

138 The project is being conducted by the ABA Science and Technology Section's Electronic Commercial Payments Committee, together with the Committee on Cyberspace Law of the Business Law Section of the ABA. http://www.abanet.org/buslaw/cyber/ecommerce/groups.html (Accessed 31 May 2002).

139 R Bruce, B McKern, I Pollard & M Skully (eds), *Handbook of Australian Corporate Finance*, 5th edn, Butterworths, Sydney, 1997, p. 407.

140 The Depository Trust Company was integrated in 1999 with the National Securities Clearing Corporation Depository to form the Depository Trust & Clearing Corporation: See National Securities Clearing Corporation, http://www.nscc.com (Accessed 3 June 2002).

141 David L Mengle, *Behind the Money Market: Clearing and Settling Money Market Instruments*, Federal Reserve Bank of Richmond Economic Review, September/October 1992, pp. 3-11.

to the Official Comments on Article 8,[142] this facilitates making items such as money market instruments eligible for deposit in clearing corporations.

## Canada

Until recently, the division of responsibilities between federal and provincial legislatures under Canadian constitutional law has precluded the extension of screen-based clearing and settlement services to trades in money market securities such as banker's acceptances and commercial paper. This is because conventional negotiable instruments are subject to the Canadian Bills of Exchange Act, a federal law, whereas screen-based deliveries of securities on deposit with a clearing agency are validated by provincial law.

The solution has been the creation, under a federal law entitled the *Depository Bills and Notes Act 1998*,[143] of a new class of money market instruments expressly designed to be a medium of investment and the subject of screen-based deliveries made in accordance with provincial law.

Under the Depository Bills and Notes Act, the new classes of banker's acceptances and promissory notes are said to be, in pith and substance, the same as the old form of negotiable banker's acceptances and promissory notes. However, while the practical effect of, and the commercial value of, the instruments under the new law are substantially the same as those under the old law, the legal regimes which produce those results are significantly different. In other words, the legal relations of the parties to a depository bill or note are significantly different from those of parties to a negotiable instrument which is subject to the Canadian Bills of Exchange Act.

The Depository Bills and Notes Act, although expressly designed to create a class of instruments appropriate for electronic trading and settlement, has retained a requirement for writing. One of the reasons for retaining physical certificates was to avoid what has been referred to as 'the very serious and almost insoluble problems in the Canadian rules of conflicts of law governing debt securities'. By ensuring that every screen-based position representing a debt security is backed up by a physical certificate in the possession of the depository, the Act may provide a sure foundation for recognition of its effect by foreign and out-of-home provincial courts. [144]

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142 Cornell Law School (1998) *U.C.C. – Article 8 – Investment Securities (Revised 1998) – Official Comments* http://www2.law.cornell.edu/cgi-bin/foliocgi.exe/ucc8/query=[jump!3A!27c8!2D102!27]/doc/{@334} (Accessed 3 June 2002).

143 The Depository Bills and Notes Act (Chapter 13 of the 1998 Statutes of Canada (SC.1998,c.13)) became law on 11 June 1998.

144 Bradley Crawford, The Depository Bills and Notes Act: Negotiable Instruments for the Electronic Age, *Banking & Finance Law Review,* February 1999, vol. 14, no.2, pp. 205- 243.

## United Kingdom

The Jack Committee recommended in its 1989 Report, *Banking Services: Law and Practice* [145] that a new Negotiable Instruments Act should contain provisions giving to screen-based or book-entry transactions, operated by an approved depository and satisfying certain basic statutory requirements, the same status as equivalent transactions in negotiable instruments generally.[146] The Government of the day responded that it intended to legislate to give transactions in dematerialised instruments the same status as transactions in negotiable instruments generally.[147]

Although operating without direct statutory backing, market participants are currently able to immobilise money market securities such as bills of exchange, certificates of deposit and commercial paper with the Central Money Markets Office (the CMO) in a depository run by the Bank of England. CRESTCo, which operates the UK securities settlement system, CREST, [148] has owned the CMO since September 1999, and is responsible for operating the CMO service, including the depository.

Instruments held within the CMO are intended by the market to be negotiable. Since September 1994, it has been possible for sterling certificates of deposit to be issued into the CMO system in dematerialised form. The relevant dematerialisation documentation (dematerialisation agreement and the CMO deed of covenant) is drafted with a view to replicating contractually the benefits of negotiability. [149]

The Consultation Paper on the Future of Money Market Instruments (issued by the Bank of England's Sterling Money Market Liaison Group in November 1999)[150] considered the dematerialisation of Money Market Instruments (MMIs) (certificates of deposit, bills of exchange, commercial paper and Treasury Bills) and their integration into CREST. The Consultation Paper proposed that CREST records serve as the definitive record of ownership of MMIs and that negotiability not be replicated for dematerialised MMIs.

The possible integration of MMIs more fully into the gilts/equity settlement process appears to involve MMIs having the same legal characteristics as gilts and equities, including losing their identity as separate instruments and becoming fungible in the

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145 RB Jack, *Banking Services: Law & Practice - Report by the Review Committee,* CM 622, Her Majesty's Stationery Office, London, 1989.

146 The Jack Committee Report, Recommendation 8(9), p. 74.

147 White Paper entitled *Banking Services: Law and Practice* , CM 1026, Her Majesty's Stationery Office, London, March 1990, Annex 6 (Negotiable instruments) at paragraph 6.10, p. 27.

148 CREST is the UK's electronic settlement system for transactions in corporate registered securities, and since July 2000, British Government stock ('gilts'). In September 2002, CRESTCo merged with Euroclear, a European securities settlement system. For further details on the CREST (not an acronym) system, see Joanna Benjamin, *The Law of Global Custody*, Butterworths, London, 1996, Chapter 13 and the CRESTCo Homepage. http://www.crestco.co.uk

149 See Joanna Benjamin, *The Law of Global Custody*, Butterworths, London, 1996, Chapter 12.

150 Bank of England, *The Future of Money Market Instruments – A consultation*, November 1999. http://www.bankofengland.co.uk/markets/money/mmfuture.pdf (Accessed 4 June 2002).

dematerialised state. The November 1999 Consultation Paper recommended that the changes be implemented, as far as practicable, using section 207 of the *Companies Act 1989* (UK).[151] However, detailed legal and legislative issues, such as the exact legal provisions for the transfer of title to MMIs in CREST, have been left to HM Treasury Solicitors to determine.

Progress on implementing the dematerialisation and settlement of MMIs in CREST has continued with the publication of further consultation papers by the Bank of England in March 2000 and January 2001[152] and by CRESTCo in January 2001[153], and the establishment of working groups with market participation. CRESTCo and the Bank of England are continuing discussions with HM Treasury and HM Treasury Solicitors about the necessary legislative changes.

## UNCITRAL Model Law on Electronic Commerce

The UNCITRAL Model Law on Electronic Commerce has been the paradigm law on which a number of countries, including Australia, Singapore, Canada and various States of the United States (for example, Massachusetts and Illinois) have based electronic commerce legislation intended to encourage media and functional equivalence or neutrality between paper and electronic documents with legal significance.

The Attorney-General's Expert Group Report of March 1998[154] recommended the adoption in Australia of provisions based on the UNCITRAL Model Law to cover all data messages in trade and commerce, or with government, subject to some exceptions. The Electronic Transactions Act is the Government's response to that Report.[155]

While the Attorney-General's Expert Group did not consider whether Australian legislation based on the UNCITRAL Model Law should exempt bills of exchange, a number of jurisdictions have provided that their UNCITRAL Model Law-based

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151 Section 207 of the Companies Act 1989 (UK) (as amended by the Bank of England Act 1998) effectively requires that the rights and obligations relating to dematerialised instruments should be as similar as those relating to physical instruments as practicable. Subsection (10) stipulates that 'the reference to transfer without a written instrument includes, in relation to bearer securities, transfer without delivery'.

152 For further details, see the Bank of England website at http://www.bankofengland.co.uk/markets/money/mmfuture.htm (Accessed 5 June 2002).

153 For further details, see the CRESTCo website at http://www.crestco.co.uk/products/cmo/cmo_intro.html (Accessed 5 June 2002).

154 Electronic Commerce Expert Group to the Attorney General, *Electronic Commerce: Building the Legal Framework*,. March 1998. http://law.gov.au/aghome/advisory/eceg/ecegreport.html (Accessed 4 June 2002).

155 The Bill was introduced into the Parliament on 30 June 1999, and was assented to on 10 December 1999. Details and advice on the operation of the Act are available at *The AGD e-Commerce Homepage.* http://www.law.gov.au/publications/ecommerce/February 2002. (Accessed 31 May 2002).

electronic commerce legislation not apply to traditional negotiable instruments. For example, section 4 of the Electronic Transactions Act 1998 (Singapore) provides that Parts II (Electronic Records and Signatures) and IV (Electronic Contracts) shall not apply to any rule of law requiring writing or signatures in relation to, among other things, negotiable instruments.[156] The 1999 draft Canadian Uniform Electronic Commerce Act does not apply generally to negotiable instruments. However, the Comments to the Canadian Act (Annotated) note that the principle of exclusion is not that such documents should not be created electronically; rather, it is said, they seem to require more detailed rules, or more safeguards for their users, than can be established by a general purpose statute like the Canadian Act.[157]

UNCITRAL itself continues to be engaged on the issues which arise in connection with development of an electronic equivalent to paper-based negotiable instruments. However, as was noted in Chapter 7, the UNCITRAL Secretariat has proposed that an analysis of the specific requirements for such a comprehensive legal framework might best be undertaken in the course of UNCITRAL's consideration of wider legal issues relating to the transfer of rights, in particular, the transfer of rights in tangible goods by electronic means.[158]

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156 LawNet. *Electronic Transactions Act*. http://www.lawnet.com.sg/freeaccess/ETA.htm (Accessed 4 June 2002).

157 Uniform Law Conference of Canada *Uniform Electronic Commerce Act* 1999 (Annotated). http://www.law.ualberta.ca/alri/ulc/acts/euecafa.htm (Accessed 4 June 2002). See now http://www.ulca.ca.

158 United Nations Commission on International Trade Law, Working Group on Electronic Commerce, A/CN.9/WG.IV/WP.94, 14 February 2002, http://www.uncitral.org/en-index.htm (Accessed 4 June 2002).

# APPENDIX FOUR

## A.1 INTRODUCTION

Following receipt of the terms of reference, the Working Group placed advertisements in metropolitan newspapers inviting submissions from interested parties. Information about the Review was also circulated to persons and organisations likely to have an interest in it. The Working Group received expressions of interest in the Review and written submissions from the persons and organisations listed below.

## A.2 LIST OF SUBMISSIONS

The following is a list of the submissions that were received. Submissions marked *Confidential* have been denoted with an asterisk.

Austraclear Limited

Australian Bankers' Association (ABA)

Australian Financial Markets Association (AFMA)

Australian Society of Corporate Treasurers (ASCT) (now known as the Finance and Treasury Association)

Australian Stock Exchange (ASX)

Australian Treasury Operations Association (ATOA) (now known as the Australia Financial Operations Association)

Department of Industry, Science and Resources (now the Department of Industry, Tourism and Resources)

Law Council of Australia (LCA)

National Australia Bank*

R A McGee & Co Pty Limited

Mr Ken Robson, Barrister (Western Australia)

Westpac Banking Corporation

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