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The New Old Law of Electronic Money

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THE NEW OLD LAW OF ELECTRONIC MONEY

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A variety of electronic money systems have recently been proposed or implemented in which the initial transaction between the parties would—without any contact to the banking system—result in the instantaneous transfer of bank credit. For example, "smart-card" systems and various systems that have been proposed for internet payment transactions would operate by loading transferable value onto a device, so that a payment transaction could be completed by a transaction between the parties, without any contact to the banking system. It is generally assumed that there is no present law, statutory or judge-made, that applies directly to such electronic money systems. This article contends, to the contrary, that such electronic systems are essentially identical to the system of circulating bank notes that flourished in the United States in the early nineteenth century. Indeed, in its strongest form, the claim considered in this article is not simply that the law of circulating bank notes might serve as a source of potential analogies, but that this body of case law already applies to such systems as a matter of ordinary principles of stare decisis.

I. INTRODUCTION

IN the late twentieth and now early twenty-first centuries, a variety of payment systems have evolved or have been proposed. Many are simply new ways of transferring claims to bank accounts, so that completion of the payment requires a series of steps to actually change the parties' claims against their banks. For example, when debit cards are used in point-of-purchase transactions, the payment can be completed only if the merchant has contact with the banking system so that the amount of the purchase can be deducted from the buyer's account and credited to the seller's account. Some of the proposed systems, however, would operate in a different fashion. The initial transaction between the parties would—without any contact to the banking system—result in the instantaneous transfer of bank credit. For example, "smart-card" systems and various systems that have been proposed for Internet payment transactions would operate by loading transferable value onto a device, so that

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a payment transaction could be completed by a transaction between the parties, without any contact to the banking system.

Such systems are often referred to as "electronic money" systems.[1] It is generally assumed that there is no existing body of statutory or common law that would apply to such systems. For example, a 1996 Department of Treasury report states:

> In short, currently, no body of transactional rules comprehensively defines the rights and obligations arising from electronic cash transactions. The gaps might be filled by contracts between the parties or by principles of law applicable to other payment systems that might apply by analogy. The rights and obligations of parties regarding risk allocation in electronic cash transactions thus may vary with the system at issue. The significance of that uncertainty to the development of electronic cash systems will depend upon the degree to which the systems can successfully reduce risk by design and allocate risk by agreement.[2]

The thesis of the present article is that this view is wrong. Neither courts confronting questions that might be posed by systems of electronic money nor lawyers participating in the design and implementation of such systems will be writing on a clean slate. Rather, at least some of the legal issues posed by such systems can be analyzed by looking to the extensive body of case law developed in the early nineteenth century concerning circulating bank notes. Indeed, in its strongest form, the claim considered in this article is not simply that one might look to the law of circulating bank notes as a source of potential analogies, but that this body of case law may already apply to such systems as a matter of ordinary principles of stare decisis.

II. VARIETIES OF PAYMENT SYSTEMS

In considering the law that may apply to various forms of payment systems, it is useful to divide systems into three categories: currency, deposit account transfer systems, and note transfer systems.

A. CURRENCY

The simplest form of payment system is currency. Currency is a medium of exchange that the sovereign has declared to be "money" in the fairly strong sense of "legal tender." That is, money is a form of circulating medium the transfer of which automatically discharges the underlying

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1. *See generally* American Bar Association Task Force on Stored-Value Cards, *A Commercial Lawyer's Take on the Electronic Purse: An Analysis of Commercial Law Issues Associated with Stored-Value Cards and Electronic Money*, 52 BUS. LAW. 653 (1997). This report is perhaps the most comprehensive treatment of electronic money issues, including at least brief treatment of the nineteenth-century case law on circulating bank notes that is discussed in detail in this article.

2. U. S. DEP'T OF TREASURY, TOWARD ELECTRONIC MONEY AND BANKING: THE ROLE OF GOVERNMENT App. 1 (1996), *available at* http://www.occ.treas.gov/netbank/ra.htm.

debt for which it was transferred.[3]

The simplest form of currency system is a specie-based system. In a specie-based system, the medium of exchange is a quantity of precious metal that the community treats as having inherent value.[4] The role of the sovereign in such a system is primarily to control the minting of the precious metal into coins and to establish the value of coins so minted. For much of recorded history, the center point of the sovereign's power over the monetary system was the exclusivity of the power to mint precious metal into coins, to declare the value of the coins so minted, and to declare that the coins operated as legal tender at their minted value.[5] In the United States, this fundamental power rests solely with the federal government under the constitutional provisions that grant to the United States Congress the power "to coin Money [and] regulate the value thereof"[6] and that deny the states any power to "coin Money; emit Bills of Credit; [or] make any Thing but gold and silver Coin a Tender in Payment of Debts."[7]

In the modern United States, the only significant category of money in this narrow sense is paper money.[8] The paper money that is treated as currency is issued by the Federal Reserve Banks under a comprehensive and complex federal regime directed primarily at the important issue of public policy posed by control of the money supply.[9] From the standpoint of the law of payment systems, the only really significant legislation is the provision of federal law making Federal Reserve notes legal tender.[10]

The private law of payment systems for currency is quite simple. If A wishes to make payment to B by means of currency, all that is required is a delivery of the currency. At the moment of delivery, the underlying obligation is satisfied and the recipient of the currency becomes the party entitled to it. Because the payment transaction is instantaneous, a currency recipient need not worry about the credit-worthiness of the transferor. By contrast, suppose that A makes payment to B by delivery of a check. The physical delivery of the check is only the first step of the

3. *See generally* FREDERICK A. MANN, THE LEGAL ASPECT OF MONEY 1-30 (5th ed. 1992).

4. *Id.* at 14-19.

5. *See generally* ALBERT FEAVEARYEAR, THE POUND STERLING: A HISTORY OF ENGLISH MONEY (2d ed. 1963).

6. U.S. CONST. art. I, § 8, cl. 5.

7. U.S. CONST. art. I, § 10, cl. 1. There is a substantial question, now of only historical interest, about whether the original intent of these constitutional provisions was to prohibit the federal as well as state governments from issuing legal tender paper money. *See* Kenneth W. Dam, *The Legal Tender Cases*, 1981 SUP. CT. REV. 367.

8. Coins remain legal tender but do not contain any significant quantity of precious metal. Thus, like paper money, coins' value rests solely on the declaration of the sovereign.

9. *See generally* BD. OF GOVERNORS OF THE FED. RESERVE SYS., THE FEDERAL RESERVE SYSTEM: PURPOSES & FUNCTIONS 17-59 (8th ed. 1994).

10. 31 U.S.C. § 5103 (2000) ("United States coins and currency (including Federal reserve notes and circulating notes of Federal reserve banks and national banks) are legal tender for all debts, public charges, taxes, and dues. Foreign gold or silver coins are not legal tender for debts.")

process. Payment does not occur until after B deposits the check and the process of check collection is completed. If—and this is a big if—nothing goes wrong, the collection process results in a debit to A's account at the payor bank and a credit to B's account at the bank where B deposited the check. Until that collection process is completed, the person who takes payment by check runs the risk of the creditworthiness of the person who makes payment.

A currency recipient also faces little, if any, risk of fraud by the transferor. The rules of property transfer are quite different for currency and other forms of property. The ordinary rules of personal property transfer start with the principle that a transferee gets only such title as the transferor had.[11] Accordingly, if ordinary personal property is stolen, the owner can recover it even from one who gave value for the property without notice of adverse claims.[12] By contrast, a person who takes currency gets good title, even if her claim is traced through a thief. Indeed, that proposition is so fundamental that it is a bit hard to find a definitive citation. The usual citation is *Miller v. Race*.[13] But *Miller* did not involve actual currency. Rather, *Miller* held that Bank of England notes, which were not at the time formally legal tender, were governed by the same rules as money itself. Accordingly, the owner of a stolen Bank of England note could not recover it from a person who innocently received it for value.

The principle that good title to money can be obtained even by a transfer through a thief is most commonly cited in cases where the issue is whether the item in question should be governed by the money rules or the rules for ordinary chattels. For example, in a mid-nineteenth-century Massachusetts case, a privately minted gold token from the gold rush days of mid-nineteenth-century California had somehow found its way back to Massachusetts.[14] The Massachusetts court ruled, however, that it should be governed by the ordinary chattel rules, not the money rules.[15] By contrast, in a late twentieth-century case, it was held that the money rules applied to some $500 and $1000 bills that were still outstanding, even though the United States no longer issues currency in such large denominations.[16]

11. RAY ANDREWS BROWN, THE LAW OF PERSONAL PROPERTY § 9.3 (3d ed. 1975).
12. *Id.*
13. 97 Eng. Rep. 398 (K.B. 1758).
14. Chapman v. Cole, 78 Mass. (12 Gray) 141 (1858).
15. As I have elsewhere observed, the case could be understood as a reflection of "the ordinary attitude of proper Yankees to the bizarre practices of Californians, [to wit] the fact that people in California treated it as money didn't make it so." James S. Rogers, *Negotiability, Property, and Identity*, 12 CARDOZO L. REV. 471, 503 n.81 (1990) [hereinafter Rogers, *Negotiability*].
16. City of Portland v. Berry, 739 P.2d 1041 (Or. Ct. App. 1987).

B. Deposit-Account Transfer Systems

Most modern payments systems, however, are made by some system for the transfer of bank credit from one person's bank account to another person's bank account. Adopting the convenient terminology used in Uniform Commercial Code ("U.C.C.") Article 4A concerning wholesale wire transfers, we can describe all such systems as ones in which bank credit is transferred from the "Originator's" account to the "Beneficiary's" account.[17] Prior to the payment transaction, Originator has a bank account balance with Originator's Bank, and Beneficiary has a bank account balance with "Beneficiary's Bank." The goal of the payment transaction is to effect a transfer of some portion of that bank credit, or, more precisely, to reduce the liability of Originator's Bank to Originator and to make a corresponding increase in the liability of Beneficiary's Bank to Beneficiary.

The oldest deposit account transfer system in current use is, of course, the check system. The Originator, or "drawer" in check terminology,[18] maintains a checking account with Originator's Bank, the "drawee" or "payor bank" in check terminology.[19] The objective of the check payment transaction is to transfer some portion of that bank credit from Originator's account to Beneficiary's account. The process begins with delivery of the check from drawer to payee. That delivery does not, in itself, result in any change in the state of the parties' bank accounts.[20] The check might or might not be paid, depending, among other things, on whether it was drawn on sufficient funds and whether the drawer stops payment. Thus, the payment transaction consists of (1) the immediate transaction between Originator and Beneficiary and (2) the process of collection of the check through the banking system. In a simple collection scenario, Beneficiary (payee) deposits the check in an account at Beneficiary's Bank (depositary bank). Beneficiary's Bank gives Beneficiary provisional credit for the amount of the check at the time of deposit, but that provisional credit may be revoked if the check is returned.[21] Beneficiary's Bank forwards the check to the Originator's Bank. If the check is drawn on sufficient funds and no other problem is discovered,

17. Article 4A uses two terms—"funds transfer" and "payment order"—to describe a payment instruction. "Funds transfer" is defined in U.C.C. section 4A-104(a) as the generic term for the series of transactions that together constitute the intended transfer of bank credit. "Payment order" is defined in U.C.C. § 4A-103(a)(1) as an instruction given by one person, be it the user of the system or one of the banks participating in the system, to the party with which it is in contact directing the recipient to process a part of the funds transfer. Thus, a "funds transfer" typically consists of a series of "payment orders." U.C.C. section 4A-104(a) & cmt. 1. "Originator" is defined in U.C.C. section 4A-104(c) as "the sender of the first payment order in a funds transfer," while "beneficiary" is defined in U.C.C. § 4A-103(a)(2) as "the person to be paid by the beneficiary's bank." Citations to the U.C.C. are to the current (2005) version, which includes Article 4A (1989), and the revised version of Articles 3 and 4 (1990).

18. U.C.C. § 3-103(a)(5).

19. U.C.C. §§ 3-103(a)(4), 4-105(3).

20. U.C.C. § 3-408.

21. U.C.C. §§ 4-201(a), 4-214(a).

the check is "paid" by the payor bank.[22] "Payment," however, does not really describe a separate step. Rather, payment means only that provisional settlements made for the check on forward collection are not revoked.[23] The end result is that Beneficiary's account at Beneficiary's Bank has been credited for the amount of the check, Originator's account at Originator's Bank has been debited, and accounting entries have been made to reflect the transfer between Originator's Bank and Beneficiary's Bank, including in most cases entries on the books of other banks.

One feature that distinguishes the check system from many other deposit account transfer systems is that the flow of information and the flow of funds move in opposite directions. The information directing the funds transfer is contained on the check, but the check is delivered to the payee, rather than to the banks involved in the funds transfer. The check moves from Originator to Beneficiary. Beneficiary then initiates the bank collection process, by depositing the check with its own bank. In the useful terminology of the ill-fated Uniform New Payments Code ("UNPC"), the check system deals with "draw orders" that "pull" bank credit to the Beneficiary from the Originator.[24]

The more recently developed system of wholesale wire transfers, now governed by U.C.C. Article 4A, shares the feature of the check system that payment is made by the transfer of bank credit from one account to another. Unlike the check system, however, the instruction and the flow of funds move in the same direction.[25] Originator gives an instruction not to Beneficiary, but to Originator's own bank. Originator's Bank then transmits an instruction, ordinarily through one or more intermediary banks, to Beneficiary's Bank. By transmitting the instruction to or toward Beneficiary's Bank, Originator's Bank has accepted the Originator's payment order.[26] Upon acceptance by Originator's Bank, Originator becomes obligated to Originator's Bank for the amount of the order.[27] That obligation is ordinarily satisfied by a debit to Originator's account with Originator's Bank.[28] In the routine case, Beneficiary's Bank then gives notice to Beneficiary that the funds transfer has been received.[29] At least by the time that Beneficiary's Bank gives notice to Beneficiary, Beneficiary's Bank becomes obligated to Beneficiary.[30] Though the flow of information differs, the fundamental effect of a wholesale wire funds transfer is the same as that of a check payment: Originator's bank account with

22. U.C.C. §§ 4-215, 4-301.
23. U.C.C. § 4-215(a)(3) & cmt. 7.
24. See Unif. New Payments Code § 51 (P.E.B. Draft No. 3 1983).
25. The UNPC described these as "pay orders" that "pushed" bank credit. *Id.*
26. U.C.C. §§ 4A-209(a), 4A-301(a).
27. U.C.C. § 4A-402(c).
28. U.C.C. § 4A-403(a)(3).
29. U.C.C. § 4A-404(b).
30. U.C.C. §§ 4A-404(a), 4A-209(b)(1). In the case of a funds transfer through the Fedwire system, Beneficiary's Bank has accepted at the moment the order is received from the relevant Federal Reserve Bank, U.C.C. §§ 4A-403(a)(1), 4A-209(b)(2), so that Beneficiary's Bank becomes obligated to Beneficiary at that time, without regard to the giving of notice to Beneficiary. U.C.C. § 4A-404(a).

Originator's Bank is debited and Beneficiary's Bank account with Beneficiary's Bank is credited.

So too, various electronic payment systems that have come into common use in consumer transactions in the past few decades are, in essence, systems for making payment by transferring credit from one bank account to another. Perhaps the most familiar is the use of the automated clearing house ("ACH") system for direct deposit of payroll where the system operates by transferring credit from the employer's bank account to the account of the various employees at their own banks.[31] Similarly, other consumer uses of the ACH system, such as for consumer payments of recurring bills,[32] for representment of dishonored checks,[33] for replacement of checks by ACH transfers,[34] and the like are all systems in which payment is ultimately made by a transfer from the consumer's bank account to the bank account of the person receiving payment.

The system for consumer payments that has probably seen the most explosive use in the past decade is the debit card system. The current debit card system had its origins in the early 1970s with automated teller machine ("ATM") cards.[35] In recent years, the ATM card system has evolved into a significant independent payment system, largely as a result of the success of MasterCard and VISA in piggybacking the use of debit cards onto the existing infrastructure of the credit card clearance system.[36] Yet that system, like the check system and various uses of the ACH system, is still, at root, a system for transferring the amount of the payment from one bank account to another.

Finally, there is the credit card system.[37] Strictly speaking, one might say that the credit card system is not really a payment system, or not a complete payment system. When a consumer purchases goods or services with a credit card, the credit card transaction is completed when the merchant's account is credited and the issuing bank makes payment. The user, however, need not make payment until whatever later time is set by the credit arrangement between the issuer and the cardholder. Indeed, card issuers fervently hope that the users will not pay promptly but will instead incur significant finance charges. Perhaps because of the prominence of the credit card system in the United States, other proposed payment systems, such as for Internet sales and Internet auction payments, have in recent years developed primarily as adjuncts to the credit card system, rather than as independent payment systems. For example, the

31. *See generally* 1 DONALD I. BAKER ET AL., THE LAW OF ELECTRONIC FUND TRANSFER SYSTEMS ¶ 5.07 (2004).

32. *Id.* ch. 4.

33. *See* Glen R. McCluskey, *Electronic Check Transactions: What Law Governs?*, 58 BENCH & B. MINN. 25, 28 (Oct. 2001).

34. *See id.*

35. *See* 1 BAKER ET AL., *supra* note 31, at ¶ 6.04.

36. *Id.* ¶ 7.02.

37. *See generally* 2 BARKLEY CLARK & BARBARA CLARK, THE LAW OF BANK DEPOSITS, COLLECTIONS AND CREDIT CARDS ch. 15 (2004).

PayPal® system[38] that has become so dominant as a means of paying for goods purchased in E-Bay® auctions is, in essence, simply a way of arranging for a payment that will ultimately be made either by a charge to the user's credit card, or by a charge to the user's bank account.

C. NOTE TRANSFER SYSTEMS

In the modern world, when a bank establishes a credit in favor of a customer, it does so by entering the amount in an account maintained by the customer with the bank. The credit might be established either because the customer has made a deposit or because the bank has agreed to make a loan to the customer. In either event, the result of the transaction is a credit to an account maintained by the customer. If the account is a transaction account, the amount of the bank credit can then be transferred by any of the available modern systems for transfer of bank credit.

In the early nineteenth century, however, bank operations were conducted in a different fashion. Today, of course, banks do not issue circulating notes. Before the late nineteenth century, however, the issuance of circulating notes was a standard part of banking.[39] When one deposited money (specie) in a bank account or took out a loan from a bank, one received *notes issued by that bank*, not credit in an account at the bank. The notes were simply promissory notes issued by the bank embodying the bank's promise to pay the note (in real money, that is, specie) to the bearer. The person who received such notes from the bank could use them in making payment for other transactions. Anyone who received the bank notes could, of course, take them directly to the bank and demand payment in specie. However, so long as people in the community had confidence in the solvency of the bank, there would be little reason to do that. The paper bank note was certainly more convenient to carry around than gold coins. It could be passed along to others as a private currency. As was said in an early-nineteenth century Delaware case, "[b]ank notes constitute a large and convenient part of the currency of our country, and, by common consent, serve to a great extent all the purposes of coin."[40] Indeed, a banker was likely to regard it as an insult for someone actually to present a note for redemption in specie. As one authority notes, "[I]t had become the habit of bank officers and others to regard the presentation of notes for *redemption* in specie as an act to be reprobated, manifesting a desire to injure the bank and through it the community where it was located."[41] Of course, the proliferation of privately issued bank notes made it quite difficult to be sure whether a particular note tendered in payment was genuine or counterfeit. In response to that problem, weekly "bank note detector" publications were common.

38. *See* PayPal Homepage, http://www.paypal.com.

39. 1 FRITZ REDLICH, THE MOLDING OF AMERICAN BANKING 10-13 (2d ed. 1968).

40. Corbit v. Bank of Smyrna, 2 Del. (2 Harr.) 235, 252 (1837).

41. A. BARTON HEPBURN, A HISTORY OF CURRENCY IN THE UNITED STATES 166 (rev. ed. 1967).

In the publication, one could find information on which bank had issued which denominations, which notes were likely to be counterfeits, and what the market rate of discount was for the circulating notes of various banks.[42]

Today, we are so familiar with paper currency that it seems odd that anyone would have regarded a note issued by an ordinary bank as a medium of exchange. There are at least two ways of getting past that obstacle to understanding the history of payment systems. First, the modern sense that no one would accept a bank note, to wit, as currency is a product of the assumption that there is something better "ordinary" currency issued by, or under the control of, the government. But the issuance of legal tender paper money dates only from the time of the Civil War. Moreover, these Civil War "greenbacks" were not regarded as a desirable element of a permanent monetary system but as at best a necessary evil to meet the extraordinary circumstances of the war and at worst a flagrant affront to the Constitution, sound public policy, and morality.[43] The establishment of anything like the modern managed national currency system in the United States can be dated only from the National Bank Act of 1864[44] or perhaps the Federal Reserve Act of 1913.[45] Given the absence of governmentally controlled paper currency and the difficulties of using specie as a means of payment in anything other than the smallest transactions, the widespread acceptability of bank notes as a form of circulating medium can be understood as a product of the lack of anything better.

A second way of overcoming the sense of oddity that we now feel in looking at the currency system of the early nineteenth century is to realize that things are not really all that different today, except in form. In the early nineteenth century, it was obvious that the circulating medium consisted of notes issued by banks. Today, it is equally the case that the circulating medium of exchange consists of banks' obligations. The only difference is that the form has changed. True, banks no longer issue circulating notes. However, demand obligations of banks—in the form of deposit liabilities in checking accounts—remain the significant medium of exchange. For example, even the narrowest measure of the money supply includes not only currency but also demand obligations of commercial banks, and currency is only a small part of the total volume of the money supply.[46] Economically, the important difference between the modern currency system and that of the era of circulating bank notes is not the form of the bank obligations. Rather, the difference is that we have de-

42. BENJAMIN J. KLEBANER, AMERICAN COMMERCIAL BANKING: A HISTORY 18-19 (1990).

43. *See generally* HEPBURN, *supra* note 41, chs. XI - XIV; Dam, *supra* note 7; Hepburn v. Griswold, 75 U.S. (12 Wall.) 457 (1871).

44. 13 Stat. 99 (1864).

45. 38 Stat. 251 (1913).

46. BD. OF GOVERNORS OF THE FED. RESERVE SYS., THE FEDERAL RESERVE SYSTEM: PURPOSES & FUNCTIONS 28 (8th ed. 1994).

veloped a comprehensive regulatory, supervisory, and insurance system to minimize the risk that the prospect of bank failure poses to the monetary system.

III. E-NOTE SYSTEMS

Now let us consider the similarities and differences between "electronic money" systems and the various payment systems for which a relatively well-settled body of private law has evolved. The initial difficulty one confronts is a matter of definition and description. It would be fairly easy to provide specific descriptions of a variety of proposed electronic money systems. The citations for any such description would consist principally of URLs for the websites of the developers of the various systems, touting their advantages. By the time that anyone went to look for those references, however, the website, along with the system it described, may well have passed into oblivion.[47] Thus, rather than describe any particular system, it is better to outline, at a fairly high level of generality, the features of an electronic money system that are particularly relevant from the perspective of the private law of payment systems.[48]

A. Basic Characteristics of E-Note Systems

Assume that "Issuer"—which might be a single bank or other entity, or a grouping of entities related by some form of contract—issues what we will call "electronic notes" or "E-Notes."[49] The E-Notes are not represented by any definitive piece of paper. They exist only in the form of some electronic packet of information.

Transferability is the essence of the E-Notes. Issuer engages that it will pay the amount of the E-Note to any person to whom the E-Note has been transferred. How a transfer is accomplished may vary depending on the nature of the system. In a fairly simple "smart-card" system, transfer might be accomplished by swiping the card through some form of card-reader at a merchant, with the consequence that the E-Note is then held by the merchant rather than by the initial owner of the card. In more complex systems, such as those intended for payments for Internet transactions, transfer of the E-Notes might be accomplished by communication from one user to another over any form of electronic network,

47. *See (pointlessly), e.g.*, www.digicash.com, former website of now-defunct Digicash system.

48. A brief description of several of the systems that have been proposed is given in Jane K. Winn & Benjamin Wright, Law of Electronic Commerce § 7.04 (4th ed. 2004). One of the best descriptions of electronic money systems is found in ABA Task Force on Stored-Value Cards, *supra* note 1.

49. For simplicity, the description herein will speak of a single entity as Issuer. Systems where a group of entities act as issuers simply require some contract or other arrangement among the entities concerning the extent of liability for E-Notes issued by others. Also, the use of the term "E-Note" need not be taken to confine the discussion to systems in which the E-Notes are issued and transferable only in certain set denominations. The system might just as well permit the user to transfer value in any denomination up to the amount that has been loaded onto the user's device.

perhaps with limitations imposed by software or hardware security devices associated with the system.

The system might be limited to single use transactions. That is, once a user has transferred an E-Note to a recipient, the recipient could obtain the value only by redeeming the E-Note from Issuer or related entitles.[50] But, there is no need to assume that E-Note systems will be limited to such simple single use transactions. Rather, the system might permit the recipient of an E-Note to further transfer the E-Note to another user. Thus, an E-Note might circulate from user to user for an indefinite period of time before some user chooses to convert its value into some other form by presenting it to Issuer for redemption.

The key feature of any E-Note system is that it would permit real-time final transfers of the bank credit (or the credit of a non-bank issuer) represented by the E-Note by transactions that could be effected through a communication system outside the banking system. The transaction in which the E-Note is transferred from one user to another user would be both the beginning and the end of the payment transaction. Unlike the current check, credit card, or debit card systems, the user to user transaction would not simply be a way in which an instruction is given that will initiate a transfer of bank credit that is actually effected by some other set of transactions in the settlement process. Rather, once the user to user transaction has been effected, the transmitting user would no longer be the beneficiary of the issuing entity's credit represented by the E-Note, and the receiving user would, at that instant, become the beneficiary of the issuing entity's credit.

B. Do Other Payment System Statutes Apply to E-Note Systems?

At one time, it appeared that the American law of payment systems might move toward the development of a comprehensive statutory framework that would cover all forms of payment systems. However, the effort to develop a comprehensive Uniform New Payments Code encountered significant political obstacles, and was abandoned in the 1980s.[51] Thus, for the foreseeable future, various specific statutory regimes will apply to specific payment systems. Thus, the check system is governed by Articles 3 and 4 of the U.C.C., the wholesale wire-transfer system by Article 4A of the U.C.C., the consumer debit card system by the Federal Electronic Funds Transfer Act,[52] and the credit card system by certain provisions in

50. Redemption could be processed through some other funds transfer system, such as a wholesale wire transfer, credit to an account maintained by the recipient with the Issuer or a related entity, or even payment of the value by a paper instrument such as a check.

51. For a brief account of the history of the ill-fated Uniform New Payments Code project, and its transformation into the more limited project for addition of Article 4A on wholesale wire funds transfers and revision of Articles 3 and 4, see Fred H. Miller, *U.C.C. Articles 3, 4 and 4A: A Study in Process and Scope*, 42 Ala. L. Rev. 405 (1991).

52. Electronic Funds Transfer Act §§ 901-20, 15 U.S.C. §§ 1693-93r (2000); Federal Reserve System Regulation E, 12 C.F.R. §§ 205.1-205.17 (2005).

the Federal Consumer Credit Protection Act.[53]

In considering whether any of these existing bodies of statutory law might apply to an E-Note system, it is useful to distinguish three phases in the life of an E-Note: (1) issuance, (2) transfer, and (3) redemption. It is the second phase that presents significant new legal issues. Those are discussed in more detail below. The first and third phases present only legal issues that are either already governed by existing, well-settled law or are so closely analogous to well-settled issues that they require only the application of familiar principles to a slight variant of traditional payment arrangements.

1. Issuance

Existing commercial law already covers the initial phase of the acquisition of E-Notes. A user might get E-Notes by means of any existing payment system, for example, currency, check, or electronic funds transfer. If some dispute arises concerning a transaction in which E-Notes are acquired, the law governing the payment system used will apply. Suppose that E-Notes are acquired with currency that turns out to have been stolen. The law governing currency will determine whether the owner of the currency can assert a claim against the E-Notes. If E-Notes are acquired with a check and the check turns out to bear a forged drawer's signature or a forged indorsement, or if any other dispute arises concerning the funds transfer initiated by the check, the dispute will be governed by the law of checks, as codified in Articles 3 and 4 of the U.C.C. So too, if E-Notes are acquired by an electronic funds transfer from a deposit account maintained by the user, disputes concerning that phase of the transaction would be governed by the existing law of electronic funds transfers. In short, the fact that a particular traditional payment device is used to acquire E-notes makes no difference to the commercial analysis of a dispute about the operation of that traditional payment device. The situation is no different than if the traditional payment device were used to acquire any other product or service offered by a bank, be it E-notes, securities that the bank sells as a dealer, or commemorative t-shirts sold by the bank's public relations department.

This addresses one of the major risks of loss faced by a user of any E-Note system. The design of the E-Note system might permit a user to access a traditional deposit account by electronic means to download value in the form of E-Notes. In this use, the system could permit the user unlimited access to all funds on deposit in the account, and hence expose the user to unlimited risk of loss from an unauthorized use.[54] However, the fact that a bank depositor accesses the deposit account through the E-Note system has no bearing on the law that governs the

53. Truth in Lending Act §§ 132-34, 15 U.S.C. §§ 1642-44 (2000).

54. Note that because the bank maintaining the deposit account could permit the user to overdraw the deposit account, the potential exposure is not even limited to the amount on deposit. *Cf.* U.C.C. § 4-401(a), (b).

user's liability for an unauthorized transfer from the deposit account. Rather, that issue is governed by existing law on electronic funds transfers.

If the E-Note system is linked to a deposit account that is "established primarily for personal, family, or household use,"[55] a transfer of funds from that account to the E-Note system would constitute an "electronic fund transfer"[56] governed by the Federal Electronic Fund Transfer Act[57] and its implementing regulation, Federal Reserve System Regulation E.[58] Thus, this aspect of the E-Note system should be treated in the same fashion as any other consumer electronic funds transfer product offered by the bank that maintains the account, such as a telephone bill payment service or a home banking system. The principal substantive consequences would be that the initial disclosure requirements, error resolution procedures, and limits on liability for unauthorized transfers of the Regulation E ("Reg E") regime would apply. However, the individual transaction documentation provisions, which require paper receipts for ATM and debit card POS transactions, should not apply.[59]

Thus, with respect to the most serious possibility for consumer loss through the E-Note system—loss of funds held in a linked deposit account—existing law already resolves the matter. Under Reg E, a consumer user's liability for an unauthorized transfer from a linked deposit account to E-Notes would be limited to $50, or $500 if the consumer user fails to make a timely report of the loss of the access device, or unlimited liability if the consumer user fails to make a timely report of an unauthorized transfer that has been reported to the consumer on a periodic statement.[60]

If the E-Note system is linked to a deposit account that is not "established primarily for personal, family, or household use," a transfer of funds from that account to E-Notes would constitute a "funds transfer" governed by U.C.C. Article 4A.[61] As is the case with respect to the transfer value from a consumer's bank account into E-Notes, the principal

55. 15 U.S.C. § 1693a(2) (2000).
56. *Id.* § 1693a(6).
57. Electronic Fund Transfer Act §§ 901-20, 15 U.S.C. §§ 1693-93r (2000).
58. Federal Reserve System Regulation E, 12 C.F.R. §§ 205.1-205.17 (2005).
59. The Reg E transaction documentation requirements, 12 C.F.R. § 205.9(a) (2005), apply only to an electronic fund transfer that is initiated through an "electronic terminal." "Electronic terminal" is defined in Reg E as "an electronic device, other than a telephone operated by a consumer, through which a consumer may initiate an electronic fund transfer. The term includes, but is not limited to, point-of-sale terminals, automated teller machines, and cash dispensing machines." 12 C.F.R. § 205.2(h) (2005). The Board has indicated in an Official Staff Interpretation that the exclusion of transactions initiated by a "telephone operated by a consumer" will also cover "a transfer by a means analogous in function to a telephone, such as by home banking equipment or a facsimile machine." 12 C.F.R. Supp. I to Part 205 § 205.2(h) (2005).
60. 12 C.F.R. § 205.6 (2005).
61. The Article 4A analysis would be as follows: The commercial E-Note user would be the "originator," U.C.C. § 4A-104(c), who transmits a "payment order," U.C.C. § 4A-103(a)(1), to the bank that maintains the account, qua "originator's bank," U.C.C. § 4A-104(d), directing that same bank, qua "beneficiary's bank," U.C.C. § 4A-103(a)(3), to

consequence of the fact that a similar transaction by a commercial user is covered by U.C.C. Article 4A is that there is already an established body of law that addresses the most serious risk of loss in the E-Note system—the risk of an unauthorized use of a linked money module to drain the commercial user's ordinary deposit account. Article 4A establishes a loss allocation regime based on the concept of a "commercially reasonable security procedure." In rough form, the result of the Article 4A loss allocation rules is that if the bank makes available a commercially reasonable security procedure for testing the authenticity of payment orders, and the unauthorized instruction passes the security procedure, then the customer bears the loss unless the customer is able to prove that the unauthorized order was not caused by a breach of security within the customer's own organization.[62]

2. *Redemption*

The final phase in the life of an E-Note would be the step of presenting E-Notes to the issuer for redemption. This aspect of the system raises issues that are closely analogous to, though probably much simpler than, the process of collection of other payment media such as checks.

To be sure, if the E-Note system is most commonly used by persons who have established links to deposit accounts and routinely deposit E-Notes received by them into their linked deposit accounts, users may come to think of their relationship with the bank where they maintain their linked account as a key element of their use of the E-Note system. Indeed, merchants or others who are primarily recipients of E-Notes rather than transferors of E-Notes may care more about their legal rights

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make a payment to the same customer, qua "beneficiary," U.C.C. § 4A-103(a)(2), in the form of E-Notes.

The fact that the funds transfer is from the user to itself does not preclude application of Article 4A. The Official Comment explicitly notes this possibility. "In some cases the originator and the beneficiary may be the same person. This will occur, for example, when a corporation orders a bank to transfer funds from an account of the corporation in that bank to another account of the corporation in that bank or in some other bank." U.C.C. § 4A-104 cmt. 1, ¶ 6.

Although the usual Article 4A funds transfer is one in which the amount of the transfer is debited to one bank account and credited to another account, applicability of Article 4A does not require that the payment order direct that funds are to be credited to an account maintained by the beneficiary. Rather, the definition of "payment order," which is the key element in determining the coverage of Article 4A, requires only that the instruction direct the receiving bank to "pay, or cause another bank to pay, a fixed or determinable amount of money to a beneficiary." U.C.C. § 4A-103(a)(1). One might wonder whether an instruction directing a bank to load value in the form of an E-Note constitutes a direction to "pay . . . money." Note, however, that even in the archetypal Article 4A transaction, the result of the transfer is not actually a payment of "money" in the narrowest sense of delivery of legal tender, but is merely credit to the beneficiary's account, that is, the establishment of a relationship in which a bank becomes obligated to pay an amount of money. If, as must be the case, a direction to credit a bank account is a direction to "pay . . . money" within the meaning of U.C.C. section 4A-103(a)(1), it is hard to see why a direction to download E-Notes would not also be a direction to "pay . . . money." In both cases, the end result is that the beneficiary becomes creditor of a bank and could, though rarely would, enforce that credit claim by demanding legal tender.

62. U.C.C. §§ 4A-201 to 4A-203.

against their own bank than their rights against the bank that issued the specific E-Note. Yet, this aspect of the relationship is easily assimilated to traditional law governing deposit and collection of items in deposit accounts. Moreover, this aspect of the system could be created by traditional bilateral agreements between the bank maintaining the deposit account and its customer.

Several possible models of the E-Note collection process might be adopted. At one extreme, the system might be structured in the fashion that only the issuing bank undertakes to pay the amount of the note. If a user transferred an E-Note to its own bank for collection, the governing agreement between the user and the bank might provide that any credit given for the deposited E-Note is provisional and may be revoked or recovered if the particular E-Note is not paid, e.g., because the issuing bank has failed. Agreements among banks through whom an E-Note passed in the collection process could be structured in the same fashion.

It might, however, be economically feasible for banks to offer irrevocable credit for E-Notes deposited with them for collection, even though the collecting bank is not itself the issuing bank of that E-Note. Unlike the check collection system in which a collecting bank has no way of knowing whether a specific check will be paid by the drawee upon presentment, it should be possible for any bank taking an E-Note for collection to know, by virtue of the security system information encoded in the E-Note, that it does represent an obligation of the issuing bank. Accordingly, it should be entirely feasible for the agreement between a bank and a customer to provide that any credit given by the bank for an E-Note received by the bank for collection is irrevocable.

Indeed, it may be feasible for a bank that has established a relationship with its own customer for collection of E-Notes to offer an even greater degree of assurance. A collecting bank might agree with its customer, in advance, that it will give irrevocable credit for any E-Notes that the customer receives via a transfer that passes muster under the security systems associated with the E-Note system. Such an arrangement might be desirable if there are multiple issuers of E-Notes, because the undertaking of the collecting bank to its customer would make it feasible for the customer to accept E-Notes without an individual credit decision about each issuer. With such an agreement from its own bank, the user would—at the instant that its system accepts an E-Note—effectively have a claim not only against the issuing bank, but also against its own chosen bank. In that fashion, the E-Note system would replicate one of the desirable features of traditional bank wire transfers, in that a person receiving payment would give up its claim against the person making payment only at the moment that the person receives a claim against its own chosen bank.[63]

63. A payment by wire transfer discharges the underlying obligation at the time that a payment order is accepted by the beneficiary's bank. U.C.C. § 4A-406. That is also the moment at which the beneficiary obtains a claim against its own bank. U.C.C. § 4A-404.

Implementation of any of these models of the relationship between a user and a collecting bank should be entirely feasible by private agreement. As a matter of substantive law, any of the models described above is fully consistent with general principles implemented by specific statutes for other payment systems. Although, as noted below, U.C.C. Article 4 would not apply of its own force to an arrangement between a user and a bank that took E-Notes for collection, it does provide a useful source of analogy. Under Article 4, the default rule is that a depositary or other collecting bank can recover from its customer any value given for an instrument if the instrument is not ultimately paid, but that rule is subject to variation by agreement.[64] Thus, an analogy to Article 4 would support the enforceability of agreements between collecting banks and E-Note users concerning the extent to which the collecting bank agrees to give irrevocable credit for E-Notes.[65]

3. *Transfer*

The key phase in the life cycle of an E-Note is the stage of transferring of the E-Note from one user to another. Since that transfer occurs entirely within the E-Note system, it poses far more difficult issues than the phases of issuance or redemption. Let us consider whether any existing framework of payment system law would apply to the transfer of E-Notes from one user to another.

a. U.C.C. Articles 3 and 4

U.C.C. Article 3 governs traditional negotiable instruments, including checks, drafts, and promissory notes. The scope of Article 3 is determined by the definition of "negotiable instrument" which requires that there be a signed, written promise or order for the payment of a fixed amount of money and that the promise or order be, with certain narrow exceptions, unconditional and unaffected by any other agreement. The requirement that an Article 3 instrument be a signed writing would exclude an electronic representation of value such as an E-Note.[66]

U.C.C. Article 4 deals with the process of collection of checks and other items through the banking system. The coverage of Article 4 is set by the definition of the term "item." Although "item" is a somewhat broader term than the Article 3 concept of "negotiable instrument," the most natural reading of the scope provisions indicate that Article 4 is

64. U.C.C. §§ 4-103, 4-201, 4-214.

65. The provisions of the original version of Article 4 on the revocability of provisional credits have been applied to the credit card system with respect to credit given by merchant banks to their customers for deposited credit card slips. 2 CLARK & CLARK, *supra* note 37, at ¶ 15.02[4][b][ii]. Presumably courts would follow the same approach even under the 1990 revised version of Article 4 which explicitly excludes credit card slips from the definition of "item" in section 4-104(a)(9).

66. The possible relevance of digital signature legislation is considered *infra* text accompanying notes 192-94.

limited to paper items.[67] Accordingly, Article 4 would not of its own force apply to the transfer of E-Notes.

b. U.C.C. Article 4A

U.C.C. Article 4A sets out a comprehensive body of commercial law designed for transactions of the sort commonly referred to as wholesale level electronic funds transfers.[68] The key provision setting the scope of Article 4A is "payment order," defined in section 4A-103(a)(1) as:

1. "an instruction of a sender to a receiving bank,"
2. "transmitted orally, electronically, or in writing,"
3. "to pay, or to cause another bank to pay, a fixed or determinable amount of money to a beneficiary"
4. which "does not state a condition to payment to the beneficiary other than time of payment"
5. in an arrangement in which "the receiving bank is to be reimbursed by debiting an account of, or otherwise receiving payment from, the sender"
6. and "the instruction is transmitted by the sender directly to the receiving bank or to an agent, funds-transfer system, or communication system for transmittal to the receiving bank."

The first and sixth requirements together limit the coverage of Article 4A to systems in which payments are made by a transfer effected through the banking system. Although Article 4A could apply to virtually any payment arrangement implemented by a communication flow that proceeds from (1) the person making payment to a bank, (2) from that bank to another bank, and (3) from a bank to the person to receive payment,[69] the payment flow in an E-Note system would be different. The flow would run (1) from the banking system to the person making payment, thence (2) directly to the person receiving payment, thence (3) either to another person outside the banking system or back to the banking system. Thus, the transfer of an E-Note would not fall within the Article 4A

67. "Item" is defined as "an instrument or a promise or order to pay money handled by a bank for collection or payment." U.C.C. § 4-104(a)(9). The terms "instrument," "order," and "promise" in the definition of "item" are used in the senses defined in Article 3. U.C.C. § 4-104(c). The terms "order" and "promise" are defined as "a written [instruction/undertaking] to pay money signed by the person giving the [instruction/undertaking]." U.C.C. § 3-103(a)(8), (12).

68. A somewhat complex set of provisions effectively limit Article 4A to "business" as distinguished from "consumer" electronic fund transfers. U.C.C. section 4A-108 excludes from Article 4A funds transfers any part of which are governed by Reg E, which applies to electronic transfers to or from an account "established primarily for personal family or household purposes," 12 C.F.R. § 205.2(b)(2005), however, another provision excludes "any transfer of funds through Fedwire or through a similar wire transfer system that is used primarily for transfers between financial institutions or between businesses." 12 C.F.R. § 205.3(c)(3) (2005).

69. Although the typical transactions covered by Article 4A are in fact implemented by electronic means, the coverage of Article 4A is not limited to electronic transfers. The instruction from the paying user to the bank, from one bank to another bank, and from that bank to the receiving user could be implemented by letters written with quill pens on parchment and transmitted by carrier pigeon, yet the transaction would still be subject to Article 4A. U.C.C. § 4A-104 cmt. 6.

definition of a "payment order" because an E-Note transfer occurs entirely outside the banking system rather than by an instruction directed to a bank.

c. Federal Electronic Funds Transfer Act and Regulation E

The Federal Electronic Funds Transfer Act,[70] and its implementing administrative regulation, Federal Reserve System Regulation E,[71] deal with the rights of consumers against banks concerning electronically implemented payments from or to their bank accounts.[72] (The statute and implementing regulations are herein collectively referred to by the common shorthand "Reg E.") The typical transactions governed by Reg E are ATM transactions, debit card POS payments, and direct deposit of payroll or other benefit payments. The main substantive consequences of the applicability of Reg E are standardized disclosure requirements, transaction and account documentation requirements, and rules that, in most circumstances, limit a consumer's liability for unauthorized transactions to $50.[73]

The likely analysis of consumer uses of an E-Note system under Reg E is similar to the analysis of non-consumer uses under U.C.C. Article 4A. As noted above, Reg E would apply to the stage of issuance of an E-Note if a consumer used some electronic means to download value in the form of E-Notes from a consumer deposit account. By contrast, Reg E should not apply to the transfer of E-Notes from one user to another.

Reg E applies to "any electronic fund transfer that authorizes a financial institution to debit or credit a consumer's account."[74] The term "electronic fund transfer" is defined as "any transfer of funds that is initiated through an electronic terminal, telephone, computer, or magnetic tape for the purpose of ordering, instructing, or authorizing a financial institution to debit or credit an account."[75] A transaction in which the customer makes payment by transferring the E-Note to another user could fall within definition of "electronic fund transfer" only if the value held in the form of E-Notes was itself an "account" so that the transmission of an E-Note from the transmitting user effected a "debit . . . to an account."

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70. 15 U.S.C. § 1693-93r (2000).

71. 12 C.F.R. Part 205 (2005).

72. Reg E plays a role for consumer electronic funds transfer that is somewhat akin to the role played by U.C.C. Article 4A for non-consumer transactions. The parallel is somewhat rough, inasmuch as Article 4A establishes a comprehensive system of rules governing the rights and duties of participants at all stages of a payment transaction within its scope, while Reg E deals only with a limited range of issues concerning the relationship between a consumer user and the bank with which the consumer maintains an arrangement for electronic funds transfers.

73. 12 C.F.R. § 205.6 (2005). A consumer who fails promptly to report the loss of an access device may face liability up to $500, and a consumer who fails promptly to report an unauthorized transaction shown on a account statement may face unlimited liability. *Id.*

74. *Id.* § 205.3(a).

75. *Id.* § 205.3(b).

The concept of an "account" or "deposit account" plays a crucial role in many regulatory and commercial provisions concerning banking and payment systems. For example, the statutory provisions that determine which bank liabilities are covered by Federal Deposit Insurance Corporation ("FDIC") or similar insurance systems are generally tied to the concept of a deposit account.[76] So too, Reg E covers only those payment systems that result in a "debit or credit to a consumer's account."[77]

From the ordinary meaning of the term "account," as well as from the particular usage in banking and payments statutes, it should be possible to identify at least two minimum criteria for classification of an arrangement as a "deposit account." First, from the core etymological sense of the term "account" as a matter of "counting," it seems reasonable to assume that a relationship cannot be an "account" unless it is possible for the financial institution to "count it." That is, the dollar amount of the bank's liability must be determinable from the bank's records. Second, as used in banking and payments law, the concept of a deposit account is invariably associated with the notion that the bank liability in question is owed to a particular person. Thus, the concept of a deposit account seems to assume that the bank's own records would permit the bank to determine the amount of its obligation to each particular customer.

Even these minimal elements of the concept of a deposit account should exclude E-Notes. The central feature of an E-Note system is that it permits a user to transfer value by a transaction effected without contacting the banking system. Even if a bank that had issued E-Notes did so only in arrangements in which the identity of the particular users had been disclosed to the bank—as need not be the case depending on the system design—that would mean only that the bank's records would identify the initial holders of the E-Notes. The bank would have no way of knowing to whom those E-Notes had been transferred. Thus, it would not be possible for the bank to determine, in real time, the identity of the persons to whom it owed particular amounts represented by the E-Notes that it had issued. Accordingly, for accounting purposes, the liability of a bank that had issued E-Notes would have to be recorded on the books of the bank as an undifferentiated liability account for all outstanding E-Notes issued by that bank.

Banking and payment system regimes that use the concept of deposit account contemplate not merely that a bank be able to determine the aggregate of its liabilities to all customers, but that it be able to determine the amount owed to a particular customer. For example, FDIC insurance is limited to a certain dollar figure per account, not to an aggregate

76. In general, the term "deposit" as used in the Federal Deposit Insurance Corporation Act covers "the unpaid balance of money or its equivalent received or held by a bank . . . in the usual course of business and for which it has given or is obligated to give credit, either conditionally or unconditionally, to a commercial, checking, savings, time, or thrift account . . . ." 12 U.S.C. § 1813(*l*)(1) (2000).

77. Electronic Fund Transfers Act § 903(6), 15 U.S.C. § 1693a(6) (2000); Federal Reserve Board Regulation E, 12 C.F.R. § 205.3(a) (2005).

amount owed by the bank to all similar claimants. But if E-Notes were regarded as insured deposits, there would be no way to determine in advance the extent of the FDIC's potential liability, because the amount of E-Notes held by individual potential claimants would not be determinable. With respect to Reg E, that regulation applies only to "accounts" maintained for personal, family, or household use. In an E-Note system, E-Notes would pass freely among users, some of who might hold the value for personal, family, or household use, while others would hold the value for business purposes. There would, however, be no way for a bank that had issued E-Notes to determine whether the obligation represented by a particular E-Note was held by a consumer or by a business entity.

Indications from regulatory authorities with respect to the classification of other new forms of payment systems are generally consistent with the conclusion that E-Notes would not be covered by statutes governing deposit accounts. In 1996, the FDIC issued a General Counsel's Opinion discussing various forms of stored-value card point-of-sale payment devices.[78] The Opinion concludes that stored-value card systems in which the obligation of the issuing bank is not recorded as a liability to a specific customer, but is carried as a general liability account to be paid out to whomever presents the device for collection, would not be insured deposits.

The Federal Reserve Board ("Board") has given somewhat less clear guidance on its views of the potential scope of the concept of "account" as used in Reg E. In May 1996, the Board published for comment a set of proposed regulations on the application of Reg E to stored-value cards.[79] The Board suggested that stored-value cards might be divided into three categories: "off-line accountable," "off-line unaccountable," and "on-line."[80] The Board's suggestions concerning the treatment of "off-line unaccountable" and "on-line" stored-value system are unsurprising and are fully consistent with the analysis offered above. The Board indicated that an "off-line unaccountable" system, in which the stored-value card itself contains the only record of the value and the card is used without any communication to a bank, would not be subject to Reg E because it does not result in a debit to an account. By contrast, an "on-line" system in which the card is used only by communication to the bank, would be subject to Reg E because the card would merely be a means of instructing

78. FDIC, General Counsel's Opinion No. 8; Stored Value Cards, 61 Fed. Reg. 40490 (Aug. 2, 1996). As is common in such discussions, the term "stored value card" is used without any precise definition, but the discussion indicates that the products contemplated are primarily those directed at the retail, point-of-sale market.

The FDIC opinion indicates that "While this opinion addresses stored value cards, the Legal Division believes that in general the principles discussed herein would apply equally to stored value computer network payments products." 61 Fed. Reg. at 40490.

79. Federal Reserve Board, Electronic Fund Transfers Proposed Rule, 61 Fed. Reg. 19696 (1996). As with the FDIC General Counsel Opinion, the Federal Reserve Board rules seem to contemplate primarily retail point-of-sale systems but indicate that similar principles might apply to computer network products.

80. 61 Fed. Reg. at 19699.

the bank to debit the customer's account. It is, however, far less clear what the Board meant by its suggestions concerning the category it termed "off-line accountable" and far less clear whether the Board's suggestions are actually supported by the statutory language.

The Board seemed to be suggesting—though its language was rather guarded and hesitant—that if a smart-card system were structured in such fashion that it would be possible for the bank maintaining the system to reconstruct, at least periodically, the state of value held by individual cards, then the system might be subject to Reg E.[81] The Board gave little persuasive explanation for this conclusion, merely asserting that the circumstances that "transactions are traceable to the individual card" and that "the consumer has the right to draw upon funds held by an institution . . . strongly parallels the functioning of a deposit account."[82] Just what this "parallel" might be is a bit difficult to see. An arrangement in which a bank cannot determine who its creditor is and cannot determine the amount of its debt to any particular person who might or might not be its creditor, seems remarkably unlike a deposit account.

Whether anything will come of the Board's concept of an "off-line accountable" system remains to be seen. After some adverse commentary suggesting that the Board's regulatory proposals on stored-value cards might be premature, Congress enacted legislation prohibiting the Board from taking any final action on these proposed regulations until after the completion and submission to Congress of a study of the desirability of regulation and possible market-based alternatives to regulation.[83] The Board submitted its report in March 1997,[84] but the report studiously avoids giving any indication of the Board's intentions with respect to the proposed regulations. Nothing has happened since then, so the issue of potential Reg E coverage of E-Note systems may well be regarded, for the nonce, as a dead issue.

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81. The relevant passage reads as follows:

> In some stored-value systems, the balance of funds available is recorded on the card, but is also maintained at a central data facility at a bank or elsewhere. The systems operate off-line; there is no authorization of transactions by communication with a database at a financial institution or elsewhere. Transaction data are periodically transmitted to and maintained by a data facility. As in the case of the traditional consumer deposit account accessed by a debit card, in these stored-value card systems a consumer has the right to draw upon funds held by an institution. The maintenance of a record of value and of transactions for a given card apart from the card itself—so that transactions are traceable to the individual card—strongly parallels the functioning of a deposit account. The Board believes that the facts support a finding that such systems involve an account for purposes of the EFTA. These systems are referred to below as "off-line *accountable* stored-value systems."

Id.

82. *Id.*

83. Economic Growth and Regulatory Paperwork Reduction Act of 1996, Pub. L. No. 104-208 § 2601.

84. BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, REPORT TO CONGRESS ON THE APPLICATION OF THE ELECTRONIC FUND TRANSFER ACT TO ELECTRONIC STORED-VALUE PRODUCTS (1997).

D. The Law of Bank Notes as a Source of Law for E-Notes

The conclusion that no modern statutory law of payment systems would, of its own force, apply to an E-Note system is commonly regarded as meaning that the courts would be confronted with a wholly new task in dealing with cases that might arise if an E-Note system is put into place. That conclusion, however, overlooks another well-established body of law—the law of circulating bank notes.

As has been noted, the essence of an E-Note system is that the issuer of the E-Note (whether a bank or other entity) has undertaken to pay a designated amount either to the party to whom the E-Note was originally issued or to any party to whom the E-Note is transferred. The whole point of the device—from the standpoint of both the issuer and the users—is that the E-Note will be used as a medium of exchange. The central feature of the system is that the obligation of the issuer is owed to any person to whom the E-Note has been transferred, so that immediately upon transfer, without any further settlement or other communication to the banking system, the transferee user becomes the beneficiary of the obligation of the issuer, and the transferor user no longer has that right.

Is that a novel device? Hardly. The central description of an E-Note system is exactly the same as that of the system that was well-established in the United States in the first half of the nineteenth century—the system of circulating bank notes. The only difference is that, in the early nineteenth-century system, the bank notes took the form of writings, while in an E-Note system, the notes would take the form of some electronic embodiment of information. It is far from clear why the difference in the medium in which the obligation is embodied should matter to the governing law, or, at least, it is far from clear that the difference in the medium means that the pre-existing law of circulating paper notes can simply be ignored in working toward a legal regime for circulating E-Notes. The Anglo-American system of private law is, after all, a system built on precedent. In such a system, the fact that the law of circulating bank notes is relatively old cannot, in itself, count as a reason for concluding that that body of law has no relevance to modern transactions.

It appears, then, that lawyers planning E-Note systems, as well as courts called upon to adjudicate disputes concerning E-Notes, cannot simply ignore the established case law concerning similar forms of payment systems, particularly the nineteenth-century case law of circulating bank notes. The following sections of this paper consider several such issues, specifically (1) whether an E-Note would be "legal tender;" (2) whether adverse claims could be asserted to an E-Note; (3) whether the transfer of an E-Note discharges the underlying obligation for which it is given; and (4) what the consequences are if an E-Note that has been transferred as a means of payment turns out to have been counterfeit.

IV. IS AN E-NOTE "LEGAL TENDER"?

The first legal issue concerning E-Notes that warrants discussion, if only to eliminate confusion, is whether an E-Note would constitute "money" in the sense of "legal tender." One sometimes sees discussions suggesting that a significant disclosure issue would be raised by marketing statements comparing stored-value cards to cash, on the grounds that the value represented by a stored-value card is not legal tender.[85] It is a bit hard to see why that is a problem. In the United States, the only legal tender is currency, that is, coin and Federal Reserve Notes.[86] Virtually no modern payment system involves transfer of legal tender. But little of consequence turns on whether a certain payment device is legal tender.[87]

To say that an item is legal tender is to say that a *debtor* who proposes to satisfy an obligation by delivery of the item is entitled to do so. The emphasis on the term "debtor" is significant. The concept of legal tender does not determine whether a provider of goods or services is obligated to take a certain payment device. Saying that an item is legal tender means only that a person who has incurred a debt can discharge it by tendering the item. Legal tender has nothing to do with whether such a debt has been incurred.

A merchant would have an obligation to accept a certain payment device in exchange for goods or services only if (1) the merchant had some duty derived from other law to deal on ordinary terms with all comers and (2) payment with the device in question counts as ordinary terms for purposes of such a duty. Neither of these questions has anything to do with the concept of legal tender.

The case law that purportedly deals with whether something is or is not legal tender reflects a good deal of confusion on this basic point. A good example is *Nemser v. New York City Transit Authority*.[88] Several gadfly plaintiffs brought a declaratory judgment action challenging the policy of the New York City Transit Authority that dollar bills would not be accepted as payment for bus fare. The plaintiffs said that the policy violated the federal statute making dollar bills legal tender. Not surprisingly, the court dismissed the case, concluding that the Transit Authority's policy was reasonable. The court, however, seemed to think that the case involved interpretation of the federal statute making dollar bills legal tender. In reality, no such issue was presented.

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85. *See* Mark. E. Budnitz, *Stored Value Cards and The Consumer: The Need For Regulation*, 46 AM. U. L. REV. 1027, 1036, 1061-62 (1997).

86. 31 U.S.C § 5103 (2000) ("United States coins and currency (including Federal reserve notes and circulating notes of Federal reserve banks and national banks) are legal tender for all debts, public charges, taxes, and dues.")

87. A fair number of the cases purportedly dealing with whether something is or is not legal tender involve quixotic efforts by tax protestors asserting such arguments as that taxes are unlawful if the taxing authority permits them to be paid in anything other than gold or silver. *See, e.g.*, Walton v. Keim, 694 P.2d 1287 (Colo. Ct. App. 1984); Herald v. Idaho, 691 P.2d 1255 (Idaho 1984); Parsons v. Idaho, 745 P.2d 300, 307 (Idaho Ct. App. 1987).

88. 530 N.Y.S. 2d 493 (N.Y. Sup. Ct. 1988).

Imagine that a prospective bus rider seeks to board a bus. The bus driver says that the fare must be paid. The prospective rider tenders a dollar bill. The bus driver refuses, saying only tokens or coins are acceptable means of payment. Stop the action right at this point. Can the prospective bus rider state a claim based on the legal tender statute? No. The bus rider is not a person who has incurred a debt and seeks to discharge it by tender of something that might or might not be legal tender. Rather the prospective bus rider is someone who wants to purchase a service. The question is whether the bus company is obligated to sell that service in exchange for the medium of payment that is tendered.

To see the point more clearly, suppose that the prospective seller of goods or services is a purely private entity. Suppose further that the seller's policy on what it will accept as payment is quite bizarre. Suppose I place an advertisement in the newspaper that I have a car for sale for $8000. Someone comes to look at it and wants to buy it. I say OK, but only if payment is made by delivering 80,000 dimes to me. The prospective buyer offers to pay in cash, with 80 $100-bills, 160 $50-bills, 400 $20-bills, 800 $10-bills, 1600 $5-bills, or even 8000 $1-bills. I politely refuse, saying it's either 80,000 dimes or no car. Have I violated the legal tender statute? Clearly not. It was my car, and I am free to do with it as I wish, including imposing idiotic stipulations on the terms on which I will sell it. The legal tender statute has nothing to do with whether I am or am not obligated to sell my car, or the terms on which I am willing to sell the car.

The *Nemser* case is, of course, somewhat different because the seller of services in that case was a public transit authority rather than a private individual. A municipality or other public authority may well have an obligation to provide service on reasonable terms and without discrimination to all persons who wish to do business with it.[89] That obligation may well preclude a public utility from refusing to do business on bizarre terms, but that duty would permit the utility to establish reasonable terms. Thus, while there may be an obligation on a public utility such as the transit authority in *Nemser* to provide service on reasonable terms, that duty is a flexible one, and, in any event, has nothing to do with the legal tender statutes.

Even within its proper limited scope, the concept of legal tender has relatively little practical significance. Suppose, for example, that Debtor owes Creditor $1000. When the debt comes due, Debtor tenders to Creditor one $1000 Federal Reserve Note. Creditor, having never seen a $1000 Federal Reserve Note before, refuses to accept it. Creditor demands that Debtor pay the debt in currency of ordinary denominations, no larger than $50. Creditor then files suit against Debtor demanding judgment for $1000 plus prejudgment interest from the due date until the date of entry of the judgment. A $1000 Federal Reserve Note is in fact still "legal tender." Yet all this means is that so long as Debtor remains

89. 73B C.J.S. *Public Utilities* §§ 2, 7 (1983).

willing to pay by delivery of the Note, Creditor has only itself to blame for the fact that the debt has not been paid. Accordingly, Creditor cannot recover prejudgment interest. But, that has nothing to do with Creditor's right to the $1000 principal amount of the debt.[90]

Because payment of debts in legal tender is unusual, a creditor has only limited rights to demand legal tender. Suppose that a person has a contractual duty to perform some act and that the duty is conditioned upon the other party's payment by a certain date. Suppose that at the payment date, the debtor tenders some ordinary payment device that is not legal tender, for example, a check or bank wire transfer. Suppose that the creditor refuses to accept it, demanding that the payment be made in legal tender. Both general contract law and U.C.C. Article 2 on the sale of goods treat a demand for payment in legal tender as sufficiently unusual and surprising that the obligor is entitled to an additional period of time to make arrangements to pay in legal tender.[91]

V. ASSERTION OF ADVERSE CLAIMS TO E-NOTES

Suppose that at some point in an E-Note's life, it is transferred in a transaction that is wrongful against a person with an interest in the E-Note. In the simplest variety of such scenarios, a scalawag gets hold of the device by which the E-Note is transferred and transfers it without the consent of its owner—in short, steals it. In somewhat more complex scenarios, the E-Note might have been transferred in a transaction induced by fraud, mistake, or other invalidating cause, so that the transferor might have a claim to rescind the transaction and seek to recover the E-Note. In still other scenarios, the E-Note might be voluntarily transferred by its owner, but someone else might have acquired a lien or other interest in it in the hands of the transferor and might seek to assert that claim against the transferee.

In any such case someone might assert an adverse claim to the E-Note in the hands of a transferee. If such a claim could be asserted successfully, then the utility of E-Notes as a form of money might be significantly compromised. Fortunately, however, there is an adequate common law basis to conclude that any such claim would be cut off by a transfer of an E-Note to a person who gave value for the E-Note without notice of the adverse claim.

The first step in analyzing whether such an adverse claim could be asserted is to consider a bit more carefully the nature of the claim. Con-

90. *See, e.g.*, Liberty Nat'l Bank v. Semkoff, 84 P.2d 438 (Ok. 1938) ("A valid legal tender made by a debtor and refused by a creditor does not operate as a satisfaction of the debt; the effect of such tender when maintained being merely to discharge the debtor from liability for interest accruing subsequent to the tender and costs afterward incurred."

By contrast, suppose that Debtor had proposed to satisfy the obligation by delivering a matured $1000 U.S. Treasury Note, which is not "legal tender." Suppose that Creditor refuses the tender and sues. Because the note is not legal tender, Creditor would be entitled to prejudgment interest in addition to the $1000 principal amount.

91. RESTATEMENT (SECOND) OF CONTRACTS § 249 (1981); U.C.C. § 2-511(2).

sider analogous issues involving ordinary chattels.[92] Suppose "Owner" owns a boat, "Thief" steals it, and Thief sells the boat to "Transferee." Under the ordinary rule summed up in the maxim *nemo dat quod non habet*, Transferee can get no better interest than his transferor had. Since Transferee took from a thief, Transferee gets no title, and must return the boat to Owner.

It is worth noting that this conclusion rests on the assumption that we can identify the boat in the hands of Transferee as the same boat that belonged to Owner. To see the significance of this point, assume a slight change in our hypothetical. Thief steals a boat from Owner, but Thief no longer has the boat. Rather, Thief swapped it for a horse. Of course, Owner can assert a claim to the stolen boat against anyone who ends up with it. But, suppose that we cannot find the person who now has the boat. What about the horse that Thief got by swapping the boat? Can Owner recover the horse from Thief?

Owner cannot assert a claim of simple ownership to the horse, because it was not the same thing that was stolen from Owner. Owner might, however, seek the assistance of a court of equity. In the equity court, Owner could argue that Thief would never have had the horse but for the theft of the boat from Owner. As against Thief, that contention would prevail. Accordingly, Owner would be entitled to assert a claim to the horse by way of constructive trust or equitable lien.

Now suppose that Thief sells the horse to Transferee. Literal application of the *nemo dat* maxim would suggest that if Owner could recover the horse from Thief, then Owner can also recover the horse from Transferee. That result, however, has universally been rejected, provided that Transferee took the horse from Thief for value and without notice. Applying the equitable notion that a court will not shift a loss from one innocent party to another, it is well settled that if Owner's claim against the thing in Transferee's hands is an equitable claim, then it is cut off by a transfer to a purchaser for value without notice. By contrast, if the same thing that formerly belonged to Owner can be identified as the thing in the hands of Transferee, then Owner can recover it, even though Transferee gave value without notice of the claim.

Thus, if Transferee takes an E-Note for value and without notice, the assertion of an adverse claim to the E-Note will fail unless the claimant can succeed in an argument that the E-Note in the hands of Transferee is "the same thing" as the E-Note that was formerly in the hands of the transferor against whom the claim could be asserted. It is not enough for the claimant to say that Transferee would not have the E-Note but for the transfer of another E-Note to him; rather the claimant must succeed in a contention that it is "the same" E-Note. That may well be an extraordinarily difficult contention. Deciding what counts as "the same thing"

92. The issues outlined in this paragraph are discussed more fully in Rogers, *Negotiability*, *supra* note 15.

when the "thing" in question is a collection of encrypted data may well challenge the abilities of even the subtlest of metaphysicians.

Even if a claimant could succeed in a contention that an individual E-Note in someone's hands is the same E-Note to which the claimant formerly had a claim, the common law provides ample basis for cutting off any such claim against a transferee for value and without notice.[93] The dispositive authority would be the decision of the King's Bench in the 1758 case *Miller v. Race*.[94]

In *Miller*, a Bank of England note was stolen from the mail and passed to a person who took it for value and without notice of the theft.[95] When the note was presented to the Bank for payment, the Bank refused to pay or return the note to the person to whom it was passed. The person to whom the note was passed brought suit,[96] and the Court of King's Bench, in one of Lord Mansfield's best known opinions, held that the person to whom the note was passed got good title. The opinion in *Miller v. Race* assumes, and no one disputed this point, that if actual currency had been stolen and passed to a person who took it for value and without notice of the theft, the owner who lost the currency could not recover it. Thus, the issue in the case was whether a Bank of England note should be governed by the money rules or by the chattel rules.

To Lord Mansfield, the case was simple. He is reported to have stated that "he had no sort of doubt, but this action was well brought, and would lie against the defendant in the present case; upon the general course of business, and from the consequences to trade and commerce: which would be much incommoded by a contrary determination."[97] He commended the defendant's lawyer for his "ingenious" argument but stated that "the whole fallacy of the argument turns upon comparing bank notes to what they do not resemble, and what they ought not to be compared

93. For one of the most potentially problematic types of adverse claims, an answer may well be provided by statute. Suppose that the adverse claim is that of a person who held an Article 9 security interest in the property of a person who previously held the E-Note, either as original collateral or as proceeds. The E-Note is then transferred and the secured party asserts a claim to it in the hands of the transferee. The Revised version of Article 9 does not leave such issues solely to the law governing the particular form of payment instrument involved. Rather, U.C.C. section 9-332 states a general rule that a security interest cannot be asserted against a "transferee of money," U.C.C § 9-332(a), or against a "transferee of funds from a deposit account," U.C.C § 9-332(b).

94. 97 Eng. Rep. 398 (K.B. 1758).

95. Evidently the note was not issued in the common modern form of an engraved note for a designated round sum. Rather, it was payable to William Finney, or bearer, in the amount of twenty-one pounds and ten shillings. From the opinion, however, it is clear that notes in such form circulated as currency.

96. Procedurally, the case is a bit complex. Miller, the person to whom the note had been passed, brought an action in trover against Race, the clerk of the Bank of England, complaining that the Bank's action in refusing to return the note to Miller was wrongful. The bank defended on the grounds that the note actually belonged to the original owner, William Finney. Thus, the ultimate issue in the case was the same as if Miller still had possession and the original owner, William Finney, had brought an action to recover the note.

97. *Id.* at 401.

to, viz. to goods, or to securities, or documents for debts."[98] In the critical passage of the opinion, Lord Mansfield clearly indicated the basis of his ruling:

> Now they are not goods, not securities, nor documents for debts, nor are so esteemed: but are treated as money, as cash, in the ordinary course and transaction of business, by the general consent of mankind; which gives them the credit and currency of money, to all intents and purposes. They are as much money, as guineas themselves are; or any other current coin, that is used in common payments, as money or cash.[99]

The rule of *Miller v. Race* was quite uniformly followed by subsequent decisions in both England and the United States.[100] When the law of bills and notes was cast into statutory form, the rule of *Miller v. Race* was followed not only with respect to bank notes but also with respect to negotiable instruments of all forms. The rule has also been applied to other forms of property, such as investment securities, which, while not serving as a medium of exchange, are routinely transferred in anonymous markets.[101]

Suppose that a court must decide whether an adverse claim can be asserted to an E-Note. It seems that *Miller v. Race* disposes of the issue. If we were to state the holding of *Miller v. Race*—in the precise and narrow meaning of the term "holding" in our system of precedent—it would have to be something along the lines of "an item that is treated in commercial practice as a circulating medium of exchange, in the same fashion as actual money, is governed by the rule that a purchaser for value without notice takes good title, even though the item has been stolen." Obviously, it would make no sense to say that the holding of the case is limited to notes payable to William Finney or bearer in the amount of twenty-one pounds ten shillings. Nothing turned on the name of the original payee or the amount of the note. But, it is equally true that nothing in the case turned on the precise form of the note; rather, the ruling is based on the fact that if an item is treated in commercial practice as a circulating medium of exchange, then it is governed by the same rules of property transfers as actual money. Given that fact, it seems that the holding of the case would amply reach a case in which an E-Note is stolen and transferred to a person who takes it for value and without notice.

Let me be clear about this point. The contention here is not that a court confronted with a case of an assertion of an adverse claim to an E-

98. *Id.*

99. *Id.*

100. The numerous cases in England and the United States following *Miller v. Race* are discussed in any of the standard pre-Code sources on the law of bills and notes. *See, e.g.*, JOSEPH STORY, COMMENTARIES ON THE LAW OF PROMISSORY NOTES §§ 191-97 (1845); 2 THEOPHILUS PARSONS, A TREATISE ON THE LAW OF PROMISSORY NOTES AND BILLS OF EXCHANGE 267-79 (1863).

101. *See* Rogers, *Negotiability*, *supra* note 15, at 476-78; James Steven Rogers, *Policy Perspectives on Revised U.C.C. Article 8*, 43 U.C.L.A. L. REV. 1431, 1460-73 (1996).

Note might look to *Miller v. Race* as a potential source of analogy. Rather, the claim is that *Miller v. Race* is dispositive authority, that is, a court could not refuse to apply the case to an E-Note without either distinguishing the case from *Miller* or overruling the cases in the jurisdiction in question that have previously followed *Miller v. Race.* I assume that no court would be so bold as to overthrow 250 years of precedent following *Miller.* As to an argument that the case of an E-Note is distinguishable from that of a paper note, it is hard to see what the basis could be. By hypothesis, we are assuming that E-Notes are issued with the intent that they circulate as a medium of exchange, and are used in that fashion. An argument that the mere form of the notes—electronic versus paper—should make a difference in the governing law seems quite unpersuasive.[102]

VI. TRANSFER OF E-NOTES AS DISCHARGE OF UNDERLYING DEBT

The single issue on which the old law of negotiable instruments provides the richest source of guidance for the new law of electronic money is the question of the effect of transfer of a note on the liabilities of the parties in the underlying transactions. Suppose that goods or services are purchased, or a debt is paid, by transfer of an E-Note, but the issuer of the E-Note becomes insolvent before payment of the E-Note. Does the transferee of the now worthless E-Note have any action against the transferor of the E-Note?[103] There is a rather complex body of law on that issue, including some aspects of modern statutory negotiable instruments law, as well as case law concerning circulating bank notes dating from early-nineteenth century.

The most likely way that a person who transferred an E-Note might be pursued is by an assertion that the transfer of the E-Note did not discharge the underlying obligation, so that the transferor can still be sued on the underlying debt.[104] The analogous question under current Article

102. Indeed, any argument that *Miller* does not apply to E-Notes simply because they are electronic rather than paper would seem to be foreclosed by the Federal Electronic Signatures Act, discussed *infra* text accompanying notes 192-94.

103. It is assumed that the transfer of the E-Note will be implemented in such fashion that there would be no way to assert that the transferor had become liable on the note itself in the fashion of an indorser of a negotiable instrument.

104. Theoretically, a claim against the transferor of the E-Note might be based on an assertion that the transferor warranted the collectibility of the E-Note. It is, however, highly unlikely that a court would rule in favor of such a warranty claim. If the issue were addressed by analogy to Article 3, the relevant provision would be section 3-416 on transfer warranties. Under that section, a person who transfers an instrument warrants only that the transferor "has no *knowledge* of any insolvency proceeding" concerning the obligor of the instrument. U.C.C. § 3-416(a)(5) (emphasis added). The same result would follow if the question were considered as a matter of general common law. The transferor of the E-Note might be regarded as an assignor of a right to payment. In the absence of any specific agreement, an assignor of a right to payment does not warrant that the obligor is solvent or that the obligation will be paid. At most, the assignor makes more limited warranties to the effect that the assignor lacks knowledge of any facts that would impair the apparent value of the assigned right. As the Restatement puts it, "An assignment does

3 is governed by section 3-310, which provides that unless otherwise agreed, if an instrument is taken for an obligation, the obligation is discharged if a bank is obligated on the instrument, while the obligation is merely suspended if a bank is not obligated.[105] Application by analogy of the principle of section 3-310 would require resolution of two issues: first, what counts as an "agreement" that the underlying obligation is or is not discharged contrary to the usual default rules, and, second, what is the basis for the distinction drawn in Article 3 between instruments on which a bank is and is not obligated?

A. AGREEMENT TO DISCHARGE

The modern case law under U.C.C. section 3-310, and its predecessor in the pre-1990 version, U.C.C. section 3-802, provides relatively little guidance on what would count as an agreement to accept an instrument in discharge of an underlying obligation. The basic problem is that in modern practice the routine scenario is one in which the same person is the obligor both in the underlying transaction and on the instrument, as in the case of payment of an obligation by delivery of a check of the obligor. Most of the cases under section 3-310 and its predecessor 3-802 involve that scenario. The questions addressed are fairly fine points of detail. For example, some of the cases hold that because taking a check suspends the underlying obligation, a creditor who has taken a check cannot invoke penalty or foreclosure rights that would arise between the time that the check was taken and the time that it was paid.[106] Other such cases

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not of itself operate as a warranty that the obligor is solvent or that he will perform his obligation." RESTATEMENT (SECOND) OF CONTRACTS § 333(2) (1981).

105. The current version of Article 3 states the discharge rule in subsection (a) of section 3-310 for the most common forms of instruments on which a bank has incurred liability: certified checks, cashier's checks, and teller's check. A certified check is an ordinary personal check that has been accepted by the drawee bank, U.C.C. § 3-409(d), and accordingly, represents the obligation of that bank, U.C.C. § 3-409(a). A cashier's check is a check on which the same bank is both drawer and drawee, U.C.C. § 3-104(g), and therefore represents the obligation of the bank, U.C.C. § 3-412. A teller's check is a check drawn by one bank upon another bank, U.C.C. § 3-104(h), and therefore, represents the obligation of the drawer bank to pay, U.C.C. § 3-414(a). Subsection (c) of section 3-310 provides that the discharge rule of subsection (a) applies to any other instrument on which a bank is obligated as maker or acceptor. Subsection (b) of section 3-310 states the suspension but not the discharge rule for non-bank instruments.

Section 3-802 of the pre-1990 version of Article 3 stated essentially the same rule, the only exception being that under the former rule the discharge rule did not apply to bank instruments if the underlying obligor was also liable. Suppose, for example, that a bank issued a teller's check to its own customer as payee, and the customer used the check to pay an obligation by indorsing it to the obligor. The customer—the underlying obligor—would be liable on the instrument as the indorser. Thus under the old version of section 3-802, the underlying obligation of the customer would not have been discharged; meaning that if the bank dishonored the instrument, the customer could be sued either on the instrument as indorser or on the underlying obligation. Under current section 3-310, the underlying obligation would be discharged, but this makes little or no difference since the customer would be liable on the instrument as the indorser.

106. *See, e.g.*, Harper v. K & W Trucking Co., 725 P.2d 1066 (Ala. 1986); Merriman v. Sandeen, 267 N.W.2d 714 (Minn. 1978); Quigley v. Acker, 955 P.2d 1377 (Mont. 1998); Grumet v. Bristol, 484 A.2d 1099 (N.H. 1984).

involve timing issues, such as cases about how the suspension principle affects questions about whether interest is due for the period between the tender of a check and its payment.[107] Modern cases in which a bank instrument is taken for an underlying obligation are of relatively little assistance on the question, for the simple reason that uninsured bank failure is so rare in the modern world.[108]

One may get a bit closer to the issue by considering cases involving renewal notes. A common scenario is that several people sign a note for an original loan. When the loan comes due, the most active of the borrowers negotiates a renewal of the loan. Without telling the co-signers, the active borrower signs a renewal note and forges the signature of the co-signers of the original note. When the loan goes into default, the lender proceeds against all who signed the original note, only then discovering that some of the signatures on the renewal note were forgeries. Those whose signatures were forged defend on the grounds that although they were liable on the original note, the creditor accepted the renewal note in full satisfaction of the obligation on the original note. Since their genuine signatures did not appear on the renewal note, they are discharged if the creditor accepted the renewal note as full satisfaction of the obligation on the original note.[109]

Formally, these cases are not treated under the provision on the effect of taking an instrument for an underlying obligation, since both the liability on the original note and the renewal note are Article 3 liabilities. The issue, however, is essentially the same, inasmuch as it turns on whether the creditor discharged the liability on the original note by taking the renewal note. The effect of the relevant Article 3 provision is generally taken to be that the result turns on the intention of the parties in implementing the renewal.[110] Yet when the issue is considered a bit more carefully, it becomes apparent that the concept of intention is virtually useless. Suppose that A and B signed the original note, and that A obtained a renewal, signing the renewal note and forging B's signature. Suppose that the creditor is asked "Did you intend that A and B would be liable for the debt; or did you intend that the parties who signed the new note would be liable for the debt?" What is the creditor supposed to say? The problem arises precisely because the creditor was not aware of the fact that the parties who signed the renewal note were not the same as the parties who signed the original note. Yet under the test of "intention," the outcome rests on whether the creditor intended X or Y, where,

107. *See, e.g.*, Long v. Cuttle Const. Co., 70 Cal. Rptr. 2d 698, 699-700 (1998); Cornell v. Stimson Lumber Co., 477 P.2d 898, 899-900 (Or. 1970); Ivy v. Am. Road Ins. Co., 409 So. 2d 549, 552 (La. 1981).

108. I am aware of only one case decided after the U.C.C. was enacted in which a bank instrument was taken for an obligation and the bank failed before the instrument was paid. Chen v Roosevelt & Main St. Realty Corp., 500 N.Y.S.2d 948 (N.Y. Sup. Ct. 1986).

109. Cases are collected in Gary D. Spivey, *Annotation, Renewal Note Signed by One Comaker as Discharge of Nonsigning Comakers*, 43 A.L.R. 3d 246 (1972).

110. *See, e.g.*, Hubbard Realty Co. v. First Nat'l Bank, 704 F.2d 733, 735-36 (4th Cir. 1983); Peoples Bank of S.C. v. Robinson, 249 S.E.2d 784 (S.C. 1978).

by hypothesis, the creditor was unaware of the difference between X and Y.

Inasmuch as the test of intention is virtually useless, the significant issue in the modern cases is the allocation of the burden of proof. If the rule is that the execution of the renewal note discharges the liability on the original note, unless a contrary intent is shown, then the outcome in the usual case would be that the liability is discharged. If, on the other hand, the rule is that the execution of the renewal note discharges the liability on the original note only if the creditor so intended, then the outcome in the usual case would be that the liability is not discharged. Thus, it is significant that in the modern cases, the burden of proving intent to discharge is generally placed on the debtor, and therefore the creditor generally prevails.[111] In considering the application of the nineteenth-century law of bank notes to E-Notes, it will be equally significant to consider the precise rules on the allocation of the burden of proof. Before turning to the nineteenth-century case law, however, it is worthwhile to consider the extent to which other Article 3 rules may affect the question of discharge.

B. DEFAULT RULES UNDER U.C.C.

The basic rule of discharge in modern Article 3 is that taking an instrument for an underlying debt merely suspends the underlying obligation, unless the instrument is one on which a bank is obligated. The Official Comments to Article 3, however, simply state the rule, they do not explain it: "Subsection (a) deals with the case in which a certified check, cashier's check or teller's check is given in payment of an obligation. In that case the obligation is discharged unless there is an agreement to the contrary."[112] One frequently sees the discharge rule explained on the grounds that bank failure is so unlikely that parties presumably intend to treat bank instruments in the same fashion as cash. For example, Hawkland's treatise explains that "[t]he rationale underlying this provision is that banks seldom become insolvent, and the parties more than likely implicitly intended that the check be a substitute to payment in cash."[113]

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111. *See* cases collected in Spivey, *supra* note 109.

112. U.C.C. § 3-310 cmt. 2. The comment to the pre-1990 version of this provision, § 3-802, is similarly uninformative.

113. 6 WILLIAM D. HAWKLAND & LARY LAWRENCE, UNIFORM COMMERCIAL CODE SERIES § [Rev] 3-310:2; *see also* ELLEN A. PETERS, A NEGOTIABLE INSTRUMENTS PRIMER 45 (2d ed. 1974) ("Since banks honor their obligations with greater regularity than do private debtors, bank paper is treated almost as if it were a safer form of money."); EDWARD L. RUBIN & ROBERT COOTER, THE PAYMENT SYSTEM: CASES, MATERIALS AND ISSUES 125 (2d ed. 1994) ("What makes these [bank] checks different, of course, is that there is very little credit risk involved. Unlike the average individual or firm, banks can generally be relied upon to have money; indeed, state or federal regulators are supposed to close the bank if this assumption proves to be untrue. With no credit risk, the check is virtually equivalent to cash."); CLAYTON GILLETTE ET AL., PAYMENT SYSTEMS AND CREDIT INSTRUMENTS 78 (1996) ("These instruments are, therefore, considered to be payment mechanisms whose characteristics and creditworthiness deviate little from the money for which they serve as substitutes.")

That explanation seems plausible at first read, but the plausibility comes largely from the fact that we have become so unfamiliar with the possibility of uninsured bank failure that we no longer take these issues all that seriously. On further thought, it becomes apparent that the fact that bank failure is unlikely provides no explanation whatsoever for the discharge rule. The question is what rule we should apply in those cases—however rare they may be—in which the bank that was obligated on the instrument *does* fail. It makes no sense to say that because bank failure is unlikely the rule should be that the underlying obligation is discharged. We could just as easily say that transfer of bank paper *does not* discharge the underlying obligation and explain that the rule is unlikely to have any significant effect because bank failure is so unlikely.

The drafting history of the U.C.C. is not particularly helpful in understanding the position taken on whether taking an instrument discharges the underlying obligation—other than to suggest that the issue was, prior to the Code, somewhat more complex than it now appears. The earliest version of the rules now found in section 3-310 was in the April 1947 draft.[114] It provided that "[u]nless otherwise agreed, an instrument given for the full amount of an obligation of any person other than the maker, drawer or acceptor operates as payment, and an instrument given for a part of the amount operates as payment pro tanto."[115]

The initial comment to this provision is rather uninformative, stating only that "[t]his seems to be generally agreed, at least as a presumption."[116] In a subsequent draft, the commentary gives a bit more detail,

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A few modern discussions do recognize that there is an issue of allocation of the credit risk of the bank, but offer relatively little explanation of why that risk is to be allocated to the person who takes the bank check. *See* RONALD J. MANN, PAYMENT SYSTEMS AND OTHER FINANCIAL TRANSACTIONS: CASES, MATERIALS, AND PROBLEMS 424 (2d ed. 2003) ("Because of the bank's obligation to pay, most parties that accept such an instrument view themselves as having received final payment; the principal risk of nonpayment is the risk that the bank will become insolvent. Reflecting that perception, UCC § 3-310(a) and (c) provides (absent a contrary agreement) that the underlying obligation is discharged when the obligee takes one of those near-cash instruments. That rule imposes no substantial burden on the obligee because the obligee that doubts the solvency of the relevant bank could protect itself by refusing to accept the instrument or agreeing with the payor that the underlying obligation will remain in effect."); LARY LAWRENCE, AN INTRODUCTION TO PAYMENT SYSTEMS 209 (1997) ("The rationale is that the parties intended by the use of a bank instrument to allocate the risk of the bank's insolvency to the taker who could immediately present the bank instrument for payment. Any delay is his fault.")

114. The first draft of what became Article 3 was a partial draft that did not include any provision on the effect of taking an instrument for an underlying obligation. *See* U.C.C. ARTICLE III (Tentative Draft No. 1, 1946), *reprinted in* 2 UNIFORM COMMERCIAL CODE DRAFTS 273 (Elizabeth S. Kelly ed. 1984).

115. U.C.C. § 3-101(2) (Tentative Draft No. 2, 1947), *reprinted in* 3 UNIFORM COMMERCIAL CODE DRAFTS 45, 106 (Elizabeth S. Kelly ed. 1984).

116. U.C.C. ARTICLE 3 (Notes and Comments to Tentative Draft No. 2, 1947), *reprinted in* 3 UNIFORM COMMERCIAL CODE DRAFTS 111, 230 (Elizabeth S. Kelly ed. 1984). Substantially the same text appeared as Section 902 of the next draft, the only change being a switch from speaking of an instrument "given for" an obligation, to one "taken for" the obligation. U.C.C. § 902(2) (Proposed Final Draft No. 1), *reprinted in* 4 UNIFORM COMMERCIAL CODE DRAFTS 1, 71 (Elizabeth S. Kelly ed. 1984).

stating that the rule "is supported by a considerable number of cases."[117] The cases cited, however, are based largely on a different principle than that stated in the text.[118]

The 1949 draft deleted the provision that taking an instrument of a third party is presumed to effect a discharge, leaving no rule in the Code on the matter.[119] A year later, in the March 1950 draft, a provision on discharge re-appeared, now turning on the distinction between bank and non-bank instruments, rather than between third-party instruments and those to which the underlying obligor is a party: "Unless otherwise agreed . . . where an instrument is taken for an obligation . . . if the instrument carries the obligation of a bank as drawer, maker or acceptor, and no conditions other than presentment remain to be performed by the taker, the original obligation is pro tanto discharged."[120]

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117. U.C.C. ARTICLE 3 (Notes and Comments to Proposed Final Draft No. 1), *reprinted in* 4 UNIFORM COMMERCIAL CODE DRAFTS 73, 168 (Elizabeth S. Kelly ed. 1984).

118. The four cases cited are *Hamilton v. R.S. Dickson*, 85 F.2d 107 (2d Cir. 1936), and three other cases cited in *Hamilton*, suggesting that the citations were simply lifted from the *Hamilton* opinion without careful consideration of the issue. The four cases cited actually involve a variety of somewhat different issues. In *Hamilton* itself, the seller of bonds refused to accept either the buyer's personal check or that same check certified by the drawee bank. Instead, the bonds were delivered to a bank that the buyer used as its securities custodian and payment was made by means of a cashier's check issued by that bank. The bank that issued the cashier's check failed that evening, and the seller brought an action on the underlying obligation of the buyer to pay for the bonds. The court ruled that while an ordinary check did not extinguish the underlying obligation, "there is a variation of the general rule where the debt is created simultaneously with the obligation to make immediate payment and the creditor then takes the credit of a third party instead of insisting upon receiving payment in cash though his contract gives him that right." *Id.* at 108. The scenario in *Hamilton* was an easy one since it combined all of the principles that had been taken as justifying a conclusion of payment—the seller declined an instrument on which the buyer would have been obligated; the instrument was taken for a contemporaneous rather than precedent debt; the instrument was one on which a third party rather than the underlying obligor was obligated; and the party obligated was a bank.

The oldest of the three cases cited in *Hamilton* is *Hall v. Stevens*, 22 N.E.2d 374 (N.Y. 1889), in which a farmer received a bank draft for cattle, and the draft was dishonored when it turned out that the bank that had drawn the draft had failed. The New York Court of Appeals ruled that the farmer had taken the draft as payment, relying primarily on the principle that an instrument taken for a contemporaneous debt operates as payment. The second case cited in *Hamilton* is *Atlas S.S. Co. v. Columbian Land Co.*, 102 F. 358 (2d Cir. 1900), in which a shipping company sued for freight after a draft given for the amount of the freight was dishonored. The Second Circuit ruled that taking the draft did not constitute payment, because the instrument was taken for a precedent debt. The third case cited in *Hamilton* is *New York & Cuba Mail S.S. Co. v. Texas Co.*, 282 F. 221 (2d Cir. 1922), in which the Second Circuit ruled that a debt for freight was discharged where the note of a third party was taken at the time the debt was contracted.

Thus, the cases cited in the Comment to Proposed Final Draft No. 1 stand principally for the proposition that an instrument taken for a contemporaneous debt is presumed to be payment, while an instrument taken for a precedent debt is presumed not to be payment. By contrast, the actual rule stated in Proposed Final Draft No. 1 § 902 is based on the distinction between an instrument of a third party versus an instrument to which the underlying obligor is a party.

119. U.C.C. § 3-802 (1949), *reprinted in* 6 UNIFORM COMMERCIAL CODE DRAFTS 1, 482 (Elizabeth S. Kelly ed. 1984).

120. U.C.C. § 3-702 (1950), *reprinted in* 9 UNIFORM COMMERCIAL CODE DRAFTS 1, 56 (Elizabeth S. Kelly ed. 1984).

The comment gave little explanation, noting only that "[t]he section is new. It is intended to settle conflicts as to the effect of an instrument as payment of the obligation for which it is given."[121] In the spring 1951 version, the wording was changed slightly to the form that the provision took throughout all succeeding drafts and in the original version of the Code as enacted by the states: "Unless otherwise agreed where an instrument is taken for an underlying obligation . . . the obligation is pro tanto discharged if a bank is drawer, maker or acceptor of the instrument and there is no recourse on the instrument against the underlying obligor . . . ."[122]

The subject was discussed in somewhat greater detail in the report of the New York Law Revision Commission on the proposed Code.[123] The Law Revision Commission noted that "[t]here is much difference of opinion as to the effect on the underlying obligation when the debtor gives his creditor an instrument."[124] The report cited a variety of cases on the question of the effect of taking an instrument to which the underlying obligor is a party, and noted that in cases where the underlying obligor was not a party to the instrument, the cases distinguished between instances where the instrument was taken for a contemporaneous versus precedent debt. Curiously, the report made no mention of cases on the effect of taking a bank instrument, despite the fact that the distinction between bank instruments and non-bank instruments was the basis of the proposed Code rule. The report laconically noted that the Code rule "would change present law" but offered no opinion on whether the suggested change was or was not desirable.[125] Given that the Law Revision Commission was hardly reticent in expressing disagreement with various U.C.C. provisions, the mild treatment of the rule on discharge suggests that the Commission did not regard the topic as particularly important.

Despite the cursory treatment given to the issue in modern law, the pre-U.C.C. law of bills and notes had developed quite extensive rules on the effect of taking an instrument on the underlying obligation. It is to those issues that we now turn.

C. General Themes in Early Bills & Notes Law

The classic treatment of the impact of a transfer of an instrument on the underlying debt is found in Chief Justice Holt's decision in the early eighteenth-century case of *Ward v. Evans*.[126] A merchant named Fellows, who kept his cash with the Lombard Street goldsmith, Sir Stephen Evans,

121. U.C.C. § 3-702 (Proposed Final Draft No. 2, 1950), *reprinted in* 10 Uniform Commercial Code Drafts 1, 471 (Elizabeth S. Kelly ed. 1984).

122. U.C.C. § 3-702 (Proposed Final Draft No. 2, 1951), *reprinted in* 12 Uniform Commercial Code Drafts 1, 157 (Elizabeth S. Kelly ed. 1984).

123. 2 State Of New York, Report Of The Law Revision Commission For 1955: Study Of The Uniform Commercial Code 1204-05 (1955).

124. *Id.* at 1204.

125. *Id.*

126. 92 Eng. Rep. 120 (K.B. 1703).

instructed his servant to go to the goldsmith's shop with Ward's servant and make a payment to Ward.[127] Evans made the payment by delivery to Ward's servant of a note issued by another goldsmith, Wallis, for sixty pounds. Evans gave Ward's servant the Wallis note at about noon, at which time Wallis was still solvent. Wallis continued paying his obligations on demand all that day, but by the time that Ward's servant brought the note to Wallis for payment the next morning, Wallis had gone bankrupt and stopped paying his notes.[128]

Chief Justice Holt flatly rejected the contention that a transfer of a goldsmith's note could, in all cases, be treated as payment. As he put it:

> I am of opinion, and always was (notwithstanding the noise and cry, that it is the use of Lombard Street, as if the contrary opinion would blow up Lombard Street) that the acceptance of such a note is not actual payment. I agree . . . that the taking a note for goods sold is a payment, because it was part of the original contract; but paper is no payment where there is a precedent debt. For when such a note is given in payment, it is always intended to be taken under this condition, to be payment if the money be paid thereon in convenient time. This note was demanded within convenient time, but if the party who takes the note, keep it by him for several days, without demanding it,

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127. At the goldsmith's shop, Fellows's servant asked Evans to pay £60 10s to Ward's servant "and to indorse it on a note of £100 from [Evans] to Fellows, in part payment of the £100." *Id.* at 120. The reference to indorsing the £100 note sounds to modern readers like a reference to the practice of transferring bills and notes by indorsement. In the context of banking practice of the time, however, it is quite clear that the £100 note issued by Evans to Fellows was used in much the same fashion as a modern savings account passbook. Thus, the statement in the report that Evans "indorse[d] £60 10s as paid on the said note of £100," means only that Evans recorded on the "passbook" note that £60 10s of the original £100 deposit had been paid out, at Fellows's instruction, to Ward. *See* JAMES STEVEN ROGERS, THE EARLY HISTORY OF THE LAW OF BILLS AND NOTES 119-20 (1995) [hereinafter ROGERS, HISTORY BILLS & NOTES].

128. Although *Ward v. Evans* came to be regarded as a leading case on the question of whether a person can discharge an underlying obligation to another by delivery of a bank note or other instrument, it is interesting to note that in the case itself, Ward did not sue his original debtor, Fellows. Rather, Ward brought the action against Fellows's banker, Sir Stephen Evans. Though Evans disputed the propriety of this form of action, the court ruled against him on this point, on the theory that when Fellows directed Evans to make the payment to Ward and to "indorse" the £60 10s as paid on Fellows's £100 note, Evans became obligated to Ward for that amount. In modern terms, we might think of this as an assignment from Fellows to Ward of Fellows' claim against Evans, or, perhaps more accurately, we might treat the transaction as if Evans had opened a temporary bank account for Ward, debited Fellows' account for the £60 10s and credited that amount to Ward's temporary account, and allowed Ward to close the account by withdrawing full amount, 10s in cash and £60 in the form of the Wallis note. Thus, the issue in the case was whether delivery of a note discharged an underlying debt, but the debt in question was that of the goldsmith Evans, rather than Fellows's original debt to Ward. It may also be worth noting that the argument of plaintiff's counsel, and the reported opinions of both Chief Judge Holt and Judge Powell lay some stress on the fact that the Wallis note was taken not by Ward himself, but by his servant. The judges seemed to be of the opinion that express authority from the principal would be required to give an agent authority to receive a note in satisfaction of a debt, though it was conceded that the agent's act could be ratified if the principal chose to take the note. Although the agency issue might have provided an independent basis for decision in the case, the judges did not rest on that point but went on to consider whether receipt of the note would constitute payment.

> and the person who ought to pay it becomes insolvent, he that received it must bear the loss; because he prevented the other person from receiving the money, by detaining the note in his custody.[129]

Most of the major themes that would play a role in the development of this body of law are contained in Holt's opinion in *Ward*. First, there is the suggestion that while taking an instrument for a precedent debt does not amount to payment, taking an instrument for a contemporaneous debt does. Second, if the distinction between precedent and contemporaneous debts is accepted, there is the problem of drawing the line between those two categories. Third, if taking an instrument for a precedent debt does not automatically discharge the debt, there is the question whether the person who receives the note loses rights on the underlying transaction by delay in attempting to collect the note. Fourth, there is the question—which Holt caustically dismissed in his comment about "blowing up Lombard Street"—as to whether different rules should apply to bank notes and other instruments. These points will be considered in turn.

D. Precedent versus Contemporaneous Debts

English cases in the eighteenth and nineteenth centuries repeatedly recognize the rule that an instrument given in payment of simultaneously contracted debt is taken as payment of that debt.[130] The same result was also reached by a slightly different route in some other English decisions. Rather than viewing the transfer of the instrument as the payment phase of a transaction motivated by the desire for some other exchange, one might think of the transfer of the instrument as the whole point of the transaction. That is, one could regard the transaction as one in which the instrument was sold, with payment being made in some other form. In the modern world, this seems to be an odd perspective. But, in the commercial world of the seventeenth through nineteenth centuries, it made perfect sense. At that time, it was routine for debt instruments issued by private parties to be regarded as a medium of investment. Thus, one who held an instrument might well sell it to another.[131]

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129. 92 Eng. Rep. at 121.

130. *E.g.*, Anon., 90 Eng. Rep. 1064 (K.B. 1701) ("If a man contracts for goods, and after carrying them away gives the seller a goldsmith's note for the money, it does not amount to a payment; but if it were given at the very time of the contract, it would be prima facie evidence that it was taken in payment."); Emly v. Lye, 104 Eng. Rep. 746 (K.B. 1812) ("If a person buy goods of another who agrees to receive a certain bill in payment, the buyer's name not being on it, and that bill be afterwards dishonoured, the person who took it cannot recover the price of his goods from the buyer, for the bill is considered as a satisfaction."); Camidge v. Allenby, 108 Eng. Rep. 489, 492 (K.B. 1827) ("If the notes had been given to the plaintiff at the time when the corn was sold, he could have had no remedy upon them against the defendant. The plaintiff might have insisted upon payment in money. But if he consented to receive the notes as money, they would have been taken by him at his peril.")

131. In his classic late-nineteenth-century book on the English money market, Walter Bagehot provides a good description of the function of "bill-brokers," who made it their business to become familiar with the creditworthiness of traders so that they could purchase their bills with fair safety:

If we think of the transfer of an instrument not as the payment phase of another transaction but as the transaction itself, then it seems fairly clear that the seller of an instrument has no obligation if the instrument is not paid, assuming that he did not indorse it or otherwise give some representation as to its creditworthiness. Such a view of the transaction is reflected very early in the English decisions, as in a late seventeenth-century case where it was noted that "if *a bill* or *a note* be payable to one 'or bearer,' and he negotiate the bill, and deliver it for ready money paid to him, without any indorsement on the bill, this is a plain buying of the bill. . . ."[132] As Lord Kenyon put it in a late eighteenth-century case,

> It is extremely clear that, if the holder of a bill of exchange send it to market without indorsing his name upon it, neither morality or the laws of this country will compel him to refund the money, for which he has sold it, if he did not know at the time that it was not a good bill.[133]

In the English treatises, the question of whether a person remains obligated on an underlying transaction for which payment was made by transfer of an instrument that was subsequently dishonored was commonly treated as a question of the obligations of the seller of the instrument, rather than as a question of whether the obligation in the underlying transaction was discharged by the transfer of the instrument. For example, *Byles on Bills*, the classic nineteenth-century bills treatise,[134] describes the rule as follows:

> [T]he transferer is not even liable to refund the consideration, if the bill or note so transferred by delivery without indorsement, turn out to be of no value, by reason of the failure of the other parties to it. For the sending to market of a bill or note payable to bearer without indorsing it, is *primâ facie* a sale of the bill. And there is no implied

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> [T]here will always be a class of persons who examine more carefully than busy bankers can the nature of different securities; and who, by attending only to one class, come to be particularly well acquainted with that class. . . . They act thus as intermediaries between the borrowing public and the less qualified capitalist; knowing better than the ordinary capitalist which loans are better and which are worse, they borrow from him, and gain a profit by charging to the public more than they pay to him. . . . [B]y far the greatest of these intermediate dealers are the bill-brokers. Mercantile bills are an exceedingly difficult kind of security to understand. The relative credit of different merchants is a great 'tradition'; it is a large mass of most valuable knowledge which has never been described in books and is probably incapable of being so described. . . . No one can be a good bill-broker who has not learnt the great mercantile tradition of what is called 'the standing of the parties,' and who does not watch personally and incessantly the inevitable changes which from hour to hour impair the truth of that tradition.

WALTER BAGEHOT, LOMBARD STREET: A DESCRIPTION OF THE MONEY MARKET 281-83 (1895).

132. Bank of England v. Newman, 88 Eng. Rep. 1290, 1291 (K.B. 1699).

133. Fenn v. Harrison, 100 Eng. Rep. 842, 844 (K.B. 1790).

134. James Steven Rogers, *The Myth of Negotiability*, 31 B.C. L. REV. 265, 274 n.13 (1990) [hereinafter Rogers, *Myth*].

guarantee of the solvency of the maker, or of any other party.[135]

American authorities also recognized the rule that a transfer of a third party's instrument for a contemporaneous debt discharged the debt. In

135. JOHN B. BYLES, A TREATISE OF THE LAW OF BILLS OF EXCHANGE, PROMISSORY NOTES, BANK-NOTES AND CHECKS 146-47 (8th ed. 1862); *see also* JOHN BAYLEY, SUMMARY OF THE LAW OF BILLS OF EXCHANGE, CASH BILLS, AND PROMISSORY NOTES 103 (2d Amer. Ed. 1836) ("A person who sells a bill without becoming a party to it, incurs no liability, in case the bill is dishonored.")

There is some confusion on the point in the English authorities as a result of the decision in *Owenson v. Morse*, 101 Eng. Rep. 856 (K.B. 1796). In *Owenson*, a buyer agreed to buy silver from a silversmith but asked the smith to have the silver engraved. The buyer paid for the silver by delivering bank notes. By the time the silver was returned from the engraver to the silversmith, the bank that issued the notes had failed. The silversmith refused to deliver the goods, and the buyer brought trover for them. The buyer's argument rested on the contention that there had been a completed sale, with payment being made by delivery of the bank notes. So viewed, the loss would rest with the silversmith. It is clear from the opinion, however, that the court regarded the buyer's argument as nearly unconscionable. As Lord Kenyon observed, "This is an exercise of ingenuity on the part of the plaintiff. It is an unjust attempt by him to take from an honest tradesman certain goods which the latter meant to sell to him on receiving a fair price for them." *Id.* at 857. Not surprisingly after that introductory remark, the court ruled for the silversmith. The basis of the decision, however, was not any disagreement with the general proposition that delivery of the note of a third party amounts to payment. Rather, the decision was based on the point that there had been no completed sale, because the goods had not yet been delivered to the buyer, so the seller still had the right of stopping the goods in transit. *Id.* Later American decisions treat *Owenson* as based on the stoppage in transit point, rather than indicating any change in the basic point that contemporaneous delivery of an unindorsed note of a third party amounts to final payment. *See, e.g.*, Whitbeck v. Van Ness, 11 Johns. 409 (N.Y. Sup. Ct. 1814).

Curiously, however, Chitty's treatise treats *Owenson* as signaling a significant change in the basic rule, settled since the time of *Ward v. Evans*, that delivery of an instrument of a third party in payment of a contemporaneous debt amounts to a final payment. Chitty states that:

> A distinction was indeed once taken between the case of a transfer of a bill or check for a precedent debt, and that of a transfer for a debt arising at the time of the transfer, and it was held that if A. bought goods of B. and at the same time gave him a draft on a banker, which B. took without any objection, it would amount to payment by A., and B. could not resort to him in the event of the failure of the banker; but it is now settled, that in such case, unless it was expressly agreed at the time of the transfer, that the assignee should take the instrument assigned, as payment, and run the risk of its being paid, he may, in case of default of payment by the drawee, maintain an action against the assignor, on consideration of the transfer.

JOSEPH CHITTY, A TREATISE ON THE LAW OF BILLS OF EXCHANGE, CHECKS ON BANKERS, PROMISSORY NOTES, BANKERS' CASH NOTES, AND BANK-NOTES 123 (1799). That passage, however, appears not to have convinced even Joseph Chitty's son Edward, whose 1836 treatise states the usual rule that a transferor who does not indorse incurs no liability. 2 EDWARD CHITTY, THE COMMERCIAL AND GENERAL LAWYER 711 (1836) ("Where a bill or note is delivered without indorsement, not in payment of a pre-existent debt, but in payment or exchange for goods or other sureties sold at the time, such a transaction amounts to a sale of such bill or note, and to an election by the transferee to take it as money with all its risks, and consequently to complete payment by the transferor."). Edward Chitty's book is, as a whole, quite an oddity. It is, in essence, an adaptation of Blackstone to the assumed needs of the commercial man. For example, the work begins, as does Blackstone, with a treatment of the Right of Persons, including Parliament and the King, but adds to that passage a long dissertation on customs and excise taxes. The treatment of bills of exchange appears as a long addition following the part of Blackstone that treated contracts.

the leading case of *Whitbeck v. Van Ness*,[136] a horse was sold for ninety dollars, with the agreement that the price would be paid by transfer to the seller of a note made by a third party. When the note proved uncollectible, the seller brought an action for the price. The Supreme Court of New York noted that the general rule on contemporaneous debts was supported by both English and American authorities and found that nothing in the facts of the case suggested any contrary intention by the parties. As the court noted, "The offer was made by the defendant's agent of *Deane's* note for the horse; the plaintiff took time to consider whether it was advisable to take *Deane's* note, and, after deliberation, and, we must presume, too, after inquiry, agreed to sell the horse for the note."[137]

E. Drawing the Line Bewteen Precedent and Contempraneous Debts

Though *Ward v. Evans* stands for the proposition that a note does not discharge a pre-existing debt, nineteenth-century cases suggest that the line between precedent and contemporaneous debts might be somewhat flexible.[138] The late nineteenth-century New York case of *Hall v. Stevens*[139] provides a good illustration. Henry Hall, a farmer who lived in Fredonia, New York, about fifty miles southwest of Buffalo, had agreed to sell cattle to Joseph Stevens and company, dealers in Buffalo. Hall arrived in Buffalo midafternoon on April 10, 1882 with seventeen head of cattle. On arrival, Hall asked how the buyer planned to pay, and he was told that the buyer could get currency from its bank. The cattle were weighed and the sales price was computed, amounting to a bit over $1300, or some $23,000 in today's dollars. Hall went into the buyer's office and was told by the buyer's clerk that the buyer might not be able to get cash. Hall then waited about two hours while the buyer sent a messenger to the bank. The messenger returned not with cash, but with a bank draft payable to Hall's order. Unfortunately for Hall, the bank obligated on the draft failed, and he brought suit against the buyer of the cattle for the unpaid price. The trial court entered a directed verdict against the plaintiff, and the New York Court of Appeals affirmed. The court noted the then settled rule that if an instrument is taken for a contemporaneous debt, it is presumed to operate as payment; while if taken for a precedent debt, the presumption is the opposite.[140] One might have said that the sale of the cattle was completed at the time of delivery, with the payment

136. 11 Johns. 409 (N.Y. 1814).
137. *Id.* at 413.
138. By the end of the nineteenth century, American case law on the distinction between precedent and contemporaneous debts had become quite complex. *See* 2 Theophilus Parsons, A Treatise On The Law Of Promissory Notes And Bills Of Exchange 156-57 (1863); 3 Joseph F. Randolph, A Treatise on the Law of Commercial Paper 628-29 (1888); 3 John W. Daniel, A Treatise on the Law of Negotiable Instruments § 1452 (7th ed. 1933).
139. 22 N.E. 374 (N.Y. Sup. Ct. 1889).
140. *Id.* at 376.

being made a few hours later, in which case the seller would prevail. The New York court, however, would have none of that, ruling that the evidence presented by Hall did not even raise a jury issue. True, the delivery of the cattle and the bank draft were not exactly simultaneous, but given the need to weigh the cattle and arrange for payment, "payment and delivery can only be practically, for they cannot be actually, concurrent."[141] Accordingly, the court viewed the case as one in which an instrument was taken for a contemporaneous debt, and therefore operated as payment.

F. Diligence Required of Those who Take Notes for Precedent Debts

Even in cases where an instrument was taken for a precedent debt, the party who took the instrument might find that he lost rights on the underlying transaction by delay in dealing with the instrument. Moreover, the cases indicate that the requirements for diligent action were often so strenuous that it was likely that one who took an instrument would not be able to sue on the underlying transaction.

The classic example of this problem is the well-known early nineteenth-century English case of *Camidge v. Allenby*.[142] On Saturday morning, December 10, 1825, in York, Camidge sold and delivered corn to defendant. That afternoon, at about three o'clock, the buyer paid for the corn by delivering four banker's notes, issued by a banking firm located about forty miles from York. Unknown to either the buyer or the seller, the banking firm failed and permanently closed at eleven o'clock that day. A week later, the seller demanded that the buyer take back the notes of the failed bankers and pay for the cattle. The seller brought suit against the buyer, and won at trial, subject to the opinion of the Court of King's Bench whether the transfer of the notes would be deemed payment.

Justice Bayley, who had authored one of the leading treatises on the law of bills and notes,[143] acknowledged the distinction between instruments taken for a contemporaneous versus precedent debts, but seemed to think that the gap of a couple of hours on the day of the transaction forced the case into the precedent debt category:

> If the notes had been given to the plaintiff at the time when the corn was sold, he could have had no remedy upon them against the defendant . . . . Here the notes were given to him in payment subsequently, and the question is whether they operate as a discharge of the debt due to the plaintiff in respect of the corn.[144]

That conclusion would seem to have been fatal to the defendant's case. If the notes were taken for a precedent debt, then they would be presumed not to operate as payment, leaving it open to the plaintiff to sue for the underlying debt for the corn.

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141. *Id.*
142. 108 Eng. Rep. 489 (K.B. 1827).
143. Rogers, *Myth*, *supra* note 134, at 273 n.10.
144. 108 Eng. Rep. at 492.

The result in *Camidge*, however, was the opposite. The usual rule that an instrument taken for a precedent debt does not operate as a discharge was subject to the qualification that the person who took the instrument might lose the right to sue on the underlying debt if he delayed in attempting to obtain payment of the instrument. In *Camidge*, the recipient of the banker's note had not informed the transferor of the banker's failure until about a week after the event. That delay proved fatal, even though it is a bit hard to see what difference it could have made. After all, the banker who issued the note involved in the *Camidge* case had failed the same day that the note was delivered—indeed, several hours before the delivery of the note. Nonetheless, because the seller had neither passed on the note nor given notice until a week after receiving the instrument, he lost his right to pursue the buyer on the underlying transaction.[145]

G. Special Law of Bank Notes

Thus far, the question whether a debt is discharged by transfer of an instrument has been considered only from the perspective of the general law of bills and notes, without distinguishing bank notes from other instruments. Although no such distinction seems to have been drawn in England, in the United States there were many cases, particularly in the 1830s and 1840s, in which notes of failed banks had been transferred in settlement of claims, and the courts confronted the question whether the ordinary bills and notes rules should apply or whether the fact that the instruments were bank notes intended for circulation required special treatment.

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145. Though the ruling in *Camidge v. Allenby* that the person who took the instrument lost his rights as a result of a brief period of delay in giving notice may seem odd, in context it is more understandable. In the era when private instruments were routinely transferred as a medium of payment, it was a fairly common occurrence that an instrument used in a payment transaction turned out to have been issued by a person who became insolvent. If the instrument was transferred in a fashion that required indorsement, a party who had passed along the instrument long ago might find that the transaction would come back to haunt him if the party primarily obligated on the instrument became insolvent. In that setting, it is hardly surprising that a person sued on a bill would raise any possible contention. For example, in an early nineteenth-century Massachusetts case, the question whether the holder had delayed just a bit too long ended up turning on whether commencement day at Harvard College should be counted as a holiday in Massachusetts. City Bank v. Cutter, 20 Mass. (3 Pick.) 414 (1826). The English courts had also experimented with a less rule-bound approach to the question of diligence. In *Bickerdike v. Bollman*, 99 Eng. Rep. 1164 (K.B. 1786), the requirement of diligence was excused where a hard pressed debtor held off his creditor by giving him a bill drawn by the debtor on a person that the debtor knew had no funds due to the debtor and so would not accept the bill. Starting with a sensible seeming ruling in *Bickerdike*, the English courts were plagued for decades with increasingly technical arguments that the facts of the case fit within the *Bickerdike* rule dispensing with the requirement of diligence. *See* Rogers, History Bills & Notes *supra* note 127, at 202-10. Given how troublesome any exception to rigid rules on diligence proved in the *Bickerdike* line of cases, it is not all that surprising that by the time that *Camidge v. Allenby* arose, the English courts had lost their appetite for carving any further exceptions to the rules on diligence and were willing to apply them with a rigor that, in the abstract, seems odd.

One of the most frequently cited cases on this issue was the 1834 New York decision of *Ontario Bank v. Lightbody*.[146] Lightbody was a depositor of Ontario Bank, who, on May 30, 1828, went to the bank to withdraw $2000—over $30,000 in today's dollars. As part of the $2000 withdrawal, Ontario Bank gave him a $500 bank note issued by the Franklin Bank of New York City. Lightbody sent the note to New York City, but, unfortunately for him, it was returned since the Franklin Bank had stopped payment and closed at about ten o'clock on May 29, 1828, the day before Lightbody received the note from Ontario Bank. Lightbody demanded that Ontario Bank buy back the note from him, but Ontario Bank refused. Lightbody received about thirty percent of the face value of the bank note from the insolvency proceedings for Franklin Bank, and brought suit against Ontario Bank for the balance.

If viewed under general bills and notes law, the case would seem fairly simple. Ontario Bank owed Lightbody a debt, resulting from the original opening of the bank account. Ontario Bank delivered the Franklin Bank note in an attempt to pay that debt, but the Franklin Bank note turned out to be worth significantly less than face value. Under *Ward v. Evans*, this would seem to be a case in which Ontario Bank attempted to pay a pre-existing debt by transfer of an instrument, and thus Ontario Bank would have remained liable on the original debt when it turned out that the Franklin Bank had failed.

The New York court, however, did not view the case in that light. Rather it took account of the then-routine commercial practice of payment of debts by transfer of bank notes that were intended to circulate as money:

> The law is well settled, that where the note of a third person is received in payment of an antecedent debt, the risk of his insolvency is upon the party from whom the note is received, unless there is an agreement or understanding between the parties, either express or implied, that the party who receives the note is to take it at his own risk. The same principle is applicable to the notes of an incorporated bank, except that as to the latter there is always an implied understanding between the parties that if the bill, at the time it is received, is in fact what the party receiving it supposes it to be, he is to run the risk of any future failure of the bank. This implied agreement between the parties arises from the fact that bills of this description, so long as the bank which issued them continues to redeem them in specie at its counter, are by common consent treated as money, and are constantly passed from hand to hand as such. The receiving them as money, however, is not a legal, but only a conventional regulation, adopted by the common consent of the community; as no state is authorized to coin money, or to pass any law by which anything but gold or silver coin shall be made a legal tender in the payments of debts.[147]

146. 13 Wend. 101 (N.Y. 1834).
147. *Id.* at 104.

The notion of a rule founded on "conventional regulation" rather than a "legal" rule is an intriguing, and not wholly explained concept. Apparently, the idea is that just as the individual parties to a transaction could treat anything as payment if they made their intention clear, so too the community as a whole, by the routine practice of paying contemporaneous and precedent debts by transfer of bank notes, could have consented to treat the transfer of the bank notes as a means of payment.

Although the approach taken in *Ontario Bank* might have resulted in a simple rule that the transfer of a bank note discharges any debt, precedent or contemporaneous, the New York court introduced yet another complexity into the analysis. The court ruled that once the bank had failed, its notes could not be treated as the equivalent of currency, even though the parties were unaware of the failure at the time the note was passed.[148] In support of the *Ontario Bank* approach, it was sometimes noted that a contrary rule might encourage dishonest behavior by a party who held notes and learned, before others in the area, that the bank had failed.[149] Or, one might draw support for the *Ontario Bank* approach by drawing an analogy between notes of a failed bank and counterfeit notes.[150]

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148. As the court put it:

> This principle of considering bank bills as money, which the receiver is to take at his own risk, cannot, therefore, be carried any further than the conventional regulation extends—that is, to consider and treat them as money so long as the bank by which they are issued continues to redeem them in specie, and no longer. When, therefore, a bank stops payment, its bills cease to be a conventional representative of the legal currency of the country, whether the holder is aware of that fact or not; from that moment the bills of such bank resume their natural and legal character of promissory notes, or mere securities for the payment of money; and if they are afterwards passed off to an individual who is equally ignorant of the failure of the bank, there is no agreement on his part, either express or implied, that he shall sustain the loss which has already occurred to the original holder of the bills.

Id. at 104-05.

149. For example, the Maine court noted:

> Our numerous banks, of small capitals, or of almost no capital, issuing and pressing into circulation their notes, and gaining for them in numerous instances an ephemeral credit and currency, cannot be considered as cash, if at all, longer than their credit is maintained. To hold otherwise would open a door to frauds innumerable. The holder of the notes of a broken bank, living in its vicinity, would be tempted to hasten into remote and obscure places; and before the news of the discredit of the bills had reached there, pass them off to the simple and unwary, who would be utterly unable to prove knowledge of their discredit on the part of him, who had passed them off; and be therefore compelled to pocket the loss; whereas if the loss is made to fall upon him, in whose hands they might happen to be, at the time of the failure, no such result could happen.

Frontier Bank v. Morse, 22 Me. 88 (1842).

150. As the New Hampshire court noted:

> The case of a payment in bills of a broken bank cannot be distinguished, in principle, from that of a payment in counterfeit money. From the time of the failure of the bank they cease to be the proper representatives of money, whether they are, at the time, near to, or at a distance from, the bank. They may have a greater value than counterfeit bills, but in neither case has the

The approach taken in *Ontario Bank* was, however, by no means universally followed. One contrary approach was to apply to bank notes the same rules that had long ago been developed for bills and notes in general. The best known example of that approach was *Corbit v. Bank of Smyrna*,[151] in which the Delaware court explicitly rejected the *Ontario Bank* approach[152] and ruled that bank notes should be treated in the same fashion as any other instrument. Thus, the transfer of a bank note would operate as a discharge of a contemporaneous debt but not a precedent debt.[153]

While the approach taken in *Corbit* ensured that the loss from failed bank notes rested with the party who had accepted them—before or after the bank failed—for a contemporaneous debt, it necessarily also had the consequence that the transfer of bank notes would not operate as final payment of a precedent debt. That, in part, was the result that the *Ontario Bank* approach was intended to forestall. The problem of transfers of failed bank notes for precedent debts probably accounts for a third approach which finds significant support in the early-nineteenth-century case law. Under this approach, the transfer of a bank note results in the final payment of either a precedent or contemporaneous debt, whether the bank note was transferred before or after the bank failed.

The approach of treating the transfer of a bank note as final payment, regardless of the time that the debt was incurred or the time that the bank failed, is seen in two cases decided just after *Ontario Bank*, but evidently too soon thereafter for the *Ontario Bank* case to have been brought to the attention of the courts. The cases, both decided in 1835, are the Tennessee decision in *Scruggs v. Gass*[154] and the Alabama decision in *Lowrey v. Murrel*.[155]

In the Tennessee case, Gass purchased bacon from Scruggs for $126—about $2000 in today's dollars—sometime early in 1832. In August of that year, he transferred notes of the Bank of Macon in payment of the debt. Unknown to either party, the Macon Bank had failed in July. Given the particular sequence of events, the buyer would have lost under both the *Ontario Bank* approach and the *Corbit* approach. Under the New York rule applied in *Ontario Bank*, the transfer of the notes would not have amounted to payment because the Macon Bank had failed before the notes were transferred. Under the Pennsylvania rule applied in *Corbit*, the transfer of the notes would not have amounted to payment because the notes were transferred in payment of a pre-existing debt.

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party received what in the contemplation of both parties he was entitled to receive, if the contract was to pay a certain sum.

Fogg v. Sawyer, 9 N.H. 365, 367-68 (1838). The rules concerning counterfeit notes are discussed more fully *infra* text accompanying notes 173-84.

151. 2 Del. (2 Harr.) 235 (1837).

152. *Id.* at 253, 258-59.

153. *Id.* at 260.

154. 29 Am. Dec. 114 (Tenn. 1835).

155. 2 Port. 280 (Ala. 1835).

Given these difficulties, one can imagine how forsaken Gass must have felt when he awakened to discover the truth about the Macon Bank notes that Scruggs had taken for the bacon.

The Tennessee Supreme Court, however, ruled that the debt had been discharged. The court thought that the rules on counterfeit notes should not apply to notes of failed banks, and it treated the case as a simple matter of a completed transaction that one of the parties later regretted. Moreover, the court noted that allowing the buyer to recover might present intractable practical difficulties since it was common to accept bank notes whose worth was subject to constant fluctuation depending on the bank's reputation. As the court put it,

> To adopt a different rule would end in much litigation and confusion. If Scruggs could recover from Gass, the latter, of course, could have his remedy against the person from whom he received the paper; and by this means it would be traced back, by suits, to the holder at the period when the bank refused specie payment. And, if insolvency of the bank would authorize the recovery on the original demand, no reason is perceived why, by the same rule, partial inability to pay, on the part of the corporation, would not authorize a partial recovery for the amount the bank-notes were worth less than specie in the market—a rule which, if adopted, would threaten endless strife and litigation.[156]

The Alabama court adopted essentially the same approach, for essentially the same reasons, in *Lowry v. Murrell*.[157] Lowry owed money to Murrell and, in payment of the debt, transferred notes of a bank in Georgia that turned out to have failed. The Alabama court ruled that a seller or other creditor who takes a bank note takes the risk of the solvency of the bank, just as the buyer takes the risk of the value of goods purchased:

> If an article of property be sold in good faith, without warranty, apparently of great value, when in fact it was of little or none, the vendee is without remedy; if in the same contract, and in the same good faith, *bank notes* be taken in payment, and the result should afterwards be found so far different, that the property prove sound, but the notes unavailable from the failure of the bank, the loss must, in like manner be borne by the vendor. The principle must be the same where the payment has been made of a pre-existing debt. Bank notes are usually in rapid circulation as cash, and are apt to pass through many innocent hands after the bank has stopped payment, and before notice thereof has reached the place; after which, nothing could be more embarrassing to commerce, than to upset all such transactions; nor would there be any justice in the principle: it would carry the responsibility back to the holder who first passed the note after the moment of failure, when several subsequent holders may have passed it in like manner, and without loss to themselves.[158]

156. *Scruggs*, 29 Am. Dec. at 115.
157. 2 Port. at 280.
158. *Id.* at 285.

The same issue came before the Pennsylvania Supreme Court in *Bayard v. Shunk* in 1841.[159] The decision came sufficiently after the New York ruling in *Ontario Bank* that the Pennsylvania court had the occasion to consider the New York rule explicitly. The court found little to commend the New York approach.[160] The court noted that the Tennessee court in *Scruggs* had reached a result opposite to the New York rule, and it cited dictum from a well-known Massachusetts decision to the same effect.[161] The Pennsylvania court also relied to a considerable extent on dictum in Lord Mansfield's well-known opinion in the 1758 case of *Miller v. Race*.[162] In *Miller* the court refused to apply to Bank of England notes the ordinary rule that the true owner of a chattel can recover it from anyone who takes it from a thief.[163] As the court in *Bayard* stressed, the ultimate significance of *Miller v. Race* is that the usual property rule for chattels should not apply to bank notes that are treated as a form of currency.[164] So too, the Pennsylvania court ruled that neither the usual *Ward v. Evans* rule for negotiable instruments nor the *Ontario Bank* approach of distinguishing the transfer of notes before versus after the bank had failed was apt to the commercial practice in which bank notes were routinely transferred as a medium of payment. Speaking specifically of the *Ontario Bank* approach, the court noted:

> It is no answer to say the note of an unbroken bank may be instantly converted into coin by presenting it at the counter. To do that may require a journey from Boston to New Orleans, or between places still further apart, and the bank may have stopped in the mean time; or it may stop at the instant of presentation when situated at the place where the holder resides. And it may do so even when it is not insolvent at all, but perfectly able eventually to pay the last shilling. This distinction between previous and subsequent failure, evinced by stopping before the time of the transaction or after it, is an arbitrary and impracticable one. To such a payment we must apply the cash principle entire, or we must treat it as a transfer of negotiable paper, imposing on the transferee no more than the ordinary mercantile responsibility in regard to presentation and notice of dishonour. There is no middle ground. But to treat a bank note as an ordinary promissory note, would introduce endless confusion, and a most distressing state of litigation. We should have reclamations through hundreds of hands, and the inconvenience of having a chain of disputes between successive receivers, would more than counterbalance the good to be done by hindering a crafty man from putting off his worthless note to an unsuspecting creditor. No contrivance can prevent the accomplishment of fraud, and rules devised for the suppression of petty

159. 1 Watts & Serg. 92 (Pa. 1841).
160. *See id.* at 96-97.
161. The Massachusetts case cited in *Bayard* was *Young v. Adams*, 6 Mass. (5 Tyng) 182 (1810), which, as is discussed *infra* text accompanying note 174, dealt with the question whether the transfer of counterfeit notes amounts to payment.
162. 1 Watts & Serg. at 97.
163. 97 Eng. Rep. 398 (1758).
164. *Bayard*, 1 Watts & Serg. at 97.

mischiefs have usually introduced greater ones.[165]

H. Application of Nineteenth-Century Law to E-Notes

Let us consider, then, how a court in the twenty-first century should approach a case in which an E-Note has been transferred in payment of a debt, but it turns out that the issuer of the E-Note is insolvent. The creditor in the underlying transaction brings an action against the debtor on the underlying obligation, and the debtor defends on the grounds that the underlying obligation was discharged by transfer of the instrument.

As with the previously considered case of an assertion of an adverse claim to an E-Note,[166] it hardly seems plausible for a court to say that the issue is entirely new. Quite the contrary, the issue in the E-Note case would be just the same as the issue in the many nineteenth-century cases dealing with whether an underlying obligation is discharged by transfer of a paper instrument of a third party who proves to be insolvent. The difference is that while the adverse claim issue was quite simple, the nineteenth-century law on discharge of an obligation by transfer of an instrument was, as we have seen, quite complex.

One approach would be to say that whether the transfer of the E-Note discharges the underlying obligation is determined, in the first instance, by the distinction between precedent and contemporaneous debts. That would follow the approach taken to bank notes in the Delaware case of *Corbit v. Bank of Smyrna*, which treated bank notes under the same rules that had been developed for bills and notes generally. That approach would provide a sensible resolution to many of the scenarios that might be presented by use of E-Notes. To the extent that the E-note system is used as a payment device in ordinary retail transactions, the E-Note would commonly be transferred in payment of the purchase price of goods or services provided contemporaneously. In such cases, transfer of the E-Note would be presumed to operate as a discharge of the underlying debt. Of course, one would then be left with the problems of distinguishing precedent from contemporaneous debts and deciding what would count as evidence that, contrary to the presumption, a transfer of an E-Note was intended as a discharge of a precedent debt.

The Delaware decision in *Corbit*, however, seems to represent a distinct minority view insofar as it suggests that no special rules were required for bank notes. As we have seen, most courts in the nineteenth century ruled that special rules were required for bank notes. One approach, illustrated by the New York decision in *Ontario Bank v. Lightbody*, is that the transfer of notes of a solvent bank operates as a discharge of any debt, but the transfer of a bank note after the bank has failed is not treated as a discharge. That approach, however, presents substantial difficulties of drawing the line between bank notes passed

165. *Id.* at 98-99.
166. *See supra* text accompanying notes 92-102.

before and after the bank's failure. A simpler and probably more sensible approach is the one taken in other jurisdictions, including Tennessee, Alabama, and Pennsylvania, that a transfer of a bank note operates as a discharge of the underlying debt, whether the debt is contemporaneous or precedent, and whether the bank note is transferred before or after the bank fails.

One point that stands out in all of the early nineteenth-century cases is that the rationale for a special rule for bank instruments is completely different from that commonly given for the special bank instrument rule in modern law. As we have seen, the rule in U.C.C. Article 3, that a transfer of an instrument on which a bank is liable discharges the underlying debt, is commonly "explained" by the observation that bank failure is unlikely.[167] In the early nineteenth century, that suggestion would have seemed ludicrous—bank failure was an all too common event. Thus, the early nineteenth-century cases provide a far better basis for considering whether and why special rules are required for bank instruments. Virtually all of the American jurisdictions concluded that such special rules were required and uniformly considered that the rationale for such special rules was not that bank failure was unlikely, but that bank notes were so commonly used as a medium of payment.

It is also worth noting that although bank notes were the most common form of currency, circulating notes were also issued by other commercial entities, such as railroads, turnpike companies, and insurance companies. One of my favorite examples of such notes, from my own collection, is a two dollar circulating note issued by the Adrian Insurance Company of Michigan which bears on its face evidence of its own soundness in the form of a picture of a dog guarding a strongbox, surrounded by the legend "Capital $250,000."[168] Regrettably, no decisions concerning circulating notes issued by non-bank entities have been located. It is, however, not difficult to predict how a court in the early nineteenth century would have treated such a case. The rationale for the special rule for bank notes was not that banks were inherently different from other entities, but that bank notes were treated by commercial custom as a medium of exchange. It seems inconceivable that a nineteenth-century court would have declined to apply the special law of bank notes to printed circulating notes issued by other commercial entities that were obviously intended to operate as a circulating medium of exchange.

Perhaps a way of unifying the various approaches taken in the nineteenth-century cases can be found in the elusive concept of intention. All of the approaches found in the nineteenth-century cases were, at least in theory, only default rules that operated in the absence of specific evidence of the parties' intention. As we have seen, however, little guidance would be provided by a general rule that the outcome turns on the par-

167. *See supra* note 113.

168. One can find a sampling of such notes in the catalogs of dealers in obsolete paper money, such as Denly's of Boston, *available at* http://www.denlys.com.

ties' intentions. Rather, the significant question is what features of a transaction should be taken, in the absence of other more specific evidence, to show that the parties "intended" the transfer of the instrument to operate as final payment.

In that regard, consider two nineteenth-century New York cases, *Tobey v. Barber*[169] and *Hall v. Stevens*.[170] In *Tobey*, decided in 1809, a person had leased a farm for two years and attempted payment of the rent due by means of transfer to the lessor of some turnpike company shares and a note of a third party. When the note given by the lessee proved uncollectible, the lessor brought an action for the unpaid rent. The court, applying the rule settled since the time of *Ward v. Evans*, held that the transfer of the note did not amount to final payment of the precedent debt. As the court put it,

> The taking of the note was no extinguishment of the debt due for the rent. It is a rule well settled, and repeatedly recognized in this court, that taking a note, either of the debtor or of a third person, for a preexisting debt, is no payment, unless it be expressly agreed to take the note as payment, and to run the risk of its being paid; or unless the creditor parts with the note, or is guilty of *laches* in not presenting it for payment in due time. He is not obliged to sue upon it. He may return it when dishonored, and resort to his original demand. It only postpones the time of payment of the old debt, until a default be made in the payment of the note.[171]

Although the basis of the decision purports to be the intention of the parties, the commercial context may be far more significant. In *Tobey,* the lessee attempted to pay the rent by transferring an odd miscellany of items, including some turnpike company shares and a note issued by another private party. Today, that seems terribly odd. Why would the lessee attempt to make payment of the rent in such an odd form, instead of by the ordinary means of delivery of some device routinely treated as a medium of exchange? The answer is that, at that time and place, there was no such "ordinary" medium of exchange. At the time, long predating the development of modern banking facilities, it would not have been at all unusual for a debtor to offer to pay the debt in such a miscellany of forms. A creditor would have little choice but to accept the effort. Given the absence of any realistic choice, it is not surprising that the rule developed that the transfer of the various items should be treated only as an attempt to make payment, not as payment itself.

In contrast to *Tobey*, consider the facts of the 1889 case of *Hall v. Stevens*, discussed above, in which a farmer lost his suit for the price of cattle which he had sold for a bank draft that proved uncollectible. The farmer who sold cattle in *Hall* specifically asked how the buyer was to pay. After some discussion of whether the buyer would pay in currency, the seller

169. 5 Johns. 68 (N.Y. Sup. Ct. 1809).
170. 22 N.E. 374 (N.Y. 1889).
171. *Tobey*, 5 Johns. at 72-73.

ultimately accepted a bank draft—to which the buyer was not a party. One gets the sense from the report that the farmer took the draft with a sense of resignation, remarking, "I suppose you could not get the currency."[172] Therein lies the key. The farmer's reluctance to accept the bank draft was obviously a result of his realization that in taking it he was running a risk of bank failure, and that he would not run that risk if he had held out for currency. On the other hand, he probably felt that insisting on currency might either delay completion of the transaction or perhaps even cause the buyer to refuse to go through with the deal. He made his choice. He regretted it, but he made his choice.

Now consider a twenty-first-century transaction in which a person proposes to pay for a transaction, or a pre-existing debt, by transferring an E-Note. The seller or creditor has a host of choices about what forms of payment will be acceptable. Cash, check, credit card, debit card, electronic funds transfer, or whatever—all are available, though each offers differing degrees of convenience, expense, and risk. If the seller or creditor takes an E-Note, has he not made his choice? His situation seems just like that of the farmer in *Hall v. Stevens* who made his choice by taking the bank draft. The scenario facing the seller or creditor is nothing like that faced by the landlord in *Tobey* whose debtor offered a miscellany of possible ways of transferring value because there was no real alternative. Rather, the seller or creditor who accepts an E-Note will have done so because it seemed convenient or commercially desirable to do so rather than insisting on payment in some other medium. Given that circumstance, there is every reason to apply to the transaction a legal rule that can readily be deduced from the nineteenth-century cases, to wit, if you choose to accept an E-Note as a medium of payment, you take the risk of the possible insolvency of the issuer. If you don't like that risk, insist on some other form of payment.

VII. COUNTERFEIT E-NOTES

One problem that warrants discussion in connection with the development of E-Note systems is the concern that E-Notes might be counterfeited. A related concern is sometimes discussed in the modern literature on E-Notes under the heading of spawning. The problem of "spawning" is generally taken to cover the possibility that a user of a genuine E-Note would cause the amount thereof to be increased or, that a user of an E-Note might find a way to attain the equivalent of the proverbially desired feature of cakes, that is, the user might transfer the E-note but still have it.

Though spawning and related problems seem like novel problems of the new technology, the analogous issue of counterfeit bank notes was a routine legal issue in the early nineteenth century. Today, when paper currency is exclusively issued by a governmental agency, the form of pa-

172. *Hall*, 22 N.E. at 375.

per currency is well-known, and the governmental issuer has taken great pains to make counterfeiting difficult. In the nineteenth century, by contrast, the circulating medium of the country consisted of notes issued by an enormous number of banks and other commercial entities, all issued in their own form, with varying extents of anti-counterfeiting measures. Thus, one to whom a given bank note was tendered in payment might never have seen a note issued by that bank before, and thus would have a difficult time assuring that the note was genuine.

There are a fair number of American cases involving counterfeit bank notes, dating from the beginning of the nineteenth century. The basic rules were fairly well-established and far more uniform than the rules on the effect of transfer of genuine notes of a failed bank. The leading cases were an 1807 New York decision, *Markle v. Hatfield*,[173] and an 1810 Massachusetts case, *Young v. Adams*.[174] In both cases, the issue was seen as fairly straightforward. As Chancellor Kent put it in *Markle*,

> The justice of this case is clearly with the [seller]. He parted with his goods to the plaintiff, without receiving the compensation which was intended. It would be a matter of regret, if the law obliged us to regard a payment in counterfeit, instead of genuine, bank bills, as a valid payment of a debt, merely because the creditor did not perceive and detect the false bills, at the time of payment.[175]

The same rule was applied in any number of other cases in the early nineteenth century.[176]

As in the case of genuine notes of failed banks, however, the law on counterfeit notes cannot be understood fully without considering the consequences of the actions of the person who received the counterfeit note. For example, in an 1825 Pennsylvania case, *Raymond v. Baar*,[177] a shopkeeper's clerk received a bank note in payment for goods. When the shopkeeper first saw the note about two weeks later, he recognized it as a counterfeit. The shopkeeper, however, did not make any claim upon, or bring suit against, the person who had passed the counterfeit until some six months later. The Pennsylvania court had little trouble ruling that the delay cost the recipient the benefit of the usual rule that a debt is not discharged by transfer of a counterfeit bank note. As the court stated,

> This is a very plain case. The plaintiff was guilty of most unreasonable negligence; he kept the note six months after he knew it to be counterfeit, without giving notice to the defendant; it was his duty to return it to the defendant as soon as he discovered it to be counterfeit.[178]

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173. 2 Johns. 455 (N.Y. Sup. Ct. 1807).
174. 6 Mass. (5 Tyng) 182 (1810).
175. 2 Johns. at 459.
176. Simms v. Clark, 11 Ill. 137 (1849); Mudd v. Reeves, 2 H. & J. 368 (Md. 1808); Hargrave v. Dusenberry, 9 N.C. (2 Hawks) 326 (1823); Ramsdale v. Horton, 3 Pa. 330 (1846).
177. 13 Serg. & Rawle 318 (Pa. 1825).
178. *Id.* at 319.

There are numerous other cases in the nineteenth century in which a person who had received a counterfeit bank note lost his rights by delay in proceeding against the person who passed the note.[179]

In addition to delay in proceeding against the person who passed the counterfeit, a person who received a counterfeit might lose the right of recourse on the grounds of negligence in not detecting the falsity of the note at the time it was passed. As noted in a mid-century New York case, "There may be negligence in two ways, either in making *discovery* of the worthlessness of the paper, or in making *return* of it within a reasonable time."[180] The principle that a person who receives counterfeit notes may be precluded from recovery by failure to exercise diligence at the time the notes were passed received its fullest application in cases in which the counterfeit notes were passed to the very bank that supposedly had issued them. For example, in *Gloucester Bank v. Salem Bank*,[181] the Salem Bank held some $8500 (over $90,000 in today's dollars) in notes purportedly issued by the Gloucester Bank. The Salem bank delivered the notes to the Gloucester Bank after business hours. The next day, the notes were put away for safekeeping by the Gloucester Bank. About two weeks later, the Gloucester Bank discovered that many of the notes were counterfeit. The Gloucester Bank's action against the Salem Bank failed on the ground that although the Gloucester Bank could have taken a day or so to verify the notes, the delay of two weeks in learning that its own notes were counterfeit precluded it from recovering.

A similar issue came before the United States Supreme Court in *Bank of United States v. Bank of Georgia*.[182] The Bank of the United States presented notes of the Georgia bank to that bank and received credit for them in mutual accounts between the banks. It tuned out that the Georgia Bank notes had been fraudulently altered—changing the amounts from five to fifty dollars and from ten to one hundred dollars. The Bank of the United States brought an action on the account, that is, sued to recover the amounts of the altered notes. In an opinion by Justice Story, the United States Supreme Court ruled for the Bank of the United States. The opinion notes that the question was not the general issue of the liabilities of parties to a transfer of a counterfeit note, but whether the bank whose own notes had been counterfeited could recover the amount after accepting the notes.[183] Though a period of a couple of weeks had passed

179. Wingate v. Neidlinger, 50 Ind. 520 (1875) (counterfeit U.S. currency transferred in February 1873, demand not made until August 1873); Atwood v. Cornwall, 28 Mich. 336 (1873) (counterfeit U.S. currency transferred in March 1867, demand not made until August 1867); Thomas v. Todd, 6 Hill 340 (N.Y. Sup. Ct. 1844) (bank note received on May 5, discovered counterfeit shortly thereafter, demand not made until July 4); Pindall's Ex'rs v. NW Bank, 34 Va. (7 Leigh) 617 (1836) (bank note returned as counterfeit on March 8, demand not made on transferor until May.

180. Kenny v. First Nat'l Bank of Albany, 50 Barb. 112, 114 (N.Y. Gen. Term 1867) (emphasis in orig.).

181. 17 Mass. 33 (1820).

182. 23 U.S. (10 Wheat.) 333 (1825).

183. *Id.* at 342-43.

between the time when the notes were presented to the Georgia Bank and the time that the Georgia Bank discovered the alteration, the opinion suggests that the significant fact was not so much the delay after receiving the notes, but the fact that the bank itself had received them without detecting the alteration at the time the notes were presented. As Justice Story noted,

> the receipt by a bank of forged notes, purporting to be its own, must be deemed an adoption of them. It has the means of knowing if they are genuine; if these means are not employed, it is certainly evidence of a neglect of that duty, which the public have a right to require.[184]

As applied to E-Note systems, the principles of the nineteenth-century counterfeit bank note cases would, at first blush, seem to place the risk of counterfeit E-Notes on the party who received the E-Notes. The diligence rules developed in the setting of counterfeit bank notes may, however, produce a result that is, in practice, the opposite.

Consider first the final stage in the life of an E-Note—the stage of redemption when an E-Note is submitted to its issuer for payment in some other form. Suppose that the issuer makes the payment but later discovers that the E-Note was counterfeit. Can the issuer recover the payment on the grounds that it was made by mistake in exchange for what turned out to be a counterfeit? The decisions in *Gloucester Bank v. Salem Bank* and *Bank of United States v. Bank of Georgia* seem dispositive. In those cases, the courts ruled that the bank whose own notes had been counterfeited was precluded from recovering the amount of the payment on discovery that the notes had been counterfeited. Even more so than the nineteenth-century system of circulating bank notes, the issuer of E-Notes should be held responsible for the adequacy of whatever security devices it has put into place as part of the system. If those security measures prove inadequate, and the issuing bank pays what turns out to be a counterfeit E-Note, any attempt to recover that payment would seem precluded by the holding in such cases as *Gloucester Bank v. Salem Bank* and *Bank of United States v. Bank of Georgia.*

Now, let us consider the earlier phase in the life of an E-Note, the stage of transfer from one user to another. If an obligation is settled by the transfer of an E-Note, and the E-Note is later discovered to be counterfeit, can the transferee recover? As we have seen, the law of counterfeit bank notes and currency begins with the proposition that the transfer of a counterfeit is a nullity. However, that principle is limited by the notion

184. *Id.* at 343. In both *Gloucester Bank v. Salem Bank* and *Bank of United States v. Bank of Georgia*, the courts also stressed the analogy to Lord Mansfield's well-known ruling in *Price v. Neal*, 97 Eng. Rep. 871 (K.B. 1763), that a drawee that had accepted or paid a bill purportedly drawn on it was precluded from recovering the amount of the bill if it turned out that the drawer's signature was forged. At the time of *Price v. Neal*, the rule could, with some plausibility, be based on the notion that a drawee was expected to know the signature of its drawer. For a discussion of a modern rationale for the *Price v. Neal* rule, see James Steven Rogers, *The Basic Principle of Loss Allocation for Unauthorized Checks*, 39 WAKE FOREST L. REV. 453 (2004).

that a person to whom a counterfeit is transferred may lose the right to sue on the underlying transaction if he is guilty of a lack of care in receiving the counterfeit or a lack of promptness in reporting the problem to the transferor. The key question is what counts as sufficiently diligent action to preserve the right to sue on the underlying transaction. Again, the security systems used in the E-Note system may well provide the answer. Virtually any form of E-Note system would include some sort of security device, the function of which is to determine whether a tender E-Note is or is not genuine. Thus, a transferee will accept an E-Note only after testing it under whatever security system is in place. Remember that in the modern world a party has many choices about the form of payment that the party will accept. If a party chooses to accept an E-Note and does so after employing whatever security measures are built into the system, the diligence principle of the case law on counterfeits could well be taken to preclude the party from later objecting that the E-Note was not genuine.

VIII. CONCLUSION—APPLICATION OF THE OLD LAW OF BANK NOTES TO E-NOTES

We have seen that, at least on some issues of private law, there was a well-settled body of case law dating from the early nineteenth century concerning payment by transfer of bank notes. To be sure, the nineteenth-century case law cannot resolve all, or even most, of the legal issues that lawyers advising the architects of E-Note systems and policymakers concerned with the development of E-note systems must consider. In particular, the nineteenth-century law will provide no useful assistance on the questions of policy and law presented by such matters as whether only certain entities should be permitted to issue E-Notes and what financial conditions and disclosure regimes should be imposed on those who do issue E-Notes. But, on certain matters of private law involving disputes that might arise in the use of E-Notes, the nineteenth-century law of circulating bank notes seems entirely relevant. The old law of bank notes would provide binding rules of decision for cases involving E-notes unless the fact that the notes are in electronic rather than paper form is itself a sufficient basis for distinguishing the law of paper bank notes.

In addressing that question, the first point to consider is the impact of the conversion of the law of bills and notes from judge-made to statutory form. We have seen that the modern law of negotiable instruments, codified in Article 3 of the U.C.C., applies only to instruments that are written on paper.[185] Does this mean that the pre-statutory law of bills and notes survives only in the form of the statutory law that is limited to paper instruments? If so, then lawyers and courts confronting issues about E-Notes are free to ignore the nineteenth-century case law concerning

185. *See supra* text accompanying notes 66-67.

bank notes, except perhaps as one of many potential sources of analogy for the development of a common law of E-Notes. But, the conclusion that the pre-Code law of bank notes survives only in the form of the paper-bound rules of Article 3 will not withstand analysis.

In the first place, as a general matter, the fact that a given subject might have been, but was not, included in the U.C.C. can hardly be taken to render irrelevant the pre-Code non-statutory law. As is well known, the contours of the coverage of the U.C.C. were determined by many factors, including chance and politics. For example, motor vehicle certificate of title laws were not included because of the political difficulties of meshing the prior statues into a uniform enactment.[186] The law of agency, which in earlier times was an extremely important branch of commercial law, was originally proposed as the subject of a U.C.C. article, but soon dropped.[187] The law of personal property leases was left out of the original version of the U.C.C. but was included several decades latter as Article 4A.[188] Although it calls itself a "Code," the U.C.C. is quite explicit on the general question of its impact on related subjects that did not happen to have been included: "Unless displaced by the particular provisions of [the Uniform Commercial Code], the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, and other validating or invalidating cause shall supplement its provisions."[189] Thus, as a general matter, one should be reluctant to conclude that the enactment of the U.C.C. destroys the vitality of case law on matters not expressly covered by the Code.

With respect to the law of circulating bank notes, there is even further reason to doubt any suggestion that the enactment of the Code affects the pre-Code law. It would be one thing if, at the time the Code was adopted, there was an existing robust system of circulating bank notes, and that system was comprehensively governed by the Code. But, by the time of the enactment of the Code and its predecessors, the system of circulating bank notes was largely a memory. The Uniform Negotiable Instruments Law was promulgated in 1896, patterned on the English Bills of Exchange Act of 1882. By the time that American law of negotiable instruments became statutory, a generation had passed since the system of circulating private bank notes had come to an end. The era of private circulating bank notes ended with the enactment of the National Bank Act in 1864.[190] That Act established the beginnings of a national currency system, in which notes were still, in form, issued by individual federally chartered banks, but the notes were uniform in form, and a system

186. 1 GRANT GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 20.8 (1965).

187. Fairfax Leary & Michael A. Schmitt, *Some Bad News and Some Good news from Articles Three and Four*, 43 OHIO ST. L.J. 611, 612 (1982).

188. *See generally* Charles M. Mooney, *Personal Property Leasing: A Challenge*, 36 BUS. LAW. 1605 (1981).

189. U.C.C. § 1-103(b).

190. 13 Stat. 99 (1864).

of reserve requirements for issuance of the notes had the effect of making notes of any national bank essentially equivalent to those of any other bank. At the same time, the National Bank Act put a prohibitive tax on circulating notes of state-chartered banks, a tax upheld by the United States Supreme Court in 1869.[191] Therefore, there would have been no reason for the Uniform Negotiable Instruments Law to have dealt in any detailed way with the system of circulating bank notes that had passed into oblivion long before the statute was written.

Thus, American law of circulating notes entered a state of "suspended animation" with the end of the system of circulating bank notes in the 1860s. No legislative enactment or course of judicial decisions can be regarded as a rejection of the law of circulating notes, because there simply was no occasion to apply or further develop that body of law. The law's subject matter had effectively been legislated out of existence. Yet, if the system of circulating notes were to develop again, one assumes that the old law should continue to apply. Suppose, for example, that the provisions of federal law that effectively prohibit the issuance of circulating notes by banks were repealed, and that banks once again began issuing circulating paper notes. It is hard to see why the early nineteenth-century case law concerning circulating bank notes would not apply to them. Should one not reach the same conclusion with respect to the development of E-Note systems? If the only, or principal, difference between an E-Note system and the early-nineteenth-century system of circulating notes is that E-Notes are in electronic form while early-nineteenth-century circulating notes were written or engraved, it is hard to see why that difference in media should automatically make the nineteenth-century case law of circulating notes irrelevant.

Indeed, there is a plausible argument that courts are now precluded by statute from refusing to apply the nineteenth-century case law of circulating notes to E-Notes. In 2000, the federal government enacted the Electronic Signatures in Global and National Commerce Act ("Electronic Signatures Act")[192] which, with various differences of detail, covers the same basic territory as the Uniform Electronic Transactions Act.[193] The principal objective of the Electronic Signatures Act was to overcome obstacles to electronic contracting posed by the statute of frauds or other statutory requirements of writings or signatures. Yet, the key provisions of the Electronic Signatures Act are not limited to that objective. The statute provides that

> Notwithstanding any statute, regulation, or other rule of law (other than this title and title II), with respect to any transaction in or affecting interstate or foreign commerce—

191. Veazie Bank v. Fenno, 75 U.S. 533 (1869).

192. 15 U.S.C. §§ 7001 et seq. (2000).

193. For discussion of the federal law, and its relationship to state enactments of the Uniform Electronic Transactions Act, see Robert A. Wittie & Jane K. Winn, *E-Sign of the Times*, E-COMMERCE LAW REPORT (July 2000).

> (1) a signature, contract, or other record relating to such transaction may not be denied legal effect, validity, or enforceability solely because it is in electronic form; and
> (2) a contract relating to such transaction may not be denied legal effect, validity, or enforceability solely because an electronic signature or electronic record was used in its formation.

Let us suppose that an E-Note system is implemented, and a dispute involving the use of an E-Note goes to litigation. Suppose that the issue in the lawsuit is one on which there was extensive case law in the early nineteenth century concerning circulating bank notes. Is the court free to ignore the nineteenth-century cases merely because they involved written notes while the case at hand involves an electronic note? The minimum reading of the impact of the Electronic Signatures Act would be that a court could not say that the electronic note is unenforceable merely because it is in electronic rather than written form. But, it is by no means clear that the impact of the Electronic Signatures Act is that limited.

The Electronic Signatures Act states that a contract may not be denied "legal effect" solely on the ground that it is in electronic form. Let us consider how that mandate would apply in litigation involving E-Notes. Suppose that the issue presented in a case involving an E-Note is analogous to a matter involving circulating paper bank notes on which there is a substantial body of case law dating from the early nineteenth century. Suppose further that the nineteenth-century case law on circulating bank notes would, if applied to the case, produce a certain outcome. Is it not a denial of "legal effect" to say that a different outcome should be reached for the electronic note, merely because it is in electronic rather than written form?[194]

Thus, we have seen that, contrary to common assumptions that underlie most modern discussion of the law of electronic money, courts addressing questions that might be posed by systems of electronic money will not be called upon to make entirely new law, unguided by precedent. To be sure, many of the legal issues presented by E-Notes systems, such as matters of disclosure and regulation, are genuinely new. On issues of

194. There is a provision in the Electronic Signatures Act that, in general, defers to state enactments of the Uniform Commercial Code for rules on electronic contracts and signature requirements. That provision, however, does not seem to affect the question of the application of the Electronic Signatures Act to E-Notes. The provision in question states that the basic rule, quoted above, "shall not apply to a contract or other record to the extent it is governed by . . . the Uniform Commercial Code, as in effect in any State . . . ." 15 U.S.C. § 7003(a)(3) (2000). But, as we have seen, Article 3 of the Uniform Commercial Code does not apply to a note in electronic form. Since an E-Note would not be "governed by the Uniform Commercial Code," the exclusion in the federal Electronic Signatures Act seems to be inapplicable.

Another provision of the federal Electronic Signatures Act creates rules on "transferable records," designed to permit electronic documentation of mortgage lending arrangements. 15 U.S.C. § 7021 (2000). The effect of these provisions is to make much of Article 3, particularly the provisions specifying the rights of holders in due course, applicable to electronic notes. That provision might have had a significant effect on E-Notes but for the fact that it is explicitly limited to a note issued in electronic form that "relates to a loan secured by real property." 15 U.S.C. § 7021(a)(1)(C) (2000).

private law, however, the extensive body of case law developed in the early nineteenth century concerning circulating bank notes provides, at the very least, a powerful source of analogy. Indeed, we have found no plausible basis for concluding that the difference between circulating notes in paper form and circulating notes in electronic form is, in itself, a sufficient basis for distinguishing the old law from the new. In short, the early-nineteenth-century law of bank notes already *is* the New Old Law of Electronic Money.