Held Up In Due Course: Codification and the Victory of Form over Intent in Negotiable Instrument Law

Kurt Eggert
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Article

HELD UP IN DUE COURSE:
CODIFICATION AND THE VICTORY OF
FORM OVER INTENT IN NEGOTIABLE
INSTRUMENT LAW

Kurt Eggert [Fnd1]
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I. INTRODUCTION

The holder in due course doctrine is part of the little-known, often-ignored backwater that is negotiable instruments law and, simultaneously, is at the heart of today's great crisis of the American financial system, predatory lending. On the one hand, even the authors of the standard treatise on the Uniform Commercial Code open their chapter on the holder in due course doctrine with this question: Given the declining significance of the holder in due course doctrine, why study it? [Fn1] Grant Gilmore has called negotiable instruments law "so dreary a subject," one "which has disappeared from the curricula of most forward-looking law schools." [Fn2] On the other hand, in years of Congressional hearings designed to understand and halt a "national scandal," [Fn3] predatory lending and the resulting foreclosures that are devastating poorer communities throughout the country--advocates for residential borrowers are calling for an end to the holder in due course doctrine. These advocates decry the doctrine's pernicious effect on defenseless homeowners, as it encourages fraud and sharp practices by unscrupulous lenders, aids them in their attempt to plunder the equity in borrowers' homes, and leaves its victims, most often the elderly, minorities, and the financially unsophisticated, defenseless and threatened with foreclosure when the initial lenders almost immediately negotiate the loans to a third party. [Fn4] A recent analysis of lending practices estimated that predatory lending costs U.S. borrowers $9.1 billion annually; an estimate that expressly and intentionally excludes perhaps the greatest damage caused, residential foreclosures. [Fn5] Worse yet, the problem of mortgage fraud and unscrupulous lending appears to be growing. [Fn6]

This article is the first of a two part series on the holder in due course doctrine and is part of an effort to understand this odd juxtaposition, to understand how the holder in due course doctrine, once so important to the economic development of England and the United States, has become part of a system of assigning risk of fraud and misrepresentation that encourages those very deceptive practices by lenders. All the while, the holder in due course doctrine is almost completely unknown to the general public and especially to the victims of the deceit and high cost loans that it encourages.

This analysis is divided into two parts, published as separate but related articles. This first article undertakes a reinterpretation of the history of the development of the holder in due course doctrine and shows how negotiable instruments law changed from a crucial and reasonably efficient means of transferring and transporting capital into an inefficient, unnecessary, and even dangerous tool used by the financial industry against consumers. I argue that negotiability and its primary effects were once understood by the people who created negotiable instruments and that they by and large intended to create those instruments and be bound by those effects. Because of this knowledge and intent by the instruments' makers, the law of negotiable instruments developed and worked fairly efficiently given the primitive financial systems available. As the knowledge of negotiable instruments declined and as those instruments came to be created by many who have no idea of the nature or legal effects of negotiability, this efficiency has diminished alarmingly. Negotiable instrument law and the financial industry have come to assign the risk of fraud, theft and deception in such a way as to increase and encourage deceptive practices.
Part II of this first article is a discussion of the competing theories regarding the development of negotiable instruments law. The traditional theory is that negotiable instruments law represents one of the greatest developments of commercial law and sees the codification of the common law of negotiable instruments as a necessary method of preserving the great advances made by such notable English judges as Lord Mansfield in developing that law. A newer school of thought is that the codification movement did preserve the common law of negotiable instruments, but did so at a price, as it prevented judges from improving that law when faced with new situations. A third school doubts whether negotiability and, specifically, the holder in due course rule has any current effect or perhaps was ever the central element of negotiable instruments law.

Part III of this article lays out the definition and basic elements of a negotiable instrument and Part IV describes and defines the holder in due course doctrine, which has long been considered the defining element of negotiable instruments law. The central purpose of the holder in due course doctrine, which protects a bona fide assignee from most claims and defenses that the maker of a note had against the original beneficiary of the note, had been to increase the transferability and liquidity of negotiable instruments. In this way, the doctrine effectively turned negotiable instruments into a replacement for currency by relieving the buyers of those instruments of most of their concern regarding any claims or defenses the makers might have had.

In Part V, I argue that, during the initial development of negotiable instruments law during the 17th and 18th centuries, changes in the law governing those instruments followed and roughly tracked changes in the usage of the instruments and in the intent of the makers of those instruments. As a result of an appreciation for the role of intent in the creation of negotiable instruments, that law worked fairly efficiently, especially given the relatively primitive framework of the financial, communication, and transportation systems of the time. Part VI describes the decline of the use of negotiable instruments after the classical period, as the wide use of negotiable instruments ended and common understanding of their legal implications disappeared.

During the codification of the law of negotiable instruments, at the end of the nineteenth century, there was a sea change in the relationship between intent, formal requirements, and the creation of negotiable instruments, a change that is the topic of Part VII. Negotiability was no longer conceived of as the product of the intent of the maker of the instrument. Formal requirements were no longer considered necessary merely as evidence from which the intent to create a negotiable instrument could be inferred. Instead, negotiability came to be seen solely as a question of the form of the instrument itself, completely independent of the intent, or lack thereof, of the maker. The victory of form over intent in the codification of negotiable instruments law is a cause of the widespread and profound misuse of negotiable instruments that has occurred since codification, as consumers and homeowners create negotiable instruments secured by their purchases, homes, or other property, with little or no understanding that they are doing so, or of the legal effects of negotiability.

The holder in due course doctrine was widely used during the twentieth century to victimize purchasers of home improvements and consumer goods on credit, who found to their dismay that even though the goods or services they had purchased either were faulty or were never even delivered or provided, they were still fully liable on their credit purchase contracts because those contracts had been assigned to third parties. The third parties typically claimed ignorance of the underlying fraud, even when they dealt hand-in-glove through many years and many transactions with the unscrupulous home improvers or sellers. Action by a federal regulatory agency finally ended the use of the holder in due course doctrine in these forms of consumer contracts during the 1970s.

The holder in due course doctrine has again come to be broadly effective against unwitting makers of
negotiable instruments, now against consumers not of goods or services but of credit itself. My second of
these two articles on the holder in due course doctrine, Held Up in Due Course: Securitization, Predatory
Lending and the Holder In Due Course Doctrine, [Fn7] to be published in April 2002, will discuss how the
holder in due course doctrine has again become part of the victimization ***Page368 of the makers of
negotiable instruments. In this follow-up article, I discuss the interaction of the holder in due course doctrine
and assignment of risk issues with two significant trends in modern residential lending that have combined to
create a fertile environment for predatory lending: the growing securitization of residential mortgages and the
troubling rise of the subprime mortgage industry.

Securitizers, who transform the relatively non-liquid notes secured by real property into very liquid
securities, seek to avoid all risk of loss for themselves and their investors, both through contractual
arrangements with originators of loans and through the use of negotiable instruments, with the protection of
the holder in due course doctrine. In this way, investors in securitized mortgages are protected even while
buying predatory loans, whether the originator of the loan goes bankrupt or not. The subprime market has
provided securitizers a rich banquet of high cost, high interest loans that the securitizers have been eager to
package, too confident that they and their investors could avoid liability or loss for the deceptive practices
used by many of the originators of subprime loans. Even though these securitizers, as the primary funders
and buyers of subprime loans, are in the best position to police the practices of the subprime originators, they
have been discouraged from doing so by bearing too little risk if the loans are steeped in fraud and deception.
In this way, investors in loan pools have been financing the creation of predatory loans, and the holder in due
course doctrine has been protecting those investors.

II. THE COMPETING THEORIES REGARDING THE HISTORY OF NEGOTIABILITY

In the traditional narrative of the development of negotiable instruments law, the emergence of negotiability
has been treated like the arrival of divine, heaven-bestowed wisdom, first dimly perceived, then gradually
appearing in all of its radiant glory. [Fn8] Some early exponents of the traditional view assumed that some
forms of negotiable instruments have existed for at least a thousand years and searched earnestly for them in
the historical record, looking for aspects of negotiability in such documents as a monk's direction in 771 a.d.
that a church assume the right to avenge his death if the monk were murdered. ***Page369[Fn9] William
Everett Britton relates that Wigmore cites a note, payable to bearer, dated approximately 2100 b.c. [Fn10]

Other traditionalists see negotiability as a more modern invention, a sign of humankind's development and
reign over the archaic law that had fettered commerce. J. Milnes Holden, Holdsworth's heir in
systematically detailing the history of negotiable instruments, described the first clear instance of the holder
in due course doctrine being applied by an English court with the statement, "A chariot had been driven
through the hitherto impregnable lines of the common law maxim nemo dat quod non habet." [Fn11] This
maxim of property law translates roughly as "one cannot give what one does not have." [Fn12] Traditionalists consider the goal of codifying the common law of negotiable instruments to be preserving the
great advances made by the majestic common law judges, such as Lord Mansfield, in developing and
extending the role and rules of negotiability. [Fn13]

A contrary view has arisen, which views the present-day survival of negotiable instruments law as an
unintended by-product of the general movement to codify the common law, a movement that started with
Jeremy Bentham, [Fn14] gathered steam at the end of the nineteenth century with the English Bills of
Exchange Act [Fn15] and the American ***Page370 Negotiable Instruments Law, [Fn16] and sustained
enough momentum to result in the Uniform Commercial Code. If not for the codification of negotiable
instruments law, this theory concludes, much of that law would have been overruled by judges who would
have recognized its growing unworkability and irrelevance. By taking negotiable instruments law out of the
body of common law, where judges could fix or discard it, and by codifying it, so that the judges could not
change it, the codifiers preserved the negotiable instruments law of the eighteenth century intact and
prevented the common law system from paring down and altering this law, even when it no longer met the
needs of those affected by it. [Fn17]

The patron saint of this theory is Grant Gilmore, the greatest commercial law specialist of his generation.
Early in his career, Gilmore helped draft the Uniform Commercial Code, [Fn18] working under the
supervision and falling under the influence of Karl Llewellyn, [Fn19] who in turn was too greatly influenced
by his admiration for Lord Mansfield, at that time considered the father of negotiable instruments law.
[Fn20] Late in life, Gilmore came to rue that the drafters of the ***Page371 U.C.C. had agreed to maximize
the negotiability of instruments without adequately investigating whether the doctrine of negotiability still
made sense. [Fn21] He coined the oft-repeated description of the UCC's Article 3, which covers the law of
negotiable instruments, as "a museum of antiquities--a treasure house crammed full of ancient artifacts
whose use and function have long since been forgotten" and stated that codification had preserved the past,
"like a fly in amber." [Fn22] More recently, a noted academic stated that it seems as though "no lawmaker
has thought creatively about negotiable instruments since Mansfield's efforts in the middle of the eighteenth
century." [Fn23]

A third collection of theories holds that negotiability is no longer important, [Fn24] and perhaps was never
the central organizing principle of bills and notes during their early history. [Fn25] Under this school of
***Page372 thought, Gilmore's criticism of the unthinking preservation of negotiable instruments law may
be true, but has itself become irrelevant. [Fn26] Because the parties to negotiable instruments no longer rely
on negotiability to protect their interests, this theory concludes, the law of negotiable instruments may be
preserved, but it is preserved like a vestigial tail and, while useless, is also harmless. [Fn27]

In all of these views, and generally throughout the commentary on negotiability, is the argument that the
 codification of negotiable instruments law left that law essentially unchanged. [Fn28] The codifiers
supposedly preserved the law much as they found it, or even embalmed ***Page373 it, only embedded now
in a code rather than residing in thousands of sometimes conflicting court decisions. Rather than changing
the law, the codifiers supposedly contented themselves by and large with resolving some of those conflicts in
favor of more negotiability. [Fn29]

This article is an attempt to construct an alternative history of negotiable instruments, to show that
negotiability was once a fairly useful, efficient, and fair method of risk allocation and wealth transfer, at least
given the rudimentary financial tools available during negotiability's classical period, but now has become, at
least in the area of non-commercial consumer or residential loans, strikingly inefficient and inequitable.
Rather than being preserved in amber, virtually unchanged since the days of Lord Mansfield, the law of
negotiable instruments has undergone, I will argue, a fundamental change, a change that has robbed these
instruments of their efficiency and fairness. Codification changed the law of negotiable instruments by
removing the role of intent in the creation of negotiable instruments, and by making that creation solely a
question of the form of the document. Far from being irrelevant, the doctrine of negotiability and the
codification's change in negotiable instruments law are part of the assignment of risk that is at the center of
one of the American financial system's greatest current plagues, predatory lending. [Fn30]

When the doctrine of negotiability was originated and through most of the first two centuries of its use,
negotiable instruments were by and large created by those who understood the basic concept of negotiability,
and understood as well that they were creating a negotiable instrument. Thus, the maker of a note or a bill of
exchange could attempt to obtain full value for its negotiability, and to minimize the ***Page374 risk that
such negotiability would create. The development of negotiable instruments law tracked the changes in the understanding and intent of the users of those instruments, as their use was first limited to foreign merchants and their domestic trading partners, then to all merchants, and then, as they came into general use and were more widely understood, to all of the populace. At first, only bills of exchange were negotiable, but then as people used notes intending they be negotiable, negotiability was extended to notes as well.

Since the late 1800's, by comparison, few non-commercial borrowers have understood the basic aspects of negotiability, even while many consumers and residential borrowers have been, unintentionally, making negotiable instruments. Because of this unintentional use, borrowers have not realized their risk in making a negotiable instrument. As a result, homeowners signing deeds of trust secured by their houses have fallen prey to a series of fraudulent schemes meant to deprive them of the equity in their houses without the homeowners being able to protect themselves.

III. WHAT IS A NEGOTIABLE INSTRUMENT?

A negotiable instrument is an unconditional, assignable promise to pay a fixed amount of money, either on demand or at some specific time. \[\text{Fn31}\] Two common forms of negotiable instruments used currently are the check and the promissory note. \[\text{Fn32}\] Checks are designed for the immediate transfer of money, and consist of an instruction by the drawer or writer of the check to his or her bank to pay a set sum of money upon demand to a third party or to whomever the third party specifies the money be paid. Promissory notes, on the other hand, are typically used as a method of providing credit. What makes these two contracts for the transfer of money negotiable instruments is the fact that they can be transferred by the party who has the right to receive money to a third party simply by indorsing the instrument over to the third party.

The basic rules of negotiable instruments have long been unchanged and, as noted by W.S. Holdsworth, are:

1. The instrument is transferable and, once transferred, the transferee can sue on the instrument in his or her own name.

   ***Page375 a. if payable to the bearer, the instrument is transferable by delivery alone

   b. if made payable to order; the instrument is transferable by indorsement and delivery

2. It is presumed that consideration was given for the instrument.

3. Even if the transferor did not have title or the title was defective, a transferee will acquire good title if he or she acquired the instrument "in good faith and for value." \[\text{Fn33}\]

IV. THE HOLDER IN DUE COURSE DOCTRINE

The third of these rules is the holder in due course doctrine, \[\text{Fn34}\] which provides that if one who holds an instrument that has been indorsed to him is not chargeable with knowledge of or participation in certain wrongful acts, then most of the defenses that the maker of the note had to the original beneficiary of the note cannot be used against the new holder. \[\text{Fn35}\] The cutting off of defenses upon transfer to a holder in due course has long been considered the central element of negotiable instruments, \[\text{Fn36}\] so that, as James Steven Rogers notes, any theory of negotiable instruments must explain and account for this doctrine. \[\text{Fn37}\]
The holder in due course doctrine does not cut off all defenses that a borrower or maker of the negotiable instrument might have. The few defenses that remain to the maker of the instrument are the so-called "real defenses," which include infancy, duress, lack of legal capacity, illegality of the transaction, discharge of the obligor through bankruptcy, and fraud causing the drawer of the instrument not to know, for reasons that were not her fault, the nature of the instrument she was signing. These defenses are rare and fairly difficult to prove. Among the defenses that are cut off when the instrument is transferred to a holder in due course, called the "personal defenses," are the more common and easier to prove claims, such as: (a) that the drawer of the instrument, while not completely incompetent, was less than fully competent; (b) that while she knew the nature of the document she was signing, misrepresentations had been made to her regarding its terms or effects or other conditions; (c) that undue influence had been used against her to coerce her into signing the instrument.

The holder in due course doctrine had two primary functions, both of which can now be better performed by other means. One function was to create a currency substitute, greatly needed in the seventeenth and eighteenth centuries when there was insufficient currency and inadequate means to transport that currency for the economy of the day. As discussed in section VI infra, the usefulness of negotiable instruments as a currency substitute disappeared by the mid-nineteenth century.

Another function of the holder in due course doctrine was to make negotiable instruments more easily transferable by removing a great barrier to their transferability, the fear that the maker of a note will have a defense to it. The holder in due course doctrine is intended to increase the liquidity of notes and thus their usefulness to commerce. One appellate court noted:

The purpose of conferring HDC [holder in due course] status is to encourage and facilitate the circulation of commercial paper. "It is sometimes said that the holder in due course doctrine is like oil in the wheels of commerce and that those wheels would grind to a quick halt without such lubrication."

This function of the holder in due course has, at least as far as residential or consumer loans, been taken over by the securitization of those loans, discussed in the second article in this discussion, which provides greater liquidity than did the holder in due course doctrine. The holder in due course doctrine lives on in residential loans, those secured by the residences of the borrowers, long after its legitimate purposes have disappeared.

V. THE ROLE OF INTENT IN THE DEVELOPMENT OF NOTES AND BILLS OF EXCHANGE

The history of the development of negotiable instruments is the story of the law's recognition of the intention of the makers of such instruments and of their realization of the advantages of negotiability. Originally, the use of negotiable instruments was limited to those few merchants who would understand them and only a particular form of negotiable instruments was judicially recognized by the court. As more people knowingly intended to create negotiable instruments, and as they intended different kinds of instruments to be negotiable, the courts eliminated most limitations on who could use negotiable instruments and, prodded by Parliament, what instruments could be negotiable, all the while tracking the intent of the makers of instruments.

Before the seventeenth century, bills of exchange were fairly arcane, complex devices for the transfer of capital and were little used by the general populace or even many merchants. As noted by James Steven Rogers, pre-seventeenth century writers described the mechanisms of exchange as "the most mysterious part of the Art of Merchandizing and Traffique." Another wrote: "To many, if not most Merchants, [exchange] remains a Mystery, and is indeed the greatest and weightiest Mystery that is to be found in the
whole Map of Trade." [Fn45] Using the tools of exchange required knowledge of the values of various currencies and a means to track and predict the fluctuation of currency, no mean task for the average merchant. [Fn46]

Bills of exchange were developed to solve a basic problem, how to transport capital from one place to another or from one country to another, without having to undertake the dangerous task of hauling bullion or other valuables, risking theft. The most basic example of this use is that of a merchant who wished to travel to a distant city and buy goods without having to carry the money needed for the purchase. John Marius, in his book Advice Concerning Bills of Exchange, first published in 1651, described how the merchant could avoid carrying money:

Suppose I were to go from London to Plymouth, there to employ monies in the buying of some commodity, I deliver my monies herein London to some body who giveth me his Bill of Exchange on his Friend, Factor, or Servant at Plymouth payable to my selfe, so I carry the Bill along with me, and receive my money my selfe by vertue thereof at Plymouth. [Fn47]

Much more complex transactions occurred when a merchant bought and sold goods in several distant markets, and merchants required a system of settling accounts with distant creditors and debtors. They began using letters of exchange that directed payment to be made at a specific great fair, the great fairs being held regularly in different towns and cities throughout Europe. [Fn48] At the great fairs, the merchants' bankers, armed with letters of exchange for the receipt of money and with money to pay off the creditors of their clients, would attend the fairs, meet together and pay each other as needed, working with the exchangers who, because their business was giving currency of one country in exchange for another, could accurately calculate the exchange rate for the debts and credits incurred in a multitude of foreign countries. [Fn49] As the bankers were both paying off the bills of merchants and receiving money on bills owed to merchants, the bankers would often need little actual currency to settle their accounts. [Fn50]

Most commonly during their early use, bills of exchange had four parties. The original maker of the bill (the "payer"), who wished to pay a sum of money to the intended recipient of the money (the "ultimate recipient" or "payee"), would pay that sum of money to a third party (the "drawer" of the bill), often a local exchanger, who would draw a bill for that amount. The bill was made out as an instruction to a fourth party (the "drawee"), often an exchanger near the ultimate recipient, to pay to the ultimate recipient the set sum of money. Then the payer could send the payee the bill, the payee would take the bill to the drawee, and the drawee would, if he accepted the bill, pay the sum of money to the payee. [Fn51] Later, the drawee and drawer had to settle up, most likely in the course of settling a multitude of debts among many parties, some debts going one way, some the other.

Later, with the decline of the great fairs and the entrance of bills of exchange into more regular commerce, bills were specified to be payable a set time after the date the bill was made rather than at a great fair. This time period was called a "usance," meaning the conventional time that an exchange would take between the two cities involved in the bill. [Fn52] No longer having to wait until a specific fair, the payee could present the bill before it was payable to the drawee, and if the drawee accepted it, normally by writing on the bill, then the drawee was transformed into an acceptor, and the payee could rely on payment by the acceptor at the time the bill was due. [Fn53]

In addition to the mere transportation of money, bills of exchange also fulfilled the useful purpose of providing a means of credit. Bills of exchange, though they originally presumed funds of the drawer of the note in the hands of the drawee, were converted to instruments of credit through the practice of drawing the instruments on a drawee who did not hold funds of the drawer and then regularly redrawing the bills of exchange as they became due. [Fn54] In this way, the makers of bills of exchange, by intentionally drawing
a bill, payable at some future time, upon a drawee who did not hold their money, changed the nature of bills of exchange from a mere payment instrument to a credit instrument. Credit is central to trade, allowing merchants to buy goods without ready cash, and the use of bills of exchange in England as a means of credit was recognized by the 1560s. [Fn55] While effectively providing credit, this practice of redrawing bills often put the borrower and his reputation at the mercy of the creditor, since if the creditor refused to redraw the bill of exchange, the borrower could be ruined unless he could procure sufficient capital elsewhere to pay the bill almost immediately. [Fn56]

It appears that, at first, the use of bills of exchange was intended to be quite limited, restricted, at least in theory, to use by merchants only in connection with foreign trade, and that only later were bills made in connection with internal trade. [Fn57] This initial restriction to foreign traders and their domestic trading partners seems reasonable given how mysterious the rules of exchange were considered. Because those rules seemed too difficult for the domestic merchant to comprehend, it would make sense for the law to prevent such a common merchant from being caught up in a series of rules that he did not understand.

After bills of exchange came to be used more widely, their validity was also broadened, though at first only to merchants in general, and not to non-merchants. [Fn58] Originally, only merchants could be sued directly on bills of exchange, and for non-merchants such a bill was only evidence of a debt. For example, in the 1640 Eaglechild’s Case, [Fn59] the court stated that "upon [a] bill of exchange between party, and party who [were] not merchants, there cannot be a declaration upon the law merchants, but there may be a declaration upon the assumpsit, and give the acceptance of the bill in evidence." [Fn60] In Bromwich v. Loyd, [Fn61] Chief Justice Treby stated that at first actions on bills of exchange were allowed only where foreign merchants traded with English merchants, that later such actions were allowed whenever any merchants used bills of exchange, and then finally actions on bills of exchange could be brought against anyone who used such bills. [Fn62] Rogers argues that this restriction limiting actions on bills of exchange to merchants may never have been taken too seriously, and he notes that courts found ways around the restriction when faced with a non-merchant drawing a bill of exchange, such as concluding that the mere act of drawing a bill of exchange made a non-merchant into a merchant, if only for that purpose. [Fn63] One interesting way that courts possibly circumvented this rule was to conclude that parties using bills intended to be treated as merchants. [Fn64] Even if the rule restricting actions on bills of exchange to merchants was a rule honored primarily by its breach, it does show that, initially, bills of exchange were considered a part of a merchant's business, a specialized art for the businessperson, and alien to the life of the non-merchant. The binding legal effect of negotiability was limited, at least theoretically, to those few likely to understand the effects of negotiability.

This limitation on negotiability was eliminated as negotiable instruments became more widely used and understood. In Woodward v. Rowe, [Fn65] the court expressly discarded the rule restricting actions on bills of exchange to merchants, and held that anyone who participates in the formation of a bill of exchange can be liable therefore, whether merchant or not. [Fn66] Though the defendant argued that it was only by the custom of merchants that the holder of a bill could proceed against the maker of the bill if the proposed acceptor refuses to pay, the court held that "the law of merchants is the law of the land, and the custome is good enough generally for any man, without naming him merchant . . ." [Fn67]

The complexity of bills of exchange and the inconvenience caused by the necessity of having four parties to a bill, the original maker, the drawer, the payee, and the drawee, was diminished when methods were developed to make a bill with only three and sometimes two parties. [Fn68] The common method for a three-party bill of exchange was to have the original maker of the bill draw the bill on himself. [Fn69] On very rare occasions, at least in some parts of the United States, a bill could involve only one party, where a man drew a bill on himself payable to his own order, though this type of bill may have been treated as a note
rather than a bill. [Fn70]

A. Bills of Exchange and Their Increasing Economic Importance

With these changes, bills became much more widespread in their use, among merchants and non-merchants alike, and soon were so much part of daily life that even the non-merchant became familiar with their use. Rogers notes that, in 1687, Chief Justice Holt remarked that "we all have bills directed to us, or payable to us," and that many of the eighteenth century primers on the laws of bills were intended for lay people and small traders rather than only for lawyers and more sophisticated businessmen. [Fn71]

Bills of exchange became a crucial part of the economy, for there did not exist a sufficiently established money supply for all the commerce of England, and the bank of England had not yet begun issuing the bank notes that would later take over the role of currency. How much bills of exchange functioned as currency in people's daily life can be seen in the case Peacock v. Rhodes [Fn72] in which a man had his pocket picked, losing several bills of exchange he was carrying in his pocketbook. Later, a cloth seller received the stolen bill at his shop for the purchase of cloth and other goods and gave as change cash and several smaller bills of exchange. [Fn73]

Bills of exchange became generally useful in commerce (outside the exchange needs of merchants), because of their easy transferability. Rather than going to the drawee directly for payment on the bill, the payee could instead negotiate the bill to a fifth party by indorsing the bill to that fifth party, who could indorse it over to a sixth, and so on, each transferring it in exchange for some other good or service, using it essentially as money. Bills were transferred so often, in fact, that there was often no more room on the back of the bill for further indorsements, and so grew the practice of physically attaching to the original bill an allonge, an additional piece of paper on which further indorsement could be made. [Fn74] Ultimately, some recipient of the bill would take it to the drawee, and if the drawee accepted it and paid it, then the life of the bill was ended, and the bill's value as currency was over, but before that time, it acted as money. The transfer of bills by indorsement seems to have been unknown to Malynes, but was described by Marius, and so likely came into existence shortly before the middle of the seventeenth century. [Fn75]

Another crucial element buttressing the value of bills and notes was the fact that the holder of a note could seek recovery not only from the acceptor or drawer, but also from any previous indorser of the note. Each new indorsement of the bill bound the indorser as would the drawing of a new bill. [Fn76] As the bill wended its way through commerce, being indorsed from holder to holder, it became more valuable, since its value was essentially vouched for by each indorser. [Fn77] As noted in the case Bomley v. Frazier, [Fn78] "In common experience every body knows, that the more indorsements a bill has, the greater credit it bears. . . ." [Fn79] Therefore, even if the bill or the original indorsement had been forged, so long as subsequent holders had actually indorsed the note, the holder could proceed against those previous indorsers and recover the value of the note. [Fn80] The ultimate holder did not even have to make a demand against the drawer of the bill, but could sue the indorser without delaying to make such a demand. [Fn81] The value of the bill would also be increased if the drawee accepted it well before paying it. The holder could then indorse the accepted bill to a new indorsee, who could take the bill confident that it would be paid because it had already been accepted. The acceptance of the drawee acted as a guarantee of the bill.

In addition to the protections provided by the potential liability of previous indorsers and the drawee, a primary basis for the value of a bill of exchange was the intense social and financial pressure on the drawer of a bill of exchange to honor the bill. Honoring one's bills was a point of great honor, and anyone who failed to do so would quickly gain notoriety and would find it extremely difficult to find others who would
accept his bills. For this reason, people of this time would struggle mightily to pay their bills of exchange even while they failed to pay their other debts. This struggle to pay one's bills of exchange was no doubt encouraged by the threat of debtors' prison that faced any who did not pay his bills or notes. [Fn82]

From the twin notions of the bona fide purchaser and the transferability by indorsement sprang the doctrine of merger, the notion that the physical bill itself, the very piece of paper, constituted, and did not merely evidence, the claim or debt that had created it. [Fn83]

***Page385*** To transfer the debt, one had also to transfer the physical paper that embodied the bill, and by receiving the bill and marking paid across it when it was paid, one could extinguish the bill. This doctrine protected the holder of a note, because he could keep safe his interest in the note by protecting the bill itself. The payer on the bill was protected as well, because he could not be dragged into fights between various claimants to a bill so long as he paid the possessor of the bill to whom the bill had been indorsed. [Fn84] James Steven Rogers has argued that this was the great accomplishment of negotiability—it essentially constituted a title recognition system, so that the drawee of the bill could determine to whom the bill should be paid by determining who physically possessed the bill. [Fn85] Thus, the holder of the bill did not need to present any evidence of the underlying debt, but could present the bill itself. Rogers adds that the purpose might not have been so much to establish that the ultimate holders of the note are the true owners, but rather to allow anyone in possession of the note to prevent others from becoming a holder in due course or successfully claiming an ownership interest. [Fn86] Rogers also notes how clumsy a title recognition system negotiability is, and importantly, that the holder in due course doctrine is not necessary for this purpose of negotiability. [Fn87]

B. The Development of Promissory Notes and the Battle Over Their Negotiability: Intent Wins a Round Against Form

Promissory notes developed later than bills of exchange, differing from bills by having only two parties, the maker of the note who becomes the debtor on it, and the beneficiary of the note, who is the creditor. Promissory notes became much more common once goldsmiths became the favored storers of money for merchants. Merchants previously had stored their excess money in the King's mint in the Tower of London, [Fn88] and goldsmith's income had then been derived chiefly from selling jewelry, mounting and selling jewels, and making gold and silver plate. [Fn89] The popularity of the King's mint as a storage place declined precipitously after Charles I, in 1638, forcibly borrowed a large sum of money by taking it from the mint. [Fn90] Instead of leaving their money to be perhaps repeatedly "borrowed" by the king, merchants took to leaving their money with goldsmiths and in exchange receiving notes signed by the goldsmith. [Fn91] Goldsmiths also received money from gentlemen, who deposited the rents of their estates, and from merchants' servants, who surreptitiously lent to the goldsmiths their masters' cash at hand. [Fn92] The goldsmiths were able to lend the money they received to merchants and others in need, at higher interest rates than the goldsmiths had paid to borrow the money. [Fn93]

Goldsmiths' notes were, by today's standards, remarkably terse and straightforward documents. An early goldsmith's note is worded as follows:

Novr 28: 1684 I promise to pay unto Rigt Honble ye Ld North & Grey or bearer Ninty pounds at demand for Mr ffran Child & myself
The simplicity of goldsmiths' notes was likely prompted by the goldsmith's position, at different times, on both sides of transactions rendered in notes. Goldsmiths borrowed money from some merchants, gentlemen and merchants' servants, giving notes in return, and also lent money to others, receiving notes for the loans. Because they were at various times both borrowers and lenders, presumably goldsmiths had an interest in ensuring that the laws concerning promissory notes remained straightforward and fair for both parties to the note.

Unlike bills of exchange, the transferability of promissory notes through indorsement was not originally recognized at the common law. Goldsmiths and others clearly wanted to gain the advantages of such easy transferability for goldsmiths' notes, since this would increase the value to the recipient of the notes without significantly affecting the burden on the goldsmith.

In the famous case of Clerke v. Martin, the court was confronted with the question of whether it should recognize the intent of the makers of promissory notes that they be negotiable, as bills of exchange were, or if instead, the mere formal properties of the instrument would render them non-negotiable. The parties to the promissory note at issue appeared to intend that it be negotiable, for the promissory note stated that it was payable to the plaintiff or his order, but they used a form, that of a promissory note rather than a bill of exchange, that had not been judicially recognized as negotiable. When the plaintiff brought an action to collect on the note, the defendant argued that, because the note was not a bill of exchange, the plaintiff should not have sued directly on the note, but rather should have brought an action indebitatus assumpsit for money lent, with the non-negotiable note merely being evidence of the debt.

The court refused to accept plaintiff's argument that because the note was payable to plaintiff or his order, it was negotiable and equivalent to a bill of exchange. The report on the case states that Chief Justice Holt was "totis viribus" against the action and that "maintaining of these actions upon such notes were innovations upon the rules of the common law; and that it amounted to the setting up a new sort of specialty, unknown to the common law, and invented in Lombard Street, which attempted in these matters of bills of exchange to give laws to Westminster-Hall." The following year, in Buller v. Crips, a case involving the indorsement of a promissory note to a third party who brought action against the maker of the note, counsel for plaintiff attempted to distinguish Clerke v. Martin. While the court was adjourned in the midst of the case, Holt discussed with two famous merchants in London the practice of indorsing notes, and the merchants informed him that they often made notes, viewing them as bills of exchange. Despite this evidence that these merchants made promissory notes intending them to be as negotiable as bills of exchange, Holt refused to recognize the transferability of notes, declaring that the parties could have accomplished all they wanted by drawing a bill of exchange. As Holt knew, there was no ancient basis for the negotiability of goldsmiths' notes, which were of fairly recent creation. Holt concluded that the form of the instrument should take precedence over the intent of the parties, finding them non-negotiable, and so ignored not only the intent of the particular parties to the instrument at hand, but also the general intent of parties in making this kind of instrument.

Holt's decision has been widely criticized for being a misguided attempt to limit negotiability. His real error, though, was to conclude that the formal qualities of a promissory note, rather than the general intent of the parties using such instruments, should determine whether the promissory note was negotiable. By ignoring the intent of parties who use promissory notes, Holt unnecessarily slowed the development of negotiability and upset the use of promissory notes by goldsmiths and others who had used them, thinking they were negotiable.
Not for the last time, the monied commercial interests appealed for statutory succor from the rulings of a judge. [Fn104] Parliament swiftly overruled Holt by enacting the Statute of Anne, which stated that promissory notes are to be assignable and endorsable in the same manner as bills of exchange. [Fn105] In the act itself, Parliament noted that it was putting promissory notes on the same footing as bills of exchange in order to encourage trade and commerce. [Fn106] Had the goldsmiths chosen to create negotiable instruments, Holt noted, they could have made two-party bills of exchange using a convoluted method, but instead they chose to make notes, which the common law considered non-negotiable. Holt seemed to feel that the goldsmiths had no one to blame but themselves for their creation of non-negotiable notes, whereas the goldsmiths acted as if formal restrictions on negotiable instruments should not override the intent of the makers of such instruments. With the help of Parliament, the goldsmiths and intent won out over mere formalism. [Fn107]

C. Adding the Cut-Off of Defenses to Negotiability

The final element of negotiability of bills and notes, that of the cut-off of defenses as to a bona fide holder, or in current terminology, a holder in due course, was firmly established by the end of the seventeenth century. [Fn108] In a series of cases in the common law courts and the court of Chancery during the last years of the seventeenth century, bona fide transferees were found to have a good claim on the bill even though there was a lack of consideration in the initial transaction in one case, [Fn109] and the bill had been lost, found by a stranger, then transferred to the bona fide transferee in another case. [Fn110] In the first of these cases, the Lord Chancellor noted that granting relief against "an honest creditor [who came] by this bill fairly for the satisfaction of a just debt . . . would tend to destroy trade which is carried on every where by bills of exchange." [Fn111] The holder in due course doctrine was cemented in a series of famous cases decided by Lord Mansfield, beginning with Miller v. Race, [Fn112] which concerned a Bank of England note that had been transferred to an innkeeper after it had been stolen from the mails. Mansfield refused to follow the reported statement of Chief Justice Holt in the case Ford v. Hopkins, [Fn113] in which Holt distinguished money, which could not be recovered from someone who received it for value from a thief, from bank notes and lottery tickets, which could be recovered because they are identifiable, having distinct marks or numbers on them. Using a method of distinguishing prior cases unavailable to today's judges, Mansfield merely concluded that the previous case must have been erroneously reported, stating in Miller, "It is a pity that reporters sometimes catch at quaint expressions that may happen to be dropped at the Bar or Bench; and mistake their meaning." [Fn114] Mansfield concluded that the holder of the Bank of England note held good title despite the previous theft.

When Lord Mansfield was faced with the question of whether bearer instruments were negotiable in the case Grant v. Vaughan, [Fn115] he demonstrated the importance of intent in the creation of negotiable instruments. Lord Mansfield overruled his own jury's verdict, ruling that the negotiability of bearer instruments was a question of law, and that such bills payable to bearer were negotiable. Lord Mansfield stated, "For when payable 'to A. B. or bearer,' they [the bills] are clearly intended to be transferred in the most easy manner, even without indorsement." [Fn116]

With these changes, bills of exchange became a useful currency substitute. Negotiable bills and notes were critical to the expanding English and American economies because there was not sufficient currency in circulation to give substance to all of the transactions of those economies. [Fn117] There was no issuance of paper money that was legal tender until the time of the Civil War, and before then, the only legal tender currency was specie, or coins made of precious metals. [Fn118] It was the importance of this use as currency that convinced the common law judges to give bills and notes the various aspects of negotiability so as to maximize their transferability. [Fn119]
D. The Efficiency of Negotiable Instruments Law in the Classical Period

With this history in hand, if we examine the economic efficiency of a bill of exchange at the time of Lord Mansfield, we find that the bill of exchange operated fairly efficiently, both in causing bills to be created when their creation would benefit the original parties to the bill, and in spreading risk in an efficient manner.

As will be more developed fully in the next article, the efficiency of the formation of negotiable instruments may be analyzed both in terms of contract formation, to examine whether the transaction was bilaterally voluntary and informed, and in terms of risk distribution. To see whether the initial drawing of the bill of exchange satisfied Milton Friedman's test for a transaction that benefits both parties, namely whether the transaction is bilaterally voluntary and informed, one should determine how well the makers and holders of negotiable instruments knew what the primary effects of those instruments were. As noted in section V supra, by the end of the seventeenth century, bills of exchange were no longer viewed by that part of the populace engaging in commerce as an arcane, unknowable art. Instead, anyone engaged in business regularly made and received bills of exchange, even receiving them as change in larger transactions. Because people were on both ends of the bill of exchange transaction, and because they so regularly transacted business using bills of exchange, they were knowledgeable about their use, relying as we have seen on various short primers on the subject.

Unlike today, analysis of the negotiability of instruments focused on the intent of the drawer of the note in determining whether the note would be negotiable. For example, Joseph Story, in his Commentaries on the Law of Promissory Notes, etc., stated, "In order to make a Promissory Note negotiable, it is not essential that it should in terms be payable to bearer or to order. Any other equivalent expressions, clearly demonstrating the intention to make it negotiable, will be of equal force and validity."

The risks involved in the drawing of a bill were sizeable, and included the following: The bill could be lost, stolen, damaged or destroyed before it was accepted or after. The bill could have been forged or the product of fraud or of a servant's drawing the bill for the servant's own benefit. One of the parties could die, become bankrupt, or disappear, either by moving, or by his location simply having been forgotten.

Bills of exchange were relatively efficient spreaders of risk. For the purposes of this article, we shall focus primarily on the risk of defenses to the negotiable instrument, such as defenses based on fraud, though significant other risks, such as the risk of insolvency, were also spread by bills of exchange. When an eighteenth century merchant made a bill of exchange in the course of business, the holder in due course doctrine spread the risk of loss due to fraud against the maker in the following manner, assuming that the party who committed the fraud was either insolvent or unavailable. As between the ultimate holder of the bill and the maker of the bill, the maker bore the risk, a reasonable allocation, since he would have been most able to prevent himself from being defrauded. The ultimate holder of the note did not know anything about the underlying transaction, whether it was fraudulent or fair, whether the maker of the note received the agreed amount of consideration, either in goods or in money, for making the note, and the expense of obtaining this information could have been enormous and far beyond the amount of risk involved.

The bill itself was a nearly barren document, typically containing only a few precise terms, and was not accompanied by information about the maker of the bill or any of the other parties. If the bill was negotiated only locally or was made by someone of note, the ultimate holder might know the maker of the note, but if the bill made its way to a distant town or country, the ultimate holder would have had to spend significant resources to procure information about the maker. For large notes, this might have been a good investment, but for small notes, it would not have been. As bills came to be used as currency by the general populace, many holders of notes did not even have the access to information about the creditworthiness of
makers of notes that might be available to more experienced businesspeople. In this way, the bill of exchange reduced information costs by assigning the risk to the party with the least expensive means to obtain information regarding the initial transaction, namely the maker of the note rather than the ultimate holder, and initial indorsers over subsequent indorsers. [Fn125] As noted by Harold R. Weinberg, the "negotiability doctrine not only sought to relieve ultimate bona fide holders of the defense risk, but also sought to move the indorsement risk up the chain of indorsements toward the payee." [Fn126]

The exceptions to the holder in due course doctrine also operated efficiently. The defenses of the maker of the note were not cut off if they were the so-called "real defenses," such as the infancy or incapacity of the maker of the note or where the maker could not know the nature of the note. [Fn127] In such a case, the maker of the bill could not take precautions against the initial fraud, forgery, or mistaken creation of the note and so, as between the maker of the note and the ultimate holder, the ultimate holder of the note at least had the chance of seeking information regarding the making of the bill and thereby discovering the defects in the making of it. [Fn128]

More importantly, the ultimate holder of the bill could also seek to recover from any indorser of the bill, and each indorser could seek to recover from previous indorsers of the bill. In this way, the holder of the bills and the indorsers would, if the bill had enough value to make litigation cost effective, in the end, seek repayment from the initial indorser of the bill, who would be the one most likely to have obtained the bill through fraud, or at least with knowledge that it was the product of forgery, fraud in fact, or made by a minor or incompetent. If the initial indorser were a scoundrel and had disappeared or was bankrupt, then the risk of loss would tend to fall on whichever indorser had dealt with the scoundrel, and so was most likely to know that the initial indorser was corrupt and to have been able to prevent the initial indorser from profiting from his fraud.

In the 1790 case, Mead v. Young, [Fn129] the court used a precaution analysis to determine whether a bona fide indorsee should be able to recover from the drawer/acceptor of a bill despite the fact that the indorsee held the instrument by virtue of a forged indorsement. [Fn130] The court determined that the indorsee should bear the loss because he was better able to determine that the indorsement had been forged. [Fn131]

The negotiable instruments law worked fairly efficiently, because people could protect themselves by taking bills only from others they knew, either directly or by reputation, or bills that had been indorsed previously by someone they knew. Bills efficiently carried information about their validity through their series of indorsements, and the method of spreading risk encouraged the maker of the bill to take care when he was the one most able to prevent fraud, while spreading the risks to other parties that the maker of the bill could not effectively prevent.

The indorsement system spread not only the risk of loss due to forgery or fraud against the maker, but also loss caused by fraud or bankruptcy of the maker, and it spread this risk widely because negotiable instruments were so often negotiated. As Gilmore notes, bills that were the subject of litigation had been transferred often in a lengthy series of indorsements. [Fn132] Some bills were indorsed as many as fifty or more times. [Fn133] With such frequent indorsement, not only did the ultimate holder have more people to sue should the maker be bankrupt, but each of the indorsers bore a smaller risk that they would be sued. The bill gained value with new indorsements, because the new holder had more indorsers to sue if the drawee of the note refused to accept it, and if the new holder in turn indorsed the bill, there was less likelihood that the ultimate holder of the note would sue that particular indorser or indorsee. [Fn134]

The maker of the bill often had a great hand in drafting the bill. Because bills were so simple, people could
draft their own bills. Goldsmiths, who issued goldsmith notes when holding the money of gentlemen or merchants, either directly or through their less than honest servants, had developed this practice of issuing these notes, and so directly controlled any innovation that might affect the notes. Because the notes were so simply drafted and were often drafted by their makers, the makers of the notes typically were intimately familiar with all of the contents thereof and, through the primers and treatises on the subject of negotiable instruments, could learn the rules regarding these instruments. They were, therefore, likely to be highly responsive to the rules, and so would alter their activities based on the rules. [Fn135]

In one regard, the common law's method of creating the law of negotiable instruments was fundamentally inefficient, in that it prevented parties from knowing whether the instrument they were using in a transaction was negotiable unless it had already received the blessing of negotiability from the common law courts. For example, makers of goldsmiths' notes apparently assumed that their notes were negotiable and had treated them as bills of exchange for thirty years before their negotiability was brought to the test in Buller v. Crips. [Fn136] During that time, the goldsmiths and their clients had no way of knowing for certain whether the notes goldsmiths issued were negotiable or not, and so the value of those notes was uncertain. If the notes turned out not to be negotiable, then the goldsmiths retained defenses to the notes they made after they were assigned and the notes were mere evidence of debt that had to be proved, and so the notes had less value to the assignees. Similarly, the borrowers of notes from goldsmiths would retain defenses after the goldsmiths had assigned the notes made by the borrowers, and so the notes of borrowers would be less valuable to the goldsmiths and their assignees. [Fn137]

When Holt declared that their expectations were incorrect, in a stroke, he simultaneously devalued all of the outstanding notes, resurrecting all of the personal defenses that might have been applied to them. Understandably, there was an almost immediate move to undo his act, and Holt was ordered to appear before the House of Lords regarding the successful legislative effort to reverse his common law decision. [Fn138] It is unclear from the statute itself whether it applied to notes made before the date, and so restored the loss in value they had suffered by Holt's decision, or only to notes made after the date of the act. [Fn139]

E. The Relative Unimportance of the Holder in Due Course Doctrine During the Classical Period

While this inability to discover, absent judicial decision, whether newly developed instruments were, in fact, negotiable, may seem like an important flaw, it probably did less harm during the classical period of negotiable instruments than might be assumed. [Fn140] First of all, merchants and others could always use tried and true forms of negotiable instruments and therefore avoid this uncertainty.

More importantly, negotiability as we think of it, including the cut-off of defenses when assigned to a holder in due course, was likely a less important attribute of negotiable instruments than it is now. James Steven Rogers has noted that the treatise writers of the eighteenth and nineteenth century did not have the same fascination with the holder in due course doctrine as academics of the twentieth century, that while the doctrine is clearly part of the law, it did not occupy the foreground in the study of negotiable instruments law as it does in casebooks and treatises today. Rogers examined the four treatises on negotiable instruments that dominated the field beginning in the 1780s through at least the mid-nineteenth century, [Fn141] and found that where each treatise specified the defining characteristics of negotiable instruments, none included the cut-off of defenses. [Fn142] None had a separate chapter on the rights of holders in due course, and none organized its discussion of the defenses available to the maker of a note according to the holder in due course distinction between real and personal defenses. [Fn143]
Rogers speculates, with some authority, that the reason for this lack of emphasis on the holder in due course doctrine is that, in the eighteenth century, there was little reason for the ultimate holder of the note to require the holder in due course doctrine, because the maker of the note so rarely had any defenses other than the so-called real defenses. For example, when a goldsmith took the money of a merchant and issued a note, the goldsmith could hardly argue that the note was the result of misrepresentation or duress. The goldsmith could well have handwritten the note, and so could not claim lack of knowledge as to its contents. Even if the goldsmith could somehow claim that the note was tainted, his recovery would be to give back the money he had received and claim the note void, hardly the result to be desired by the goldsmith, who had likely already lent the money elsewhere at higher interest.

Similarly, in an example put forward by Rogers, a merchant might use a bill to draw money from his factor after the factor had sold the merchant's goods, or to draw money from the merchant banker who had agreed to accept his bills. [Fn144] Here, the merchant's purpose is not to obtain funds from the person he gave the bill to, but rather from the acceptor of the bill. [Fn145] By insulating the merchant from the party lending money and by leaving the drafting of the bill in the hands of the merchant, the system of bills of exchange may have given some measure of protection, however minimal, to merchants from their lenders. Rogers also notes that many of the personal defenses to notes that exist now, such as breach of warranty, or other set-offs or counterclaims, were procedurally unavailable until the late nineteenth century, and so there was less value in the cut-off of defenses since there were fewer defenses to be cut off. Not until the late nineteenth and early twentieth century did the holder in due course doctrine come to dominate the law of bills and notes. [Fn146]

Because the maker of a bill had few personal defenses to be cut off, the holder in due course doctrine did not greatly increase the risk to the maker of the bill. This low risk, combined with the public's greater knowledge of the law regarding negotiable instruments, meant that makers of bills of exchange were unlikely to be tripped up by the holder in due course doctrine and inadvertently create negotiable instruments that did not benefit them. The negotiable instruments law of the eighteenth century functioned fairly efficiently, in that it assigned risks in a way that we would recognize today as being efficient, and it provided a system of rules that allowed those creating negotiable instruments to do so in an informed way, and so be able to determine whether the creation of the negotiable instrument did benefit them.

VI. CHANGES IN NEGOTIABLE INSTRUMENTS AFTER THE CLASSICAL PERIOD

A. The Declining Use of and Familiarity With Negotiable Instruments in Daily Life

After the initial creation of the negotiability of promissory notes and bills of exchange and through the course of the codification of that law, the use and importance of negotiable instruments diminished in almost every sector of daily life. By the latter part of the nineteenth century, the use of privately circulating negotiable instruments had largely dissipated in both the United States and in England. [Fn147] Grant Gilmore writes: "[M]ercantile bills began to disappear after 1850 and had, for all practical purposes, passed out of use by the early part of this century. The vital functions which they had served for nearly a century were rendered obsolete by currency reforms and by the modern uses of bank credit." [Fn148] Mercantile paper no longer had an active market, [Fn149] and rather than being carried on by individual creation and indorsement of bills of exchange or promissory notes, the payment system was supported instead by financial institutions and governmental***Page400 entities. [Fn150] Bills of exchange were replaced by bank notes as the basic units of currency. In England, even issuance of notes by banks other than the bank of England declined after the Bank Charter Act of 1844, which was intended to concentrate the issuance of bank notes in
the Bank of England. [Fn151] In the place of circulating notes and bills of exchange, merchants depended more on lines of credit or checks for their financing and payment. [Fn152]

With this great decline in the circulation of negotiable instruments came a corresponding decrease in knowledge about the purpose and effect of negotiable instruments law among members of the public. Negotiable instruments reverted to their sixteenth century status as the "greatest and weightiest mystery to be found in the whole Map of Trade." [Fn153] This change is reflected in the concurrent and dramatic alteration in both the form and nature of the books describing negotiable instruments law. Until the mid-nineteenth century, the treatises that dominated the understanding of negotiable instruments were by and large practical guides in the use and effects of bills of exchange. With names that clearly stated their pragmatic purpose, such as John Byles's A Practical Compendium of the Law of Bills of Exchange, Promissory Notes, Bankers' Cash-Notes, and Checks, the treatises were designed primarily to provide solutions to regular problems that arose in the use of various forms of negotiable instruments. By comparison, the equivalent works of the late nineteenth century were largely theoretical in nature, more concerned with an awestruck and almost metaphysical discussion of the history and meaning of "negotiability." [Fn154]

James Rogers has labeled this change in thinking about the law of negotiable instruments as the change from "exogenous" law, which looks outward to the world of non-legal behavior, to "endogenous" law, which looks inward to its own system of classification through purely legal concepts. [Fn155] As a result, the treatises governing negotiable instruments were much less useful or accessible to non-lawyers attempting to learn about those instruments.

B. The Resurgent Use of Negotiable Instruments by Non-Merchants

Only long after this great decline in the use of negotiable instruments other than checks did there arise the use of such instruments by consumers. When both England and the United States codified their respective negotiable instruments laws, the American Uniform Negotiable Instrument Law in 1896 and the English Bills of Exchange Act of 1882, consumer credit was almost non-existent and consumers signed few negotiable instruments. [Fn156] However, after the codification of negotiable instruments law, intrepid owners of capital, at first banks, then small finance companies, discovered a rich new market for lending: lending to relatively poor non-merchants. [Fn157] To protect themselves against this risky lending, the lenders turned to what had been the weaker, less commercially sound form of negotiable instruments, the promissory note. [Fn158] However, to use promissory notes as the basis for loans to non-merchants, the banks and finance companies had to transform them completely.

Instead of trusting to the good name of the borrowers or indorsers or to the guarantee provided by the acceptors of bills, these lenders began to trust in collateral. The lenders became intent on securing the loans with real or personal property so that they could turn to the security should the borrowers default. The lenders' need to rely on security caused them to change the form of promissory notes completely. Instead of the simple, straightforward instruments used from before the time of Lord Mansfield, which were drafted by hand and easily understood by all parties to them, the notes used by 1900 had grown, in Grant Gilmore's words, to "monstrous size." [Fn159] This size was necessary to allow the drafters to address all of the new concerns that their need for security added. [Fn160]

Among these concerns are the borrower's duty to post and care for real or personal property as security for the loan, the lender's right to obtain that property upon default, the potential need for additional property as collateral, the costs of seizing the collateral, and the possibility of accelerating the lender's rights to any of his
In order to provide for each of these contingencies, the lender inevitably drafted a promissory note that violated what some had considered a fundamental rule of drafting negotiable instruments, that the negotiable instrument must be "framed in the fewest possible words" so that it could have a specific and precise meaning. Some courts recoiled against the new, monstrous-sized notes, concerned that they bore little resemblance to the notes that had, through their simplicity, functioned as currency. For example, in the case Lincoln National Bank v. Perry, the original beneficiary of a note had allegedly improperly sold the bonds that he held as security for the note, then negotiated the note to a bank, which claimed to be a holder in due course and thereby free from any defenses related to the collateral sale. The court found that the note was rendered non-negotiable by its extensive terms providing for the sale of collateral.

The court also gave a painfully accurate prediction of the future abuse of complicated notes, stating:

Furthermore, as notes and bills are designed to circulate freely, and to take the place of money in commercial transactions, sound policy would seem to dictate that they should be in form as concise as possible, and that the obligation assumed by the maker or makers should be expressed in plain and simple language. It is easy to foresee that, if parties are permitted to burden negotiable notes with all sorts of collateral engagements, they will frequently be used for the purpose of entrapping the inexperienced and the unwary into agreements which they had no intention of making, against which the law will afford them no redress. We hold, therefore, that the note in suit was a nonnegotiable instrument.

It is not intuitive that notes secured by real or personal property could be negotiable. In fact, if a negotiable instrument should be a "courier without luggage," the presence of security would eliminate negotiability by requiring the packing of voluminous and heavy baggage. Also, the effect of having a security interest is diametrically opposed to a primary purpose of the holder in due course doctrine. That doctrine was intended to ease transferability of an instrument by allowing an indorsee to take the instrument without having to inquire into the underlying transaction. This would avoid the information costs necessary to ascertain whether the maker of the instrument had any defenses to it and to allow the negotiable instrument to act as currency. Attaching a security interest to the instrument vastly decreases the easy transferability of a note by giving the indorsee strong incentive to obtain information regarding the value of the property securing the loan, so that tying the value of the instrument to the value of a parcel of land reduces its similarity to currency.

The mortgage also does not satisfy the requirements of negotiable instruments, in that mortgages pertain to land, and not to money, and do not have a set date for payment, but rather often permit the acceleration of the mortgage.

While lenders had long relied on mortgages to secure their debts, use of mortgages had been complicated by the English legal system's antiquated view of the nature of a mortgage and its relationship to the land and to the debt. English courts of the nineteenth century were hostile to security transactions. As a result, non-possessory security interests, those in which the borrower rather than the lender held the property, were not judicially recognized in the common law. Following the beginning of the twentieth century, however, the practice of securing loans with non-possessory liens on the personal and household possessions of borrowers became common.

To circumvent the objections to the negotiability of notes secured by property, some courts created the legal fiction that, as the mortgage passes to the indorsee of the note as an incident to the note, the mortgage, like the note, is taken by a holder in due course free and clear of any equities between the original mortgagor and mortgagee. This view was not universal, however. Even in his 1903 edition of his treatise on Negotiable Instruments, John W. Daniel, while arguing for the negotiability of mortgages, cites numerous cases containing the argument that a mortgage, while incident to a negotiable instrument, is not itself
VII. HOW CODIFICATION CHANGED THE ROLE OF INTENT IN THE LAW OF NEGOTIABLE INSTRUMENTS

A. The British Bills of Exchange Act: Eliminating the Requirement of Words of Negotiability in Bills of Exchange

While the law regarding negotiable instruments was originally created by judges, it was seen as fertile ground for codification, to allow those dealing with negotiable instruments to be able to refer to a single code to discover the law regarding those instruments, rather than having to consult a myriad of possibly contradictory cases. The British codification of negotiable instruments law, the Bills of Exchange Act of 1882, was the first codification of any complete branch of English commercial law, and the method by which the Bills of Exchange Act was drafted and passed demonstrates how easily the codification process could be captured by the banking industry.

The principal author of the Bills of Exchange Act was Judge M.D. Chalmers. When he conceived of codifying negotiable instruments law, Chalmers was influenced by the Indian Penal Code of 1860. To further that project, he set out to create a digest of the laws governing negotiable instruments, basing that digest on the more than 2,500 English cases he reviewed on the subject, augmented by American decisions, Continental codes and text writers to fill in gaps in the English law. In 1780, two years after Chalmers' Digest was published, Judge Chalmers read a paper before the Institute of Bankers about the possibility of codifying negotiable instruments, and later Chalmers received instructions from the Institute of Bankers and the Associated Chambers of Commerce to prepare a bill to codify that subject. Thus, the bankers and businessmen who decided on Chalmers as the initial drafter of the negotiable instruments law had a detailed view of what the result of Chalmers' drafting would likely be, and so could pick Chalmers as a drafter based on their agreement with his methods.

Even though Chalmers had been hand picked by bankers and businessmen, his work was still carefully picked over by the bankers and their lawyers, who had a great voice in its contents. When Chalmers first submitted a draft of the bill, he did so to a sub-committee of the Council of the Institute of Bankers who, in Chalmers's words, "carefully tested such portions of it as dealt with matters of usage uncovered by authority." The president of the Institute of Bankers, Sir John Lubbock, M.P., introduced the bill in the House of Commons. Then, after the bill was read twice in the House of Commons, it was sent to a Select Committee made up of bankers, merchants and lawyers, who further amended it. The bill was then read to House a third time and sent to the House of Lords without alteration. The House of Lords made a few amendments, agreed to by the House of Commons, and the bill passed. This process shows a codification process directed, if not captured, by the banking and mercantile interests of the day.

Chalmers claimed that his goal was "to reproduce as exactly as possible the existing law, whether it seemed good, bad, or indifferent in its effects." Relying on this comment, modern academics have assumed that the Bills of Exchange Act and its equivalent in the United States, the Negotiable Instruments Law, did little to change the law of negotiable instruments. In fact, the Bills of Exchange Act altered negotiable instruments law significantly. Chalmers himself admitted that in the process of codifying, he had to address and decide many areas of the law that had conflicting opinions or a dearth of opinions regarding
them. [Fn181]

More importantly, the Bills of Exchange Act of 1882 fundamentally changed the negotiable instruments law by eliminating the requirement that bills of exchange contain words indicating the intent that the bill be negotiable. Prior to the passage of the Bills of Exchange Act, bills of exchange, to be negotiable, were required to contain words evidencing this intent, such as "payable to X or to his order" or "payable to bearer." These exact words, although typical, were not required. Still, some words authorizing transfer were necessary to make an instrument negotiable. [Fn182]

The Bills of Exchange Act, however, reversed this traditional rule, so that a bill was negotiable unless it contained words prohibiting transfer or indicating an intention that it would not be transferable. [Fn183] In this way, the Bills of Exchange Act caused people to create negotiable instruments even without expressing a specific intent to do so, and so likely led to the inadvertent creation of negotiable instruments. [Fn184] Or more accurately, perhaps, the Act recognized that the words of negotiability no longer indicated any intent on the part of many makers of negotiable instruments that the instruments be negotiable. Given the decline in the understanding of the rules of negotiable instruments, whether those specific words were used or not did little to indicate whether many makers of instruments intended them to be negotiable.

B. The Triumph of Form over Intent: The Negotiable Instruments Law of the United States

In 1886, J. Dove Wilson wrote, "At present nearly all the civilised nations--the only important exception being the United States of America, whose code is still only in draft--have codified their law of bills . . . ." [Fn185] The United States fairly quickly took up the task of codifying its negotiable instruments law. Individual states had attempted codification to varying extents, from Florida's few simple provisions to California's complete codification. [Fn186] In 1895, an organization now known as the National Conference of Commissioners on Uniform State Laws adopted a resolution calling for the drafting of a "bill relating to commercial paper" based on the British Bills of Exchange Act and "such other sources of information as may be deemed proper to consult." [Fn187] In 1895, the job of drafting the codification of negotiable instruments law in the United States was given to John J. Crawford, a New York lawyer who had made a "special study" of negotiable instruments. [Fn188] While Crawford was directed to follow the Bills of Exchange Act, he instead relied more heavily, for the structure of the Act, on California's codification of negotiable instruments law, which had itself been patterned after the Field Code proposed, but not enacted, for New York. [Fn189]

The purpose of the codification of negotiable instruments law was three-fold: first, to relieve courts, attorneys, bankers and merchants from having to consult a large and conflicting body of cases applicable in each jurisdiction to determine the exact rules governing negotiable instruments; second, to promote a national uniformity of rules, so that the same group of courts, attorneys, bankers, and merchants could apply the same discrete body of rules for negotiable instruments created in any jurisdiction in the country; [Fn190] and third, to increase the negotiability of instruments, free from local or latent impediments hindering their negotiability. [Fn191] As interstate commerce increased, the diversity in law among the states became increasingly irksome; not only to business people, but also to judges and lawyers. [Fn192] One writer complained that legal treatises, which previously had presented the law of the day in a useful, systematic format, had, by the end of the nineteenth century, become too cumbersome, and had lost their certainty and authority. [Fn193]

While Crawford's work was by no means conducted in secret, [Fn194] it was so little publicized that even Professor James Barr Ames, perhaps the foremost negotiable instruments law expert of his day, was
completely in the dark regarding its drafting until it had already been adopted by four state legislatures. [Fn195] A year after Crawford's work was approved, when an American Banker's Association Committee on Uniform Laws was directed to prepare a uniform law for negotiable instruments, it reported that the N.I.L. appeared to be a better law for its purpose than any they could conceivably draft. [Fn196] The bankers and their allies strongly supported the passage of the N.I.L., [Fn197] which is understandable, given that the N.I.L. was drafted almost exactly as the banks desired. [Fn198] Connecticut, in 1897, was the first state to enact the Uniform Negotiable Instruments Law (NIL), while the Canal Zone, in 1933, was the last jurisdiction to enact it. [Fn199]

Among the questions that the N.I.L. settled, no doubt to the satisfaction of the banking industry, were that the negotiability of an instrument is not destroyed by a clause providing for the costs of collection or for attorney's fees if the obligor defaults, or that a holder can collect the face value of an instrument even when he paid less for it. [Fn200] Further, a negotiable instrument could authorize the selling of collateral security in the event of a default, which implied, of course, that the note could involve the deposit of collateral without losing its negotiability. [Fn201] Each of these changes is a step away from the notion that negotiability is necessary so negotiable instruments can function as currency. Currency, unlike the new negotiable instruments approved by the N.I.L., does not provide for collection costs, attorney's fees, or specific collateral security. [Fn202] These changes also, for the most part, led to the drafting of longer, more complicated instruments.

Given its thoroughness on other matters, the N.I.L. was surprisingly silent regarding the "real defenses" that would not be cut off by assignment of an instrument, and these rules had to be imposed by the courts. [Fn203] Sponsored as it was by banks, the N.I.L. almost completely focuses on the rights of holders of negotiable instruments, the role banks typically played. As Llewellyn recognized, "The N.I.L. is a holder's Act. The holder is its center, the holder is its subject." [Fn204]

While the N.I.L. was likely intended to be a summary of existing law, and was recognized judicially as a "codification of the law merchant," [Fn205] as noted by M.B.W. Sinclair, "[S]ummaries vary greatly according to the purposes, intentional or otherwise, of the summarizer" and the N.I.L. suited its principal sponsors, the lawyers for the banking industry. [Fn206]

Rather than merely summarizing the existing law, the N.I.L. fundamentally changed it, like the British Bills of Exchange Act, by altering the role of intent in the creation of negotiable instruments. It did so in a completely different manner than the Bills of Exchange Act. While the English Act expressly eliminated the requirement for words of negotiability for bills of exchange, it did not purport to define, for all purposes, what a negotiable instrument was and what its essential requirements were. Instead, the Bills of Exchange Act merely provided a system of rules for some of the existing negotiable instruments of the day. [Fn207] For example, the English Act generally defined what a bill of exchange was and separately what a note was, but never did it provide an overarching description of the requirements to create a negotiable instrument in general. [Fn208] Nor did the British Act specify any special form of words that were essential to create a valid bill of exchange. [Fn209]

By comparison, the N.I.L. provided a rigorous definition of what constituted a negotiable instrument, stating specific rules that, if satisfied, conferred negotiability. [Fn210] In doing so, the N.I.L. changed the existing negotiable instruments law from one regulating certain existing negotiable instruments to a law determining the negotiability of any conceivable instrument. [Fn211] To be negotiable, an instrument no longer had to be in one of the forms long recognized by common use. Instead, it merely had to conform to the formulaic requirements set forth in the law. [Fn212]
Before the N.I.L., negotiability had long been seen as the product of the intent of the original parties to the instrument, a conception of negotiability that can be observed in the leading treatises of the day. Charles P. Norton, in his Handbook of the Law of Bills and Notes, published only two years before Crawford began drafting the N.I.L., indicated "The instrument must contain express words of negotiability, although there is no set form of such expression. It is enough if the intention of the parties to make it negotiable can be fairly construed from the terms of the contract." John W. Daniel, in perhaps the most authoritative treatise on negotiable instruments published in the years before the passage of the N.I.L., concurred, noting that "Words in a bill, from which it can be inferred that the person making it, or any other party to it, intended it to be negotiable, will give it a transferable quality against that person." Melville M. Bigelow was even more blunt, stating "[N]o formal words are necessary [to make an instrument negotiable]. It is enough if it can be fairly inferred by the terms of the contract that the intention was to make it negotiable. The intention is the test." Under the reasoning of the common law, therefore, if the "words of negotiability" such as "pay to order" or "pay to bearer" ceased to demonstrate that the party making an instrument intended it to be negotiable, then those words would no longer be sufficient to render that instrument negotiable.

The N.I.L. eliminated the common law's focus on intent and instead relied solely on a set of formal requirements for negotiability. Grant Gilmore noted, "Few generalizations have been more often repeated, or by generations of lawyers more devoutly believed, than this: negotiability is a matter rather of form than substance. . . . To determine the negotiability of any instrument, all that need be done is to lay it against the yardstick of NIL sections 1-10: if it is an exact fit it is negotiable; a hair's breadth over or under and it is not." Intent, either of the maker of the note specifically or of makers of similar notes generally, became irrelevant.

Section 10 of the N.I.L., designed to preserve the negotiability of instruments that vary from the exact requirements of the N.I.L., shows how fully the N.I.L. had displaced the common law's focus on intent. Section 10 states: "The instrument need not follow the language of this act, but any terms are sufficient which clearly indicate an intention to conform to the requirements hereof."

Intention to conform to a set of formal requirements is but the palest shadow of the intention to create a negotiable instrument, as all that matters is whether the parties followed, or appeared to be attempting to follow, the N.I.L. While negotiability depended on formal requirements before codification, those formal requirements were used as evidence to discern the intent for negotiability. After codification, formal requirements were not the handmaidens of intent; they became the sole rulers of negotiability. Even though the same words conferred negotiability under the new code, they ceased doing so merely as evidence from which intent could be inferred. Instead, they conferred negotiability by the power of their own formal sufficiency. Form had triumphed over intent, opening the door for the unintentional creation of negotiable instruments.

C. The Increasing, Unwitting, and Hazardous Creation of Negotiable Instruments by Consumers

After the drafting and during the states' enactment of the N.I.L., the consumer debt of the United States increased from a trickle to a flood, with the consumer installment purchase industry growing dramatically between 1900 and 1918, and the amount of consumer debt more than doubling during the 1920s alone. Some form of installment credit was used in the purchase of most durable goods by 1930, as the automobile manufacturing industry developed the use of credit as a mass-marketing technique for the cars it produced, and many of the automobile companies established their own financing subsidiaries.
With this growth in consumer debt came an equally dramatic increase in the use of negotiable instruments to embody those debts. Long gone were the days when negotiable instruments circulated widely as currency and when most users were at various times both the makers and holders of negotiable instruments. Instead, consumers by and large were solely the makers of negotiable instruments, using printed form contracts they did not draft, with the financial institutions the ultimate holders. Such a limited role gave consumers less opportunity to learn the laws of negotiable instruments. Consumers no longer learned the process, rules and effects of negotiation, because the negotiation of the instruments they created was done between the merchant and the purchasers of the instruments, out of the consumers' view and scrutiny. Consumers no longer wrote out the negotiable instruments they made, nor did they receive bills of exchange as change. As a result, consumers created negotiable instruments having little idea they were doing so and without foreseeing the arcane but fearsome powers that the words of negotiability could have over them. Rapidly, consumers became the victims of unethical lending.

Common knowledge of negotiable instruments law had shrunk so rapidly that not even attorneys were as learned in its intricacies as they had once been. As early as 1944, Llewellyn noted the declining hours dedicated by law schools to negotiable instruments in a lecture to a class on that subject: "We have cut the course [on negotiable paper and banking] to two semester-hours. Last year it was three. Moore used to give it four. Harvard used to give it six. You have two." At the same time, sophisticated legal minds were investigating the use and effects of form contracts. The term "contracts of adhesion" appeared for the first time at about this time. The problems resulting from consumers being victimized by their creation of negotiable instruments have been widely recognized. Consumers have signed contracts of adhesion, unaware that once the merchants assigned those contracts, the consumers would lose almost all of their rights to contest whether they owed the money. Faced with consumers burdened with worthless automobiles, household appliances, or home improvements and lenders who claimed holder in due course status, courts sought ways to ameliorate the most pernicious effects of the holder in due course doctrine in consumer transactions. One method was for the court to determine that the particular promissory note along with its related security interest were, in aggregate, not a negotiable instrument, either because the terms of the mortgage required additional performance that was incorporated into the promissory note, rendering the note non-negotiable, or because the security agreement was not negotiable and so afforded the consumer a means of asserting all of his defenses to recovery under the note. Another method was to find that the ultimate holder of a promissory note was so closely connected to the original beneficiary of the note that the two in essence consisted of a joint enterprise, and the ultimate holder of the note could not deny knowledge of the improper methods employed by the originator of the note.

D. Article 3 of the Uniform Commercial Code: Negotiability in Excelsis

During a flurry of consumer litigation designed to attack these effects of the holder in due course doctrine, the N.I.L. was redrafted to become Article 3 of the Uniform Commercial Code. The task of reworking the N.I.L. was given to Professor William Prosser, even though Prosser had almost no experience with negotiable instruments law and perhaps never felt at home in this area. Prosser floundered in attempting to rework the N.I.L. Karl Llewellyn, who directed the U.C.C. drafting, claimed that he had selected Prosser because he wanted a first-rate legal mind unfettered by previous study of the area to take a fresh look at negotiable instruments law. His darker, unstated motive might have been to keep control of Article 3 by appointing a drafter who knew far less on the subject than did Llewellyn himself.
and so might defer to Llewellyn. [Fn238]

Given the already recognized need to protect consumers, [Fn239] Llewellyn initially wanted to provide different rules for consumers and non-consumer, commercial actors. [Fn240] Such a decision, common among the commercial codes of civil law countries, [Fn241] would have allowed the drafters of the U.C.C. to apply rules, such as the holder in due course doctrine, only to commercial interests, and not to the poorest and least educated members of society who purchase goods using consumer installment transactions. [Fn242] Protections against usury could have been included in the U.C.C., as Llewellyn had apparently intended, at least initially. [Fn243] Instead, by and large, there has been little differentiation between consumers and non-consumers in the U.C.C. [Fn244] In this, as in many other areas, Llewellyn's specific plans for the shape and substance ***Page418 of the U.C.C. were thwarted by the desire to draft a uniform code that would be enacted. [Fn245]

Although some have theorized that the failure to provide a separate set of rules for consumers was an oversight, [Fn246] the drafters of the U.C.C. were in fact concerned about consumer rights. [Fn247] Initially, the drafters sought to prevent consumers from losing their defenses to third party purchasers of retail installment contracts either through waiver of defense clauses or through the negotiability of a note with a grant of a security interest, but this provision was ultimately deleted. [Fn248] A proposed Article VI dealing with consumer mortgages would have preserved the claims and defenses of a consumer against a secured party, [Fn249] and a proposed Article VII would have mandated that, for non-merchant debtors, any "successor in interest of a financier takes subject to any defenses which the borrower has against the original financier." [Fn250] Instead of having special protections, consumers were swept up with the rest of commerce into the terms of Article 3, which, like the N.I.L. before it, provided that negotiability depended solely on the form of the instrument.

After an intense battle, [Fn251] the drafters of the U.C.C. concluded that they had to satisfy the banking industry and the other business interest groups who would either aid or prevent the passage of the U.C.C., and so consulted with the banking and business groups during the drafting process, both formally through advisory committees and informally through frequent contact between the business interests ***Page419 and the drafters. [Fn252] Banking counsel and lobbyists were consistently present at the joint meetings of the American Law Institute and the Uniform Laws Commissions and, in that way, scrupulously monitored the development of the U.C.C., objecting strenuously whenever a draft conflicted with bankers' interests. [Fn253] The banking industry had influential state lobbies that could either help push the Code through state legislatures or prevent its passage by the states, which would have rendered the Code a nullity, since it would have no effect unless adopted by the states. [Fn254] The drafters sought the comments of the business and banking interests on the completed draft of the U.C.C. and all too often bowed to the wishes of the banking and other business interests. [Fn255]

Although his final product was little different from the N.I.L. [Fn256] Prosser did expand the role of negotiability [Fn257] as the final version of Article 3 shifted the risk of loss in various areas from creditors to consumers, apparently under pressure from banking interests. [Fn258] Two ***Page420 examples of the U.C.C. drafters increasing negotiability to placate banking interests can be found in the Report of the Subcommittee on Article 3, drafted in 1954, after banking counsel objected strenuously to the then-current draft of the U.C.C. during hearings held by the New York Law Revision Commission, also in 1954. [Fn259] First, banking interests had criticized the restriction regarding which borrower duties could be inserted into a note without affecting its negotiability. Although bills and notes originally could only include promises to pay money and no other promises, at the risk of losing their negotiability, banks had long wanted the freedom to include other promises by borrowers. Although the N.I.L. had given banks the right to insert attorneys fees and collection costs provisions, banks desired the ability to require borrowers to maintain the collateral
and do other acts beside pay money, such as give additional collateral without demand by the holder, all without forfeiting the negotiability of the note. The subcommittee gave in to the banks' wishes, and recommended that restrictions on additional undertakings by borrowers be relaxed. [Fn260] Any such change would move negotiable instruments even further from their historic currency function.

In addition, the banking interests wanted to eliminate from the then-current draft of Article 3 a clause that would have made it more difficult to be a holder in due course. The clause would have limited holder in due course status to those who took the instrument in good faith, which was defined to include "the observance of the reasonable commercial standards of any business in which the holder may be engaged." [Fn261] Bank counsel argued that this inclusion of an objective, reasonable business standard, which would have protected consumers whenever a bank obtained a note that somehow did not meet the reasonable business standards of the banking industry, would have been a change in the then existing law requiring only subjective good faith on the part of the holder. Concluding that there was little difference between a subjective standard and an objective one, the subcommittee recommended that the bank's preferred standard be used. [Fn262] Through this process, the banking industry received its desired protections for holders of negotiable instruments.

At the same time the drafters were giving in to the banking industry's calls for increased negotiability of notes, they were ignoring the needs of borrowers for protection from the sharp practices to which this increased negotiability would inexorably lead. The drafters ultimately rejected all efforts to write consumer protection into the U.C.C., fearing it would prevent the Code from being enacted by the states, and also from a concern that consumer protection was not yet ready for codification. [Fn263] Instead of recognizing the growing body of case law that would eliminate holder in due course protection for the buyers of many consumer notes, the U.C.C. ignored it. Grant Gilmore, who had taken part in the drafting of the U.C.C., wrote

The most outrageous thing about article 3, a statute drafted in the 1940s, is that there is no reference, in text or comment, to the then rapidly developing body of case law holding that finance companies and banks to which consumer notes were negotiated could not hold the notes free of the consumer's contract defenses because of their close connection with the dealer-sellers. [Fn264]

Frederick Beutel was even more blunt, stating that "Uniform Commercial Code is a misnomer; it should be called the Lawyers and Bankers Relief Act." [Fn265] In addition to the opposition of the banking industry, one cause of the U.C.C.'s lacunae regarding consumer protection in negotiable instruments may have been the hostility shown to any limitation on negotiability by many law review articles of the day. [Fn266] In the end, through the efforts of the banks and their lawyers, virtually unopposed by any consumer protection advocates, the U.C.C. emerged as a pro-bank and anti-consumer document. [Fn267] Backed by the American Bar Association and the "hearty approval" of the American Banker's Association, [Fn268] the U.C.C. was passed in some form by every state.

Ironically, even while the drafters of the U.C.C. were scrupulously preserving or increasing the role of negotiability in promissory notes, the basic purposes of the rules of negotiability had vanished. Notes no longer circulated as a form of or replacement for currency. In fact, notes rarely circulated at all. At most, they typically would be transferred once, to a bank or finance company, and remain there until paid. [Fn269] Therefore, the holder in due course doctrine was no longer needed to insure that notes could act as currency or be easily transferable.

Even the method by which the holder in due course doctrine purportedly made instruments more easily transferable was no longer valid. Previously, it had been thought that negotiability was crucial to maintain a market for instruments because it allowed buyers to purchase those instruments without any knowledge of
the distant maker of the instrument or of the underlying transaction. [Fn270] As noted by Gilmore, a bona
fide purchaser was "protected not because of his praiseworthy character, but to the end that commercial
transactions may be engaged in without elaborate investigation of property rights." [Fn271] When
negotiable instruments traveled around the world with clipper ships and were not encumbered with a security
interest, it was thought that a buyer had to be able to buy them with no information regarding the maker of
the note or the transaction creating the note, since that information was too expensive to obtain. [Fn272]
However, when negotiable instruments were transferred only once and furthermore are secured by real or
personal property, the holder not only is likely to have easy access to information regarding the borrower and
the borrower's property interest, but is also likely to have strong motive to do so.

E. Consumer Protection and Victimization in the Wake of Article 3

Without any meaningful consumer protection in the U.C.C., consumers were left to the varied protections of
state statutes and judicial decisions. Several states passed various statutory limitations of the holder in due
course doctrine regarding consumer credit, leaving a fairly ineffectual patchwork of consumer protection.
[Fn273] Case by case ***Page424 litigation, on the other hand, was commonly too expensive for the poor
consumers who relied on consumer credit, [Fn274] giving their lenders a tremendous advantage in litigation
because the lenders could refuse to settle quickly and then wear down the consumers until the harried
borrowers either dropped the suit or agreed to terms favoring the lenders. [Fn275] Furthermore, while each
borrower had only his or her own loan to worry about, lenders, looking out for their long-term interests, had
a greater incentive to fight for changes in the law that helped themselves and other lenders. Lenders could
plot long-term strategies to obtain changes in the case law that would help them. [Fn276] One such strategy
would be to settle as much as possible any cases with facts especially unfavorable to lenders, while insisting
on trying all cases with facts favorable to lenders. By trying such cases and participating in any appeals, the
lenders could hope to shape favorable case law since it would largely be based on cases where the lenders
appeared sympathetic or the borrowers unsympathetic. [Fn277]

Retail sellers and lenders responded to state regulation of the holder in due course doctrine by inserting waiver
of defense clauses in their contracts, which became common in consumer credit transactions, [Fn278] or by
"dragging the body," where the retail seller would physically ***Page425 bring the consumer to the lender's
office so that the consumer would obtain a putatively "direct" loan and, the lender hoped, would not be able
to assert any connection between the lender and seller that would prevent the cut-off of defenses. [Fn279]
Both practices were barred by legislation in some states. [Fn280] It appeared that the ability of retail sellers
to peddle their consumer credit obligations free of the defenses of the consumers was the very element that
enabled them to engage in their nefarious methods of defrauding consumers. [Fn281] The finance companies
could insert waiver of defense clauses in their form contracts and rely on the holder in due course doctrine
because the consumer was typically unaware of the consequences of signing. [Fn282]

The use of negotiable instruments, or instruments that, through waiver of defense clauses, had elements of
negotiability, became widespread in many sectors of the economy that dealt with consumers. Hand in hand
with this use of true or quasi-negotiability came the victimization of consumers. Consumers were tricked
into buying, on credit, home improvements that were never delivered or were so poorly done that they
decreased the value of the consumer's homes. Or they bought cars that could barely make it out of the
parking lot, or overpriced and inoperative televisions or other household goods. [Fn283] In ***Page426
many of these cases, consumers were unable to protect their legal rights because the credit instrument was
held by a holder in due course, who would collect however mistreated the consumer had been.

F. The FTC's Holder in Due Course Rule: Protecting Consumers from the Effects of Unintentionally
Creating Negotiable Instruments

Finally, after widespread complaint about the abuse caused by the holder in due course doctrine in retail installment contracts, the Federal Trade Commission ("FTC") in 1975 promulgated the Holder in Due Course Rule, a trade regulation which requires sellers to include in their credit instruments a notice that anyone who takes those credit instruments as a holder does so subject to any and all claims and defenses that could be asserted against the seller. The FTC's Holder in Due Course Rule, which took effect May 14, 1976, does not, by itself, create any additional rights or remedies for a consumer, but instead merely preserves those rights or defenses the consumer has, regardless of who holds the credit instrument.

The FTC, which is relatively immune to the type of pressures applied to the U.C.C. drafters, stepped in after concluding that unethical merchants were cheating thousands of consumers, while the merchants and their financiers relied on the holder in due course doctrine to force the consumers to pay the lenders, despite the fraud committed by the sellers. The FTC found that the holder in due course doctrine was being abused in consumer goods and services as diverse as the sale of frozen meat and swimming pools, language training and cemetery plots. At first, the FTC acted on a case by case basis, but then it issued general staff instructions that it was an unfair or deceptive practice to use the holder in due course doctrine to deprive a consumer of his or her defenses. After twice serving notice that it intended to act against the holder in due course doctrine as applied to consumer transactions, holding two sets of hearings, and compiling a massive record, the FTC finally promulgated its rule.

Based on the belief that the market for consumer credit was economically marred by the use of adhesion contracts which consumers could rarely understand, the FTC's stated goal in promulgating the Holder in Due Course Rule was to place the risk of loss caused by unscrupulous merchants onto the lenders, rather than the consumers. In this way, the FTC hoped to force the lenders to police the merchants they dealt with, and relied on the lenders' greater ability to obtain information regarding the practices of merchants and to return the loss to the merchants who caused the loss. The FTC's rule not only abolishes the holder in due course rule, it reverses it in an iron-clad manner. Not only does the FTC's rule assign the risk of loss to the assignees of credit instruments, it makes the assignment of loss unwaivable by consumers, preventing merchants from circumventing the rule merely by including language in their contracts undoing the FTC's action. Ironically, by reversing the holder in due course doctrine as to consumer credit instruments, the FTC hoped to accomplish the same task that the system of indorsing negotiable instruments once had done, putting the risk of loss onto the party who most directly dealt with the party who caused the loss. Once assigned this loss, lenders could seek recovery from the dishonest merchants or, at least, be given a reason to stop buying consumer papers from those merchants. Unethical merchants would find their business's income stream drying up when they could no longer sell their credit instruments and instead were forced to try to collect their income from angry customers who retained their defenses to those instruments.

The FTC thus employed an explicitly economic analysis of the risk-spreading function of the holder in due course doctrine, going so far as to note that "where certain seller misconduct costs cannot be eliminated from the market we would require that such costs be internalized, so that the prices paid by consumers more accurately reflect the true social costs of engaging in a credit sale transaction." At the time, there was broad opposition in the lending community to the FTC's new rule, and bankers, finance companies and their lobbyists did what they could to stop the FTC from passing this rule, making widespread predictions of the calamity they claimed would result. The FTC's restriction on the holder in due course doctrine was supposed to drive up the costs of consumer credit or dry...
The demise of small businesses and even whole industries was predicted. It is telling that this fundamental change in the application of the holder in due course doctrine was made by an administrative agency relatively immune to the sway of bankers, and not by any of the other bodies which had considered the rule and its troubling effects on consumers. As noted by White and Summers, "In one stroke of their pen the clever rascals at the FTC did what Congress would have feared to do, what the courts could do only piecemeal and over decades, and what state legislatures had refused to do."

Instead of the predicted dire consequences, it appears that the suppliers of consumer goods and credit, at least the honest ones, have accommodated themselves easily to the FTC Holder in Due Course Rule, with only a slight drop in the amount of consumer credit available. White and Summers declare that the FTC's rule "has caused some adjustments in the market, largely unseen, but it surely has not had the catastrophic impact upon consumer market that some predicted." Edward Rubin agrees, stating, "[T]he financial community has not been particularly perturbed by the FTC Rule. . . ."

One of the tactics financial institutions have used to avoid the loss this rule would otherwise assign to them is requiring merchants to assign notes to them "with recourse" so that, should the consumer object, the financial institution can force the merchant to buy the note back and deal with the dissatisfied consumer himself. Though it has been argued that the FTC's rule has dampened the market for unproven products or sellers, one sign of how little damage the FTC Holder in Due Course Rule has caused to financial institutions and other businesses is the lack of lobbying the affected businesses conducted against the rule after it was put into place. In fact, even when the FTC later affirmatively sought comment on the Holder in Due Course Rule, it received little response. This outcome should have been more universally predicted. Even Homer Kripke, a self-styled defender of the credit industry observed, "In a reputable milieu-- reputable merchants, reputable products, reputable financers--the freedom from defenses rule is statistically unnecessary. In poverty areas it works badly. Its time has run out."

**VIII. CONCLUSION**

With the enactment of the Federal Trade Commission's Holder in Due Course Rule, it appeared that the importance of the holder in due course doctrine was bound to fade, and for a time it did. Those notes created by consumer credit contracts were no longer subject to the rule. Notes secured by real property were still held by the banks and other lenders that originated them, such that few holders in due course were created. Had this state of affairs remained, the assignment of risk of fraud and deception might have functioned effectively and caused little harm to homeowners.

Unfortunately, as will be discussed in the second article in this discussion, the residential mortgage industry changed dramatically after the Federal Trade Commission enacted their rule. With the advent of securitization, notes no longer were held until maturity by their originator and instead came to be assigned almost immediately upon their creation. With the access to capital markets that securitization provided, lenders dramatically expanded the amount of lending made available to borrowers with less than perfect credit, and the subprime loan market expanded rapidly. With these developments, and while protected from risk of loss both by contractual arrangements with the originators of loans and by the holder in due course doctrine, the capital markets began supplying funds to lenders who used the same deceptive practices in the residential mortgage industry that their predecessor consumer credit lenders had used in the dark days before the Federal Trade Commission abrogated the holder in due course doctrine in that area. Once again, the holder in due course doctrine was used to assign the risk of deception to the
victims of that deception, even though those victims almost universally did not understand the holder in due course doctrine or its effects.

[Fn1]. Assistant Professor of Law, Chapman University School of Law. J.D. 1984, University of California-Berkeley (Boalt Hall). I would like to thank Daniel Bogart for useful suggestions, Nancy Schultz for helpful editing, and Caroline Hahn for cheerful research. I would also like to thank the staff of the Western Center on Law & Poverty for providing me office space. Most of all, I would like to thank Clare Pastore for her patience and help, both in her extensive comments on this article and otherwise. Any errors are, of course, mine.

[Fn1]. James J. White & Robert S. Summers, Uniform Commercial Code 503 (4th ed. 1995). White and Summers conclude their unconvincing answer to this question by stating, "Finally, one needs to understand the holder in due course doctrine to be a self-respecting lawyer. Like knowledge of a variety of other doctrines of marginal utility (such as the rule against perpetuities) knowledge of the holder in due course doctrine remains a badge of the lawyer." Id. at 504.


[Fn4]. See, e.g., testimony of Margot Saunders of the National Consumer Law Center before the House Committee on Banking and Financial Services, 5/24/00 Cong. Testimony, 2000 WL 19304095, and before House Committee on Banking and Financial Services regarding the Increase in Predatory Lending and Appropriate Remedial Actions, 9/16/98 Cong. Testimony, 1998 WL 18089596, and also testimony of Kathleen Keest of the National Consumer Law Center before the Subcommittee on Consumer Credit and Insurance of the House Committee on Banking, Finance and Urban Affairs, 3/22/94 Cong. Testimony, 1994 WL 14184322.


[Fn7]. Kurt Eggert, Held Up In Due Course: Securitization, Predatory Lending and the Holder In Due Course Doctrine, 35 Creighton L. Rev. (forthcoming April 2002).

[Fn8]. W.S. Holdsworth, who thought that negotiable instruments were likely first developed in Italy before or during the first half of the fourteenth century, called negotiable instruments "the most remarkable institution of our commercial law. ..." W.S. Holdsworth, The Origins and Early History of Negotiable Instruments, Part II, 31 Law Q. Rev. 173, 173 (1915).


"That chariot was driven by Holt C.J. and Somers L.C. and the motive power was simply 'the course of trade'; in other words, the custom of merchants." Id. at 64-65 & n.4. The case Holden was describing was Anon., 91 Eng. Rep. 119 (K.B. 1699).


[Fn13]. A more modern and wiser example of this view can be found in Edward L. Rubin, Learning From Lord Mansfield: Toward a Transferability Law for Modern Commercial Practice, 31 Idaho L. Rev. 775 (1995).

[Fn14]. See Lindsay Farmer, Response, The Principle of the Codification We Recommend Has Never Yet Been Understood, 18 Law & Hist. Rev. 441, 442 (2000); and Lindsay Farmer, Reconstructing the English Codification Debate: The Criminal Law Commissioners, 1833-45, 18 Law & Hist. Rev. 397, 410 (2000). Jeremy Bentham had gone so far as to write to President James Madison, offering in 1811 to draft a complete code of law for the United States to liberate it from "the yoke of... the wordless, as well as boundless, and shapeless shape of common, alias unwritten law." Andrew P. Morriss, Codification of the Law in the West, in Law in the Western United States 45 (Gordon Morris Bukken ed., 2000).

[Fn15]. The Bills of Exchange Act of 1882, which governed negotiable instruments in England, was credited by its principal author as being the "first successful attempt to codify any branch of English commercial law...." M.D. Chalmers, Codification of Mercantile Law, Address Before the American Bar Association (August 1902), 19 Law Q. Rev. 10, 11 (1903).

[Fn16]. The Negotiable Instruments Law, a model code, gained its inspiration from the English example, but borrowed much of its structure from the California Civil Code. See Frederick K. Beutel, The Development of State Statutes on Negotiable Paper Prior to the Negotiable Instruments Law, 40 Colum. L. Rev. 836, 851 (1940).

[Fn17]. This argument can be seen in the both the title and text of M.B.W. Sinclair's article, Codification of Negotiable Instruments Law: A Tale of Reiterated Anachronism, 21 U. Tol. L. Rev. 625, 642 (1990).

[Fn18]. Gilmore was a member of the drafting staff for the U.C.C. from 1948 to 1951 and initially was such a believer in the project that he defended the Code from Frederick K. Beutel's furious attack in Beutel's article The Proposed Uniform (?) Commercial Code Should Not Be Adopted, 61 Yale L.J. 334 (1952). Gilmore's spirited defense, entitled The Uniform Commercial Code: A Reply to Professor Beutel, 61 Yale L.J. 364 (1952), was an attempt to respond to each of Beutel's principal criticisms. Even Gilmore, advocate for the U.C.C. though he was, could not bring himself to defend Article 4 on Bank Deposits and Collections, which Beutel characterized as "A Piece of Vicious Class Legislation," more favorable to the interests of banks and bankers than their own "American Bankers Association Bank Collections Code which their lobby failed to put over on the legislatures." Id. at 357, 362-63.

[Fn19]. Gilmore later wrote,

One of the ideas I took from Llewellyn's bounteous store was that the good faith purchaser is always right and that the story of his triumph was not only one of the most fascinating episodes in our nineteenth-century legal history (which it was), but was also one of continuing relevance for our own time (which, I have belatedly come to believe, it is not).


[Fn20]. Gilmore wrote,

In Llewellyn's case, his pro-N.I.L. or pro-negotiability stance can be plausibly associated with his lifelong fascination with what he called the Grand Style in pre-Civil War American case law and with his reverence, above all other judges, for Lord Mansfield. As a general rule, anything--including negotiability--which was good enough for Lord Mansfield was good enough for Llewellyn.

[Fn21]. Gilmore, 13 Creighton L. Rev. at 461.

[Fn22]. Id. at 441, 461 (1979). Gilmore, ever the phrase-turner, also said "[T]ime seems to have been suspended, nothing has changed, the late twentieth century law of negotiable instruments is still the law for clipper ships and their exotic cargoes from the Indies." Id. at 448. Gilmore's analysis is more complex than this description, of course. He discusses how the formalism, an attempt to halt the change in law by arresting it in a set of fixed propositions, dominated the law between the Civil War and World War I. He distinguishes formalism from activism, where judges felt free to adapt the law "with a light-hearted disregard for precedent," which occurred before the Civil War and after World War I. Id. at 441-43. Gilmore argues that the distinction is one more of form than of substance, and that change is relentless, and that formalism "did nothing to arrest the rate of change in the law." Id.


[Fn24]. The most extensive and best documented statement of this argument can be found in Ronald J. Mann, Searching for Negotiability in Payment and Credit Systems, 44 UCLA L. Rev. 951 (1997), wherein Mann argues that various forces, many, of which, like technological changes, are unrelated to law, have rendered the doctrine of negotiability toothless and useless. Using interviews with those who actually work with negotiable instruments, such as bankers, and by making site visits to check-processing centers, Mann presents evidence that in many areas of the payment system the parties to many transactions no longer depend on the negotiable quality of the instruments that embody the transaction. Perhaps the weakest link in Mann's argument concerns that part of our nation's payment and credit system that is the subject of this article, loans secured by the borrower's residence. Mann argues that a single, unimportant clause in the standard note renders this note non-negotiable. His argument, specifically, is that because the note requires the homeowner to send a notice that the homeowner plans to repay some of the principal of the loan, this requirement constitutes an undertaking to do an act in addition to the mere payment of money. Such an additional undertaking, his analysis concludes, prevents the note from being a negotiable instrument under the terms of the Uniform Commercial Code (U.C.C.) § 3-104(a)(3). Id. Mann cites no cases in which a court has found a note non-negotiable based on this language, and were courts to begin to do so regularly, no doubt the language he cites would be immediately removed by the lenders who have used it.

[Fn25]. The clearest argument against the central importance of negotiability, and specifically the cut-off of defenses upon the negotiation of an instrument to a holder in due course, in the early law of bills and notes can be found in James Steven Rogers' iconoclastic and painstakingly documented rewriting of the history of early payment systems in James Steven Rogers, The Early History of the Law of Bills and Notes (1995). There, Rogers argues that many legal historians have allowed their fixation on negotiability as the central organizing premise of bills and notes to cloud their understanding of the history of commercial law. For example, he seeks to disprove the traditional notion that the law merchant was once a separate, specialized body of customary law, transnational in nature and adjudicated in its own specialized mercantile tribunals and not in common law courts and that, when these specialized courts were in decline and merchants were finally forced to bring their actions in the common law courts, the common law judges were initially hostile toward the law merchant. With time, this traditional theory continues, the antagonism of common law judges toward the law merchant abated, and the law merchant was finally incorporated into the common law. Instead, Rogers proposes that common law courts did handle commercial cases and even exchange contracts before the supposed incorporation of the law merchant into the common law occurred. However, Rogers states, there was no law regarding bills and notes separate from the underlying debts or exchanges. Id. He writes, Until the seventeenth century there is virtually no evidence that any of the courts in England treated bills of exchange as themselves creating legal obligations distinct from the obligations arising out of the underlying exchange transaction. In this era, it is an anachronism to speak of a law of bills of exchange; at most there was a law of exchange contracts.

Id. at 51.

[Fn26]. Gilmore himself seems to have been of two minds regarding the preservation of classical negotiability, at times criticizing that preservation harshly and at other times viewing it as a harmless anachronism, either mostly irrelevant or, where relevant, destined to be "ritually disemboweled by the courts." Gilmore, 13 Creighton L. Rev. at 461.
Edward L. Rubin, in Learning from Lord Mansfield: Toward a Transferability Law for Modern Commercial Practice, 31 Idaho L. Rev. 775 (1995), concludes that negotiability is relatively unimportant in the modern mortgage industry, and its primary function is not to assign risk of fraud in the creation of the loan but rather to assign risk of default by the borrower. Id. He states: "Preservation of defenses is not a crucial factor in this case, since there are few defenses to payment of a mortgage note ..." Id. at 793. While there may be few defenses to mortgages issued by ethical lenders to prime customers, as will be discussed in the second article in this set, there are often significant defenses to a subprime and predatory loan, too many of which are cut off by the holder in due course doctrine. See Kurt Eggert, Held Up in Due Course: Securitization, Predatory Lending and the Holder In Due Course Doctrine, 35 Creighton L. Rev. (forthcoming April 2002).

For one example among many, see Gregory E. Maggs, The Holder in Due Course Doctrine as a Default Rule, 32 Ga. L. Rev. 783, 784 (1998), stating:

The holder in due course doctrine has remained largely unchanged for hundreds of years. Lord Mansfield clarified the holder in due course doctrine in several important common-law cases decided during the late 1700s. His rules were later codified in the Uniform Negotiable Instruments Law (N.I.L.), a model act drafted in 1896 and eventually adopted by forty-eight states.

Id.


My argument differs significantly from Grant Gilmore's argument found in Formalism and the Law of Negotiable Instruments, 13 Creighton L. Rev. 441 (1979). Gilmore argued that the difference between formalism and activism was itself largely one of form, not function, and that rules generated by the urge toward formalism will be dismantled by the courts. Id. at 461. Gilmore further argued that the codification of negotiable instruments was the victory of formalism over substance, with little real world effect. By substance, however, Gilmore did not refer to the intent of the maker of the instrument, but merely to whether the instrument circulates in the market. He declared, paraphrasing Justice Joseph Story, with approval, "[T]he law of negotiable instruments reflects the market; if instruments, whatever their form, do not circulate in a market, the negotiability idea becomes irrelevant." Id. at 454. Gilmore did not address the intent of the maker of the instrument, an issue at the very heart of my argument.


For a discussion of the battle over whether checks are negotiable instruments, with the learned Justice Story insisting that, despite their form and because they are not meant to circulate as currency, they are not, see Gilmore, 13 Creighton L. Rev. at 454-55.


The name, "holder in due course" was first used in England's Bills of Exchange Act of 1882, 45 & 46 Vict., c. 61 ("B.E.A."). Before the passage of the B.E.A., a holder in due course was known as a bona fide purchaser or assignee. The American codification of negotiable instruments law has followed this nomenclature of the English act. See Ann M. Burkhart, Lenders and Land, 64 Mo. L. Rev. 249, 262-63 (1999).

Currently, the holder in due course doctrine is codified in U.C.C. § 3-302 (1996).

Holdsworth calls the cut off of defenses to the holder in due course "the most important and most characteristic" of all of negotiability's features. Holdsworth, supra note 33, at 165.


Section 3-305 of the Uniform Commercial Code separates defenses of the obligor of a negotiable instrument into two categories, the "real defenses," good even against the holder in due course, and the "personal defenses," which cannot be used against the holder in due course unless the defenses somehow arise from the holder's own
behavior.


[Fn40]. Fraud in factum or in the execution, which requires that there was no true agreement to the instrument, is very rare. For a discussion of the "real defenses" and possible justification on efficiency grounds for their separate treatment by the U.C.C., see Clayton P. Gillette, Rules, Standards, and Precautions in Payment Systems, 82 Va. L. Rev. 181, 237-243 (1996).

[Fn41]. U.C.C. § 3-305(b) provides that a holder in due course holds an instrument free from all defenses except the real defenses listed in § 3-305(a)(1).

[Fn42]. The U.S. Supreme Court stated: "The law [regarding the holder in due course doctrine] was thus framed, and has been so administered, in order to encourage the free circulation of negotiable paper by giving confidence and security to those who receive it for value. ..." Goodman v. Simonds, 61 U.S. 343, 365 (1857).


[Fn44]. Rogers, supra note 37, at 96 (quoting Lewes Roberts, The Merchants Map of Commerce wherein the Universal Manner and Matter of Trade is Compendiously Handled 39 (2d ed. 1671)).

[Fn45]. Id. at 96 n.4 (quoting John Scarlett, The Stile of Exchanges, Preface 1 (1682)).

[Fn46]. Id. at 96.

[Fn47]. J. Milnes Holden, The History of Negotiable Instruments in English Law 43 (1955) (quoting John Marius, Advice Concerning Bills of Exchange 3 (London 1651)). Marius, though not a lawyer and in fact contemptuous of lawyers, had an apparently accurate knowledge of the legal principles of instruments of exchange, based on his years of experience as a notary public and his service at the Royal Exchange in London involving both inland and outland instruments. Id. at 42.

[Fn48]. W.S. Holdsworth, The Origins and Early History of Negotiable Instruments Part I, 31 Law Q. Rev. 12, 27 (1915). The earliest fairs where such exchange occurred were held at Champagne, and when these fairs declined during the fourteenth century, fairs at Lyons, Anvers, and Genoa took over this function. Id.

[Fn49]. Holdsworth, 31 Law Q. Rev. at 27.

[Fn50]. Id. at 28.


[Fn56]. For a famous literary example of a creditor threatening to ruin his borrower by refusing to redraw a bill, see Charles Dickens, Bleak House (Gordon N. Ray ed., 1956) (1853).

[Fn57]. 8 W.S. Holdsworth, A History of English Law 151-58 (1925). Holdsworth notes that Marius cites a 1608 book of John Trenchant for the view that previously Exchange should only be recognized between towns "in subjection unto divers lords' who do not allow the transport of money, or because of the risk of loss in transport." Id. at 158 n.3 (citation omitted). See Bromwich v. Loyd, 125 Eng. Rep. 870 (C.P. 1697). Once bills were used in internal trade, as well as foreign trade, the law distinguished between outland bills, used in foreign trade, and inland bills, used in internal trade. See also J. Milnes Holden, The History of Negotiable Instruments in English Law 47 (1955).

[Fn58]. Joseph Chitty, A Practical Treatise on Bills of Exchange, Checks on Bankers, Promissory Notes, Bankers' Cash, Notes and Bank Notes 17 (2d Amer. 1809).


[Fn60]. Eaglechild's Case, 124 Eng. Rep. 426 (C.P. 1640) (emphasis added). See also Oaste v. Taylor, 79 Eng. Rep. 262, 262 (K.B. 1612) ("After verdict, upon non assumptis pleaded, and found for the plaintiff, it was moved in arrest of judgment, because the defendant is not averred to be a merchant at the time the bill accepted.").


[Fn64]. See Frederick v. Cotton, 89 Eng. Rep. 760 (K.B. 1690) ("Case upon the custom of merchants against the acceptor of a bill: after verdict it was moved in arrest of judgment, that the parties were not averred to be merchants; and upon debate the Court said, that they would intend them such."). It appears that the court was arguing that the parties intended to be treated as merchants, though this interpretation is open to dispute, given the vagueness of the case note.


[Fn67]. Woodward, 84 Eng. Rep. at 85. Frederick Read concludes that the Woodward case did not establish that the law merchant applies to non-merchant litigants, and states that the common law did not recognize this application until 1692, when Holt ruled that by drawing a bill, even a non-merchant was brought into the custom of merchants. See Frederick Read, The Origin, Early History and Later Development of Bills of Exchange and Certain Other Negotiable Instruments Part I, 4 Can. Bar Rev. 440 (1926) and Frederick Read, The Origin, Early History and Later Development of Bills of Exchange and Certain Other Negotiable Instruments Part II, 4 Can. Bar. Rev. 665, 670-71 (1926) (citing Hodges v. Steward, 88 Eng. Rep. 1148 (K.B. 1693)).

[Fn68]. 8 W.S. Holdsworth, A History of English Law 158 (1925). See also Buller v. Crips, 87 Eng. Rep. 793, 793-94 (Q.B. 1702) (detailing Holt's explanation of making a two party bill of exchange, an explanation he used to defend his position that notes need not be rendered negotiable, since there already existed a method of making a two party negotiable instrument).


[Fn70]. Joseph Chitty, Practical Treatise on Bills of Exchange, Checks on Bankers, Promissory Notes, Bankers' Cash
Notes, and Bank Notes 19 (1826).


[Fn74]. Grant Gilmore calls the use of an allonge an "odd practice" and notes, "In an excess of antiquarian zeal the draftsmen of U.C.C. Article 3 have preserved the use of the allonge. See U.C.C. § 3-202(2) and the accompanying comment." Grant Gilmore, Formalism and the Law of Negotiable Instruments, 13 Creighton L. Rev. 441, 448 n.13 (1979). For the renewed use of allonges in the age of securitization, see Kurt Eggert, Held Up in Due Course: Securitization, Predatory Lending and the Holder In Due Course Doctrine, 35 Creighton L. Rev. (forthcoming April 2002). Apparently, everything archaic is new again.


[Fn82]. The ability to have one's debtor thrown into prison for failing to pay the debt when due was the basis for the original prohibition against the transference of a creditor's right to collect the debt. Since the punishment was so severe and so personal to the debtor, the debtor was considered free to select which of his potential creditors the debtor could trust with such a threatening means of collecting the debt. See Holdsworth, 31 Law Q. Rev. at 13-14.

[Fn83]. Gilmore, 13 Creighton L. Rev. at 449. Gilmore states that the merger doctrine emerged slowly after the elements of negotiability had been established. He writes:

The merger idea ... seems to have emerged gradually from the early case law. That is, the courts did not start with a theory from which certain necessary consequences were deduced. Only after the courts had worked out the rules for transfer and payment was it possible to construct a theory to explain the rules.

Id. at 449 n.15. Whitman lists as three ramifications of the merger doctrine, which he calls the "notion that a negotiable instrument is a reification of the obligation it describes," the following: (1) the holder in due course doctrine; (2) the fact that the right to payment may only be acquired by obtaining the instrument itself; and (3) the
rule that once an instrument has been delivered to an assignee, payment to anyone else is done at the payer's peril, even if the payer did not know of the assignment. Dale A. Whitman, Reforming the Law: The Payment Rule as a Paradigm, 1998 B.Y.U. L. Rev. 1169, 1169-71 (1998).

[Fn84]. Gilmore, 13 Creighton L. Rev. at 449-50.

[Fn85]. James Steven Rogers, Negotiability as a System of Title Recognition, 48 Ohio St. L.J. 197 (1987).

[Fn86]. Rogers, 48 Ohio St. L.J. at 208.

[Fn87]. Id. at 197.


[Fn89]. Holden, supra note 88, at 71 n.2.

[Fn90]. Id.

[Fn91]. Id. at 72.

[Fn92]. This description appears to come from a small, very rare pamphlet, printed in 1676, entitled The Mystery of the New Fashioned Goldsmiths or Bankers, a version of which was reproduced in J.B. Martin, The Grasshopper in Lombard Street 285-92 (Burt Franklin 1968) (1892). The pamphlet bears no name of an author, a bookseller, or a printer, reflecting how controversial it must have been in its day. See J. Milnes Holden, The History of Negotiable Instruments in English Law 72 n.2 (1955). Holden notes that the version of the pamphlet reproduced by Martin does not contain the reference to merchants' servants lending their masters' money to goldsmiths, but that J.W. Gilbert quoted such a passage from a different version of the pamphlet in his book J.W. Gilbert, History and Principles of Banking 19 (1866 ed.). According to Ralph W. Angler, an attribution of such a passage to this pamphlet may also be found in William Cranch, 3 Select Essays 82, which Cranch attributes to Anderson. Ralph W. Aigler, Commercial Instruments, the Law Merchant, and Negotiability, 8 Minn. L. Rev. 361, 364 n.14 (1924).

[Fn93]. Aigler, 8 Minn. L. Rev. at 364 n.14.


[Fn95]. Goldsmiths, however, demanded more of a bond when they lent money than they gave when they borrowed money. The author of the Mystery of the New fashioned Goldsmiths or Bankers noted:

They give only personal Security, and many times their Notes for £500, £1000, or more, when they owe before they give that Note, twenty times the value of their own Estates, and yet these free Lenders will scarce be satisfied with two or three mens bonds for £1000 that are known to be worth £1000 a man ....

Holden, supra note 94, at 72.


[Fn98]. Clerke, 92 Eng. Rep. at 6. Interestingly, the action was brought by the original beneficiary of the note, and not by a transferee. Id.

[Fn99]. Clerke, 92 Eng. Rep. at 6. This ruling has been roundly condemned by traditional commentators, viewing it as an untoward restriction on negotiability. As Holden states, "[I]t would be difficult to find any other group of decisions in any branch of the law which has brought forth such a torrent of unkind epithets, as those applied to Holt as a result of his judgment in Clerke v. Martin (1702)." J. Milnes Holden, The History of Negotiable Instruments in English Law 80 (1955).
Goldsmiths began issuing receipts for gold and silver deposits about 1645, and these receipts, consisting of promises to pay the sum deposited, evolved into goldsmiths' notes, which third parties began accepting as payment. See Ali Khan, The Evolution of Money: A Story of Constitutional Nullification, 67 U. Cin. L. Rev. 393, 410 n.85 (1999).

See John F. Dolan, Standby Letters of Credit and Fraud (Is the Standby Only Another Invention of the Goldsmiths in Lombard Street?), 7 Cardozo L. Rev. 1, 31 (1985) for the theory that the goldsmiths sought legislative relief rather than merely using a different form of instrument because Holt's ruling could prevent them from profiting from this lucrative creation of a method of payment.

Whereas it hath been held, That Notes in Writing ... are not assignable or indorsible over, within the Custom of Merchants .... Therefore to the Intent to encourage Trade and Commerce, which will be much advanced, if such Notes shall have the same Effect as Inland Bills of Exchange, and shall be negotiated in like manner; be it enacted ...That all Notes in Writing ... shall be assignable or indorsible over, in the same Manner as Inland Bills of Exchange are or may be, according to the Custom of Merchants ...

3 & 4 Ann., c. 9 (1704) (Eng.). For a discussion of whether Holt suggested the passage of this statute or had a more modest role in its passage, see Dolan, 7 Cardozo L. Rev. at 32.

The development of negotiable instruments in the American colonies proceeded at a different, in some ways faster, but also less uniform pace. The law varied dramatically by colony, based in part on such influences as the Dutch rule of New York, with their differing customs regarding commercial paper allowing greater negotiability than their English counterparts. See Frederick K. Beutel, Colonial Sources of the Negotiable Instrument Law of the United States, 34 Ill. L. Rev. 137, 146-147 (1939).


Miller v. Race, 97 Eng. Rep. 398, 398 (K.B. 1758). Of course, precedent did not have the binding force that it has now, since the decisions of the court were thought of as mere manifestations of the fixed, eternal common law, rather than the creators of it. An individual judge could therefore conclude that another court had erred and had strayed from the common law, and so refuse to follow the previous decision. J.H. Baker, An Introduction to English Legal History 227 (1990). Baker gives an interesting account of the development of precedent, Id. at 225-30, and states, "The duty of repeating errors [i.e. precedent] ... may have resulted from the improved quality of law reports following developments in shorthand techniques, which made the ipsissima verba of the judges available as an authentic text and made bold distinguishing more difficult. But it was more likely a result of the hierarchical
system of appellate courts established in the last century." Id. at 229.


[Fn118]. James Steven Rogers, The Myth of Negotiability, 31 B.C. L. Rev. 265, 272 (1990). Rogers, in The Early History of the Law of Bills and Notes, cautions against over-emphasizing the role of bills and notes in the economies of the seventeenth and eighteenth century, arguing that local economies could operate without any payment media, either bills and notes or currency, through the use of credit by local storekeepers. Farmers could obtain goods by using this credit throughout the growing season, and then pay back their debt by selling their goods through the same local storekeepers at harvest time. In this way, the farmers could both buy and sell from the storekeepers without requiring any significant currency or currency substitute. See James Steven Rogers, The Early History of the Law of Bills and Notes 110 (1995).

[Fn119]. Theophilus Parsons stated the commonly held view that the purpose of negotiable instruments law was to provide a currency substitute:

[N]egotiable paper is the adequate representative of money, and of actual credit, in the transaction of business. ... [T]he whole system of the law of negotiable paper has for its object to make this paper in fact such representative, and to secure its prompt and available convertibility, and to provide for the safety of those who use this implement, either by making it or receiving it, in good faith.


[Fn121]. See discussion of this point supra note 71 and accompanying text.

[Fn122]. Joseph Story, Commentaries on the Law of Promissory Notes and Guaranties of Notes, and Checks on Banks and Bankers 48-49 (5th ed. 1859) (citation omitted). Isaac Edwards stated, "[A]ny words in a bill or note from whence it can be inferred that the person making it intended it to be negotiable, will give it a transferable quality against him." Isaac Edwards, Treatise on Bills of Exchange and Promissory Notes 164-65 (1857) (citation omitted).


Bad faith and bankruptcy opened new vistas of complexity. A drawee, upon learning of the drawer's insolvency, might choose not to accept the bill. News of the drawer's insolvency might not reach the drawee until after acceptance. The drawer may have countermanded the bill, perhaps because the remitter had defrauded him or, as sometimes happened, because his servant had drawn the bill and absconded with the money.

Id.

[Fn124]. Gilmore states: "These bills moved in a world-wide market, typically ending up in the possession of people who knew nothing about the transaction which had given rise to the bill, had no way of finding out anything about the transaction and, in any case, had not the slightest interest in it." Gilmore, 13 Creighton L. Rev. at 448.


[Fn126]. Weinberg, 70 Ky. L.J. at 578.
[Fn127]. See discussion of the real defenses in section IV supra.

[Fn128]. That the risk of forgery of notes and bills of exchange was much in the public's mind can be seen by how often that risk is mentioned in works of literature of the time. An example from Chapter 54 of Charles Dickens' David Copperfield,

"I cannot help thinking," said Mrs. Micawber, with an air of deep sagacity, "that there are members of my family who have been apprehensive that Mr. Micawber would solicit them for their names--I do not mean to be conferred in Baptism upon our children, but to be inscribed on Bills of Exchange, and negotiated in the Money Market."


[Fn131]. This view of Mead v. Young as embodying a precaution analysis of the effect of the holder in due course doctrine can be found in Benjamin Geva, Forged Check Indorsement Losses Under the UCC: The Role of Policy in the Emergence of Law Merchant from Common Law, 45 Wayne L. Rev. 1733, 1752-54 (2000), which draws on Friedrich Kessler, Forged Indorsements, 47 Yale L.J. 863, 863-71 (1938).

[Fn132]. Gilmore, 13 Creighton L. Rev. at 448 (citing Robertson v. Kensington, 128 Eng. Rep. 238, 239 (Ex. Ch. 1811) and including the following from the earlier case Peacock v. Rhodes, 99 Eng. Rep. 402, 402 (K.B. 1781): "William Ingham, to whom the bill was payable, indorsed it; John Daltry received it from him, and indorsed it; Joseph Fisher received it from John Daltry; and it was stolen ... before the plaintiff took it in payment ....").

[Fn133]. See James Steven Rogers, The Early History of the Law of Bills and Notes 112 (1995) (noting that a Manchester banker told a Parliamentary Committee in 1826 that he had seen bills with fifty or more indorsements, stating, "I have seen slips of paper attached to a bill as long as a sheet of paper could go, and when that was filled another attached to that." (citation omitted).

[Fn134]. Harold R. Weinberg refers to this spreading of risk as "a portfolio of promises over which the risk of insolvency is diversified." Weinberg, 70 Ky. L.J. at 572 (citation omitted).

[Fn135]. Rule responsiveness as a sign of the efficiency of loss allocation will be discussed more fully in Kurt Eggert, Held Up in Due Course: Securitization, Predatory Lending and the Holder In Due Course Doctrine, 35 Creighton L. Rev. (forthcoming April 2002).


[Fn137]. As discussed in section V(E), infra, this uncertainty was not as significant as it might appear, since goldsmiths rarely had valid defenses to their notes.


[Fn139]. The statute itself states,

That all Notes in Writing, that after the first Day of May, in the Year of our Lord, one thousand seven hundred and five, shall be made and signed by any Person or Persons ... Goldsmith, Merchant, or Trader ... shall be assignable or indorsible over, in the same Manner as Inland Bills of Exchange are or may be, according to the Custom of Merchants.

3 & 4 Ann., c. 9 (1704) (Eng).

[Fn140]. The "classical period" of negotiable instruments law has been described as that time "from the early eighteenth to the early nineteenth centuries," when the law was fully developed and in use, and before other payment systems took over the function of bills of exchanges. See Jane Kaufman Winn, Couriers Without Luggage:


[Fn142]. Rogers, supra note 141 at 7.

[Fn143]. Id. at 7-8. Rogers notes, "It was not until the eighth edition of Byles, published in 1862, that a passage expressly discussing the rights of 'bona fide holders' was added, and this passage amounted to only a few pages in the chapter entitled 'Of the Consideration."' Id. at 7 n.12.

[Fn144]. A factor, according to Black's Law Dictionary, is "a commercial agent, employed by a principal to sell merchandise consigned to him for that purpose, for and in behalf of the principal, but usually in his own name, being entrusted with the possession and control of the goods, and being remunerated by a commission, commonly called 'factorage.'" Black's Law Dictionary 592 (6th ed. 1990).

[Fn145]. Rogers, supra note 141, at 191.

[Fn146]. James Steven Rogers, The Myth of Negotiability, 31 B.C. L. Rev. 265, 280-81 (1990). Rogers states that Theophilus Parsons' 1863 Treatise on the Law of Promissory Notes and Bills of Exchange is the first such work on bills and notes that Rogers has discovered to include a chapter devoted to bona fide holders of instrument and their rights. Id. at 281.

[Fn147]. Rogers, 31 B.C. L. Rev. at 316.


[Fn150]. Rogers, 31 B.C. L. Rev. 316-17.

[Fn151]. J. Milnes Holden, The History of Negotiable Instruments in English Law 278 (1955). The last private English bank having the right to issue bank notes as currency was Messrs. Fox, Fowler & Co., which lost that right in 1921 when it merged with another bank. Id.


[Fn153]. See Rogers, supra note 141, at 96 n.4 (quoting John Scarlett, The Stile of Exchanges, Preface 1 (1682)), discussed in section V supra.

[Fn154]. Rogers, 31 B.C. L. Rev. at 322. Rogers says: "The law turned inwards, so to speak, looking to its own legal concepts and categories as the points of major significance, rather than defining itself and concerning itself with problems and concerns drawn from an actual body of commercial practice." Id.

[Fn155]. Rogers, 31 B.C. L. Rev. at 320. Rogers states:
For want of better locutions, I shall use the term 'exogenous' to refer to classifications of the sort that delimit the scope of a body of law by reference to a discrete body of non-legal behavior, and 'endogenous' to refer to classifications of the sort that delimit the scope of a body of law by reference to purely legal concepts.
Id.

[Fn156] Vern Countryman, The Holder in Due Course and Other Anachronisms in Consumer Credit, 52 Tex. L. Rev. 1, 1-2 (1973) ("When the term 'holder in due course' was coined in the English Bills of Exchange Act of 1882, there were doubtless consumers about, but their problems went unrecognized and, in any event, they rarely signed negotiable instruments.").


[Fn158] Grant Gilmore, The Commercial Doctrine of Good Faith Purchase, 63 Yale L.J. 1057, 1070 (1954). Gilmore notes that promissory notes, a later invention than bills of exchange, were seen as "less 'commercial' than bills," and an indorser of a promissory note assumed less liability to later transferees than did a bill's indorser. Gilmore, 63 Yale L.J. at 1070.


[Fn160] K.N. Llewellyn, Meet Negotiable Instruments, 44 Colum. L. Rev. 299, 322 (1944). Llewellyn described the bulking up of instruments used to provide security for loans in his article Meet Negotiable Instruments: "But once a man starts thinking up unhappy contingencies and sets about the careful legal covering of himself against each of them, he has embarked upon a course which ends only with the incorporation of a fifteen volume encyclopedia of law and procedure, or else with plain exhaustion." Id.

[Fn161] See Gilmore, 13 Creighton L. Rev. at 453; Llewellyn, 44 Colum. L. Rev. at 322-23.

[Fn162] Chief Justice Gibson of the Pennsylvania Supreme Court, famously stated: "[A] negotiable bill or note is a courier without luggage. It is a requisite that it be framed in the fewest possible words, and those importing the most certain and precise contract." Overton v. Tyler, 3 Pa. 346 (1846).

[Fn163] 66 F. 887 (8th Cir. 1895).

[Fn164] Lincoln Nat'l Bank v. Perry, 66 F. 887, 894 (8th Cir. 1895) (citations omitted).

[Fn165] See, People's Savings Bank v. Bates, 120 U.S. 556, 564-65 (1887) (A chattel mortgage given as security for pre-existing debt without further consideration was not negotiable: "The rules established in the interests of commerce to facilitate the negotiation of mercantile paper, which, for all practical purposes, passes by delivery as money, and is the representative of money, ought not, in reason, to embrace instruments conveying or transferring real or personal property as security for the payment of money.").

[Fn166] The courts still, in the late nineteenth century, clung to the notion that negotiable instruments functioned as currency, and were "representative of money." When faced with newer forms of negotiable instruments, like bills of lading, made negotiable by statute, which clearly did not function as money, a Pennsylvania court sought to distinguish these newer, negotiable but somehow not fully, classically negotiable, instruments from bills of exchange and promissory notes, which still functioned as the representative of money. Merchants' Nat'l Bank v. Shaw, 2 F. Cas. 597, 597-600 (C.C.E.D. Pa. 1876) (No. 843), aff'd, 101 U.S. 557 (1879).


[Fn168] See e.g., Twyne's Case, 76 Eng. Rep. 809 (Star Ch. 1601).


[Fn170] See Gilmore, 63 Yale L.J. at 1082 n.84, 1083 n.87.


[Fn174]. M.D. Chalmers, An Experiment in Codification, 2 Law Q. Rev. 125, 125, 127 (1886); Britton, supra note 173, at 9.

[Fn175]. Chalmers, 2 Law Q. Rev. at 127. The greater part of this work was by a Mr. Billinghurst, of the London and Westminster Bank and a Mr. Slater, of the London and County Bank. Id. at 127 n.1.

[Fn176]. Chalmers, 2 Law Q. Rev. at 127.

[Fn177]. Id. For a listing of the members of the committee, see id. at 127 n.2.

[Fn178]. Chalmers, 2 Law Q. Rev. at 128.

[Fn179]. Id. at 126.


[Fn181]. M.D. Chalmers, An Experiment in Codification, 2 Law Q. Rev. 125, 126 (1886) ("Of course codification pure and simple is an impossibility. The draftsman comes across doubtful points of law which he must decide one way or the other. Again, voluminous though our case law is, there are occasional gaps which a codifying Bill must bridge over if it aims at anything like completeness.").


[Fn183]. Bills of Exchange Act, 1882, 45 & 46 Vict. c. 61, § 8(4) (Eng.). Chalmers, in his commentary on the Act, stated, "This sub-section alters the law. Before the Act it was held in England that a bill or note drawn payable to a specified person without the addition of words authorizing transfer, e.g. "Pay C," was not negotiable [footnote omitted]. In Scotland it was held that a bill or note was negotiable unless it contained words prohibiting transfer, as, for instance, "Pay C only." The Act has adopted the Scottish rule." M.D. Chalmers, A Digest of the Law of Bills of Exchange, Promissory Notes, Cheques and Negotiable Instruments 30 (9th ed., 1927).

[Fn184]. Even before the passage of the Bills of Exchange Act, some English courts had held that notes lacking words of negotiability satisfied the Statute of Anne and so were negotiable. See William Everett Britton, Cases on the Law of Bills and Notes 5 n.1 (3d ed., 1941) (citing Burchell v. Slocock, 92 Eng. Rep. 502, 502 (K.B. 1728); Smith v. Kendall 101 Eng. Rep. 469, 469-70 (K.B. 1794) and also noting that in the United States, the case law was more mixed). Holdsworth is more emphatic, stating that the Statute of Anne "was interpreted to mean that all such notes, whether payable to A simply or to A or order or to A or bearer, were made negotiable." W.S. Holdsworth, The Origins and Early History of Negotiable Instruments, Part IV, 32 Law Q. Rev. 20, 34 (1916) (emphasis in original). Chalmers, however, seems to have believed that express words authorizing transfer were required for the negotiability of both bills and notes. See supra note 183 and accompanying text.


[Fn188]. Eaton, 2 Mich. L. Rev. at 265; John W. Crawford, The Negotiable Instruments Law, Preface (1897). Crawford was actually appointed by a three member sub-committee chosen by the Committee on Commercial Law after that committee had been charged by the Committee on Commercial Law with procuring a draft of uniform legislation regarding negotiable instruments. Eaton, 2 Mich. L. Rev. at 264-65.

[Fn189]. Frederick K. Beutel, The Development of State Statutes on Negotiable Paper Prior to the Negotiable Instruments Law, 40 Colum. L. Rev. 836, 850-51 (1940). For a history of the drafting of the Field Code and its rejection by New York, but adoption, with minor variations, by North and South Dakota, Montana and California, see Rodolfo Batiza, Sources of the Field Civil Code: the Civil Law Influences on a Common Law Code, 60 Tulsa L. Rev. 799, 818 (1986). See Andrew P. Morriss, Codification of the Law in the West, in Law in the Western United States 45, 46-47 (Gordon Morris Bakken, ed. 2000) (arguing that states, such as Montana, adopted a variant of the Field Code not to replace the common law, but rather because, due to their short life, they had too little common law to function effectively).


[Fn191]. Amasa M. Eaton, who was active both in the framing and the adoption of the N.I.L. as a member of the Conference of Commissioners on Uniform State Laws, called this increase in negotiability, free from local or latent infirmities, the "great object sought to be accomplished" by the N.I.L., to protect from "prejudice and disappointment" the "innocent holders, as against all the parties to the instrument professedly bound thereby." Amasa M. Eaton, The Attitude of the Bench and the Bar Toward the Uniform Negotiable Instruments Law, 77 Cent. L.J. 282, 283 (1913). By this time, the "innocent holders" that the N.I.L. would protect were mostly banks.


[Fn193]. C.C. Bunney, Codification, 20 Am. L. Rev. 22, 23 (1886).

[Fn194]. The first draft, "was sent to all the Commissioners on Uniform Laws and to many of the authors and experts on that subject inviting comment. Lyman D. Brewster, The Promotion of Uniform Legislation, 6 Yale L.J. 132, 133 (1897).

[Fn195]. Eaton, 2 Mich. L. Rev. at 268; Grant Gilmore, Formalism and the Law of Negotiable Instruments, 13 Creighton L. Rev. 441, 456-57 (1979). Gilmore states, "I do not know whether the banks drafted the N.I.L. The truth is that no one knows anything about the drafting of the N.I.L.: it was carried out almost in secret." Id. at 457.

[Fn196]. Eaton, 2 Mich. L. Rev. at 266.


[Fn198]. Gilmore, 13 Creighton L. Rev. at 457.

[Fn199]. Frederick K. Beutel, Beutel's Brannan's Negotiable Instruments Law 1353-54 (7th ed. 1948).

[Fn200]. James Barr Ames, The Negotiable Instruments Law, 14 Harv. L. Rev. 241, 243 (1900). Ames, though, thought that nothing but good could come from these changes. Id.

[Fn201]. Joseph Doddridge Brannan, The Negotiable Instruments Law Annotated 8 (2d ed. 1911). See also Grant Gilmore, The Commercial Doctrine of Good Faith Purchase, 63 Yale L.J. 1057, 1071 (1954). Gilmore notes that, even though there was no suggestion in the N.I.L. that it was intended to restrict negotiability to any forms of paper then in use, the N.I.L. was later, and likely against all intentions of its drafter or supporters, taken to mean that a note could not be negotiable if it referred to a mortgage, though its negotiability was not impaired if it was secured by a mortgage to which it did not refer. Id. at 1084-88.

[Fn202]. The discounting of currency, on the other hand, has long existed, usually in less developed currencies, such as where a new payment system has been introduced, or where one player in the payment system has significant market power. See generally Alan S. Frankel, Monopoly and Competition in the Supply and Exchange of Money, 66 Antitrust L.J. 313 (1998).


[Fn204]. K.N. Llewellyn, Meet Negotiable Instruments, 44 Colum. L. Rev. 299, 328 (1944).


[Fn207]. Frederick K. Beutel, Brannan's Negotiable Instruments 77-78 (7th ed. 1948).

[Fn208]. Bills of Exchange Act, 1882, 45 & 46 Vict. c. 61, § 3(1) (Eng.).


[Fn211]. Beutel suggests that a desire to include all negotiable instruments was a reason that Crawford followed the outline for the California Code rather than the Bills of Exchange Act. Because many states had statutes in place covering one specific negotiable instrument, such as bonds, an incomplete codification, one that provided rules only for a few existing forms of negotiable instruments, might have left those already extent statutes in effect, leading to a non-uniform negotiable instruments law. Therefore, Beutel proposed, that the N.I.L.'s draftsmen likely followed California's all-inclusive codification of negotiable instruments law rather than the Bills of Exchange Act's more limited codification in order to preempt all other law governing negotiable instruments. Also, codes similar to the California Code had already been enacted in six other states, and Beutel argued that if the N.I.L. were not drafted as broadly as the California Code, states might choose to follow the California model rather than the N.I.L. Frederick K. Beutel, The Development of State Statutes on Negotiable Paper Prior to the Negotiable Instruments Law, 40
Colum. L. Rev. 836, 852-853 (1940).


[Fn213]. For early evidence of the importance given to the intent of the maker of an instrument, see discussion in section V supra, specifically note 116 and accompanying text.


[Fn215]. 1 John W. Daniel, a Treatise on the Law of Negotiable Instruments § 106 (1876). The contrast between the common law attitude toward the intent required to create a negotiable instrument and the formalistic requirements of the N.I.L. is perhaps expressed most starkly in the 1933 edition of Daniel's treatise, re-edited after his death by Thomas H. Calvert. Calvert decided to preserve the discussion of the pre-N.I.L. common law contained in previous editions of the work, while combining it with portions of the N.I.L. and a discussion of their effect. J. Daniel, A Treatise on the Law of Negotiable Instruments v (Thomas H. Calvert ed., 7th ed. 1933). In the common law section, the Daniel treatise states: "Words in a bill, from which it can be inferred that the person making it, or any other party to it, intended it to be negotiable, will give it a transferable quality against that person," while the N.I.L. sections responds, "Under the statute, a note payable to order or to bearer and negotiable and payable at a certain place is negotiable within the meaning of the statute, and a note order or draft which is not payable to order or bearer is not negotiable." Id. at 159.


[Fn217]. See e.g., Joseph Chitty, A Practical Treatise on Bills of Exchange, Checks on Bankers, Promissory Notes, Bankers' Cash, Notes and Bank Notes 58 (1st Am. ed. 1809) ("If, however, it be intended to be negotiable, care must be taken that the operative words of transfer commonly used in bills, be inserted therein. The modes of making a bill transferable, are by drawing it either payable to A. B. or order, or to A. B. or bearer, or to the drawer's own order, or to bearer generally.") (emphasis in original). Byles seems absolutely to require the words "order" or "bearer" to render a note negotiable, stating, "Unless a bill or note be payable to order or to bearer, it is not negotiable ..." John Barnard Byles, A Treatise of the Law of Bills of Exchange, Promissory Notes, Bank-Notes, Bankers' Cash-Notes and Checks 150 (4th Am. ed. 1856) (emphasis in original). But in a footnote, he relents, stating "The words 'or order' or words tantamount, are necessary to make a note negotiable." Id. at n.1 (emphasis added). "Words tantamount" would almost necessarily be those expressing a similar intent that the bill or note be negotiable.

[Fn218]. For example, Christopher G. Tiedeman stated, "While the original purpose of these words [of negotiability] was to show the maker's or drawer's consent to the transfer of the paper to others, so as to pass legal title, they now survive the repeal of the common law prohibition of the assignment of choses in action, as evidence of the intention to give to the paper the characteristics of negotiability." Christopher G. Tiedeman, A Treatise on the Law of Bills and Notes, Checks 21 (1898). See also the treatises of Joseph Story and Isaac Edwards, quoted at footnote 122 supra.

[Fn219]. See United States v. White, 2 Hill 59 (N.Y. Sup. Ct. 1841) (quoting Joseph Chitty, A Practical Treatise on Bills of Exchange, Checks on Bankers, Promissory Notes, Bankers' Cash Notes, and Bank Notes 218 (9th Am. ed. 1839) which states "[A]ny words in a bill ... from whence it can be inferred that the person making it, or any other party to it, intended it to be negotiable, will give it a transferable quality against that person."). See also Farquhar v. Fidelity Ins., Etc., Co., 8 F. Cas. 1068, 1068 (C.C. Pa. 1878) ("It is an essential feature of a negotiable note that it should be made transferable, so as to give the holder a right of action in his own name. Hence it has been held that the use of the ordinary terms 'or order,' 'or bearer,' are not indispensable to impress upon it this quality of transferability. Words of equivalent meaning, which clearly show the intention of the maker, are equally effectual.").

[Fn220]. By comparison, the Statute of Anne did not seek rigorously to define what constituted a promissory note, but rather to declare that promissory notes were negotiable. See discussion of the requirements of that statute in note 184 supra and the declaratory purpose of the Statute of Anne in J. Milnes Holden, The History of Negotiable
Instruments in English Law 80 (1955).


[Fn222]. Frederick K. Beutel, Brannan's Negotiable Instruments Law 9 (5th ed. 1932).

[Fn223]. Gilmore, 63 Yale L.J. at 1093.


[Fn226]. See American Nat'l Bank v. Sommerville Inc., 216 P. 376 (Cal. 1923) (providing facts where car buyer was induced in to signing a contract with a waiver of defenses, only to find, after the contract was assigned to a finance company and then pledged to a bank, that the car would never be delivered). See also Gene A. Marsh, The Hard Sell in Consumer Credit: How the Folks in Marketing Can Put You in Court, 52 Consumer Fin. L.Q. Rep. 295 (1998) (citing Ford Motor Co. v. FTC, 120 F.2d 175 (6th Cir. 1941); Gen. Motors Corp. v. FTC, 114 F.2d 33 (2d Cir. 1940) and stating that in the 1930's, car manufacturers were misleading consumers with claims of six percent financing for loans that were actually at much higher interest rates).

[Fn227]. K.N. Llewellyn, Meet Negotiable Instruments, 44 Colum. L. Rev. 299, 301 (1944) (emphasis in the original).


[Fn232]. Gilmore has stated,

It is hard, and it becomes each year harder, for counsel to explain convincingly why 'the law' requires that a hard-pressed wage-earner who has been bilked by a now-insolvent seller into buying junk masquerading as a television set or a washing machine must pay the full price to a bank or finance company whose own relationship with the fraudulent seller has been intimate, long-continued and profitable.


[Fn235]. See Sinclair, 21 U. Tol. L. Rev. at 647 (discussing Commercial Credit Co. v. Childs, 137 S.W.2d 260 (Ark. 1940)).


[Fn237]. Mentschikoff, 43 Ohio St. L.J. at 543.

[Fn238]. See Rapson, 41 Bus. Law. at 676 n.4 (citing Letter from Grant Gilmore to Donald J. Rapson (Oct. 8, 1980)) for this possible motive.


[Fn244]. Edward L. Rubin, The Code, The Consumer, and the Institutional Structure of the Common Law, 75 Wash. U. L.Q. 11, 14 (1997). Rubin notes the U.C.C. "inherits the common law's blindness to consumer concerns" and so is indifferent to consumers. Id. For exceptions to this indifference, see U.C.C. § 9-206(1), and 2-719(3).

[Fn245]. See generally Gregory E. Maggs, Karl Llewellyn's Fading Imprint on the Jurisprudence of the Uniform Commercial Code, 71 U. Colo. L. Rev. 541 (2000) (discussing how Llewellyn's vision for the U.C.C. was initially and even more over time has been rejected by the drafters and revisers of the U.C.C.).


[Fn250]. See Kamp, 51 SMU L. Rev. at 343 (citing Tentative Draft No. 3, Article VII § 7-108(2)-(3) (1949), reprinted in 5 Uniform Commercial Code Drafts 222 (Elizabeth S. Kelly ed., 1984)).


[Fn254]. Patchel, 78 Minn. L. Rev. at 101.

[Fn255]. See id. at 100-01. See also Fairfax Leary, Reflections of a Drafter: Fairfax Leary, 43 Ohio St. L.J. 557, 558 (1982). Leary wrote:

All along there were other indirect pressures on the draftsmen from special interests. These pressures were felt through various and sundry people who got the information from their contacts and passed it on. There was great pressure to produce an adoptable Code, and, therefore, certain interests who might oppose the Code had to be pacified.

Leary, 43 Ohio St. L.J. at 558. For a general discussion of the capture of the U.C.C. drafting process by conservative business interests, see Edward J. Janger, Predicting When the Uniform Law Process Will Fail: Article 9, Capture, and the Race to the Bottom, 83 Iowa L. Rev. 569 (1998).


I once commented that article 3 is the N.I.L. doubled in spades-- negotiability in excelsis--and went on to say that the article gravely reviews each of the pressure points that had emerged in the N.I.L. case law and resolves the issue in favor of negotiability and the holder in due course.

Gilmore, 15 Ga. L. Rev. at 619 (referring to comments made in Grant Gilmore, Formalism and the Law of Negotiable Instruments, 13 Creighton L. Rev. 441, 461 (1979)).

[Fn258]. Edward Rubin, Efficiency, Equity and the Proposed Revision of Articles 3 and 4, 42 Ala. L. Rev. 551, 554 (1991). The extent to which bankers controlled the U.C.C. codification process can be seen in the fate of Fairfax Leary, a commercial law specialist, who had been chosen by Llewellyn to draft Article 4, regarding bank collection. Leary's draft was much more sensitive to consumers' interests than its predecessor, the American Bankers Association's Bank Collection Code. After reviewing Leary's draft, the New York Clearing House Association, the entity responsible for processing the electronic transfers of New York banks, notified Llewellyn that it would oppose the entire U.C.C. if Leary's draft were included. Llewellyn relieved Leary of the drafting, which was ultimately undertaken by a committee of bank counsel. See Rubin, 42 Ala. L. Rev. at 555. Even Grant Gilmore, in his defense of the U.C.C. from Frederick Beutel's charge that it was a "sell-out" to the banker's lobby, admitted that Article 4 was almost solely the product of a group of banking counsel. Gilmore declined to defend Article 4, saying he would leave the defense to someone "who [could] undertake it with a better heart." Grant Gilmore, The Uniform Commercial Code: A Reply to Professor Beutel, 61 Yale L.J. 364, 374 (1952).

[Fn259]. Report of the Sub-Committee on Article 3 Uniform Commercial Code to the Editorial Board of the

[Fn260]. 1954 Article 3 Sub-Committee Report, Sec. III, 3-104, at 3.


[Fn262]. 1954 Article 3 Sub-Committee Report, Sec. III, 3-302, at 3-4.


[Fn265]. Frederick K. Beutel, The Proposed Uniform (?) Commercial Code Should Not Be Adopted, 61 Yale L.J. 334, 363 (1952). Beutel's vitriol against the proposed U.C.C. has become famous. In the same article, he includes as a section heading, "Article 4--Bank Deposits and Collections, Is a Piece of Vicious Class Legislation." Id. at 357. He later concludes, "This article is a deliberate sell-out of the American Law Institute and the Commission of Uniform Laws to the bank lobby in return for their support of the rest of the code .... Such a sell-out is beneath the dignity of both organizations and is a tremendous blow to their prestige as scientific bodies." Id. at 362-63.

[Fn266]. Gilmore has stated that "The law review literature of the 1920's and 1930's is bursting at the seams with learned articles and faculty-inspired student notes deploring the short-sightedness and narrow-mindedness of the courts in failing to appreciate the beauty of what came to be called the 'mercantile approach.'" Gilmore, 15 Ga. L. Rev. at 615-16 (citing Henry W. Ballantine, Purchase for Value and Estoppel, 6 Minn. L. Rev. 87 (1922), and John Barker Waite, Caveat Emptor and the Judicial Process, 25 Colum. L. Rev. 129 (1922) as samples of law review literature).

[Fn267]. Allen Kamp observed, "The process was captured by bank attorneys, who saw the issues from the perspective of their clients. Their influence outweighed that of the only group with a consumer perspective, the few law professors who were involved. Few legislators were interested in these arcane issues. The end result was a pro-bank statute." Allen R. Kamp, Uptown Act: A History of the Uniform Commercial Code: 1940-49, 51 SMU L. Rev. 275, 346 (1998).

[Fn269]. Fairfax Leary, Jr., Book Review, 64 Harv. L. Rev. 688, 689 (1951) (reviewing Frederick K. Buetel, Interpretation of Uniform Commercial Laws, Cases and Materials (1950)).


[Fn272]. See discussion of this point in section V(D) supra.


The economically strategic defendant will examine its portfolio of cases, and potential future cases, and identify the one that offers the best prospects for success, thereby strategically setting a favorable precedent. The defendant may base the determination of these prospects on a variety of factors, including the relatively unsympathetic nature of a given plaintiff, facts unique to the complaint, the favorability of a given forum or judge or potential appellate judges, and the relative ability of plaintiffs counsel. Once the defendant identifies the case, the defendant will prosecute it, regardless of the settlement interest of the plaintiff. Cross, 86 Cornell L. Rev. at 7.

[Fn278]. Ralph J. Rohner, Holder in Due Course in Consumer Transactions: Requiem, Revival, or Reformation?, 60 Cornell L. Rev. 503, 507 (1975). Courts have expressed early and intermittent reluctance to enforce such clauses, viewing them as improper attempts to provide negotiability by contract. Id. at 507 n.21. See also Grant Gilmore, The Commercial Doctrine of Good Faith Purchase, 63 Yale L.J. 1057, 1095-98 (1954). However, the U.C.C. authorizes waiver of defense clauses, subject to "any statute or decision which establishes a different rule for buyers or lessees of consumer goods." U.C.C. § 9-206 (2001). For a time, finance companies were so enamored of the effect of cut-off clauses that they relied on these cut-off clauses in place of drafting negotiable instruments for consumers. Grant Gilmore, The Commercial Doctrine of Good Faith Purchase, 63 Yale L.J. 1057, 1095 (1954).

[Fn279]. Michael F. Sturley, The Legal Impact of the Federal Trade Commission's Holder in Due Course Notice on a Negotiable Instrument: How Clever Are the Rascals at the FTC?, 68 N.C. L. Rev. 953, 955 n.12 (1990). A handful of states even permitted the more egregious practice of inserting into a consumer contract a confession of judgment, allowing a creditor to obtain a judgment immediately upon default. Ralph J. Rohner, Holder in Due Course in Consumer Transactions: Requiem, Revival, or Reformation?, 60 Cornell L. Rev. 503, 510 & n.31 (1975) (citation omitted). Even worse was the use of wage assignments, which allowed a creditor to receive all or a portion of the debtor's wages even without receiving a judgment, simply by filing the assignment with the debtor's employer. American Financial Services Ass'n v. FTC, 767 F.2d 957, 974 (D.C. Cir. 1985). In American Financial Services, the court upheld the FTC's ban on wage assignments, finding that the harm they caused to consumers' financial interests, their employment, and their legal rights overshadowed their benefit to creditors.
[Fn280]. See Fred H. Miller, Consumers and the Code, the Search for the Proper Formula, 75 Wash. U. L.Q. 187, 191-92 (1997); Rohner, 60 Cornell L. Rev. at 522-23.

[Fn281]. Rohner, 60 Cornell L. Rev. at 530.


[Fn283]. For statistical and anecdotal testimony regarding the substantial and prolonged consumer injury caused by the application of the holder in due course doctrine to consumer contracts, see Promulgation of Trade Regulation Rule and Statement of Basis and Purpose, 40 Fed. Reg. 53,506, 53,509-14 (Nov. 18, 1975). Michael Sturley described the situation as follows: "Inner-city stores were selling shoddy furniture, fly-by-night contractors were promising to install aluminum siding that never appeared, the proverbial used car dealers were hawking lemons, and countless other shady characters were operating in similar fashion in scores of different fields." Sturley, 68 N.C. L. Rev. at 954.


[Fn285]. Promulgation of Trade Regulation Rule and Statement of Basis and Purpose, 40 Fed. Reg. 53,506, 53,509-10 (Nov. 18, 1975). It is confusing that what is commonly known as the "FTC Holder in Due Course Rule" actually abrogated the holder in due course doctrine for certain consumer transactions. At first, the FTC rule did not seem to affect credit instruments that omitted the required notice. However, in the most recent revision of Article 9 of the U.C.C., new sections 9-403 and 9-404 state that where a law or regulation such as the FTC Holder in Due Course Rule requires a consumer credit contract to include a particular notice, the contract will be treated as though that notice were included in instances where it is inappropriately omitted. See Thomas J. Buteweg, The New Consumer Provisions in Revised U.C.C. Article 9, 54 Consumer Fin. L.Q. Rep. 185, 189 (2000); Fred H. Miller, Consumer Provisions in the Revised U.C.C., 53 Consumer Fin. L.Q. Rep. 95, 96 (1999). The FTC Holder in Due Course rule can be compared to the Uniform Consumer Credit Code (U.C.C.C.), adopted by a few states, that bars merchants from taking any negotiable instruments, with the exception of checks, from consumers. See Gregory E. Maggs, The Holder in Due Course Doctrine as a Default Rule, 32 Ga. L. Rev. 783, 797 (1998).


[Fn292]. See Rohner, 60 Cornell L. Rev. at 525 (citing FTC Record and Transcript Hearings on Proposed Trade Regulation Rule, FTC Docket No. 215-31-1 (Jan. 26, 1971), containing materials from both the 1971 and 1973 hearings).


[Fn294]. Preservation of Consumers' Claims and Defenses, supra note 290, at 53,523. See Rohner, 60 Cornell L. Rev. at 542-43 ("How can a financier police his dealers? He can investigate a dealer's general reputation for honesty, integrity, and solvency. He can periodically renew that investigation ... What financiers collectively can do to police the market ... is withdraw, or threaten to withhold, their credit supply from merchants with bad track records. It is this power to cut off the dealer's essential commodity that is the tangible policing mechanism.").

[Fn295]. See section V(D), supra, for how the holder in due course doctrine was intended to assign the risk of loss to the party most directly dealing with the party causing the loss.

[Fn296]. See supra note 137 and accompanying text.


[Fn302]. Rohner, 60 Cornell L. Rev. at 528 & n.133 (citation omitted). See also Robert J. Banta, Negotiability in Consumer Sales: The Need for Further Study, 53 Neb. L. Rev. 195, 196-97 (1974) ("[M]any banking and financial institutions argue that if they were subject to consumer defenses, consumer credit might vanish or become so expensive as to be prohibitive.").

[Fn303]. Marsh, 45 Ala. L. Rev. at 43. See also Rohner, 60 Cornell L. Rev. at 536 n.166 (citing National Tire
Dealers & Retreaders Ass'n Comments to the FTC on Revised Proposed Rule, March 5, 1973, in FTC Record 5966-67).


[Fn305] William H. Lawrence & John H. Minan, The Effect of Abrogating the Holder-in-Due-Course Doctrine on the Commercialization of Innovative Consumer Products, 64 B.U. L. Rev. 325, 338 & n.51 (1984) (citing N.Y. Times, Oct. 7, 1976, § L, at 81, col. 2) (noting that The Wharton Forecasting Institute estimated that only a 5.5% reduction in the amount of consumer credit was caused by the FTC's Holder in Due Course Rule in 1976). Given the amount of consumer credit supplied by dishonest merchants, if there had been no such drop in the amount of consumer credit, that would have been a sign that the FTC's efforts had no beneficial effect.

[Fn306] James J. White & Robert S. Summers, Uniform Commercial Code 503 (4th ed. 1995). They conclude, "Indeed, twenty years from now we may conclude that it caused barely a ripple on the consumer credit pond." Id.


[Fn310] Rubin, 31 Idaho L. Rev. at 801.


[Fn313] Kurt Eggert, Held Up in Due Course: Securitization, Predatory Lending and the Holder In Due Course Doctrine, 35 Creighton L. Rev. (forthcoming April 2002).

END OF ARTICLE