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For My Parents,
Robert and Lenore Whaley

PREFACE

As we shall see, paper-based payment systems are rapidly giving way to the electronic transfer of funds. Soon we can expect that electronic payment will be the norm, and paper transfers increasingly rare. Given that, it makes little sense to call casebooks on point "Negotiable *Instruments* Law" or "Commercial *Paper*," and a number of recent books have opted for a title such as "Payment and Credit Systems Law." I have chosen to call this work "Problems and Materials on Payment Law." The omission of a reference to "credit" is deliberate. Of course, promissory notes and credit cards are used to acquire credit (as are checks when the drawer is attempting to ride the float period during their collection), but the law covered by the casebooks doesn't focus on the credit function. If it did, it would have to cover all the credit issues better left to a course in consumer law (qualifying for credit, granting credit, the disclosing of credit information, etc.). Instead, even with promissory notes and credit cards, the legal issues we are concerned with deal with payment problems: who owes what to whom? Consequently, the umbrella term "payment law" seems to me the best shorthand reference to our subject.

This book explores the law of payment primarily through focusing on a series of Problems designed to encourage the student to concentrate on the exact statutory language in the Uniform Commercial Code, the Electronic Fund Transfer Act, and the Expedited Funds Availability Act. While I have included illustrative cases to demonstrate the reactions of the courts to these issues, I have used only those I felt were very important; most UCC court decisions are too imposing, either factually or legally, to make good pedagogical tools.

Unfortunately, students reared on the case method sometimes have trouble concentrating on Problem after Problem. Such an attitude here can be academically fatal. As a guide to the degree of concentration required, I have used a hierarchy of signals. When the Problem states "Read §3-406," I mean "Put down this book, pick up the Uniform Commercial Code, and study §3-406 carefully." When the instruction is "See §3-406," the reader need look at the cited section only if unsure of the answer. "Cf. §3-406," or simply "§3-406," is a lesser reference included as a guide for the curious.

I have heard it said that law students cannot follow legal Problems having more than two characters. If true, payment law would be unteachable, as its issues almost always involve three or more parties. To help the reader keep them straight, I have given the characters in my Problems distinctive names and, I hope, have created interesting factual patterns, all designed to keep the mind alive.

I have edited the footnotes out of most cases; the ones that remain have been stripped of their original numbering and have been consecutively numbered with my own footnotes. Unless clearly indicated otherwise, all footnotes in the cases are the court's own. I have also taken the liberty to change most statutory citations in cases to their simple Uniform Commercial Code form.

I wish to acknowledge the debt I owe to the late Professor R. Bruce Townsend, formerly of the faculty of the Indiana University, Indianapolis Law School, one of the drafters of the Uniform Commercial Code and my mentor in my early days of teaching this subject. Professor John J. Slain, New York University School of law, also deserves my thanks for helping me organize my initial exploration of the world of investment securities. As always, I am indebted to the fine people at Aspen Publishers, who have taken good care of me through seven casebooks. Finally, my grateful thanks goes to my many students, who through the years have taught me as much about the law as I taught them.

Douglas J. Whaley

December 2007

Problems and Materials on Payment Law

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CHAPTER 1
NEGOTIABILITY

I. INTRODUCTION

There is not, of course, enough money to go around, and what money is available is frequently too physically awkward to be moved easily. Human civilization has been able to create additional sources of money in the form of transferable contractual debt. Thus, one can borrow money and give the lender a written promise to repay it (a promissory note) and in this way realize early expected future prosperity. We solved the problem of the awkwardness of the physical transfer of money, and the concomitant possibility of its theft while in transit, by putting the money in the hands of a guarded depository (typically a bank) and then issuing written orders (drafts) for the money's transfer to various people.

In time, complicated things began to happen to these pieces of paper. For one thing, they were transferred (negotiated) through many hands before being presented for payment. If payment was then refused for some reason (the goods proved defective, the maker was financially embarrassed, the bank failed to open its doors one morning), rules had to be invented to straighten out who owed what to whom and to establish which defenses would be good against the person demanding payment

and which would not. Similarly, if the instrument was stolen or forged, rules had to be established to put the risk of loss on somebody. Article 3 (Negotiable Instruments) and Article 4 (Bank Deposits and Collections) of the Uniform Commercial Code are designed to supply these rules.

Article 3 replaces its widely adopted predecessor, the Negotiable Instruments Law (hereinafter the NIL), and Article 4 replaces the not-so-widely adopted Bank Collection Code. Article 8 (Investment Securities), discussed in Chapter 8 of this book, deals with similar problems raised by the transfer of stocks and bonds. A more recent addition to the Uniform Commercial Code is Article 4A, which addresses legal issues arising from wire transfers of funds; it, along with similar issues arising under the Electronic Fund Transfer Act, a federal statute, is explored in Chapter 5.

Articles 3 and 4 of the Code were written in the 1950s and promulgated in their most widely adopted version in 1962. The rules contained in these Articles varied but little from ones codified in the NIL (first proposed in 1896). But nineteenth-century law serves poorly in a society now living in the twenty-first century, particularly for banking matters, where computers have replaced paper and have made compliance with many of the old rules impossible. In 1990 the American Law Institute and the National Conference of Commissioners on Uniform State Laws promulgated revised versions of Articles 3 and 4 for adoption by the states. These versions modernize the rules, replace archaic language in the original articles, and answer a host of questions raised by the case law and by commentators over 30 years of litigation.

Finally, in 2002 new changes to Articles 3 and 4 were also proposed, but these changes have so far not been widely adopted (as of this writing in 2007, only Arkansas, Kentucky, Minnesota, Nevada, and Texas have done so).

II. TYPES OF NEGOTIABLE INSTRUMENTS

There are many types of negotiable instruments in the world. *Money* itself is technically a negotiable instrument. A dollar *bill* is a *bill of exchange*— that is, a *draft* (defined below) drawn on the United States Treasury. The Code deals with investment securities (stocks and bonds) in Article 8, and with wire transfers in Article 4A, these matters being specifically excluded from the coverage of Article 3 by §3-102(a).

The types of negotiable instruments that Article 3 does cover can be divided into two basic categories: *notes* and *drafts*.