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The Irrelevance of Negotiable Instruments Concepts in the Law of the Check-Based Payment System*

James Steven Rogers**

I. Introduction

The evolution in recent years of alternatives to the check system, such as credit card systems and electronic funds transfer systems, has prompted considerable interest in the law of payment systems. In 1977 the Permanent Editorial Board for the Uniform Commercial Code responded to the many changes in technology and commercial practice by creating a committee to suggest revisions to Articles 3, 4, and 8 of the Uniform Commercial Code (U.C.C.).¹ The work of the so-called 3-4-8 Committee culminated in the draft of a proposed Uniform New Payments Code (U.N.P.C.)² covering all payment systems other than cash. The U.N.P.C., however, was not received favorably by many influential sectors of the bar³ and essentially has been abandoned.⁴ Instead, the Permanent Editorial Board now proposes to draft a separate article for wire transfers as well as various amendments to the existing Articles 3 and 4.⁵

The opposition to the unified approach of the U.N.P.C. stems in

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⁴ See A.L.I., 1985 ANNUAL REPORT 15 (1986) (commenting that a comprehensive payments code has no realistic chance for adoption in the foreseeable future).
part from an implicit assumption that, so far as the present check-based system is concerned, there is nothing wrong with Articles 3 and 4 of the U.C.C. Expressed in slightly different terms, the popular assumption is that present law is well adapted to the technology and practice of the check-based payment system, and that problems are created only by the development of new and different technologies. 6 This Article suggests that this assumption is unfounded; that the system of law in Articles 3 and 4 of the U.C.C. is generations behind the development of commercial practice; and that the basic conceptual structure of Articles 3 and 4 is fundamentally ill-suited even to the paper-based check system.

The core of much of the present law of the check system is the proposition that checks are negotiable instruments; that is, that the concepts of negotiable instruments law provide a sensible foundation on which to erect a system of law specifying the rights and duties of participants in check transactions. 7 What I shall refer to as the "negotiable instruments law approach" rests on three assumptions concerning the design of legal rules for the check-based payment system:

First—it is important to specify certain standardized liabilities incurred by the parties to checks, independent of their obligations arising out of the underlying transactions.

Second—it is important that these independent liabilities, along with the instructions given by the checks to the banking system for making payment, be "reified" in the pieces of paper used, so that checks may be regarded as items of property subject to property law concepts like transfer, title, and conversion.

6. See, e.g., Leary & Fry, supra note 3, at 284 (stating that Articles 3 and 4 of the UCC "primarily relate to what may be called paper-based modes; they may not comfortably cover new modes [of payment]"); Miller, Report on the New Payments Code, 41 Bus. LAW. 1007, 1007-08 (1986) (stating that the "belief that certain technological advances necessitated various amendments to Uniform Commercial Code articles 3 and 4").

7. The Epstein and Martin casebook, for example, argues that without the protections of holder in due course status

not too many people would be interested in taking a check, note, or whatever. That is the traditional justification both for negotiability and for the holder in due course doctrine—oiling the wheels of commerce. Checks have to be negotiable if they are going to be able to pass from hand to hand (if only from the hand of one bank to another) to get back to the bank on which they are drawn.

D. Epstein & J. Martin, Basic Uniform Commercial Code Teaching Materials 408-09 (2d ed. 1983); see also H. Bailey, Brady on Bank Checks § 2.15, at 2-26 to -28 (5th ed. 1979) ("The basic reason for the desirability of negotiable commercial paper is that any person who acquires it as a holder in due course . . . [is not] affected by any defense which may exist between the parties to the contract who caused the paper to be issued."); I W. Hawkland, A Transactional Guide to the Uniform Commercial Code § 2.0301, at 455 (1964) ("The widespread use of negotiable instruments is not accidental. Banks and merchants will take a check under circumstances in which they would refuse to accept a simple contract containing a promise to pay money. . . . The acceptability of negotiable instruments is due to the extraordinary concept of negotiability.").

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Third—it is important to apply to checks the rule of transfer that permits a transferee to become a holder in due course, taking free of most claims and defenses.

Briefly stated, the thesis of this Article is that these assumptions are false; for that reason negotiable instruments law concepts are at best irrelevant, and often misleading, in understanding the law of the check system.

II. Checks as Instruments of Bank Credit Transfer

In assessing the soundness of the view that checks should be regarded as negotiable instruments, it is important initially to clarify the role of checks in the monetary system. Aside from electronic funds transfers, the bulk of the payments in the modern economy are made by checks and the bulk of the money supply consists of bank deposits subject to transfer by check.8 Currency forms only a small part of the monetary system.9 In a sense, therefore, checks are a substitute for currency, just as in earlier times bank notes and notes issued by nonfinancial entities were substitutes for specie. To those interested in “macro” matters of monetary policy and economic history, this is an important truth. To those interested in the “micro” matter of the law governing the rights and obligations of participants in the payment systems, however, the similarity of economic function between checks and other specie substitutes can be misleading.

Consider first the sort of legal categories and concepts appropriate to the relatively simple monetary system in which specie is the only form of money. One may puzzle at great length over the complex social phenomenon of the use of precious metals as money;10 for purposes of legal analysis, though, most of that interesting line of inquiry is not significant.11 The important characteristic of a specie-based monetary system is that money is completely reified. A gold or silver coin that the sovereign has minted and declared to be current coin of the realm is money—

8. Federal Reserve Board figures for December 1986 show that bank deposits subject to transfer by check accounted for 74% of M1, the basic measure of money stock. See 73 FED. RES. BULL. A13 (Mar. 1987).
10. For an overview of the economists’ efforts, see J. GALBRAITH, MONEY: WHENCE IT CAME, WHERE IT WENT (1975).
11. Important and difficult legal questions can arise, even in a simple specie-based system, concerning the meaning of monetarily denominated obligations and the effect on such obligations of major changes in the value of money. See generally F. MANN, THE LEGAL ASPECT OF MONEY (4th ed. 1982). These matters, however, are beyond the scope of payment system law embodied in Articles 3 and 4 of the U.C.C.
it does not represent money or substitute for money; it is money. Accordingly, fairly simplistic property notions will suffice as the basis of payment system law. For example, deciding what counts as payment in such a system requires merely specifying the appropriate rules for the transfer of ownership of coins. Moreover, the set of property transfer rules that evolved in the specie-based system are simple: possession here is ten-tenths of the law.\textsuperscript{12}

Relatively little modification of basic legal concepts is required to pass from a specie-based system to a bank note system, that is, a monetary system in which payments are made by transferring not specie itself but paper bank notes that are not themselves legal tender but embody the promise of a bank to pay in specie. The essence of a bank note system is that bank credit is used as a substitute for specie as a medium of exchange. The use of promises to pay money as substitutes for money is, to be sure, an innovation of major economic significance, and a sophisticated legal structure is required to control the dangers inherent in the use of bank credit as money.\textsuperscript{13} Nonetheless, the use of credit as money in the bank note system requires little modification of the basic legal concepts of payment systems law.

Just as in a specie system the individual items of minted precious metal are complete reifications of money, so too in a bank note system the individual paper bank notes are complete reifications of the money substitute, bank credit. Accordingly, the same set of property and property transfer concepts used in analyzing payment transactions between participants in the specie system can be employed in the bank note system. As in the specie system, the ownership of money can be viewed as a relationship between a person and a thing; the only difference is that the thing, a bank note, is of symbolic rather than inherent value. Nonetheless, so long as the symbol serves as a complete reification of the bank's promise to pay money, basic property and property transfer concepts remain useful; only the object of the concepts changes. Establishing a legal framework for the bank note monetary system is only a matter of apply-

\textsuperscript{12} Well, maybe 99 and 44/100ths. Ill-gotten coin can be recovered by its true owner from the immediate scalawag, but once it is transferred to another party who lacks notice of the evil, the new possessor acquires the full rights of ownership. Ironically, it is difficult to locate authority for this proposition in the pure specie-based payment system setting, for even the cases that do involve coin tend to rely on Miller v. Race, 1 Burr. 452, 97 Eng. Rep. 398 (K.B. 1758), for the proposition that a bona fide taker of coin from a thief gets good title. \textit{E.g.}, Chapman v. Cole, 78 Mass. (12 Gray) 141, 143 (1858); Brown v. Perera, 176 N.Y.S. 215, 220 (App. Div. 1918).

\textsuperscript{13} An overview of the American effort to devise satisfactory legal controls over the use of bank credit as money can be found in any of the standard works on banking history. \textit{E.g.}, B. \textsc{Hammond}, \textsc{Banks and Politics in America from the Revolution to the Civil War} 188-96 (1957); F. \textsc{Redlich}, \textsc{The Molding of American Banking} (2d ed. 1968).
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ing the property transfer rules used in a specie system to the pieces of paper representing banks' promises to pay money. Thus, in the Anglo-American legal system, the significant steps were the recognition of the free transferability of debts embodied in written promises to pay;\textsuperscript{14} and second, the application to those writings of the rule that good title to currency can be derived even from a thief.\textsuperscript{15}

The transition from a payment system based on bank notes to a payment system based on deposit accounts subject to transfer by check is, in an odd sense, both a simple and a complex matter. To modern students of economics and banking, nothing seems simpler than the notion that bank deposits are every bit as much a money substitute as bank notes.\textsuperscript{16} Even the narrowest measure of money stock, for example, includes commercial bank demand deposits as well as currency.\textsuperscript{17} Students of banking and economic history, however, know what a long struggle this modern recognition represents. Scholars of the history of American banking theory and policy have been struck by the obsession of eighteenth- and nineteenth-century thinkers and politicians with bank note issue, and their failure to recognize that bank deposits play essentially the same economic role.\textsuperscript{18} Given this background, I can anticipate roars of protest—or, more likely, laughter—at the suggestion that there is an important difference between a monetary system based on bank note issue and a monetary system based on demand deposits subject to checks. Nonetheless, the difference, although of little or no concern from the perspective of monetary theory and policy, is of major concern for payment systems law.

In both a bank note system and a check system, payments are made by the transfer of bank credit from one person to another. The two systems, however, differ significantly in the role played by the pieces of paper. In the bank note system, the bank notes themselves are reifications of bank credit. The holder of a bank note is, by virtue of holding that note, the creditor of the issuing bank. When payment is made by transferring a bank note from one person to another, the act of transferring possession of the bank note effects the transfer of the bank credit. For

\textsuperscript{14} See, e.g., Promissory Note Act, 1704, 3 & 4 Anne, ch. 8 (making promissory notes generally assignable); Bank of England Act, 1694, 5 & 6 W. & M., ch. 20, § 8 (declaring that Bank of England bills are assignable).


\textsuperscript{16} See, e.g., P. SAMUELSON, ECONOMICS 274-93 (11th ed. 1980) (stressing the primary importance of bank deposits to the money supply).


\textsuperscript{18} E.g., B. HAMMOND, supra note 13, at 137-42, 188-91, 688-95; F. REDLICH, supra note 13, at 12-13, 91; 2 id. at 1-8, 60, 207-08.
that reason, a system of legal rules governing such a payment system can be erected appropriately on a foundation of ordinary property concepts. In such a system, it is entirely sensible to discuss questions of good title, transfer, and conversion, because the note, which represents the bank credit, is a reification of money.

In the check system, however, the check is not a reification, embodiment, or representation of bank credit. In the usual case of an uncertified check, the drawee bank never incurs any contractual liability on the instrument. Although the drawer of the check incurs secondary liability under section 3-413(2), the bank on which the check is drawn has no contractual obligation to the payee or any other holder of the check. The transfer of bank credit through check payment occurs not as the instrument passes from person to person but when the instrument ultimately is presented to and paid by the drawee bank. In short, a check is simply an instruction directing the transfer of bank credit, not a medium for the transfer of bank credit.

To illustrate the difference between checks and bank notes in bank credit monetary systems, it is instructive to trace the steps taken by a check in a typical payment transaction and the relationship between the check and the transfer of bank credit. For convenience, consider a typical sales transaction in which the person making the payment is the buyer and the person receiving the payment is the seller. At the outset, assume that the buyer has opened a checking account with the drawee bank. Because of his deposit of funds, the buyer is the beneficiary of a certain amount of bank credit. The drawee bank gives the buyer a supply of blank checks that he can use to instruct the drawee bank to transfer the deposit credit to others.

The buyer can initiate the process of payment by drawing a check for the appropriate amount to the order of the seller and delivering the
check to him. Although this transaction might have significant legal consequences, it does not transfer bank credit from the buyer (the drawer) to the seller (the payee). Indeed, Article 3 makes this quite explicit: "A check or other draft does not of itself operate as an assignment of any funds in the hands of the drawee available for its payment, and the drawee is not liable on the instrument until he accepts it."^23

Although issuance of a check does not itself effect a transfer of bank credit, a check does authorize the drawee bank to transfer credit from the drawer to the payee. It is possible, therefore, to characterize this initial step in the transaction as a transfer from the drawer to the payee of a thing of value: authorization to receive bank credit. Such a characterization, however, is wholly inapt. At the moment the payee receives the check, he cannot know whether the authorization it represents has any value. The check might be drawn on insufficient funds or on a nonexistent account. In addition, the authorization is revocable by means of a stop payment order. 24

Thus, in the initial step of issuance of the check by the drawer to the payee, there is no occasion to analyze the transaction in the language of property transfer. The transfer of the money substitute—bank credit—has not yet happened. Thus it is hardly appropriate to describe the delivery of the check by the drawer to the payee as a transfer of a writing that represents bank credit. The check, in a sense, represents the credit of the drawer, but bank credit and not the drawer's credit is the money substitute in this system. Although it is possible to describe the check as an item of property, checks are so bereft of genuine value that it is only misleading to analyze the transaction in these terms.

Beyond the initial step of issuance of the check, the simplest scenario for completing the payment transaction is for the payee to deposit the check in an account maintained at the same bank on which the check was drawn. The payor bank will verify the authenticity of the check and the state of the drawer's account; if all is in order, the bank immediately will debit the drawer's account and credit the payee's account. The transfer of bank credit is effected by accounting entries on the books of the bank. Although the check is used in this transaction to instruct the bank to make this transfer, the check itself is not the mecha-

23. U.C.C. § 3-409(1) (1978). By issuing the check to the payee, the drawer does incur liability "on the instrument," id. § 3-413(2); this liability, however, has little significance other than as an acknowledgment of the underlying obligation of the buyer to the seller, see infra subpart III(A).

24. Indeed, commercial law other than that of Article 3 accurately reflects mercantile custom in not viewing a check as an item of value, but as a simple authorization of payment. Thus, in the sales law setting, "payment by check is conditional and is defeated as between the parties by dishonor of the check on due presentment." U.C.C. § 2-511(3) (1978).
nism that effects the transfer. Indeed, the check is not very significant. The drawer could use a variety of forms of communication to initiate the transfer of bank credit. For example, the transfer banks of medieval Europe provided a mechanism for payment by book transfer of bank credit but the transfers were initiated by oral instructions given to the banker in the presence of the party receiving the transfer.25

In most cases, of course, the check's path is more complicated, involving several entities within the banking system and several coordinated transfers of bank credit. The check's role, however, remains the same no matter how convoluted the path. Assume, for example, that the payee deposits the check for collection in an account maintained at a bank other than the one on which the check is drawn. Obviously, at a physical level, something has passed from the payee to the depositary bank, yet that alone would hardly warrant characterization of the transaction in the language of property transfers. If any occasion exists for the use of the language of property transfers, it must be in the context of the effect of the transaction on the parties' claims to bank credit.26 The deposit of the check for collection, however, has no more effect in transferring bank credit than did the issuance of the check from the drawer to the payee. The indorsement and delivery of the check from the payee to the depositary bank does authorize the drawee bank to transfer credit to the depositary bank for the benefit of the payee, but the authorization to receive credit is different from the right to receive credit. Indeed, the most basic rule on check collections in Article 4 is that the mere deposit of a check does not effect a final transfer of the authorization to receive payment: "Unless a contrary intent clearly appears and prior to the time that a settlement given by a collecting bank for an item is or becomes final . . . the bank is an agent or sub-agent of the owner of the item and any settlement given for the item is provisional."27 Although this basic rule of check collection is expressed in property language, that characterization is by no means essential. Indeed, the rule is designed precisely to ensure that the rights of collecting banks will not be prejudiced by those aspects of the system that suggest or permit a property-transfer characterization.28

26. Under the negotiable instruments law approach to check collections, the transfer of the paper check from the payee to the depositary bank may effect the transfer of the drawer's liability to the depositary bank; however, as discussed below, this feature is at best troublesome. See infra subpart III(C).
28. In pre-Code law, questions of the liability of collecting banks often turned on whether the
The collection of a check, of course, ultimately affects claims to bank credit. The structure of the collection process, however, makes it wholly misleading to regard the check as an embodiment of claims to bank credit. Although it would be possible to design a check collection system in which no notations of credit for the check were made until the check reached the payor bank and the decision to pay was made, such a system would be terribly cumbersome. Rather, because nearly all checks in fact are paid, it is simpler for each collecting bank in the chain to give provisional credit for the amount of the check to its predecessor in the chain as the check moves toward the payor bank. Then, in the unlikely event that the payor bank dishonors the check, the credits can be reversed. This practice, of course, is characteristic of the American check collection system, and is reflected in the rules of Article 4 concerning the entry of provisional settlements as checks are forwarded for collection, the “firming up” of provisional credits if the check ultimately is paid by the payor bank, and the revocation of such credits, or other form of charge-back, if the check ultimately is not paid.

At each step in the process of check collection, a transfer of bank credit is made, provisional at the outset but ordinarily ripening without further action into final settlement. The “transfer” of the check itself, however, must not be confused with the transfer of bank credit initiated by the check. In fact, in the present check collection system, the flow of bank credit is opposite to the flow of checks; if, for example, bank A transfers a check to bank B, then bank B must grant bank A provisional credit. The important point, though, is not that checks and bank credit


collecting bank was an agent of the depositor or, alternatively, a purchaser of the item deposited for collection. See, e.g., 5 W. HAWKLAND, F. LEARY & R. ALDERMAN, UNIFORM COMMERCIAL CODE SERIES 4-201:01 (1984) (noting that, before the enactment of the U.C.C., “it would often be necessary to determine whether the depositor of a check or the bank had title to the item . . . [and] much time was spent, and effort expended, in determining whether the bank was a purchaser of the item or merely an agent for collection”). Article 4 purports to diminish or eliminate the significance of these title questions, see U.C.C. § 4-201 official comment 1 (1978), but the drafters continue to use property language throughout. Indeed, property language apparently was so magnetic that the drafters invented a new property-based concept: the collecting bank’s security interest in deposited items. See id. §§ 4-208, 4-209 (1978). The Article 4 “security interest” concept, however, has nothing in common with Article 9 secured financing transactions. Indeed, the function of § 4-208(3) is to ensure that calling the collecting bank’s interest in the check a “security interest” will not have the effect of triggering any of the usual Article 9 rules. Rather, the point seems to have been to find some property law location short of purchaser that would preserve to collecting banks whatever advantages might flow from maintaining that they have some interest in the item beyond mere custody as agent for the depositor.

29. U.C.C. §§ 4-201, 4-301 (1978).
30. Id. § 4-213.
31. Id. §§ 4-212, 4-301.
32. In the jargon of payment systems law, the check system is a “debit transfer” system rather than a “credit transfer” system. See generally N. PENNEY & D. BAKER, THE LAW OF ELECTRONIC
move in opposite directions—that feature is particular to the present check system. Rather, the important point—which is quite general to modern payment systems—is the conceptual distinction between the transfer of checks and the transfer of bank credit that the checks initiate.

In a bank note system, each step in the transfer of a note effects, without more, a transfer of bank credit from the issuing bank to the holder of the instrument. Accordingly, it is entirely understandable that the law described the problems presented by the bank note system within a conceptual structure that regarded the note itself as an embodiment of bank credit and hence an appropriate object for analysis in terms of property law concepts. In the modern check collection system, however, that conceptual structure is inapt. Although checks initiate and direct the transfer of bank credit in the payment system, they never represent or embody bank credit.

In summary, the notion that checks are negotiable instruments, in the sense that checks are transferable embodiments of credit, cannot be explained by the role of checks in effecting transfers of bank credit. It is true that, from the perspective of monetary theory, there is no significant difference between a payment system based on the transfer of bank credit via bank notes and a payment system based on the transfer of bank credit via deposits subject to check. Nevertheless, from the perspective of the law governing the rights and duties of participants in the system, the difference is considerable. Indeed, the continued application of negotiable instruments concepts to the law of checks may well rest on nothing more than a failure to recognize this difference.

The discussion of negotiable instruments law in the casebooks and treatises generally does recognize, at least in passing, that negotiable instruments law evolved in response to the use of debt instruments, like bank notes, as currency substitutes. Ordinarily, however, the discussion in these books then immediately jumps to the modern use of checks as a payment system, thus implying, if not stating explicitly, that checks in the modern payment system are indistinguishable from notes in the bank note payment system of earlier times. That simply is not the case. The
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bank notes and other circulating private debt instruments of the era of *Miller v. Race* actually were embodiments of the credit being transferred, and hence appropriate objects of a property-based system of legal rules. By contrast, the checks of the modern monetary system are only pieces of paper that instruct the banking system concerning the transfer of bank credit.

III. The Liability of Parties "On the Instrument"

Even if the negotiable instruments view of checks cannot be justified on the basis of the role of checks in transferring bank credit, that view might be justified on the basis that checks are transferable embodiments of the underlying liabilities of the participants in a check transaction. The examination of the role of these liabilities in the check system can be divided into three parts: (1) the role of drawers' liability in the legal relationship between the drawer and the payee; (2) the role of indorsers' liability in the check collection process; and (3) the role of drawers' liability in the check collection process.

See also A. Schwartz & R. Scott, Commercial Transactions: Principles and Policies 872 (1982) ("Checks symbolize the function of negotiable instruments as a substitute for cash and other methods of paying obligations."); B. Stone, Uniform Commercial Code in a Nutshell 162 (1975) ("Commercial paper may be used as a cash substitute. A check is thus used as a medium of payment, e.g., to transmit funds safely from A to B.").

This confusion about the role of negotiability in the use of checks as a payment system is not limited to the lawyers. Professor Usher, an important modern scholar of the early history of banking, seems to assume that the operation of interbank clearances in the check collection system is not possible absent the classification of checks as negotiable instruments. See A. Usher, supra note 25, at 186-88.


36. The only modern setting in which checks are used in a fashion akin to the bank notes of earlier times involves items on which a bank incurs primary liability, such as cashier's checks, bank checks, and certified checks. In at least some common uses of such instruments, the check initially is made payable to the person who buys it from the bank. The check then is indorsed to make payment to another. In these cases, the transfer of the instrument outside the banking system effects a transfer of claims to bank credit. Because these instruments are used in a way that parallels the payment system of the era in which negotiable instruments law evolved, this is the sole setting in which the results produced by the application of negotiable instruments law are apt. For example, one who sells goods to another and accepts in payment an indorsed bank check that initially was drawn to the order of the buyer ordinarily should not be subject to the risk that the bank later will assert a defense, such as that the buyer fraudulently induced the bank to issue the check. The possibility that some transactions may require rules akin to those of negotiable instruments law, however, cannot justify continued application of the negotiable instruments rules to the more common uses of checks. Rather, a special set of rules for these bank instruments is needed.

37. It might be suggested that the point of regarding checks as negotiable instruments is that
A. The Liability of the Drawer to the Payee

The rules of Article 3 concerning the liabilities of parties to negotiable instruments reflect the assumption that it is important to create a system of independent liabilities based solely upon the issuance of the instruments. Thus, section 3-413(2) provides that the drawer of a check "engages that upon dishonor . . . he will pay the amount of the draft to the holder . . . ." Section 3-414 similarly provides that "every indorser engages that upon dishonor . . . he will pay the instrument . . . to the holder . . . ." These matters are familiar and apparently simple; nevertheless, it is worth reflecting on the nature and function of these liabilities.

Checks, of course, are commonly used to effect the payment of obligations that arise under other bodies of substantive law, like the obligation of the buyer to pay the purchase price in a sales transaction. The obligations incurred by parties to checks, however, are of a different nature than those that arise under the law of sales or other bodies of law. The obligation of the buyer to pay the purchase price of accepted goods is triggered by real world events like the delivery of goods. The liability of the drawer of a check, however, is triggered not by a genuine economic transaction like the receipt of a bargained-for thing of value, but by the physical act of placing certain symbols on a piece of paper. The very different facts that must be established to recover judgment in actions to enforce these two sorts of liabilities make the distinction clear.

In an action to enforce a buyer's obligation for the price, the seller must prove the facts concerning the transaction that gave rise to the obligation. For example, the seller must establish an overt action manifesting an agreement for the exchange of goods for a price and the actual delivery of conforming goods to the buyer. By contrast, to establish the prima facie liability of the drawer, the payee need only show that the drawer signed the check and that it was not paid by the drawee. The underlying concepts, however, may be passed from person to person by indorsement, outside the banking system. There is, however, an air of considerable unreality about this suggestion. Indeed, the law school classroom is probably the only place that one is likely to encounter a transaction in which a check payable to one person is indorsed over to another in satisfaction of an unrelated debt. In the typical case, a check simply is deposited for collection by the original payee. Occasionally checks are indorsed in order to avoid having the original payee deposit the check for collection and then draw a new check to the intended recipient. These transactions, however, can be regarded as mere amendments to the payment instruction represented by the check as originally drawn. The objective of this Article is to demonstrate that negotiable instruments concepts are neither essential nor useful in the design of general rules for checks as instructions to the banking system for the transfer of funds. If that argument is successful, it readily follows that no different set of concepts is required to take account of the possibility that the person originally designated as the funds transfer recipient will wish to amend the instruction to designate a different recipient.

In the analysis of the relationship between the immediate parties to a transaction in which payment is effected by a check, the function of the independent liability of the drawer "on the instrument," as distinguished from the underlying obligation under the law of sales, is essentially evidentiary and formal. Under section 3-802(1)(b), the acceptance by the payee of an ordinary check suspends but does not discharge the drawer's underlying obligation.39 On dishonor of the check by the drawee, the payee can bring an action on either the instrument or the underlying obligation.40

The advantage of the action on the instrument over the action on the underlying obligation is a matter of procedure. Under section 3-307(2), the payee can establish a prima facie case for recovery simply by producing the instrument and establishing the authenticity of the signature.41 Moreover, any dispute about the authenticity of the drawer's signature must be raised by the pleadings42 and the party contesting the effectiveness of a signature must introduce evidence rebutting its presumed authenticity.43 Once the signature is established, whether by actual proof or presumption, the payee is entitled to recover unless the drawer establishes a defense.44

The advantages of the action on the instrument, however, go no further than the matter of the allocation of the initial burden of proof. There is nothing magical about the liability of the drawer of a check that affects the range of substantive defenses that the drawer can raise.45 The defenses of failure of consideration, breach of implied or express warrant-

39. "Unless otherwise agreed where an instrument is taken for an underlying obligation . . . the obligation is suspended pro tanto until the instrument is due or if it is payable on demand until its presentment." Id. § 3-802(1).
40. Id.
41. "When signatures are admitted or established, production of the instrument entitles a holder to recover on it unless the defendant establishes a defense." Id. § 3-307(2).
42. Id. § 3-307(2) & official comment 1.
43. Id. § 3-307(1)(b). Under the rules of interpretation set out in §§ 1-201(8) and 1-201(31), the precise effect of the presumption of authenticity of the signature is that the party denying the authenticity of the signature bears the burden of production on that issue, although the party claiming under the signature bears the burden of persuasion.
44. Id. § 3-307(2).
45. The mystique of negotiable instruments law, however, is sufficiently strong that even financially sophisticated people such as law students tend to approach the formalities of negotiable instruments law with all the timorousness of faithful pagans handling the temple idols. I have great fun in class playing on these notions by writing out, signing, and passing about notes payable to bearer in the amount of $1,000,000. The students never seem to be wholly persuaded by my suggestion that, if anyone were foolish enough to sue me on such instruments, the explanation that it was simply a bit of professorial histrionics would supply a complete defense. Accordingly, deferring to the students' assumptions about proper sacramental etiquette, I usually collect and destroy the magic writings at the end of the class. The students always seem relieved—or disappointed.
ties, prior satisfaction, as well as others are available to the drawer in an action on the instrument just as they are in an action by the seller to recover on the underlying obligation.46

There is, of course, nothing odd about the development of formal devices to signify the attachment of legal obligations, both to simplify the proof of legal obligations and to emphasize for the parties the significance of their actions.47 Handshakes, delivery of clods of earth, written contracts, and seals all serve a function as familiar as it is useful. On the other hand, there is no necessary connection between the formal devices used to seal bargains or simplify the proof of obligations, and the devices used to initiate transfers of funds in payment of obligations. It would be entirely possible to construct a payment system much like the present check system in which the written instrument authorizing payment did not serve also as a memorial or embodiment of the underlying payment obligation. Checks could operate purely as payment instructions that, if not honored would play no role in the payee's legal recourse for recovery of the unobtained payment. The evidentiary function of the rules on the drawer's liability on the instrument could be performed by some other writing or device. For example, one might have a rule of sales law providing that, if a seller has the buyer sign a copy of a bill of sale or delivery receipt, the seller is prima facie entitled to recover the sales price.

Indeed, we already make extensive use of payment systems in which the writings used to initiate the funds transfers do not embody any independent obligations. For example, one who obtains goods with a bank credit card presumably remains liable to the merchant under sales law for the price of the goods in the event that the merchant does not obtain payment from the cardholder's bank.48 At one time, the providers of

46. Section 3-302(2) provides that the payee of an instrument may be a holder in due course of the instrument; this provision, however, is irrelevant in the simple action under consideration here by the payee against the drawer. The drawer, by hypothesis, is a party "with whom the holder [payee] has dealt," and, therefore, a party who may assert any defenses under § 3-305(2).

47. Cf. Fuller, Consideration and Form, 41 COLUM. L. REV. 799, 800-01 (1941) (explaining that formal legal devices serve evidentiary, cautionary, and channeling functions).

48. There seems to be no case law on this matter. It would be odd to suppose that a merchant who delivers goods to a credit card buyer thereby forfeits the right to payment for the goods in the event that payment is not received from the credit card issuer. The specification of the terms of the obligation, however, raises difficulties because the credit card buyer agrees to pay only on the deferred payment terms provided in the credit card agreement. The absence of case law might be attributable to the difficulty of imagining circumstances that would result in nonpayment of the credit card slips by the credit card issuer without also triggering some other plausible basis for cardholder liability. Thus, in cases in which the merchant's failure to receive payment is attributable to a failure to detect fraudulent or otherwise improper card use, the merchant probably would have an action against the buyer for illegitimately obtaining property. Nonetheless, it seems entirely sensible to say that the buyer's liability in such a case rests on sales law and that the effect of the improper credit card use is simply to deprive the buyer of any defense that he had not agreed to pay the sum on demand. The litmus test of the independence of the sales law obligation from the mecha-
Negotiability Concepts and the Check System

credit card systems believed that credit card slips should resemble drafts. 49 Today, however, the legends on credit card slips generally state only that the cardholder authorizes the issuing bank to pay the amount shown on the slip to the merchant and that the cardholder agrees to pay that amount to the issuing bank in accordance with the agreement between the cardholder and the issuing bank. Thus, the slip plays no role in the legal relationship between the selling merchant and the buying customer. 50

I do not, of course, mean to suggest that it is inappropriate to couple the evidentiary function with the primary function of checks as payment instructions. It is certainly convenient, as well as consonant with common expectations, to regard issuance of a check as acknowledgment of a prima facie liability in the underlying transaction. It is, however, quite important to realize that the concept of drawer’s liability on the instrument serves only this incidental function and is in no sense essential to the law of checks as a payment system.

B. Liability of Indorser

The drawer is not the only party to incur contractual liability on the instrument under the rules of Article 3. Aside from uncommon cases in which the payee presents the check directly to the payor bank for payment over the counter, the payee will deposit the check at another bank for collection. The depositary bank will require the payee to indorse the check, 51 and that indorsement will trigger certain liabilities under Article 3. Specifically, section 3-414 provides “that upon dishonor and any necessary notice of dishonor and protest [the payee] will pay the instrument according to its tenor at the time of his indorsement to the holder or to any subsequent indorser who takes it up.” Nonetheless, examination of the legal relations of the participants in the check collection system reveals that the role of this indorsement liability is limited.

The central legal problem of the check collection process derives from two of its key aspects: first, the process is not instantaneous; and


50. See id. (discussing the nature of the relationships in credit card systems).

51. In the case of deposit of a check for collection by a bank, the depositary bank is authorized to supply the depositor’s indorsement if it is omitted. U.C.C. \$ 4-205 (1978).
second, the funds transfer instruction and the funds move in opposite directions. These two characteristics make it impractical for final settlements in the chain of stepwise transfers of bank credit to be effected simultaneously with the physical transmission of the check. Aside from the unrealistic solution of having each collecting bank in the chain give final and irrevocable credit for the amount of the check despite the possibility that the check will not be paid by the payor bank, two solutions to the problem are available. First, the collecting banks might transmit the check toward the payor bank without making any account entries. Instead, the collecting banks would keep track of the chain of account entries to be made on receipt of positive notice of payment of the check by the payor bank. Although this mechanism is, in a sense, how certain so-called noncash items are handled, it would be a horribly inefficient if not an utterly impractical means of processing the enormous volume of bank credit transfers effected daily through the check collection system. Accordingly, the banking system has developed a second solution based on provisional settlements. In the present system, the account entries that ultimately will settle a funds transfer are made simultaneously with the transmission of the check, and hence in advance of the actual determination by the payor bank to pay the check. Because most checks in fact are paid, nothing more needs to be done in the usual case. When the check is not paid by the payor bank, however, all the previously made account entries must be reversed.

The legal characterization of the provisional settlement system of check collection could take a variety of forms. Characterizing the checks as negotiable instruments and the steps in the transmission of the check as negotiations effected by indorsements could provide a legal framework for the reversal of provisional transfers when checks ultimately are not paid. The depositary bank's right to undo the accounting credit it made to the payee's account on deposit could be described as a realization of the right of the depositary bank, qua holder of the check, to collect on the payee-depositor's indorsement. Similarly, the right of each bank in the chain of collecting banks to undo the accounting credit given to the prior collecting bank could be based on the prior bank's indorsement of the check upon transfer.

In fact, however, the legal framework of the check collection system does not rest on the liability of indorsers "on the instrument." Rather, the right of each collecting bank to undo the provisional settlements

52. See Federal Reserve Bank of Atlanta, Operating Circular No. 15, Collection of Noncash Items (1979), reprinted in B. Clark, supra note 49, app. at 177-95; Leary & Tarlow, Reflections on Articles 3 and 4 for a Review Committee, 48 Temp. L.Q. 919, 934-35 (1975).
given in the check collection process derives from a far simpler and more direct basis: the charge-back concept of section 4-212.

If a collecting bank has made provisional settlement with its customer for an item and itself fails by reason of dishonor, suspension of payments by a bank or otherwise to receive a settlement for the item which is or becomes final, the bank may revoke the settlement given by it, charge back the amount of any credit given for the item to its customer's account or obtain refund from its customer.

The Article 4 charge-back right makes it difficult to see any need for the Article 3 indorsement liability insofar as the process of bank collection of checks is concerned. Because the Article 4 charge-back right closely parallels the Article 3 indorsement liability, one could argue that the charge-back right rather than the indorsement liability is superfluous. A sound basis exists, however, for regarding the negotiable instruments approach as the superfluous. In short, the Article 4 charge-back right correctly focuses on the real matter of interest—the payment. By contrast, the indorsement approach addresses the problem precisely backwards. Rather than directly providing for the reversal of provisional credits, the negotiable instruments approach derives the reversal of credits from a legal theory based on the instrument used to initiate the funds transfer.

It is hard to see the reason for establishing a system that creates liabilities to be reified into pieces of paper and then bases the right to reverse provisional settlements on a set of rules tied to the pieces of paper. Instead, the rules should be based directly on the obligations of the participants in the funds transfer, without regard to the form of the mechanism used to give the instruction. Occam's razor, then, provides sufficient grounds for dispensing with the concept of indorsement liabilities.

53. U.C.C. § 4-212 (1978). Similarly, the deferred posting provision of § 4-301 allows the payor bank to give provisional settlement for an item when it is presented and then revoke that settlement if, within the appropriate time, it decides not to pay the item.

54. Perhaps circumstances exist in which a collecting bank may for one reason or another be precluded from exercising the right of charge-back, by undue delay or the like, and yet still retain the right to proceed against prior parties on their indorsement liability. It is, however, difficult to imagine how this might happen given that the procedural requirements for enforcing the charge-back right generally parallel the procedural requirements for enforcing indorsement liability under Article 3. Compare id. § 4-212 (right of charge-back until final payment occurs) with id. § 3-414 (upon necessary notice and protest of dishonor, an indorser engages to pay the instrument) and id. § 3-501(2)(a) (unless excused, notice of dishonor is necessary to charge any indorser) and id. § 3-508(2) (timing of notice of dishonor). In any event, if there are any situations in which these two sets of rights are not congruent, that fact hardly should be a reason for insisting on the importance of maintaining the concept of indorsement liabilities. Rather, any incongruities that may exist can only demonstrate the undesirability of maintaining the parallel system: if there is some good reason to cut off a particular bank's charge-back right in some circumstance, the bank hardly should be allowed to make an end-run around that decision by invoking indorsement liability.
ties in the check collection system.55

C. Liability of the Drawer to Collecting Banks

Thus far, the concept of liabilities "on the instrument" has been considered in the context of the relationship between the drawer and the payee, and in the context of the relationship between the payee and the depositary bank. One area remains to be considered in this assessment of the utility of the negotiable instruments conception of checks: the function of drawers' liability in actions by collecting banks against drawers.

The issue of the drawer's liability to a "transferee" of the check arises most often as follows: The drawer issues a check to the payee, and the payee deposits the check for collection at the depositary bank. The check is forwarded for collection but is returned to the depositary bank.

55. Although the overwhelming majority of checks unquestionably are deposited for collection in a bank by the payee, payees occasionally cash checks at nonbank check cashing entities such as grocery stores and "check cashing agencies." Customarily, these agencies are willing to cash checks only when the risk of nonpayment is relatively low, as is the case, for example, with payroll checks and government checks.

Indeed, a large part of the business of nonbank check cashing entities consists of transactions in which the customer appears as drawer rather than indorser of the check, as when grocery stores cash checks drawn by their customers payable "to the order of cash." In that setting, indorsement liability is irrelevant and the liability of the customer "on the instrument" as drawer merely serves the function of acknowledgement of the customer's liability in the underlying transaction to reimburse the check cashing agency if the check is not paid.

To the extent that nonbank check cashing entities might need to recover payments made to payees on checks that are dishonored, there is no good reason to treat them in a fashion different from collecting banks. A check cashing entity that cashes a check for a customer named as the payee of a check faces the same problem as collecting banks: the check cashing entity generally is not able to tell at the time of receipt of the check whether it will be paid. In the nature of the business, however, the check cashing entity does not have available to it the solution developed by collecting banks of making only a provisional credit for the amount of the check and deferring availability until a sufficient time has passed for it to learn of nonpayment. The point of such a check cashing entity's business is to hand over cash. Although the check cashing entity's practical problem, therefore, is more acute than that of the depositary bank, the problem, and hence the appropriate conceptual framework for its resolution, is essentially the same as in the setting of direct bank deposit for collection. What the check cashing entity needs is the right to recover the payment made to the customer in the event that the check is not paid. The most apt way of conceptualizing this right, as in the case of direct bank collections, is by directing attention to the payment and its recovery rather than to the check.

To illustrate the point, suppose that a check cashing agency cashes a check for a customer on which the customer is the payee, but the customer neglects to indorse it and the check cashing agency does not notice the omission. If the check is unpaid, either because of the missing indorsement or another reason, does the check cashing agency have the legal right to recover the amount from the customer? A negative answer would be utterly outrageous; yet there is surely no basis for saying that the customer's liability to the check cashing agency is based on indorsement liability under negotiable instruments law. Rather, the customer's liability to reimburse the check cashing agency should rest on the same principles as collecting banks' liability in the setting of bank collections: the check cashing agency has paid money to the customer on the basis of the assumption that the check would be paid. If that assumption turns out to be wrong, the check cashing agency ought to get restitution. The right to restitution is not in the least dependent on the negotiable instruments concept of checks.
unpaid. In most cases, of course, the depositary bank simply will exercise its right of charge-back against its customer, the payee of the check. If, however, the depositary bank chooses not to pursue its customer, or if that right proves unavailing, the depositary bank, under Articles 3 and 4, will have a powerful right of recovery against the drawer.

Under section 3-413, the drawer is obligated, upon dishonor, to pay the instrument to the holder. Because Article 4 regards the transaction in which the payee delivers the check to the depositary bank for collection as a "transfer" and "negotiation" of the check, the depositary bank qualifies as a holder entitled to enforce the drawer’s prima facie liability on the instrument. That right, however, is only the start. The depositary bank generally can qualify as a holder in due course, and hence can enforce the drawer’s liability on the instrument despite any defenses that the drawer might have against the payee. Thus, in the context of an action by the depositary bank against the drawer, the full panoply of negotiable instruments law concepts is brought into play: the check is viewed as an embodiment of the independent liability of the drawer; the reification of the drawer’s liability is freely transferable, and the transferee is given the special rights of a holder in due course. The inquiry, then, is whether it is appropriate to apply any or all of these concepts in this context.

A common explanation of the rule that allows a depositary bank to recover from the drawer is that it is desirable for depositary banks to permit their customers promptly to withdraw funds represented by deposited checks, and that, if depositary banks are unable to collect from

56. For no particular reason, § 3-413 does not specify the precise beneficiary of the drawer’s obligation. Section 3-414, by contrast, specifically states that indorsement liability runs “to the holder or to any subsequent indorser who takes it up.” Various other sections, however, including §§ 3-301 and 3-307(2), as well as the general structure of Article 3, make it quite clear that the § 3-413 liability of the drawer extends to any holder of the instrument.

57. See, e.g., U.C.C. § 4-205 (1978) (a depositary bank that has taken an item for collection may supply any missing indorsement necessary for title); id. § 4-206 (for transfer between banks, any agreed method can identify the transferor bank); id. § 4-207(2) (specifying the warranty that customers and collecting banks give upon transfer).

58. Although Article 4 never explicitly states that the deposit of a check for collection is a “negotiation” to the depositary bank, the depositor’s customary indorsement, supplied if necessary by the depositary bank under § 4-205, would have this effect under the ordinary Article 3 rules. See id. § 3-202.

59. See id. §§ 4-208, 4-209.

60. Indeed, a major current issue in banking law is the need for legislation and other reform to reduce the delay in the availability for withdrawal of funds represented by deposited checks. See Baxter & Patrikis, The Check-Hold Revolution, 18 U.C.C. L.J. 99 (1985); Jordan, Ending the Floating Check Game: The Policy Arguments for Delayed Availability Reform, 36 HASTINGS L.J. 515 (1985); Check-Hold Bill Advances, N.Y. Times, Feb. 26, 1987, at 34, col. 4 (reporting that a congressional banking subcommittee approved a bill limiting the time that banks can take to clear check deposits to one business day for checks drawn on local banks and four business days for nonlocal checks).
drawers on returned checks, they will be reluctant to allow such withdrawals.61 That argument, however, is wholly unpersuasive because an extraordinarily unlikely set of circumstances must conjoin for the depositary bank's rights against the drawer to be of any value.62

In most cases in which checks are returned to depositary banks unpaid, the banks are able to recover the amount by charge-back to depositors' accounts.63 In that event, of course, the depositary bank's rights against the drawer are unimportant. Of the remaining group of checks returned unpaid, the depositary bank's legal rights against the drawer are significant only if there is a good prospect of being able to collect a judgment from the drawer. Some sense of the likelihood of recovery from the drawer can be obtained by considering the possible reasons for checks being returned unpaid. The most common reason is that the check was drawn on insufficient funds.64 Aside from insufficient funds checks that are attributable to inadvertent error on the part of the drawer—and those generally are paid on resubmission for collection65—the mere issuance of


62. The essence of this argument was suggested fifteen years ago in Dean Rosenthal's well-known article, Rosenthal, Negotiability—Who Needs It?, 71 COLUM. L. REV. 375 (1971). Rosenthal, however, limited his argument to the question whether collecting banks should be given holder in due course status. Id. at 375 n.1. Although he pointed out that an unlikely combination of circumstances must occur for collecting banks' holder in due course rights to come into play, he did not seem to notice that this observation not only proves the insignificance of collecting banks' holder in due course status, but also calls into question the notion that it is important to impose on the drawer an independent liability "on the instrument" and to extend that liability to transferees of the check, like collecting banks. The point is not just that cutting off defenses is unimportant, but that the set of cases in which it would be worthwhile for a collecting bank to sue the drawer at all, either free from or subject to defenses, is insignificantly small.

63. Moreover, to put the matter into perspective, it should be borne in mind that the entire set of returned checks is a fraction of a percent of the total volume of checks processed. See Leary, Check Handling Under Article Four of the Uniform Commercial Code, 49 MARQ. L. REV. 331, 333 n.7 (1965) (reporting that 99.5% by number, and 99.75% by dollar value, of all issued checks are paid).

64. A 1981 survey conducted by the Bank Administration Institute yielded the following data on the reasons for transit item returns among the responding banks:

<table>
<thead>
<tr>
<th>Reason</th>
<th>By Number of Items</th>
<th>By Dollar Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insufficient funds</td>
<td>71.2%</td>
<td>47.4%</td>
</tr>
<tr>
<td>Uncollected funds</td>
<td>2.7</td>
<td>4.1</td>
</tr>
<tr>
<td>Payment stopped</td>
<td>2.7</td>
<td>3.4</td>
</tr>
<tr>
<td>Account closed/not found</td>
<td>4.4</td>
<td>1.3</td>
</tr>
<tr>
<td>Irregular signature</td>
<td>1.3</td>
<td>2.3</td>
</tr>
<tr>
<td>Missing endorsement</td>
<td>4.9</td>
<td>27.8</td>
</tr>
<tr>
<td>Other</td>
<td>12.8</td>
<td>13.6</td>
</tr>
<tr>
<td>Total</td>
<td>100.0%</td>
<td>100.0%</td>
</tr>
</tbody>
</table>


65. See Leary, supra note 63, at 333 n.7 (stating that about one-half of all initially dishonored checks are paid on resubmission).
Negotiability Concepts and the Check System

a check on insufficient funds usually is a strong warning that the drawer's financial situation is precarious. Most of the other likely reasons for the dishonor of checks, such as a closed or nonexistent account, a signature forgery, a garnished account, or bankruptcy, also are sure indicia of the futility of pursuing the drawer. Indeed, the only category of returned checks for which there is any likelihood that pursuit of the drawer would be worthwhile is that of checks on which payment has been stopped. Stop payments, however, account for only a small percentage of all returns. Thus, it is safe to conclude that the subset for which there is any point in a depositary bank's proceeding against the drawer is extremely small in proportion to the total set of returned checks. The check collection system functions adequately despite the bulk of the returned check cases in which there is no point in pursuing the drawer. In a practical sense, therefore, the bank's right to proceed against the drawer is relatively insignificant.

One might abandon the claim that a depositary bank's right to enforce the liability of the drawer has any significant practical effect on the system as a whole, yet maintain the belief that, however rare the situations in which it matters, the set of rules allowing a depositary bank to enforce that liability effects the fairest resolution of the problem. In assessing that argument, recall that a collecting bank's right of action against a drawer of a dishonored check matters only if the drawer of the check is solvent and worth pursuing. Ordinarily, then, the check must have been dishonored for the reason that the drawer stopped payment. Thus, the question of the propriety of the drawer's liability to collecting banks reduces to whether one who has initiated a funds transfer should be able to countermand it after one of the banks in the chain has relied to its detriment on the assumption that the check probably will be paid. So viewed, the case for the collecting bank's right to collect from the drawer is not unappealing. Yet, what is most significant about this view of the problem is that it brings out an important similarity to other problems in the law of payment systems. The drawer's liability to collecting banks is, on careful analysis, but one part of the larger problem of finality of payment.

Consider the analogous issue in the context of the rights of the payor bank against the drawer. Despite occasional fussing by the bankers, both

66. The 1981 figure was about 3%. See BANK ADMINISTRATION INSTITUTE, supra note 64, at 54.

67. Professor Scott has suggested that this argument provides a general basis for the imposition of independent liabilities on the initiators of funds transfer orders. See Scott, Corporate Wire Transfers and the Uniform New Payments Code, 83 COLUM. L. REV. 1664, 1684-85 (1983).
commercial practice and commercial law have long insisted on the right of the drawer of a check to stop payment. The stop payment right, of course, must be timely exercised. Under section 4-303(1), a stop-payment order is ineffective to terminate the payor bank’s right to pay the check and charge the payment to the drawer’s account “if the . . . stop-order . . . is received . . . and a reasonable time for the bank to act thereon expires” after the bank has done any of a number of events that constitute final payment. Although the term “final payment” covers a variety of different and difficult matters, one aspect of the issue is simply that once the payor bank relies on the drawer’s payment instruction by either making payment or committing itself to do so, it is fair to hold the drawer responsible for the amount of the payment. The payment, after all, never would have occurred had the drawer not issued the check, and the drawer cannot complai relatively noisy if a last minute effort to prevent completion of the transfer proves unsuccessful.

The problems posed in the context of a collecting bank’s rights against the drawer on an unpaid check and in the context of the payor bank’s right to make payment and charge it to the drawer’s account are quite similar. Thus, for much the same reason that once the payor has made final payment it is too late for the drawer to countermand the funds transfer instruction, we might conclude that, once a prior bank in the chain of collection has given a provisional credit, the drawer’s attempt to countermand the instruction cannot be given full effect. Accordingly, the drawer could be held responsible for the amount of the order to the bank—here a collecting bank rather than the payor bank—that made the payment and now finds itself unable to recover it.

The question of whether the collecting bank should be given rights against the drawer really comes down to one’s view of the importance of the drawer’s right to stop payment. If one thinks it important to preserve that right as far as possible up to the moment that the payor bank makes final payment, then it is hardly consistent to allow the collecting bank’s decision to permit the payee to draw on uncollected funds to erode the drawer’s stop-payment right. By contrast, if one views the right to stop payment as merely an incidental product of delays in the payment system, then perhaps the time at which the payment becomes “final”—in the sense that the drawer cannot ultimately avoid liability to the banks for the amount—should be pushed back to the moment at which any of the banks in the chain relied to their detriment on the assumption that the order would be paid.

68. See U.C.C. § 4-403 & official comment 2 (1978).
69. The events are specified id. §§ 4-303(1)(a)-(c).
The realization that the problem of collecting banks' rights against drawers is an aspect of the general issue of finality of payment suggests another analogy. Just as the payor bank is not entitled initially to charge the drawer's account for a wrongful payment over a stop order, so too a depositary bank that allows the payee to draw on provisional credit despite an effective stop order should not be initially entitled to recover that amount from the drawer simply on the ground that the drawer issued the check. Nonetheless, in the payor bank versus drawer setting, the conclusion that the bank made a wrongful payment over a stop order is not the end of the matter.

Under section 4-407, the payor bank is entitled to recoup its loss through subrogation from the party who was unjustly enriched by the payment. When a payor bank pays a check over a proper stop order and hence cannot charge the payment to the drawer's account, the payee has received payment from the payor bank's funds rather than the drawer's funds. If the drawer has no valid basis for resisting his obligation to the payee, the drawer has been unjustly enriched at the expense of the payor bank. Accordingly, the payor bank, standing in the shoes of the payee, can collect from the drawer on the drawer's obligation to the payee. On the other hand, if the drawer has a valid basis for resisting payment to the payee, then the payee has been unjustly enriched and the payor bank, standing in the shoes of the drawer, can collect from the payee. The subrogation approach of section 4-407, which imposes liability on the drawer only to the extent that he is unjustly enriched, provides—or, if fully implemented, would provide—a sensible solution to the difficulties apparent with section 4-407 as presently written. First, the provision in section 4-407(a) that the drawee is subrogated to the rights of any holder in due course transfers into the drawee-drawer situation the wholly unjustifiable results of the application of the holder in due course principles. Students confronting § 4-407 invariably wish to know "who's subrogated to the rights that who would have if what had happened?" In those terms, the question is impossible to answer. The key is to begin from the realization that § 4-407's objective is to require the party unjustly enriched by the payment to disgorge that unjust enrichment. The payor bank, therefore, is subrogated to whatever set of rights is appropriate to effect that disgorgement. Ironically, the leading treatise on the Code suggests that the reference to the unjust enrichment principle in § 4-407 "at best states the purpose of the section, and at worst it adds meaningless confusion." J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE § 17-6, at 691 n.134 (2d ed. 1980). In fact, the only intelligible explanation of § 4-407 that I know of is found in Professor Palmer's treatise on the law of restitution. Palmer shows how all of the specifics of the operation of § 4-407 can be understood by viewing the unjust enrichment concept as the guidepost, and the subrogation mechanism as purely a remedial technique. See 3 G. PALMER, THE LAW OF RESTITUTION § 14.24(d), at 300-06 (1978).

70. Section 4-407 is not easily comprehended. The difficulty in understanding it, however, is largely a result of mistakenly viewing the concept of subrogation as a substantive doctrine rather than as a procedural device for the accomplishment of objectives determined by other substantive principles. Students confronting § 4-407 invariably wish to know "who's subrogated to the rights that who would have if what had happened?" In those terms, the question is impossible to answer. The key is to begin from the realization that § 4-407's objective is to require the party unjustly enriched by the payment to disgorge that unjust enrichment. The payor bank, therefore, is subrogated to whatever set of rights is appropriate to effect that disgorgement. Ironically, the leading treatise on the Code suggests that the reference to the unjust enrichment principle in § 4-407 "at best states the purpose of the section, and at worst it adds meaningless confusion." J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE § 17-6, at 691 n.134 (2d ed. 1980). In fact, the only intelligible explanation of § 4-407 that I know of is found in Professor Palmer's treatise on the law of restitution. Palmer shows how all of the specifics of the operation of § 4-407 can be understood by viewing the unjust enrichment concept as the guidepost, and the subrogation mechanism as purely a remedial technique. See 3 G. PALMER, THE LAW OF RESTITUTION § 14.24(d), at 300-06 (1978).

71. The point of the stop payment right, after all, is not to have banks buy things for their customers, but to preserve the procedural and negotiating advantages that one obtains by stopping payment on a check given in a transaction that has gone awry.

72. A number of difficulties are apparent with § 4-407 as presently written. First, the provision in § 4-407(a) that the drawee is subrogated to the rights of any holder in due course transfers into the drawee-drawer situation the wholly unjustifiable results of the application of the holder in due
the problem of the rights of the payor bank against the drawer.

The unjust enrichment approach of section 4-407 is readily adaptable to the problem of the rights of collecting banks against the drawer. The present cumbersome mechanism of independent, transferable liabilities reified in checks easily could be replaced with a straightforward rule permitting a depositary bank that has made a payment to its depositor on a check that is returned unpaid to recover the payment from the drawer by subrogation, if it is unable to recover the payment by charge-back against the payee. The depositary bank would be subrogated to the rights of the payee against the drawer to the extent necessary to require the drawer to disgorge any unjust enrichment he may have received by not having made any payment to the payee.\(^\text{73}\)

IV. Fraud and Forgery Problems

The problem of allocating forgery and fraud losses in the check collection system provides a perfect illustration of the unnecessarily Byzantine complexities introduced into payment systems law by the negotiable instruments approach. Generations of law students no doubt have been struck by the discovery that it requires weeks of study of arcane questions about the concepts of holder, holder in due course, negotiation, conversion, and warranty of title to reach a conclusion that can be stated in a few words: "for bearer instruments, the loss falls on the fellow before the scalawag; for order instruments, the loss falls on the fellow after the scalawag." I confess that I finally have come to the conclusion that the students are right. Why not just say so, instead of going through all this gobbledygook about conversion, warranty, and so forth?

Consider, for example, the simple matter of determining the rights course concept in the setting of collecting banks versus drawers. Furthermore, the provision in § 4-403(3) that the "burden of establishing the fact and amount of loss resulting from payment of an item contrary to a binding stop payment order is on the customer," effectively may render the drawer's stop payment right, and the subrogation provisions for effectuating that right when the payor wrongfully pays over a proper stop order, nugatory by preventing the drawer from having the payor bank recredit his account in the first place. See J. WHITE & R. SUMMERS, supra note 70, § 17-6, at 683. The advantage of the subrogation approach is that, if fully implemented, it would preserve to the drawer the procedural advantage that he sought to obtain by stopping payment: the payor bank that pays over a stop order would have to recredit the drawer's account and then, standing in the shoes of the payee, pursue the drawer, just as the payee might have done had the stop order been honored.

\(^{73}\) To be sure, this subrogation analysis would produce the same results as giving the depositary bank the right to sue the drawer for the amount of his liability "on the instrument," although without holder in due course rights. We have, then, the same phenomenon to which I have been calling attention throughout this Article: the negotiable instruments view of checks is, at best, a roundabout mechanism for reaching results that could be reached through a simpler analysis that focuses not on the check itself as a transferable reification of liabilities and instructions, but instead directly on the funds transfers of which checks are only the implementing mechanism.
Negotiability Concepts and the Check System

of a payee from whom a check is stolen. Suppose the drawer writes a check on his account at the payor bank payable to the order of the payee and the drawer delivers the check to the payee. The scalawag steals the check from the payee and cashes it at the depositary bank. The depositary bank presents the check to the payor bank, which pays it. The standard analysis—familiar to all commercial law teachers, if to no one else—proceeds more or less as follows. 74

First suppose that the payee did not indorse the check before the scalawag stole it. The payee, having been in possession of an instrument drawn to his order, was the holder and owner of the check. The scalawag did not become the holder of the check because he did not possess an instrument drawn or indorsed to him, his order, bearer, or in blank, nor did he acquire the instrument by negotiation, which requires a voluntary delivery and a genuine indorsement. Even if the scalawag had written words on the back of the check that resembled the payee’s signature, the words would not constitute an indorsement of the check, because an indorsement must be written by or on behalf of the holder of the check and the scalawag was not the holder of the check. Similarly, because the scalawag was not the holder, he could not indorse the check when he cashed it at the depositary bank, and therefore the depositary bank could not become the holder of the check. Accordingly, the bank could not become a holder in due course of the check, and therefore it took the check subject to the payee’s claim of rightful ownership. Having dealt with the check in a fashion inconsistent with the payee’s claim of ownership, the depositary bank is liable to the payee for conversion of the check, unless, of course, the court decides—as few have done—to pay any attention to the odd exculpatory provision in section 3-419(3). 75 Alternatively, the payee may elect to sue the payor bank rather than the depositary bank, in which case the question arises whether paying a check over a forged indorsement amounts to a conversion of the check. That is an intriguing puzzle in this property language analysis, but section 3-419(1)(c) resolves it by saying that “[a]n instrument is converted when . . . it is paid on a forged indorsement,” which, by the way, is perhaps the only useful statement in that section. Of course, if the payee proceeds against the payor bank, the bank will not be without recourse.

74. Discussion of and citations for the propositions in the next two text paragraphs can be found in any of the standard authorities. E.g., J. WHITE & R. SUMMERS, supra note 70, ch. 15.
75. Section 3-419(3) provides that, subject to a few exceptions, a representative, including a depositary or collecting bank, who has in good faith and in accordance with reasonable commercial standards . . . dealt with an instrument or its proceeds on behalf of one who was not the true owner, is not liable in conversion or otherwise to the true owner beyond the amount of any proceeds remaining in his hands.
Section 4-207 provides that, upon presentment, the depositary bank warranted that it had good title to the check. The depositary bank, of course, was not a holder of the check, and, presumably, having good title to a check includes, at the least, being a holder of the check. Accordingly, the depositary bank is liable to the payor bank for breach of the warranty of good title to the check.

By contrast, consider what happens if the payee foolishly indorses the check in blank before it is stolen. The scalawag's status is less clear. On the one hand, he possesses an instrument indorsed in blank, apparently qualifying him as a holder of the check under section 1-201(20). On the other hand, the negotiation of an instrument in bearer form does require voluntary delivery, and section 3-202 seems to imply that negotiation is necessary to become a holder. Regardless of the scalawag's status, the depositary bank clearly was a holder; it was in possession of a check indorsed in blank and the check was delivered voluntarily to the bank by the scalawag. As a holder, the depositary bank is eligible for holder in due course status. Therefore, the depositary bank took free from the payee's claim of ownership, and cannot be guilty of conversion. Finally, because the depositary bank had good title to the check, it did not breach any warranties on presentment of the check to the payor bank.

I do not mean to suggest that it is impossible to reach an appropriate resolution of the matter through this approach. The question is whether it makes sense to approach the problem this way. A number of aspects of this approach are rather odd. First, all of the steps in the proof—for example, the conclusion that the depositary bank is liable for conversion because it was not a holder—have the distinct ring of question-begging. Second, the critical steps in the proof—such as the proposition that collecting or cashing a check for a nonholder is conversion, or that good title requires being a holder—are never actually stated in the text of the statute. These peculiarities could be overlooked, were they not manifestations of a more fundamental defect.

The most striking aspect of the standard analysis set out above is that it proceeds entirely in terms of concepts of ownership directed at the check. The analysis consists of a detailed examination and characteriza-

76. A "holder" is "a person who is in possession of a document of title or an instrument or a certified investment security drawn, issued, or indorsed to him or his order or to bearer or in blank." U.C.C. § 1-201(20) (1978).
77. Id. §§ 1-201(14), 3-202(1).
78. Id. § 3-207 official comments 1, 2.
79. The "value" requirement of holder in due course status, see id. § 3-302(1)(a), can be met through the notion of "security interest," id. §§ 4-208, 4-209.
tion of the peregrinations of the check, and every step in the analysis consists of the assertion or denial of a claim of a property interest in the check. Curiously absent is any focus on, and nearly any mention of, the payment. The point of the check system, after all, is to direct the transfer of funds. The scenario of the collection and payment of a stolen check, with or without forged indorsement, is simply an instance of a misdirected funds transfer. Why, then, should the law approach the problem from the perspective of the instruction rather than from the perspective of the transfer itself?

Approached from the perspective of the transfer, the stolen check case is quite simple: The drawer gave instructions for the transfer of funds to the payee. Because of the scalawag's intervention, the funds instead were transferred to the scalawag leaving the payee unpaid. The basic question of policy on which all of the specific rules turn is whether the loss should rest on the providers or on the users of the payment system. The rules of the check collection system ultimately do embody—if cumbersomely—the principle that the losses should fall on the providers. Once that basic policy decision is made, the design of specific rules of risk allocation becomes straightforward. Absent a specific reason in particular cases for shifting the risk to one of the payment system users, the only decision is which of the payment system providers should bear the loss. None of these matters needs to be addressed through the negotiable instruments approach involving the application of property law concepts to the pieces of paper or other media used as instructions to initiate payment transfers.

Indeed, a striking aspect of the conventional analysis of forgery and fraud is the contrast between the analyses employed when the problem is approached from the perspective of the drawer rather than from the perspective of the payee. To the drawer, of course, the check is only an instruction. Thus, even within the negotiable instruments approach to the check system, there is no plausible way to think of the check as an item of property belonging to the drawer. Accordingly, although the analysis of remedies for the payee proceeds in terms of property concepts, the analysis of remedies for the drawer is free of this odd conceptual framework.

Recall the simple scenario in which the payor bank pays over the scalawag's forged indorsement a check drawn by the drawer to the order

80. *See, e.g.,* Stone & Webster Eng'g Corp. v. First Nat'l Bank & Trust Co., 345 Mass. 1, 8, 184 N.E.2d 358, 362 (1962) (drawer has no conversion action against collecting bank that took check over forged indorsement because drawer's property interest in check is limited to the physical piece of paper on which it is written).
of the payee. Instead of approaching the matter from the perspective of the payee’s recourse against the banks, suppose the payee obtains a new payment of the underlying debt from the drawer and the drawer seeks recourse against the banks. The analysis is wholly unproblematic. The payor bank cannot charge the the drawer’s account; the payor bank, as debtor to the drawer for the amount of his account balance, can discharge its debt to the drawer only by paying money on the drawer’s instructions.81 In the forged indorsement case, the payor bank did not do so, and hence still owes the drawer the full amount of his account balance undiminished by the wrongful payment.82 In reaching this simple result, there is no occasion to view the check in any manner other than as an instruction followed incorrectly by the payor bank. Simple contractual principles fully suffice to implement the basic proposition that the drawer, as a user of the payment system, is not responsible for the losses attendant on misdirected funds transfers.

The question remains whether the loss should rest with the payor bank or the depositary bank. At this level, there is something to be said for employing the notion that the risk should fall on the party best able to have prevented it, even though in the majority of cases an ordinarily prudent bank probably could not have prevented it. Article 4 reaches this result by approaching the problem from the negotiable instruments perspective. The depositary bank is said to have warranted “good title” to the check and is liable to the payor bank for the breach of this warranty.83 There is, however, no particular reason for approaching the matter from the standpoint of the instruction rather than from the standpoint of the payment. Indeed, in pre-Code law, the warranty of title approach was relatively uncommon. Instead, the right of a payor bank to recover from the presenter a payment over a forged indorsement commonly rested on much simpler restitution analysis. The payor bank, having inadvertently paid out money to the presenter, could recover the mistaken payment in a common-law action in assumpsit.84 Thus, the

81. See U.C.C. § 4-401 (1978) (bank may only charge properly payable items against customer’s account).
82. See H. BAILEY, supra note 7, § 23.2, at 23-3 to -5.
84. For discussion of the general approach of pre-Code law to this matter, see E. FARNsworth, CASES AND MATERIALS ON COMMERCIAL PAPER 268 (3d ed. 1984); 3 G. PALMER, supra note 70, § 14.23(a), at 283-85. Clear statements of the restitution approach can be found in First Nat’l Bank v. City Nat’l Bank, 182 Mass. 130, 136, 65 N.E. 24, 25 (1902); Canal Bank v. Bank of Albany, 1 Hill 287, 289-90 (N.Y. Sup. Ct. 1841). For discussion of the warranty of title approach, see Clearfield Trust Co. v. United States, 318 U.S. 363, 368 (1943) (stating that one who presents a check for payment warrants that he has title to it and the right to receive payment).

The Uniform Negotiable Instruments Law (N.I.L.) contained provisions on warranty of genuineness of signatures on transfer of instruments, see N.I.L. §§ 65, 66 (1896), but no provisions on
application of property concepts to checks is no more essential in analyzing the allocation of the risk of loss of misdirected funds transfers among payment system providers than it is in allocating risks between payment system providers and payment system users. The warranty of title approach adopted by the U.C.C. has few virtues other than its consistency with the Code's insistence on wrenching every aspect of the law of the check system into the framework of negotiable instruments law.

The ease with which we can frame the rules for the allocation of the risks of misdirected transfers without negotiable instruments concepts in the context of a drawer seeking recourse against the banks compels a reexamination of the approach taken to the same problem in the context of a payee rather than a drawer. Here, too, there is no conceptual obstacle, nor lack of common-law precedent, for an approach that focuses directly on the real problem—the misdirected funds transfer—rather than

warranties on presentment. See F. BEUTEL, BEUTEL'S BRANNAN NEGOTIABLE INSTRUMENTS LAW §§ 65-66 (1948). The N.I.L. transfer warranty provisions were held inapplicable to payor banks on the grounds that the presentment of a check to the payor bank for payment is not a transfer. E.g., First Nat'l Bank, 182 Mass. at 134, 65 N.E. at 24-25 (holding that an indorsement that is not made for the purpose of a transfer does not carry with it a guarantee of previous indorsements); State Planters Bank & Trust Co. v. Fifth-Third Union Trust Co., 56 Ohio App. 309, 321, 10 N.E.2d 935, 941 (1937) (same). The only difficulty with the restitution approach was the result of the widespread but dubious application of the general proposition that

if money is mispaid to an agent expressly for the use of his principal, and the agent has paid it over, [the agent] is not liable in an action by the person who mispaid it: because it is just, that one man should not be a loser by the mistake of another; and the person who made the mistake is not without redress, but has his remedy over against the principal.

Buller v. Harrison, 2 Cowp. 565, 566, 98 Eng. Rep. 1243, 1244 (K.B. 1777). Drawing on the notion that collecting banks are "agents" for the depositor, courts often held that the payor bank could not recover directly from the presenting collecting bank in an action for money paid by mistake, but instead would have to pursue the depositor directly. E.g., National Park Bank v. Seaboard Bank, 114 N.Y. 28, 34-35, 20 N.E. 632, 633-34 (1889) ("[A]n agent who has received money paid by mistake cannot be compelled to repay it where he has paid it over to his principal without notice."). Because the application of the agency rule in this setting yielded results inconvenient to the check collection system, banks responded by including the "prior indorsements guaranteed" legend on their indorsement stamps, and the Federal Reserve System's check collection regulations adopted this warranty of indorsement notion. See Regulation J, 12 C.F.R § 210.5(b) (1986); E. FARNsworth, supra, at 268.

The comments to § 4-207 indicate that the warranty of good title on presentment approach was intended to adopt the result produced by the prior indorsements guaranteed device. See U.C.C. § 4-207 official comment 2 (1978). In typical fashion, the Code insists on stating this rule in the language of property talk—"warranty of good title"—even though the bankers' practice the Code adopted did not do so, but spoke directly of warranting the genuineness of prior indorsements. The switch to the property law warranty of "good title" was, of course, unnecessary; even the guaranty of prior indorsements approach need not have been adopted had the courts been more careful in the application of restitution principles in this setting. The difficulty was simply that the defense of payment over by an agent, which was evolved in circumstances having nothing to do with check collections, see, e.g., Buller v. Harrison, 2 Cowp. at 566, 98 Eng. Rep. at 1243 (concerning an agent who received money for the principal on an insurance policy); Mowatt v. McClelan, 1 Wend. 173, 173-74 (N.Y. Sup. Ct. 1828) (concerning an attorney who received money for a client), should not have been applied in the setting of check collections, notwithstanding that, for other reasons, it was sometimes convenient to regard collecting banks as the "agents" of the depositors.
an approach that focuses on claims of title to the check. The situation is that the drawer instructed the bank to transfer funds to the payee and, instead, the bank transferred funds to the scalawag. Once again, the law of restitution provides a simple alternative to the complex analysis of negotiable instruments law.

In a variety of situations, the law of restitution provides remedies for the mistaken payment of money that not only permit the party who made the mistaken payment to recover it, but also, in appropriate circumstances, permit the intended recipient to recover the money from the actual recipient. Accordingly, it is not difficult to find a common-law remedy permitting the payee to recover from the depositary bank the amount he was entitled to receive. Indeed, this approach was used commonly in the pre-Code decisions dealing with the problem of payment over forged indorsements as an alternative to the conversion rationale ultimately adopted by the U.C.C.

85. E.g., King County v. Odman, 8 Wash. 2d 32, 36, 111 P.2d 228, 230 (1941) (permitting the true owner of land to recover rentals paid by the tenant to a party mistakenly thought to be the owner); RESTATEMENT OF RESTITUTION § 126 (1936).

86. Here, as in the case of the payor bank's right to recover funds paid on a check bearing a forged indorsement, one must be careful. Restitution principles should not prevent liability of the collecting bank as an "agent" of the depositor merely because the "agent" turned over the mistaken payment to his principal. See supra note 84. In this situation, the pre-Code decisions generally did not allow that defense to the collecting bank. See Kessler, Forged Indorsements, 47 YALE L.J. 863, 874 & n.49 (1938). Although the Code here places the liability of collecting banks on a conversion basis, it also manages to pick up the one aspect of the restitution approach that is ill-suited to the check collection system. See U.C.C. § 3-419(3) (1978) ([A] representative, including a depositary or collecting bank... is not liable in conversion or otherwise to the true owner beyond the amount of any proceeds remaining in his hands.) Fittingly, the courts have paid little attention to this provision. See, e.g., Cooper v. Union Bank, 9 Cal. 3d 371, 384-85, 507 P.2d 609, 619-20, 107 Cal. Rptr. 1, 11-12 (1973).

87. E.g., Allen v. M. Mendelson & Son, 207 Ala. 527, 528, 93 So. 416, 417 (1922); Merchants' & Mfrs.' Ass'n v. First Nat'l Bank, 40 Ariz. 531, 536, 14 P.2d 717, 718 (1932); cf. United States Portland Cement Co. v. United States Nat'l Bank, 61 Colo. 334, 338, 157 P. 202, 203 (1916) (holding the payee can recover from the depositary bank that collected a check over a forged indorsement, on the theory that the payee can "ratify" the collection of a check from the payor and thus the depositary bank holds funds due to the payee); Henderson v. Lincoln Rochester Trust Co., 303 N.Y. 27, 33, 100 N.E.2d 117, 120 (1951) (same). For a discussion of these theories of recovery, see Kessler, supra note 86, at 874. Cases are collected in Annotation, Right of Check Owner to Recover Against One Cashing It on Forged or Unauthorized Indorsement and Procuring Payment by Drawee, 100 A.L.R.2d 670 (1965).

It sometimes is difficult to tell whether the courts were applying a restitution-based theory or a theory based on tort or property. Even if the problem is viewed as a matter of conversion of the payee's property interest in the check, the payee could bring an action in assumpsit by the common law device of "waive the tort and sue in assumpsit." See, e.g., Independent Oil Men's Ass'n v. Fort Dearborn Nat'l Bank, 311 Ill. 278, 281, 142 N.E. 458, 459 (1924) (deciding that a payee can waive the tort of conversion and sue in assumpsit for money had and received by a bank that cashed checks on forged indorsements and collected money from drawee banks); Arnold v. The Cheque Bank, 1 C.P.D. 578, 585 (1876) (stating that the plaintiffs may waive the tort action and recover the proceeds of the check in an action for money had and received).

The advantage of an approach focusing directly on the improper payment rather than on questions of title to the check is illustrated by situations in which the check was purloined by the scala-
I do not wish to suggest that the law of restitution rather than the law of negotiable instruments provides the "true" analysis of check collection problems. Indeed, we probably would be better off if we sought no "theory" of check collection, but instead adopted rules of risk allocation and recovery that respond directly to the problem of mistaken payments. Much can be learned, however, from an awareness of the alternative analysis that the law of restitution provides. First, of course, is the notion that the basic concept of negotiable instruments law—that negotiable instruments as embodiments of promises or orders or both for the payment of money can be regarded as items of property—is unnecessary in the design of the laws governing the use of checks. Moreover, if one were forced to choose the "truer" theory, the law of restitution would be the clear winner because the restitution approach focuses on the real matter of concern, the misdirected payment. That lesson is particularly important at a time when a variety of new payment mechanisms are evolving to direct transfers of bank credit.

V. Conclusion

None of the central assumptions of the negotiable instruments approach to the check system proves accurate. Neither the concept of independent liabilities on the instrument, nor the notion that checks can be regarded as items of property, nor the holder in due course rules play any useful role in payment systems law for the paper-based check system. The time is long overdue to begin thinking about the check system, and teaching the law of payment systems generally, without reliance on the concepts of negotiable instruments law.

A reader thoroughly familiar with the law of negotiable instruments might object that this Article shows only that it is possible to achieve appropriate resolutions of the problems of payment systems without the conceptual framework of negotiable instrument law, but this does not prove that we should abandon the familiar concepts of negotiable instru-

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88. The wooden application of principles drawn from the law of restitution can produce unfortunate results in the check collection system, see, e.g., cases cited supra note 84, nearly as easily as the wooden application of tort or property principles.
ments law. That objection, however, is itself the best illustration of the perversity of the negotiable instruments approach to the check system. The negotiable instruments framework seems sensible only because it is, at least to some of us, familiar.

One who suggests that the negotiable instruments framework provides a plausible approach to the problems of payment systems law should listen, I think, a bit more closely to the students who must learn the subject anew, and should reflect a bit more deeply on the source of the students' sense that this is all an arcane wordgame, mastery of which is a rite of passage into the profession. One might also consider how plausible the negotiable instruments approach to the check system would seem if we applied similar techniques to other legal problems. For example, recall that delightful case on the intricacies of voidable title, Cundy v. Lindsay. The rogue Alfred Blenkarn, by carefully careless penmanship, tricked Lindsay & Co., linen manufacturers in Belfast, into believing that they were dealing with the respected firm of W. Blenkiron & Co. Blenkarn thereby acquired on credit from Lindsay & Co. several lots of cambric handkerchiefs, resold them to Cundy, and vanished with the money. Suppose instead, however, that Blenkarn had written to Lindsay & Co. asking them to send him a quote on the sale of handkerchiefs; that Lindsay & Co., thinking they were dealing with Blenkiron, sent in response a written offer; and that Blenkarn sent a written acceptance. Some rules clearly are required to decide what sort of contractual relationship, if any, would be created under these circumstances. It would be unthinkable, however, to approach the matter by asking questions such as whether Blenkarn got good title to the letter written by Lindsay & Co. containing the offer, or whether Blenkarn converted not the handkerchiefs, but the letter. Articles 3 and 4, however, deal in precisely this manner with the analogous questions presented by fraud in connection with the funds transfer instructions.

89. There are, of course, a number of well-known suggestions in the literature that perhaps the entire concept of negotiability is outdated. E.g., Gilmore, Formalism and the Law of Negotiable Instruments, 13 CREIGHTON L. REV. 441, 446-48 (1979); Rosenthal, supra note 62, at 375-77. The casebooks' treatment of such ideas, however, is quite curious. Excerpts from Rosenthal and Gilmore are now standard ornaments in current casebooks on commercial paper; this produces the odd effect of introducing students to the subject matter by saying, more or less, "None of this probably makes any difference, but you've got to learn it anyway." See, e.g., E. FARNSWORTH & J. HONNOLD, CASES AND MATERIALS ON COMMERCIAL LAW 89 (4th ed. 1985) (quoting Gilmore); L. FRANKEL, J. MCDONNELL & R. NIMMER, supra note 34, at 6-7 (1982) (quoting Gilmore); A. SCHWARTZ & R. SCOTT, supra note 34, at 1006-08 (1982) (quoting Rosenthal). In the spirit of full disclosure, I should add to that list Rogers, Teaching Materials on Commercial Law, 14-60 to -66 (1983) (unpublished manuscript).

90. 3 App. Cas. 459 (H.L. 1878).
91. Id. at 460.
92. Id.
The fundamental flaw in the negotiable instruments view of the check system is that, by focusing on the check rather than the transfer, it approaches the entire matter backwards. Doing so makes the law of check collections grossly overcomplex, obscures many important issues, and frustrates the effort to understand the similarities and differences among various forms of payment systems. The solution is simply to reverse our usual approach and think of checks not as a specific form of negotiable instrument but as one form of instruction for the transfer of funds. That conception, of course, was at the heart of the Uniform New Payments Code. The failure of the profession to embrace the U.N.P.C. should be taken not as proof of the satisfactory state of our present law but as a clear demonstration of the need for much rethinking of basic concepts. Without a better understanding of what is important and what is nonsense in the present law of the check system, the rationalization of payment systems law, to say nothing of its unification, will continue to elude us.

93. An example from the U.N.P.C. nicely illustrates the point. To those accustomed to the negotiable instruments view of the law of checks, the specification of the liabilities of the parties "on the instruments" seems a simple matter. Indeed, it seems almost self-evident that such specification is one of the things that the law of payment systems should do. In fact, however, the notion of independent liabilities on the instrument really is not needed, see supra Part III, and importing into new payment systems the propositions about liabilities "on the instrument" that seem such truisms in the check system may well produce odd results. Thus, the U.N.P.C., which was intended to cover the usual form of bank credit card system like MasterCard and VISA, see U.N.P.C. § 2 & comment I(d), § 10(1) & comment 5 (Proposed Official Draft No. 3, 1983), seemingly considered it simple and noncontroversial to extend to all payment orders the specification of the independent liability of the drawer now found for checks in U.C.C. § 3-413 (1978). See U.N.P.C. supra § 100 & comment 1. In a bank credit card system, however, that just will not do. The user of a credit card does not intend to incur a demand liability, but only an obligation to pay in accordance with the credit terms arranged with the card issuer. To extend liabilities akin to the § 3-413 drawer's liability to credit card users would impose on a credit card buyer an immediate liability to the merchant or to other banks in the system for the full amount of the purchase. The problem is not simply that independent liability cannot be extended easily to bank credit card systems. Rather, the anomalies produced by the application of that concept to a system that combines a payment device and a credit-extension device are symptomatic of the essential irrelevance of the negotiable instruments concepts to payment systems generally.