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Commercial Paper in Economic Theory and Legal History

BY HAROLD R. WEINBERG*

INTRODUCTION

Commercial paper played a significant role in antebellum America by partially filling the void resulting from the shortage of gold and silver coinage and the absence of a reliable paper currency. Although most legal historians would agree with this premise,¹ a controversy has arisen in recent years concerning negotiability, that collection of legal rules which greatly enhanced the usefulness of bills of exchange and promissory notes in commerce and finance.

Many scholars believe that negotiability, along with other pre-Civil War legal doctrines, was intended to facilitate the development of a national market system and economic growth. This view typically holds that courts acted with the general approval of society and either ignores any major wealth redistributive consequences of these developments or assumes that such consequences were unanticipated.²

A very different view of the rise of commercial paper negotiability during 1780-1860 has been advanced by Morton Horwitz.³ In *The Transformation of American Law* he argues that American judges developed negotiability primarily to protect mercantile and entrepreneurial minorities that stood to gain from an expanding market economy.⁴ This was accomplished at the expense of persons possessing a pre- or anti-commercial consciousness. The sweeping transformation described by Horwitz,

* Professor of Law, University of Kentucky College of Law. This paper is based upon a formal comment given at the antebellum commercial law program held during the 1980 Annual Meeting of the American Society for Legal History in Philadelphia, Pa. The author would like to thank Tony Freyer and Richard Kilbourne for their suggestions and Gerald Henderson for his research assistance.

¹ See, e.g., L. FRIEDMAN, *A HISTORY OF AMERICAN LAW* 235-37 (1972).

² See generally Book Review, *A Plot Too Doctrinaire*, 55 TEX. L. REV. 1307 (1977).

³ M. HORWITZ, *THE TRANSFORMATION OF AMERICAN LAW, 1780-1860* (1977).

⁴ *Id.* at 212-26.

which was also reflected in property, contract, and other areas of law, was one in which enterprise was subsidized and protected while farmers, workers, consumers, and less powerful groups were increasingly disadvantaged.⁵

This controversy among legal historians bears an illuminating relationship to the work of other analysts who have sought to employ economic tools to advance the understanding of legal doctrine. Numerous studies of common law rules, including many relating to the branches of law discussed by Horwitz, suggest that judge-made law can be understood "as if" it were the product of judges who sought to maximize social wealth by utilizing a criterion of economic efficiency.⁶ This conclusion is obviously at variance with the Horwitzian view of antebellum legal history. It must also be unsatisfactory to historians whose training does not permit them to be satisfied with "as if" explanations, but which requires them to ask why common law rules approximate an efficient allocation of resources.

Analysts have begun to explore two lines of explanation for the emergence of efficient case law. "Visible hand" theories postulate the existence of judges who sought to announce efficient doctrine.⁷ "Invisible hand" theories, on the other hand, do not depend on judicial motivations. They hold, for example, that the costs imposed by an inefficient rule create an incentive for litigants to expend resources in order to obtain the rule's modification or reversal.⁸ Efficient legal doctrine might therefore have evolved even if judges were indifferent to or biased against efficiency as a decisional criterion.

Parts I and II of this article seek to advance the inquiry into the significance of commercial paper in legal history by presenting a positive economic analysis of some of the decision rules that were important to commercial paper negotiability.⁹ It is hoped

⁵ *Id.* at 253-54.

⁶ See R. POSNER, *ECONOMIC ANALYSIS OF LAW* (2d ed. 1977).

⁷ *Id.* at § 19.7. See also Weinberg, *Markets Overt, Voidable Titles, and Feckless Agents: Judges and Efficiency in the Antebellum Doctrine of Good Faith Purchase*, 56 TUL. L. REV. 1 (1981).

⁸ See Terrebonne, *A Strictly Evolutionary Model of Common Law*, 10 J. LEG. STUD. 397 (1981).

⁹ See generally *Symposium on Efficiency as a Legal Concern*, 8 HOFSTRA L. REV.

that this theory might be of use to historical studies of the allocative, distributive, or other characteristics of the judicially created negotiability doctrine applied prior to the Civil War. The article's conclusion offers some suggestions concerning how this inquiry might be further advanced. It is also hoped that this analysis will have relevance to modern commercial paper law, much of which closely resembles the rules applied by nineteenth century judges.¹⁰

I. COMMERCIAL PAPER AS A MONEY SUBSTITUTE

Money reduces the costs of market trading in two ways.¹¹ First, it functions as a medium of exchange. Goods can be exchanged for money and vice versa in multilateral transactions whereas a moneyless society would be forced to rely on a system of bilateral exchange, or barter. Furthermore, by functioning as a medium of exchange money also makes possible efficiencies through productive specialization. An individual's or firm's output of products or services can be exchanged for money which can in turn be used to purchase any service or commodity available in the market.¹² In addition to its service as a medium of exchange, money functions as a store of value. It enables consumers or firms to set aside income for future consumption or production. An inventory of money can be employed to bridge temporal gaps between receipts and expenditures.¹³

485 (1980) (concerning whether economic efficiency is a worthy and obtainable goal of social policy).

¹⁰ Development of the law of commercial paper accelerated in England under Lord Mansfield (1756-1788), and these developments were very influential in America. See G. GILMORE, *THE AGES OF AMERICAN LAW* 24 (1977). Common law commercial paper doctrine continued to evolve in this country after 1860. For these reasons some of the authorities referred to herein precede or follow the period 1780-1860 by a few years. The law of commercial paper as initially codified in the Uniform Negotiable Instruments Law (promulgated in 1896) and currently in Article 3 of the Uniform Commercial Code bears the strong imprint of the common law. See W. BRITTON, *HANDBOOK ON THE LAW OF BILLS AND NOTES* 5-9 (2d ed. 1961).

¹¹ J. HIRSHLEIFER, *PRICE THEORY AND APPLICATIONS* § 8.D (1976). Money also functions as an accounting unit which can be employed to place values on assets or debts. *Id.*

¹² *Id.* at § 6.A. See also 1 A. SMITH, *AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS* 26-28 (1776) (Cannan ed. 1976).

¹³ An advantage of commercial paper during the antebellum period was that it was less costly than metallic money to transfer or store. See Kilbourne, *Antebellum Commer-*

Commercial paper consisted of private written contractual instruments adapted to serve as money substitutes. The simplest form of commercial paper employed during the antebellum period was the promissory note wherein a maker agreed to pay a specified sum to a payee.¹⁴ The sum might be payable on demand or at some specified future date. Slightly more complex was the bill of exchange, or draft.¹⁵ By this instrument a drawer would order a drawee to pay a specified amount to a payee. The drawer's order bound him to pay if the drawee refused to honor the bill. The drawee could contractually bind himself to honor the bill through the act of acceptance which often consisted of signing the instrument. In theory, though sometimes not in practice, the drawee would be holding funds for or otherwise be indebted to the drawer and hence would be willing to accept the bill.¹⁶

Either form of commercial paper could and did serve as a money substitute. For example, the payee of a promissory note might transfer the paper to a merchant in payment for a purchase of goods. Actually, the use of commercial paper in antebellum commerce and finance was frequently much more elaborate than this. The paper often passed through several sets of hands, multiple parties became obligors on the paper, and various agents, banks, and brokers became involved in the papers' handling, discounting, and collection.¹⁷ However, the point fundamental to this discussion is that commercial paper was an acceptable money substitute because creditors, merchants, and others were willing to do business in reliance upon individuals' and business firms' written promises of payment. With this in mind, we can proceed with an economic analysis of the manner in which

cial Law: Civil Law Approaches to Secured Transactions, 70 Ky. L.J. (in print) (1981-82). See generally Waterman, *The Promissory Note as a Substitute for Money*, 14 MINN. L. REV. 313 (1930).

¹⁴ See J. STORY, COMMENTARIES ON THE LAW OF PROMISSORY NOTES (6th ed. Boston 1868) [hereinafter cited as STORY ON NOTES].

¹⁵ See J. STORY, COMMENTARIES ON THE LAW OF BILLS OF EXCHANGE (2d. ed. Boston 1847) [hereinafter cited as STORY ON BILLS].

¹⁶ *Id.* at § 13. There might be no money debt owed by drawee to drawer in the case of an accommodation acceptance.

¹⁷ See A. GREEF, *THE COMMERCIAL PAPER HOUSE IN THE UNITED STATES* 3-37 (1938).

various negotiability rules may have enhanced commercial paper in its money substitute role.

For purposes of this analysis, it is useful to view commercial paper and negotiability from the perspective of risk and to recognize that, economically speaking, risk is a cost.¹⁸ A transferee who acquires commercial paper in payment of a debt or for goods or services confronts several classes of risks. For the moment, this article will focus on two of them: the insolvency risk and the defense risk.¹⁹ A simple example will help to illustrate the significance of negotiability with respect to these risks. Suppose A makes a promissory note for \$300 payable to the order of B in one month as payment for a shipment of lumber. After receiving possession of the note B indorses and transfers it to C in payment for the current purchase of a wagon. C, in turn, indorses and transfers the note to pay D for a debt previously incurred.

D, to the extent that he is looking to A for payment, must be concerned with the possibility that A will not have the \$300 necessary to honor the note at the appointed time.²⁰ Information can help to counteract uncertainty concerning the risk of A's insolvency.²¹ D may seek to reduce his risk by purchasing reports concerning A's financial reliability.²² But the process of acquiring information is costly in that it can require the expenditure of money and time, both scarce resources. The doctrine of negotiability provided D with a less costly means to reduce the insolvency risk.

¹⁸ See P. LAYARD & A. WALTERS, MICRO-ECONOMIC THEORY 360-62 (1978).

¹⁹ There were many possible defenses including usury, legal incompetence, and *ultra vires*. See STORY ON NOTES, *supra* note 14, at §§ 407-408(a). In addition, the paper in the hands of a transferee might be subject to ownership claims.

²⁰ The extent of his concern would be a function of his risk aversity (that is, the subjective positive or negative utility he derives from exposure to risk) plus the actuarial value of the risk (probability times magnitude). See R. POSNER, *supra* note 6, at § 4.5. It is safe to assume that many antebellum creditors were risk averse. See L. FRIEDMAN, *supra* note 1, at 236-37.

²¹ See Hirshleifer, *Where Are We in the Theory of Information?*, 63 AM. ECON. REV. 31 (1973).

²² Given the demand for information concerning credit worthiness, it is not surprising that the antebellum market provided credit reporting services. See T. FREYER, FORUMS OF ORDER: THE FEDERAL COURTS AND BUSINESS IN AMERICAN HISTORY 8 (1979). Expertise in evaluating credit risks was important to the success of note brokers. See generally A. GREEF, *supra* note 17, at 30-32.

One important attribute of negotiable commercial paper was that a person who signed as maker or indorser became bound to honor the paper to subsequent transferees with whom he would have no direct dealings.²³ Thus, if the law considered the note in the example to be negotiable, *D* would have rights against *A*, *B*, and *C*. In effect, *D* holds a portfolio of promises over which the risk of insolvency is diversified.²⁴ *A* might be robbed of all his money and be unable to honor his promise, but it is less likely that *A*, *B*, and *C* would have all suffered this misfortune.²⁵ Diversification was less beneficial for reducing risks that were more likely to affect *A*, *B*, and *C*'s solvency simultaneously such as a financial panic.

The risk of defenses such as failure of consideration could be similarly reduced through diversification so long as each party was permitted to interpose only his own defenses and not those of other parties.²⁶ Therefore, the negotiability doctrine also reduced the risk that *A* would assert a defense arising out of *B*'s performance of the lumber contract. However, a second significant consequence of negotiability provided particularly deserving transferees with protection against many defenses that a maker or indorser was entitled to assert against a mere contract assignee.²⁷ In order to receive this protection a transferee such as *D* would have to be a holder of the note who acquired it in the

²³ STORY ON BILLS, *supra* note 15, at §§ 107-08; STORY ON NOTES, *supra* note 14, at §§ 128, 135. The law also provided transferees with warranty rights against their immediate prior transferors.

²⁴ See generally POSNER, *supra* note 6, at § 15.1.

²⁵ See A. SMITH, *supra* note 12, at 329.

Though the drawer, acceptor, and endorser of the bill, should all of them, be persons of doubtful credit; yet, still the shortness of the date gives some security to the owner of the bill. Though all of them may be very likely to become bankrupts, it is a chance if they all become so in so short a time. The house is crazy, says a weary traveller to himself, and will not stand very long; but it is a chance if it falls to-night, and I will venture, therefore, to sleep in it to-night.

Id.

²⁶ In some situations a party could assert third party rights. See generally W. BRITTON, *supra* note 10, at §§ 157-60.

²⁷ STORY ON BILLS, *supra* note 15, at § 188; STORY ON NOTES, *supra* note 14, at § 191. Transferees may not have received protection against certain defenses such as usury. See

usual course of trade, for a valuable consideration, and without notice of any defense or other infirmity.²⁸ We may adopt Justice Story's phraseology and call this protected class "bona fide holders." Of course, bona fide holder status did not completely eliminate the defense risk. A could always seek to assert defenses against D by arguing, for example, that D was not a bona fide holder or that the note was not negotiable.²⁹ D would then have to decide whether the cost of litigating these issues with A was justified in light of the expected recovery and in light of the possibilities of enforcing the note against B or C.

While negotiability made the note more like money by reducing D's uncertainty concerning defenses, this gain may have been offset by diseconomies resulting from the placement of the risk of loss of defenses on A. Thus, it is necessary to also analyze the relative efficiency of these persons as risk bearers. A would clearly be the more efficient risk bearer to the extent that he had control over whether he had a defense. For example, if the price of the lumber was \$300 plus one horse, A's intentional failure to tender the horse could have caused B to refuse to deliver the lumber.³⁰ Assuming that A's defense was legitimate and not the result of A's failure to perform his side of the contract, two additional lines of inquiry are helpful in comparing A and D as risk bearers. First, it is necessary to consider the respective risk prevention capabilities of each person. Second, it is also necessary to consider their respective insurance capabilities.³¹

Under a legal regime of negotiability, A would have a variety of means to evaluate and reduce the possibility that a defense might be cut off by a bona fide holder.³² A was in privity with B.

M. HORWITZ, *supra* note 3, at 219-20. See also notes 37 & 103-04 *infra* and accompanying text.

²⁸ STORY ON BILLS, *supra* note 15, at § 188; STORY ON NOTES, *supra* note 14, at § 191.

²⁹ See note 45 *infra* and the accompanying text.

³⁰ A disincentive against dishonest or opportunistic conduct would lie in the harm that it could do to a commercial paper obligor's credit reputation. See note 22 *supra* and H. DEMSETZ, ECONOMIC, LEGAL, AND POLITICAL DIMENSIONS OF COMPETITION 37-38 (1982).

³¹ See R. POSNER, *supra* note 6, at §§ 4.5, 6.2-3.

³² This analysis assumes that the maker perceives the risk of cut off defenses. An inefficient allocation of resources can result if the maker is unaware of this cost when he signs

This could help A evaluate the likelihood of B's nonperformance prior to issuing the note.³³ This, along with information based on general knowledge and prior experience concerning the possibility that a bona fide holder might seek to enforce the note, would enable A to estimate the probability that his defenses would be cut off. The product of this probability and three hundred dollars, the face amount of the note and a base approximation of the magnitude of A's loss if he were deprived of defenses,³⁴ would provide a measure of the expected value of the risk.

Depending on the outcome of his evaluation of the likelihood that a defense would arise and be cut off, A could obtain additional information concerning B, withhold the note until he received the lumber, or take other risk reductive steps. Each of these measures would have attendant incremental costs which A would have to balance against the incremental value of the risk reduction purchased. Obtaining additional information about B's potential performance might require expenditures of time and money. The price for the lumber could be higher if B agreed away the right to a predelivery payment by negotiable note, thus foregoing the opportunity to immediately negotiate the note to C in order to purchase the wagon. Transaction costs relating to working out the terms of the lumber contract might be increased to the extent that protective measures resulted in nonstandard terms. A would be willing to purchase risk reduction up to the

the instrument. For a discussion of this source of inefficiency in a twentieth century context, see Geva, *Optimality and Preservation of Consumer Defenses—A Model for Reform*, 31 CASE W. RES. L. REV. 51, 54-63 (1980). The holder's perceptions are also important. A transferee that charges a discount based on the assumption that he will be subject to any defenses that may arise receives a windfall if it turns out that he is protected by negotiability doctrine.

³³ A's defense risk was not limited to the possibility that his defenses might be cut off by a bona fide holder. It would also include, for example, the possibility that he would be forced into litigation to establish a defense against a non-bona fide holder. A's risks relating to defenses would have been elements of the set of all risks relating to the contract. For example, the risk that B's nonperformance would necessitate the purchase of substitute lumber at a higher price. Means of risk reduction relating to defenses could help reduce these other risks as well.

³⁴ A's loss could exceed payment of \$300 for lumber never received. He might have to pay interest in order to borrow the money, or the payment might render him unable to continue in business. B might not be equally liable for all these damages or might be insolvent. See *Hadley v. Baxendale*, 156 Eng. Rep. 145 (Ex. 1854). The loss might be less than \$300 if B's performance had some value to A.

point that its marginal cost equaled its marginal benefit.

Information concerning the likelihood of *B*'s nonperformance would also enhance *A*'s capability to insure, perhaps by paying a third party to guarantee *B*'s performance under what would amount to a contract of market insurance. As a less costly alternative, *A* might pay a slightly lower price to each person from whom he purchases goods and services, thereby spreading the risk of loss of defenses through a form of self-insurance.

Under a legal regime of nonnegotiability, remote holders such as *D* would seek to reduce the possibility of being subject to defenses. Given the exigencies of antebellum communications and transportation, *D* could be handicapped in this endeavor if *A* and *B* were geographically distant.³⁵ Thus, it may have been relatively costly for *D* to evaluate the probability of being subject to defenses. Assuming that this risk could be evaluated, *D* might avoid the risk by refusing to purchase the note. If *D* preferred not to completely forego the opportunity to enforce the note, then he might require that compensation for accepting the defense risk be reflected in the discount. *D* would also have means to insure against the risk. He might pay a third party to guarantee the note. He might also self-insure by acquiring a portfolio of multiple instruments bearing the names of different obligors and, thus, bearing different risks. *D* might also self-insure by increasing the discount charged to all transferors from whom he acquires commercial paper.³⁶

In summary, placement of the risk of cut off defenses on *A* and relieving *D* of the risk of being subject to defenses if he was a bona fide holder may have been economically correct given the probability of *A*'s superior access to information concerning the transaction which generated the note. This access would give *A* an advantage in both preventing and insuring against his risk. Any margin of superiority enjoyed by *A* would be reduced if the analysis also reflects the possibility that *D* might diversify his risks through multiple indorsements on *A*'s note. This additional

³⁵ See T. COCHRAN & W. MILLER, *THE AGE OF ENTERPRISE* 56-59 (Rev. ed. 1961). Of course, it also is possible that *A* and *B* resided near or were otherwise well known to *D*.

³⁶ The size of the discount would also have reflected other factors such as *D*'s inability to obtain immediate payment under time notes.

attribute of negotiability would have been particularly important to *D* if other means of self-insurance were less effective because he did not deal in commercial paper in volume.

Some obligors and bona fide holders may have been more or less efficient than *A* and *D* with respect to preventing or insuring against the risk of cut off defenses. Avoidance of the administrative costs and uncertainty of particularized inquiries might have justified a rule that always permitted bona fide holders to cut off defenses even if the rule led to inefficient results in occasional cases. However, negotiability doctrine ultimately developed so as to permit certain groups of commercially unsophisticated persons to assert defenses against bona fide holders, perhaps because these obligors did not enjoy an advantage in dealing with the defense risk.³⁷ Bona fide holders were also subject to certain defenses such as that an instrument originated in a usurious transaction. The classes of defenses not cut off by bona fide holders, sometimes called "real defenses," were narrowly defined and probably less common and less easily trumped-up than the "personal defenses" such as failure of consideration and most types of fraud that were cut off. Thus, the real defenses may not have significantly impaired the utility of commercial paper in its money substitute role.

This analysis suggests how the requirements for bona fide holder status served a risk-shifting function. Bona fide holders were permitted to have generalized knowledge of the "defense riskiness" of commercial paper. But this special status was not available to a holder with knowledge of a particular defense at the time he acquired the paper.³⁸ Requirements of lack of knowledge, acquisition in the ordinary course of trade, and bona fides shifted the defense risk from obligors to holders who could have avoided a known defense risk by refusing to give value against the paper but instead chose to take that risk on the theory that the paper would prove to be more valuable than its cost.³⁹ The

³⁷ This development took place after midcentury when the importance of commercial paper's money substitute role had begun to diminish. See note 94 *infra*. Concerning the defenses that could be successfully asserted against a bona fide holder, see generally text accompanying notes 102-04 *infra*; W. BRITTON, *supra* note 10, at 125; M. HORWITZ, *supra* note 3, at 219.

³⁸ See notes 41-42 *infra* and the accompanying text.

³⁹ See R. POSNER, *supra* note 6, at § 6.6.

decision to take the risk may have been based on an assessment that the circumstances of acquisition were such that a court would mistakenly hold that the acquisition met the requirements for bona fide holder protection. It may also have reflected a holder's preference for risk or gambling.⁴⁰

The optimal level of transferee risk prevention would have reflected the severity of the standard of care created by these bona fide holder requirements. Would-be bona fide holders would have to take greater precautions if the standard ruled out transfers that would have excited the suspicions of a prudent person than if it ruled out only those involving gross negligence in failing to learn of a defense.⁴¹ A lower standard of care, by narrowing the circumstances that could impugn bona fide holder status, would have made commercial paper less risky and more attractive as a money substitute. But it might also have reduced transferees' incentives to exercise care in the acquisition of commercial paper and made the intentional purchase of questionable paper more attractive. It comes as no surprise that issues such as the appropriate standard of good faith for bona fide holders were of much concern during the antebellum period.⁴²

Having examined the positions of *A* and *D*, it is now appropriate to consider the situations of *B* and *C*, the intermediaries in the chain of negotiation. It will be recalled that *B* received the note directly from *A* in payment for lumber and then indorsed it to *C* for the current purchase of a wagon. *B* was the payee and dealt directly with *A*. It would not further the circulation of commercial paper to permit *B* to take free of *A*'s defenses and the law did not afford *B* such protection.⁴³ *C*, on the other hand, may have been deserving of bona fide holder protection from the defense risk if he had sought to enforce *A*'s contract. The reason *C*

⁴⁰ See note 20 *supra* for a discussion of risk aversity.

⁴¹ On the other hand, a higher standard for transferees may have reduced the optimal level of precautions for commercial paper obligors.

⁴² See STORY ON BILLS, *supra* note 15, at § 194; STORY ON NOTES, *supra* note 14, at § 197; 3 J. KENT, COMMENTARIES ON AMERICAN LAW 81-82. See also Rightmire, *The Doctrine of Bad Faith in the Law of Negotiable Instruments*, 18 MICH. L. REV. 355 (1920).

⁴³ The courts did recognize, however, that there was reason to protect a person who appeared to be the payee on the face of a note but who was actually a remote purchaser. See Aigler, *Payees as Holders in Due Course*, 36 YALE L.J. 608 (1927).

deserves special attention is that he chose to indorse and transfer the note, thereby taking on indorser liability to subsequent transferees.

C's indorsement risk resulted from the possibility that he would be called upon by *D* to honor his indorser's contract if *A* did not meet his obligation as a maker. This risk was reduced by C's ability to look to *B* who had previously indorsed and to *A* on his maker's contract.⁴⁴ Thus, negotiability doctrine not only sought to relieve ultimate bona fide holders of the defense risk, but also sought to move the indorsement risk up the chain of indorsements toward the payee. This would have been an efficient rule to the extent of the probability that there was a direct relationship between the order of indorsement and each intermediate indorser's capability to evaluate the probability and magnitude of the risk that the maker might assert a defense. If *B* honored his indorsement contract, then all subsequent transferees would be insulated from the unpleasanties between *A* and *B* who would then bear most of the costs of their dispute.

A variety of other rules were also intended to enhance commercial paper in its antebellum medium of exchange role. Spare form requirements, such as that bills or notes contain an unconditional order or promise to pay a sum certain in metallic money, enabled transferees to quickly ascertain the terms of the promises embodied in the paper.⁴⁵ Title to commercial paper could be

⁴⁴ Holders could indorse "without recourse" if they wanted to avoid this risk. But they may have remained liable to their immediate transferees on a breach of warranty theory despite this form of indorsement. See Britton, *The Liability of a Transferor by Delivery and A Qualified Indorser*, 40 YALE L.J. 215 (1930).

The indorsement risk was also reduced by a set of rules which required holders to initially seek payment from the maker or the drawee of a draft and to give prompt notice to prior indorsers if such payment was not forthcoming as per the terms of the instrument. See 2 J. DANIEL, A TREATISE ON THE LAW OF NEGOTIABLE INSTRUMENTS ch. XXIX (3rd ed. 1882). These rules may have been efficient because possession of the instrument provided a holder such as *D* with two important advantages over prior indorsers. First, the instrument would have specified the amount, time, place and other details relating to payment. Second, physical presentment of the instrument was normally required to obtain payment and promptness in obtaining payment would tend to reduce the insolvency risk and perhaps other risks as well. See *id.* at ch. XLVI; 1 *id.* at XVII-XX. It was well understood that the insolvency risk increased with the passage of time. See note 25 *supra*.

⁴⁵ See STORY ON BILLS, *supra* note 15, at §§ 32-69; STORY ON NOTES, *supra* note 14, at §§ 8-59. Chattel notes payable, for example, in hay or hogs, were denied negotiable status because of their nonstandard nature. L. FRIEDMAN, *supra* note 1, at 236.

passed merely by delivery or delivery with the indorsement of the transferor.⁴⁶ Holders who brought suit on commercial paper enjoyed certain procedural advantages denied to mere contract assignees.⁴⁷ The "shelter" doctrine provided that a bona fide holder could transfer his right to take free of defenses to his immediate transferee even if the transferee could not qualify for bona fide holder status in his own right.⁴⁸ Thus, the law of negotiability served to make each bill and note "a courier without luggage."⁴⁹

Finally, one can observe that if it was the pervasive importance of commercial paper as a medium of exchange that supported antebellum negotiability doctrine, the application of this doctrine might be questioned by a judge when it appeared that the paper in question had not served such a function. For example, the troublesome question of whether pledgees of commercial paper given to secure an antecedent debt had given the requisite value for bona fide holder status may have reflected a judicial perception that pledged paper was less like coinage circulating from hand to hand in commerce and more like a silver cup or a keg of whiskey given as collateral.⁵⁰ Such personalty represented a store of value, but did not circulate widely as an exchange medium. The issue of whether taking commercial paper in satisfaction of a pre-existing debt constituted receiving value may have fallen somewhere between the case of a pledge and the case described in the example in which *C* received the note in current payment for a wagon.⁵¹ The paper's store of value

⁴⁶ See STORY ON BILLS, *supra* note 15 at § 109; STORY ON NOTES, *supra* note 14, at § 43.

⁴⁷ See STORY ON BILLS, *supra* note 15, at §§ 178, 193; STORY ON NOTES, *supra* note 14, at §§ 181, 196.

⁴⁸ See STORY ON BILLS, *supra* note 15, at § 189; STORY ON NOTES, *supra* note 14, at § 191.

⁴⁹ *Overton v. Tyler*, 3 Pa. 346, 347 (1846). The law of negotiable instruments also benefitted the obligor. For example, payment to a holder discharged the instrument and the underlying obligation. Gilmore, *Formalism and the Law of Negotiable Instruments*, 13 CREIGHTON L. REV. 441, 450 (1979).

⁵⁰ This was an important issue. See STORY ON BILLS, *supra* note 15, at § 191; STORY ON NOTES, *supra* note 14, at § 195. Concerning pledges, see generally 1 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY §§ 1.1, 1.3 (1965) which includes antebellum references.

⁵¹ See STORY ON BILLS, *supra* note 15, at § 192; STORY ON NOTES, *supra* note 14, at § 195.

function may have been highlighted and its medium of exchange function less apparent, particularly if the holder-creditor planned to require payment on the note rather than to renegotiate it. Of course, metallic money would have been at least as acceptable to a creditor in search of security for or payment of an antecedent debt and would certainly have not ceased to be viewed as money in the creditor's hands. Commercial paper may have been properly viewed in the same light by courts holding that antecedent creditors receiving commercial paper gave value in these situations.⁵²

II. NEGOTIABILITY AND WRONGDOING

Thus far this analysis has largely ignored the possibility that commercial paper was sometimes employed in fraudulent or other socially disapproved activities.⁵³ However, it has been suggested that the species of commercial paper referred to as "accommodation paper" was sometimes judicially perceived as tainted and that this may have been a factor in the formulation of case law involving negotiability.⁵⁴ It is therefore appropriate, in conjunction with our earlier discussion of possible diseconomies resulting from negotiability, to analyze whether forms of wrongdoing associated with accommodation paper or other criminal or tortious conduct were exacerbated by the development of negotiability.⁵⁵

Initially, it is necessary to recognize that accommodation paper can be divided into three distinct subcategories, each of which was common in American commerce and finance prior to the Civil War.⁵⁶ One type bore the signature of an accommoda-

⁵² See, e.g., *Swift v. Tyson*, 41 U.S. (16 Pet.) 1, 19-20 (1842).

⁵³ We have seen a relationship between negotiability doctrine and gambling. See the accompanying text at note 40 *supra*. Antebellum judges were concerned with speculation in commercial paper. See M. HORWITZ, *supra* note 3, at 216.

⁵⁴ For a discussion of judicial attitudes toward the negotiability of accommodation paper, see Freyer, *Antebellum Commercial Law: Common Law Approaches to Secured Transactions*, 70 Ky. L.J. (No. 2) (1981-82).

⁵⁵ Concerning the costs of various forms of wrongdoing, see Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169, 179-80 (1968).

⁵⁶ See generally T. FREYER, *supra* note 22, at 10-11; R. KILBOURNE, *LOUISIANA COMMERCIAL LAW: THE ANTEBELLUM PERIOD* 137-38 (1980); H. KROOS & C. GILBERT, *AMER-*

tion party who was actually a surety. The surety would lend his signature in order to enhance the attractiveness of a bill of exchange or note to potential transferees. In our example above, A would have been an accommodation maker if he issued the note to B not in payment for lumber, but solely to enable B to purchase the wagon from C. Accommodation parties also signed as drawers, acceptors, and indorsers. A second type of accommodation paper was commercial paper issued for a pre-existing debt.⁵⁷ A pre-existing debt was involved in the case of the renewal notes executed in conjunction with medium or long term loans. The debtor issued successive short term renewal notes with the understanding that the debt would be extended upon each note's maturity. Antebellum commercial usage was such that a note issued to evidence a prior debt might also carry the signature of a surety-type accommodation party.⁵⁸ The accommodation label was also applied to a third type of commercial paper that was actually nothing more than written evidence of accounts receivable. In our example, A's note given in payment for the lumber could have fallen into this category.

Accommodation paper of the surety type may have been accurately perceived as sometimes being employed as an instrument of fraud.⁵⁹ Accommodation signatures, which were certainly placed on notes to induce third party reliance, often did not evidence actual obligations and may have sometimes been made without any intent to ever honor the paper. Accommodation paper of the pre-existing debt type may have been the subject of judicial disapproval because it did not issue for a current obligation and, perhaps, because of a bias against long-term borrowing.

All types of accommodation paper were difficult to distin-

ICAN BUSINESS HISTORY 111-14 (1972); F. REDLICH, *THE MOLDING OF AMERICAN BANKING* 11-12, 44-45 (1968).

⁵⁷ The negotiability of such paper presents an issue which is distinct from that of whether a transferee who took commercial paper in satisfaction of an antecedent debt gave sufficient value to be a bona fide holder. The latter issue is discussed at notes 50-52 *supra* and accompanying text.

⁵⁸ See, e.g., *Bank of Montgomery County v. Walker*, 9 Serg. & Rawle 229 (Pa. 1823).

⁵⁹ See T. FREYER, *supra* note 22, at 10-11; Freyer, *supra* note 54.

guish on their face from nonaccommodation paper.⁶⁰ A legal rule that interfered with the full negotiability of any type of accommodation paper would have necessarily increased the riskiness of all commercial paper transactions. Thus, the importance of commercial paper as a medium of exchange was often given as a sufficient rationale for permitting bona fide holders to enforce accommodation paper in the same manner as any other commercial paper.⁶¹ An economic analysis of the relationship between negotiability and the disapproved practices associated with accommodation paper suggests that such a rule would not have resulted in important diseconomies.⁶²

A decision rule impairing the negotiability of any type of commercial paper would have to be justified in light of the fact that the paper may have been issued as part of a consensual commercial or financial transaction which the participants viewed as mutually beneficial and value enhancing and which was free from tortious or criminal motivations. An individual might lend his name as an accommodation in anticipation of a hoped for future benefit. A financing arrangement involving renewal notes could enable the debtor to purchase an expensive capital good, such as a ship, and allow the creditor to earn a profit. Accounts receivable type accommodation paper enabled sellers and capital poor buyers to enter into credit sales. Further analysis illustrates the ambiguous and sometimes inefficient results of limiting negotiability in order to deal with the abuses associated with accommodation paper. Surety-type accommodation paper is used in the discussion because of the concrete nature of the fraud in which it was sometimes employed.

⁶⁰ Commercial paper brokers may have sought to distinguish accommodation from nonaccommodation paper. R. KILBOURNE, *supra* note 56, at 137 n.65.

⁶¹ The paper could be legally enforced even if the holder knew that it bore a surety-type accommodation. See *Grant and Cary v. Ellicott*, 7 Wend. 227 (1831). See generally J. KENT, *supra* note 42, at 86; STORY ON BILLS, *supra* note 15, at § 190; STORY ON NOTES, *supra* note 14, at § 194.

⁶² It is possible that surety-type accommodation paper was troublesome because of a belief that it was unfair for accommodation parties to have to honor their contract or because the special law of suretyship applied to accommodation signatures. However, it seems plausible that accommodation signers generally understood the risk of signing when they gave their accommodations. See L. FRIEDMAN, *supra* note 1, at 236-37; R. KILBOURNE, *supra* note 56, at 147.

The quantity of commercial paper demanded would increase as its cost decreased, *ceteris paribus*.⁶³ Commercial paper would be less costly to bona fide holders if they could expect to be free of the risk of inability to fully enforce surety-type accommodation paper. This could result in an increase in demand for all legitimate appearing commercial paper. If producers of fraudulent but facially legitimate accommodation paper could increase their output, as seems likely, one result of removing this risk from bona fide holders would be an increase in the quantity of fraudulent accommodation paper in the market. At the same time, however, allowing full bona fide holder recovery on accommodation contracts also would increase the costs of producing fraudulent paper.⁶⁴ All accommodation paper signers, including defrauders, would have to be concerned with the possibility of being legally required to honor their contracts if the paper was ultimately negotiated to a bona fide holder.⁶⁵ Thus, the effects of a rule treating surety-type accommodation paper like any other commercial paper would have been countervailing and it is not obvious which would have predominated.

On the other hand, a rule impairing bona fide holder recovery on surety-type accommodation paper by allowing accommodation parties to raise the defense of lack of consideration against bona fide holders would have made commercial paper a more risky medium of exchange by decreasing the reliability of its information content.⁶⁶ This could decrease the demand for all commercial paper, although given the general antebellum money shortage it is highly likely that commercial paper would still have been employed as an exchange medium. But transferees would have diverted additional resources from other uses in order to reduce their risks and discounts would have increased in size.⁶⁷

⁶³ See generally J. HIRSHLEIFER, *supra* note 11, at chs. 2, 4.

⁶⁴ See generally *id.* at ch. 14.

⁶⁵ See *Bank of Montgomery County v. Walker*, 9 Serg. & Rawle at 239-40.

⁶⁶ See generally R. MCKENZIE & G. TULLOCK, *THE NEW WORLD OF ECONOMICS* 151-53 (3d ed. 1981). The paper's information content would be even more diminished if the rule made accommodation paper completely nonnegotiable so that any obligor could assert defenses.

⁶⁷ See notes 35-37 *supra* and the accompanying text for a discussion of the means available for transferees to reduce their risks.

Thus, a rule impairing bona fide holder recovery on accommodation paper may have been perverse from an efficiency point of view.

While the existence of actual illegality or tortious conduct in cases involving accommodation paper, broadly defined, was often doubtful, antebellum judges frequently encountered cases in which commercial paper had most certainly been the subject of theft, fraud, unauthorized alteration, or forgery. Keeping in mind the preceding discussion, the following observations suggest some issues which might be addressed in an economic analysis of the rules applied to these more concrete forms of wrongdoing.⁶⁸

Consider commercial paper stolen from the maker's possession immediately after it was signed by the maker or paper issued by the maker in reliance upon fraudulent representations by the payee. Each situation presents something less than a voluntary market transaction which can be presumed to reallocate resources to a more valuable use.⁶⁹ Theft involves a coerced wealth transfer which is the antithesis of efficient exchange. Theft of a promise to pay \$100 in one month, if legally enforceable, is much like the theft of \$100 in cash.⁷⁰ Issuance of the note in the fraud situation may seem voluntary in that the maker signed and delivered of his own free will, but there was market failure resulting from disinformation introduced by the payee.⁷¹

The lack of a voluntary exchange in each case might provide an efficiency-based rationale for permitting the maker to recover his instrument, even from a bona fide holder. But there would have been a voluntary exchange between the bona fide holder and his immediate transferor. The requirements for bona fide holder status seem to have been designed to insure that it was obtained only by holders who acquired commercial paper in transactions that were voluntary, value maximizing, and entered into with an honest expectation of obtaining good title. Thus, the effi-

⁶⁸ See also Weinberg, *Sales Law, Economics, and the Negotiability of Goods*, 9 J. LEG. STUD. 569 (1980).

⁶⁹ See R. POSNER, *supra* note 6, at §§ 4.6-4.7.

⁷⁰ The present value of the note would be less than \$100 because of the types of risks discussed in this article and the contractually specified delay in obtaining payment.

⁷¹ See R. POSNER, *supra* note 6, at §§ 4.6-7.

ciency of voluntary exchange supports the title claims of both the maker of the note and the bona fide holder. Absent an agreement directly between these persons, there is no way to be certain that the former would obtain more utility by being relieved of his promise through return of the note than would the latter by being permitted to enforce or negotiate its obligations.⁷²

It is important to observe that many courts required that an instrument be voluntarily "delivered" before it would bind the obligor.⁷³ (The stolen note in the example would not have been delivered by the maker.) This requirement created a property right not only in the paper and ink composing the physical note but also, more importantly, in the signer's contractual integrity.⁷⁴ The requirement that a person's genuine signature be placed on commercial paper before he became legally bound thereon served the same function of preserving freedom from nonconsen-

⁷² See *id.* at § 1.2. This discussion assumes that a person with a defective title can be a bona fide holder. It became improper at some point, perhaps after enactment of the Uniform Negotiable Instruments Law promulgated in 1896, to refer to one who took a forged indorsement as "holder." See W. BRITTON, *supra* note 10, at §§ 3, 158. Such a transferee could not be a bona fide holder even if he met all other requirements for this status.

⁷³ See I. J. DANIEL, *supra* note 44, at § 63.

⁷⁴ As one court observed:

The wrongful act of a thief or a trespasser may deprive the holder of his property in a note which has once become a note, or property, by delivery, and may transfer the title to an innocent purchaser for value. But a note in the hands of the maker before delivery is not property, nor the subject of ownership, as such; it is, in law, but a blank piece of paper. Can the *theft* or wrongful *seizure* of this paper create a *valid contract* on the part of the maker *against his will*, where *none* existed *before*? There is no principle of the law of contracts upon which this can be done, unless the facts of the case are such that, in justice and fairness, as between the maker and the innocent holder, the maker ought to be estopped to deny the making and delivery of the note. . . .

We do not assert that the general rule we are discussing—that "where one of two innocent parties must suffer," etc.—must be confined exclusively to cases where a confidence has been placed in some other person (in reference to delivery) and abused. There may be cases where the culpable negligence or recklessness of the maker in allowing an undelivered note to get into circulation, might justly estop him from setting up non-delivery; as if he were knowingly to throw it into the street, or otherwise leave it accessible to the public, with no person present to guard against its abduction under circumstances when he might reasonably apprehend that it would be likely to be taken.

sual "contract" obligations.⁷⁵

Like the defense risk discussed earlier, obligors and bona fide holders could reduce the risks relating to commercial paper that was taken from obligors through theft, fraud, and other forms of wrongdoing by taking preventive measures or through insurance. Identification of the more efficient class in this regard would help to determine whether a decision rule protecting the members of one class was more appropriate than a rule protecting the other. It is noteworthy that as the law of commercial paper developed, the failure to observe precautions with respect to the custody, execution, completion, or delivery of commercial paper became an important factor in cases deciding whether bona fide holders took free of the defenses or title claims of makers or other obligors.⁷⁶ This standard affected the level of risk prevention and insurance optimal for makers and other obligors and could impede the use of commercial paper if set too high.⁷⁷

Future analysis of the efficiency of legal doctrine used to resolve disputes between obligors and bona fide holders of commercial paper which was the subject of criminal or tortious wrongdoing would also have to consider a particular rule's effect on the supply of and demand for such paper and on the level of wrongdoing-related diseconomies.⁷⁸ There is evidence that some courts were concerned with the impact of negotiability on crime. For example, it was suggested that the bona fide holder of an instrument bearing a forged indorsement should not be protected by a negotiability rule because he (rather than the obligor) was in the best position to pursue the forger.⁷⁹ In terms of economic theory, the possibility of a successful pursuit and punishment

⁷⁵ See 2 J. DANIEL, *supra* note 44, at § 1351.

⁷⁶ See generally Britton, *Negligence in the Law of Bills and Notes*, 24 COLUM. L. REV. 695 (1924). Compare the problem of defining an appropriate standard of care for bona fide holders, discussed at notes 38-42 *supra* and accompanying text.

⁷⁷ One might draw an interesting comparison between the resulting pattern of commercial paper rules and tort liability rules. See generally Brown, *Toward an Economic Theory of Liability*, 2 J. LEG. STUD. 323 (1973).

⁷⁸ See note 55 *supra* and the accompanying text concerning diseconomies resulting from wrongdoing.

⁷⁹ Whether the forgery victim or bona fide holder had been the more negligent actor was also considered. See generally Kessler, *Forged Indorsements*, 47 YALE L.J. 863, 866-68, 871-72 (1938).

would have imposed a risk-cost on the production of forged paper.⁸⁰

CONCLUSION:

EFFICIENCY VERSUS WEALTH REDISTRIBUTION VERSUS . . .

The historical examination of antebellum commercial law is in its infancy. Perhaps one of Professor Horwitz' most important contributions to this endeavor is the interest which he has generated in the field, an interest largely resulting from his challenge to the "generally shared assumption that 'modernization' is an unqualified good and that the development of legal doctrines to reflect the triumph of a market system was both inevitable and desirable."⁸¹ Debate has been heightened by his contention that "'commercial uniformity' and 'legal certainty and predictability' are often uncritically put forth as explanations of the rise of commercial law, without the slightest understanding that each of these disembodied constructs conceals a whole set of political and economic values which were, in fact, resisted from the beginning of the century."⁸² This conclusion offers some observations concerning how the inquiry stimulated by Horwitz might be advanced and suggests how existing research provides an important counterpoint to the themes he developed in his discussion of "the rise of negotiability."⁸³

Among other things, this article suggests how persons whose livelihoods were directly or indirectly dependent on commercial or financial activity could have been benefited by negotiable

⁸⁰ Transferors of forged paper also bore the costs of potential warranty or indorsement liability to transferees. *See id.* at 872-75.

⁸¹ M. HORWITZ, *supra* note 3, at 211-12. The publication of Horwitz' work stimulated an outpouring of comment and review, most of which has been directed at portions of his book dealing with subject matter other than the negotiability of commercial paper. *See, e.g.,* Simpson, *The Horwitz Thesis and the History of Contracts*, 46 U. CHI. L. REV. 533 (1979).

⁸² M. HORWITZ, *supra* note 3, at 212.

⁸³ *Id.* at 212-26. Horwitz argues that promissory notes were not as well known as bills of exchange at the beginning of the antebellum period and that it is doubtful whether notes, as opposed to bills, were considered negotiable at this time. *See id.* at 214-15, nn. 6-12. Whether or not this is accurate, Horwitz is certainly correct that negotiability doctrine applicable to both bills and notes continued to evolve during 1780-1860.

commercial paper in its role as a money substitute.⁸⁴ Professor Horwitz did not deny the benefits provided by these instruments when he asserted that judicially fashioned commercial law doctrines such as negotiability "were primarily meant to protect those groups that stood to benefit from an expanding market economy."⁸⁵ Rather, his concern lies with those groups in society that did not stand to benefit from expansion and those "opposed to the expanding values of a market economy."⁸⁶

One difficulty in coming to grips with these concerns in Professor Horwitz' discussion of negotiability lies in the vaguely defined composition of these two groups of nonbeneficiaries which were not necessarily identical. The former group might contain persons who were unable to enter the market place. Of the latter group we are told little more than it possessed "a still dominant precommercial consciousness of rural and religious America"⁸⁷ It may have consisted of persons who did not benefit from market expansion by choice or persons who did benefit but nonetheless objected philosophically to economic development. Horwitz' reference to the "commercially unsophisticated"⁸⁸ could pertain to the members of either group.

Undoubtedly there were Americans who confronted insurmountable barriers excluding them from the benefits of commercial or financial endeavors facilitated by negotiability of commercial paper and who, as a result, fell into Professor Horwitz'

⁸⁴ The class of direct beneficiaries of negotiability consisted of many subclasses including shipping, agricultural, merchant, and financial interests. See R. KILBOURNE, *supra* note 56, at 159, 169. Commercial paper litigation, which may have been most frequent during periods of financial stress, frequently involved members of these subclasses. *Id.* at 133, 165, 206. In addition to direct beneficiaries, there may have been indirect beneficiaries such as persons who obtained employment in a growing economy.

⁸⁵ M. HORWITZ, *supra* note 3, at 212.

⁸⁶ *Id.* at 211.

⁸⁷ *Id.* Professor Horwitz also did not elaborate upon what he considered to be a major policy issue contributing to resistance to negotiability: "[T]he continuing fear that through negotiability of notes legislatures would lose control over the money supply." *Id.* at 213, 218. It is unclear whether this fear was grounded in concern over erosion of legislative power, inflationary increases in the general price level, or the wealth transfers theoretically obtainable by a private money issuer through unanticipated inflation. Concerning the latter two possibilities, see generally Klein, Crawford, and Alchian, *Vertical Integration, Appropriate Rents, and the Competitive Contracting Process*, 11 J. LAW & ECON. 297, 324 (1978).

⁸⁸ M. HORWITZ, *supra* note 3, at 219.

first group. These persons may have been handicapped by economic ignorance, geographic separation from any market place in which commercial paper was employed, wealth endowments that were insufficient to stake entry, or in other ways. There is also evidence, however, that commercial paper was utilized by Americans with limited financial resources and expertise no more substantial than that required to utilize a modern checking account.⁸⁹ Moreover, antebellum conditions were such that persons who were unsuccessful in commercial or financial endeavors might discreetly disappear only to try again at some future time.⁹⁰ Persons who lacked a credit reputation sufficiently sound to permit them to negotiate their commercial paper to banks could obtain discounts from note brokers.⁹¹ Thus, one can plausibly argue that under antebellum circumstances negotiability doctrine helped to lower entrance barriers by reducing the riskiness of instruments executed by debtors who lacked a reputation for credit worthiness.⁹²

The possibility that relatively unsophisticated individuals might become involved in commercial paper usage suggests an explanation for any increase in judicial acceptance enjoyed by negotiability from 1780 to 1860 which, unlike Professor Horwitz' explanation, is not dependent on the existence of pro-commercial treatise writers and federal judges bent on advancing the interests of merchants and entrepreneurs. This explanation would recognize that novices might not have understood that by executing an instrument they were, in effect, agreeing to not assert defenses or claims against bona fide holders. A legal environment in which the state of negotiability doctrine was uncertain would have reinforced this naivete. Antebellum courts might have become more willing to adopt or expand protection for bona fide holders as the risks involved in signing commercial paper became more broadly understood.⁹³

⁸⁹ See L. FRIEDMAN, *supra* note 1, at 236, 468; A. GREEF, *supra* note 17, at 1-37; Freyer, *supra* note 54, (in print).

⁹⁰ See T. FREYER, *supra* note 22, at 9, 57.

⁹¹ See A. GREEF, *supra* note 17, at 1-37.

⁹² See note 37 *supra* and the accompanying text for a discussion of the advantages credit information would give to a potential creditor.

⁹³ See generally Posner, *The Ethical and Political Basis of the Efficiency Norm in Common Law Adjudication*, 8 HOFSTRA L. REV. 487 (1980).

It should be observed here that twentieth century commercial paper developments suggest a drawing back from commercial paper negotiability.⁹⁴ Courts and legislatures gradually began to disallow financiers' claims to the rights of a holder in due course (the twentieth century's equivalent to a bona fide holder) on promissory notes executed by consumers.⁹⁵ One reason that consumers were permitted to assert defenses against remote holders was that they had not understood or bargained for the possibility of their loss.⁹⁶ Language from judicial opinions quoted by Professor Horwitz seems to suggest that nineteenth century courts were also concerned with whether parties signatory to commercial paper had fully understood the consequences of affixing their names to the instrument.⁹⁷

There undoubtedly also were Americans who fell into Professor Horwitz' second group of persons whose precommercial and religious consciousness was offended by economic development.⁹⁸ However, disputes which ultimately focused on some aspect of negotiability were seldom if ever skirmishes between this group and "aggressive business interests."⁹⁹ Nor were these disputes necessarily resolved on the basis of pro- or anti-commercial judicial bias. For example, one can postulate that sectional rivalry was influential in shaping developments relating to negotiabil-

⁹⁴ Professor Gilmore has suggested that currency reforms and modern uses of bank credit had begun to make commercial paper obsolete as a money substitute by the mid-nineteenth century. Gilmore, *The Good Faith Purchase Idea and the Uniform Commercial Code: Confessions of a Repentant Draftsman*, 15 GA. L. REV. 605, 613 (1981). However, courts still recognize that some types of commercial paper function like money. See *Ashford v. Thomas Cook & Son*, 471 P.2d 530 (Hawaii 1970).

⁹⁵ See U.C.C. § 3-305 (1972). See generally Rohner, *Holder in Due Course in Consumer Transactions: Requiem, Revival, or Reformation?*, 60 CORNELL L. REV. 503 (1975). Holder in due course protection on consumer notes was substantially abolished in 1975 by the Federal Trade Commission. 16 CFR § 433.1-.2 (1979).

⁹⁶ Economic analysis demonstrates how an inefficient allocation of resources can result from a debtor's failure to perceive the risk of lost defenses when deciding whether to execute a note. See note 32 *supra*.

⁹⁷ See M. HORWITZ, *supra* note 3, at 217.

⁹⁸ Perhaps they disliked "speculation" involving commercial paper. See A. GREEF, *supra* note 17, at 13-26 for a discussion of the speculative nature of the antebellum commercial paper business.

⁹⁹ M. HORWITZ, *supra* note 3, at 211. See Freyer, *supra* note 54; note 84 *supra* for discussions of the identities of the combatants in antebellum commercial paper litigation.

ity.¹⁰⁰ Courts may not have favored debtors or creditors, farmers or businessmen, but were instead interested in protecting the members of these classes within their jurisdictions against outsiders.

Furthermore, precedential constraints may have had more to do with the final result of some negotiability-related litigation than any form of judicial bias. As one example, the outcome of cases considering the issue of whether bona fide holder status could be obtained by persons who acquired negotiable instruments as security for or in satisfaction of a pre-existing indebtedness may have been substantially influenced by a doctrinal need to find payment of a present consideration by the holder.¹⁰¹

Finally, at least one postbellum development in the law of negotiable instruments does not seem consistent with Professor Horwitz' conclusion that by around 1850 "[l]aw, once conceived of as protective, regulative, paternalistic, and, above all, a paramount expression of the moral sense of the community, had come to be thought of as facilitative of individual desires and as simply reflective of the existing organization of economic and political power."¹⁰² After 1869 many American courts began to protect persons who signed negotiable instruments in reliance upon misrepresentations concerning the character of the instrument.¹⁰³ A common case was that in which the signer had been led to believe that he was executing an agreement authorizing him to sell some manufactured product on commission. Persons who may have been incapable of judging their self interest, such as the aged, sick, and illiterate, were often the victims of this type of

¹⁰⁰ See T. FREYER, *supra* note 22, at 11, 13, 15, 22-23, 28-29. See also A. GREEF, *supra* note 17, at 18. But see R. KILBOURNE, *supra* note 56, at 206.

¹⁰¹ See *Coddington v. Bay*, 20 Johns 637 (N.Y. 1822). See generally 1 J. DANIEL, *supra* note 73, at §§ 820-32.

¹⁰² M. HORWITZ, *supra* note 3, at 253. Professor Horwitz also argues that the formalism characteristic of postbellum judicial opinions was designed to consolidate the legal gains achieved by groups possessing economic and political power. *Id.* at 253-66. This argument is challenged by Professor Gilmore, who concludes that, but for legislative intervention, "the law of negotiable instruments would in all probability have, by the early part of this century, . . . become a sort of ghostly echo from the past . . ." because the money substitute role of commercial paper became less important. Gilmore, *supra* note 49, at 456.

¹⁰³ See generally Britton, *Fraud in the Inception of Bills and Notes*, 9 CORNELL L.Q. 138 (1923-24).

fraud and, correspondingly, the beneficiaries of this judicial limitation on the protection afforded bona fide holders.¹⁰⁴

¹⁰⁴ *Id.* at 141-42.