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## TOWARD A JURISPRUDENCE OF BANK-CUSTOMER RELATIONS

PETER A. ALCES†

### I. INTRODUCTION

This is an Article about contradictions. First, there is the oxymoron suggested by the title: we are not used to so flagrant a juxtaposition of the theoretical, "jurisprudence," with the practical, the interstices of the bank-customer relationship. Second, contemporary payments law presents contradictory, often confusing, legislative predispositions. Articles 3<sup>1</sup> and 4<sup>2</sup> of the Uniform Commercial Code (UCC), which govern the negotiation, payment, and collection of checks,<sup>3</sup> are particularly indulgent of the rights

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1. Although there is no specific "scope" provision in Article 3, § 3-101 of the Uniform Commercial Code (U.C.C.) sets forth the short title of the Article: "This Article shall be known and may be cited as Uniform Commercial Code—Commercial Paper." U.C.C. § 3-101 (1977). Limitations to the scope of the Article are provided in § 3-103. Money, documents of title, and investment securities are specifically excluded, and the Article is explicitly made subject to the provisions of Articles 4 and 9. *See id.* § 3-103.

2. There is no specific "scope" section to Article 4. However, § 4-101 sets forth the short title of the Article: "This Article shall be known and may be cited as Uniform Commercial Code—Bank Deposits and Collections." *Id.* § 4-101. Moreover, in the case of conflict between the provisions of Articles 3 and 4, the Article 4 provisions will govern. *See id.* §§ 3-103(2), 4-102(1) & comment 1.

3. Checks, as traditionally processed, clearly fit within the Article 4 definition of "items": negotiable and nonnegotiable paper calling for the payment of money. *See id.* § 4-104(1)(g) & comment 4. The increasing use of electronic transfer messages in the check collection system has lead to questions regarding the continued application of Article 4 to modern bank collection practice. "The



of financial institutions.<sup>4</sup> Conversely, the law governing electronic fund transfers<sup>5</sup> and credit cards<sup>6</sup> is clearly a product of the consumer

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conclusion that Article 4 is inapplicable to evolving payment systems is based primarily on the view that a stored electronic payment message does not fit the UCC definition of an 'item' . . . ." Alces, *A Jurisprudential Perspective for the True Codification of Payments Law*, 53 *FORDHAM L. REV.* 83, 85 n.7 (1984) (citing *Evra Corp. v. Swiss Bank Corp.*, 673 F.2d 951, 955 (7th Cir.), *cert. denied*, 459 U.S. 1017 (1982); *Delbrueck & Co. v. Manufacturers Hanover Trust Co.*, 609 F.2d 1047, 1051 (2d Cir. 1979); *Jetton, Evra Corp. v. Swiss Bank Corp.: Consequential Damages for Bank Negligence in Wire Transfers*, 9 *RUTGERS COMPUTER & TECH. L.J.* 369, 398 & n.127 (1983)). For further discussion of the potential obsolescence of Articles 3 and 4, see Dunne, *The Checkless Society and Articles 3 and 4*, 24 *BUS. LAW.* 127, 127-28 (1968); Penney, *Articles 4 and 8 of the Uniform Commercial Code*, 26 *LA. L. REV.* 259, 264 (1966); Penney, *Bank Statements, Cancelled Checks, and Article Four in the Electronic Age*, 65 *MICH. L. REV.* 1341, 1357-60 (1967). See generally Dunne, *Variation on a Theme by Parkinson or Some Proposals for the Uniform Commercial Code and the Checkless Society*, 75 *YALE L.J.* 788 (1966) (system of check use is inefficient). But see Clarke, *An Item is an Item is an Item: Article 4 of the U.C.C. and the Electronic Age*, 25 *BUS. LAW.* 109 (1969) (Article 4 can accommodate the issues presented by new payment systems).

4. Many commentators have noted the bias of Article 4 towards the rights of financial institutions. See, e.g., Beutel, *The Proposed Uniform [?] Commercial Code Should Not Be Adopted*, 61 *YALE L.J.* 334, 357-63 (1952); Gilmore, *The Uniform Commercial Code: A Reply to Professor Beutel*, 61 *YALE L.J.* 364, 374-79 (1952); Leary & Schmitt, *Some Bad News and Some Good News from Articles Three and Four*, 43 *OHIO ST. L.J.* 611, 613-15 (1982); McDonnell, *Bank Liability for Fraudulent Checks: The Clash of the Utilitarian and Paternalist Creeds Under the Uniform Commercial Code*, 73 *GEO. L.J.* 1399, 1409-13 (1985). But cf. Pape, *Stop Payment in the Uniform New Payments Code*, 9 *RUTGERS COMPUTER & TECH. L.J.* 353, 353 & n.3 (1983) (suggesting that the U.C.C., at least in regard to stop payment orders, takes a "balancing" approach between the rights of consumers and the rights of banks).

5. See 15 U.S.C. §§ 1693-1693r (1982) (codifying as amended the Electronic Fund Transfer Act of 1978 (E.F.T.A.)). The purpose of the Act is to provide "a basic framework establishing the rights, liabilities, and responsibilities of participants in electronic fund transfer systems . . . [and to provide for] individual consumer rights." *Id.* § 1693(b) (emphasis added). For further discussion of the E.F.T.A., see Brandel & Olliff, *The Electronic Fund Transfer Act: A Primer*, 40 *OHIO ST. L.J.* 531 (1979); Fox, *Another Step Toward the Cashless Society? The 1978 Federal Electronic Fund Transfer Act*, 18 *AM. BUS. L.J.* 209 (1980); Schellie, *Electronic Fund Transfer Act*, 34 *BUS. LAW.* 1441 (1979); Taffer, *The Making of the Electronic Fund Transfer Act: A Look at Consumer Liability and Error Resolution*, 13 *U.S.F.L. REV.* 231 (1979).

6. See, e.g., 15 U.S.C. §§ 1666-1666j (1982 & Supp. II 1984) (codifying as amended the Fair Credit Billing Act of 1974); 12 C.F.R. §§ 226.1).29 (1986) (Regulation Z). Regulation Z establishes liability limits for holders of credit cards, *id.* § 226.12(b)(1), delineates procedures for dealing with credit card disputes, *id.* § 226.13(c)(d), and describes the information that must be given to customers



movement. Why the law supporting different payment modes should proceed from two diametrically opposed frames of reference is not intuitively obvious. In fact, given the essential similarities among the available payment media, such stark opposition is counter-intuitive and intimates the operation of forces not immediately apparent.

Good sense may be made in the course of attempting to reconcile those contradictions. There is no alchemy involved in expounding a jurisprudence of the relationship between a financial institution and its customer. Karl Llewellyn, principal architect of the UCC, explained the roles of jurisprudential inquiry by suggesting that investigation of legal matters<sup>7</sup> may be pursued on three levels: jurisprudence for the hundred, for the hundred thousand, and for the hundred million.<sup>8</sup> He had no real interest in sustained ratiocinations that would only excite the hundred, "the more esoteric tradition of the writers about the writers and for the writers . . . in the language or in the general tradition of professional philosophy."<sup>9</sup> Llewellyn's thesis, as ultimately executed in Article 2 of the UCC, required focus on the other two levels, jurisprudence for the hundred thousand and for the hundred million. "Jurisprudence for the hundred thousand" formulates the

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in their periodic statements, *id.* § 226.7. See generally Weistart, *Consumer Protection in the Credit Card Industry: Federal Legislative Controls*, 70 MICH. L. REV. 1475 (1972) (discussing statutes and regulations governing credit cards); Note, *Credit Cards: Distributing Fraud Loss*, 77 YALE L.J. 1418 (1968) (discussing legislation dealing with credit card fraud). The Fair Credit Billing Act establishes procedures for the resolution of credit card billing errors. See 15 U.S.C. §§ 1666-1666j; N. PENNEY & D. BAKER, *THE LAW OF ELECTRONIC FUND TRANSFER SYSTEMS* ¶ 10.02[2][d], at 10-32 to -34 (1980). These laws are more solicitous of certain consumer rights than is Article 4. See Alces, *supra* note 3, at 96 (citing Nimmer, *Consumer Payment Systems: Leverage Effects Within An Electronic Funds Transfer System*, 17 HOUS. L. REV. 487, 507-09 (1980)).

7. Llewellyn was mindful not to unnecessarily narrow the scope of the concept of "law," see Llewellyn, *A Realistic Jurisprudence—The Next Step*, 30 COLUM. L. REV. 431, 432 (1930), specifically stating: "I have no desire to exclude anything from matters legal." *Id.* at 432.

8. See K. Llewellyn, *Law in Our Society* (1950) (unpublished course materials) reprinted in part in W. TWINING, *KARL LLEWELLYN AND THE REALIST MOVEMENT* 499-500 (1973); see also *id.* at 173 ("Llewellyn distinguished between 'jurisprudence for the hundred', 'jurisprudence for the hundred thousand', . . . and 'jurisprudence for the hundred million.'").

9. K. Llewellyn, *supra* note 8, at 499; see also W. TWINING, *supra* note 8, at 173 ("In a very high proportion of [Llewellyn's] teaching and writing he denied, not always convincingly, that he was concerned with 'jurisprudence for the hundred' and claimed to be operating at the level of 'jurisprudence for the hundred thousand.'").

concentration of Llewellyn's writing: "for the Bar in daily living, and for the citizen who is willing to take a moment off to ponder. . . . 'Almost any rule of law can be put into language an ordinary man can understand.' The same is true of problems about law. Both jobs badly need doing."<sup>10</sup> This Article assumes that meaningful examination of commercial issues must proceed from the perspective of the hundred thousand; if the UCC fails that group, it cannot hope to secure the "hundred million," the citizenry at large.<sup>11</sup> The bank customer, then, should be able to understand what the bank is doing and why, and a sound jurisprudence of the bank-customer relationship ought to derive from such a "realistic" perspective.

Even those who are able to come to terms with the relationship between jurisprudence and commercial transactions will be troubled by the second apparent contradiction: the inconsistent treatment of similar transactions occasioned by the divergent legislative perspectives from which our payments law has developed. The UCC, particularly in Article 4, serves the interests of financial institutions. Therefore, the consumer who pays by a draft drawn on a bank is subject to the institutional bias of uniform state check collection law. If that same consumer uses a Visa or Master Card check, federal law may<sup>12</sup> govern and offer protection mechanisms nowhere contemplated by the drafters of the UCC. While the source of this contradiction can and will be explained, the disparate treatment of largely indistinguishable payments media cannot be rationalized. The American Law Institute (ALI)<sup>13</sup> and the National Conference

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10. K. Llewellyn, *supra* note 8, at 500.

11. Llewellyn stated: "Men . . . can understand the guts of Jurisprudence. . . . (The bank clerk and the Negotiable Instruments Law. The warehouseman and the Uniform Warehouse Receipts Act. The union and the Wagner Act.—The citizen in general?)" *Id.*

12. "Visa checks" are one type of modern payment device about which current law is uncertain and contradictory. They are furnished to cardholders by the issuer or financial institution and they permit the cardholder to write checks against his line of credit. Substantial questions have arisen concerning the law applicable to this new payment device. See Memorandum from Donald J. Rapson to the 1983 Uniform New Payments Code Invitational Conference (Sept. 30, 1983) (Should "MasterChecking" be treated as a method of payment or an extension of credit, a check loan, or a credit card cash advance?) (on file at *The Wayne Law Review*).

13. The American Law Institute (ALI) had its origins in a committee organized in 1921 under the auspices of the Association of American Law Schools. This initial committee reported in 1922 and recommended the foundation of a permanent body, the ALI. The ALI's first project was to be a Restatement of



of Commissioners for Uniform State Laws (N.C.C.U.S.L.)<sup>14</sup> joined in support of the Uniform New Payments Code (U.N.P.C.)<sup>15</sup> project to develop a comprehensive statute that would treat similar media similarly. The deterioration of that project informs the analysis developed here.<sup>16</sup>

This Article will compare the equities claimed in support of both the profinancial and consumer-protectionist payments legislation. First, the check law of the UCC is compared to federal electronic fund transfer law by focusing on the liability of financial institutions for paying over a valid stop order. Then, the jurisprudential foundations of the most Llewellynesque portions of the UCC are explored to formulate the impact of legal realism on commercial codification. The substance of Article 2 rules reveals the unique perspective of the realistic approach and the development of commercial law along lines consistent with tort, rather than contract, principles. Finally, this Article will demonstrate that thoughtful jurisprudential analysis is a crucial prerequisite to the promulgation of coherent commercial law. The Article concludes that the application of realistic principles to payments legislation best accommodates the interests of banks as well as their customers. The use of realistic principles as a foundation for future codification efforts can resolve the imbalances prevalent in existing law by establishing an intermediate position between the two extremes. There is room for true consensus.

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the Law. See W. TWINING, *supra* note 8, at 273-74. See generally Goodrich, *The Story of the American Law Institute*, 1951 WASH. U.L.Q. 283 (history and overview of ALI activities); Lewis, *History of the American Law Institute and the First Restatement of the Law*, in RESTATEMENT IN THE COURTS 1 (1945) (discussing evolution of ALI and Restatement).

14. The N.C.C.U.S.L. was founded in 1892 and is comprised of unpaid commissioners appointed by state governors and responsible for preparing legislation for possible adoption by state legislatures. W. TWINING, *supra* note 8, at 272. See generally Dunham, *A History of the National Conference of Commissioners on Uniform State Laws*, 30 LAW & CONTEMP. PROBS. 233 (1965) (discussion of unification of law in U.S.).

15. UNIFORM NEW PAYMENTS CODE (perm. ed. bd. draft no. 3, 1983) [hereinafter cited as U.N.P.C.]. The U.N.P.C. was to be preemptive payments legislation. Indeed, the U.N.P.C. was drafted to apply to "any orders funds [sic] payable by or at, or transmitted by or to, an account institution." *Id.* § 2(1) (emphasis added). A covered "account institution" is defined as "any person which in the ordinary course of its business maintains accounts for its customers," *id.* § 53(1), and an "order" is broadly defined to include both electronic and paper-based transfers, *id.* § 10 & comment 2 (discussing the purpose and existing law).

16. See *Report of the Director*, in AMERICAN LAW INSTITUTE, 1985 ANNUAL REPORT 15-16.



## II. CONTEMPORARY PAYMENTS LAW

Unlike the uniform law of sales, payments law has not developed systematically along lines established by reference to thoughtful jurisprudential principles.<sup>17</sup> A comparison of the legislative foundations of Article 4 of the UCC and representative branches of new payments systems law reveals that the competing legislative initiatives do not properly accommodate the opposing interests of financial institutions and their customers. During the formative years of the check collection system in the United States, the American Bankers Association advocated the development of common law and statutory principles that would insulate banks from risk and reinforce the superior bargaining position of its constituency.<sup>18</sup> Those efforts at risk avoidance are better viewed as commercially shrewd than necessarily evil; the more transaction risk banks could avoid and impose on their customers, the more profitable the banking business could become. However, it is one thing to absolve the bank lobby from moral blame for advocating its self-interest, but quite another to abdicate to that interest group nearly absolute legislative authority. The history of Article 4 of the UCC suggests that bank interests may have been overrepresented on the committee responsible for the final draft of the Deposits and Collections provisions of the Code. An analysis of the language, operation, and legislative history of section 4-407 illustrates the predisposition of Article 4.

### A. *The Payor Bank's Right to Subrogation on Improper Payment Under Section 4-407 of the UCC*

Although a drawer retains the "absolute" right to stop payment on a check any time prior to its payment,<sup>19</sup> section 4-407 of the

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17. For a discussion of the genesis of the U.C.C., especially in regard to Article 2 and its predecessors, see W. TWINING, *supra* note 8, at 270-301.

18. See Scott, *The Risk Fixers*, 91 HARV. L. REV. 737, 740-76 (1978). "The commercial law of bank collections . . . reflects the desire of transactors to alter the competitive effects of the existing allocation of risk. Commercial legislation becomes the method by which particular interests achieve their substantive objectives, instead of a means by which society develops a rational payments system." *Id.* at 792.

19. See U.C.C. § 4-403 (1977) ("Customer's Right to Stop Payment; Burden of Proof of Loss") & comment 2, which states: "The position taken by this section is that stopping payment is a service which depositors expect and are entitled to receive from banks notwithstanding its difficulty, inconvenience and expense."

UCC<sup>20</sup> effectively shifts the risk of a bank's wrongful payment of an item in contravention of the stop payment order from the bank to the customer. In an action by the drawer against its bank to recover the amount wrongfully paid, section 4-407 allows the bank to assert the defenses of the payee or any holder of the instrument.<sup>21</sup> If the check previously had come into the possession of a holder in due course,<sup>22</sup> the drawer would have virtually no recourse<sup>23</sup> against the drawee bank. The depository bank,<sup>24</sup> or any intermediary bank,<sup>25</sup> including the presenting bank,<sup>26</sup> may qualify for holder in due course status as long as it gives "value"<sup>27</sup> for the paper. Since most checks are presented through banking channels rather than "over the counter," and since depository banks give value when they permit a customer to draw against uncollected funds,<sup>28</sup> the subrogation rights provided by section 4-407 are substantial.<sup>29</sup>

The average check, according to a 1982 report,<sup>30</sup> is drawn for \$570. This amount may be significant to individual consumers,

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20. *Id.* § 4-407 ("Payor Bank's Right to Subrogation on Improper Payment").

21. *See id.*

22. *See id.* § 3-302(1) (defining holder in due course status).

23. *See id.* § 4-407(a) (establishing the payor bank's right to be subrogated to the rights "of any holder in due course on the item against the drawer or maker").

24. A "depository bank" is defined as "the first bank to which an item is transferred for collection even though it is also the payor bank." *Id.* § 4-105(a).

25. An "intermediary bank" is defined as "any bank to which an item is transferred in course of collection except the depository or payor bank." *Id.* § 4-105(c).

26. A "presenting bank" is defined as "any bank presenting an item except a payor bank." *Id.* § 4-105(e). "Presentment" is defined in Article 4, *see id.* § 4-104(3), by reference to § 3-504, which formulates "presentment" as "a demand for acceptance or payment made upon the maker, acceptor, drawee, or other payor by or on behalf of the holder." *Id.* § 3-504(1).

27. *See id.* § 3-302(1)(a) (requiring that holder in due course take the instrument for value). Banks may give "value" and achieve holder in due course status under Article 4 by the operation of two sections. One section accords banks a security interest in a check or its proceeds in certain circumstances. *See id.* § 4-208(1). The other establishes that, for the purpose of holder in due course status, "value" is given on an item in which the bank has a security interest to the extent of that security interest. *See id.* § 4-209; *infra* notes 217-29 and accompanying text.

28. *See* U.C.C. §§ 4-208(1)(c), 4-209.

29. *See* Sun 'N Sand, Inc. v. United Cal. Bank, 21 Cal. 3d 671, 582 P.2d 920, 148 Cal. Rptr. 329 (1978).

30. *See* ARTHUR D. LITTLE, INC., ISSUES AND NEEDS IN THE NATION'S PAYMENT SYSTEM 12, table 1 (1982).



but is not likely to justify economically the drawer's initiation and prosecution of a lawsuit against the drawee that has paid over a stop order. In many instances, the amount of a wrongfully paid check might exceed the state's small claims court jurisdictional limit and yet be insufficient to justify the litigation expense and delays inherent in a standard tort or contract case. Certainly, were the litigation postures reversed, it is unlikely that a payor bank would initiate an action to recover its wrongful payment of the average check. Early drafts of Article 4 did not authorize a drawee to unilaterally debit the drawer's account for an item paid over a valid stop order.<sup>31</sup> In late 1951 however, the portion of draft section 4-507 that prohibited a bank from debiting a customer's account after wrongfully paying an item was deleted.<sup>32</sup> The section 4-407 subrogation rights thereafter were used defensively by drawee banks.

A relic of the pre-1951 formulation appears in the section 4-407 language providing that the drawee's rights under the provision are only available "to prevent unjust enrichment and only to the extent necessary to prevent loss to the bank by reason of its payment of the item."<sup>33</sup> As the subrogation provision now operates, the unjust enrichment language is not coextensive with the second portion of the same clause preventing loss to the bank by reason of its wrongful payment.<sup>34</sup> Section 4-407 permits the bank to recoup its loss absolutely, not subject to the unjust enrichment limitation, provided the bank can fortuitously identify a prior holder in due course.<sup>35</sup> However, when the drawer stops payment for cause and

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31. See, e.g., U.C.C. § 4-507 (Proposed Final Draft No. 2, Spring 1951), *reprinted in* 12 UNIFORM COMMERCIAL CODE: DRAFTS 188 (E. Kelly ed. 1984) [hereinafter cited as U.C.C.: DRAFTS].

32. See U.C.C. §§ 4-101 to -407 (Final Text Ed. 1951), *reprinted in* 12 U.C.C.: DRAFTS, *supra* note 31, at 536-57.

33. U.C.C. § 4-407. Similar language appeared in code drafts dating back to at least 1950. See U.C.C. § 4-402 (Proposed Final Draft, Spring 1950), *reprinted in* 10 U.C.C.: DRAFTS, *supra* note 31, at 532-33.

34. See *South Shore Nat'l Bank v. Donner*, 104 N.J. Super. 169, 177, 249 A.2d 25, 30 (1969) ("While the remedy afforded by section 4-407 is in part expressly directed to the prevention of 'unjust enrichment,' nowhere in the statute is there any requirement that all of the defendants who may be joined in the action be 'unjustly enriched.'").

35. This perversion of the unjust enrichment doctrine contradicts the accepted understanding of the concept. The Restatement of Restitution explains that the equitable right to subrogation arises when the "property of one person is used [to discharge] an obligation owed by another . . . under such circumstances that the other would be unjustly enriched by the retention of the benefits thus

the payor is permitted to assume the rights of a holder in due course, unjust enrichment is inapposite. Subsection (c) of 4-407, which subrogates the payor to rights of the drawer against the payee, should sufficiently protect the payor in this setting.<sup>36</sup> The justification for the holder in due course concept, if it has any application in contemporary payments law,<sup>37</sup> is absent from the section 4-407 subrogation contest. The original "law merchant" interest in cash substitutes does not support a rule that sanctions drawee negligence. The expediency of the payments system is not improved by commercial paper laws that insulate negligent practices from victims' efforts to recoup their losses. Under the current formulation, the drawer whose account has been charged over a valid stop payment order must initiate legal action to recover the misapplied funds. To prevail, the drawer must overcome the drawee's assertion of holder in due course rights. Given the relative ease with which depository banks may claim holder in due course status under Article 4,<sup>38</sup> the drawer invariably will be unable to overcome that assertion.

Notwithstanding the Code drafters' protestations that the UCC was designed to describe and clarify rather than change the commercial practices existing at the time of its composition,<sup>39</sup> Article 4, particularly in section 4-407, readjusted rights existing prior to its promulgation. Pre-UCC law provided that a bank that paid over a valid stop payment order would be liable to the drawer for

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conferred." RESTATEMENT OF THE LAW OF RESTITUTION § 162 (1937). A drawer who pays for goods by check and then stops payment without cause is not injured when the payee receives payment even if that is only accomplished by the bank's payment over the stop order. To avoid unjust enrichment in that context, the payor need not assume the rights of a holder in due course because § 4-407 allows the payor to subrogate the rights of the payee. See U.C.C. § 4-407(b).

36. See U.C.C. § 4-407(c).

37. For a cogent critique of the effects of holder in due course status in the context of checks, see Rosenthal, *Negotiability: Who Needs It?* 71 COLUM. L. REV. 375, 381-94 (1971); see also Gilmore, *The Good Faith Purchase Idea and the Uniform Commercial Code: Confessions of a Repentant Draftsman*, 15 GA. L. REV. 605 (1981) (questioning efficacy of general notion of the "good faith purchaser" in modern commercial law).

38. See *supra* notes 19-29 and accompanying text.

39. See, e.g., Gilmore, *supra* note 4, at 377-78 ("The Code is not of course a reform statute; it is not designed to bring the millenium . . . . It is an honest effort to state basic rules of commercial law which reflect, more accurately and flexibly than do the present rules, going methods of operation.").



the amount of the check.<sup>40</sup> This provision could lead to harsh results. A drawer might stop payment of a check for no legitimate reason. Then, if the bank paid over the stop order, the drawer could retain any consideration he received from the payee of the check and require the drawee to recredit his account. The bank would be liable for the amount of the check and the drawer would, upon the recredit, be unjustly enriched to the extent that the consideration he received from the payee was valuable. That strict liability rule was inefficient and unjust. Subrogation theory developed to mitigate the harshness of that result.<sup>41</sup> A bank that negligently paid over a stop order would be strictly liable to the drawer subject to the bank's right to subrogation against a party unjustly enriched, possibly the drawer.<sup>42</sup> It was suggested that application of subrogation principles would solve "the social welfare-maximizing equation."<sup>43</sup>

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40. See F. BEUTEL, BRANNON NEGOTIABLE INSTRUMENTS LAW 1316 (7th ed. 1948) ("Since a check is not an assignment of the drawer's funds, the bank is liable to him for paying it in disregard of a countermand.") (citing *Hiroshima v. Bank of Italy*, 78 Cal. App. 362, 248 P. 947 (1926); *First Nat'l Bank of Miami v. Davis*, 150 Fla. 673, 8 So.2d 403 (1942); *Miller v. Chatham & Phoenix Nat'l Bank*, 126 Misc. 559, 214 N.Y.S. 76 (1926); *Wall v. Franklin Trust Co.*, 84 Pa. Super. Ct. 392 (1925); *Pease & Dwyer Co. v. State Nat'l Bank*, 114 Tenn. 693, 88 S.W. 172 (1905); *Huffman v. Farmers' Nat'l Bank*, 10 S.W.2d 753 (Tex. Civ. App. 1928)).

41. See Comment, *Stop Payment: An Ailing Service to the Business Community*, 20 U. CHI. L. REV. 667, 673-74 (1953) ("To reduce the sanction for failure to [heed a stop-payment order] . . . several theories have been advanced. . . . The most favored theory is that of subrogation . . .").

42. In this way, subrogation elegantly satisfies the sanction criterion . . . : the real burden that stop payment seeks to minimize—finding, and getting and executing judgment against a party wrongfully paid—is clearly placed upon the bank, but there is no penalty . . . insofar as the failure causes no injury.

*Id.* at 674.

43. *Id.* Banking interests, however, were not comfortable with this social welfare calculus. The bankers were in favor of eliminating the drawer's right to stop payment, by relying upon freedom of contract principles. In passbooks and stop order forms, the banks included clauses exculpating them from negligently paying over a stop order. *Id.* at 675; see Note, *Exculpation Contracts in Stop-Payment Orders*, 6 RUTGERS L. REV. 577, 579 (1952) ("[B]anks have resorted to release clauses to protect themselves against responsibility for failure to obey stop-payment orders."); see also Malcolm, *Article 4—A Battle With Complexity*, 1952 WIS. L. REV. 265, 266 ("[T]he practice had developed for banks to state . . . on deposit tickets, bank statements, collection letters and acknowledgments of receipt of items the terms under which they would undertake collection of

The subrogation theory appeared in the 1934 draft of a Uniform Bank Collection Act prepared by the N.C.C.U.S.L. but was never promulgated.<sup>44</sup> The theory reappeared in the 1949 draft of Article 3 in Comment 8 to section 3-415, and precluded banks from contractually avoiding their stop payment obligation.<sup>45</sup> Comment 8, however, gave effect to the subrogation theory stating:

The drawee is . . . entitled to subrogation to prevent unjust enrichment. It has sometimes been said that payment cannot be stopped against a holder in due course, but the statement is inaccurate. The payment can be stopped, but the drawee, if he pays, becomes subrogated to the rights of a holder in due course against the drawer.<sup>46</sup>

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items.'').

Such clauses were found to be valid in some states. *See* Comment, *supra* note 41, at 675 (citing *Hodrick v. Fidelity Trust Co.*, 96 Ind. App. 342, 183 N.E. 488 (1932); *Tremont Trust Co. v. Burack*, 235 Mass. 398, 126 N.E. 782 (1920); *Gaita v. Windsor Bank*, 251 N.Y. 152, 167 N.E. 203 (1929)). Most states, however, found that such clauses violated either public policy or the consideration rules of contract doctrine and thus invalidated them on one or the other of these grounds. *See* Comment, *supra* note 41, at 675 (citing *Hiroshima v. Bank of Italy*, 78 Cal. App. 362, 248 P. 947 (1926) (public policy); *Grisinger v. Golden State Bank*, 92 Cal. App. 443, 268 P. 425 (1928) (public policy); *Calimita v. Tradesmen's Nat'l Bank*, 135 Conn. 326, 64 A.2d 46 (1949) (consideration); *Reinhardt v. Passaic-Clifton Nat'l Bank & Trust Co.*, 16 N.J. Super. 430, 84 A.2d 741 (1951), *aff'd*, 9 N.J. 607, 89 A.2d 242 (1952) (consideration; *Speroff v. First-Central Trust Co.*, 149 Ohio St. 415, 79 N.E.2d 119 (1948) (public policy); *Thomas v. First Nat'l Bank*, 126 L.I. 203 (Pa. 1952) (public policy); Note, *supra* at 589-90.

44. Section 14 of a proposed draft of this Act read as follows:

A bank of payment which prematurely pays a post-dated item drawn on or made or accepted payable at such bank, or which pays an item contrary to a duly received stop order, may, at its election, treat the item as unpaid and have such rights upon the item against the drawer or person making or accepting the item so payable as the holder thereof *to whom it paid* would have in such case, or treat it as paid and have such rights growing out of the transaction giving rise to the item as the drawer or person making the item so payable would have against the person to whom it was issued.

Unif. Bank Collection Act § 14 (5th Tent. Draft 1934), *reprinted in* HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS 172-73 (1934) (emphasis in original), *and noted in* Comment, *supra* note 41, at 674 n.33.

45. Subsection 3-415(4) of the 1949 draft read as follows: "Although the drawee cannot by contract avoid its obligations under this section, it may make a reasonable charge for stopping payment." U.C.C. §3-415 (Draft, May 1949), *reprinted in* 7 U.C.C.: DRAFTS, *supra* note 31, at 384.

46. U.C.C. § 3-415 comment 8 (Draft, May 1949), *reprinted in* 7 U.C.C.: DRAFTS, *supra* note 31, at 386.



Notwithstanding the questionable logic of providing the drawee subrogation to holder in due course rights,<sup>47</sup> the section clearly and correctly placed the initial loss on the negligent drawee. A bank could not debit the drawer's account but was required to incur the expense and uncertainty of a legal proceeding to obtain reimbursement for loss attributable to its own negligence.<sup>48</sup>

At hearings on the UCC held in January 1951, Article 4 was severely criticized by representatives of financial institution interests. In May 1951, Article 4 was deleted from the Code.<sup>49</sup> By September of the same year, a draft reworked by bankers and their counsel was quickly approved by the ALI and N.C.C.U.S.L.<sup>50</sup> The Bank Deposits and Collections Article remains today essentially as adjusted by the bank lobby.<sup>51</sup> The final November 1951 draft altered the litigation posture of banks and their customers in the context of a wrongful payment over a stop order. Banks were now permitted to charge their customer's account and then to interpose defensively the rights of an available holder in due course in the customer's action against the bank. In sum, the bank lobby

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47. See *supra* notes 19-29 and accompanying text.

48. See U.C.C. § 4-507 (Revisions of Articles 2, 4 & 9, Sept. 1950), reprinted in 11 U.C.C.: DRAFTS, *supra* note 31, at 383-84. This section read as follows:

To prevent unjust enrichment, a bank which has paid a customer's item which it may not charge in full to his account may in an action:

(a) against a prior holder who has received the payment, recover any part thereof due its customer or any prior party in respect of the transaction in which the customer of the depositary bank acquired the item; and

(b) against the drawer, maker or acceptor recover any amount which would have been due from him on the item if payment had been refused.

The bank has no right to charge the customer's account in respect of such cause of action. The bank may bring either or both such actions but may have only one satisfaction and any right to consequential or punitive damages remains with the customer or holder.

*Id.* The provision denying the drawee bank the right to debit its customer's account last appeared in the September 3, 1951 Text Edition of Article 4 as § 4-407. It was deleted in the Final Text Edition, dated November 1951. Compare 12 U.C.C.: DRAFTS, *supra* note 31 at 188, with *id.* at 557.

49. Beutel, *supra* note 4, at 359.

50. Professor Beutel observed that the new draft was mailed to the members of the ALI and N.C.C.U.S.L. less than three weeks before the vote on the revisions. *Id.* & n.141.

51. Compare U.C.C. §§ 4-101 to -504, with U.C.C. §§ 4-101 to -407 (Final Text Ed. 1951), reprinted in 12 U.C.C.: DRAFTS, *supra* note 31, at 536-57.

changed the pre-Code law to enhance the interests of financial institutions.

Malcolm's discussion of the stop payment problem reveals the obfuscation accomplished by banking interests. In a 1952 law review article he explained that "with the tremendous volume of items handled, it is impossible for banks to successfully receive, process and give effect to, each stop payment order that is received."<sup>52</sup> He then described the banks' use of exculpatory clauses in stop order forms and cited a report of the Committee on Bank Operations of the Section of Corporation, Banking and Business Law of the American Bar Association.<sup>53</sup>

[The Report] concluded that *by the weight of authority* such clauses are supported by adequate consideration and held not to be against public policy. The argument is further advanced that by drawing and issuing a check the depositor has set in motion a course of events looking toward the negotiation and payment of the check, and if he elects to change his mind he should assume the risk of not being able to reverse the process he has started in the absence of bad faith on the part of the bank.<sup>54</sup>

There are two significant problems with Malcolm's analysis. First, he misrepresented the law; and second, the proximate causation and assumption of risk arguments contradict established liability theories and commercial paper policies. The ABA report cited by Malcolm reviewed the case law in only five states<sup>55</sup> and the San Juan District of Puerto Rico. Although the report concluded that such clauses were upheld in Indiana, Massachusetts, and New York, it refused to express an opinion as to whether an exculpatory clause obviated "the criticism that there is no consideration for such agreement on the part of the depositor, or as to whether such a contract stands on a different or better footing with respect to public policy."<sup>56</sup> A law review note published the same year as

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52. Malcolm, *supra* note 43, at 296.

53. Committee on Bank Operations, ABA Section of Corporation, Banking and Business Law, *Validity of Exculpatory Clauses in Stop Payment Notices*, 5 BUS. LAW. 101 (1949) [hereinafter cited as *Exculpatory Clauses*].

54. Malcolm, *supra* note 43, at 297 (emphasis added) (footnote deleted).

55. The five states covered in the report were: Indiana, Massachusetts, New York, California, and Ohio. See *Exculpatory Clauses*, *supra* note 53, at 101. California and Ohio were cited as invalidating such clauses in deposit contracts as void against public policy. See *id.*

56. *Id.* at 107.



the Malcolm Article concluded that while exculpatory clauses might insulate banks from the consequences of inadvertence or accident, "[t]his is a release from absolute liability, but not from negligence. For negligent acts the bank will still be liable, whatever the wording of the release clause."<sup>57</sup> Cases support this construction of pre-Code law.<sup>58</sup> While the essential distinction between "inadvertence or accident" and negligence may be difficult to formulate, or even imagine, the cases do not support the position that banks should be insulated from liability only when they have not acted in bad faith.

Malcolm's causation and assumption of risk arguments are perhaps most troubling because they display the drafters' predisposition toward the bank-customer relationship and thus explain the profinancial institution bias of Article 4. His assertion that the customer is in some way responsible for the wrongful payment because the customer is the cause in fact of the check's entering the collection process, imposes an unreasonabler burden on depositors. In effect, customers would become insurers of their banks' item clearance procedures.<sup>59</sup> It is inconceivable that such a position would be tenable in a Code that in very certain terms recognizes the efficacy of a stop payment right:

The position taken by . . . section [4-403] is that stopping payment is a service which depositors expect and are entitled to receive from banks notwithstanding its difficulty, inconvenience and expense. The inevitable occasional losses through failure to stop should be borne by the banks as a cost of the business of banking.<sup>60</sup>

How could the section 4-403 stop payment right and the accompanying Comment coexist with the sweeping provision of subrogation rights in section 4-407? The answer is that the inclusion of section 4-403 in Article 4 is similar to the reference to "unjust enrichment" in section 4-407. It can only be explained as a remnant

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57. Note, *supra* note 43, at 590.

58. See Comment, *supra* note 43 & the authorities cited therein.

59. Moreover, Malcolm's argument proves too much. Given his predisposition, perhaps a drawer should be liable for the amount of an item that the drawee pays over a forged payee's endorsement, see U.C.C. § 4-401, because the drawer is responsible for the check entering the collection process.

60. *Id.* § 4-403 comment 2.

of the prebank lobby version of Article 4,<sup>61</sup> as developed by a drafting committee less concerned with assuring the bank lobby virtually every conceivable benefit available through commercial paper legislation,<sup>62</sup> and more concerned with striking a balance between the interests of banks and their customers.

*B. New Payment Systems Law and the Provision of Individual Consumer Rights*

The argument that efficient processing of payments requires financial institutions to be afforded every deference in legislation or the financial world will come to an end is no longer convincing, and probably never was accurate. But such thinking supported the drafting of Article 4. Recent experience suggests that Armageddon is not a certain consequence of legislating that banks be solicitous of their customers' interests. Although consumer protection measures are not without their own costs,<sup>63</sup> proponents of such legislation argue that the benefits in justice and fairness offset those costs.<sup>64</sup>

The Federal Electronic Funds Transfer Act (E.F.T.A.),<sup>65</sup> drafted along the lines suggested by the federal law governing credit card transactions,<sup>66</sup> acknowledges that its "primary objective . . . is the provision of individual consumer rights."<sup>67</sup> The scope of the Act includes preauthorized debits and credits<sup>68</sup> and recurring telephone

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61. See, e.g., *id.* § 4-507 (Revisions of Articles 2, 4 & 9, Sept. 1950), reprinted in 11 U.C.C.: DRAFTS, *supra* note 31, at 383-84 (expressly denying bank's "right" to charge the customer's account for payment over a valid stop order).

62. For a brief discussion of the drafters' attempt to satisfy the New York banking interests, see Rapson, Book Review, 41 BUS. LAW. 675, 676 n.4, 677 (1986) (reviewing F. MILLER & A. HARRELL, *THE LAW OF MODERN PAYMENT SYSTEMS AND NOTES* (1985)) (quoting a letter from Grant Gilmore to Donald J. Rapson (Oct. 8, 1980) stating: "Malcolm, who was a man of the highest personal integrity, understood that it was his function to do whatever was necessary to placate the New York group (who, nevertheless, refused to be placated)." (footnote omitted)).

63. The disclosure and compliance burdens imposed on financial institutions are significant. See N. PENNEY & D. BAKER, *supra* note 6, ¶ 11-02, at 11-7 to -25.

64. See Budnitz, *The Finicky Computer, the Paperless Telex and the Fallible Swiss: Bank Technology and the Law*, 25 B.C.L. REV. 259 (1984) (describing the "humanizers" approach to payments legislation and the role of technology); see also *infra* notes 187-95 and accompanying text.

65. 15 U.S.C. §§ 1693-1693r (1982).

66. See, e.g., 15 U.S.C. §§ 1666-1666j (1982 & Supp. II 1984).

67. 15 U.S.C. § 1693(b).

68. See N. PENNEY & D. BAKER, *supra* note 6, ¶¶ 4.05[5][b], 5.01[1][2]; 15 U.S.C. § 1693e.



transactions,<sup>69</sup> as well as automated teller machine and point-of-sale systems.<sup>70</sup> The Act also establishes the liability of financial institutions for failing "to stop payment of a preauthorized transfer from a consumer's account when instructed to do so."<sup>71</sup> The accompanying regulation explains that "[a] consumer may stop payment of a preauthorized electronic fund transfer from the consumer's account by notifying the financial institution orally or in writing at any time up to 3 business days before the scheduled date of the transfer."<sup>72</sup> If the financial institution "unintentionally" fails to stop payment when properly instructed to do so, the E.F.T.A. provides that "the financial institution shall be liable for actual damages proved."<sup>73</sup> Section 908 of the Act clarifies that the failure to honor a proper stop payment request is "an error"<sup>74</sup> and requires the financial institution to "correct the error . . . including the crediting of interest where applicable."<sup>75</sup>

The E.F.T.A., then, imposes the initial loss and perhaps the burden of initiating litigation<sup>76</sup> on the financial institution that failed to honor the stop payment order. The Act includes no subrogation provision as does UCC section 4-407.<sup>77</sup> In addition, the E.F.T.A. exposes the financial institution to all "actual damages" proved, a phrase that has been construed under the UCC<sup>78</sup> to extend to emotional distress and other consequential damages.<sup>79</sup>

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69. See N. PENNEY & D. BAKER, *supra* note 6, ¶ 5.05[3][f], n.233. Nonrecurring telephone transactions are excepted by 15 U.S.C. § 1693a(6)(E).

70. See 15 U.S.C. § 1693a(6) (describing scope of E.F.T.A.).

71. *Id.* § 1693h(a)(3).

72. 12 C.F.R. § 205.10(c) (1985).

73. 15 U.S.C. § 1693h(c).

74. An "error" is defined by the Act as "an unauthorized electronic fund transfer." *Id.* § 1693f(f)(1). A payment over a stop order is "unauthorized" and thus fits within the statutory definition of an "error."

75. *Id.* § 1693f(b).

76. See *id.* § 1693f(c) (requiring, in most circumstances, provisional recredit to the customer's account for amount of alleged error). Assuming the customer has received the recredit, the customer need only withdraw funds from the disputed account to force the bank into court for the recovery of its alleged loss.

77. A consumer may thus avoid a payment and wrongfully retain the consideration received; the financial institution that has paid over the stop payment order is not subrogated to the rights of the payee. Similarly, if the consumer has a defense good against the recipient of the payment, the Act does not subrogate the financial institution to the rights of the consumer-customer.

78. See U.C.C. § 4-402 (1977) ("Bank's Liability to Customer for Wrongful Dishonor").

79. See, e.g., *Twin City Bank v. Issacs*, 283 Ark. 127, 672 S.W.2d 651

To permit subrogation in the check collection process and not provide for it in the context of electronic funds transfers is unreasonable. Subrogation to the rights of the drawer or payee should be expressly provided in both bodies of law. Subrogation to the rights of a holder in due course should not be available. Both the check law and electronic funds transfer law should preclude a financial institution's debiting a consumer account to realize the benefits of that subrogation right.<sup>80</sup>

The drafters of the Uniform New Payments Code (U.N.P.C.), in the last draft publicly circulated, approached this formulation but did not impose on financial institutions the expense of initiating litigation to determine the viability of subrogation rights.<sup>81</sup> Unless that burden is unequivocally imposed on the financial institutions, they may use the subrogation theory to a much greater extent than contemplated by principles of unjust enrichment. Also, the U.N.P.C. would have left "[t]he burden of establishing the fact and amount

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(1984) (damages for mental suffering available under § 4-402 even when bank's wrongful dishonor not tantamount to level of culpability for intentional infliction of emotional distress); *Kendall Yacht Corp. v. United Cal. Bank*, 50 Cal. App. 3d 949, 123 Cal. Rptr. 848 (1975) ("tortious" damages for emotional distress recoverable under § 4-402 and not precluded because "wrongful dishonor" may also embrace a contract claim); *Bank v. Sims*, 435 S.W.2d 57 (Ky. 1968) (§ 4-402 codifies common law, which allowed recovery of both direct and consequential damages); *Northern Bank v. Palmer*, 525 S.W.2d 718 (Tex. Civ. App. 1975) (mental distress may be considered in awarding consequential damages under § 4-402).

80. The provision precluding a bank's debit of its customer's account in the September 3, 1951 draft of the U.C.C. has been previously discussed. See *supra* notes 44-51 and accompanying text. For the text of this provision, see *supra* note 48.

81. See U.N.P.C., *supra* note 15, § 432, at 327. That section reads as follows:

If a payor account institution has paid an order of the drawer which has been stopped or reversed, or otherwise under circumstances giving a basis for objection by the drawer, to prevent unjust enrichment and only to the extent necessary to prevent loss to the account institution by reason of its payment of the order, the account institution shall be subrogated to the rights

(a) the payee or other party to which payment was made, on the order or under the transaction out of which the order arose against the drawer;

(b) the drawer, on the order or under the transaction out of which the order arose against the payee or party to which payment was made; and

(c) any funds claimant with due-course rights on the order against the drawer.

*Id.*



of loss resulting from the payment of an order contrary to a binding stop order" on the customer.<sup>82</sup> The combination of this formulation from Article 4 of the UCC<sup>83</sup> and the requirement of a provisional recredit pending resolution of the error from the E.F.T.A. is incongruous.<sup>84</sup>

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82. U.N.P.C., *supra* note 15, § 425, at 288.

83. See U.C.C. § 4-403(1).

84. The U.N.P.C. contains a recredit provision similar to that contained in the E.F.T.A. See U.N.P.C., *supra* note 15, § 302(2)(a). This section provides as follows:

(2) The account institution shall investigate and determine within sixty (60) days after receiving a notice of an error whether the alleged error occurred, and shall transmit the results of its investigation and determination to the customer, provided that if the account institution does not complete the investigation to the extent of its own records and transmit the results of such investigation to the customer pursuant to subsection (1) within ten (10) business days, the account institution:

(a) shall make a provisional adjustment to the customer's account for the amount of the alleged error, or the maximum amount of recredit due to the customer if the alleged error is determined to be an error in fact, or \$500, whichever is less, during the investigation (including interest where applicable), or, where the alleged error concerns an extension of credit, shall refrain during the investigation from taking any action to collect the amount disputed (including finance charges, late payment charges, or other charges computed on such amount) and not apply against the credit limit the amount indicated to be in error of \$500, whichever is less . . . .

*Id.* at 212-13. This section is similar to the E.F.T.A. recredit provision. Compare *id.*, with 15 U.S.C. § 1693f(c) (discussed *supra* note 76). Unlike the E.F.T.A., however, which clearly gives consumers a genuine recredit "right," the U.N.P.C.'s incorporation of language similar to that contained in U.C.C. § 4-403(3) in U.N.P.C. § 425 dilutes significantly the proconsumer orientation of the U.N.P.C.'s recredit provision. U.N.P.C. § 425, like U.C.C. § 4-403(3), imposes the burden of proof on the customer, not on the bank. Professor Clark has described the § 4-403(3) "fact and amount of loss" burden on bank customers as "a wonder of bank lobbying." B. CLARK, *THE LAW OF BANK DEPOSITS, COLLECTIONS AND CREDIT CARDS*, ¶ 2.6[2], at 2-48 (rev. ed. 1981). The principal problem with the provision is its uncertain and potentially harsh operation in connection with § 4-407 subrogation rights. It is unclear what the customer must prove—whether the customer must show that a sufficiently precise stop order was issued, or must also establish that the payor's § 4-407 subrogation right would be unavailable against the customer on the facts of the particular case. The September 1950 Draft of § 4-503, the predecessor to current § 4-403, described the "Customer's Right to Stop Payment" in substantially the same terms as the present formulation but without subsection (3). Compare U.C.C. § 4-507 (Revisions of Articles 2, 4 & 9, Sept. 1950), reprinted in U.C.C.: DRAFTS, *supra* note 31, at 383-84, with U.C.C. § 4-403. The burden to prove fact and amount of loss was not expressly imposed on the customer until the September 1951 Draft, the one profoundly

The U.N.P.C. drafters assembled a rule from diametrically opposed component parts (UCC and E.F.T.A.) and concluded with a patchwork that does not properly address the problem. They would have improved the law governing electronic fund transfers by providing a subrogation provision, but undermined that improvement by juxtaposing with it the requirement that the customer bear the burden of proving the fact and amount of loss. If future efforts to codify payments law are to succeed, the drafters must first develop a mature jurisprudential frame of reference. Only then can payments law achieve the necessary accommodation of the conflicting interests involved. A viable foundation for such a pursuit may be found in the principles of legal realism as expounded by Karl Llewellyn.

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influenced by the banking lobby. A 1954 commentary recognized that "it may be argued that under the Code the drawer makes out a prima facie case when he shows (1) a valid stop-payment order and (2) that a charge has been made to his account." Morrison & Sneed, *Bank Collections: The Stop-Payment Transaction—A Comparative Study*, 32 TEX. L. REV. 259, 316 (1954). However, the commentators find more convincing the illustration offered at the September 1951 N.C.C.U.S.L. meeting on the U.C.C.:

[S]ometimes a check "is stopped when there has been no failure of consideration, and the burden should be on the drawer of the check to show how much he has been damaged, which, in other words, means that if he gave a check for \$1000 for some goods which were not as warranted, and they were only worth \$500 but the bank wrongly paid the check anyway, he must show that the goods were worth only \$500 . . . due to the wrongful payment of the check. . . ."

*Id.* at 316-17 (quoting National Conference of Commissioners on Uniform State Laws, *Proceedings in the Committee of the Whole, Uniform Commercial Code, Sept. 10-15, 1951*, at 56-57 (remarks of Mr. Birbaum)) (on file at *The Wayne Law Review*).

A federal district court in Massachusetts has read § 4-403(3) and § 4-407 to impose the onerous burden on a customer "to avoid circuity of action." *Universal C.I.T. Credit Corp. v. Guaranty Bank & Trust Co.*, 161 F. Supp. 790, 794 (D. Mass. 1958). District Judge Wyzanski concluded "that [the customer] is not allowed to recover because it has not borne its burden of showing that it suffered loss . . . ; [drawer] suffered no loss because it would have been liable to [intermediary bank] as a holder in due course in any event." *Id.* at 794-95. Not all of the cases have embraced the perspective of the N.C.C.U.S.L. illustration, however. The New York court in *Thomas v. Marine Midland Tinkers Nat'l Bank*, 86 Misc. 2d 284, 381 N.Y.S.2d 797 (Civ. Ct. 1976), gave effect to the policy underlying § 4-403 by granting judgment to the plaintiff-customer and imposing on the payor bank the burden of producing evidence that would show that the customer did not suffer loss. The facts reveal that the *Thomas* decision was particularly indulgent of the customer's rights; the plaintiff's stop order misidentified the check number. The court considered the error de minimis, though perhaps it was not, from the perspective of the bank's computer. The § 4-403 formulation of the burden of proof is at least awkward and probably unjust.



## III. JURISPRUDENCE AND COMMERCIAL LAW

Commentators have considered *the* jurisprudence of the Code from the viewpoint of legal philosophy<sup>85</sup>—jurisprudence “for the hundred.”<sup>86</sup> Several articles have suggested perspectives for practice under the Code, describing methods of construing particular provisions.<sup>87</sup> Not since Llewellyn’s death, however, has the efficacy of *drafting* commercial law from the legal realists’ frame of reference been examined. A discussion of realism and its relationship to commercial law is a prerequisite to appraising the value of applying realistic principles to payments law. The necessity and consequences of delegating responsibility for the several Articles of the UCC undermined Llewellyn’s efforts to impress his understanding of legal realism on the entire Code.<sup>88</sup> Nevertheless, Article 2 demonstrates, to a considerable extent, the application of his views to the sale<sup>89</sup> of goods.<sup>90</sup> The realistic principles embodied in

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85. See, e.g., Carroll, *Harpooning Whales, Of Which Karl N. Llewellyn Is The Hero Of The Piece; Or Searching For More Expansion Joints in Karl's Crumbling Cathedral*, 12 B.C. INDUS. & COM. L. REV. 139 (1970); Danzig, *A Comment on the Jurisprudence of the U.C.C.*, 27 STAN. L. REV. 621 (1975); Leff, *Unconscionability and the Code—The Emperor's New Clause*, 155 U. PA. L.R. 485 (1967).

86. See *supra* notes 8-10 and accompanying text for a discussion of Llewellyn’s division of legal studies into three distinct levels, including “jurisprudence for the hundred.”

87. Hawkland, *Uniform Commercial “Code” Methodology*, 1962 U. ILL. L.F. 291.

88. See Carroll, *supra* note 85, at 151. Carroll explains that “it is impossible to assess accurately the degree to which Llewellyn lost control of the code or the extent to which his purposes were frustrated,” especially since Llewellyn “did not write in detail on this subject.” *Id.* Carroll then provides a quotation of Llewellyn’s that reflects the drafters’ disappointment in certain sections of the Code: “I am ashamed of it in some ways; there are so many pieces that I could make a little better; there are so many beautiful ideas that I tried to get in that would have been good for the law, but I was voted down.” *Id.* at 152 (citing Llewellyn, *Why a Commercial Code?* 22 TENN. R. REV. 779, 784 (1953)).

89. Article 2 is titled “Sales” and, by its terms, would seem to apply only to sales transactions, not leases or bailments. However, the scope provision, U.C.C. § 2-102 (1977), refers to “transactions in goods,” and has been a ready source for the argument that Article 2 should be given broad application. See, e.g., *Hertz Commercial Leasing Corp. v. Transportation Credit Clearing House*, 59 Misc. 2d 226, 298 N.Y.S.2d 392 (1969) (applying warranty provisions of Article 2 to a lease transaction by analogy), *rev’d on other grounds*, 64 Misc. 2d 910, 316 N.Y.S.2d 585 (1970); see also Annot., 17 A.L.R. 3d 1010 (1968).

90. Courts are not consistent in determining when a transaction is a sale of goods or services. Compare *Gulash v. Stylarama, Inc.*, 33 Conn. Supp. 108, 364 A.2d 1221 (1975) (installation of swimming pool is a service outside scope

Article 2 facilitate the use of tort analysis and endeavor to reflect and accommodate the unique nature of the commercial community. Nothing is peculiar to the law of sales that would compromise its service as a model for payments law.<sup>91</sup> As the commercial bar and academicians turn their attention to the codification of payments law, the approach utilized in the Sales Article must be considered. Succinctly, what has worked for sales may also work for payments. This portion of the Article formulates an essential principle of Llewellyn's legal realism, situation sense,<sup>92</sup> and considers how the

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of Article 2), *with* Riffe v. Black, 548 S.W.2d 175 (Ky. 1977) (installation of swimming pool within scope of Article 2; warranty sections of sales provisions applicable). *See* Annot., 4 A.L.R. 4th 85 (1981). It has been observed that courts are not blind to the effects of applying Article 2 to the facts of a particular case. "Considerable judicial hostility has long existed as to the [§ 2-201] Statute of Frauds. A general disposition against its application to prevent proof of a contract is served by determining that a given set of facts is not within the scope of Article 2." Deussenbert, *Strategies in Preparing, Interpreting and Managing Sales Contracts* 6, 7, *appearing in* 19TH ANNUAL UNIFORM COMMERCIAL CODE INSTITUTE (course materials) (March 6-8, 1986) (citing *Computer Servicer, Inc. v. Beacon Mfg. Co.*, 328 F. Supp. 653 (N.D.S.C. 1970) *aff'd mem.*, 443 F.2d 906 (4th Cir. 1971); *Buttorf v. United Elec. Labs., Inc.*, 459 S.W.2d 581 (Ky. App. 1970); *National Historic Shrines Found. v. Dali*, 4 U.C.C. REP. SERV. (CALLAGHAN) 71 (N.Y. Sup. Ct. 1967)) (on file at *The Wayne L. Review*).

91. The argument could be made that Article 2 is fundamentally distinguishable from Article 4 insofar as the relative bargaining positions of typical transactors is concerned. A buyer in a sales transaction may, and indeed usually will, be a seller in the next transaction. J.C. Penney buys from sellers and sells to buyers. Therefore, large merchant interests would support legislation that fairly accommodates the interests of both buyers and sellers.

Payments law, however, is concerned with striking a balance between banks and their customers. Few customers act as banks, just as few banks act as consumers of bank services in the same way individuals and smaller businesses "consume" retail banking services. When the banks are considering payments legislation, then, it would not be difficult to support rules that protect bank interests at the expense of consumer interests. Such a posture would be efficacious until a coherent and effective consumer lobby formed. That dichotomy would explain why Articles 2 and 4 differ in their balancing of conflicting interests, but does not justify the inequitable balance that this Article argues resulted from the lobbying dynamics in the early 1950s. Article 2 provides an approach to balancing competing commercial interests that does not unduly favor one constituency over another and, therefore, should inform the drafting of new payments law.

92. Twining notes that Llewellyn's use of the term "situation sense" is obscure and suggests further that Llewellyn failed to use the term consistently: "[I]s [Llewellyn] referring to a faculty or to actual perception or the signification or meaning of a situation or to something else?" After a brief analysis, Twining concludes that "sense cannot mean faculty, but it could mean either 'the meaning



homogeneity of commercial interests may make possible the coherent application of tort principles to payment issues.

Because the UCC is a code, it makes demands on attorneys not fully appreciated by those who perceive its provisions as a system of discrete answers to typical controversies.<sup>93</sup> Rarely is a commercial court constrained to reach a particular result under the most Llewellynesque provisions of Article 2. Instead, the sections invite a reexamination of the equities attending the particular facts in issue. "Article II . . . operated as a means of dictating a method. That method was designed to prompt decision not according to the letter or the logic of a statute or a juristic concept but rather according to the 'situation-reason.'"<sup>94</sup> Though Llewellyn's elaboration of situation reason, or situation sense, has not provided a model of clarity, his persistent emphasis on the

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of the situation' or what would be sensible (i.e., judicious) in this situation."

Twining argues that lying within this definition of "situation sense" is evidence that Llewellyn "was lured by his flirtation with natural law into deviation from his normal stance as an empiricist and ethical relativist," because "meaning of the situation" gives rise to a metaphysical inquiry about "finding . . . immanent law . . . not known by empirical methods." Perhaps, though, Twining placed too much emphasis on the word "sense" and not enough on "situation." Indeed, he begins his discussion by defining the parameters of "sense" and then filtering the "situation" through that delimitation. The result is that Twining further obscures Llewellyn's phrase and turns the inquiry in a direction opposite of what Llewellyn intended. See W. TWINING, *supra* note 8, at 219-21.

"Realism was never a philosophy [although] [i]t is persistently treated as such. But realism is a method which can serve any goal at all." Herein lies the importance of the word "situation." To deemphasize its meaning in favor of "sense" is to commit Twining's analytical mistake. Llewellyn, recognizing that realism and its corresponding terminology might be misinterpreted in just this way, cautioned that: "[the] main trouble with treating the descriptive or technological branch of a discipline as a philosophy is that any preliminary or partial work is likely to be viewed as if it were trying to be a whole, with negative implications read in, indeed read in even though they be denied." See K. LLEWELLYN, *THE COMMON LAW TRADITION: DECIDING APPEALS* 509-10, n.2 (1960). Llewellyn's "situation sense" found its way into the comments to U.C.C. § 2-612 ("Installment Contract"; Breach):

Even where a clause speaks of "a separate contract for all purposes," a commercial reading of the language under the section on good faith and commercial standards requires that the singleness of the document and the negotiation, *together with the sense of the situation*, prevail over any uncommercial and legalistic interpretation.

U.C.C. § 2-612 comment 3 (emphasis added).

93. See Scott, *supra* note 18, at 738 ("Commercial law has become largely the province of the adept reader of statutes, and the methodology of the Code is the skill of working out language puzzles.").

94. See Danzig, *supra* note 85, at 632.

immanent law of a fact pattern suggests that he considered situation sense to be a venerable juristic concept. For the commercial transactor and his counsel, nice questions of immanent justice do little to establish the contours of a deal or to reveal the best litigation posture when the deal falls apart. In *The Common Law Tradition*,<sup>95</sup> Llewellyn argued that situation sense has meaning on that pragmatic level. He used Justice Benjamin Cardozo's *MacPherson v. Buick Motor Co.*<sup>96</sup> opinion to describe his concept of situation sense.<sup>97</sup> Llewellyn concluded that Cardozo's method reflected the "Grand Style" of adjudication. What can be distilled from Llewellyn's *MacPherson* section of *The Common Law Tradition* formulates what Llewellyn endeavored to draft into Article 2 of the Code.<sup>98</sup>

Cardozo impressed Llewellyn by separating the *principle* or *reason* for a rule from the *precedential authority*: "That principle is then reformulated to fit the modern need, to solve the case in hand, and to guide the future, its reason being made as explicit as itself."<sup>99</sup> Precedent is thereby "*cleaned up*."<sup>100</sup> If the statute or code is the only source of the law, the creative judge need not

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95. K. LLEWELLYN, *supra* note 92.

96. 217 N.Y. 382, 111 N.E. 1050 (1916).

97. To understand Llewellyn's demonstration of situation sense in *MacPherson*, it is important first to understand that Cardozo was developing the common law, not construing a code.

98. Llewellyn was impressed with Cardozo's *MacPherson* opinion:

Equally important, *MacPherson v. Buick* shows the "style of reason" at its best, in full recrudescence, indeed in full recapture, both in the deciding and in the opinion-writing, and more than two generations ago. It displays, in addition, an identifiable manner and technique of opinion-writing peculiarly adapted to the present-day task of getting back to the reasoned creative method of the early nineteenth century, while both capitalizing on and reckoning with the insight and authority embodied in the intervening cases—while also disposing of such of them as may prove too remote from life because either the Formal Style or some other aberration has in the interim lost contact with life-needs or even made conscious rapprochement therewith seem immaterial.

K. LLEWELLYN, *supra* note 92, at 431. Cardozo was a uniquely talented jurist, able to impose his creative abilities on the facts of a controversy to discover "the individual equities." *Id.* at 430. A Cardozo would not need a particular form of commercial statute to reach commercially sound decisions. His rhetorical prowess could manipulate the ostensibly formalistic statutory prescriptions and proscriptions as nimbly as he could impose his creative constructions on common law precedent. See G. GILMORE, *THE DEATH OF CONTRACT* 62-63 (1974) (noting Cardozo's delight "in weaving gossamer spider webs of consideration").

99. K. LLEWELLYN, *supra* note 92, at 431.

100. *Id.*



expend efforts "cleaning up" precedent, and the less skilled jurist will not be distracted by the need to distinguish troublesome precedent. The UCC, because it is a code, is consistent with what Llewellyn admired in *MacPherson*. In his important article concerning UCC methodology, Chancellor Hawkland recognized that courts construing provisions of the Code should focus more on the language of the Act's provisions than on other courts' construction of those provisions.<sup>101</sup>

Llewellyn praised Cardozo's ability to manipulate the scope of the liability principle to suit the facts of the case. Cardozo observed: "Precedents drawn from the days of travel by stage coach do not fit the conditions of travel to-day,"<sup>102</sup> and Llewellyn remarked: "A question seen thus widens out; and, as is familiar, the resulting rule or principle must therefore also widen out, to fit the *now perceived sense* and need which only such a viewing of the question could have opened."<sup>103</sup> Good commercial law, for Llewellyn, would be drafted "to permit the continued expansion of commercial practices through custom, usage and agreement of the parties."<sup>104</sup>

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101. Hawkland, *supra* note 87, at 292 (citing and quoting Gilmore, *Legal Realism: Its Cause and Cure*, 70 YALE L.J. 1037, 1043 (1961) ("A 'Code' . . . remains at all times its own best evidence of what it means: cases decided under it may be interesting, persuasive, cogent, but each new case must be referred for decision to the undefiled code text.")).

102. 217 N.Y. at 391, 111 N.E. at 1053.

103. K. LLEWELLYN, *supra* note 92, at 432.

104. U.C.C. § 1-102 states:

(1) This Act shall be literally construed and applied to promote its underlying purposes and policies.

(2) Underlying purposes and policies of this Act are

(a) to simplify, clarify and modernize the law governing commercial transactions;

(b) to permit the continued expansion of commercial practices through custom, usage and agreement of the parties;

(c) to make uniform the law among the various jurisdictions.

(3) The effect of provisions of this Act may be varied by agreement, except as otherwise provided in this Act and except that the obligations of good faith, diligence, reasonableness and care prescribed by this Act may not be disclaimed by agreement but the parties may by agreement determine the standards by which the performance of such obligations is to be measured if such standards are not manifestly unreasonable.

(4) The presence in certain provisions of this Act of the words "unless otherwise agreed" or words of similar import does not imply that the effect of other provisions may not be varied by agreement under subsection (3).

(5) In this Act unless the context otherwise requires

(a) words in the singular number include the plural, and in the

Central concepts would be fluid, not static, and principle would "be recurred to constantly, so as to correct and readjust precedent."<sup>105</sup> Justice Cardozo's method is the type of analysis vindicated by Llewellyn's legal realism. The dynamic nature of commercial transactions mandates such a method just as it seems most acutely to defy static formulation and application: "To speak of an exclusively correct interpretation, one which would be the true meaning of the statute from the beginning to the end of its day, is altogether erroneous."<sup>106</sup>

Insofar as legal realism provides a means to discover and effectuate the goals and policies common among commercial transactors, it facilitates code treatment of commercial transactions. A code is a "pre-emptive, systematic, and comprehensive enactment of a whole field of law."<sup>107</sup> Before an area of law may be codified successfully, it must be delimited along functional lines: to be "comprehensive" an enactment must describe the rights and liabilities in a discrete "operational-body-of-law."<sup>108</sup> This requirement dictates that the set of laws "be sufficiently inclusive and independent to enable it to be administered in accordance with its own *basic policies*."<sup>109</sup>

The attraction between commercial law and codification is a function of the insular (but not provincial in the pejorative sense) nature of commercial transactions. Llewellyn was impatient with comprehensive theories of human behavior that obscured the forest for the trees: "The effects of official action *must* then be different for different persons or groups, according to the interests, habits, complexes, occupations."<sup>110</sup> To ignore distinctions that matter is

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plural include the singular;

(b) words of the masculine gender include the feminine and the neuter, and when the sense so indicates words of the neuter gender may refer to any gender.

105. K. LLEWELLYN, *supra* note 92, at 436.

106. B. CARDOZO, *THE NATURE OF THE JUDICIAL PROCESS* 84-85 (1921) (quoting Kohler, *Interpretation of Law*, translated in 9 MODERN LEGAL PHILOSOPHY SERIES 192 (1969)).

107. Hawkland, *supra* note 87, at 292.

108. *See id.* at 310.

109. *Id.* (emphasis added).

110. *See* K. Llewellyn, *Legal Tradition and Social Science Method—A Realist's Critique*, reprinted in K. LLEWELLYN, *JURISPRUDENCE: REALISM IN THEORY AND PRACTICE* 77 (1962). "We live in a specialized, a differentiated society. We live in groups, in constellations, unlike, far from, hardly aware of most of those others who are the rest of us." *Id.* at 81.



to engage in "lump-concept thinking,"<sup>111</sup> anathema to a Llewellyn realist. The business community's preoccupation with certainty, predictability, and stability, tempered but not undermined by a vigorous need and desire for flexibility in the application of law to facts, resulted in the development of a "bar beginning then to specialize in clients (industrial clients who needed steadiness of law)."<sup>112</sup> Once such a group of lawyers and clients took form, a code could serve the group's idiosyncratic needs and aptitudes:

In the commercial field "reasonable reckonability" of outcome was most soundly based on the premise that in the market commercial necessity generates to a large extent its own uniformities of values and patterns of behavior; commercial self interest spurs most businessmen to act within widely recognized leeways of decency and honesty: gross abuses tend to be self-defeating and can be checked in any case by making "honesty", "good faith", and "reasonableness" the principal baselines for adjudication.<sup>113</sup>

Commercial transactors often need less guidance to structure a transaction or even to pick up the pieces afterward than do similarly situated laymen. Even the Code's detractors have recognized the distinct characteristics of the commercial community: "[Commercial law] is at the margin of public law. It deals with a subcommunity . . . whose members occupy a status position distinct from society at large [and] whose disputes are often resolved by informal

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111. See W. TWINING, *supra* note 8, at 136. Twining writes: [T]here is a recurring theme of the need to be distrustful of broad generalizations and especially of "lump concepts." This theme reaches a crescendo in the analysis of "title." By "lump concepts" Llewellyn meant abstract legal conceptions, such as "right", "possession", "consideration", "title to goods", and "servant." . . . A general concept which "lumped together" socially disparate situations . . . or which was used in different contexts to perform different functions . . . was to be viewed with skepticism.

*Id.* at 136-37. See also U.C.C. § 2-401 (describing the limited application of "title" concepts in Article 2). See generally K. Llewellyn, *supra* note 110, at 95-97 (discussing "the role of concepts").

112. Llewellyn, *On the Good, the True, the Beautiful, in Law*, 9 U. CHI. L. REV. 224, 240 (1942).

113. W. TWINING, *supra* note 8, at 336. "Implicit in this view is a belief that legal rules have a more marginal role to play in generating business expectations than some critics of the Code allow and that tight drafting will often be at least as likely to defeat commercial expectations as provide a basis for them." *Id.*

negotiation or in private forums.”<sup>114</sup> It is not necessary that all groups concerned with the commercial law share the same level of sophistication, so long as substantial differences in levels of sophistication are made part of the calculus used to determine the transactors’ relative standards of care.<sup>115</sup>

The merchant provisions in Article 2 evidence that all affected transactors need not have identical, or even nearly identical, interests and levels of sophistication for comprehensive codification of an entire field of law to work.<sup>116</sup> It is enough that the parties have a sufficient identity of interests in particular recurring transactions to agree upon certain fundamental “uniformities of values and patterns of behavior.”<sup>117</sup> Commercial law drafted from the perspective of only one of the affected interest groups may obscure the object of commercial codification. The resulting legislation will not achieve an equilibrium; it will sacrifice the balance that a true accommodation of the opposing interests can accomplish. The tension produced by the opposition of competing interests may serve the needs of commerce by spawning flexible yet certain legislation that is responsive to the interests of the transactors and the exigencies of varied circumstances.<sup>118</sup> Llewellyn’s legal realism

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114. Danzig, *supra* note 85, at 622.

115. U.C.C. § 2-104(1), the “merchant” definition, illustrates well how a commercial statute can consider varying levels of transactor sophistication without compromising the demands for certainty and stability in commercial law. The comment to the provision explains that the merchant concept is fluid:

The professional status under the definition may be based upon specialized knowledge as to the goods, specialized knowledge as to business practices, or specialized knowledge as to both *and which kind of specialized knowledge may be sufficient to establish the merchant status is indicated by the nature of the provisions.*

U.C.C. § 2-104 comment 2 (emphasis added). U.C.C. §§ 2-103, 2-104, 2-201, 2-205, 2-207, 2-209, 2-312, 2-314, 2-327, 2-403, 2-509, 2-603, 2-605, and 2-609 refer to “merchants.” Opening mail and making representations regarding the integrity of goods offered for sale are essentially different. Article 2 recognizes that difference and requires courts to acknowledge it in determining the responsibilities of transactors. U.C.C. § 2-104, comment 2. Thus, the provisions afford courts an opportunity to avoid making bad law when confronted by hard cases.

116. For a discussion of the impact of Karl Llewellyn on the development of the Article 2 merchant rules, see Hillinger, *The Article 2 Merchant Rules: Karl Llewellyn’s Attempt to Achieve the Good, the True, the Beautiful in Commercial Law*, 73 GEO. L.J. 1141 (1985).

117. W. TWINING, *supra* note 8, at 336.

118. Legislation that vindicates the vested interests of one group to the detriment of others affected by recurring transactions will, if Article 4 provides an accurate example, rely upon formalism, an inappropriate predisposition for



supplies the method for discovering the proper balance of interests among the various parties to typical payment transactions.<sup>119</sup>

#### IV. THE SALES LAW PERSPECTIVE: TORT ANALYSIS AND DRAFTING WITH A FOCUS ON FACTUAL DETERMINATIONS

##### A. *The Relationship of Tort and Contract*

It has become axiomatic that our commercial law is a branch of the law of contracts.<sup>120</sup> The apparent close relationship between commercial law and contract law seems substantial, in part, because Article 2 of the UCC governs one type of contract, the sales contract. Indeed, the superficial similarities between the two fields belie a fundamental affinity. Several provisions of the Code reinforce such apparent parallels:

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a body of law that would recognize as its premise "reasonable reckonability" of outcome." *Id.*

The Code is founded not only on faith in the capacity of the business community for satisfactory self-regulation within a framework of very broadly drafted rules, but also on a faith in judges to make honest, sensible commercially well-informed decisions once they have been given some base-lines for judgment. Thus "reckonability" can be hoped for if judges can be expected to act in accordance with business expectations; uniformity within the leeway of broad rules will be promoted by uniformities of expectations, values and practices within the commercial world.

*Id.*

One-sided legislation provides a poor model for subsequent codification efforts. In the case of payments law, the financial institution power-play that resulted in Article 4 has occasioned an equal and opposite reaction from the representatives of consumer interests in credit card and electronic funds transfer law. *See supra* text accompanying notes 63-84. Consequently, neither Article 4 nor the E.F.T.A. serves properly the interests of all affected transactors. The chauvinism of both Article 4 and the E.F.T.A. renders them an inadequate model for legislation that would endeavor to balance the interests of banks and their customers.

119. *See supra* note 92 for a discussion of Llewellyn's approach to legal realism as "method."

120. It is not atypical to find that "Contracts" and "Sales" are taught in the same first year law school course. Indeed, many professors of commercial law also teach contract law. *See* Mooney, *Old Kontract Principles and Karl's New Kode: An Essay on the Jurisprudence of Our New Commercial Law*, 11 VILL. L. REV. 213 (1966) (arguing that the U.C.C. has "mortally wounded" the general theory of contract by replacing Langdellian formalism with Karl Llewellyn's legal realism).

Article 2 contains a statute of frauds,<sup>121</sup> a parol evidence

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121. Compare U.C.C. § 2-201 (1977) which provides:

(1) Except as otherwise provided in this section a contract for the sale of goods for the price of \$500 or more is not enforceable by way of action or defense unless there is some writing sufficient to indicate that a contract for sale has been made between the parties and signed by the party against whom enforcement is sought or by his authorized agent or broker. A writing is not insufficient because it omits or incorrectly states a term agreed upon but the contract is not enforceable under this paragraph beyond the quantity of goods shown in such writing.

(2) Between merchants if within a reasonable time a writing in confirmation of the contract and sufficient against the sender is received and the party receiving it has reason to know its contents, it satisfies the requirements of subsection (1) against such party unless written notice of objection to its contents is given within 10 days after it is received.

(3) A contract which does not satisfy the requirements of subsection (1) but which is valid in other respects is enforceable

(a) if the goods are to be specially manufactured for the buyer and are not suitable for sale to others in the ordinary course of the seller's business and the seller, before notice of repudiation is received and under circumstances which reasonably indicate that the goods are for the buyer, has made either a substantial beginning of their manufacture or commitments for their procurement;

(b) if the party against whom enforcement is sought admits in his pleading, testimony or otherwise in court that a contract for sale was made, but the contract is not enforceable under this provision beyond the quantity of goods admitted;

(c) with respect to goods for which payment has been made and accepted or which have been received and accepted (Sec. 2-606)[.]

with the 1676 Act for the Prevention of Fraud and Perjuries, 29 Car. II, ch. 3, III Stat. at Large 385, 386, which provides in part:

IV. And be it further enacted by the Authority aforesaid, That from and after the said four and twentieth Day of *June* no Action shall be brought [(1)] whereby to charge any Executor or Administrator upon any special Promise, to answer Damages out of his own Estate; (2) or whereby to charge the Defendant upon any special Promise to answer for the Debt, Default, or Miscarriage of another Person; (3) or to charge any Person upon any Agreement made upon Consideration of Marriage; (4) or upon any Contract [f]or Sale of Lands, Tenements or Hereditaments, or any Interest in or concerning them; (5) or upon any Agreement that is not to be performed within the Space of one Year from the making thereof; (6) unless the Agreement upon which such Action shall be brought, or some *Memorandum* or Note thereof, shall be in Writing, and signed by the Party to be charged therewith, or some other Person thereunto by him lawfully authorized.

. . . .

XVII. And be it further enacted by the Authority aforesaid, That



rule<sup>122</sup> a modification of the common law "mirror image" rule<sup>123</sup>

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from and after the said four and twentieth Day of *June* no Contract for the Sale of any Goods, Wares and Merchandizes, for the Price of ten Pounds Sterling or upwards, shall be allowed to be good, except the Buyer shall accept Part of the Goods so sold, and actually receive the same, or give something in earnest to bind the Bargain, or in Part of Payment, or that some Note or *Memorandum* in Writing of the said Bargain be made and signed by the Parties to be charged by such Contract, or their Agents thereunto lawfully authorized.

122. Compare U.C.C. § 2-202, which provides:

Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented

(a) by course of dealing or usage of trade (Section 1-205) or by course of performance (Section 2-208); and

(b) by evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement[.]

with 3 A. CORBIN, CONTRACTS § 573 (1960) (footnote omitted), which states: When two parties have made a contract and have expressed it in a writing to which they have both assented as the complete and accurate integration of that contract, evidence, whether parol or otherwise, of antecedent understandings and negotiations will not be admitted for the purpose of varying or contradicting the writing.

123. Compare U.C.C. § 2-207, which provides:

(1) A definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time operates as an acceptance even though it states terms additional to or different from those offered or agreed upon, unless acceptance is expressly made conditional on assent to the additional or different terms.

(2) The additional terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless:

- (a) the offer expressly limits acceptance to the terms of the offer;
- (b) they materially alter it;
- (c) notification of objection to them has already been given or is given within a reasonable time after notice of them is received.

(3) Conduct by both parties which recognizes the existence of a contract is sufficient to establish a contract for sale although the writings of the parties do not otherwise establish a contract. In such cases the terms of the particular contract consist of those terms on which the writings of the parties agree, together with any supplementary terms incorporated under any other provisions of this Act[.]

with RESTATEMENT (SECOND) OF CONTRACTS §§ 60, 61 (1979), which state:

[§ 60] If an offer prescribes the place, time or manner of acceptance

and a provision that adjusts the preexisting duty rule.<sup>124</sup> Notwithstanding the contract law terminology employed, those UCC sections are better understood in terms of tort rather than traditional contract conceptions. Most of Article 2 lends itself to such an approach.<sup>125</sup> Over a decade ago, Professor Grant Gilmore demon-

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its terms in this respect must be complied with in order to create a contract. If an offer merely suggests a permitted place, time or manner of acceptance, another method of acceptance is not precluded.

[§ 61] An acceptance which requests a change or addition to the terms of the offer is not thereby invalidated unless the acceptance is made to depend on an assent to the changed or added terms.

Comment:

a. *Interpretation of acceptance.* An acceptance must be unequivocal. But the mere inclusion of words requesting a modification of the proposed terms does not prevent a purported acceptance from closing the contract unless, if fairly interpreted, the offeree's assent depends on the offeror's further acquiescence in the modification.

124. Compare U.C.C. § 2-709, which provides:

(1) An agreement modifying a contract within this Article needs no consideration to be binding.

(2) A signed agreement which excludes modification or rescission except by a signed writing cannot be otherwise modified or rescinded, but except as between merchants such a requirement on a form supplied by the merchant must be separately signed by the other party.

(3) The requirements of the statute of frauds section of this Article (Section 2-201) must be satisfied if the contract as modified is within its provisions.

(4) Although an attempt at modification or rescission does not satisfy the requirements of subsection (2) or (3) it can operate as a waiver.

(5) A party who has made a waiver affecting an executory portion of the contract may retract the waiver by reasonable notification received by the other party that strict performance will be required of any term waived, unless the retraction would be unjust in view of a material change of position in reliance on the waiver[.]

with J. CALAMARI, *CONTRACTS* § 4-7 (1977) (footnotes omitted), which states:

As a general proposition the courts have ruled that where a party does or promises to do what he is already legally obligated to do or promises to refrain from doing or refrains from doing what he is not legally privileged to do he has not incurred detriment. The preexisting duty need not be contractual. Thus, for example, if one promises to pay his or her spouse a thousand dollars at the end of the year if the spouse carried out the obligations of the marriage, the spouse would not be entitled to the money because the spouse would merely have performed a pre-existing legal duty. So also a sheriff may not obtain a reward for the capture of a criminal if the capture is within the general scope of his duties.

125. See, e.g., *infra* text accompanying notes 153-73.



strated the consequences of what Corbin,<sup>126</sup> Llewellyn,<sup>127</sup> and even Holmes<sup>128</sup> had appreciated years before, "the fusing of contract and tort in a unified theory of civil obligation."<sup>129</sup> Contract law replaces abstraction for analysis; it is "what is left in the law relating to agreements when all particularities of person and subject-matter are removed."<sup>130</sup> The area of legal analysis that focuses on the particularities, and indeed makes them determinative, is tort law.<sup>131</sup> One well-read in tort cases would quickly conclude that the doctrine of

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126. Arthur Corbin is generally considered an important precursor to the Realists, due primarily to his interest in empirical, historical, and doctrinal studies. See G. GILMORE, *supra* note 98, at 79-80; W. TWINING, *supra* note 8, at 27-34. For example, these studies revealed that the formalistic contract doctrine of "consideration" was not uniformly employed by courts in resolving contract disputes. Indeed, courts often employed various theories of "estoppel" to enforce promises that were not supported by consideration. See G. GILMORE, *supra* note 98, at 58-65. Such promises, of course, would not have been enforced under the formal law of "contracts" and represented the existence of a "reliance interest" enforcement theory operating outside the scope of traditional contract law. See *id.* at 71; RESTATEMENT (SECOND) OF CONTRACTS § 90 (1979) (providing for promissory estoppel).

127. See Llewellyn, *On Warranty of Quality, and Society*, 36 COLUM. L. REV. 699, 713 (1936) (describing the regulation of commerce as a progressive culmination of conditions, needs, and theories ranging from arm's-length transaction, tort, contract, *res ipsa loquitur*, and third party warranty to central regulation by guild or state).

128. See O.W. HOLMES, *THE COMMON LAW* 13 (Belknap Press ed. 1963) ("But it must be remembered that the distinction between tort and breaches of contract, and especially between remedies for the two, is not found ready made."); see also Sullivan, *Punitive Damages in the Law of Contract: The Reality and the Illusion of Legal Change*, 61 MINN. L. REV. 207, 252 (1977), stating:

[R]ecent decisions sanctioning the award of punitive damages in contract do not manifest much concern as to whether the plaintiff's claim falls on the tort or contract side . . . . [I]t suggests that the most important question . . . may be not whether punitive damage awards are consistent with contract damage principles, but rather, what is the likely effect of the recent cases on the continued integrity of distinctions between contract and tort, and what are the implications of undermining those distinctions.

129. G. GILMORE, *supra* note 98, at 90. Professor Gilmore stated:

It is not only on the products liability front that the erosion of the negligence idea has been proceeding. Indeed the decline and fall of the nineteenth century idea that tort liability is, or should be, based on negligence or other fault matches the decline and fall of nineteenth century consideration and contract theory . . . .

*Id.* at 94.

130. *Id.* at 6 (quoting L. FRIEDMAN, *CONTRACT LAW IN AMERICA* 20 (1965)).

131. The central concepts of tort law are foreseeability, the reasonable person standard, and evaluations of proximate causation by reference to objective criteria. See W. PROSSER & W. KEETON, *TORTS* §§ 43, 32, 42.

stare decisis is respected more in the breach than the observance: concepts and "limitations" of causes of action can only be understood by reference to the particularities, the idiosyncratic elements that distinguish one case from another.<sup>132</sup> What "rules" there are provide guidance rather than dispositive answers.<sup>133</sup>

What really matters is this, that the judge is under a duty, within the limits of his power of innovation, to maintain a relation between law and morals, between the precepts of jurisprudence and those of reason and good conscience. I suppose it is true in a certain sense that this duty was never doubted. One feels at times, however, that it was obscured by the analytical jurists, who, in stressing verbal niceties of definition, made a corresponding sacrifice of emphasis upon the deeper and finer realities of ends and aims and functions.<sup>134</sup>

Technical competence comes easier than the development of good situation sense. However, the better lawyers and judges, those comfortable with the Grand Style of legal analysis, would be uncomfortable if constrained by statutory law that championed form over substance. In the grand tradition of legal argument "*the rule follows where its reasons leads; where the reason stops, there stops the rule.*"<sup>135</sup> Justice Cardozo wrote disparagingly of rules that would compel results without reference to reason.<sup>136</sup> He was concerned that rules could mandate unconscious, mechanical determination of results and acknowledged the "bulk and pressure of the rules" that would inhibit the creative energy of judges. Notwithstanding the tendency of legislatures to accommodate formalistic construction of statutes and the analytical jurists' preoccupation with the mechanical application of law to facts, responsible courts and the attorneys appearing before them must innovate:<sup>137</sup>

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132. See Prosser, *The Fall of the Citadel*, 50 MINN. L. REV. 791, 802 (1966) ("No one disputed that the 'warranty' was a matter of strict liability. No one denied that where there was no privity, liability to the consumer could not sound in contract and must be a matter of tort. Why not, then . . . strict liability in tort . . .?").

133. See *supra* text accompanying notes 102-05.

134. B. CARDOZO, *supra* note 106, at 133-34 (footnote omitted).

135. K. LLEWELLYN, *THE BRAMBLE BUSH* 157-58 (1960) (emphasis in original).

136. See B. CARDOZO, *supra* note 106, at 84.

137. *Id.* at 136-38.



"within the confines of [remaining] open spaces . . . choice moves with a freedom which stamps its action as creative."<sup>138</sup> As in eating a pair of shoes, indeed the best parts are the holes.<sup>139</sup> And the holes are inevitable;<sup>140</sup> those inevitable gaps provide the stuff of law, the material of judicial opinions.

*B. The Contrast Between Tort and Contract Principles in the UCC*

The Code's rules provide more guidance and certainty than is available from the common law system of precedent.<sup>141</sup> Rather than prepackaging an invariable conclusion to facts "marshalled"<sup>142</sup> in a particular way, Article 2 is drafted so that transactors' and courts' conceptions of justice may be effectuated.<sup>143</sup> The "true code" concept,<sup>144</sup> the elaborate definitions and thorough system

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138. *Id.* at 115.

139. See Fuller, *The Case of the Speluncean Explorers*, 62 HARV. L. REV. 616, 634 (1949). In Fuller's hypothetical case designed to explore divergent jurisprudential traditions, it is noted that the perspective of one of the justices was similar to that of a man who ate a pair of shoes. "Asked how he liked them, he replied that the part he liked best was the holes. That is the way my [fellow Supreme Court Justice] feels about statutes; the more holes they have in them the better he likes them. In short, he doesn't like statutes." *Id.* at 634.

140. See B. CARDOZO, *supra* note 106, at 16.

141. See K. LLEWELLYN, *supra* note 92, at 62-63, concerning "The Leeways of Precedents" in the common law system. Chancellor (then Professor) Hawkland recognized that the Code addresses the shortcomings of stare decisis by requiring courts to consistently refer to the statute and by distracting courts' attention from case law under the Code. See Hawkland, *supra* note 87, at 292 (citing Gilmore, *supra* note 110, at 1043).

142. "[T]he tort law . . . is relatively unimportant in most tort cases. The successful tort lawyer has never been a specialist in law. His specialty lies in marshalling and presenting facts." Hawkland, *supra* note 87, at 294 n.11.

143. Karl Llewellyn stated:

[A]ny reframing of particular legal doctrines, any addition to or clarification of the techniques of decision, must not only better serve control of arbitrariness and guidance to justice, but must also satisfy men's craving for reasonable certainty of *form* as well as substance, and for dignity of process as well as dignity of result.

Llewellyn, *On Reading and Using the Newer Jurisprudence*, 40 COLUM. L. REV. 581, 610 (1940) (emphasis in original).

144. See Hawkland, *supra* note 87, at 292, which states:

A "code" is a pre-emptive, systematic, and comprehensive enactment of a whole field of law. It is pre-emptive in that it displaces all other law in its subject area . . . . It is systematic in that all of its parts, arranged in an orderly fashion and stated with a consistent terminology, form an interlocking, integrated body, revealing its own plan and

of cross referencing, provide the "certainty of *form*" and "dignity of process" in the UCC. However, it is the language of the individual provisions, the guidance of the comments,<sup>145</sup> and the application of the Grand Style of adjudication that guarantee "certainty of substance" and "dignity of result." The Code's provisions work best when they reflect "a consideration of the nature of the particular transaction as a practical matter."<sup>146</sup> Article 2 illustrates the efficacy of this focus.

The language of Justice Cardozo's tort analysis is familiar to those who have focused their attention on sales transactions:

The master in the discharge of his duty to protect the servant against harm must exercise the degree of care that is commonly exercised in like circumstance by men of ordinary prudence. The triers of the facts in determining whether that standard has been attained must consult the habits of life, the every day beliefs and practices, of the men and women about them.<sup>147</sup>

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containing its own methodology. It is comprehensive in that it is sufficiently inclusive and independent to enable it to be administered in accordance with its own basic policies.

*Id.* (footnote omitted); see also, Alces, *supra* note 3, at 89, which states: UCC drafters . . . expended considerable effort formulating a jurisprudence of commercial codification and applying it to the provisions of the UCC. Their perspective was founded on concepts of legal realism and, as a result, they established commercial procedures that make the UCC more a restatement of expedient commercial practices than an effort to modify business custom.

145. Some writers have focused on the comments as a source of guidance in resolving Code disputes. See, e.g., McDonnell, *Purposive Interpretation of the Uniform Commercial Code: Some Implications for Jurisprudence*, 126 U. PA. L. REV. 795, 797-98 (1978) ("The theory of purposive interpretation is rooted in the concept of law as a means to select social ends—a method of social engineering. It seeks to define legal standards in terms of the purpose they are designed to implement."). Further, "the drafters' attempt to use the commentary to facilitate purposive construction was linked with the underlying goal of uniformity. . . . The official commentary indicates that, at least at times, articulated purpose is to control statutory text in Code interpretation." *Id.* at 800.

146. O.W. HOLMES, *supra* note 128, at 283. Holmes felt that "the most important element of decision is not any technical, or even any general principle of contracts, but a consideration of the nature of the particular transaction as a practical matter." *Id.* Moreover, "[a]n answer cannot be obtained from any general theory . . . . But the grounds of decision are purely practical, and can never be elicited from grammar or from logic." *Id.* at 264.

147. B. CARDOZO, *supra* note 106, at 63.



Likewise, "Good Faith" in the case of an Article 2 merchant means "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade."<sup>148</sup> Indeed, there may be no better example of the disparity between Article 2 and the Commercial Paper/Bank Collections Articles than the "good faith" provisions governing transactions in each Article. This conflict depicts well the tension between the two drafting predispositions and biases as well as the political consequences of choosing one style over the other. Section 1-201(19) defines "good faith" as "honesty in fact in the conduct or transaction concerned."<sup>149</sup> This provision, the so called "pure heart—empty head" standard, is effective in all Articles of the UCC. Article 2, however, establishes an enhanced, objective standard.<sup>150</sup> The focus on reasonableness illustrates the influence of Llewellyn's legal realism. The intentional exclusion of a similar provision in an early draft of Article 3 concerning holders in due course reveals the predisposition of those who lobbied against it.<sup>151</sup> Although the objective standard may remain

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148. See U.C.C. § 2-103(1)(b) (1977).

149. *Id.* § 1-201(19).

150. *Id.* § 2-103(1)(b) provides: "In this Article unless the context otherwise requires . . . '[g]ood faith' in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade."

151. Professor Braucher wrote:

An early draft of the Revised Sales Act sought to add a requirement that action by a merchant or banker, to be in good faith, be "taken in reasonable course of business"; in early drafts of the Code this became a provision that "good faith includes observance by a person of the reasonable commercial standards of any business or trade in which he is engaged." The ABA Section objected that this language was ambiguous and might be read to freeze commercial practices, and the editorial board agreed to limit the general definition of "good faith" to honesty in fact, using more specific language for any case where a party was required to meet reasonable commercial standards. The result was that such specific provisions were inserted in several places. Perhaps most important was the provision in section 2-103 that throughout Article 2—Sales "'good faith' in the case of a merchant includes the observance of reasonable commercial standards," and the provision in section 3-302 that to be a holder in due course of commercial paper the holder must take "in good faith including the observance of the reasonable commercial standards of any business in which the holder may be engaged."

The provision as to holders in due course was perhaps the item most vigorously discussed in the New York hearings. On behalf of the Chase Bank it was said that it revived the rule of *Gill v. Cubitt* [3 B. & C. 466, 107 Eng. Rep. 806 (1824)]. The sponsors asserted that the provision merely made reasonable commercial standards relevant on the

in the commercial paper context by operation of the "notice" provisions,<sup>152</sup> the fact that commercial reasonableness is expressly made determinative in Article 2 but expurgated from the commercial paper setting corroborates the thesis of this Article.

Perhaps one of the best examples of what Llewellyn was up to in his application of realistic principles to the law of sales is found in the provisions dealing with tender, acceptance, rejection, and revocation of goods—the UCC "Tarr"-Baby.<sup>153</sup>

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issue of good faith, in accordance with precedent. A third view was that it would be a rare case where the presence of the controverted language would affect the outcome. The one case in which that language was considered by a Pennsylvania court supports the third view; and that view probably influenced the decision of the editorial board to yield in Supplement No. 1 by deleting the reference to reasonable commercial standards.

The New York commission approved the deletion of the reference to reasonable commercial standards in the definition of holder in due course. With respect to the comparable provision in Article 2—Sales, the commission recommended that the definition of good faith be revised to emphasize reasonable standards of fair dealing in the trade rather than reasonable standards of care. That recommendation was consistent with an earlier suggestion by the ABA Section that good faith might well include some element to "commercial decency" and with a reference by the New York Court of Appeals to "the good old rule that there is in every contract an implied covenant of fair dealing." The change was made in the 1956 revision.

Braucher, *The Legislative History of the Uniform Commercial Code*, 58 COLUM. L. REV. 798, 812-13 (1958) (footnotes omitted).

152. See U.C.C. §§ 1-201(25), 3-302, 3-304. Whether a holder has taken an instrument without notice of claims or defenses to payment on the instrument is to be determined by reference to objective indicia. A holder has taken with notice, and cannot be a holder in due course, if, circumstances surrounding the holder's acquisition of the paper indicate that the holder had "reason to know" of the existence of a claim or defense. *Id.* § 1-201(25). Several courts have adopted the "inferable knowledge test" of notice. See, e.g., *Eldon's Super Fresh Stores, Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 296 Minn. 130, 207 N.W.2d 282 (1973); *Mid-Continent Nat'l Bank v. Bank of Independence*, 523 S.W.2d 569 (Mo. App. 1975); *O.P. Ganjo, Inc. v. Tri-Urban Realty Co.*, 108 N.J. Super. 517, 261 A.2d 722 (1969). Another approach applies a "duty to inquire" test. See, e.g., *Winter & Hirsch, Inc. v. Passarelli*, 122 Ill. App. 2d 372, 259 N.E.2d 312 (1970); *Kaw Valley State Bank & Trust Co. v. Riddle*, 219 Kan. 550, 549 P.2d 927 (1976); *Sun 'N Sand, Inc. v. United Cal. Bank*, 21 Cal. 3d 671, 582 P.2d 920, 148 Cal. Rptr. 329 (1978); see also W. HAWKLAND & L. LAWRENCE, U.C.C. SERIES § 3-304:05 (Art. 3) (1984) (describing the inferable knowledge test as the majority rule).

153. See Whaley, *Tender, Acceptance, Rejection and Revocation—The U.C.C.'s "Tarr"-Baby*, 24 DRAKE L. REV. 52 (1974), in which the U.C.C. rules concerning tender, acceptance, rejection, and revocation are referred to acronymously as the "Tarr" sections.



Consideration of sections 2-508,<sup>154</sup> 2-601,<sup>155</sup> and 2-612<sup>156</sup> illustrates the style of Article 2. Section 2-601 is the Article 2 "perfect tender" rule.<sup>157</sup> The provision has received considerable attention in the legal periodicals<sup>158</sup> as well as in the

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154. U.C.C. § 2-508 provides:

(1) Where any tender or delivery by the seller is rejected because non-conforming and the time for performance has not yet expired, the seller may seasonably notify the buyer of his intention to cure and may then within the contract time make a conforming delivery.

(2) Where the buyer rejects a non-conforming tender which the seller had reasonable grounds to believe would be acceptable with or without money allowance the seller may if he seasonably notifies the buyer have a further reasonable time to substitute a conforming tender.

155. *Id.* § 2-601 provides:

Subject to the provisions of this Article on breach in installment contracts (Section 2-612) and unless otherwise agreed under the sections on contractual limitations of remedy (Sections 2-718 and 2-719), if the goods or the tender of delivery fail in any respect to conform to the contract, the buyer may

(a) reject the whole;

(b) accept the whole;

(c) accept any commercial unit or units and reject the rest.

156. *Id.* § 2-612 provides:

(1) An "installment contract" is one which requires or authorizes the delivery of goods in separate lots to be separately accepted, even though the contract contains a clause "each delivery is a separate contract" or its equivalent.

(2) The buyer may reject any installment which is non-conforming if the non-conformity substantially impairs the value of that installment and cannot be cured or if the non-conformity is a defect in the required documents; but if the non-conformity does not fall within subsection (3) and the seller gives adequate assurance of its cure the buyer must accept that installment.

(3) Whenever non-conformity or default with respect to one or more installments substantially impairs the value of the whole contract there is a breach of the whole. But the aggrieved party reinstates the contract if he accepts a non-conforming installment without seasonably notifying of cancellation or if he brings an action with respect only to past installments or demands performance as to future installments.

157. See Schmitt & Frisch, *The Perfect Tender Rule—An Acceptable Interpretation*, 13 U. Tol. L. Rev. 1375 (1982). The perfect tender rule permits a buyer to reject any nonconforming goods. However, the buyer's right to reject is often limited by the seller's right to "cure" the defect as provided in U.C.C. § 2-508(2). See also Peters, *Remedies for Breach of Contracts Relating to the Sale of Goods Under the Uniform Commercial Code: A Roadmap for Article Two*, 73 YALE L.J. 199 (1963).

158. See, e.g., Minitier, *Buyer's Right of Rejection: A Quarter Century Under the Uniform Commercial Code, and Recent International Developments*, 13 GA. L. REV. 805 (1979) (complex U.C.C. provisions concerning rejection and

courts.<sup>159</sup> This fascination revolves around the ostensibly inflexible language of section 2-601 and the creative interpretations to which it has been subjected. The section seems to leave all the options with the buyer; the right to reject arises "if the goods or the tender of delivery fail *in any respect* to conform to the contract."<sup>160</sup> This statutory direction appears to permit little, if any, deviation from absolutely perfect tender. Counsel would be reluctant to advise a seller to assume too casual an attitude toward performance responsibilities.

The language of the cases, however, betrays a certain vacillation between the absolute direction of section 2-601 and the demands of justice in the individual case.<sup>161</sup> A review of these cases discloses

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cure have resulted in sliding-scale "substantial breach" test); Phillips, *Revocation of Acceptance and the Consumer Buyer*, 75 COM. L.J. 354 (1970) (revoking buyer must prove that goods are "substantially" defective whereas rejecting buyer need only show that goods are nonconforming in any respect); Note, *Uniform Commercial Code—Sections 2-508 and 2-608—Limitations on the Perfect-Tender Rule*, 69 MICH. L. REV. 130 (1970) (seller's right to correct defect in original tender under § 2-508 and "substantial impairment" rule of § 2-608 limit the perfect tender concept); Note, *Uniform Commercial Code—Seller's Right to Cure a Nonconforming Tender*, 15 WAYNE L. REV. 938 (1969) ("major-minor" defect test does not incorporate seller's reasonable belief or acceptability, however, such belief *should* be determinative of seller's right to cure nonconforming tender after time of performance).

159. See *McKenzie v. AlaOhio Coals, Inc.*, 29 U.C.C. REP. SERV. (Callaghan) 852 D.D.C. 1979 (coal with ash content of 13.5% to 16% nonconforming when purchase order specified ash content not to exceed 7.5%); *National Fleet Supply, Inc. v. Fairchild*, 450 N.E.2d 1015 (Ind. Ct. App. 1983) (buyer has power to reject goods or tender that fail, in any respect, to conform to contract; rejection is generally not available for goods or delivery that fail, in some small respect, to conform to sales contract terms); *Deaton, Inc. v. Aeroglide Corp.*, 99 N.M. 253, 657 P.2d 1093 (1982) (delivery of dump trucks appearing previously used constituted delivery of nonconforming goods to distributor).

160. U.C.C. § 2-601 (emphasis added). Section 2-106(2) defines "conforming" goods as those that "are in accordance with the obligations under the contract."

For court interpretations of conforming goods, see *Irrigation Motor & Pump Co. v. Belcher*, 29 Colo. App. 343, 483 P.2d 980 (1971) (nonconformity not a question of quantity and quality of goods alone, but of performance of the seller's entire contractual undertaking); *Stockard v. Vernon Co.*, 9 U.C.C. REP. SERV. (Callaghan) 1067 (Okla. Ct. App. 1971) (receipt of calendars six days late, making timely delivery by plaintiff difficult, deemed nonconformity).

161. U.C.C. § 2-601 can be given a strict or relaxed reading. Therefore, courts have had difficulty deciding whether it is a "perfect tender" or "substantial performance" provision and have often conveyed the impression that the evaluation of the transactor's "bona fides" is a determinative factor. Movements in the market price between the time of contracting and buyer's attempted rejection



that, notwithstanding the absolute language of the provision, there are enough loose joints in the Code to accommodate what Professor McDonnell would refer to as "purposive interpretation" of the perfect tender rule.<sup>162</sup> Several commercial courts have focused their analysis on facts and equity to avoid a harsh result.<sup>163</sup> In so doing, they have often reached the most commercially reasonable<sup>164</sup> result, either by finding that the parties have "otherwise agreed" to less than perfect tender,<sup>165</sup> or by invoking the section 2-508 cure provision.<sup>166</sup> The limits of the right to cure have been described by

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can also be decisive in whether the perfect tender rule is strictly or liberally interpreted. See *Envirex, Inc. v. Ecological Recovery Assoc. Inc.*, 454 F. Supp. 1329 (M.D. Pa. 1978) ("substantial performance" rule incorporated into § 2-601 permits buyer to reject goods even for technical breach so as to require perfection in buyer performance), *aff'd*, 601 F.2d 574 (3d Cir. 1979); *Jones v. Abriani*, 169 Ind. App. 556, 350 N.E.2d 635 (1976) (mobile home nonconforming good if fails to meet contract requirements and buyer does not forfeit down payment pursuant to liquidated damages clause in sales contract unless perfect tender made); *Rose v. Epley Motor Sales*, 288 N.C. 53, 215 S.E.2d 573 (1975) (used car destroyed by engine fire three hours after purchase deemed nonconforming).

162. See McDonnell, *supra* note 145.

163. See, e.g., *Marine Mart, Inc. v. L.D. Pearce*, 252 Ark.r 601, 608-09, 480 S.W.2d 133, 137 (1972), in which delivery of boat supposedly "identical" to showroom model was a nonconforming good because of damage that occurred during delivery. Seller's attempts to cure failed and consequently, the chancellor determined the sales contract should be rescinded. In affirming the decision, the Arkansas Supreme Court stated that "[w]hat constitutes a nonconforming delivery, acceptance, rejection or revocation of acceptance are questions of facts." *Id.* See also *Clark v. Zaid, Inc.*, 263 Md. 127, 282 A.2d 483 (1971), in which the court considered the original quality, the nature and the extent of damage, and whether the damage could be repaired to restore the original quality and appearance in determining whether the purchaser of dining room furniture rightfully rejected the goods as nonconforming after their delivery in damaged condition.

164. See *Whaley*, *supra* note 153, at 54; see also *Danzig*, *supra* note 85, at 632 ("Llewellyn's UCC Article II more often operated as a means of dictating a method. That method was designed to prompt decision not according to the letter or the logic of a statute or a juristic concept but rather according to the 'situation-reason.'").

165. The Pennsylvania Court of Common Pleas stated:

[I]t was the understanding of the parties, confirmed by the course of dealings between them, that the time and quantities of the deliveries and the variance in the sizes of the sheets of materials were not of the essence of the contract. These matters were varied from time to time as circumstances might dictate, and were not observed strictly by either plaintiff or defendant nor insisted upon by either.

*Bomyte Co. v. L-Co Cabinet Corp.*, 40 North. Leg. J. 172, 182 (Pa. Ct. Com. Pl. 1968), *aff'd*, 217 Pa. Super. 811, 270 A.2d 253 (1970).

166. "Subsection [2-508] (2) seeks to avoid injustice to the seller by reason of a surprise rejection by the buyer." U.C.C. § 2-508 comment 2.

reference to the seriousness of the defect<sup>167</sup> and the expectations of the rejecting buyer,<sup>168</sup> necessarily fact-determinative analyses.<sup>169</sup>

Although the courts have applied the section 2-508 cure provision to less than "perfect tender" situations, the section 2-601 perfect tender provision makes no reference to the seller's right to cure. However, in section 2-612, which governs breach of installment contracts, there is an express reference to the seller's right to cure found in subsection (2).<sup>170</sup> Comment 4 to UCC section 2-612 articulates the Code's approach to acceptance, in the context of installment sales: "A clause requiring accurate compliance as a condition to the right to acceptance must . . . avoid imposing hardship by surprise and is subject to waiver or to displacement by practical construction."<sup>171</sup> It is not at all clear why this predisposition would apply only to installment contracts. Professor Whaley has recognized the essential similarity of the section 2-601 single delivery, and the section 2-612 installment sales contracts,

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167. See *Zabriskie Chevrolet, Inc. v. Smith*, 99 N.J. Super. 441, 458, 240 A.2d 195, 205 (1968), in which an auto dealer attempted to cure tender of a new auto that was rendered completely inoperable by mechanical failure near the showroom. The court rejected the dealer's attempted cure because "for a majority of people the purchase of a new car is a major investment, rationalized by peace of mind that flows from dependability and safety [and] [o]nce their faith is shaken, the vehicle loses not only its real value in their eyes, but becomes an instrument whose integrity is substantially impaired." *Id.* See also *Bartus v. Riccardi*, 55 Misc. 2d 3, 284 N.Y.S.2d 222 (1967) (plaintiff hearing aid manufacturer entitled to cure after its representative provided defendant with an improved version of the hearing aid ordered).

168. See *General Motors Corp. v. Halco Instruments, Inc.*, 124 Ga. App. 630, 185 S.E.2d 619 (1971) (several month old auto that needed installation of new springs, rear arm control, and new rubber bumpers did not entitle buyer to recovery of full purchase price); *Rozmus v. Thompson's Lincoln Mercury Co.*, 209 Pa. Super. 120, 224 A.2d 782 (1966) (loud noises from engine of new auto easily corrected by tightening mounting bolts of drive shaft did not constitute "substantial impairment"); *Reece v. Yeager Ford Sales, Inc.*, 155 W. Va. 461, 184 S.E.2d 722 (1971) (minor defects in new car not affecting operation and costing only \$80 to repair not substantial impairment in value to make car nonconforming, and possession of car for 3400 miles exceeded reasonable time for rescission).

169. See Whaley, *supra* note 153, at 57. Section 2-508 cure applies, by its own terms, only to situations in which (1) the time for the seller's performance has not expired, or (2) the seller has reasonable grounds to believe his nonconforming tender will be acceptable. While the first criterion might accommodate certain, even formalistic, determination, the second one requiring an objective evaluation of the seller's belief, provides a way for courts to balance equities. See U.C.C. § 2.508.

170. See *supra* note 156 for the text of U.C.C. § 2-612.

171. U.C.C. § 2-612 comment 4.



concluding that any distinction between the two "is largely a fiction."<sup>172</sup> Comment 3 to section 2-612 advises that "the sense of the situation [should] prevail over any uncommercial and legalistic interpretation."<sup>173</sup> In sum, there is little to restrain a court that seeks to do justice when confronted with what would otherwise be an uncomfortable tender and acceptance problem according to formalistic "perfect tender" principles.

As demonstrated in the acceptance sections, Llewellyn enhanced the effectiveness of Article 2 "rules" by setting the "words and paper in perspective."<sup>174</sup> Legal realism, with its emphasis on context rather than dogma, was by no means an abdication of rules. At most, Llewellyn's jurisprudence counsels a healthy "rule-skepticism."<sup>175</sup> There is a tension, however, that clearly invites vigorous, if perhaps naive, criticism: "flexible" rules may be tantamount to no rules, and a commercial law system preoccupied with flexibility sacrifices certainty and predictability.<sup>176</sup> Yet a realist's response to criticisms of flexible rules would be that formalism, the alternative to flexibility, frustrates and does not serve the interests of commercial transactors. A court confronted with a formalistic enactment will often reach what it deems to be the right result, notwithstanding the pressures imposed by the letter of the statute. Llewellyn's Sales Article proceeds from a different jurisprudential perspective than that which guided the drafting of Article 4. The reasonableness of the transactors' conduct, a tort concept, has direct application in Article 2. However, its application is inapposite in the law of commercial paper, at least from the perspective of financial institutions.<sup>177</sup> Article 2 vindicates the conclusion that tort principles provide the means to utilize flexibility as a constructive, rather than disruptive, force in the commercial law.<sup>178</sup> Such flexibility provides a system of analysis in which facts are determinative, rules are opportunities rather than obstacles, and commercial rea-

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172. Whaley, *supra* note 153, at 53.

173. U.C.C. § 2-612 comment 3.

174. Llewellyn, *supra* note 7, at 453.

175. See Verdun-Jones, *The Jurisprudence of Karl Llewellyn*, 1 DALHOUSIE L.J. 441 (1974).

176. See Report of New York Law Revision Committee 28 (1956) (criticizing a provision of a draft that relied heavily on principles of commercial reasonableness); cf. Leff, *supra* note 85, at 558 (concluding, with regard to § 2-302, that "it has, really, no reality referent, and all of its explanatory material ranges between the irrelevant and the misleading").

177. See *supra* text accompanying notes 149-152.

178. See *supra* text accompanying notes 85-118.

sonableness facilitates situation sense and dignity of substance and result.<sup>179</sup>

V. THE INTEGRATION OF PAYMENTS LEGISLATION:  
OBSTACLES AND OPPORTUNITIES

Any pervasive, preemptive effort to codify payments law will fail without the acquiescence, if not active support, of the affected interest groups.<sup>180</sup> Such support must not be obtained at the price of unjust, and therefore, ill-reasoned resolution of trouble cases.<sup>181</sup> Expediency should be only a secondary goal. Accommodation of opposing positions requires representatives of financial institutions and consumer groups to abandon intransigent postures to advance the commercial codification movement. They will all, certainly, deny motivations that would hamper realization of the right and just result. That is lobbying.

The Reporter of the U.N.P.C. project suggested that market forces have already supplied the impetus for consensus.<sup>182</sup> That

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179. See *supra* text accompanying note 143.

180. It was primarily the financial institutions' uneasiness with the perceived consumer orientation of the U.N.P.C. that lead to the project's demise. See Alces, *supra* note 3, at 89 n.21; see also Leary & Fry, *A "Systems" Approach to Payment Modes: Moving Toward a New Payments Code*, 16 U.C.C. L.J. 283, 286 n.8 (1984) (The 3-4-8 Committee asked its Reporter, Professor Scott, to rework P.E.B. Draft No. 3 of the U.N.P.C. and to "leave consumer protection measures to federal enactments.").

181. The case of trouble, again, is the case of doubt, or is that in which discipline has failed, or is that in which unruly personality is breaking through into new paths of action or of leadership, or is that in which an ancient institution is being tried against emergent forces. It is the case of trouble which makes, breaks, twists, or flatly establishes a rule, an institution, an authority. Not all such cases do so. There are also petty rows, the routine of law-stuff which exists among primitives as well as among moderns. For all that, if there be a portion of a society's life in which tensions of the culture come to expression, in which the play of variant urges can be felt and seen, in which emergent power-patterns, ancient security-drives, religion, politics, personality, and cross-purposed views of justice tangle in the open, that portion of the life will concentrate in the case of trouble or disturbance. Not only the making of new law and the effect of old, but the hold and the thrust of all other vital aspects of the culture, shine clear in the crucible of conflict.

K. LLEWELLYN & E. HOEBEL, *THE CHEYENNE WAY* 29 (1941).

182. See Scott, *supra* note 18, at 792; Memorandum from Professor Hal Scott to National Conference of Commissioners on Uniform State Laws 43 (June 15, 1983) (introduction to U.N.P.C., P.E.B. Draft No. 3).



argument has been refuted from the clear perspective of hindsight.<sup>183</sup> Given the demise of the U.N.P.C. effort, it is easy to despair of considering the codification of payments law from the perspective of Karl Llewellyn's legal realism. Those who represent the interests of financial institutions offer the bald assertion that what is good for banks is ultimately good for bank customers. The representatives of the interests of financial institutions argue, essentially, that we ought not complain of legislation that streamlines the flow of payments and makes business easier for banks. Impediments to the smooth transfer of funds would merely frustrate rather than serve the interests of consumers.<sup>184</sup> Such unwieldy impediments might be accommodated, but at a cost that would ultimately be borne by bank customers.<sup>185</sup> This line of argument is provocative but not entirely correct.

Imposing the costs of the stop payment "right," or any other consumer protection measure, on financial institutions operates much as would a tax. At first blush, the cost of a protection, a tax-like cost, would appear, ultimately, to be passed to the consumer by financial institutions acting as mere conduits to transfer the financial burden to consumers. This assertion, however, is not entirely accurate: "[N]ot all taxes are borne by the supplier [bank], nor are all taxes passed on to consumers [bank customers], as is often asserted. Who bears the increased cost in what proportion depends on the supply and demand relationships."<sup>186</sup>

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183. See Alces, *supra* note 3, at 101-03 (describing the financial institutions lobby's case against the U.N.P.C. and suggesting reasons for market forces failure to accommodate the development of preemptive payments legislation).

184. See New York Clearing House, *Statement on the Proposed Uniform New Payments Code* 13, 14 (Sept. 29, 1983) (elimination of *Price v. Neal* rule would impair utility of checks because merchants would remain liable for length of applicable statute of limitations) (on file at *The Wayne Law Review*).

185. For the argument that the expense of providing a right to reverse payments would be shifted from financial institutions to consumers of financial services, see Alces, *supra* note 3, at 110-11 (citing R. Brandel, Remarks at the Uniform New Payments Code 1983 Invitational Conference (Sept. 30, 1983)).

186. A. ALCHIAN & W. ALLEN, *EXCHANGE & PRODUCTION: COMPETITION, COORDINATION, & CONTROL* 66 (3d ed. 1983). If a bank attempts to impose the full cost increase created by a new legal obligation on its customers, fewer financial services would be "consumed." Any price increase decreases demand and moves consumers up their demand schedule. The bank does not realize the benefit of a higher price, only the detriment of a reduced demand. The amount of the increased cost passed on to consumers, then, will depend on the slopes or "elasticity" of the demand and supply curves. The more elastic the supply curve, the more the cost that will be passed on. The market establishes the new equilibrium; the discretion of financial institutions cannot.

The consequences of this micro-economic reality are significant for the drafters of payments law concerned about the relative legal positions of banks and bank customers. It is inappropriate to assume that consumers ultimately pay the full cost of all consumer protection measures. If that were so, financial institutions would have no reason to resist such measures. Consumer lawyers emphasize the disparity of bargaining power and conclude:

The law of [payment systems<sup>187</sup>] should not be dictated by bank technology, nor should the law conflict with banks' reasonable use of electronic equipment. Rather, the law should embody the fundamental principles to which commercial law<sup>188</sup> has always tried to be faithful, and bank technology should have to find its place in the context of those principles. Those principles allow customers to take advantage of their rights as long as they conduct themselves in a reasonable fashion.<sup>189</sup> Similarly, banks must behave in accordance with reasonable commercial standards, using ordinary care.<sup>190,191</sup>

The "humanizers' approach to technology"<sup>192</sup> reflected in this excerpt is intriguing but provides little guidance. The further "specificity" that the author offers is designed "to prevent judges [and presumably jurors] from interpreting reasonableness in whatever manner conforms to their individual values."<sup>193</sup> Although the

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187. In the original text, the author writes specifically about stop payment law. His observations, however, may be applied fairly to the law of payment systems generally. Prior to joining the Emory Law School faculty, Professor Budnitz was the Litigation Coordinator of the National Consumer Law Center in Boston, Massachusetts.

188. For discussion of essential or fundamental principles in the commercial law, see Alces, *supra* note 3, at 91 (citing Gilmore, *The Uniform Commercial Code: A Reply to Professor Beutel*, 61 YALE L.J. 364, 365 (1952); Llewellyn, *Problems of Codifying Security Law*, 13 LAW & CONTEMP. PROBS. 687, 696 (1948)). *But cf.* Scott, *supra* note 18, at 737 (asserting there is no jurisprudence of commercial law) (footnote added).

189. U.C.C. §§ 3-406, 4-406(1) (1977) (portion of original footnote omitted). For the full text of the original footnote, see Budnitz, *supra* note 64, at 283 n.199.

190. *See, e.g.*, U.C.C. §§ 3-406, 4-103(1), 4-406(1), (3) (portion of original footnote omitted). For the full text of the original footnote, see Budnitz, *supra* note 64, at 283 n.200.

191. Budnitz, *supra* note 64, at 283.

192. *Id.* at 284.

193. *Id.* at 283.



laudable terms of the commentator's more specific recommendations accommodate situation sense adjudication,<sup>194</sup> the formulation is cosmetic rather than fundamental legal realism. It does little more than substantiate the criticism of the UCC's common law approach.<sup>195</sup> To understand legal realism in commercial code jurisprudence is to recognize that specification cannot inhibit judges' and juries' reference to their individual values.

If market or other social forces ultimately lead to a new comprehensive payments law effort, the frustrations and inconsistencies of the past commercial codification projects should provide a valuable lesson. Article 2 demonstrates what can work; Article 4, the E.F.T.A., and the U.N.P.C. confirm that the lack of a coherent jurisprudential perspective will undermine even the most ambitious formalistic efforts. Rather than admonishing triers of fact and law to do the reasonable thing, a hollow direction, legal realism establishes a regime, a regularized practice that would, through instrumentalist techniques, reveal the crucial situation sense. This is a difficult, but indispensable idea:

[S]ince the ultimate effectuation of a purpose is in terms of action, of behavior, the verbal formulation, to be an efficient tool, must be such as will produce the behavior desired.

. . . [O]ne of the statutory draftsman's major problems is . . . to make sure that his formula, when it becomes an official rule, will not merely bask in the sun upon the books. He must so shape it as to *induce its application* . . . .<sup>196</sup>

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194. See *supra* note 92 and the sources cited for a discussion of situation sense.

195. See, e.g., Danzig, *supra* note 85, at 627 ("The troublesome vacuity of the unconscionability provision [U.C.C. § 2-302] underscores not only the passivity of the Legislature in the UCC—Llewellyn scheme, but also the singular difficulties that that jurisprudential approach has in dealing with issues involving moral judgments."); Leff, *supra* note 85, at 488 ("One central thesis of this essay is that the draftsmen failed fully to appreciate the significance of the unconscionability concept's necessary procedure-substance dichotomy and that such failure is one of the primary reasons for section 2-302's final amorphous unintelligibility and its accompanying commentary's final irrelevance."). Leff's article has been described as the "silliest of them all" considering the unconscionability issue. Dawson, *Unconscionable Coercion: The German Version*, 89 HARV. L. REV. 1041, 1041 n.1 (1976).

196. Llewellyn, *supra* note 7, at 452 (emphasis in original) (footnote omitted).

The draftsman must induce compliance such that affected parties order their affairs to realize the benefits conferred by the formulation. The only responsible way to determine the most proper formulation is to observe the behavior of the interested transactors and draft the law to urge them in the direction of that reasonable behavior that would assure "certainty of substance" and "dignity of result."<sup>197</sup> However, measuring all behavior by reference to an undifferentiated and vague reasonableness standard is insufficient. Although ultimately triers of fact and law will interpret the dimensions of a particular controversy by their own sense of justice, the way in which the governing legislation is drafted may structure their deliberations.

Article 2, as demonstrated above,<sup>198</sup> incorporates the reasonableness analysis derived from tort law. It does not, however, dictate that analytical method without elaboration.<sup>199</sup> Llewellyn's legal realism consistently provides a means to supplant the formalistic strictures of traditional contract law with the fact-determinative, situation-specific approach of tort analysis. For example, section 2-201, the Code's primary<sup>200</sup> statute of frauds provision, describes *a procedure* that merchants<sup>201</sup> *may utilize* to avoid the unjust results provided by the common law.<sup>202</sup> No longer may a merchant acknowledge with impunity his receipt of a written

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197. See Llewellyn, *supra* note 143, at 610; *supra* text accompanying notes 143-46.

198. See *supra* text accompanying notes 153-73.

199. See U.C.C. § 2-508; *supra* text accompanying notes 163-66. The cure provision works with the acceptance provisions of § 2-601 and § 2-612 by describing the circumstances that lead to the conclusion that the seller should be given what amounts to a second chance: either the time for performance has not yet expired or the seller "had reasonable grounds to believe the non-conforming tender would be acceptable." If one of the criteria are satisfied, imagining why the harsh results of a formalistic "perfect tender" rule should be permitted to frustrate the justified expectations of commercial transactors is difficult. Moreover, the tender, acceptance, and cure provisions do not sacrifice the certainty of commercial transactions or impair the expectations of the affected transactors.

200. Other Code provisions imposing a writing requirement are §§ 3-104 (Commercial Paper), 5-104 (Letters of Credit), and 9-203 (Secured Transactions).

201. See U.C.C. § 2-104(1).

202. See *id.* § 2-201(2). The full text of this subsection is reproduced *supra* note 121. The subsection provides that a confirmatory writing sufficient to charge the sending merchant will bind the addressee merchant if the recipient "has reason to know its contents" and fails to return written objection to its contents within 10 days. By providing that regime, the drafters permitted the parties to a sales transaction to posture themselves in such a way that the equities would clearly appear.



confirmation and avoid enforcement of the contract because his "signature"<sup>203</sup> is not on the piece of paper. Article 2 thus establishes criteria that are consistent with general conceptions of fair dealing, urging transactors and courts in the commercially reasonable direction.<sup>204</sup>

Similarly, section 2-209 is drafted to avoid the harsh application of the contract law preexisting duty rule. Although the drafters limited the availability of contract modification mechanisms, they devised the waiver concept to invite courts to reach the right result.<sup>205</sup> Section 2-209 allows the equities to be adjusted by the conduct of one or both the parties. Triers of fact and law are thus left free to reach the decision to which they feel compelled, without violating the statutory language. In addition, predictability and certainty are not sacrificed because the provision mandates compliance with particular requirements to support a particular result. This would not be true had the drafters of section 2-209 merely directed courts to find for the litigant whose behavior appeared most reasonable, based on actions of similarly situated transactors. The provision avoids formalistic analysis by cataloguing indicia or badges of commercial reasonableness consistent with our understanding of justice, instead of dispositively describing what is and what is not reasonable. Article 2 works because it guides rather than prescribes. The commercial paper provisions do not share the same insight.

The *inefficacy* of the Article 4 treatment of the stop payment "right" starkly contrasts the efficacy of legal realism in sales law.<sup>206</sup> The section 4-407 subrogation provision is a certain, albeit elaborate, device for financial institutions to impose a myopic view of justice and commercial reasonableness on bank customers.<sup>207</sup>

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203. "'Signed' includes any symbol executed or adopted by a party with a present intention to authenticate a writing." U.C.C. § 1-201(30).

204. See also *id.* § 2-103(1)(b) ("In this Article unless the context otherwise requires . . . '[g]ood faith' in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.").

205. *Id.* § 2-209(5) provides:

A party who has made a waiver affecting an executory portion of the contract may retract the waiver by reasonable notification received by the other party that strict performance will be required of any term waived, unless the retraction would be unjust in view of a material change of position in reliance on the waiver.

206. See *supra* text accompanying notes 19-33.

207. If a bank can identify a prior holder in due course, it may avoid its obligation to its customer after it has negligently paid an item over a stop payment order. U.C.C. § 4-407(a); see *supra* text accompanying notes 19-29.

There is no room for "situation sense," no opportunity for triers of fact or law to reach the right result. Holder in due course status, a legal conclusion that has outlived its reason,<sup>208</sup> becomes the means to arrive at an answer. A customer who has complied scrupulously with the requirements of section 4-403,<sup>209</sup> and may very well be blameless in all aspects of the transaction concerned, will *necessarily* lose to a negligent bank able to identify a prior holder in due course. That has not always been the case<sup>210</sup> and is perhaps the best evidence that Article 4 owes little to Llewellyn's legal realism. Although defenders of the commercial paper provisions will argue the unique need for certainty, speed, and efficiency dictated by the role of negotiable instruments in our economy,<sup>211</sup> that position has been refuted by commentators.<sup>212</sup> The demands for certainty apparently are not as great when financial institutions would be subject to the inflexible aspects of formalistic analysis.<sup>213</sup>

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208. See *supra* text accompanying notes 35-38 and sources cited in note 37.

209. See *supra* note 19.

210. See *supra* text accompanying notes 33-62 for a drafting history of the stop payment "right" in Article 4.

211. It is axiomatic that negotiable instruments should be "couriers without luggage." U.C.C. § 3-104 comment 3 (Proposed Final Draft, Spring 1950), reprinted in 10 U.C.C.: DRAFTS, *supra* note 31, at 319. The negotiability regime and the holder in due course doctrine are designed to assure that instruments will flow in commerce as expeditiously as cash, but with fewer security problems. In a case that contributed significantly to the development of negotiable instruments law, Lord Mansfield emphasized the cash-substitute nature of commercial paper. *Miller v. Race*, 97 Eng. Rep. 398, 401 (K.B. 1758).

In commenting upon the efficacy of reversibility of payment provisions in the U.N.P.C., Roland Brandel recently suggested that it would be more appropriate to burden the small claims courts with disputes concerning payment for goods than it would be to burden the payment system, which puts a high premium on certainty, finality, and celerity. R. Brandel, Remarks at the Uniform New Payments Code 1983 Invitational Conference (Sept. 30, 1983) (on file at *The Wayne Law Review*). For a thorough description of the high-speed procedures that banks utilize to clear checks, see M. MAYER, *THE BANKERS* 119-54 (1974).

212. See, e.g., Rosenthal, *supra* note 36, at 401 ("In a number of situations today, negotiability, and specifically the protection of holders in due course, are not necessary or even helpful in fostering the flow of commerce."); U.N.P.C. § 103 comment 2, at 104-05 ("Times have changed since *Peacock v. Rhodes*, 99 Eng. Rep. 402, was decided by the King's Bench in 1781. Those parties to whom checks are negotiated rely principally on the credit of the persons from whom they take the checks, rather than on the credit of drawers."). U.N.P.C. § 103 would have effectively destroyed the negotiability and holder in due course concepts in the context of consumer checks.

213. Although U.C.C. § 4-103(1) provides that "[t]he effect of the provisions



Recall that the bank lobby resisted the application of an objective standard in the original good faith element of holder in due course status for fear that it "might be read to freeze commercial practices."<sup>214</sup> Also, the final payment provision of Article 4,<sup>215</sup> arguably, leaves banks quite free to determine the exact point at which *their* liability on an item matures.<sup>216</sup>

Although other instances of the double standard assured by Article 4 may be uncovered, perhaps the most revealing example is the bifurcated approach to "giving value" for purposes of acquiring holder in due course status. Section 3-303 limits the ways in which a holder may be deemed to have given value to exclude executory promises as well as certain commitments not directly referable to the acquisition of the item.<sup>217</sup> Comment 6 explains

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of this Article may be varied by agreement," there is little question that the only "agreement" that might alter the provisions of the Bank Deposits and Collections law would be the account agreement executed by a customer at the time an account is opened. There is no haggling over the terms of such agreement. Professor Gilmore lamented with regard to the provision, "The only bright [spot is] . . . that a court, construing Section 4-103 according to its fair meaning, might be disposed to hold the Article unconstitutional as an improper delegation of legislative power to private interests . . . ." Gilmore, *supra* note 4, at 375-76.

214. See Braucher, *supra* note 151, at 812 (citing 1951 A.B.A. SECTION REPORT 126-28, 181).

215. See U.C.C. § 4-213(1)(c), which provides that "[a]n item is finally paid by a payor bank when the bank has done any of the following, whichever happens first: . . . completed the process of posting the item to the indicated account of the drawer, maker or other person to be charged therewith." *Id.* § 4-209(e) defines "process of posting" as including "correcting or reversing an entry or erroneous action with respect to the item."

216. See *West Side Bank v. Marine Nat'l Exch. Bank*, 37 Wis. 2d 661, 155 N.W.2d 587 (1968), in which the court held that the process of posting was not completed until the midnight deadline. The result of the decision was to permit a drawee/payor to reverse a payment decision up to its midnight deadline for any reason whatsoever. In fact, in *West Side Bank*, the court found that the rules of the Milwaukee Clearing House Association could extend the midnight deadline because U.C.C. §§ 4-103(1), (2) sanctioned the adjustment of that deadline. 37 Wis. 2d at 672, 155 N.W.2d at 593.

The *West Side Bank* opinion has not been consistently followed by the courts. For courts rejecting the *West Side Bank* analysis, see *H. Schultz & Sons, Inc. v. Bank of Suffolk County*, 439 F. Supp. 1137 (E.D.N.Y. 1977); *Community Bank v. United States Nat'l Bank of Oregon*, 276 Or. 471, 555 P.2d 435 (1976). Commentators have also questioned *West Side Bank*. See, e.g., J. WHITE & R. SUMMERS, *UNIFORM COMMERCIAL CODE*, 623-24 (2d ed. 1980); W. HAWKLAND & L. LAWRENCE, *supra* note 152, at § 4-213:04 (Art. 4) (1984); Malcolm, *Reflections on West Side Bank: A Draftsman's View*, 18 CATH. U.L. REV. 23 (1968).

217. U.C.C. § 3-303 provides:

that the type of "irrevocable commitment" contemplated by section 3-303(c) as sufficient "value" would be an "irrevocable commitment to a third person, such as a letter of credit issued when an instrument is taken."<sup>218</sup> Less irrevocable commitments would be mere executory promises, sufficient as consideration but insufficient as value.<sup>219</sup>

Contrast with section 3-303 "value," the Article 4 "security interest" concept. Section 4-209 alters the section 3-303 value determination by providing:

For purposes of determining its status as a holder in due course, the bank has given value to the extent that it has a security interest in an item provided that the bank otherwise complies with the requirements of Section 3-302 [220] on what constitutes a holder in due course.<sup>221</sup>

The comment to section 4-209 explains that "[t]he provision is in accord with . . . Article 3 (Section 3-303)."<sup>222</sup> Perhaps from the

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A holder takes the instrument for value

(a) to the extent that the agreed consideration has been performed or that he acquires a security interest in or a lien on the instrument otherwise than by legal process;

(b) when he takes the instrument in payment of or as security for an antecedent claim against any person whether or not the claim is due;

(c) when he gives a negotiable instrument for it or makes an irrevocable commitment to a third person.

218. *Id.* § 3-303 comment 6.

219. See *Bennett v. United States Fidelity & Guaranty Co.*, 19 N.C. App. 66, 198 S.E.2d 33, *cert. denied*, 284 N.C. 121, 199 S.E.2d 659 (1973) (§ 3-303(c) contemplates simultaneous exchange and does not include commitments made by holder after acquiring instrument). "The commitment has to be of such a character that it cannot be rescinded when the holder learns of a claim or defense on the instrument in return for which the holder gave the commitment." W. HAWKLAND & L. LAWRENCE, *supra* note 152, at § 3-303:07 (Art. 3) (1984). Courts have been disposed to find a holder's placing documents, instruments, or money in escrow to be a sufficiently irrevocable commitment to constitute giving value. See *Crest Finance Co. v. First Bank of Westmont*, 37 Ill. 2d 243, 226 N.E.2d 369 (1967); *Schranz v. I.L. Grossman, Inc.*, 90 Ill. App. 3d 507, 412 N.E.2d 1378 (1980).

220. U.C.C. § 3-302(1) provides:

A holder in due course is a holder who takes the instrument

(a) for value; and

(b) in good faith; and

(c) without notice that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person.

221. *Id.* U.C.C. § 4-209.

222. *Id.* § 4-209 comment.



perspective of the Article 4 drafter, sections 3-303 and 4-209 are coextensive. Consideration of section 4-208,<sup>223</sup> however, supports a less symmetrical conclusion. Professor Rosenthal, in his Article describing the incongruities of the negotiability concept, illustrated how the "first-in-first-out" rule of section 4-208(2)<sup>224</sup> protects banks in a manner not available to nonbank holders.<sup>225</sup> A bank, then,

223. *Id.* § 4-208. The title of this section is "Security Interest of Collecting Bank in Items, Accompanying Documents and Proceeds."

224. *Id.* § 4-208(2) provides:

When credit which has been given for several items received at one time or pursuant to a single agreement is withdrawn or applied in part the security interest remains upon all the items, any accompanying documents or the proceeds of either. For the purpose of this section, credits first given are first withdrawn.

225. Rosenthal, *supra* note 37, at 382-88. Professor Rosenthal's illustration is as follows:

Suppose that an appliance dealer has \$100 in his account on February 1st. On February 2nd, he sells a defective refrigerator for \$500, and is paid by the buyer with a check in that amount, which he deposits the same day. On February 3rd, the dealer makes a number of cash sales and deposits \$5,000 in cash in his account. On February 4th, he writes checks totaling \$2,000 to pay his creditors, and they, having been worried about his credit, promptly cash the checks at the dealer's bank. Meanwhile, the buyer has stopped payment on his \$500 check, but the depository bank finds out about this only on February 5th.

If the provisional credit of the buyer's check is included until revoked, the dealer's account as of the close of business on each day was as follows:

February 1	—	\$ 100
February 2	—	600
February 3	—	5,600
February 4	—	3,600
February 5	—	3,100

Even if the provisional credit for the buyer's check is not taken into consideration, the dealer's account as of the close of business on each day would have been as follows:

February 1	—	\$ 100
February 2	—	100
February 3	—	5,100
February 4	—	3,100
February 5	—	3,100

At no point will the bank have taken the buyer's check into account in permitting withdrawals; in fact, the bank was legally required to honor the \$2,000 in checks drawn on February 4th and would have been liable for any proximately resulting damages if it had dishonored them.

Despite all of these facts, the bank may well qualify as a holder in due course of the buyer's \$500 check. The reason for this is the rule

without actual reliance on a check, may become a holder in due course of the instrument while a nonbank transferee would not because section 3-303 expressly excludes executory promises from its definition of value.<sup>226</sup> This apparent inequity was not present in the pre-Code law.<sup>227</sup>

To discern the important commercial interest that might be vindicated by the 4-208/3-303 dichotomy is difficult. Chancellor Hawkland explained the commercial transactors' interest in certainty in terms of stability.<sup>228</sup> No apparent reason exists for concluding that section 4-208 better assures certainty in this area of the law than does section 3-303. Seemingly, *actual reliance*, an intermediate position between those assured by section 3-303 (executory promise insufficient) and section 4-208 (credit available for withdrawal as of right sufficient), would best serve the interests of commerce and justice. Moreover, imposing on banks the burden of proving actual reliance would place no greater burden on

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of first-in-first-out: section 4-208(2) of the Code provides that "credits first given are first withdrawn" for purposes of the rule under which a depositary bank may become a holder in due course.

*Id.* at 386-87 (footnotes omitted).

226. "An executory promise to give value is not itself value . . . ." U.C.C. § 3-303 comment 3.

227. "Even where the credit is made without special contract that the credit is only provisional, the bank does not become a holder for value until the depositor has actually availed himself of the credit so given by drawing on it." 2 Report of New York Law Revision Committee 910 (1955) (citing *National Bank of Ashtabula v. Bradley*, 264 F. 700 (W.D.N.Y. 1920); *Bath Nat'l Bank v. Sonnenstrahl, Inc.*, 249 N.Y. 391, 164 N.E. 327 (1928); *Riverside Bank v. Woodhaven Junction Land Co.*, 34 A.D. 359, 54 N.Y.S. 266 (1898)). "Paragraph (b) of Section 4-208(1) goes beyond both the present provision of N.Y.N.I.L. § 350-b . . . and the common law banker's lien in giving a security interest where credit has been made available for withdrawal but has not yet been drawn upon." *Id.* at 1344. Also, early drafts of U.C.C. § 4-208 did not provide that a bank had given value by merely having given credit available for withdrawal as of right. See, e.g., U.C.C. § 4-208 (Proposed Final Draft, Spring 1950), *reprinted in* 10 U.C.C.: DRAFTS, *supra* note 31, at 505. U.C.C. § 4-211 of the September 1950 Revisions of Article 4 is the first instance in which the formulation of current section 4-208(1)(b) begins to take form. U.C.C. § 4-211 (Revisions of Articles 2, 4 & 9, Sept. 1950), *reprinted in* 11 U.C.C.: DRAFTS, *supra* note 31, at 370-71. It was not until the 1956 Recommendations of the Editorial Board for the U.C.C., however, that § 4-208(1)(b) was finalized. The reason given for the revision is "to reflect more accurately the self-liquidating nature of a collecting bank's security interest in the ordinary case where collection is effected." U.C.C. § 4-208 (1956 Recommendations of Editorial Board for the U.C.C.), *reprinted in* 18 U.C.C.: DRAFTS, *supra* note 31, at 172.

228. Hawkland, *supra* note 87, at 293-99, 320.



depository banks than is currently imposed by section 3-307(3).<sup>229</sup> The continued application of double standards will frustrate efforts to achieve the integration of payments law.

## VI. CONCLUSION

Drafters must *balance* costs. They must determine whether the benefits to be derived by consumer protection legislation are sufficient to justify the costs that consumers will be forced to assume; whether the benefits of negotiability and the expeditious flow of payments are overstated. The method of legal realism described in this Article affords a proven frame of reference to guide the resolution of those tensions. Consumer and financial institution practices must be consulted to properly order the statutory checks and balances designed to assure dignity of result. If, in reality, banks do not rely on the creditworthiness of those who draw checks to the order of their customers, the payments law should not recognize and give effect to any fiction that assumes they do. Likewise, consumers should not benefit at the expense of their banks if, in reality, reimbursing the consumer for his bank's failure to effect the stop of an electronic funds transfer causes the consumer no loss. Subrogation theory is appropriate, but only to avoid unjust enrichment and not to unfairly favor financial institutions. As this Article has endeavored to demonstrate, the resolution of the imbalance between proconsumer and profinancial institution legislation often lies between the extremes established by the two bodies of law. The electronic fund transfer law has, to a considerable extent, been a response to the inequities perpetuated by the bank lobby's version of Article 4. By the use of jurisprudential and historical analysis, this Article has established a foundation for the codification of payments law. Concrete proposals have been offered to provide an illustration of the means of accommodation with regard to section 4-407 subrogation issues and 4-208/4-209 value issues.

Before a comprehensive and preemptive body of payments law will advance the codified commercial law, we must distill the coherent compromise of interests from the incongruities produced by the lobbying efforts of special interest groups. This Article affords an initial, albeit modest, step in that direction. The drafters

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229. U.C.C. § 3-307(3) provides: "After it is shown that a defense exists a person claiming the rights of a holder in due course has the burden of establishing that he or some person under whom he claims is in all respects a holder in due course."

of payments law should examine the Sales Article of the UCC to facilitate their efforts. Its vocabulary provides a useful prototype and the more Llewellynesque provisions of Article 2 represent, perhaps, the best application of jurisprudential principles to concrete "trouble cases."