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NEGOTIABLE INSTRUMENTS AND OTHER PAYMENT SYSTEMS: PROBLEMS AND MATERIALS

by

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DEDICATION

Professor Lewis dedicates this book to:
RACHEL BAYLA GREGG
The new light in his life
and, of course,
her parents, LIZ and BEN, her uncle DANNY
her great-grandmother, ANNE LEWIS, her great-grandfather,
EARL MELTZER
and, most importantly,
her Grandma, my loving and supportive wife,
JUDY

Professor Resnicoff dedicates this book to:
his terrific children,
MENACHEM, BAILA, GOLDIE, ETTIE, TZIPPY & YITZY,
his wonderful and special parents,
JACK IRWIN (ob"m) and BLANCHE FLORENCE RESNICOFF,
his very dear in-laws,
SHMUEL YEHUDA (ob"m) and CHANA GERTNER,
and his loving wife,
GITA

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PREFACE

INTRODUCTION TO PAYMENT SYSTEMS

The first questions that ought to be asked — and answered — in a course on payment systems are what are payments systems and why do we need them. We will answer these questions and, as we do so, we will briefly discuss the principal modern payment systems that we will cover in this book.

By a "payment system" we mean both a set of processes by which one can transfer value from one place to another or from one person to another and the body of law that applies to such processes.

Initially, payment was exclusively made by giving someone something of intrinsic value — either services or goods. Thus, if someone, Able, wanted apples, he would either work for a person, Betty, who had extra apples or give Betty something else of intrinsic value, such as pears. This system had many drawbacks. For example, assume Betty wants cucumbers, but has no need for Able's services or pears. Without the adoption of some generally accepted medium of exchange, it would be difficult for Able to get her apples. Similarly, suppose it takes a while for Betty to find someone who both has cucumbers and wants apples. By the time she finds him, the apples may have spoiled. Accordingly, there is a need to find a way to store value indefinitely.

In response to these problems, and others, a payment system involving "money" or "cash" was developed. In the United States, Congress has the constitutional authority to coin money and regulate its value, and the individual States are constitutionally forbidden from issuing competing forms of money. See Article I, Sections 8 and 10. Because, unlike apples, federally issued money does not generally spoil and because federal law specifies that such money can be used to satisfy all types of debts in the United States, 31 U.S.C. §5103, people are prepared to take this money in exchange for their goods or services.

But the money payment system is imperfect. In order to have enough money available for unanticipated purchases, people would have to carry relatively large sums of cash. But doing so may often be inconvenient. In addition, doing so could also be costly. While a person keeps his money in a bank, for instance, he can earn interest on it. While the cash is in a person's pocket, it earns nothing. Moreover, carrying cash — or sending it through the mail — is risky because it can be lost or stolen. In fact, if everyone carried relatively large amounts of cash, and prospective criminals knew this, the incidence of robberies might increase.

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To address these concerns, people started using various forms of writings that they could fill out, sign and give instead of cash. The principal payment system governing such writings is "negotiable instruments law," which we will begin to examine in detail in Chapter 2. You are undoubtedly familiar with the most common type of negotiable instrument, the check. By carrying a few blank checks, a person enjoys the ability to be able to transfer large amounts of money while exposing himself to very little risk of loss.

If a merchant is not prepared to rely on the creditworthiness of a prospective buyer, the negotiable instruments payment system breaks down. Similarly, sometimes there is a need to transfer value to someone who is far away. If there is sufficient lead time, one could mail a negotiable instrument. But if the transfer must be made quickly, the mail is too slow. Alternative payment systems, such as the electronic transfer of funds, discussed in Chapters 18 and 19, and the use of credit cards, discussed in Chapter 20, help resolve these problems. Electronic transfers can be effectuated speedily, sometimes almost instantaneously, thereby minimizing a merchant's risk. Credit card information can be given over the phone to a merchant who is far away, and it enables the merchant to rely on the creditworthiness of the credit card issuer, and not just that of the customer who is the credit card holder.