THE EARLY HISTORY OF THE LAW OF BILLS AND NOTES

A STUDY OF THE ORIGINS OF ANGLO-AMERICAN COMMERCIAL LAW

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INTRODUCTION

English commercial law is commonly said to have developed by a process of incorporation of the law merchant.[1] In rough form, the conventional theory is that before the seventeenth century commercial cases were not heard in the regular common law courts but in specialized mercantile tribunals associated with fairs and principal cities and towns. Cases brought in these courts were decided not by the regular judges but by the merchants themselves. The substantive law applied was not the common law but the law merchant, a specialized body of transnational customary law based on commercial practice and uncluttered by the technicalities of the common law. By the sixteenth and seventeenth centuries, however, the mercantile courts of the fairs and towns went into decline, and merchants were forced to bring their cases in the common law courts. Initially the judges of the common law courts were unfamiliar with and even hostile toward the law merchant. At most, the common law courts would treat the principles of the law merchant as customary rules that required specific proof in each case. In time, the antagonism of the common law judges was overcome, and the courts began to treat the rules of the law merchant as authentic principles of law, binding of their own force

[1] The incorporation theory of the history of commercial law in general can be found in various sources, including Holdsworth, *History of English Law*, 5: 102–54; Macdonell, Introduction to Smith's *Compendium of Mercantile Law*, lxiii–lxxxiii; Plucknett, *History of the Common Law*, 657–70; and Scrutton, *Elements of Mercantile Law*, 1–39. With specific reference to the law of bills, see Beutel, 'Development of Negotiable Instruments'; Fifoot, 'Development of the Law of Negotiable Instruments'; Holden, *History of Negotiable Instruments*; Jenks, 'Early History of Negotiable Instruments'; Street, *Foundations of Legal Liability*, 2: 323–428. For criticism of the incorporation theory see Baker, 'Law Merchant and Common Law'; Coquillette, *Civilian Writers of Doctors' Commons*, 149–58, 215–55; Ewart, 'What is the Law Merchant?'; Sutherland, 'Law Merchant in England'.

without special proof as custom. By the end of the seventeenth century, the courts began to recognize explicitly that the law merchant was part of the common law. In the eighteenth century, particularly during the tenure of Lord Mansfield as Chief Justice of the King's Bench from 1756 to 1788, the process of incorporation was largely completed.

The general thesis of this book is that the traditional incorporation theory is inaccurate, at least with respect to the law of bills and notes. The judges of the English common law courts did not borrow the rules of the law of bills from sources external to the common law system. Rather, the English law of bills developed within the common law system itself, in response to developments in commercial and financial practice. Though this book considers only the law of bills and notes, the conclusions drawn have broader relevance. Assumptions about the early history of the law of bills of exchange have played a major role in the formulation of the incorporation theory of the origins of English commercial law in general. The fact that the incorporation theory is inaccurate with respect to bills casts considerable doubt on its soundness as applied to other areas.

Most accounts of the history of the law of bills and notes are based on the assumption that the main focus of this body of law has always been the concept of negotiability, in the sense of the rules that permit a bona fide holder to take an instrument free from all claims to it and free from most defences that the parties obligated on it might have had in the underlying transaction for which the instrument was given. The pre-eminent place of the concept of negotiability in modern law is apparent in virtually any modern book on the law of bills and notes. The books typically begin with an introductory chapter or passage explaining how the concept of negotiability differs from the general rules of assignment applicable to other forms of property and why this special concept is essential to commercial transactions.[2] The chapter or chapters

[2] The following passage from Bigelow, *Law of Bills, Notes, and Cheques*, 2–3, is illustrative:

> Negotiability is the property by which certain choses in action, that is, undertakings to pay, pass from hand to hand like money. The common law knew nothing of that; or rather the common law repudiated entirely the notion that a promise by A to B could be treated as a promise extending also to C. The utmost which the law allowed was assignment; and that only after long debate and serious misgiving. Assignment merely works the appoint-

devoted to the holder in due course will be the major parts of the books, and all other chapters will emphasize the relationship between the matters under discussion and the holder in due course doctrine. The discussion of the formal requirements of negotiable instruments will typically explain that the point of the definitional rules is to specify the requirements that an instrument must meet if a purchaser is to qualify as a holder in due course; the treatment of transfer rules will explain that unless the transfer takes the proper form the transferee will not be a holder who can qualify as a holder in due course; and the discussion of defences will consist primarily of a differentiation of the 'personal' defences which cannot be asserted against a holder in due course from the 'real' defences which can.[3]

Given this sense of modern law, it is not surprising that legal historians have taken it as their agenda to describe the process by which the concept of negotiability developed. Holdsworth, for example, began his treatment of the topic by noting that 'the characteristic features of negotiability in our modern law ... are three in number: (i) Negotiable instruments are transferable by delivery if made payable to bearer, or by indorsement and delivery if made payable to order; and the transferee to whom they have been thus delivered can sue upon them in his own name. (ii) Consideration is presumed. (iii) A transferee, who takes one of these instruments in good faith and for value, acquires a good title, even though his transferor had a defective title, or no title at all.'[4] He then stated that 'the questions which I must try to answer are, first, what were the germs from which instruments having these qualities were developed; and, secondly, what were the technical processes by which this development took place?'[5]

The focus on the concept of negotiability is very much related to the idea that the origins of English commercial law are to be found

ment of another as beneficiary of the assignor's rights; the assignee 'takes the shoes' of the assignor. That would never have served the purpose of circulating paper; that purpose required a denial of the maxim Nemo dat quod non habet. The new taker of a bill of exchange must have a perfect right, if his purchase of it was in due course, a right in no way to be affected by the rights of him from whom he bought it.

[3] The principal mid-twentieth-century American book on the subject stated explicitly that the holder in due course 'principle, with its ramifications, is, by far, the most important principle in the whole law of bills and notes'. Britton, *Law of Bills and Notes*, 25.

[4] Holdsworth, *History of English Law* 8: 113–14. [5] Ibid., 114.

in the struggle between the law merchant and the common law. Bills of exchange seem to present the clearest case of a conflict between the rules of the law merchant and those of the common law. It is generally assumed that one of the main functions of bills of exchange has always been to serve as freely transferable evidences of indebtedness that could be used as currency substitutes. The holder in due course rules seem to be essential if debt instruments are to be used as currency substitutes.[6] It is commonly asserted that the principles of negotiability were developed as part of the law merchant as early as the Middle Ages, but the merchants faced formidable difficulties in their effort to have English law recognize the economically essential concept of negotiability. Thus, most accounts of the early history of the English law of bills have focused on explaining how the concept of negotiability developed and how it was introduced into the common law. The following passage, from an early-twentieth-century American treatise on the law of bills, is typical of the story that has become familiar to generations of lawyers:

> Originally all instruments, including bills of exchange, promissory notes and bank checks were non-negotiable – in the sense that the maker could, when asked for payment, deduct from the amount due on the instrument any just claim that he had against the original owner. Such a claim was termed a counter-claim, or set-off. In the revival of commerce in Italy, in the eleventh century, merchants and traders, feeling the need of a commercial instrument, similar to a bank bill that could be used in their barter and trade and commercial transactions, and realizing that no such instrument could be passed from hand to hand or sold readily, no matter how good the financial standing of the maker was, if he, the maker, could always insist on adjusting accounts with the original owner – adopted a custom later known as the law merchant, under which notes, checks, drafts, and bills of exchange, drawn in certain prescribed forms, and in the hands of a *bona fide* purchaser, could be enforced to their full extent against the maker, regardless of certain defences or counter-claims that the maker might have against the original holder. Such instruments were negotiable and such was the origin of negotiability.[7]

[6] The modern term 'holder in due course' has been used for convenience even though this is somewhat anachronistic. The term 'holder in due course' seems to have been first used in the Bills of Exchange Act of 1882, 45 & 46 Vict., c. 61. Before then the common phrase was 'bona fide holder'. Indeed, Chalmers, the draftsman of the Bills of Exchange Act, had used the conventional 'bona fide' terminology four years earlier in his *Digest of the Law of Bills of Exchange*, which served as the model for the 1882 Act.

[7] Ogden, *Law of Negotiable Instruments*, 9–10.

One of the themes of this book is that it is a mistake to treat the concept of negotiability as the centrepiece of the history of the law of bills and notes. Surprising as this may seem to modern lawyers, the holder in due course rules played only a modest role in the law of bills and notes in the era when this body of law developed. One way of demonstrating that point is by an analysis of the issues involved in reported decisions concerning bills and notes. In the period from the beginning of the eighteenth century to the end of Lord Mansfield's tenure as Chief Justice of the King's Bench in 1788, there were over 200 reported cases concerning bills and notes. The issues presented in these cases can be divided roughly as follows:[8]

Issue	Cases	Percentage
Pleading and procedure	39	18%
Diligence (e.g. time of presentment, notice of dishonour, etc.)	30	14%
Bankruptcy cases involving bills	31	14%
Formal requirements of bills and notes	27	13%
Other bills and notes law issues (e.g. form of indorsements, damages in actions on dishonoured bills, liabilities of parties, etc.)	27	13%
Whether taking instrument discharges debt (mostly cases where parties took bank notes for debts and the bank failed before the notes were presented)	17	8%
Acceptance (e.g. what counts as acceptance, parol acceptances, conditional acceptances, etc.)	17	8%

[8] This tabulation is based on the collection in J. Chitty, Jr, *Treatise on Bills of Exchange*, which reprints all of the statutes and reported decisions on bills and notes from the early seventeenth century until 1833. The tabulation is necessarily somewhat imprecise. Cases included in Chitty's collection that only tangentially involve bills have been excluded from the calculation, and no effort has been made to verify whether Chitty included all reported cases from the period covered. The categorization of the cases is also somewhat imprecise, but suffices for the purpose of demonstrating that holder in due course issues were by no means dominant.

Issues other than bills and notes law (e.g. infancy and other capacity issues, illegality of consideration, etc., when raised by immediate parties)	16	7%
Holder in due course – lost or stolen instrument	6	3%
Holder in due course – defences	5	2%
Total	215	100%

Most of these subjects will be analysed in detail in chapters 8 and 9. For present purposes, the important point is that cases involving efforts to assert claims or defences against holders in due course formed only a small part of the corpus of the law of bills and notes.

An examination of treatises on the law of bills published in the late eighteenth and early nineteenth centuries confirms the view that the role of the concept of negotiability has been greatly exaggerated. Although there are a few English law books concerning the subject in the early and mid-eighteenth century, the modern tradition of bills and notes treatises begins with the generation of legal writers who flourished just after the retirement of Lord Mansfield as Chief Justice of the King's Bench in 1788. Four books first published in this era stand out as the pre-eminent works on the law of bills and notes in the late eighteenth and early nineteenth centuries. In order of the appearance of the first editions, they are John Bayley, *A Short Treatise on the Law of Bills of Exchange, Cash Bills, and Promissory Notes* (1789); Stewart Kyd, *A Treatise on the Law of Bills of Exchange and Promissory Notes* (1790); Joseph Chitty, *A Treatise on the Law of Bills of Exchange, Checks on Bankers, Promissory Notes, Bankers' Cash Notes, and Bank-Notes* (1799); and John Byles, *A Practical Compendium of the Law of Bills of Exchange, Promissory Notes, Bankers' Cash-Notes, and Checks* (1829). Each of these went through numerous editions, and together they dominated the field until at least the mid-nineteenth century. One can get a fair picture of the profession's sense of this body of law by looking at the organization and emphasis of the topics in these four works.[9]

[9] A more detailed discussion of these and other treatises, and their authors, appears in Rogers, 'The Myth of Negotiability', 272–83. The author, however, cannot

There is a striking difference between the twentieth-century books and the treatises of the late eighteenth and early nineteenth centuries in the way that they describe the distinguishing characteristics of negotiable instruments. The twentieth-century books invariably state that the key definitional characteristic of negotiable instruments is negotiability, in the sense of freedom from claims and defences. By contrast, Byles stated that 'the contracts arising upon a bill of exchange ... differ from other simple contracts in these two particulars: first, that they are assignable; secondly, that consideration will be presumed until the contrary appear'.[10] Kyd, Bayley, and Chitty had similar passages specifying the two peculiar characteristics of bills of exchange as assignability and presumption of consideration.[11] The distinctive characteristic of the modern definitions, negotiability in the sense of freedom from claims and defences, is conspicuously absent. Neither Bayley, nor Kyd, nor Chitty, nor Byles had an introductory passage or chapter explaining the concept of negotiability in the sense of freedom from claims and defences. None of them had a passage contrasting negotiability with mere assignability. None of them had a separate chapter on the rights of bona fide holders.[12]

resist repeating two interesting bits of trivia about the authors of bills and notes treatises. (1) Stewart Kyd probably has the distinction of being the only author of bills treatise ever to have been indicted for treason. In the 1790s he was a member of the Society for Constitutional Information and, along with Thomas Hardy, John Horne Tooke, and ten others, was indicted for high treason in 1794. Hardy and Tooke were tried first and were acquitted, whereupon the charges against Kyd were dropped. *Dictionary of National Biography*, 11: 348. (2) John Barnard Byles was responsible for what may be the only bills and notes joke. He is said to have named his horse 'Bills' so that as he rode up people could say, 'Here comes Byles on Bills'. Simpson, ed., *Biographical Dictionary of the Common Law*, 95.

[10] Byles, 2.

[11] Kyd, 30–32; Bayley, 1; Chitty, 1–2, 7–8. Chitty is the only one of these authors whose statement of the characteristics of bills comes close to mentioning the modern concept of negotiability. He states that bills of exchange 'are instruments by means of which a creditor may assign to a third person, not originally party to a contract, the *legal* as well as equitable interest in a debt raised by it, so as to vest in such assignee a right of action against the original debtor'. Chitty, 1.

[12] It was not until the eighth edition of Byles, published in 1862, that a passage expressly discussing the rights of 'bona fide holders' was added, and this passage amounted to only a few pages in the chapter entitled 'Of the Consideration'.

The early books also differ dramatically from modern works in their treatment of defences to actions on bills and notes. Twentieth-century books on negotiable instruments always include a lengthy section on defences, organized in accordance with the holder in due course rules that distinguish between real and personal defences. The earlier books had no chapter on the holder in due course doctrine, and the coverage of defences was not organized around any such concept. Rather, the matters that would now be placed under the headings of real and personal defences were treated in a variety of places. For example, the defence that some party to the instrument lacked contractual capacity, on grounds of infancy, insanity, or the like, which would be treated in twentieth-century books in the section on the real defences, is often treated in the earlier books in a chapter or chapters entitled something like 'Of the Parties to a Bill of Exchange' along with many other issues of capacity and agency. Similarly, the defences that the twentieth-century authors take to be the primary concern of the law of bills and notes, such as breach of warranty, fraud, or other matters relating to the original payee's failure properly to render the performance for which the instrument was given, are treated in the earlier books in a variety of places, rarely with much prominence. Thus, in both Bayley and Kyd the defences of illegality, want, or failure of consideration were not covered in the principal chapters of the books on the major legal issues concerning bills, but were placed into a final chapter on procedure and evidence in actions on bills.[13] In Chitty, these issues were treated somewhat as an aside in a chapter on the form of bills of exchange in which Chitty gives the typical language of a bill of exchange, appending the discussion of consideration to

Byles, *Law of Bills of Exchange*, 8th edn, 111–12. The first law book on bills and notes to include an entire chapter specifically devoted to the rights of bona fide holders of instruments seems to be Theophilus Parsons' 1863 work, *Law of Promissory Notes and Bills of Exchange*.

[13] In the first edition of Bayley, this chapter was entitled 'Of the Evidence necessary to entitle the Plaintiff to recover upon a Bill or Note, and the Defence which may be set up against him', and comprised eight of the total of seventy pages in the book. The consideration defences got only four pages, most of that being on illegality of consideration. Similarly the first edition of Kyd had a final chapter entitled 'Of the Proof necessary at the Trial, and of the Defence that may be set up there', which accounted for twenty-nine of the total of one hundred and sixty pages in the book. The consideration defences were covered in the last five pages of this chapter.

his mention of the phrase 'for value received' that customarily appeared in bills of exchange.

Even where the defences of failure of consideration and the like are given more prominence, the discussion is far from what one familiar with twentieth-century works would expect. In twentieth-century books, the discussion of these defences focuses on the original obligor's effort to raise defences when sued by a transferee of the instrument. Defences available between the original parties usually receive only brief treatment. In treatises of the late eighteenth and early nineteenth centuries, the emphasis is just the reverse. Byles, for example, had a separate chapter entitled 'Of the Consideration' which covered, among other things, some of the defences that twentieth-century authors discuss under the heading of real and personal defences. Byles began his discussion of consideration by explaining that although there is a presumption of consideration in actions on bills, that presumption can be rebutted in actions between immediate parties to a bill.[14] He then proceeded with a detailed examination of whether particular contentions do or do not give rise to good defences of want, failure, or illegality of consideration. There is nothing of the sense, so prominent in twentieth-century books, that the problem is whether a bona fide purchaser takes subject to defences available against the original holder, nor is there any mention of the argument that such special treatment for bona fide purchasers is necessary in order to promote the use of bills in commerce. Indeed, the phrase 'bona fide holder' does not even appear in the discussion.

Lest the point be misunderstood, I should hasten to add that it is not my contention that the rules that twentieth-century lawyers catalogue under the heading of holder in due course were unknown in earlier times or that they were unimportant. It is clear from any number of cases in the seventeenth and eighteenth centuries that the judges thought that protection of the rights of bona fide holders was an important consideration in the law of bills and notes. So too, though the treatises of that era do not use the holder in due course concept as a central organizing principle, one can find in the treatises statements that are substantively equivalent to the modern holder in due course rules, albeit often expressed in

[14] Byles, *Law of Bills of Exchange*, 37–38.

different terms.[15] The point is not that the substantive rules were different in earlier times. Rather, the point is that a history of the law of bills and notes written solely or predominantly from the perspective of an effort to trace the evolution of these particular rules is bound to be seriously distorted. The holder in due course rules were important, but they were not the be all and end all of the law of bills.

The orthodox accounts of the history of the law of bills and notes push to the level of a priori assumption all of the issues that ought to be principal subjects of the historical inquiry. If one takes it as axiomatic that the law of bills and notes evolved in response to a universal mercantile need for freely transferable debt instruments, and that the main theme in the history of the English law of bills was the struggle to get the common law courts to accept the principles of negotiability, then there is no place or need for empirical historical inquiry into actual mercantile practice with bills and notes nor for study of the relationship between changes in mercantile practice and changes in commercial law. For example, a large part of Jenks' seminal 1893 article on the early history of negotiable instruments law consisted of a synopsis of the findings of continental jurists concerning the presence of language akin to order and bearer clauses in a miscellany of medieval documents, including not only early bills of exchange and bonds evidencing debts, but also real estate conveyances, provisions of wills concerning the designation of guardians, and a writing 'in which a monk makes over to the church (amongst other things) the right to avenge his death if he shall be murdered'.[16] Yet the only thing that links this hodgepodge to the law of bills of exchange is the a priori assumption that the whole point of the development of the law of bills was to make possible a system in which debt instruments could freely be transferred. Without that assumption, there is no reason to regard instances of transfers of legal documents as part of the history of mercantile practice or law. Theories about the development and significance of bearer clauses and order clauses might be of interest in the history of representation in litigation, but that would be a part of the history of civil procedure, not commercial law. What Holdsworth, Jenks, Scrutton, and others

[15] E.g., Byles, *Law of Bills of Exchange*, 37–38.
[16] Jenks, 'Early History of Negotiable Instruments', 61.

have provided is not really an account of the history of the law of bills and notes, but an account of the supposed origins of the legal concept of negotiability. The goal of the present work is to reverse that focus.