Promissory Notes

Howard Darmstadter

My affection for promissory notes resembles the affection that archaeologists feel for King Tut's tomb — the joy of encountering an abundance of antiquities in a small space. In the box below, I've excerpted some illustrative promissory-note language — by no means the worst of the genre — highlighting those passages that may provide particular delight to connoisseurs of the prolix.

Memorial Promissory Note

For value received, the undersigned, Borrower Corp., a Delaware corporation, **hereby** promises to pay to **the order of** Lender Corp. at First National Bank, New York, NY on April 1, 2004 **in lawful money of the United States of America,** the principal sum of **ten million dollars ($10,000,000),** with interest **on the unpaid principal balance from the date hereof until maturity.**

Interest on this note shall accrue on any unpaid principal balance for each day during the term of this note at a per annum rate of 7%. Interest shall be computed on the basis of a year of 360 days and actual days elapsed. **Payment of interest** on the unpaid balance hereof **shall be made** in arrears on the first business day of each month during the term hereof and at maturity. **All payments of principal and interest shall be made** without setoff, deduction or counter-claim.

The Borrower **hereby** waives **diligence,** presentment, **demand, protest, notice of dishonor and notice of any kind whatsoever.**

In this article, I'll discuss the promissory notes I call "memorial notes." These notes are used solely to evidence an obligation. They may be contrasted with what I call "commercial notes," which are meant to be passed from holder to holder in the stream of commerce.

On the bookcase behind my desk, entombed in Lucite, rests in honored glory a commercial promissory note. It reads in its entirety (without signatures, countersignatures, or corporate logo) as follows:

> PROMISSORY NOTE
>
> NOTE NUMBER 0000201 5/28/93 $8,248,000.00
> On 6/01/93, for value received, Smith Barney, Harris Upham & Co. Incorporated Promises To Pay To The Order Of **BEARER**
> The Sum Of $***8,248,000.00* Plus Interest $*****2,676.89 Dollars
> Payable At Morgan Guaranty Trust Company of NY — New York, New York.

Things don't happen much faster than that.

Every year my employer issues billions of dollars' worth of these notes (commonly referred to as "commercial paper"), a tiny fraction of the commercial paper in circulation. Few lawyers labor over the wording of commercial notes. No lender asks for more words or would pay a fraction of a basis point for them. Contrary to the presupposition of most lawyers, lenders often prefer to rely on market practices unsullied by legalisms. No one wants to sit down and read fine print in commercial paper.

If you find it hard to believe that so much money can change hands with so little verbiage, reflect on the simplicity of another commercial instrument whose importance dwarfs that of the commercial note. I refer, of course, to the check. You give them, you take them, you seldom question their wording. The check-collection system would not be improved by allowing clever people to modify the check's minimalist phraseology.

We may now proceed to nibble at the overstuffed prose of the memorial note, pausing for a few legal lessons along the way.

For value received. As luck would have it, the first words of the note raise interesting issues. First, despite the ubiquity of those three words (they even appear in my commercial note), the words are not necessary for an instrument to be a promissory note. Nothing in UCC Article 3, "Negotiable Instruments," requires the phrase. (Article 3 comes in two flavors: 1952 (Article 3 Classic) and the 1990 revision. The 1990 revision has been adopted in most states, but there are some important holdouts, such as New York and Guam. Unless noted, everything said here applies to both versions.)

Article 3 will govern if the note is negotiable. This is not the place, nor am I the man, to initiate you into all the mysteries of negotiability. For the present, you need only understand that if a note meets the formal standards for negotiability set out in Article 3, certain holders of the note will not be subject to defenses of the note's maker (i.e., the person who signed it) or any prior endorser, even though the defenses would be available on a simple contract. Such a fortunate holder is called a "holder in due course."

A holder in due course has to take the note for value and without notice of any defenses. A note's bare recital that it has been issued *for value received* is not much help in establishing holder-in-due-course status. If you take a note from someone other than

the maker, the maker's receipt of value doesn't establish that you gave value to the intermediary holder. If, however, you took the note directly from the maker, you are likely to have notice of any defenses.

Although *for value received* is unlikely to help establish holder-in-due-course status, might it not be useful to a holder who is not a holder in due course? (There's no established terminology for a holder who is not a holder in due course; I'll call the unlucky fellow a "vulnerable holder.") Against a vulnerable holder, failure of consideration can be a defense, so having the note say that it is issued *for value received* may provide some evidence of consideration. For the typical commercial note, with its stripped-down wording, *for value received* might seem to have some (slight) evidentiary value.

As it happens, however, the maker or endorser of a negotiable promissory note has the burden under the UCC of establishing the defense of lack of consideration.[1] Even before the UCC, the courts had universally come to regard a negotiable note as carrying a presumption of consideration. This presumption became part of the Uniform Negotiable Instruments Law, the precursor to UCC Article 3.

In 19th-century England, there were statutes — repealed more than a century ago — that required a note to recite *for value received* if interest and damages were to be recovered or if issued in payment for coal (!). In the middle of that century, some English authorities considered it advisable to always insert *for value received* in a note, but that view seems to have died out well before the end of the century.[2]

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[1] U.C.C. § 3–307(2) (1952); § 3–308(b) (1990).

[2] Ltrs. from Professor Bruce A. Campbell, University of Toledo College of Law (Mar. 27 & May 5, 1997) (on file with author).

Of course, many memorial notes do not need *for value received* to demonstrate consideration. For example, master or grid promissory notes describe the making of loans to the extent that *for value received* becomes superfluous. Other notes may refer to loan agreements or other documents that demonstrate consideration.

Even if your particular note doesn't on its face or by reference evidence consideration, how much should you worry? After all, failure of consideration is also a defense against a *check* held by a vulnerable holder. (By 1785, the English courts had settled that the words *for value received* were not necessary for bills of exchange, a category that includes checks.[3]) Yet few lawyers would decorate a check's memo line with *for value received.* My guess is that, in the vast majority of cases, proving consideration will be quite easy without help from *for value received.*

I have probably beaten this horse to death. Leaving in *for value received* does not make a note less readable. In addition, someone will add, the phrase might provide a bit of protection for a vulnerable holder. So why not leave the established practice alone?

If you're going to stay up nights worrying about lack of consideration, by all means leave in *for value received.* The lesson comes from reflecting on how those five syllables got there. They arrived centuries ago for reasons I have not inquired into. They have remained ever since because no one has had the will to remove them. The trembling associate doesn't know why the words are there but appreciates that no one will criticize their presence if they stay.

There is a slight probability that it might be handy someday to have *for value received* in our note. But the only reason we insist on addressing this particular low probability is that *the words are*

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[3] James Steven Rogers, *The Early History of the Law of Bills and Notes* 214 & n. 69 (Cambridge U. Press 1995).

already there. We don't insist on adding these words to checks, and we don't (I hope) insist on adding clauses to our documents to address situations of similarly low probability.

The argument against *for value received* is not that the words serve no conceivable use but that everything in a document should be directed toward outcomes whose expected value — the probability of the outcome multiplied by its cost — crosses some threshold. For example, if a 1% likely outcome would cost $10 billion, the expected value of the outcome is $100 million — enough to require our attention. If, however, the outcome would cost $1 million but is .01% likely, or is 1% likely but would cost only $10,000, the expected value is $100 — not worth legal time and resources.

We seldom know the exact probability of an outcome and often can't compute its exact cost. But we should develop a gut feel for probability and cost that is a good enough basis to judge the utility of a provision. I think that lawyers should generally have more guts.

We may now turn to the other highlighted language in the memorial promissory note.

The undersigned. You'll want to spell out the name of the maker so that you can add identifiers such as "a Delaware corporation." *The undersigned* is therefore redundant, besides being a bit stiff.

Hereby. The sentence begins, *[Maker] promises to pay*, not *[Maker] promised to pay*, *[Maker] will promise to pay*, or *[Maker] would promise to pay*. There may be times we have to distinguish an action taken by the document from an action merely referred to. This is not one of those times.

The order of. If a note is payable "to" someone rather than payable "to the order of" someone, the note will not be negotiable.

But for memorial notes (as opposed to commercial paper and similar notes that are intended to be passed around), negotiability may be impossible or undesirable. I frequently draft promissory notes between subsidiaries, primarily to comfort our auditors. These notes display an annoying tendency to get themselves lost. I therefore leave out *to the order of* and title these notes "Nonnegotiable Promissory Note." It helps me sleep at night.

If you want your note to be negotiable, you'll need *to the order of*. Just be careful what you want.

In lawful money of the United States of America. The legal pen at work. In a note between a domestic maker and a domestic payee that is governed by the law of one of these United States, won't "$" do the trick? If the note truly has some transnational aspect, "US$" will work. (Have you ever seen a check drawn on a U.S. bank indicate the currency's provenance by anything more than "$"?)

Ten million dollars ($10,000,000). This would best be replaced by *$10 million*. Note that the pros — the people who fill in the blanks in commercial paper — use numerals alone rather than words alone or numerals and words together. My appeal to authority is not totally convincing here, however, because the pros would also write the number as *$10,000,000.00*. In my view, writing all those zeros, plus the useless recitation of cents, is asking for trouble.

On the unpaid principal balance, etc. This phrase says nothing that isn't said in the first sentence of the following paragraph.

Payment of interest shall be made. A few extra words give it that artistic touch. Try *Interest shall be paid* or (even better) *[Maker] shall pay interest.*

Diligence, demand, protest, notice of dishonor and notice of any kind whatsoever. The 1952 version of Article 3 provides that "where without excuse any necessary presentment or notice of dishonor is delayed beyond the time when it is due, . . . any [e]ndorser

is discharged . . . ." Presentment (for our purposes, a demand on the maker for payment) must be made on the date the note is due. Moreover, if the maker refuses to pay (i.e., dishonors) the note, the holder has to give an endorser notice of the dishonor before midnight of the third business day after dishonor. So if a note endorsed to you matures on April 1, 2006, you had better present the note for payment on April 1 and, if it is dishonored, notify the endorser within three days. Or have a good excuse. Or a waiver.[4]

The rule dates from at least 1703.[5] "In the late seventeenth century and throughout the eighteenth century, . . . the issue of what was a reasonable time for presentment seems to have accounted for a fairly large percentage of the bills and notes cases . . . ."[6]

Article 3 (1990) is more relaxed. An endorser is discharged only if the holder fails to give notice of dishonor within 30 days of dishonor. For a note payable on a fixed date, dishonor occurs automatically (without presentment) on that date if the note is not paid.[7]

Waiving presentment and notice of dishonor is, therefore, potentially important, and it takes only four words. Article 3 (1990) says that waiving presentment also waives notice of dishonor. Under the 1952 version, waiver of protest waives presentment and notice of dishonor. So *The borrower waives presentment* (or *waives protest* under 1952 Article 3) does the trick.[8]

This is true at least for negotiable notes. What about nonnegotiable notes? The comments to Article 3 (1990) say that "it may be

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[4] U.C.C. §§ 3–502(1), 3–504(1), 3–508(2) (1952).

[5] Rogers, *supra* n. 3, at 202–03.

[6] *Id.* at 203–04.

[7] U.C.C. §§ 3–503(c), 3–502(a)(3) (1990).

[8] U.C.C. § 3–504(b) (1990); § 3–511(5) (1952).

appropriate . . . for a court to apply one or more provisions of Article 3 to [an instrument that is not negotiable] by analogy . . . ."[9] Thus, a waiver that works for negotiable instruments is likely to work for nonnegotiable instruments.

Incidentally, our commercial note doesn't need a waiver of presentment or protest. Because it is payable to bearer, it is negotiated by delivery. The liability of endorsers is therefore usually irrelevant.

Do today's longer-winded notes give added protection?

> "The notes used to be so square," he [an investor named Carter] said, holding a pair of index fingers six inches apart. "'I promise to pay.'" Now, said Carter, indicating a telephone directory, the documents are "so thick." He said that the shorter ones were harder to get out of. "There is no defense for 'I promise to pay,'" he said.[10]

[9] U.C.C. § 3–104 cmt. 2 (1990).

[10] James Grant, *Money of the Mind: Borrowing and Lending in America from the Civil War to Michael Milken* 405 (Farrar Straus Giroux 1992).