

Promissory Note

A **promissory note** is a legal instrument (more particularly, a financial instrument), in which one party (the *maker* or *issuer*) promises in writing to pay a determinate sum of money to the other (the *payee*), either at a fixed or determinable future time or on demand of the payee, under specific terms. If the promissory note is unconditional and readily salable, it is called a negotiable instrument.^[1]

Referred to as a **note payable** in accounting (as distinguished from accounts payable), or commonly as just a "note", it is internationally defined by the *Convention providing a uniform law for bills of exchange and promissory notes*, although regional variations exist. Bank note is frequently referred to as a promissory note: a promissory note made by a bank and payable to bearer on demand. Mortgage notes are another prominent example.

Overview

The terms of a note usually include the principal amount, the interest rate if any, the parties, the date, the terms of repayment (which could include interest) and the maturity date. Sometimes, provisions are included concerning the payee's rights in the event of a default, which may include foreclosure of the maker's assets. **Demand promissory notes** are notes that do not carry a specific maturity date, but are due on demand of the lender. Usually the lender will only give the borrower a few days' notice before the payment is due. For loans between individuals, writing and signing a promissory note are often instrumental for tax and record keeping. A promissory note alone is typically unsecured,^[2] but these may be used in combination with security agreements such as mortgage, in which case they are called mortgage notes.

International law

Definition and usage of promissory notes are internationally established by the *Convention providing a uniform law for bills of exchange and promissory notes*, signed in Geneva in 1930.^[3] Article 75 of the treaty stated that a promissory note shall contain:

- the term "*promissory note*" inserted in the body of the instrument and expressed in the language employed in drawing up the instrument
- an unconditional promise to pay a determinate sum of money;
- a statement of the time of payment;
- a statement of the place where payment is to be made;
- the name of the person to whom or to whose order payment is to be made;
- a statement of the date and of the place where the promissory note is issued;

- the signature of the person who issues the instrument (maker).

United States law

In the United States, a promissory note that meets certain conditions is a negotiable instrument regulated by article 3 of the Uniform Commercial Code. Negotiable promissory notes called mortgage notes are used extensively in combination with mortgages in the financing of real estate transactions. One prominent example is the Fannie Mae model standard form contract Multistate Fixed-Rate Note 3200, which is publicly available.^[4] Promissory notes, or commercial papers, are also issued to provide capital to businesses. However, Promissory Notes act as a source of Finance to the company's creditors.

The various State law enactments of the Uniform Commercial Code define what is and what is not a promissory note, in section 3-104(d):

“ § 3-104. NEGOTIABLE INSTRUMENT.

...

(d) A promise or order other than a check is not an instrument if, at the time it is issued or first comes into possession of a holder, it contains a conspicuous statement, however expressed, to the effect that the promise or order is not negotiable or is not an instrument governed by this Article.

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Thus, a writing containing such a disclaimer removes such a writing from the definition of *negotiable instrument*, instead simply memorializing a contract.

British law

“ § 83. BILLS OF EXCHANGE ACT 1882. Part IV.^[5]

...

Promissory note defined

(1)A promissory note is an unconditional promise in writing made by one person to another signed by the maker, engaging to pay, on demand or at a fixed or determinable future time, a sum certain in money, to, or to the order of, a specified person or to bearer.

(2)An instrument in the form of a note payable to maker's order is not a note within the meaning of this section unless and until it is indorsed by the maker.

(3)A note is not invalid by reason only that it contains also a pledge of collateral

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security with authority to sell or dispose thereof.

(4) A note which is, or on the face of it purports to be, both made and payable within the British Islands is an inland note. Any other note is a foreign note.

History

Historically, promissory notes have acted as a form of privately issued currency. Flying cash or *fei qian* was a promissory note used during the Tang dynasty (618 – 907). Flying cash was regularly used by Chinese tea merchants, and could be exchanged for hard currency at provincial capitals.^[6] According to tradition, in 1325 a promissory note was signed in Milan. There's constance of promissory notes being issued in 1384 between Genova and Barcelona, although the letters themselves are lost. The same happens for the ones issued in Valencia in 1371 by Bernat de Codinachs for Manuel d'Entença, a merchant from Huesca (then part of the Crown of Aragon), amounting a total of 100 florins.^[7] In all these cases, the promissory notes were used as a rudimentary system of paper-money, for the amounts issued could not be easily transported in metal coins between the cities involved. Ginaldo Giovanni Battista Strozzi issued an early form of promissory note in Medina del Campo (Spain), against the city of Besançon in 1553.^[8] However, there exists notice of promissory notes being in used in the Mediterranean commerce well before that date.

Difference from IOU

Promissory notes differ from IOUs in that they contain a specific promise to pay, rather than simply acknowledging that a debt exists. In common speech, other terms, such as "loan", "loan agreement", and "loan contract" may be used interchangeably with "promissory note" but these terms do not have the same legal meaning.

Difference from loan contract

Whereas promissory notes are evidence of a loan, they are not the same as loan agreements. In fact, the loan agreement is legally distinct from any promissory notes associated therewith. The loan agreement contains all of the terms and conditions of the loan contract.

Negotiability

Negotiable instruments are unconditional and impose few to no duties on the issuer or payee other than payment. In the United States, whether a promissory note is a negotiable instrument can have significant legal impacts, as only negotiable instruments are subject to Article 3 of the Uniform Commercial Code and the application of the holder in due course rule.^[1] The negotiability of mortgage notes has been debated, particularly due to the obligations and "baggage" associated with mortgages; however, in mortgage notes are often determined to be negotiable instruments.^[1]

In the United States, the Non-Negotiable Long Form Promissory Note is a document used when negotiability is not required.^[9]

References

1. Whaley DJ. (2012). Mortgage Foreclosures, Promissory Notes, and the Uniform Commercial Code. *Western State University Law Review*. LexisNexis entry
2. The Promissory Note. ExpertLaw.com.
3. <http://www.jus.uio.no/english/services/library/treaties/09/9-03/bills-exchange-notes.xml>
4. Single-family notes. Fannie Mae.
5. [1][2]
6. William N. Goetzmann; K. Geert Rouwenhorst (2005). *The Origins of Value: The Financial Innovations that Created Modern Capital Markets*. Oxford University Press. p. 68. ISBN 978-0-19-517571-4.
7. As noted by Manuel Sanchis Guarner in *La Ciutat de València*. Ajuntament de València, València. Cinquena Edició 1989, plana 172. Quote in Catalan

Onorables senyors, nosaltres havem pres ací en Monsó, C florins de cambi de mossén Manuel d'Entença..., vos plàcia complir e donar aquí en València, per ell al honrat En Bernat de Codinachs, vista la present. Per la lletra que us enviam, vos fem saber aquells haviem ops. Plàtia-us, senyors, aquest cambi aja bon compliment.

8. <http://www.delsolmedina.com/La%20primera%20letra%20de%20cambio.htm>
9. Non-Negotiable Long Form Promissory Note. Practical Law Company.

Source: http://en.wikipedia.org/wiki/Promissory_note
April, 2014