The Characterization of the Demand Deposit as a Loan under Fractional Reserve Banking: A Critical Legal Analysis

Assistant professor **Mejd Aures BENLALA**[1]

Abstract

Under fractional reserve banking system, banks activity and operations rely primarily on demand deposits, which are often known as current accounts, especially when it comes to granting loans. Consequently, bank deposits are the primary source of 'inexpensive' funding for commercial banks. This article aims to analyze and discuss the widely agreed upon characterization of the demand deposit as a loan contract. Since all today's legal systems consider the demand deposit a loan contract, this article attempts to challenge this characterization by discussing the arguments and building blocks of the loan theory and examining the essence of both contracts through the lens of law and jurisprudence. The paper concludes that the demand deposit contract cannot be considered a loan contract, with supporting solid arguments from economic and legal perspectives.

Keywords: *fractional reserve banking; jurisprudence; demand deposit contract; loan contract; civil law; common law; hybrid legal systems.*

JEL Classification: K12, K15, P40

1. Introduction

In essence, money deposit operations are not merely a physical (or digital/electronic) procedure that is limited to the customer handing over the money to the bank employee (or transferring funds), and then retrieving it whenever he wants, or as agreed upon. They are primordially legal actions between the bank and the customer.

Bank deposits are distinguished by a set of characteristics, leading to a disagreement of the jurisprudence about its legal nature. Some consider it a complete deposit to which the general rules stipulated in the Civil Code are applied, while another part of the jurisprudence considers it an abnormal or irregular deposit, based on the fact that banks are not obligated to return the same deposit, but rather to return a similar or an equal to it. As for the third opinion, which is the overwhelmingly accepted and adopted one, they consider it a loan because of the financial conduct of the bank regarding the use of the deposited money as its own implying and assuming a transfer of ownership of the deposited amounts from the customer to the bank upon deposit.

Since it is well known and established that banks operate under fractional reserve banking system, the article adopts a descriptive analytical approach to explore the roots and background of the widely established characterization of the demand deposit as a loan contract in all today's legal systems (Common Law, Civil Law and hybrid legal systems). The paper looks into the economic and legal elements of the demand deposit with the aim to detect its characteristic distinctive features in comparison with the loan contract. This paper makes a unique contribution by examining the demand deposit contract from economic and legal perspectives. It discusses the arguments put forward in support of the characterization of the demand deposit as a loan contract, provides compelling arguments to refute this characterization and concludes that the demand deposit cannot be a loan contract.

Some of the most influential and pertinent previous research on the subject came from Huerta de Soto[2](2006) and Bagus & Howden (2009[3], 2013[4]) and mostly revolved around the fractional reserve banking system and whether it should be considered fraudulent or illegal, with the proposition of a full (100%) reserve system as a solution to remedy that. Huerta de Soto provided compelling

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[1] Mejd Aures Benlala - Department of Economics, University of Batna 1, Algeria, majdaures.benlala@univ-batna.dz.

[2] J. Huerta de Soto, *Money, Bank Credit, and Economic Cycles.* Ludwig Von Mises Institute, Auburn, AL., 2006.

[3] P. Bagus & D. Howden, 'The Legitimacy of Loan Maturity Mismatching: A Risky, but not Fraudulent, Undertaking'. *Journal of Business Ethics*, vol. 90, no. 3, 2009, pp. 399-406, http://dx.doi.org/10.1007/s10551-009-0050-z.

[4] P. Bagus & D. Howden, 'Deposits, Loans and Banking: Clarifying the Debate', *The American Journal of Economics and Sociology,* vol. 72, no. 3, 2013, pp. 627-644, http://dx.doi.org/10.1111/ajes.12023.

arguments to support the characterization of the demand deposit as an irregular deposit contract, and this article expands on his work by delving deeper into the loan theory in order to expose its inherent flaws and loopholes from the perspectives of economics and law. Even argumentative papers of Rozeff[5](2010) and Huber[6](2013) in response to the full reserve banking proponents focused merely on putting forward arguments against the full reserve system from an economic perspective, largely ignoring the legal perspective. These discussions did not address some major economic and legal issues related to the characterization of the demand deposit as a loan contract (which is essentially known to be the main driver of the fractional reserve banking system).

As the fundamental element of this article is to discuss the characterization of the demand deposit account as a loan contract, the first section describes the basic economic concept of a demand deposit. Section two presents an overview of the stance of all different legal systems on the classification of this contract. The final part of this article concisely discusses fractional reserve banking, then tackles the subject matter with a thorough and detailed discussion of the characterization of the demand deposit as a loan contract from these two different (yet interlocked) perspectives: economics and law.

2. What is a demand deposit (economic concept)?

Deposit (the noun) in English language is defined in the Merriam Webster dictionary as ‘the state of being deposited, something placed for safekeeping: such as money deposited in a bank’. The Britannica dictionary defines it as ‘an amount of money that is put in a bank account’, so the deposit is what is deposited - i.e. left – whether it is money or other things with the one who keeps it, in order to return it to the one who deposited it whenever he asks for it.

In economics, deposit can be defined as everything that individuals or organizations put in banks temporarily, short or long, for the purpose of safekeeping. These deposits are often embodied in the form of legal money, although they can sometimes take other forms. The demand deposit, which is also called the current deposit or the current account (even checking account and transaction account in some countries), is considered one of the most common bank deposits, as it represents the largest part of the bank’s resources. It is an agreement between the bank and the customer according to which the latter deposits a sum of money with the bank, provided that he has the right to withdraw it upon request. Demand deposits have characteristics that distinguish them from other deposits, and as its name indicates, these deposits are always at the disposal of their owners, who can resort to withdrawing them in whole or in part whenever they want, and without prior notice – this is true for almost all forms of current accounts[7].

Even if it is in the possession of the bank, the deposit is at the absolute disposal of its owner. The bank is not entitled to impose restrictions or conditions on its owner during the withdrawal, and it may not use any argument that would constitute an obstacle for depositors to use these deposits. In return for this feature, the owners of this type of deposit cannot benefit from interests. They cannot impose this on banks due to the nature of this type of deposit, even though the bank can use these deposits to make loans, and nothing prevents it from doing so. This banking practice enables banks to exploit and use inexpensive financial resources allowing for expansion of loans at a relatively very low cost. This underlines the importance of this type of deposit, as it constitute the main source of money and loan expansion in banking activity, making the bulk of its external resources.[8]

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[5] M. Rozeff, ‘Rothbard on Fractional Reserve Banking: A Critique’, *The Independent Review*, vol. 14, no. 4, 2010, pp. 497-512, https://www.independent.org/pdf/tir/tir_14_04_02_rozeff.pdf, (accessed 18 April 2022).

[6] J. Huber, ‘*Notes on the occasion of reading Jesús Huerta de Soto’*. Sovereignmoney, 2013, https://sovereignmoney.site/notes-on-huerta-de-soto-and-neo-austrian-school/, (accessed 15 August 2022).

[7] J. Woerner, ‘Demand deposit account in banking’, *Study* [website], https://study.com/learn/lesson/what-is-a-demand-deposit.html, (accessed 21 February 2022).

[8] Corporate finance institute team, ‘Demand deposit’, *Corporatefinanceinstitute* [website], https://corporatefinanceinstitute.com/ resources/wealth-management/demand-deposit/, (accessed 11 May 2022).

Demand deposits make up most of a particular measure of the money supply - M1[9]. As of October 2022, the total amount of demand deposit accounts in the U.S. was $5.26 trillion. This compares to $1.4 trillion five years ago and $733 billion 10 years ago.[10]

3. The demand deposit legal nature (characterization)

In this section, the paper provides a comprehensive portrayal of the current legally accepted characterization of the demand deposit account in different legal systems and jurisprudences.

Before going through the modern era's legal characterization of the demand deposit, it has to be noted that Roman legal tradition described in detail the covenant of monetary 'demand' deposit and the principles that govern it, along with the crucial differences between this contract and other legal contracts, such as the loan. Roman bankers' operations included two different types of contract. The first one was in the form of a deposit, which involved no right to interest and obliged the depositary to maintain the full, continuous availability of the money in favor of the depositor, who had absolute privilege in the case of bankruptcy. And, the second form of operation they carried out was receiving loans, which obligated the banker to pay interest to lenders, who lacked all privileges in the case of bankruptcy. This offers an unequivocal clarity in the distinction between the two contracts.[11]

3.1. English law (common law)

Acting as a depository for the money of members of the public is essentially the most basic service a bank can provide. Commercial banking is based on this service; as it provides a legal definition for banking. The public generally holds its deposits with banks in the form of accounts. As a matter of English law current account holders are entitled by contract to demand cash over the bank's counter and to have checks (cheques) honored and collected.[12]

The characterization of the demand deposit account as a loan comes from the identification of the relationship between customer and bank in relation to the current account as basically that of creditor and debtor. That is why banks can be served (third party debt/garnishee orders) by the judgment creditors of its customers. This means that a third party debt/garnishee order obliges the bank to pay the judgment creditor rather than its customer what is owed.[13]

In common law, other important obligations associated with the current account are contained in the classic statement in the judgment of Atkin LJ in *Joachimson v. Swiss Bank Corp.*, (1921): „The bank undertakes to receive money and to collect bills for its customer's account. The proceeds so received are not to be held in trust for the customer, but the bank borrows the proceeds and undertakes to repay them. The promise to repay is to repay at the branch of the bank where the account is kept, and during banking hours. It includes a promise to repay any part of the amount due against the written order of the customer addressed to the bank at the branch, and as such written orders may be outstanding in the ordinary course of business for two or three days, it is a term of the contract that the bank will not cease to do business with the customer except upon reasonable notice. The customer on his part undertakes to exercise reasonable care in executing his written orders so as not to mislead the bank or facilitate forgery".[14]

The legal position in relation to the banker-customer is largely expressed as being constituted by implied terms.[15]

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[9] Federal Reserve, Money Stock Measures - H.6 Release, *Federal Reserve* [website], https://www.federalreserve.gov/releases/h6/current/default.htm, (accessed 25 October 2022).
[10] Federal Reserve Economic Data, Demand deposits (WDNNS), FRED [website], https://fred.stlouisfed.org/series/WDDNS, (accessed 25 October 2022).
[11] Huerta de Soto, pp. 34-35.
[12] R. Cranston, *Principles of Banking Law,* 2nd ed., Oxford University Press, Oxford, 2002, p. 159.
[13] Ibid, p. 160.
[14] *Joachimson v. Swiss Bank Corporation* [1921] 3 KB 110, p. 127.
[15] E.P. Ellinger, E. Lomnicka & C. Hare, *Ellinger's Modern Banking Law,* 5th ed., Oxford University Press, Oxford, 2011, pp. 121-122.

Going back in the common law precedents' history, *Foley v. Hill* was a historical development when, in 1848, the House of Lords characterized the banker-customer relationship as fundamentally a debtor-creditor relationship. This enabled banks to treat money deposited with them as their own. Consequently, the only obligation they had was to return an equivalent amount. This brushed aside all rival characterizations — bailment, trust, or agency — on the grounds of limitations on how the moneys could be employed which was essentially incompatible with the envisaged ownership of the deposited money by the bank. As Lord Cottenham LC noted, the characterization of the bank as debtor meant the money placed in the custody of a banker is, to all intents and purposes, the money of the banker, to do with it as he pleases; he is guilty of no breach of trust in employing it.[16]

Lord Cottenham LC said: „Money, when paid into a bank, ceases altogether to be the money of the principal; it is by then the money of the banker, who is bound to return an equivalent by paying a similar sum to that deposited with him when he is asked for it. The money paid into a banker's is money known by the principal to be placed there for the purpose of being under the control of the banker; it is then the banker's money; he is known to deal with it as his own; he makes what profit of it he can, which profit he retains to himself, paying back only the principal, according to the custom of bankers in some places, or the principal and a small rate of interest, according to the custom of bankers in other places. The money placed in custody of a banker is, to all intents and purposes, the money of the banker, to do with it as he pleases; he is guilty of no breach of trust in employing it; he is not answerable to the principal if he puts it into jeopardy, if he engages in a hazardous speculation; he is not bound to keep it or deal with it as the property of his principal; but he is, of course, answerable for the amount, because he has contracted, having received that money, to repay to the principal, when demanded, a sum equivalent to that paid into his hands. That has been the subject of discussion in various cases, and that has been established to be the relative situation of banker and customer. That being established to be the relative situations of banker and customer, the banker is not an agent or factor, but he is a debtor".[17]

3.2. French law and Spanish law (civil law)

In French law, when explaining deposits received by banks Article 02 of the Law n° 84-46 of January 24, 1984 relating to the activity and control of credit institutions stipulates „Funds received from the public are considered to be funds that a person collects from a third party, in particular in the form of deposits, with the right to use them for their own account, but on condition that they be returned."[18]

Similarly, in Spanish law we find that the Law 10/2014 of 26 June 2014 on the regulation, supervision and solvency of credit institutions defines credit institutions by mentioning their exclusive job of collecting funds from the public to be used in granting loans, Article 01 stipulates „Credit institutions are authorized companies whose activity consists of receiving deposits or other reimbursable funds from the public and of granting loans on their own account"[19]. Moreover, Article 309 of the Spanish Commercial Code stipulates that: „Provided, with the consent of the depositor, the depositary of the goods subject to deposit disposes of these, either for himself or his business, or for the operations he is entrusted, the rights and obligations inherent to depositor and depositary shall cease, and the rules and provisions applicable to business loans or agencies or the contract in substitution of the deposit into which they may have entered, shall apply".[20]

[16] Cranston, p. 131.
[17] *Foley v. Hill*. (1848) 2 HLC 28. 9 ER 1002, p. 36.
[18] Loi n° 84-46 du 24 janvier 1984 relative à l'activité et au contrôle des établissements de crédit, Article 2, https://www.legifrance.gouv.fr/loda/id/JORFTEXT000000504724/, (accessed 13 January 2022).
[19] Law No. 10/2014 of 26 June 2014 on the regulation, supervision and solvency of credit institutions (Boletín Oficial del Estado 27 June 2014), Article 1, https://www.bde.es/f/webbde/INF/MenuHorizontal/Normativa/eng/ficheros/Ley_10_2014_LOSSEC.PDF, (accessed 13 January 2022).
[20] Royal decree of 22 August 1885, issuing Spanish code of commerce, English translation, 2012, Article 309, available at: https://www.mjusticia.gob.es/es/AreaTematica/DocumentacionPublicaciones/Documents/Code_of_Comerce_(Codigo_de_Comercio).PDF, (accessed 15 February 2022).

3.3. Hybrid legal systems (Arab legal systems)

Many Arab legislations defined the cash bank deposit in its commercial law, or in a law specific to banking - bank operations - , as in Article 301 of the Egyptian Trade Law which stipulates that ‘a cash deposit is a contract that authorizes the bank to own the deposited money and use of it in accordance with its activity, with an obligation to return the same amount to the depositor in accordance with the terms of the contract.’[21]

Article 339 of the Omani Commercial Law defines a cash bank deposit as ‘a cash deposit, a contract that authorizes the bank to own the money deposited with it and to deploy and use it in accordance with its professional activity with an obligation to return the same amount to the depositor and the refund shall be in the same type of currency.’[22] And that is exactly what Article 115 of the Jordanian Commercial Law stipulates in its first paragraph; stating that, ‘The bank that receives as a deposit a sum of money becomes its property, and it must return it with an equivalent value in one payment or in installments at the depositor’s first request, or according to the conditions, dates or prior notification specified in the contract,’[23] and this is similar to what is stipulated in Article 307 of the Lebanese Commercial Code as well.[24] Articles 414 and 416 of the Qatar Commercial Law[25] provide similar concepts and rules stating that the ownership of the deposited money shifts from the hands of the current account holder to the bank. Article 992 of the UAE civil code stipulates that ‘If the property bailed (deposited) is a sum of money or a thing which can be destroyed by use and the depositor permits the depository to use it, it shall be regarded as a contract of loan.’[26] And similar conceptualization can be found in the Syrian Law in Article 402, and the Libyan Law in Article 232.

The Algerian legislator set a definition of the deposit in the Civil Code (1975), similar to other Arab legislations, Article 590 stipulates that ‘a deposit is a contract whereby the depositor delivers something transferred to the depositor, provided that he maintains and safe keeps it for a period of time.’[27] However, Article 598 of the Algerian Civil Code, which explores types of deposits, states that ‘if the deposit is a sum of money, or something else that is consumed and the depositor is authorized to use it, the contract is considered a loan.’[28] Now the Algerian Money and Credit Law of 2003, defines banking operations according to Article 66 as following ‘Banking operations include receiving money from the public and loan operations, as well as providing and managing means of payment.’[29] Furthermore, Article 67 states ‘Money received from the public is considered money received from others, especially in the form of deposits with the right to use them for the account of the recipient, provided they are returned.’[30] Unsurprisingly, the Algerian legislator’s definition of money deposits is largely similar to the aforementioned French law.

4. Fractional reserve banking system ‘fraud’ debate

Before I delve into the discussion part of this article, I would like to concisely exhibit the fraudulence of the fractional reserve banking system (this is slightly related to the ensuing discussion

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[21] Law No. 17 of 1999 issuing the Egyptian Trade Law, Article 301, https://www.ilo.org/dyn/natlex/natlex4.detail?p_isn=54063&p_lang=en, (accessed 15 March 2022).

[22] Oman Royal decree No. 55/90 of 1990 issuing the Commercial Law, Article 339, https://omanportal.gov.om/wps/wcm/connect/7b72e2d8-ba8e-48d4-b44e-c7c3570b639b/OMAN+I+COMMERCIAL+law1.pdf?MOD=AJPERES, (accessed 16 March 2022).

[23] Jordan Commercial Law No. 12 of 1966, Article 115, https://maqam.najah.edu/legislation/16/, (accessed 16 March 2022).

[24] Lebanese Code of Commerce legislative-decree No. 304 of 24/12/1942, Article 307, http://www.e-lawyerassistance.com/LegislationsPDF/lebanon/commercialcodeAr.pdf, (accessed 16 March 2022).

[25] Qatar Commercial Law No. 27 of 2006, Articles 414-416, https://wipolex.wipo.int/en/legislation/details/10390, (accessed 16 March 2022).

[26] Federal Law No. 5 of 1985 on the Civil Transactions Law of the United Arab Emirates, Article 992, https://legaladviceme.com/legislation/126/uae-federal-law-5-of-1985-on-civil-transactions-law-of-united-arab-emirates, (accessed 17 March 2022).

[27] Algerian Civil Code, order No. 75-58 of September the 26th 1975, Article 590, https://www.trans-lex.org/603300/_/algerian-civil-code-order-no-75-58-of-september-the-26th-1975/, (accessed 17 March 2022).

[28] Ibid, Article 598.

[29] Algerian Order 03-11 of August 26th, 2003, relating to Money and Credit, Article 66, https://www.commerce.gov.dz/ar/reglementation/ordonnance-n-deg-03-11.

[30] Ibid, Article 67.

section of this article). The vast majority of proponents of fractional reserve banking (like White[31]) put forward a central point of argument which is that for fraud to exist, someone must be deceived, and the overwhelming majority of bank customers do not consider themselves to be duped. This argument neglects the fact that there are all degrees of (deceiving and duping) from slight misrepresentation to grave and judiciously thought out fraud. And the extent of it varies depending on the fraud claims and charges involved. Now for the sake of the argument, let us consider White's position, which is as follows: a fractional reserve bank promises to return the exact sum deposited to depositors. Then the money is loaned out or invested by the bank and that involves the risk that these loans or investments go bad. And sure in the long run, once every twenty or thirty years loans do go wrong, which puts one or more large banks in a position of default since they can't repay all the money they owe depositors. So they go bust, but how much fraud or misrepresentation takes place there? Of course commercial banks do not advertise nor disclose the fact that there is a one in ten or twenty chance that depositors and similar bank creditors will lose their money! Au contraire: their publicity typically stresses the safety of the relevant bank. Hence, there is undoubtedly an element of fraud there. And although the contract governing an account at a typical bank may say something different, it is near irrelevant (according to them). The typical bank customer does not read nor understand what is written in the contract. Therefore, banks are guilty of a certain amount of misrepresentation (fraud and duping). The actual degree of this fraud actually depends on their capital ratios. Example, in a scenario of a 10% capital ratio, a bank effectively declares that it will not go insolvent because there is a minimal chance of its assets falling in value by more than about 10%, a claim which is clearly irrational and blatantly dishonest. That is why, the higher the capital ratio, the less the fraud until the bank reaches the 100% ratio. And that is full reserve banking system pure and simple and entirely fraud free.[32]

5. Discussion

I must draw the attention to the fact that this discussion (and the article in its entirety) deals with the demand deposit (current account) and not the other types of deposit contracts (time deposit and all its subtypes). In addition to that, keep in mind that both conventional and Islamic banks operate under the fractional reserve system (they do not keep 100% reserves), which is relevant to the ensuing discussion.

All today's legal systems and the majority of jurists consider the current account (demand deposit) as a loan contract, as displayed in the previous part of this article, and in an effort to challenge this characterization, this part of the research paper will discuss this conceptualization by providing solid arguments from economic and legal perspectives.

First, we can all agree that there is an objective nature of legal concepts such as "deposit", "loan" and "property." Hence the essence of loan and deposit exists independently of subjective interpretations.

It is very important to draw the attention to the fact that the debtor-creditor characterization adopted by all legislations and legal systems contradicts many aspects of the debtor-creditor covenant. Evidently, the bank cannot be obliged to seek out its creditor, or to repay the loan it was due as soon as the customer had had the money paid into its account. On the contrary, unlike any ordinary creditor, the customer have no right to demand repayment of the deposit at any time and place. Rather, it was blatantly established that the bank's obligation was not a debt pure and simple, in a way that would permit the customer to sue for it without warning, but rather a debt for which demand had to be made, and at the branch linked with the account (where it was opened and held). Under the umbrella of practical business necessity, the leading legal authority resorted to customs of bankers and the course

[31] L.H., White, 'Accounting for Fractional-Reserve Banknotes and Deposits - or, What's Twenty Quid to the Bloody Midland Bank?' *Independent Review*, vol.7, no.3, 2003, pp. 423-425. http://www.independent.org/pdf/tir/tir_07_3_white.pdf (accessed 18 October 2022).

[32] R.S., Musgrave, 'The Solution is Full Reserve / 100% Reserve Banking', MPRA Paper 57955, University Library of Munich, Germany, 2014, p. 57-58. https://mpra.ub.uni-muenchen.de/57955/1/MPRA_paper_57955.pdf (accessed 18 October 2022).

of business to explain the discrepancies with ordinary debtor-creditor law.[33] But this raises an intriguing question, shouldn't the leading authority take into account the interests and vulnerabilities of the customer? Basing a jurisprudence on the course of business and custom of bankers is sound and understandable, only when dealing with business law matters, in which both parties are conducting a commercial and business activity. That is why, even proponents of the characterization of the demand deposit as a loan contract admit that bending the ordinary law of debtor-creditor to shelter and take in the bank-customer relationship might engender confusion and ambiguity around this relationship and the nature of the deposit-taking activity of the bank.

Commenting on *Foley v. Hill*, Lord Chorley concisely noted that the lack of development of modern contract law in 1848 led the judges to accept and endorse the long-established cause of action in debt as an explanation of the bank-customer relationship.[34]

Furthermore, it appears that the basis for this jurisprudence is in contract. In fact, they established that contract dominates the law relating to the customer's money deposit with the bank. In *Bank of Marin v. England* (1966), the US Supreme Court declared that the relationship of bank and depositor is that of debtor and creditor, founded upon contract.[35]

So, the other line of argument here is; contract is pervasive. Since these demand deposit (current account) contracts are standard-form contracts, known as contracts of adhesion (in both legislations: Civil law - French Civil Code, 2018, Art. 1110[36] - and Common law - *Steven v. Fidelity & Casualty Co*., 1962[37]), they put the customer in a weaker position due to the unequal power relations inherent in this type of contracts. Which adds another compelling reason for the leading authority to take into account the interests and vulnerabilities of the customer, when striving to explain the deviations of the debtor-creditor relationship (in a demand deposit contract) from ordinary debtor-creditor law. So when judges and legislators invoke the implied terms rule in their attempt to explain the ambiguity embedded in the demand deposit contract (I used the word 'embedded' because this is a contract of adhesion drafted by the bank and the customer has no bargaining power), common legal sense would dictate that if the terms of a contract are ambiguous, the bank 'the party responsible for drafting the contract' should not benefit from the ambiguity caused by it. The ambiguity in this case is even suspicious and unacceptable since the bank could 'and should' have simply drafted the contract as a loan covenant with a clear and straightforward language (legal nature and clauses). When banks grant loans they use standard-form contracts drafted as loan covenants, there is no ambiguity concerning the legal essence and characterization of these loan contracts, unlike the demand deposit contracts.

What is more, under the *contra proferentem* rule, where there is doubt about the meaning of the contract or a dispute involving the ambiguity of a term in a written contract the courts interpret standard form contracts against the party that drafted the contract for their benefit, because only that party (the bank in this case) had the ability to draft the contract to remove ambiguity.[38]

Now the leading legal authority (in both Civil law and Common law jurisprudences) intervened to elucidate the ambiguity surrounding the demand deposit covenant, however they did not explain it under the rule of *contra proferentem* nor did they protect the weaker party (the customer/depositor) of the adhesion contract. The standard-form contract of the current account (demand deposit) does not clearly state that it is a loan contract, nor does it inform of a debtor-creditor relationship between the customer and the bank. Furthermore, from a social and economic perspective, the bank is the service provider (granting loans) not the customer, as when the customer deposits his money with the bank in the form of a time deposit or investment deposit, he obviously knows without a shadow of doubt that he is loaning the bank in return for an interest or a profit, so

[33] Cranston, p. 132.
[34] L. Chorley, *The law of Contract in Relation to the Law of Banking*, Gilbart Lectures on Banking, London, 1964, pp. 6-7.
[35] *Bank of Marin v. England* (1966) 385 U.S. 99.
[36] French Civil Code Loi No. 1999-5 of 6 January 1999, https://www.legifrance.gouv.fr/codes/article_lc/LEGIARTI000036829815, (accessed 7 June 2022).
[37] *Steven v. Fidelity Casualty Co.* (1962) 58 Cal.2d 862, 27 Cal.Rptr. 172, 377 P.2d 284.
[38] S. Wright, Contract law: the contra proferentem rule, *Gibbs Wright litigation lawyers* [website], https://gibbswrightlawyers.com.au/publications/contract-law-the-contra-proferentem-rule, (accessed 28 October 2022).

the bank is still the service provider. This conceptualization does not accord with the demand deposit where under the debtor-creditor legislation the customer becomes a service provider without any profit or interest in return.

Another line of argument revolves around the fact that the demand deposit contract is a standard-form contract which involves putting the burden on the drafting party to show that the provisions included in the contract were "worth judicial enforcement" over the applicable default rules “the rules that govern a deposit contract”. This would also involve deeming the customer’s reasonable expectations of the transaction to be the contract, and that if the standardized form granted the drafter "contractual discretionary power," that power's exercise "cannot nullify or contradict the contract." similarly, based on the concept of reasonable expectations, The Restatement Second of Contracts stated that if the dominant party had reason to know that the weaker assenting party "would not do so if he knew that the writing contained a particular term, the term is not part of the agreement."[39]

Now let us look into the conversion of the current account from a demand deposit into a loan, the discussion tackles the economic and legal problems and questions stemming from this characterization. By examining the purpose or cause of each respective contract, we can deduce a radical distinction between them. In a demand deposit contract, the depositor wishes to safe-keep and maintain the availability of his deposited money at all times. Depositors do not give up the availability of their money but retain the right to withdraw them on demand. This essential purpose of the deposit contract is valid regardless of the type or particular characteristics of the deposited good (fungible or non-fungible). By comparison, a loan contract involves the loss of the availability of the money (or other goods) for an agreed upon time. The lender is willingly giving up availability out of generosity or for an agreed upon interest. Therefore, the borrower gains the availability and utilization of the money for a fixed and determined term, while the lender relinquishes the availability and sacrifices the utilization. In sharp contrast, in a demand deposit only the depositor retains the complete and continuous availability of the money and its utilization. This is attractive to depositors because they regard the money safer under the custody of the depositary and they can benefit from the offered convenience services such as ATMs, debit cards, etc.

More importantly, the distinct economic foundation on which each contract is based lays down the basis for the essential difference between the two contracts. Ludwig Von Mises argues that if the loan in the economic sense means the exchange of a present good or a present service against a future good or a future service, then it is hardly possible to include the transactions in question [irregular deposits or demand deposits] under the conception of credit. A depositor of a sum of money who acquires in exchange for it a claim convertible into money at any time which will perform exactly the same service for him as the sum it refers to, has exchanged no present good for a future good. The claim that he has acquired by his deposit is also a present good for him. The depositing of the money in no way means that he has renounced immediate disposal over the utility that it commands.[40]

Notice that ‘a claim convertible into money’ in today’s forms includes cheques, debit cards, smart phone paying apps and ATM’s services (available balance and cash withdrawals). Von Mises rejects the characterization of the demand deposit as a credit transaction, because of the absence of the essential element, namely the exchange of present goods for future goods.

Hence, from an economic point of view the difference between the two contracts is quite clear: the loan entails the exchange of present goods for future goods, unlike the demand deposit. As a result, in the demand deposit the availability of the deposited goods is not transferred, it remains continuously available to the depositor, whereas in the loan contract the availability of the goods is always transferred from the lender to the borrower.

In addition, in economics the loan contract involves an interest payment closely related to the exchange of present goods for future goods, although interest payment may be waived out of generosity by the lender. However, only the lender can willingly forgo his right to an interest payment

[39] P. Linzer, ‘Implied, Inferred, and Imposed: Default Rules and Adhesion Contracts - the Need for Radical Surgery’, *Pace Law Rev*iew, vol. 28:195, 2008, p. 12, https://digitalcommons.pace.edu/plr/vol28/iss2/3, (accessed 13 September 2022).
[40] L. Von Mises, *The Theory of Money and Credit*, Liberty Classics, Indianapolis, Ind, 1980, pp. 300-301.

and that should not be forced upon him in a contract of adhesion drafted by the bank. On the other hand, as there is no exchange of present goods for future goods in the demand deposit contract there is no such interest payment. The fact that the depositor holds the right to withdraw his deposit at any time along with the depositary's corresponding obligation to maintain continuous availability of the same amount of the deposited money impose an absolute impossibility of including an interest agreement in the demand deposit contract.[41]

To sum up, the incompatibility with an interest agreement, the uninterrupted and continuous availability of the deposited money and the absence of the exchange of present goods for future goods are economic foundational differences that arise from the distinctive legal nature and essence of the 'irregular' demand deposit contract, which contrasts deeply with the loan contract's legal essence.

This brings us to the fundamental legal differences between the two contracts. First and foremost, we have two radically distinct and different causes or purposes of the contract. While the essential purpose of the loan contract is to transfer of the availability of the loaned good or money to the borrower granting him the use of it for a period of time, the essential purpose or cause for the depositor in a demand deposit contract is the custody or safekeeping of the money, which is closely connected with the continuous availability of the deposited money to the depositor. Moreover, a maximum or determinable term is an essential element identifying a loan contract. But the deposit contract lacks a term for returning the money because it is "on demand" and the depositor retains full availability and the right to withdraw his money at any time. Civil law experts unanimously agree that a term is essential to a loan contract, which excludes the irregular deposit contract since it has no term.[42]

The other essential legal difference pertains to the obligations of the two parties: in the irregular deposit contract the legal obligation consists of the custody or safekeeping of the deposited money (the same amount), which must be kept continually available to the depositor. In contrast, this obligation does not exist in the loan contract, and the borrower have the right to use the loaned money with total freedom. This helps immensely when we speak of the legal "transfer of ownership" in the two contracts, as they are very dissimilar concepts. Complete transfer of ownership and availability from lender to borrower is only found in the loan contract. Here the loaner transfers the full property title 'ownership' of the money to the borrower, however in a demand deposit he just transfers the physical possession not the full ownership, as he retains the right to claim it at any time. Essentially, he does not transfer the full availability to the depositary, as he maintains the full availability of the money. This is why demand deposits are problematic because the depository uses and lends part of the deposit acting as the owner. This creates duplicate property titles, which violates natural law and all subsequent laws. Complete transfer of ownership and availability from lender to borrower is only found in the loan contract. Here the loaner transfers the full property title of the money to the borrower, however in a demand deposit he just transfers the physical possession not the full ownership, as he retains the right to claim it at any time. Essentially, he does not transfer the full availability to the depositary, as he maintains the full availability of the money. This is why demand deposits are problematic because the depository uses and lends part of the deposit acting as the owner. So under title transfer theory of contracts, this creates duplicate property titles, which violates natural law and all subsequent laws.[43]

Since all banks today operate under the fractional reserve system (they don't keep 100 percent reserves) we can further assess the demand deposit from a legal point of view in several ways.

I will start with a concise portrayal, if the aim of the depositor is to have full availability of the deposited money while the bank receives the money with the purpose of taking full ownership to grant loans to third parties, we end up with conflicting purposes of the contract, which makes it voidable as this commercial interaction lacks a real "meeting of the minds or intentions".

Therefore, it seems obvious that each of the parties to the demand deposit contract thinks it is

[41] Huerta de Soto, p. 16.
[42] Ibid, p. 18.
[43] E. Medina & P. Bagus, 'A Critique of the Pure Natural Law Approach to Loan Maturity Mismatching and Fractional Reserve Banking'. *Dialogi Polityczne*, 2018, p. 13, http://dx.doi.org/10.12775/DP.2018.001.

taking part into a different contract. If depositors hand over money thinking they are making a deposit, while the bank receives it as thinking it is a loan, what kind of contract that contains two disparate legal causes do we have here? How can both parties simultaneously retain the availability of the same amount of deposited/loaned money? Because banks don't keep 100 percent of the same amount of deposited money in their possession at all times, but rather use most of what they receive to make personal loans and investments, and because the depositor is illogically promised full availability of the money he deposited, we end up with "dual availability" which is very disquieting and confusing from a legal perspective, how can the deposited money be simultaneously available to both the bank and the customer.[44] Therefore, rather than to say it is difficult to come up with a legal description of this contract, it would be more accurate and honest to say such contract is legally impossible.

The reality is that a contract with all its underlying rights and obligations should be legally clarified and determined before the execution of the contract. Because the demand deposit is a standard-form contract drafted by the bank, the burden of clarifying the essence and legal nature of this contract falls upon the bank's shoulders. The bank should state in the demand deposit 'current account' contract that it is a loan, just like it does when granting loans to other borrowers (it lends money through standard-form loan contracts). It is unacceptable to expect an ordinary customer/ depositor (the weaker party) to enter into a contract that lacks a clear legal characterization, which is to be explained and decided by the stronger party that drafted the standard-form contract and its advocates and defenders. If the depositor was informed that the contract he is entering into is a loan contract by which he will grant a loan to the bank, making him relinquish availability, utilization and ownership of his money, he would certainly not think of the contract as if it were a deposit, and he might well decide to keep the money out of the bank.

So, with this type of contract, either the depositor finds himself deceived if he believes that full availability of the money deposited exists or he is party of an unenforceable contract with contradictory purposes.

Evidently, the bank cannot use the deposited money (loan it to a third party) while that same money is still owned by the depositor and available to him at all times, to withdraw it or use it by other means of payment, such as cheques and debit cards. If his bank statement states: available balance, available means he is still the owner of the deposited money, So how can it be at the same time 'simultaneously' used by the bank in granting loans to a third party?

Since no depositor intends to grant loans to banks, advocates of this economic and legal conundrum know that when banks treat demand deposits as loans they are failing their customers and acting against their intentions and trust, so they resort to looking at this legal issue from the bank's perspective, ignoring the interests of the customer and the society at large, in their endeavor to defend the bank's position and interests. The depositor in a demand deposit covenant is seeking a service from the bank, which is the safekeeping of his money with continuous availability for him to use it at all times. He has no intention to grant the bank a loan with no profit or interest in return. He is not the service provider. Granting loans is a service exclusively provided by the bank, which is just like time deposits, where depositors know they are relinquishing the ownership and use of their money to the bank because they will benefit from a profit or an interest payment at maturity.

What is the purpose here, is it to serve banks or the individual and the society at large?

To conclude this part of the discussion, I would like to address some misconceptions found in the research of those responding to arguments against the loan theory. Rozeff (2010) argues that depositors relinquish their money property rights in exchange for an account with certain predefined rights.[45] However, since those account rights (such as cash withdrawals and debit card purchases) are inherently related to the money deposited, it becomes unimaginable to enjoy the benefits of the account rights without having (keeping) the property rights to the money deposited and connected to this account. He then says that when banks grant loans they create new money in the form of a purchase of the borrower's IOU in exchange of the bank's IOUs (banknotes). The question is: where

[44] Huerta de Soto, pp. 136-138.
[45] M. Rozeff, 'Rothbard on Fractional Reserve Banking: A Critique', *The Independent Review*, vol. 14, no. 4, 2010, p. 500, https://www.independent.org/pdf/tir/tir_14_04_02_rozeff.pdf, (accessed 20 September 2022).

did they get those banknotes (money)? It must be the money deposited in the demand deposit account of the depositor, which exposes the duplicate property title and dual availability conundrums again. And if they say no this is new money and has nothing to do with the money deposited by the depositor into his demand deposit account, then we say, why do you need to characterize the demand deposit as a loan (why do you need to borrow from depositors of the current account) and why don't you keep full reserves for demand deposits since you don't need or use their money?

6. Conclusion

Demand deposits (current accounts) are regarded as loan contracts in all today's legal systems. Banks are able to obtain funds at extremely low costs thanks to this characterization. Under fractional reserve banking system, in which banks do not maintain 100% reserves, banks use reserves coming primarily from demand deposit accounts to grant loans to third parties. Monetary demand deposits were regarded as deposit (or irregular deposit) contracts up until recently (about 200 years ago). However, since then the theory of the loan contract gained traction and became the universally accepted legal characterization of what a demand deposit is. By comparing the essential elements of this contract with the loan contract from economic and legal perspectives, this study provides solid arguments, which cannot be disregarded, to demonstrate that the demand deposit cannot be a loan contract.

There is clear evidence, with solid arguments that refute the loan theory with regard to the demand deposit contract, in issues pertaining to the debtor-creditor relationship, the standard-form contract and the contractual discretionary power, duplicate property titles, and the distinct economic and legal purposes of the two contracts. Law is not an entirely subjective discipline. Objective legal concepts and foundational principles have long been established and evolved within a reliable referential framework.

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