116th MAINE LEGISLATURE

FIRST REGULAR SESSION-1993

Legislative Document **No. 381**

S.P. 129 In Senate, February 9, 1993

An Act to Enact a New Article on Negotiable Instruments in and to Make Necessary Conforming Amendments to the Uniform Commercial Code.

Reference to the Committee on Judiciary suggested and ordered printed.

JOY J. O'BRIEN
Secretary of the Senate

Presented by Senator CONLEY of Cumberland.
Cosponsored by Senator: HANLEY of Oxford.

S.P. 129 is a two-hundred and forty-three page bill regarding the Uniform Commercial Code and is somewhat less than of general interest. Because of the size and expense of printing this bill, only 100 copies are available (vs. 1400 copies of most L.D.'s). Because of the reduced printing, the normal distribution of Legislative Documents will not be followed on this L.D.

Be it enacted by the People of the State of Maine as follows:

PART A

Sec. A-1. 11 MRSA Art. 3, as amended, is repealed.

Sec. A-2. 11 MRSA Art. 3-A is enacted to read:

ARTICLE 3-A

NEGOTIABLE INSTRUMENTS

PART 1

GENERAL PROVISIONS AND DEFINITIONS

§3-1101. Short title

This Article is known and may be cited as "Uniform Commercial Code -- Negotiable Instruments."

§3-1102. Subject matter

(1) This Article applies to negotiable instruments. It does not apply to money, to payment orders governed by Article 4-A, or to securities governed by Article 8.

(2) If there is conflict between this Article and Article 4 or 9, Article 4 or 9 governs.

(3) Regulations of the Board of Governors of the Federal Reserve System and operating circulars of the Federal Reserve Banks supersede any inconsistent provision of this Article to the extent of the inconsistency.

Uniform Commercial Code Comment

1. Former Article 3 had no provision affirmatively stating its scope. Former Section 3-103 was a limitation on scope. In revised Article 3 [Article 3-A], Section 3-102 [section 3-1102] states that Article 3 [Article 3-A] applies to "negotiable instruments," defined in Section 3-104. Section 3-104(b) [section 3-1104(2)] also defines the term "instrument" as a synonym for "negotiable instrument." In most places Article 3 [Article 3-A] uses the shorter term "instrument." This follows the convention used in former Article 3.

2. The reference in former Section 3-103(1) to "documents of title" is omitted as superfluous because these documents contain no promise to pay money. The definition of "payment

order" in Section 4A-103(a)(1)(iii) [section 4-1103(1)(a)] excludes drafts which are governed by Article 3 [Article 3-A]. Section 3-102(a) [section 3-1102(1)] makes clear that a payment order governed by Article 4-A is not governed by Article 3 [Article 3-A]. Thus, Article 3 [Article 3-A] and Article 4A are mutually exclusive.

Article 8 states in Section 8-102(1)(c) that "A writing that is a certificated security is governed by this Article and not by Article 3, even though it also meets the requirements of that Article." Section 3-102(a) [section 3-1102(1)] conforms to this provision. With respect to some promises or orders to pay money, there may be a question whether the promise or order is an instrument under Section 3-104(a) [section 3-1104(1)] or a certificated security under Section 8-102(1)(a). Whether a writing is covered by Article 3 [Article 3-A] or Article 8 has important consequences. Among other things, under Section 8-207, the issuer of a certificated security may treat the registered owner as the owner for all purposes until the presentment for registration of a transfer. The issuer of a negotiable instrument, on the other hand, may discharge its obligation to pay the instrument only by paying a person entitled to enforce under Section 3-301 [section 3-1301]. There are also important consequences to an indorser. An indorser of a security does not undertake the issuer's obligation or make any warranty that the issuer will honor the underlying obligation, while an indorser of a negotiable instrument becomes secondarily liable on the underlying obligation.

Ordinarily the distinction between instruments and certificated securities in non-bearer form should be relatively clear. A certificated security under Article 8 must be in registered form (Section 8-102(1)(a)(i)) so that it can be registered on the issuer's records. By contrast, registration plays no part in Article 3 [Article 3-A]. The distinction between an instrument and a certificated security in bearer form may be somewhat more difficult and will generally lie in the economic functions of the two writings. Ordinarily, negotiable instruments under Article 3 [Article 3-A] will be separate and distinct instruments, while certificated securities under Article 8 will be either one of a class or series or by their terms divisible into a class or series (Section 8-102(1)(a)(iii)). Thus, a promissory note in bearer form could come under either Article 3 [Article 3-A] if it were simply an individual note, or under Article 8 if it were one of a series of notes or divisible into a series. An additional distinction is whether the instrument is of the type commonly dealt in on securities exchanges or markets or commonly recognized as a medium for investment (Section 8-102(1)(a)(ii)). Thus, a check written in bearer form (i.e., a check made payable to "cash") would not be a

certificated security within Article 8 of the Uniform Commercial Code.

Occasionally, a particular writing may fit the definition of both a negotiable instrument under Article 3 [Article 3-A] and of an investment security under Article 8. In such cases, the instrument is subject exclusively to the requirements of Article 8. Section 8-102(1)(c) and Section 3-102(a) [section 3-1102(1)].

3. Although the terms of Article 3 [Article 3-A] apply to transactions by Federal Reserve Banks, federal preemption would make ineffective any Article 3 [Article 3-A] provision that conflicts with federal law. The activities of the Federal Reserve Banks are governed by regulations of the Federal Reserve Board and by operating circulars issued by the Reserve Banks themselves. In some instances, the operating circulars are issued pursuant to a Federal Reserve Board regulation. In other cases, the Reserve Bank issues the operating circular under its own authority under the Federal Reserve Act, subject to review by the Federal Reserve Board. Section 3-102(c) [section 3-1102(3)] states that Federal Reserve Board regulations and operating circulars of the Federal Reserve Banks supersede any inconsistent provision of Article 3 [Article 3-A] to the extent of the inconsistency. Federal Reserve Board regulations, being valid exercises of regulatory authority pursuant to a federal statute, take precedence over state law if there is an inconsistency. Childs v. Federal Reserve Bank of Dallas, 719 F.2d 812 (5th Cir. 1983), reh. den. 724 F.2d 127 (5th Cir. 1984). Section 3-102(c) [section 3-1102(3)] treats operating circulars as having the same effect whether issued under the Reserve Bank's own authority or under a Federal Reserve Board regulation. Federal statutes may also preempt Article 3 [Article 3-A]. For example, the Expedited Funds Availability Act, 12 U.S.C. § 4001 et seq., provides that the Act and the regulations issued pursuant to the Act supersede any inconsistent provisions of the UCC. 12 U.S.C. § 4007(b).

4. In Clearfield Trust Co. v. United States, 318 U.S. 363 (1943), the Court held that if the United States is a party to an instrument, its rights and duties are governed by federal common law in the absence of a specific federal statute or regulation. In United States v. Kimbell Foods, Inc., 440 U.S. 715 (1979), the Court stated a three-pronged test to ascertain whether the federal common-law rule should follow the state rule. In most instances courts under the Kimbell test have shown a willingness to adopt UCC rules in formulating federal common law on the subject. In Kimbell the Court adopted the priorities rules of Article 9.

5. In 1989 the United Nations Commission on International Trade Law completed a Convention on International Bills of

Exchange and International Promissory Notes. If the United States becomes a party to this Convention, the Convention will preempt state law with respect to international bills and notes governed by the Convention. Thus, an international bill of exchange or promissory note that meets the definition of instrument in Section 3-104 [section 3-1104] will not be governed by Article 3 [Article 3-A] if it is governed by the Convention.

§3-1103. Definitions

(1) In this Article, unless the context indicates otherwise, the following terms have the following meanings.

(a) "Acceptor" means a drawee who has accepted a draft.

(b) "Drawee" means a person ordered in a draft to make payment.

(c) "Drawer" means a person who signs or is identified in a draft as a person ordering payment.

(d) "Good faith" means honesty in fact and the observance of reasonable commercial standards of fair dealing.

(e) "Maker" means a person who signs or is identified in a note as a person undertaking to pay.

(f) "Order" means a written instruction to pay money signed by the person giving the instruction. The instruction may be addressed to any person, including the person giving the instruction, or to one or more persons jointly or in the alternative but not in succession. An authorization to pay is not an order unless the person authorized to pay is also instructed to pay.

(g) "Ordinary care" in the case of a person engaged in business means observance of reasonable commercial standards, prevailing in the area in which the person is located, with respect to the business in which the person is engaged. In the case of a bank that takes an instrument for processing for collection or payment by automated means, reasonable commercial standards do not require the bank to examine the instrument if the failure to examine does not violate the bank's prescribed procedures and the bank's procedures do not vary unreasonably from general banking usage not disapproved by this Article or Article 4.

(h) "Party" means a party to an instrument.

(i) "Promise" means a written undertaking to pay money signed by the person undertaking to pay. An acknowledgment of an obligation by the obligor is not a promise unless the obligor also undertakes to pay the obligation.

(j) "Prove" with respect to a fact means to meet the burden of establishing the fact (section 1-201, subsection (8)).

(k) "Remitter" means a person who purchases an instrument from its issuer if the instrument is payable to an identified person other than the purchaser.

(2) Other definitions applying to this Article and the sections in which they appear are:

"Acceptance"	Section 3-1409
"Accommodated party"	Section 3-1419
"Accommodation party"	Section 3-1419
"Alteration"	Section 3-1407
"Anomalous indorsement"	Section 3-1205
"Blank indorsement"	Section 3-1205
"Cashier's check"	Section 3-1104
"Certificate of deposit"	Section 3-1104
"Certified check"	Section 3-1409
"Check"	Section 3-1104
"Consideration"	Section 3-1303
"Draft"	Section 3-1104
"Holder in due course"	Section 3-1302
"Incomplete instrument"	Section 3-1115
"Indorsement"	Section 3-1204
"Indorser"	Section 3-1204
"Instrument"	Section 3-1104
"Issue"	Section 3-1105
"Issuer"	Section 3-1105
"Negotiable instrument"	Section 3-1104
"Negotiation"	Section 3-1201
"Note"	Section 3-1104
"Payable at a definite time"	Section 3-1108
"Payable on demand"	Section 3-1108
"Payable to bearer"	Section 3-1109
"Payable to order"	Section 3-1109
"Payment"	Section 3-1602
"Person entitled to enforce"	Section 3-1301
"Presentment"	Section 3-1501
"Reacquisition"	Section 3-1207
"Special indorsement"	Section 3-1205
"Teller's check"	Section 3-1104
"Transfer of instrument"	Section 3-1203
"Traveler's check"	Section 3-1104
"Value"	Section 3-1303

(3) The following definitions in other Articles apply to this Article:

"Bank"	Section 4-105
"Banking day"	Section 4-104
"Clearing house"	Section 4-104
"Collecting bank"	Section 4-105
"Depositary bank"	Section 4-105
"Documentary draft"	Section 4-104
"Intermediary bank"	Section 4-105
"Item"	Section 4-104
"Payor bank"	Section 4-105
"Suspends payments"	Section 4-104

(4) In addition Article 1 contains general definitions and principles of construction and interpretation applicable throughout this Article.

Uniform Commercial Code Comment

1. Subsection (a) [subsection (1)] defines some common terms used throughout the Article that were not defined by former Article 3 and adds the definitions of "order" and "promise" found in former Section 3-102(1)(b) and (c).

2. The definition of "order" includes an instruction given by the signer to itself. The most common example of this kind of order is a cashier's check: a draft with respect to which the drawer and drawee are the same bank or branches of the same bank. Former Section 3-118(a) [section 3-118(1)] treated a cashier's check as a note. It stated "a draft drawn on the drawer is effective as a note." Although it is technically more correct to treat a cashier's check as a promise by the issuing bank to pay rather than an order to pay, a cashier's check is in the form of a check and it is normally referred to as a check. Thus, revised Article 3 [Article 3-A] follows banking practice in referring to a cashier's check as both a draft and a check rather than a note. Some insurance companies also follow the practice of issuing drafts in which the drawer draws on itself and makes the draft payable at or through a bank. These instruments are also treated as drafts. The obligation of the drawer of a cashier's check or other draft drawn on the drawer is stated in Section 3-412 [section 3-1412].

An order may be addressed to more than one person as drawee either jointly or in the alternative. The authorization of alternative drawees follows former Section 3-102(1)(b) and recognizes the practice of drawers, such as corporations issuing dividend checks, who for commercial convenience name a number of

drawees, usually in different parts of the country. Section 3-501(b)(1) [section 3-1501(2)(a)] provides that presentment may be made to any one of multiple drawees. Drawees in succession are not permitted because the holder should not be required to make more than one presentment. Dishonor by any drawee named in the draft entitles the holder to rights of recourse against the drawer or indorsers.

3. The last sentence of subsection (a)(9) [subsection (1)(i)] is intended to make it clear that an I.O.U. or other written acknowledgement of indebtedness is not a note unless there is also an undertaking to pay the obligation.

4. Subsection (a)(4) [subsection (1)(d)] introduces a definition of good faith to apply to Articles 3 [Article 3-A] and 4. Former Articles 3 and 4 used the definition in Section 1-201(19). The definition in subsection (a)(4) [subsection (1)(d)] is consistent with the definitions of good faith applicable to Articles 2, 2A, 4, and 4A. The definition requires not only honesty in fact but also "observance of reasonable commercial standards of fair dealing." Although fair dealing is a broad term that must be defined in context, it is clear that it is concerned with the fairness of conduct rather than the care with which an act is performed. Failure to exercise ordinary care in conducting a transaction is an entirely different concept than failure to deal fairly in conducting the transaction. Both fair dealing and ordinary care, which is defined in Section 3-103(a)(7) [section 3-1103(1)(g)], are to be judged in the light of reasonable commercial standards, but those standards in each case are directed to different aspects of commercial conduct.

5. Subsection (a)(7) [subsection (1)(g)] is a definition of ordinary care which is applicable not only to Article 3 [Article 3-A] but to Article 4 as well. See Section 4-104(c) [section 4-104(3)]. The general rule is stated in the first sentence of subsection (a)(7) [subsection (1)(g)] and it applies both to banks and to persons engaged in businesses other than banking. Ordinary care means observance of reasonable commercial standards of the relevant business prevailing in the area in which the person is located. The second sentence of subsection (a)(7) [subsection (1)(g)] is a particular rule limited to the duty of a bank to examine an instrument taken by a bank for processing for collection or payment by automated means. This particular rule applies primarily to Section 4-406 and it is discussed in Comment 4 to that section. Nothing in Section 3-103(a)(7) [section 3-1103(1)(g)] is intended to prevent a customer from proving that the procedures followed by a bank are unreasonable, arbitrary, or unfair.

6. In subsection (c) [subsection (3)] reference is made to a new definition of "bank" in amended Article 4.

§3-1104. Negotiable instrument

(1) Except as provided in subsections (3) and (4), "negotiable instrument" means an unconditional promise or order to pay a fixed amount of money, with or without interest or other charges described in the promise or order, if it:

(a) Is payable to bearer or to order at the time it is issued or first comes into possession of a holder;

(b) Is payable on demand or at a definite time; and

(c) Does not state any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money, but the promise or order may contain:

(i) An undertaking or power to give, maintain or protect collateral to secure payment;

(ii) An authorization or power to the holder to confess judgment or realize on or dispose of collateral; or

(iii) A waiver of the benefit of any law intended for the advantage or protection of an obligor.

(2) "Instrument" means a negotiable instrument.

(3) An order that meets all of the requirements of subsection (1), paragraphs (b) and (c) and otherwise falls within the definition of "check" in subsection (6) is a negotiable instrument and a check.

(4) 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.

(5) An instrument is a "note" if it is a promise and is a "draft" if it is an order. If an instrument falls within the definition of both "note" and "draft," a person entitled to enforce the instrument may treat it as either.

(6) "Check" means:

(a) A draft, other than a documentary draft, payable on demand and drawn on a bank; or

(b) A cashier's check or teller's check. An instrument may be a check even though it is described on its face by another term, such as "money order."

(7) "Cashier's check" means a draft with respect to which the drawer and drawee are the same bank or branches of the same bank.

(8) "Teller's check" means a draft drawn by a bank:

(a) On another bank; or

(b) Payable at or through a bank.

(9) "Traveler's check" means an instrument that:

(a) Is payable on demand;

(b) Is drawn on or payable at or through a bank;

(c) Is designated by the term "traveler's check" or by a substantially similar term; and

(d) Requires as a condition to payment a countersignature by a person whose specimen signature appears on the instrument.

(10) "Certificate of deposit" means an instrument containing an acknowledgment by a bank that a sum of money has been received by the bank and a promise by the bank to repay the sum of money. A certificate of deposit is a note of the bank.

Uniform Commercial Code Comment

1. The definition of "negotiable instrument" defines the scope of Article 3 [Article 3-A] since Section 3-102 [section 3-1102] states: "This Article applies to negotiable instruments." The definition in Section 3-104(a) [section 3-1104(1)] incorporates other definitions in Article 3 [Article 3-A]. An instrument is either a "promise," defined in Section 3-103(a)(9) [section 3-1103(1)(i)], or "order," defined in Section 3-103(a)(6) [section 3-1103(1)(f)]. A promise is a written undertaking to pay money signed by the person undertaking to pay. An order is a written instruction to pay money signed by the person giving the instruction. Thus, the term "negotiable instrument" is limited to a signed writing that orders or promises payment of money. "Money" is defined in Section 1-201(24) and is not limited to United States dollars. It also includes a medium of exchange established by a foreign government

or monetary units of account established by an intergovernmental organization or by agreement between two or more nations. Five other requirements are stated in Section 3-104(a) [section 3-1104(1)]: First, the promise or order must be "unconditional." The quoted term is explained in Section 3-106 [section 3-1106]. Second, the amount of money must be "a fixed amount * * * with or without interest or other charges described in the promise or order." Section 3-112(b) [section 3-1112(2)] relates to "interest." Third, the promise or order must be "payable to bearer or to order." The quoted phrase is explained in Section 3-109 [section 3-1109]. An exception to this requirement is stated in subsection (c) [subsection (3)]. Fourth, the promise or order must be payable "on demand or at a definite time." The quoted phrase is explained in Section 3-108 [section 3-1108]. Fifth, the promise or order may not state "any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money" with three exceptions. The quoted phrase is based on the first sentence of N.I.L. Section 5 which is the precursor of "no other promise, order, obligation or power given by the maker or drawer" appearing in former Section 3-104(1)(b). The words "instruction" and "undertaking" are used instead of "order" and "promise" that are used in the N.I.L. formulation because the latter words are defined terms that include only orders or promises to pay money. The three exceptions stated in Section 3-104(a)(3) [section 3-1104(1)(c)] are based on and are intended to have the same meaning as former Section 3-112(1)(b), (c), (d), and (e), as well as N.I.L. § 5(1), (2), and (3). Subsection (b) [subsection (2)] states that "instrument" means a "negotiable instrument." This follows former Section 3-102(1)(e) which treated the two terms as synonymous.

2. Unless subsection (c) [subsection (3)] applies, the effect of subsection (a)(1) [subsection (1)(a)] and Section 3-102(a) [section 3-1102(1)] is to exclude from Article 3 [Article 3-A] any promise or order that is not payable to bearer or to order. There is no provision in revised Article 3 [Article 3-A] that is comparable to former Section 3-805. The Comment to former Section 3-805 states that the typical example of a writing covered by that section is a check reading "Pay John Doe." Such a check was governed by former Article 3 but there could not be a holder in due course of the check. Under Section 3-104(c) [section 3-1104(3)] such a check is governed by revised Article 3 [Article 3-A] and there can be a holder in due course of the check. But subsection (c) [subsection (3)] applies only to checks. The Comment to former Section 3-805 does not state any example other than the check to illustrate that section. Subsection (c) [subsection (3)] is based on the belief that it is good policy to treat checks, which are payment instruments, as negotiable instruments whether or not they contain the words "to

the order of". These words are almost always pre-printed on the check form. Occasionally the drawer of a check may strike out these words before issuing the check. In the past some credit unions used check forms that did not contain the quoted words. Such check forms may still be in use but they are no longer common. Absence of the quoted words can easily be overlooked and should not affect the rights of holders who may pay money or give credit for a check without being aware that it is not in the conventional form.

Total exclusion from Article 3 [Article 3-A] of other promises or orders that are not payable to bearer or to order serves a useful purpose. It provides a simple device to clearly exclude a writing that does not fit the pattern of typical negotiable instruments and which is not intended to be a negotiable instrument. If a writing could be an instrument despite the absence of "to order" or "to bearer" language and a dispute arises with respect to the writing, it might be argued that the writing is a negotiable instrument because the other requirements of subsection (a) [subsection (1)] are somehow met. Even if the argument is eventually found to be without merit it can be used as a litigation ploy. Words making a promise or order payable to bearer or to order are the most distinguishing feature of a negotiable instrument and such words are frequently referred to as "words of negotiability." Article 3 [Article 3-A] is not meant to apply to contracts for the sale of goods or services or the sale or lease of real property or similar writings that may contain a promise to pay money. The use of words of negotiability in such contracts would be an aberration. Absence of the words precludes any argument that such contracts might be negotiable instruments.

An order or promise that is excluded from Article 3 [Article 3-A] because of the requirements of Section 3-104(a) [section 3-1104(1)] may nevertheless be similar to a negotiable instrument in many respects. Although such a writing cannot be made a negotiable instrument within Article 3 [Article 3-A] by contract or conduct of its parties, nothing in Section 3-104 [section 3-1104] or in Section 3-102 [section 3-1102] is intended to mean that in a particular case involving such a writing a court could not arrive at a result similar to the result that would follow if the writing were a negotiable instrument. For example, a court might find that the obligor with respect to a promise that does not fall within Section 3-104(a) [section 3-1104(1)] is precluded from asserting a defense against a bona fide purchaser. The preclusion could be based on estoppel or ordinary principles of contract. It does not depend upon the law of negotiable instruments. An example is stated in the paragraph following Case #2 in Comment 4 to Section 3-302 [section 3-1302].

Moreover, consistent with the principle stated in Section 1-102(2)(b), the immediate parties to an order or promise that is not an instrument may provide by agreement that one or more of the provisions of Article 3 [Article 3-A] determine their rights and obligations under the writing. Upholding the parties' choice is not inconsistent with Article 3 [Article 3-A]. Such an agreement may bind a transferee of the writing if the transferee has notice of it or the agreement arises from usage of trade and the agreement does not violate other law or public policy. An example of such an agreement is a provision that a transferee of the writing has the rights of a holder in due course stated in Article 3 [Article 3-A] if the transferee took rights under the writing in good faith, for value, and without notice of a claim or defense.

Even without an agreement of the parties to an order or promise that is not an instrument, it may be appropriate, consistent with the principles stated in Section 1-102(2), for a court to apply one or more provisions of Article 3 [Article 3-A] to the writing by analogy, taking into account the expectations of the parties and the differences between the writing and an instrument governed by Article 3 [Article 3-A]. Whether such application is appropriate depends upon the facts of each case.

3. Subsection (d) [subsection (4)] allows exclusion from Article 3 [Article 3-A] of a writing that would otherwise be an instrument under subsection (a) [subsection (1)] by a statement to the effect that the writing is not negotiable or is not governed by Article 3 [Article 3-A] . For example, a promissory note can be stamped with the legend NOT NEGOTIABLE. The effect under subsection (d) [subsection (4)] is not only to negate the possibility of a holder in due course, but to prevent the writing from being a negotiable instrument for any purpose. Subsection (d) [subsection (4)] does not, however, apply to a check. If a writing is excluded from Article 3 [Article 3-A] by subsection (d) [subsection (4)], a court could, nevertheless, apply Article 3 [Article 3-A] principles to it by analogy as stated in Comment 2.

4. Instruments are divided into two general categories: drafts and notes. A draft is an instrument that is an order. A note is an instrument that is a promise. Section 3-104(e) [section 3-1104(5)]. The term "bill of exchange" is not used in Article 3 [Article 3-A]. It is generally understood to be a synonym for the term "draft." Subsections (f) [subsection (6)] through (j) [subsection (10)] define particular instruments that fall within the categories of draft and note. The term "draft," defined in subsection (e) [subsection (5)], includes a "check" which is defined in subsection (f) [subsection (6)]. "Check" includes a share draft drawn on a credit union payable through a

bank because the definition of bank (Section 4-104) includes credit unions. However, a draft drawn on an insurance company payable through a bank is not a check because it is not drawn on a bank. "Money orders" are sold both by banks and non-banks. They vary in form and their form determines how they are treated in Article 3 [Article 3-A]. The most common form of money order sold by banks is that of an ordinary check drawn by the purchaser except that the amount is machine impressed. That kind of money order is a check under Article 3 [Article 3-A] and is subject to a stop order by the purchaser-drawer as in the case of ordinary checks. The seller bank is the drawee and has no obligation to a holder to pay the money order. If a money order falls within the definition of a teller's check, the rules applicable to teller's checks apply. Postal money orders are subject to federal law. "Teller's check" is separately defined in subsection (h) [subsection (8)]. A teller's check is always drawn by a bank and is usually drawn on another bank. In some cases a teller's check is drawn on a nonbank but is made payable at or through a bank. Article 3 [Article 3-A] treats both types of teller's check identically, and both are included in the definition of "check." A cashier's check, defined in subsection (g) [subsection (7)], is also included in the definition of "check." Traveler's checks are issued both by banks and non-banks and may be in the form of a note or draft. Subsection (i) [subsection (9)] states the essential characteristics of a traveler's check. The requirement that the instrument be "drawn on or payable at or through a bank" may be satisfied without words on the instrument that identify a bank as drawee or paying agent so long as the instrument bears an appropriate routing number that identifies a bank as paying agent.

The definitions in Regulation CC § 229.2 of the terms "check," "cashier's check," "teller's check," and "traveler's check" are different from the definitions of those terms in Article 3 [Article 3-A].

Certificates of deposit are treated in former Article 3 as a separate type of instrument. In revised Article 3 [Article 3-A], Section 3-104(j) [section 3-1104(10)] treats them as notes.

§3-1105. Issue of instrument

(1) "Issue" means the first delivery of an instrument by the maker or drawer, whether to a holder or nonholder, for the purpose of giving rights on the instrument to any person.

(2) An unissued instrument, or an unissued incomplete instrument that is completed, is binding on the maker or drawer, but nonissuance is a defense. An instrument that is conditionally issued or is issued for a special purpose is binding on the maker or drawer, but failure to fulfill the condition or special purpose is a defense.

(3) "Issuer" applies to issued and unissued instruments and means a maker or drawer of an instrument.

Uniform Commercial Code Comment

1. Under former Section 3-102(1)(a) "issue" was defined as the first delivery to a "holder or a remitter" but the term "remitter" was neither defined nor otherwise used. In revised Article 3 [Article 3-A], Section 3-105(a) [section 3-1105(1)] defines "issue" more broadly to include the first delivery to anyone by the drawer or maker for the purpose of giving rights to anyone on the instrument. "Delivery" with respect to instruments is defined in Section 1-201(14) as meaning "voluntary transfer of possession."

2. Subsection (b) [subsection (2)] continues the rule that nonissuance, conditional issuance or issuance for a special purpose is a defense of the maker or drawer of an instrument. Thus, the defense can be asserted against a person other than a holder in due course. The same rule applies to nonissuance of an incomplete instrument later completed.

3. Subsection (c) [subsection (3)] defines "issuer" to include the signer of an unissued instrument for convenience of reference in the statute.

§3-1106. Unconditional promise or order

(1) Except as provided in this section, for the purposes of section 3-1104, subsection (1), a promise or order is unconditional unless it states:

(a) An express condition to payment;

(b) That the promise or order is subject to or governed by another writing; or

(c) That rights or obligations with respect to the promise or order are stated in another writing. A reference to another writing does not of itself make the promise or order conditional.

(2) A promise or order is not made conditional:

(a) By a reference to another writing for a statement of rights with respect to collateral, prepayment or acceleration; or

(b) Because payment is limited to resort to a particular fund or source.

(3) If a promise or order requires, as a condition to payment, a countersignature by a person whose specimen signature appears on the promise or order, the condition does not make the promise or order conditional for the purposes of section 3-1104, subsection (1). If the person whose specimen signature appears on an instrument fails to countersign the instrument, the failure to countersign is a defense to the obligation of the issuer, but the failure does not prevent a transferee of the instrument from becoming a holder of the instrument.

(4) If a promise or order at the time it is issued or first comes into possession of a holder contains a statement, required by applicable statutory or administrative law, to the effect that the rights of a holder or transferee are subject to claims or defenses that the issuer could assert against the original payee, the promise or order is not thereby made conditional for the purposes of section 3-1104, subsection (1); but if the promise or order is an instrument, there can not be a holder in due course of the instrument.

Uniform Commercial Code Comment

1. This provision replaces former Section 3-105. Its purpose is to define when a promise or order fulfills the requirement in Section 3-104(a) [section 3-1104(1)] that it be an "unconditional" promise or order to pay. Under Section 3-106(a) [section 3-1106(1)] a promise or order is deemed to be unconditional unless one of the two tests of the subsection make the promise or order conditional. If the promise or order states an express condition to payment, the promise or order is not an instrument. For example, a promise states, "I promise to pay $100,000 to the order of John Doe if he conveys title to Blackacre to me." The promise is not an instrument because there is an express condition to payment. However, suppose a promise states, "In consideration of John Doe's promise to convey title to Blackacre I promise to pay $100,000 to the order of John Doe." That promise can be an instrument if Section 3-104 [section 3-1104] is otherwise satisfied. Although the recital of the executory promise of Doe to convey Blackacre might be read as an implied condition that the promise be performed, the condition is not an express condition as required by Section 3-106(a)(i) [section 3-1106(1)(a)]. This result is consistent with former Section 3-105(1)(a) and (b). Former Section 3-105(1)(b) is not repeated in Section 3-106 [section 3-1106] because it is not necessary. It is an example of an implied condition. Former Section 3-105(1)(d), (e), and (f) and the first clause of former Section 3-105(1)(c) are other examples of implied conditions.

They are not repeated in Section 3-106 [section 3-1106] because they are not necessary. The law is not changed.

Section 3-106(a)(ii) and (iii) [section 3-1106(1)(b) and (c)] carry forward the substance of former Section 3-105(2)(a). The only change is the use of "writing" instead of "agreement" and a broadening of the language that can result in conditionality. For example, a promissory note is not an instrument defined by Section 3-104 [section 3-1104] if it contains any of the following statements: 1. "This note is subject to a contract of sale dated April 1, 1990 between the payee and maker of this note." 2. "This note is subject to a loan and security agreement dated April 1, 1990 between the payee and maker of this note." 3. "Rights and obligations of the parties with respect to this note are stated in an agreement dated April 1, 1990 between the payee and maker of this note." It is not relevant whether any condition to payment is or is not stated in the writing to which reference is made. The rationale is that the holder of a negotiable instrument should not be required to examine another document to determine rights with respect to payment. But subsection (b)(i) [subsection (2)(a)] permits reference to a separate writing for information with respect to collateral, prepayment, or acceleration.

Many notes issued in commercial transactions are secured by collateral, are subject to acceleration in the event of default, or are subject to prepayment. A statement of rights and obligations concerning collateral, prepayment, or acceleration does not prevent the note from being an instrument if the statement is in the note itself. See Section 3-104(a)(3) [section 3-1104(1)(c)] and Section 3-108(b) [section 3-1108(2)]. In some cases it may be convenient not to include a statement concerning collateral, prepayment, or acceleration in the note, but rather to refer to an accompanying loan agreement, security agreement or mortgage for that statement. Subsection (b)(i) [subsection (2))b)] allows a reference to the appropriate writing for a statement of these rights. For example, a note would not be made conditional by the following statement: "This note is secured by a security interest in collateral described in a security agreement dated April 1, 1990 between the payee and maker of this note. Rights and obligations with respect to the collateral are [stated in] [governed by] the security agreement." The bracketed words are alternatives, either of which complies.

Subsection (b)(ii) [subsection (2)(b)] addresses the issues covered by former Section 3-105(1)(f), (g), and (h) and Section 3-105(2)(b). Under Section 3-106(a) [section 3-1106(1)] a promise or order is not made conditional because payment is limited to payment from a particular source or fund. This

reverses the result of former Section 3-105(2)(b). There is no cogent reason why the general credit of a legal entity must be pledged to have a negotiable instrument. Market forces determine the marketability of instruments of this kind. If potential buyers don't want promises or orders that are payable only from a particular source or fund, they won't take them, but Article 3 [Article 3-A] should apply.

2. Subsection (c) [subsection (3)] applies to traveler's checks or other instruments that may require a countersignature. Although the requirement of a countersignature is a condition to the obligation to pay, traveler's checks are treated in the commercial world as money substitutes and therefore should be governed by Article 3 [Article 3-A]. The first sentence of subsection (c) [subsection (3)] allows a traveler's check to meet the definition of instrument by stating that the countersignature condition does not make it conditional for the purposes of Section 3-104 [section 3-1104]. The second sentence states the effect of a failure to meet the condition. Suppose a thief steals a traveler's check and cashes it by skillfully imitating the specimen signature so that the countersignature appears to be authentic. The countersignature is for the purpose of identification of the owner of the instrument. It is not an indorsement. Subsection (c) [subsection (3)] provides that the failure of the owner to countersign does not prevent a transferee from becoming a holder. Thus, the merchant or bank that cashed the traveler's check becomes a holder when the traveler's check is taken. The forged countersignature is a defense to the obligation of the issuer to pay the instrument, and is included in defenses under Section 3-305(a)(2) [section 3-1305(1)(b)]. These defenses may not be asserted against a holder in due course. Whether a holder has notice of the defense is a factual question. If the countersignature is a very bad forgery, there may be notice. But if the merchant or bank cashed a traveler's check and the countersignature appeared to be similar to the specimen signature, there might not be notice that the countersignature was forged. Thus, the merchant or bank could be a holder in due course.

3. Subsection (d) [subsection (4)] concerns the effect of a statement to the effect that the rights of a holder or transferee are subject to claims and defenses that the issuer could assert against the original payee. The subsection applies only if the statement is required by statutory or administrative law. The prime example is the Federal Trade Commission Rule (16 C.F.R. Part 433) preserving consumers' claims and defenses in consumer credit sales. The intent of the FTC rule is to make it impossible for there to be a holder in due course of a note bearing the FTC legend and undoubtedly that is the result. But, under former Article 3, the legend may also have had the

unintended effect of making the note conditional, thus excluding the note from former Article 3 altogether. Subsection (d) [subsection (4)] is designed to make it possible to preclude the possibility of a holder in due course without excluding the instrument from Article 3 [Article 3-A]. Most of the provisions of Article 3 [Article 3-A] are not affected by the holder-in-due-course doctrine and there is no reason why Article 3 [Article 3-A] should not apply to a note bearing the FTC legend if holder-in-due-course rights are not involved. Under subsection (d) [subsection (4)] the statement does not make the note conditional. If the note otherwise meets the requirements of Section 3-104(a) [section 3-1104(1)] it is a negotiable instrument for all purposes except that there cannot be a holder in due course of the note. No particular form of legend or statement is required by subsection (d) [subsection (4)]. The form of a particular legend or statement may be determined by the other statute or administrative law. For example, the FTC legend required in a note taken by the seller in a consumer sale of goods or services is tailored to that particular transaction and therefore uses language that is somewhat different from that stated in subsection (d) [subsection (4)], but the difference in expression does not affect the essential similarity of the message conveyed. The effect of the FTC legend is to make the rights of a holder or transferee subject to claims or defenses that the issuer could assert against the original payee of the note.

§3-1107. Instrument payable in foreign money

Unless the instrument otherwise provides, an instrument that states the amount payable in foreign money may be paid in the foreign money or in an equivalent amount in dollars calculated by using the current bank-offered spot rate at the place of payment for the purchase of dollars on the day on which the instrument is paid.

Uniform Commercial Code Comment

The definition of instrument in Section 3-104 [section 3-1104] requires that the promise or order be payable in "money." That term is defined in Section 1-201(24) and is not limited to United States dollars. Section 3-107 [section 3-1107] states than [sic] an instrument payable in foreign money may be paid in dollars if the instrument does not prohibit it. It also states a conversion rate which applies in the absence of a different conversion rate stated in the instrument. The reference in former Section 3-107(1) to instruments payable in "currency" or "current funds" has been dropped as superfluous.

§3-1108. Payable on demand or at definite time

(1) A promise or order is "payable on demand" if it:

(a) States that it is payable on demand or at sight, or otherwise indicates that it is payable at the will of the holder; or

(b) Does not state any time of payment.

(2) A promise or order is "payable at a definite time" if it is payable on elapse of a definite period of time after sight or acceptance or at a fixed date or dates or at a time or times readily ascertainable at the time the promise or order is issued, subject to rights of:

(a) Prepayment;

(b) Acceleration;

(c) Extension at the option of the holder; or

(d) Extension to a further definite time at the option of the maker or acceptor or automatically upon or after a specified act or event.

(3) If an instrument, payable at a fixed date, is also payable upon demand made before the fixed date, the instrument is payable on demand until the fixed date and, if demand for payment is not made before that date, becomes payable at a definite time on the fixed date.

Uniform Commercial Code Comment

This section is a restatement of former Section 3-108 and Section 3-109. Subsection (b) [subsection (2)] broadens former Section 3-109 somewhat by providing that a definite time includes a time readily ascertainable at the time the promise or order is issued. Subsection (b)(iii) and (iv) [subsection (2)(c) and (d)] restates former Section 3-109(1)(d). It adopts the generally accepted rule that a clause providing for extension at the option of the holder, even without a time limit, does not affect negotiability since the holder is given only a right which the holder would have without the clause. If the extension is to be at the option of the maker or acceptor or is to be automatic, a definite time limit must be stated or the time of payment remains uncertain and the order or promise is not a negotiable instrument. If a definite time limit is stated, the effect upon certainty of time of payment is the same as if the instrument were made payable at the ultimate date with a term providing for acceleration.

§3-1109. Payable to bearer or to order

(1) A promise or order is payable to bearer if it:

(a) States that it is payable to bearer or to the order of bearer or otherwise indicates that the person in possession of the promise or order is entitled to payment;

(b) Does not state a payee; or

(c) States that it is payable to or to the order of cash or otherwise indicates that it is not payable to an identified person.

(2) A promise or order that is not payable to bearer is payable to order if it is payable:

(a) To the order of an identified person; or

(b) To an identified person or order.

A promise or order that is payable to order is payable to the identified person.

(3) An instrument payable to bearer may become payable to an identified person if it is specially indorsed pursuant to Section 3-1205, subsection (1). An instrument payable to an identified person may become payable to bearer if it is indorsed in blank pursuant to Section 3-1205, subsection (2).

Uniform Commercial Code Comment

1. Under Section 3-104(a) [section 3-1104(1)], a promise or order cannot be an instrument unless the instrument is payable to bearer or to order when it is issued or unless Section 3-104(c) [section 3-1104(3)] applies. The terms "payable to bearer" and "payable to order" are defined in Section 3-109 [section 3-1109]. The quoted terms are also relevant in determining how an instrument is negotiated. If the instrument is payable to bearer it can be negotiated by delivery alone. Section 3-201(b) [section 3-1201(2)]. An instrument that is payable to an identified person cannot be negotiated without the indorsement of the identified person. Section 3-201(b) [section 3-1201(2)]. An instrument payable to order is payable to an identified person. Section 3-109(b) [section 3-1109(2)]. Thus, an instrument payable to order requires the indorsement of the person to whose order the instrument is payable.

2. Subsection (a) [subsection (1)] states when an instrument is payable to bearer. An instrument is payable to bearer if it states that it is payable to bearer, but some instruments use ambiguous terms. For example, check forms usually have the words "to the order of" printed at the beginning of the line to be filled in for the name of the payee. If the drawer writes in the word "bearer" or "cash," the check reads "to the order of bearer" or "to the order of cash." In each case the check is payable to bearer. Sometimes the drawer will write the name of the payee "John Doe" but will add the words "or bearer." In that case the check is payable to bearer. Subsection (a) [subsection (1)]. Under subsection (b) [subsection (2)], if an instrument is payable to bearer it can't be payable to order. This is different from former Section 3-110(3). An instrument that purports to be payable both to order and bearer states contradictory terms. A transferee of the instrument should be able to rely on the bearer term and acquire rights as a holder without obtaining the indorsement of the identified payee. An instrument is also payable to bearer if it does not state a payee. Instruments that do not state a payee are in most cases incomplete instruments. In some cases the drawer of a check may deliver or mail it to the person to be paid without filling in the line for the name of the payee. Under subsection (a) [subsection (1)] the check is payable to bearer when it is sent or delivered. It is also an incomplete instrument. This case is discussed in Comment 2 to Section 3-115 [section 3-1115]. Subsection (a)(3) [subsection (1)(c)] contains the words "otherwise indicates that it is not payable to an identified person." The quoted words are meant to cover uncommon cases in which an instrument indicates that it is not meant to be payable to a specific person. Such an instrument is treated like a check payable to "cash." The quoted words are not meant to apply to an instrument stating that it is payable to an identified person such as "ABC Corporation" if ABC Corporation is a nonexistent company. Although the holder of the check cannot be the nonexistent company, the instrument is not payable to bearer. Negotiation of such an instrument is governed by Section 3-404(b) [section 3-1404(2)].

§3-1110. Identification of person to whom instrument is payable

(1) The person to whom an instrument is initially payable is determined by the intent of the person, whether or not authorized, signing as, or in the name or behalf of, the issuer of the instrument. The instrument is payable to the person intended by the signer even if that person is identified in the instrument by a name or other identification that is not that of the intended person. If more than one person signs in the name or behalf of the issuer of an instrument and all the signers do not intend the same person as payee, the instrument is payable to any person intended by one or more of the signers.

(2) If the signature of the issuer of an instrument is made by automated means, such as a check-writing machine, the payee of the instrument is determined by the intent of the person who supplied the name or identification of the payee, whether or not authorized to do so.

(3) A person to whom an instrument is payable may be identified in any way, including by name, identifying number, office or account number. For the purpose of determining the holder of an instrument, the following rules apply:

(a) If an instrument is payable to an account and the account is identified only by number, the instrument is payable to the person to whom the account is payable. If an instrument is payable to an account identified by number and by the name of a person, the instrument is payable to the named person, whether or not that person is the owner of the account identified by number.

(b) If an instrument is payable to:

(i) A trust, an estate or a person described as trustee or representative of a trust or estate, the instrument is payable to the trustee, the representative or a successor of either, whether or not the beneficiary or estate is also named;

(ii) A person described as agent or similar representative of a named or identified person, the instrument is payable to the represented person, the representative or a successor of the representative;

(iii) A fund or organization that is not a legal entity, the instrument is payable to a representative of the members of the fund or organization; or

(iv) An office or to a person described as holding an office, the instrument is payable to the named person, the incumbent of the office or a successor to the incumbent.

(4) If an instrument is payable to 2 or more persons alternatively, it is payable to any of them and may be negotiated, discharged or enforced by any or all of them in possession of the instrument. If an instrument is payable to 2 or more persons not alternatively, it is payable to all of them and may be negotiated, discharged or enforced only by all of them. If an instrument payable to 2 or more persons is ambiguous as to whether it is payable to the persons alternatively, the instrument is payable to the persons alternatively.

Uniform Commercial Code Comment

1. Section 3-110 [section 3-1110] states rules for determining the identity of the person to whom an instrument is initially payable if the instrument is payable to an identified person. This issue usually arises in a dispute over the validity of an indorsement in the name of the payee. Subsection (a) [subsection (1)] states the general rule that the person to whom an instrument is payable is determined by the intent of "the person, whether or not authorized, signing as, or in the name or behalf of, the issuer of the instrument." "Issuer" means the maker or drawer of the instrument. Section 3-105(c) [section 3-1105(3)]. If X signs a check as drawer of a check on X's account, the intent of X controls. If X, as President of Corporation, signs a check as President in behalf of Corporation as drawer, the intent of X controls. If X forges Y's signature as drawer of a check, the intent of X also controls. Under Section 3-103(a)(3) [section 3-1103(1)(c)], Y is referred to as the drawer of the check because the signing of Y's name identifies Y as the drawer. But since Y's signature was forged Y has no liability as drawer (Section 3-403(a) [section 3-1403(1)]) unless some other provision of Article 3 [Article 3-A] or Article 4 makes Y liable. Since X, even though unauthorized, signed in the name of Y as issuer, the intent of X determines to whom the check is payable.

In the case of a check payable to "John Smith," since there are many people in the world named "John Smith" it is not possible to identify the payee of the check unless there is some further identification or the intention of the drawer is determined. Name alone is sufficient under subsection (a) [subsection (1)], but the intention of the drawer determines which John Smith is the person to whom the check is payable. The same issue is presented in cases of misdescriptions of the payee. The drawer intends to pay a person known to the drawer as John Smith. In fact that person's name is James Smith or John Jones or some other entirely different name. If the check identifies the payee as John Smith, it is nevertheless payable to the person intended by the drawer. That person may indorse the check in either the name John Smith or the person's correct name or in both names. Section 3-204(d) [section 3-1204(4)]. The intent of the drawer is also controlling in fictitious payee cases. Section 3-404(b) [section 3-1404(2)]. The last sentence of subsection (a) [subsection (1)] refers to rare cases in which the signature of an organization requires more than one signature and the persons signing on behalf of the organization do not all intend the same person as payee. Any person intended by a signer for the organization is the payee and an indorsement by that person is an effective indorsement.

Subsection (b) [subsection (2)] recognizes the fact that in a large number of cases there is no human signer of an instrument because the instrument, usually a check, is produced by automated means such as a check-writing machine. In that case, the relevant intent is that of the person who supplied the name of the payee. In most cases that person is an employee of the drawer, but in some cases the person could be an outsider who is committing a fraud by introducing names of payees of checks into the system that produces the checks. A check-writing machine is likely to be operated by means of a computer in which is stored information as to name and address of the payee and the amount of the check. Access to the computer may allow production of fraudulent checks without knowledge of the organization that is the issuer of the check. Section 3-404(b) [section 3-1404(2)] is also concerned with this issue. See Case #4 in Comment 2 to Section 3-404 [section 3-1404].

2. Subsection (c) [subsection (3)] allows the payee to be identified in any way including the various ways stated. Subsection (c)(1) [subsection (3)(a)] relates to instruments payable to bank accounts. In some cases the account might be identified by name and number, and the name and number might refer to different persons. For example, a check is payable to "X Corporation Account No. 12345 in Bank of Podunk." Under the last sentence of subsection (c)(1) [subsection (3)(a)], this check is payable to X Corporation and can be negotiated by X Corporation even if Account No. 12345 is some other person's account or the check is not deposited in that account. In other cases the payee is identified by an account number and the name of the owner of the account is not stated. For example, Debtor pays Creditor by issuing a check drawn on Payor Bank. The check is payable to a bank account owned by Creditor but identified only by number. Under the first sentence of subsection (c)(1) [subsection (3)(a)] the check is payable to Creditor and, under Section 1-201(20), Creditor becomes the holder when the check is delivered. Under Section 3-201(b) [section 3-1201(2)], further negotiation of the check requires the indorsement of Creditor. But under Section 4-205(a), if the check is taken by a depositary bank for collection, the bank may become a holder without the indorsement. Under Section 3-102(b) [section 3-1102(2)], provisions of Article 4 prevail over those of Article 3 [Article 3-A]. The depositary bank warrants that the amount of the check was credited to the payee's account.

3. Subsection (c)(2) [subsection (3)(b)] replaces former Section 3-117 and subsections (1)(e), (f), and (g) of former Section 3-110. This provision merely determines who can deal with an instrument as a holder. It does not determine ownership of the instrument or its proceeds. Subsection (c)(2)(i)

[subsection (3)(b)(i)] covers trusts and estates. If the instrument is payable to the trust or estate or to the trustee or representative of the trust or estate, the instrument is payable to the trustee or representative or any successor. Under subsection (c)(2)(ii) [subsection (3)(b)(ii)], if the instrument states that it is payable to Doe, President of X Corporation, either Doe or X Corporation can be holder of the instrument. Subsection (c)(2)(iii) [subsection (3)(b)(iii)] concerns informal organizations that are not legal entities such as unincorporated clubs and the like. Any representative of the members of the organization can act as holder. Subsection (c)(2)(iv) [subsection (3)(b)(iv)] applies principally to instruments payable to public offices such as a check payable to County Tax Collector.

4. Subsection (d) [subsection (4)] replaces former Section 3-116. An instrument payable to X or Y is governed by the first sentence of subsection (d) [subsection (4)]. An instrument payable to X and Y is governed by the second sentence of subsection (d) [subsection (4)]. If an instrument is payable to X or Y, either is the payee and if either is in possession that person is the holder and the person entitled to enforce the instrument. Section 3-301 [section 3-1301]. If an instrument is payable to X and Y, neither X nor Y acting alone is the person to whom the instrument is payable. Neither person, acting alone, can be the holder of the instrument. The instrument is "payable to an identified person." The "identified person" is X and Y acting jointly. Section 3-109(b) [section 3-1109(2)] and Section 1-102(5)(a) [omitted]. Thus, under Section 1-201(20) X or Y, acting alone, cannot be the holder or the person entitled to enforce or negotiate the instrument because neither, acting alone, is the identified person stated in the instrument.

The third sentence of subsection (d) [subsection (4)] is directed to cases in which it is not clear whether an instrument is payable to multiple payees alternatively. In the case of ambiguity persons dealing with the instrument should be able to rely on the indorsement of a single payee. For example, an instrument payable to X and/or Y is treated like an instrument payable to X or Y.

§3-1111. Place of payment

Except as otherwise provided for items in Article 4, an instrument is payable at the place of payment stated in the instrument. If no place of payment is stated, an instrument is payable at the address of the drawee or maker stated in the instrument. If no address is stated, the place of payment is the place of business of the drawee or maker. If a drawee or maker has more than one place of business, the place of payment is any

place of business of the drawee or maker chosen by the person entitled to enforce the instrument. If the drawee or maker has no place of business, the place of payment is the residence of the drawee or maker.

Uniform Commercial Code Comment

If an instrument is payable at a bank in the United States, Section 3-501(b)(1) [section 3-1501(2)(a)] states that presentment must be made at the place of payment, i.e. the bank. The place of presentment of a check is governed by Regulation CC § 229.36.

§3-1112. Interest

(1) Unless otherwise provided in the instrument:

(a) An instrument is not payable with interest; and

(b) Interest on an interest-bearing instrument is payable from the date of the instrument.

(2) Interest may be stated in an instrument as a fixed or variable amount of money or it may be expressed as a fixed or variable rate or rates. The amount or rate of interest may be stated or described in the instrument in any manner and may require reference to information not contained in the instrument. If an instrument provides for interest, but the amount of interest payable can not be ascertained from the description, interest is payable at the judgment rate in effect at the place of payment of the instrument and at the time interest first accrues.

Uniform Commercial Code Comment

1. Under Section 3-104(a) [section 3-1104(1)] the requirement of a "fixed amount" applies only to principal. The amount of interest payable is that described in the instrument. If the description of interest in the instrument does not allow for the amount of interest to be ascertained, interest is payable at the judgment rate. Hence, if an instrument calls for interest, the amount of interest will always be determinable. If a variable rate of interest is prescribed, the amount of interest is ascertainable by reference to the formula or index described or referred to in the instrument. The last sentence of subsection (b) [subsection (2)] replaces subsection (d) [subsection (4)] of former Section 3-118.

2. The purpose of subsection (b) [subsection (2)] is to clarify the meaning of "interest" in the introductory clause of

Section 3-104(a) [section 3-1104(1)]. It is not intended to validate a provision for interest in an instrument if that provision violates other law.

§3-1113. Date of instrument

(1) An instrument may be antedated or postdated. The date stated determines the time of payment if the instrument is payable at a fixed period after date. Except as provided in section 4-401, subsection (1-B), an instrument payable on demand is not payable before the date of the instrument.

(2) If an instrument is undated, its date is the date of its issue or, in the case of an unissued instrument, the date it first comes into possession of a holder.

Uniform Commercial Code Comment

This section replaces former Section 3-114. Subsections (1) and (3) of former Section 3-114 are deleted as unnecessary. Section 3-113(a) [section 3-1113(1)] is based in part on subsection (2) of former Section 3-114. The rule that a demand instrument is not payable before the date of the instrument is subject to Section 4-401(c) [section 4-401(1-B)] which allows the payor bank to pay a postdated check unless the drawer has notified the bank of the postdating pursuant to a procedure prescribed in that subsection. With respect to an undated instrument, the date is the date of issue.

§3-1114. Contradictory terms of instrument

If an instrument contains contradictory terms, typewritten terms prevail over printed terms, handwritten terms prevail over both and words prevail over numbers.

Uniform Commercial Code Comment

Section 3-114 [section 3-1114] replaces subsections (b) and (c) of former Section 3-118.

§3-1115. Incomplete instrument

(1) "Incomplete instrument" means a signed writing, whether or not issued by the signer, the contents of which show at the time of signing that it is incomplete but that the signer intended it to be completed by the addition of words or numbers.

(2) Subject to subsection (3), if an incomplete instrument is an instrument under section 3-1104, it may be enforced according to its terms if it is not completed or according to its

terms as augmented by completion. If an incomplete instrument is not an instrument under section 3-1104, but after completion the requirements of section 3-1104 are met, the instrument may be enforced according to its terms as augmented by completion.

(3) If words or numbers are added to an incomplete instrument without authority of the signer, there is an alteration of the incomplete instrument under section 3-1407.

(4) The burden of establishing that words or numbers were added to an incomplete instrument without authority of the signer is on the person asserting the lack of authority.

Uniform Commercial Code Comment

1. This section generally carries forward the rules set out in former Section 3-115. The term "incomplete instrument" applies both to an "instrument," i.e. a writing meeting all the requirements of Section 3-104 [section 3-1104], and to a writing intended to be an instrument that is signed but lacks some element of an instrument. The test in both cases is whether the contents show that it is incomplete and that the signer intended that additional words or numbers be added.

2. If an incomplete instrument meets the requirements of Section 3-104 [section 3-1104] and is not completed it may be enforced in accordance with its terms. Suppose, in the following two cases, that a note delivered to the payee is incomplete solely because a space on the pre-printed note form for the due date is not filled in:

Case #1. If the incomplete instrument is never completed, the note is payable on demand. Section 3-108(a)(ii) [section 3-1108(1)(b)]. However, if the payee and the maker agreed to a due date, the maker may have a defense under Section 3-117 [section 3-1117] if demand for payment is made before the due date agreed to by the parties.

Case #2. If the payee completes the note by filling in the due date agreed to by the parties, the note is payable on the due date stated. However, if the due date filled in was not the date agreed to by the parties there is an alteration of the note. Section 3-407 [section 3-1407] governs the case.

Suppose Debtor pays Creditor by giving Creditor a check on which the space for the name of the payee is left blank. The check is an instrument but it is incomplete. The check is enforceable in its incomplete form and it is payable to bearer because it does not state a payee. Section 3-109(a)(2) [section

3-1109(1)(b)]. Thus, Creditor is a holder of the check. Normally in this kind of case Creditor would simply fill in the space with Creditor's name. When that occurs the check becomes payable to the Creditor.

3. In some cases the incomplete instrument does not meet the requirements of Section 3-104 [section 3-1104]. An example is a check with the amount not filled in. The check cannot be enforced until the amount is filled in. If the payee fills in an amount authorized by the drawer the check meets the requirements of Section 3-104 [section 3-1104] and is enforceable as completed. If the payee fills in an unauthorized amount there is an alteration of the check and Section 3-407 [section 3-1407] applies.

4. Section 3-302(a)(1) [section 3-1302(1)(a)] also bears on the problem of incomplete instruments. Under that section a person cannot be a holder in due course of the instrument if it is so incomplete as to call into question its validity. Subsection (d) [subsection (4)] of Section 3-115 [section 3-1115] is based on the last clause of subsection (2) of former Section 3-115.

§3-1116. Joint and several liability; contribution

(1) Except as otherwise provided in the instrument, 2 or more persons who have the same liability on an instrument as makers, drawers, acceptors, indorsers who indorse as joint payees or anomalous indorsers are jointly and severally liable in the capacity in which they sign.

(2) Except as provided in section 3-1419, subsection (5) or by agreement of the affected parties, a party having joint and several liability who pays the instrument is entitled to receive from any party having the same joint and several liability contribution in accordance with applicable law.

(3) Discharge of one party having joint and several liability by a person entitled to enforce the instrument does not affect the right under subsection (2) of a party having the same joint and several liability to receive contribution from the party discharged.

Uniform Commercial Code Comment

1. Subsection (a) [subsection (1)] replaces subsection (e) [subsection (5)] of former Section 3-118. Subsection (b) [subsection (2)] states contribution rights of parties with joint and several liability by referring to applicable law. But subsection (b) [subsection (2)] is subject to Section 3-419(e)

[section 3-1419(5)]. If one of the parties with joint and several liability is an accommodation party and the other is the accommodated party, Section 3-419(e) [section 3-1419(5)] applies. Subsection (c) [subsection (3)] deals with discharge. The discharge of a jointly and severally liable obligor does not affect the right of other obligors to seek contribution from the discharged obligor.

2. Indorsers normally do not have joint and several liability. Rather, an earlier indorser has liability to a later indorser. But indorsers can have joint and several liability in two cases. If an instrument is payable to two payees jointly, both payees must indorse. The indorsement is a joint indorsement and the indorsers have joint and several liability and subsection (b) [subsection (2)] applies. The other case is that of two or more anomalous indorsers. The term is defined in Section 3-205(d) [section 3-1205(4)]. An anomalous indorsement normally indicates that the indorser signed as an accommodation party. If more than one accommodation party indorses a note as an accommodation to the maker, the indorsers have joint and several liability and subsection (b) [subsection (2)] applies.

§3-1117. Other agreements affecting instrument

Subject to applicable law regarding exclusion of proof of contemporaneous or previous agreements, the obligation of a party to an instrument to pay the instrument may be modified, supplemented or nullified by a separate agreement of the obligor and a person entitled to enforce the instrument if the instrument is issued or the obligation is incurred in reliance on the agreement or as part of the same transaction giving rise to the agreement. To the extent an obligation is modified, supplemented or nullified by an agreement under this section, the agreement is a defense to the obligation.

Uniform Commercial Code Comment

1. The separate agreement might be a security agreement or mortgage or it might be an agreement that contradicts the terms of the instrument. For example, a person may be induced to sign an instrument under an agreement that the signer will not be liable on the instrument unless certain conditions are met. Suppose X requested credit from Creditor who is willing to give the credit only if an acceptable accommodation party will sign the note of X as co-maker. Y agrees to sign as co-maker on the condition that Creditor also obtain the signature of Z as co-maker. Creditor agrees and Y signs as co-maker with X. Creditor fails to obtain the signature of Z on the note. Under Sections 3-412 [section 3-1412] and 3-419(b) [section 3-1419(2)], Y is obliged to pay the note, but Section 3-117 [section 3-1117]

applies. In this case, the agreement modifies the terms of the note by stating a condition to the obligation of Y to pay the note. This case is essentially similar to a case in which a maker of a note is induced to sign the note by fraud of the holder. Although the agreement that Y not be liable on the note unless Z also signs may not have been fraudulently made, a subsequent attempt by Creditor to require Y to pay the note in violation of the agreement is a bad faith act. Section 3-1117, in treating the agreement as a defense, allows Y to assert the agreement against Creditor, but the defense would not be good against a subsequent holder in due course of the note that took it without notice of the agreement. If there cannot be a holder in due course because of Section 3-106(d) [section 3-1106(4)], a subsequent holder that took the note in good faith, for value and without knowledge of the agreement would not be able to enforce the liability of Y. This result is consistent with the risk that a holder not in due course takes with respect to fraud in inducing issuance of an instrument.

2. The effect of merger or integration clauses to the effect that a writing is intended to be the complete and exclusive statement of the terms of the agreement or that the agreement is not subject to conditions is left to the supplementary law of the jurisdiction pursuant to Section 1-103. Thus, in the case discussed in Comment 1, whether Y is permitted to prove the condition to Y's obligation to pay the note is determined by that law. Moreover, nothing in this section is intended to validate an agreement which is fraudulent or void as against public policy, as in the case of a note given to deceive a bank examiner.

§3-1118. Statute of limitations

(1) Except as provided in subsection (5), an action to enforce the obligation of a party to pay a note payable at a definite time must be commenced within 6 years after the due date or dates stated in the note or, if a due date is accelerated, within 6 years after the accelerated due date.

(2) Except as provided in subsection (4) or (5), if demand for payment is made to the maker of a note payable on demand, an action to enforce the obligation of a party to pay the note must be commenced within 6 years after the demand. If no demand for payment is made to the maker, an action to enforce the note is barred if neither principal nor interest on the note has been paid for a continuous period of 10 years.

(3) Except as provided in subsection (4), an action to enforce the obligation of a party to an unaccepted draft to pay the draft must be commenced within 3 years after dishonor of the

draft or 10 years after the date of the draft, whichever period expires first.

(4) An action to enforce the obligation of the acceptor of a certified check or the issuer of a teller's check, cashier's check or traveler's check must be commenced within 3 years after demand for payment is made to the acceptor or issuer, as the case may be.

(5) An action to enforce the obligation of a party to a certificate of deposit to pay the instrument must be commenced within 6 years after demand for payment is made to the maker, but if the instrument states a due date and the maker is not required to pay before that date, the 6-year period begins when a demand for payment is in effect and the due date has passed.

(6) An action to enforce the obligation of a party to pay an accepted draft, other than a certified check, must be commenced:

(a) Within 6 years after the due date or dates stated in the draft or acceptance if the obligation of the acceptor is payable at a definite time; or

(b) Within 6 years after the date of the acceptance if the obligation of the acceptor is payable on demand.

(7) Unless governed by other law regarding claims for indemnity or contribution, an action must be commenced within 3 years after the cause of action accrues if that action is:

(a) For conversion of an instrument, for money had and received or like action based on conversion;

(b) For breach of warranty; or

(c) To enforce an obligation, duty or right arising under this Article and not governed by this section.

Uniform Commercial Code Comment

1. Section 3-118 [section 3-1118] differs from former Section 3-122, which states when a cause of action accrues on an instrument. Section 3-118 [section 3-1118] does not define when a cause of action accrues. Accrual of a cause of action is stated in other sections of Article 3 [Article 3-A] such as those that state the various obligations of parties to an instrument. The only purpose of Section 3-118 [section 3-1118] is to define the time within which an action to enforce an obligation, duty, or right arising under Article 3 [Article 3-A] must be

commenced. Section 3-118 [section 3-1118] does not attempt to state all rules with respect to a statute of limitations. For example, the circumstances under which the running of a limitations period may be tolled is left to other law pursuant to Section 1-103.

2. The first six subsections apply to actions to enforce an obligation of any party to an instrument to pay the instrument. This changes present law in that indorsers who may become liable on an instrument after issue are subject to a period of limitations running from the same date as that of the maker or drawer. Subsections (a) [subsection (1)] and (b) [subsection (2)] apply to notes. If the note is payable at a definite time, a six-year limitations period starts at the due date of the note, subject to prior acceleration. If the note is payable on demand, there are two limitations periods. Although a note payable on demand could theoretically be called a day after it was issued, the normal expectation of the parties is that the note will remain outstanding until there is some reason to call it. If the law provides that the limitations period does not start until demand is made, the cause of action to enforce it may never be barred. On the other hand, if the limitations period starts when demand for payment may be made, i.e. at any time after the note was issued, the payee of a note on which interest or portions of principal are being paid could lose the right to enforce the note even though it was treated as a continuing obligation by the parties. Some demand notes are not enforced because the payee has forgiven the debt. This is particularly true in family and other noncommercial transactions. A demand note found after the death of the payee may be presented for payment many years after it was issued. The maker may be a relative and it may be difficult to determine whether the note represents a real or a forgiven debt. Subsection (b) [subsection (2)] is designed to bar notes that no longer represent a claim to payment and to require reasonably prompt action to enforce notes on which there is default. If a demand for payment is made to the maker, a six-year limitations period starts to run when demand is made. The second sentence of subsection (b) [subsection (2)] bars an action to enforce a demand note if no demand has been made on the note and no payment of interest or principal has been made for a continuous period of 10 years. This covers the case of a note that does not bear interest or a case in which interest due on the note has not been paid. This kind of case is likely to be a family transaction in which a failure to demand payment may indicate that the holder did not intend to enforce the obligation but neglected to destroy the note. A limitations period that bars stale claims in this kind of case is appropriate if the period is relatively long.

3. Subsection (c) [subsection (3)] applies primarily to personal uncertified checks. Checks are payment instruments rather than credit instruments. The limitations period expires three years after the date of dishonor or 10 years after the date of the check, whichever is earlier. Teller's checks, cashier's checks, certified checks, and traveler's checks are treated differently under subsection (d) [subsection (4)] because they are commonly treated as cash equivalents. A great delay in presenting a cashier's check for payment in most cases will occur because the check was mislaid during that period. The person to whom traveler's checks are issued may hold them indefinitely as a safe form of cash for use in an emergency. There is no compelling reason for barring the claim of the owner of the cashier's check or traveler's check. Under subsection (d) [subsection (4)] the claim is never barred because the three-year limitations period does not start to run until demand for payment is made. The limitations period in subsection (d) [subsection (4)] in effect applies only to cases in which there is a dispute about the legitimacy of the claim of the person demanding payment.

4. Subsection (e) [subsection (5)] covers certificates of deposit. The limitations period of six years doesn't start to run until the depositor demands payment. Most certificates of deposit are payable on demand even if they state a due date. The effect of a demand for payment before maturity is usually that the bank will pay, but that a penalty will be assessed against the depositor in the form of a reduction in the amount of interest that is paid. Subsection (e) [subsection (5)] also provides for cases in which the bank has no obligation to pay until the due date. In that case the limitations period doesn't start to run until there is a demand for payment in effect and the due date has passed.

5. Subsection (f) [subsection (6)] applies to accepted drafts other than certified checks. When a draft is accepted it is in effect turned into a note of the acceptor. In almost all cases the acceptor will agree to pay at a definite time. Subsection (f) [subsection (6)] states that in that case the six-year limitations period starts to run on the due date. In the rare case in which the obligation of the acceptor is payable on demand, the six-year limitations period starts to run at the date of the acceptance.

6. Subsection (g) [subsection (7)] covers warranty and conversion cases and other actions to enforce obligations or rights arising under Article 3 [Article 3-A]. A three-year period is stated and subsection (g) [subsection (7)] follows general law in stating that the period runs from the time the cause of action accrues. Since the traditional term "cause of action" may have been replaced in some states by "claim for

relief" or some equivalent term, the words "cause of action" have been bracketed to indicate that the words may be replaced by an appropriate substitute to conform to local practice. [Phrase is not bracketed in Maine law.]

§3-1119. Notice of right to defend action

In an action for breach of an obligation for which a 3rd person is answerable over pursuant to this Article or Article 4, the defendant may give the 3rd person written notice of the litigation and the person notified may then give similar notice to any other person who is answerable over. If the notice states that the person notified may come in and defend and that failure to do so will bind the person notified in an action later brought by the person giving the notice as to any determination of fact common to the 2 litigations, the person notified is so bound unless after seasonable receipt of the notice the person notified does come in and defend.

Uniform Commercial Code Comment

This section is a restatement of former Section 3-803.

PART 2

NEGOTIATION, TRANSFER AND INDORSEMENT

§3-1201. Negotiation

(1) "Negotiation" means a transfer of possession, whether voluntary or involuntary, of an instrument by a person other than the issuer to a person who thereby becomes its holder.

(2) Except for negotiation by a remitter, if an instrument is payable to an identified person, negotiation requires transfer of possession of the instrument and its indorsement by the holder. If an instrument is payable to bearer, it may be negotiated by transfer of possession alone.

Uniform Commercial Code Comment

1. Subsections (a) [subsection (1)] and (b) [subsection (2)] are based in part on subsection (1) of former Section 3-202. A person can become holder of an instrument when the instrument is issued to that person, or the status of holder can arise as the result of an event that occurs after issuance. "Negotiation" is the term used in Article 3 [Article 3-A] to describe this post-issuance event. Normally, negotiation occurs as the result of a voluntary transfer of possession of an instrument by a holder to another person who becomes the holder

as a result of the transfer. Negotiation always requires a change in possession of the instrument because nobody can be a holder without possessing the instrument, either directly or through an agent. But in some cases the transfer of possession is involuntary and in some cases the person transferring possession is not a holder. In defining "negotiation" former Section 3-202(1) used the word "transfer," an undefined term, and "delivery," defined in Section 1-201(14) to mean voluntary change of possession. Instead, subsections (a) [subsection (1)] and (b) [subsection (2)] use the term "transfer of possession" and, subsection (a) [subsection (1)] states that negotiation can occur by an involuntary transfer of possession. For example, if an instrument is payable to bearer and it is stolen by Thief or is found by Finder, Thief or Finder becomes the holder of the instrument when possession is obtained. In this case there is an involuntary transfer of possession that results in negotiation to Thief or Finder.

2. In most cases negotiation occurs by a transfer of possession by a holder or remitter. Remitter transactions usually involve a cashier's or teller's check. For example, Buyer buys goods from Seller and pays for them with a cashier's check of Bank that Buyer buys from Bank. The check is issued by Bank when it is delivered to Buyer, regardless of whether the check is payable to Buyer or to Seller. Section 3-105(a) [section 3-1105(1)]. If the check is payable to Buyer, negotiation to Seller is done by delivery of the check to Seller after it is indorsed by Buyer. It is more common, however, that the check when issued will be payable to Seller. In that case Buyer is referred to as the "remitter." Section 3-103(a)(11) [section 3-1103(1)(k)]. The remitter, although not a party to the check, is the owner of the check until ownership is transferred to Seller by delivery. This transfer is a negotiation because Seller becomes the holder of the check when Seller obtains possession. In some cases Seller may have acted fraudulently in obtaining possession of the check. In those cases Buyer may be entitled to rescind the transfer to Seller because of the fraud and assert a claim of ownership to the check under Section 3-306 [section 3-1306] against Seller or a subsequent transferee of the check. Section 3-202(b) [section 3-1202(2)] provides for rescission of negotiation, and that provision applies to rescission by a remitter as well as by a holder.

3. Other sections of Article 3 [Article 3-A] may modify the rule stated in the first sentence of subsection (b) [subsection (2)]. See for example, Sections 3-404, 3-405, and 3-406 [sections 3-1404, 3-1405 and 3-1406].

§3-1202. Negotiation subject to rescission

(1) Negotiation is effective even if obtained:

(a) From an infant, a corporation exceeding its powers or a person without capacity;

(b) By fraud, duress or mistake; or

(c) In breach of duty or as part of an illegal transaction.

(2) To the extent permitted by other law, negotiation may be rescinded or may be subject to other remedies, but those remedies may not be asserted against a subsequent holder in due course or a person paying the instrument in good faith and without knowledge of facts that are a basis for rescission or other remedy.

Uniform Commercial Code Comment

1. This section is based on former Section 3-207. Subsection (2) of former Section 3-207 prohibited rescission of a negotiation against holders in due course. Subsection (b) [subsection (2)] of Section 3-202 [section 3-1202] extends this protection to payor banks.

2. Subsection (a) [subsection (1)] applies even though the lack of capacity or the illegality, is of a character which goes to the essence of the transaction and makes it entirely void. It is inherent in the character of negotiable instruments that any person in possession of an instrument which by its terms is payable to that person or to bearer is a holder and may be dealt with by anyone as a holder. The principle finds its most extreme application in the well settled rule that a holder in due course may take the instrument even from a thief and be protected against the claim of the rightful owner. The policy of subsection (a) [subsection (1)] is that any person to whom an instrument is negotiated is a holder until the instrument has been recovered from that person's possession. The remedy of a person with a claim to an instrument is to recover the instrument by replevin or otherwise; to impound it or to enjoin its enforcement, collection or negotiation; to recover its proceeds from the holder; or to intervene in any action brought by the holder against the obligor. As provided in Section 3-305(c) [section 3-1305(3)], the claim of the claimant is not a defense to the obligor unless the claimant defends the action.

3. There can be no rescission or other remedy against a holder in due course or a person who pays in good faith and without notice, even though the prior negotiation may have been

fraudulent or illegal in its essence and entirely void. As against any other party the claimant may have any remedy permitted by law. This section is not intended to specify what that remedy may be, or to prevent any court from imposing conditions or limitations such as prompt action or return of the consideration received. All such questions are left to the law of the particular jurisdiction. Section 3-202 [section 3-1202] gives no right that would not otherwise exist. The section is intended to mean that any remedies afforded by other law are cut off only by a holder in due course.

§3-1203. Transfer of instrument; rights acquired by transfer

(1) An instrument is transferred when it is delivered by a person other than its issuer for the purpose of giving to the person receiving delivery the right to enforce the instrument.

(2) Transfer of an instrument, whether or not the transfer is a negotiation, vests in the transferee any right of the transferor to enforce the instrument, including any right as a holder in due course, but the transferee can not acquire rights of a holder in due course by a transfer, directly or indirectly, from a holder in due course if the transferee engaged in fraud or illegality affecting the instrument.

(3) Unless otherwise agreed, if an instrument is transferred for value and the transferee does not become a holder because of lack of indorsement by the transferor, the transferee has a specifically enforceable right to the unqualified indorsement of the transferor, but negotiation of the instrument does not occur until the indorsement is made.

(4) If a transferor purports to transfer less than the entire instrument, negotiation of the instrument does not occur. The transferee obtains no rights under this Article and has only the rights of a partial assignee.

Uniform Commercial Code Comment

1. Section 3-203 [section 3-1203] is based on former Section 3-201 which stated that a transferee received such rights as the transferor had. The former section was confusing because some rights of the transferor are not vested in the transferee unless the transfer is a negotiation. For example, a transferee that did not become the holder could not negotiate the instrument, a right that the transferor had. Former Section 3-201 did not define "transfer." Subsection (a) [subsection (1)] defines transfer by limiting it to cases in which possession of the instrument is delivered for the purpose of giving to the person receiving delivery the right to enforce the instrument.

Although transfer of an instrument might mean in a particular case that title to the instrument passes to the transferee, that result does not follow in all cases. The right to enforce an instrument and ownership of the instrument are two different concepts. A thief who steals a check payable to bearer becomes the holder of the check and a person entitled to enforce it, but does not become the owner of the check. If the thief transfers the check to a purchaser the transferee obtains the right to enforce the check. If the purchaser is not a holder in due course, the owner's claim to the check may be asserted against the purchaser. Ownership rights in instruments may be determined by principles of the law of property, independent of Article 3 [Article 3-A], which do not depend upon whether the instrument was transferred under Section 3-203 [section 3-1203]. Moreover, a person who has an ownership right in an instrument might not be a person entitled to enforce the instrument. For example, suppose X is the owner and holder of an instrument payable to X. X sells the instrument to Y but is unable to deliver immediate possession to Y. Instead, X signs a document conveying all of X's right, title, and interest in the instrument to Y. Although the document may be effective to give Y a claim to ownership of the instrument, Y is not a person entitled to enforce the instrument until Y obtains possession of the instrument. No transfer of the instrument occurs under Section 3-203(a) [section 3-1203(1)] until it is delivered to Y.

An instrument is a reified right to payment. The right is represented by the instrument itself. The right to payment is transferred by delivery of possession of the instrument "by a person other than its issuer for the purpose of giving to the person receiving delivery the right to enforce the instrument." The quoted phrase excludes issue of an instrument, defined in Section 3-1105, and cases in which a delivery of possession is for some purpose other than transfer of the right to enforce. For example, if a check is presented for payment by delivering the check to the drawee, no transfer of the check to the drawee occurs because there is no intent to give the drawee the right to enforce the check.

2. Subsection (b) [subsection (2)] states that transfer vests in the transferee any right of the transferor to enforce the instrument "including any right as a holder in due course." If the transferee is not a holder because the transferor did not indorse, the transferee is nevertheless a person entitled to enforce the instrument under Section 3-301 [section 3-1301] if the transferor was a holder at the time of transfer. Although the transferee is not a holder, under subsection (b) [subsection (2)] the transferee obtained the rights of the transferor as holder. Because the transferee's rights are derivative of the

transferor's rights, those rights must be proved. Because the transferee is not a holder, there is no presumption under Section 3-308 [section 3-1308] that the transferee, by producing the instrument, is entitled to payment. The instrument, by its terms, is not payable to the transferee and the transferee must account for possession of the unindorsed instrument by proving the transaction through which the transferee acquired it. Proof of a transfer to the transferee by a holder is proof that the transferee has acquired the rights of a holder. At that point the transferee is entitled to the presumption under Section 3-308 [section 3-1308].

Under subsection (b) [subsection (2)] a holder in due course that transfers an instrument transfers those rights as a holder in due course to the purchaser. The policy is to assure the holder in due course a free market for the instrument. There is one exception to this rule stated in the concluding clause of subsection (b) [subsection (2)]. A person who is party to fraud or illegality affecting the instrument is not permitted to wash the instrument clean by passing it into the hands of a holder in due course and then repurchasing it.

3. Subsection (c) [subsection (3)] applies only to a transfer for value. It applies only if the instrument is payable to order or specially indorsed to the transferor. The transferee acquires, in the absence of a contrary agreement, the specifically enforceable right to the indorsement of the transferor. Unless otherwise agreed, it is a right to the general indorsement of the transferor with full liability as indorser, rather than to an indorsement without recourse. The question may arise if the transferee has paid in advance and the indorsement is omitted fraudulently or through oversight. A transferor who is willing to indorse only without recourse or unwilling to indorse at all should make those intentions clear before transfer. The agreement of the transferee to take less than an unqualified indorsement need not be an express one, and the understanding may be implied from conduct, from past practice, or from the circumstances of the transaction. Subsection (c) [subsection (3)] provides that there is no negotiation of the instrument until the indorsement by the transferor is made. Until that time the transferee does not become a holder, and if earlier notice of a defense or claim is received, the transferee does not qualify as a holder in due course under Section 3-302 [section 3-1302].

4. The operation of Section 3-203 [section 3-1302] is illustrated by the following cases. In each case Payee, by fraud, induced Maker to issue a note to Payee. The fraud is a defense to the obligation of Maker to pay the note under Section 3-305(a)(2) [section 3-1305(1)(b)].

Case #1. Payee negotiated the note to X who took as a holder in due course. After the instrument became overdue X negotiated the note to Y who had notice of the fraud. Y succeeds to X's rights as a holder in due course and takes free of Maker's defense of fraud.

Case #2. Payee negotiated the note to X who took as a holder in due course. Payee then repurchased the note from X. Payee does not succeed to X's rights as a holder in due course and is subject to Maker's defense of fraud.

Case #3. Payee negotiated the note to X who took as a holder in due course. X sold the note to Purchaser who received possession. The note, however, was indorsed to X and X failed to indorse it. Purchaser is a person entitled to enforce the instrument under Section 3-301 [section 3-1301] and succeeds to the rights of X as holder in due course. Purchaser is not a holder, however, and under Section 3-308 [section 3-1308] Purchaser will have to prove the transaction with X under which the rights of X as holder in due course were acquired.

Case #4. Payee sold the note to Purchaser who took for value, in good faith and without notice of the defense of Maker. Purchaser received possession of the note but Payee neglected to indorse it. Purchaser became a person entitled to enforce the instrument but did not become the holder because of the missing indorsement. If Purchaser received notice of the defense of Maker before obtaining the indorsement of Payee, Purchaser cannot become a holder in due course because at the time notice was received the note had not been negotiated to Purchaser. If indorsement by Payee was made after Purchaser received notice, Purchaser had notice of the defense when it became the holder.

5. Subsection (d) [subsection (4)] restates former Section 3-202(3). The cause of action on an instrument cannot be split. Any indorsement which purports to convey to any party less than the entire amount of the instrument is not effective for negotiation. This is true of either "Pay A one-half," or "Pay A two-thirds and B one-third." Neither A nor B becomes a holder. On the other hand an indorsement reading merely "Pay A and B" is effective, since it transfers the entire cause of action to A and B as tenants in common. An indorsement purporting to convey less than the entire instrument does, however, operate as a partial assignment of the cause of action. Subsection (d) [subsection (4)] makes no attempt to state the legal effect of such an assignment, which is left to other law. A partial assignee of an instrument has rights only to the extent the applicable law gives rights, either at law or in equity, to a partial assignee.

§3-1204. Indorsement

(1) "Indorsement" means a signature, other than that of a signer as maker, drawer or acceptor, that alone or accompanied by other words is made on an instrument for the purpose of:

(a) Negotiating the instrument;

(b) Restricting payment of the instrument; or

(c) Incurring indorser's liability on the instrument.

Regardless of the intent of the signer, a signature and its accompanying words is an indorsement unless the accompanying words, terms of the instrument, place of the signature or other circumstances unambiguously indicate that the signature was made for a purpose other than indorsement. For the purpose of determining whether a signature is made on an instrument, a paper affixed to the instrument is a part of the instrument.

(2) "Indorser" means a person who makes an indorsement.

(3) For the purpose of determining whether the transferee of an instrument is a holder, an indorsement that transfers a security interest in the instrument is effective as an unqualified indorsement of the instrument.

(4) If an instrument is payable to a holder under a name that is not the name of the holder, indorsement may be made by the holder in the name stated in the instrument or in the holder's name or both, but signature in both names may be required by a person paying or taking the instrument for value or collection.

Uniform Commercial Code Comment

1. Subsection (a) [subsection (1)] is a definition of "indorsement," a term which was not defined in former Article 3. Indorsement is defined in terms of the purpose of the signature. If a blank or special indorsement is made to give rights as a holder to a transferee the indorsement is made for the purpose of negotiating the instrument. Subsection (a)(i) [subsection (1)(a)]. If the holder of a check has an account in the drawee bank and wants to be sure that payment of the check will be made by credit to the holder's account, the holder can indorse the check by signing the holder's name with the accompanying words "for deposit only" before presenting the check for payment to the drawee bank. In that case the purpose of the quoted words is to restrict payment of the instrument. Subsection (a)(ii)

[subsection (1)(b)]. If X wants to guarantee payment of a note signed by Y as maker, X can do so by signing X's name to the back of the note as an indorsement. This indorsement is known as an anomalous indorsement (Section 3-205(d)) [section 3-1205(4)] and is made for the purpose of incurring indorser's liability on the note. Subsection (a)(iii) [subsection (1)(c)]. In some cases an indorsement may serve more than one purpose. For example, if the holder of a check deposits it to the holder's account in a depositary bank for collection and indorses the check by signing the holder's name with the accompanying words "for deposit only" the purpose of the indorsement is both to negotiate the check to the depositary bank and to restrict payment of the check.

The "but" clause of the first sentence of subsection (a) [the blocked paragraph of subsection (1)] elaborates on former Section 3-402. In some cases it may not be clear whether a signature was meant to be that of an indorser, a party to the instrument in some other capacity such as drawer, maker or acceptor, or a person who was not signing as a party. The general rule is that a signature is an indorsement if the instrument does not indicate an unambiguous intent of the signer not to sign as an indorser. Intent may be determined by words accompanying the signature, the place of signature, or other circumstances. For example, suppose a depositary bank gives cash for a check properly indorsed by the payee. The bank requires the payee's employee to sign the back of the check as evidence that the employee received the cash. If the signature consists only of the initials of the employee it is not reasonable to assume that it was meant to be an indorsement. If there was a full signature but accompanying words indicated that it was meant as a receipt for the cash given for the check, it is not an indorsement. If the signature is not qualified in any way and appears in the place normally used for indorsements, it may be an indorsement even though the signer intended the signature to be a receipt. To take another example, suppose the drawee of a draft signs the draft on the back in the space usually used for indorsements. No words accompany the signature. Since the drawee has no reason to sign a draft unless the intent is to accept the draft, the signature is effective as an acceptance. Custom and usage may be used to determine intent. For example, by long-established custom and usage, a signature in the lower right hand corner of an instrument indicates an intent to sign as the maker of a note or the drawer of a draft. Any similar clear indication of an intent to sign in some other capacity or for some other purpose may establish that a signature is not an indorsement. For example, if the owner of a traveler's check countersigns the check in the process of negotiating it, the countersignature is not an indorsement. The countersignature is a condition to the issuer's obligation to pay and its purpose is to provide a means of verifying the identify [sic] of the person

negotiating the traveler's check by allowing comparison of the specimen signature and the countersignature. The countersignature is not necessary for negotiation and the signer does not incur indorser's liability. See Comment 2 to Section 3-106 [section 3-1106].

The last sentence of subsection (a) [subsection (1)] is based on subsection (2) of former Section 3-202. An indorsement on an allonge is valid even though there is sufficient space on the instrument for an indorsement.

2. Assume that Payee indorses a note to Creditor as security for a debt. Under subsection (b) [subsection (2)] of Section 3-203 [section 3-1203] Creditor takes Payee's rights to enforce or transfer the instrument subject to the limitations imposed by Article 9. Subsection (c) [subsection (3)] of Section 3-204 [section 3-1204] makes clear that Payee's indorsement to Creditor, even though it mentions creation of a security interest, is an unqualified indorsement that gives to Creditor the right to enforce the note as its holder.

3. Subsection (d) [subsection (4)] is a restatement of former Section 3-203. Section 3-110(a) [section 3-1110(1)] states that an instrument is payable to the person intended by the person signing as or in the name or behalf of the issuer even if that person is identified by a name that is not the true name of the person. In some cases the name used in the instrument is a misspelling of the correct name and in some cases the two names may be entirely different. The payee may indorse in the name used in the instrument, in the payee's correct name, or in both. In each case the indorsement is effective. But because an indorsement in a name different from that used in the instrument may raise a question about its validity and an indorsement in a name that is not the correct name of the payee may raise a problem of identifying the indorser, the accepted commercial practice is to indorse in both names. Subsection (d) [subsection (4)] allows a person paying or taking the instrument for value or collection to require indorsement in both names.

§3-1205. Special indorsement; blank indorsement; anomalous indorsement

(1) If an indorsement is made by the holder of an instrument, whether payable to an identified person or payable to bearer, and the indorsement identifies a person to whom it makes the instrument payable, it is a "special indorsement." When specially indorsed, an instrument becomes payable to the identified person and may be negotiated only by the indorsement of that person. The principles stated in Section 3-1110 apply to special indorsements.

(2) If an indorsement is made by the holder of an instrument and it is not a special indorsement, it is a "blank indorsement." When indorsed in blank, an instrument becomes payable to bearer and may be negotiated by transfer of possession alone until specially indorsed.

(3) The holder may convert a blank indorsement that consists only of a signature into a special indorsement by writing, above the signature of the indorser, words identifying the person to whom the instrument is made payable.

(4) "Anomalous indorsement" means an indorsement made by a person who is not the holder of the instrument. An anomalous indorsement does not affect the manner in which the instrument may be negotiated.

Uniform Commercial Code Comment

1. Subsection (a) [subsection (1)] is based on subsection (1) of former Section 3-204. It states the test of a special indorsement to be whether the indorsement identifies a person to whom the instrument is payable. Section 3-110 [section 3-1110] states rules for identifying the payee of an instrument. Section 3-205(a) [section 3-1205(1)] incorporates the principles stated in Section 3-110 [section 3-1110] in identifying an indorsee. The language of Section 3-110 [section 3-1110] refers to language used by the issuer of the instrument. When that section is used with respect to an indorsement, Section 3-110 [section 3-1110] must be read as referring to the language used by the indorser.

2. Subsection (b) [subsection (2)] is based on subsection (2) of former Section 3-204. An indorsement made by the holder is either a special or blank indorsement. If the indorsement is made by a holder and is not a special indorsement, it is a blank indorsement. For example, the holder of an instrument, intending to make a special indorsement, writes the words "Pay to the order of" without completing the indorsement by writing the name of the indorsee. The holder's signature appears under the quoted words. The indorsement is not a special indorsement because it does not identify a person to whom it makes the instrument payable. Since it is not a special indorsement it is a blank indorsement and the instrument is payable to bearer. The result is analogous to that of a check in which the name of the payee is left blank by the drawer. In that case the check is payable to bearer. See the last paragraphs of Comment 2 to Section 3-115 [section 3-1115].

A blank indorsement is usually the signature of the indorser on the back of the instrument without other words. Subsection

(c) [subsection (3)] is based on subsection (3) of former Section 3-204. A "restrictive indorsement" described in Section 3-206 [section 3-1206] can be either a blank indorsement or a special indorsement. "Pay to T, in trust for B" is a restrictive indorsement. It is also a special indorsement because it identifies T as the person to whom the instrument is payable. "For deposit only" followed by the signature of the payee of a check is a restrictive indorsement. It is also a blank indorsement because it does not identify the person to whom the instrument is payable.

3. The only effect of an "anomalous indorsement," defined in subsection (d) [subsection (4)], is to make the signer liable on the instrument as an indorser. Such an indorsement is normally made by an accommodation party. Section 3-419 [section 3-1419].

§3-1206. Restrictive indorsement

(1) An indorsement limiting payment to a particular person or otherwise prohibiting further transfer or negotiation of the instrument is not effective to prevent further transfer or negotiation of the instrument.

(2) An indorsement stating a condition to the right of the indorsee to receive payment does not affect the right of the indorsee to enforce the instrument. A person paying the instrument or taking it for value or collection may disregard the condition, and the rights and liabilities of that person are not affected by whether the condition has been fulfilled.

(3) If an instrument bears an indorsement described in section 4-201, subsection (2) or in blank or to a particular bank using the words "for deposit," "for collection" or other words indicating a purpose of having the instrument collected by a bank for the indorser or for a particular account, the following rules apply.

(a) A person, other than a bank, who purchases the instrument when so indorsed converts the instrument unless the amount paid for the instrument is received by the indorser or applied consistently with the indorsement.

(b) A depositary bank that purchases the instrument or takes it for collection when so indorsed converts the instrument unless the amount paid by the bank with respect to the instrument is received by the indorser or applied consistently with the indorsement.

(c) A payor bank that is also the depositary bank or that takes the instrument for immediate payment over the counter from a person other than a collecting bank converts the instrument unless the proceeds of the instrument are received by the indorser or applied consistently with the indorsement.

(d) Except as otherwise provided in paragraph (c), a payor bank or intermediary bank may disregard the indorsement and is not liable if the proceeds of the instrument are not received by the indorser or applied consistently with the indorsement.

(4) Except for an indorsement covered by subsection (3), if an instrument bears an indorsement using words to the effect that payment is to be made to the indorsee as agent, trustee or other fiduciary for the benefit of the indorser or another person, the following rules apply.

(a) Unless there is notice of breach of fiduciary duty as provided in section 3-1307, a person who purchases the instrument from the indorsee or takes the instrument from the indorsee for collection or payment may pay the proceeds of payment or the value given for the instrument to the indorsee without regard to whether the indorsee violates a fiduciary duty to the indorser.

(b) A subsequent transferee of the instrument or person who pays the instrument is neither given notice nor otherwise affected by the restriction in the indorsement unless the transferee or payor knows that the fiduciary dealt with the instrument or its proceeds in breach of fiduciary duty.

(5) The presence on an instrument of an indorsement to which this section applies does not prevent a purchaser of the instrument from becoming a holder in due course of the instrument unless the purchaser is a converter under subsection (3) or has notice or knowledge of breach of fiduciary duty as stated in subsection (4).

(6) In an action to enforce the obligation of a party to pay the instrument, the obligor has a defense if payment would violate an indorsement to which this section applies and the payment is not permitted by this section.

Uniform Commercial Code Comment

1. This section replaces former Sections 3-205 and 3-206 and clarifies the law of restrictive indorsements.

2. Subsection (a) [subsection (1)] provides that an indorsement that purports to limit further transfer or negotiation is ineffective to prevent further transfer or negotiation. If a payee indorses "Pay A only," A may negotiate the instrument to subsequent holders who may ignore the restriction on the indorsement. Subsection (b) [subsection (2)] provides that an indorsement that states a condition to the right of a holder to receive payment is ineffective to condition payment. Thus if a payee indorses "Pay A if A ships goods complying with our contract," the right of A to enforce the instrument is not affected by the condition. In the case of a note, the obligation of the maker to pay A is not affected by the indorsement. In the case of a check, the drawee can pay A without regard to the condition, and if the check is dishonored the drawer is liable to pay A. If the check was negotiated by the payee to A in return for a promise to perform a contract and the promise was not kept, the payee would have a defense or counterclaim against A if the check were dishonored and A sued the payee as indorser, but the payee would have that defense or counterclaim whether or not the condition to the right of A was expressed in the indorsement. Former Section 3-206 treated a conditional indorsement like indorsements for deposit or collection. In revised Article 3 [Article 3-A], Section 3-206(b) [section 3-1206(2)] rejects that approach and makes the conditional indorsement ineffective with respect to parties other than the indorser and indorsee. Since the indorsements referred to in subsections (a) [subsection (1)] and (b) [subsection (2)] are not effective as restrictive indorsements, they are no longer described as restrictive indorsements.

3. The great majority of restrictive indorsements are those that fall within subsection (c) [subsection (3)] which continues previous law. The depositary bank or the payor bank, if it takes the check for immediate payment over the counter, must act consistently with the indorsement, but an intermediary bank or payor bank that takes the check from a collecting bank is not affected by the indorsement. Any other person is also bound by the indorsement. For example, suppose a check is payable to X, who indorses in blank but writes above the signature the words "For deposit only." The check is stolen and is cashed at a grocery store by the thief. The grocery store indorses the check and deposits it in Depositary Bank. The account of the grocery store is credited and the check is forwarded to Payor Bank which pays the check. Under subsection (c) [subsection (3)], the grocery store and Depositary Bank are converters of the check because X did not receive the amount paid for the check. Payor Bank and any intermediary bank in the collection process are not liable to X. This Article does not displace the law of waiver as it may apply to restrictive indorsements. The circumstances under which a restrictive indorsement may be waived by the person who made it is not determined by this Article.

4. Subsection (d) [subsection (4)] replaces subsection (4) of former Section 3-206. Suppose Payee indorses a check "Pay to T in trust for B." T indorses in blank and delivers it to (a) Holder for value; (b) Depositary Bank for collection; or (c) Payor Bank for payment. In each case these takers can safely pay T so long as they have no notice under Section 3-307 [section 3-1307] of any breach of fiduciary duty that T may be committing. For example, under subsection (a) [subsection (1)] of Section 3-307 [section 3-1307] [sic; reference should probably be section 3-1307(2)] these takers have notice of a breach of trust if the check was taken in any transaction known by the taker to be for T's personal benefit. Subsequent transferees of the check from Holder or Depositary Bank are not affected by the restriction unless they have knowledge that T dealt with the check in breach of trust.

5. Subsection (f) [subsection (6)] allows a restrictive indorsement to be used as a defense by a person obliged to pay the instrument if that person would be liable for paying in violation of the indorsement.

§3-1207. Reacquisition

Reacquisition of an instrument occurs if it is transferred to a former holder by negotiation or otherwise. A former holder who reacquires the instrument may cancel indorsements made after the reacquirer first became a holder of the instrument. If the cancellation causes the instrument to be payable to the reacquirer or to bearer, the reacquirer may negotiate the instrument. An indorser whose indorsement is canceled is discharged and the discharge is effective against any subsequent holder.

Uniform Commercial Code Comment

Section 3-207 [section 3-1207] restates former Section 3-208. Reacquisition refers to cases in which a former holder reacquires the instrument either by negotiation from the present holder or by a transfer other than negotiation. If the reacquisition is by negotiation, the former holder reacquires the status of holder. Although Section 3-207 [section 3-1207] allows the holder to cancel all indorsements made after the holder first acquired holder status, cancellation is not necessary. Status of holder is not affected whether or not cancellation is made. But if the reacquisition is not the result of negotiation the former holder can obtain holder status only by striking the former holder's indorsement and any subsequent indorsements. The latter case is an exception to the general rule that if an instrument is payable to an identified person, the indorsement of that person

is necessary to allow a subsequent transferee to obtain the status of holder. Reacquisition without indorsement by the person to whom the instrument is payable is illustrated by two examples:

Case #1. X, a former holder, buys the instrument from Y, the present holder. Y delivers the instrument to X but fails to indorse it. Negotiation does not occur because the transfer of possession did not result in X's becoming holder. Section 3-201(a) [section 3-1201(1)]. The instrument by its terms is payable to Y, not to X. But X can obtain the status of holder by striking X's indorsement and all subsequent indorsements. When these indorsements are struck, the instrument by its terms is payable either to X or to bearer, depending upon how X originally became holder. In either case X becomes holder. Section 1-201(20).

Case #2. X, the holder of an instrument payable to X, negotiates it to Y by special indorsement. The negotiation is part of an underlying transaction between X and Y. The underlying transaction is rescinded by agreement of X and Y, and Y returns the instrument without Y's indorsement. The analysis is the same as that in Case #1. X can obtain holder status by canceling X's indorsement to Y.

In Case #1 and Case #2, X acquired ownership of the instrument after reacquisition, but X's title was clouded because the instrument by its terms was not payable to X. Normally, X can remedy the problem by obtaining Y's indorsement, but in some cases X may not be able to conveniently obtain that indorsement. Section 3-207 [section 3-1207] is a rule of convenience which relieves X of the burden of obtaining an indorsement that serves no substantive purpose. The effect of cancellation of any indorsement under Section 3-207 [section 3-1207] is to nullify it. Thus, the person whose indorsement is canceled is relieved of indorser's liability. Since cancellation is notice of discharge, discharge is effective even with respect to the rights of a holder in due course. Sections 3-601 and 3-604 [sections 3-1601 and 3-1604].

PART 3

ENFORCEMENT OF INSTRUMENTS

§3-1301. Person entitled to enforce instrument

"Person entitled to enforce" an instrument means:

(1) The holder of the instrument;

(2) A nonholder in possession of the instrument who has the rights of a holder; or

(3) A person not in possession of the instrument who is entitled to enforce the instrument pursuant to section 3-1309 or 3-1418, subsection (4). A person may be a person entitled to enforce the instrument even though the person is not the owner of the instrument or is in wrongful possession of the instrument.

Uniform Commercial Code Comment

This section replaces former Section 3-301 that stated the rights of a holder. The rights stated in former Section 3-301 to transfer, negotiate, enforce, or discharge an instrument are stated in other sections of Article 3 [Article 3-A]. In revised Article 3 [Article 3-A], Section 3-301 [section 3-1301] defines "person entitled to enforce" an instrument. The definition recognizes that enforcement is not limited to holders. The quoted phrase includes a person enforcing a lost or stolen instrument. Section 3-309 [section 3-1309]. It also includes a person in possession of an instrument who is not a holder. A nonholder in possession of an instrument includes a person that acquired rights of a holder by subrogation or under Section 3-203(a) [section 3-1203(1)]. It also includes any other person who under applicable law is a successor to the holder or otherwise acquires the holder's rights.

§3-1302. Holder in due course

(1) Subject to subsection (3) and section 3-1106, subsection (3), "holder in due course" means the holder of an instrument if:

(a) The instrument when issued or negotiated to the holder does not bear such apparent evidence of forgery or alteration or is not otherwise so irregular or incomplete as to call into question its authenticity; and

(b) The holder took the instrument:

(i) For value;

(ii) In good faith;

(iii) Without notice that the instrument is overdue or has been dishonored or that there is an uncured default with respect to payment of another instrument issued as part of the same series;

(iv) Without notice that the instrument contains an unauthorized signature or has been altered;

(v) Without notice of any claim to the instrument described in section 3-1306; and

(vi) Without notice that any party has a defense or claim in recoupment described in section 3-1305, subsection (1).

(2) Notice of discharge of a party, other than discharge in an insolvency proceeding, is not notice of a defense under subsection (1), but discharge is effective against a person who became a holder in due course with notice of the discharge. Public filing or recording of a document does not of itself constitute notice of a defense, claim in recoupment or claim to the instrument.

(3) Except to the extent a transferor or predecessor in interest has rights as a holder in due course, a person does not acquire rights of a holder in due course of an instrument taken:

(a) By legal process or by purchase in an execution, bankruptcy or creditor's sale or similar proceeding;

(b) By purchase as part of a bulk transaction not in ordinary course of business of the transferor; or

(c) As the successor in interest to an estate or other organization.

(4) If, under section 3-1303, subsection (1), paragraph (a), the promise of performance that is the consideration for an instrument has been partially performed, the holder may assert rights as a holder in due course of the instrument only to the fraction of the amount payable under the instrument equal to the value of the partial performance divided by the value of the promised performance.

(5) The person entitled to enforce the instrument may assert rights as a holder in due course only to an amount payable under the instrument which, at the time of enforcement of the instrument, does not exceed the amount of the unpaid obligation secured if:

(a) The person entitled to enforce an instrument has only a security interest in the instrument; and

(b) The person obliged to pay the instrument has a defense, claim in recoupment or claim to the instrument that may be

asserted against the person who granted the security interest.

(6) To be effective, notice must be received at a time and in a manner that gives a reasonable opportunity to act on it.

(7) This section is subject to any law limiting status as a holder in due course in particular classes of transactions.

Uniform Commercial Code Comment

1. Subsection (a)(1) [subsection (1)(a)] is a return to the N.I.L. rule that the taker of an irregular or incomplete instrument is not a person the law should protect against defenses of the obligor or claims of prior owners. This reflects a policy choice against extending the holder in due course doctrine to an instrument that is so incomplete or irregular "as to call into question its authenticity." The term "authenticity" is used to make it clear that the irregularity or incompleteness must indicate that the instrument may not be what it purports to be. Persons who purchase or pay such instruments should do so at their own risk. Under subsection (1) of former Section 3-304, irregularity or incompleteness gave a purchaser notice of a claim or defense. But it was not clear from that provision whether the claim or defense had to be related to the irregularity or incomplete aspect of the instrument. This ambiguity is not present in subsection (a)(1) [subsection (1)(a)].

2. Subsection (a)(2) [subsection (1)(b)] restates subsection (1) of former Section 3-302. Section 3-305(a) [section 3-1305(1)] makes a distinction between defenses to the obligation to pay an instrument and claims in recoupment by the maker or drawer that may be asserted to reduce the amount payable on the instrument. Because of this distinction, which was not made in former Article 3, the reference in subsection (a)(2)(vi) [subsection (1)(b)(vi)] is to both a defense and a claim in recoupment. Notice of forgery or alteration is stated separately because forgery and alteration are not technically defenses under subsection (a) [subsection (1)] of Section 3-305 [section 3-1305].

3. Discharge is also separately treated in the first sentence of subsection (b) [subsection (2)]. Except for discharge in an insolvency proceeding, which is specifically stated to be a real defense in Section 3-305(a)(1) [section 3-1305(1)(a)], discharge is not expressed in Article 3 [Article 3-A] as a defense and is not included in Section 3-305(a)(2) [section 3-1305(1)(b)]. Discharge is effective against anybody except a person having rights of a holder in due course who took the instrument without notice of the discharge. Notice of

discharge does not disqualify a person from becoming a holder in due course. For example, a check certified after it is negotiated by the payee may subsequently be negotiated to a holder. If the holder had notice that the certification occurred after negotiation by the payee, the holder necessarily had notice of the discharge of the payee as indorser. Section 3-415(d) [section 3-1415(4)]. Notice of that discharge does not prevent the holder from becoming a holder in due course, but the discharge is effective against the holder. Section 3-601(b) [section 3-1601(2)]. Notice of a defense under Section 3-305(a)(1) [section 3-1305(1)(a)] of a maker, drawer or acceptor based on a bankruptcy discharge is different. There is no reason to give holder in due course status to a person with notice of that defense. The second sentence of subsection (b) [subsection (2)] is from former Section 3-304(5).

4. Professor Britton in his treatise Bills and Notes 309 (1961) stated: "A substantial number of decisions before the [N.I.L.] indicates that at common law there was nothing in the position of the payee as such which made it impossible for him to be a holder in due course." The courts were divided, however, about whether the payee of an instrument could be a holder in due course under the N.I.L.. Some courts read N.I.L. § 52(4) to mean that a person could be a holder in due course only if the instrument was "negotiated" to that person. N.I.L. § 30 stated that "an instrument is negotiated when it is transferred from one person to another in such manner as to constitute the transferee the holder thereof." Normally, an instrument is "issued" to the payee; it is not transferred to the payee. N.I.L. § 191 defined "issue" as the "first delivery of the instrument * * * to a person who takes it as a holder." Thus, some courts concluded that the payee never could be a holder in due course. Other courts concluded that there was no evidence that the N.I.L. was intended to change the common law rule that the payee could be a holder in due course. Professor Britton states on p.318: "The typical situations which raise the [issue] are those where the defense of a maker is interposed because of fraud by a [maker who is] principal debtor * * * against a surety co-maker, or where the defense of fraud by a purchasing remitter is interposed by the drawer of the instrument against the good faith purchasing payee."

Former Section 3-302(2) stated: "A payee may be a holder in due course." This provision was intended to resolve the split of authority under the N.I.L.. It made clear that there was no intent to change the common-law rule that allowed a payee to become a holder in due course. See Comment 2 to former Section 3-302. But there was no need to put subsection (2) in former Section 3-302 because the split in authority under the N.I.L. was caused by the particular wording of N.I.L. § 52(4). The

troublesome language in that section was not repeated in former Article 3 nor is it repeated in revised Article 3 [Article 3-A]. Former Section 3-302(2) has been omitted in revised Article 3 [Article 3-A] because it is surplusage and may be misleading. The payee of an instrument can be a holder in due course, but use of the holder-in-due-course doctrine by the payee of an instrument is not the normal situation.

The primary importance of the concept of holder in due course is with respect to assertion of defenses or claims in recoupment (Section 3-305 [section 3-1305]) and of claims to the instrument (Section 3-306 [section 3-1306]). The holder-in-due-course doctrine assumes the following case as typical. Obligor issues a note or check to Obligee. Obligor is the maker of the note or drawer of the check. Obligee is the payee. Obligor has some defense to Obligor's obligation to pay the instrument. For example, Obligor issued the instrument for goods that Obligee promised to deliver. Obligee never delivered the goods. The failure of Obligee to deliver the goods is a defense. Section 3-303(b) [section 3-1303(2)]. Although Obligor has a defense against Obligee, if the instrument is negotiated to Holder and the requirements of subsection (a) [subsection (1)] are met, Holder may enforce the instrument against Obligor free of the defense. Section 3-305(b) [section 3-1305(2)]. In the typical case the holder in due course is not the payee of the instrument. Rather, the holder in due course is an immediate or remote transferee of the payee. If Obligor in our example is the only obligor on the check or note, the holder-in-due-course doctrine is irrelevant in determining rights between Obligor and Obligee with respect to the instrument.

But in a small percentage of cases it is appropriate to allow the payee of an instrument to assert rights as a holder in due course. The cases are like those referred to in the quotation from Professor Britton referred to above, or other cases in which conduct of some third party is the basis of the defense of the issuer of the instrument. The following are examples:

Case #1. Buyer pays for goods bought from Seller by giving to Seller a cashier's check bought from Bank. Bank has a defense to its obligation to pay the check because Buyer bought the check from Bank with a check known to be drawn on an account with insufficient funds to cover the check. If Bank issued the check to Buyer as payee and Buyer indorsed it over to Seller, it is clear that Seller can be a holder in due course taking free of the defense if Seller had no notice of the defense. Seller is a transferee of the check. There is no good reason why Seller's position should be any different if Bank drew the check to the order of

Seller as payee. In that case, when Buyer took delivery of the check from Bank, Buyer became the owner of the check even though Buyer was not the holder. Buyer was a remitter. Section 3-103(a)(11) [section 3-1103(1)(k)]. At that point nobody was the holder. When Buyer delivered the check to Seller, ownership of the check was transferred to Seller who also became the holder. This is a negotiation. Section 3-201 [section 3-1201]. The rights of Seller should not be affected by the fact that in one case the negotiation to Seller was by a holder and in the other case the negotiation was by a remitter. Moreover, it should be irrelevant whether Bank delivered the check to Buyer and Buyer delivered it to Seller or whether Bank delivered it directly to Seller. In either case Seller can be a holder in due course that takes free of Bank's defense.

Case #2. X fraudulently induces Y to join X in a spurious venture to purchase a business. The purchase is to be financed by a bank loan for part of the price. Bank lends money to X and Y by deposit in a joint account of X and Y who sign a note payable to Bank for the amount of the loan. X then withdraws the money from the joint account and absconds. Bank acted in good faith and without notice of the fraud of X against Y. Bank is payee of the note executed by Y, but its right to enforce the note against Y should not be affected by the fact that Y was induced to execute the note by the fraud of X. Bank can be a holder in due course that takes free of the defense of Y. Case #2 is similar to Case #1. In each case the payee of the instrument has given value to the person committing the fraud in exchange for the obligation of the person against whom the fraud was committed. In each case the payee was not party to the fraud and had no notice of it.

Suppose in Case #2 that the note does not meet the requirements of Section 3-104(a) [section 3-1104(1)] and thus is not a negotiable instrument covered by Article 3 [Article 3-A]. In that case, Bank cannot be a holder in due course but the result should be the same. Bank's rights are determined by general principles of contract law. Restatement Second, Contracts § 164(2) governs the case. If Y is induced to enter into a contract with Bank by a fraudulent misrepresentation by X, the contract is voidable by Y unless Bank "in good faith and without reason to know of the misrepresentation either gives value or relies materially on the transaction." Comment e to § 164(2) states:

> "This is the same principle that protects an innocent person who purchases goods or commercial paper in good faith, without notice and for value from one who obtained them from

the original owner by a misrepresentation. See Uniform Commercial Code §§ 2-403(1), 3-305 [section 3-1305]. In the cases that fall within [§ 164 (2)], however, the innocent person deals directly with the recipient of the misrepresentation, which is made by one not a party to the contract."

The same result follows in Case #2 if Y had been induced to sign the note as an accommodation party (Section 3-419 [section 3-1419]). If Y signs as co-maker of a note for the benefit of X, Y is a surety with respect to the obligation of X to pay the note but is liable as maker of the note to pay Bank. Section 3-419(b) [section 3-1419(2)]. If Bank is a holder in due course, the fraud of X cannot be asserted against Bank under Section 3-305(b) [section 3-1305(2)]. But the result is the same without resort to holder-in-due-course doctrine. If the note is not a negotiable instrument governed by Article 3 [Article 3-A], general rules of suretyship apply. Restatement, Security § 119 states that the surety (Y) cannot assert a defense against the creditor (Bank) based on the fraud of the principal (X) if the creditor "without knowledge of the fraud * * * extended credit to the principal on the security of the surety's promise * * *." The underlying principle of § 119 is the same as that of § 164(2) of Restatement Second, Contracts.

Case #3. Corporation draws a check payable to Bank. The check is given to an officer of Corporation who is instructed to deliver it to Bank in payment of a debt owed by Corporation to Bank. Instead, the officer, intending to defraud Corporation, delivers the check to Bank in payment of the officer's personal debt, or the check is delivered to Bank for deposit to the officer's personal account. If Bank obtains payment of the check, Bank has received funds of Corporation which have been used for the personal benefit of the officer. Corporation in this case will assert a claim to the proceeds of the check against Bank. If Bank was a holder in due course of the check it took the check free of Corporation's claim. Section 3-306 [section 3-1306]. The issue in this case is whether Bank had notice of the claim when it took the check. If Bank knew that the officer was a fiduciary with respect to the check, the issue is governed by Section 3-307 [section 3-1307].

Case #4. Employer, who owed money to X, signed a blank check and delivered it to Secretary with instructions to complete the check by typing in X's name and the amount owed to X. Secretary fraudulently completed the check by typing in the name of Y, a creditor to whom Secretary owed money. Secretary then delivered the check to Y in payment of Secretary's debt. Y obtained payment of the check. This

case is similar to Case #3. Since Secretary was authorized to complete the check, Employer is bound by Secretary's act in making the check payable to Y. The drawee bank properly paid the check. Y received funds of Employer which were used for the personal benefit of Secretary. Employer asserts a claim to these funds against Y. If Y is a holder in due course, Y takes free of the claim. Whether Y is a holder in due course depends upon whether Y had notice of Employer's claim.

5. Subsection (c) [subsection (3)] is based on former Section 3-302(3). Like former Section 3-302(3), subsection (c) [subsection (3)] is intended to state existing case law. It covers a few situations in which the purchaser takes an instrument under unusual circumstances. The purchaser is treated as a successor in interest to the prior holder and can acquire no better rights. But if the prior holder was a holder in due course, the purchaser obtains rights of a holder in due course.

Subsection (c) [subsection (3)] applies to a purchaser in an execution sale or sale in bankruptcy. It applies equally to an attaching creditor or any other person who acquires the instrument by legal process or to a representative, such as an executor, administrator, receiver or assignee for the benefit of creditors, who takes the instrument as part of an estate. Subsection (c) [subsection (3)] applies to bulk purchases lying outside of the ordinary course of business of the seller. For example, it applies to the purchase by one bank of a substantial part of the paper held by another bank which is threatened with insolvency and seeking to liquidate its assets. Subsection (c) [subsection (3)] would also apply when a new partnership takes over for value all of the assets of an old one after a new member has entered the firm, or to a reorganized or consolidated corporation taking over the assets of a predecessor.

In the absence of controlling state law to the contrary, subsection (c) [subsection (3)] applies to a sale by a state bank commissioner of the assets of an insolvent bank. However, subsection (c) [subsection (3)] may be preempted by federal law if the Federal Deposit Insurance Corporation takes over an insolvent bank. Under the governing federal law, the FDIC and similar financial institution insurers are given holder in due course status and that status is also acquired by their assignees under the shelter doctrine.

6. Subsection (d) [subsection (4)] and (e) [subsection (5)] clarify two matters not specifically addressed by former Article 3:

Case #5. Payee negotiates a $1,000 note to Holder who agrees to pay $900 for it. After paying $500, Holder learns that Payee defrauded Maker in the transaction giving rise to the note. Under subsection (d) [subsection (4)] Holder may assert rights as a holder in due course to the extent of $555.55 ($500 / $900 = .555 X $1,000 = $555.55). This formula rewards Holder with a ratable portion of the bargained for profit.

Case #6. Payee negotiates a note of Maker for $1,000 to Holder as security for payment of Payee's debt to Holder of $600. Maker has a defense which is good against Payee but of which Holder has no notice. Subsection (e) [subsection (5)] applies. Holder may assert rights as a holder in due course only to the extent of $600. Payee does not get the benefit of the holder-in-due-course status of Holder. With respect to $400 of the note, Maker may assert any rights that Maker has against Payee. A different result follows if the payee of a note negotiated it to a person who took it as a holder in due course and that person pledged the note as security for a debt. Because the defense cannot be asserted against the pledgor, the pledgee can assert rights as a holder in due course for the full amount of the note for the benefit of both the pledgor and the pledgee.

7. There is a large body of state statutory and case law restricting the use of the holder in due course doctrine in consumer transactions as well as some business transactions that raise similar issues. Subsection (g) [subsection (7)] subordinates Article 3 [Article 3-A] to that law and any other similar law that may evolve in the future. Section 3-106(d) [section 3-1106(4)] also relates to statutory or administrative law intended to restrict use of the holder-in-due-course doctrine. See Comment 3 to Section 3-106 [section 3-1106].

§3-1303. Value and consideration

(1) An instrument is issued or transferred for value if:

(a) The instrument is issued or transferred for a promise of performance, to the extent the promise has been performed;

(b) The transferee acquires a security interest or other lien in the instrument other than a lien obtained by judicial proceeding;

(c) The instrument is issued or transferred as payment of, or as security for, an antecedent claim against any person, whether or not the claim is due;

(d) The instrument is issued or transferred in exchange for a negotiable instrument; or

(e) The instrument is issued or transferred in exchange for the incurring of an irrevocable obligation to a 3rd party by the person taking the instrument.

(2) "Consideration" means any consideration sufficient to support a simple contract. The drawer or maker of an instrument has a defense if the instrument is issued without consideration. If an instrument is issued for a promise of performance, the issuer has a defense to the extent performance of the promise is due and the promise has not been performed. If an instrument is issued for value as stated in subsection (1), the instrument is also issued for consideration.

Uniform Commercial Code Comment

1. Subsection (a) [subsection (1)] is a restatement of former Section 3-303 and subsection (b) [subsection (2)] replaces former Section 3-408. The distinction between value and consideration in Article 3 [Article 3-A] is a very fine one. Whether an instrument is taken for value is relevant to the issue of whether a holder is a holder in due course. If an instrument is not issued for consideration the issuer has a defense to the obligation to pay the instrument. Consideration is defined in subsection (b) [subsection (2)] as "any consideration sufficient to support a simple contract." The definition of value in Section 1-201(44), which doesn't apply to Article 3 [Article 3-A], includes "any consideration sufficient to support a simple contract." Thus, outside Article 3 [Article 3-A], anything that is consideration is also value. A different rule applies in Article 3 [Article 3-A]. Subsection (b) [subsection (2)] of Section 3-303 [section 3-1303] states that if an instrument is issued for value it is also issued for consideration.

Case #1. X owes Y $1,000. The debt is not represented by a note. Later X issues a note to Y for the debt. Under subsection (a)(3) [subsection (1)(c)] X's note is issued for value. Under subsection (b) [subsection (2)] the note is also issued for consideration whether or not, under contract law, Y is deemed to have given consideration for the note.

Case #2. X issues a check to Y in consideration of Y's promise to perform services in the future. Although the executory promise is consideration for issuance of the check it is value only to the extent the promise is performed. Subsection (a)(1) [subsection (1)(a)].

Case #3. X issues a note to Y in consideration of Y's promise to perform services. If at the due date of the note Y's performance is not yet due, Y may enforce the note because it was issued for consideration. But if at the due date of the note, Y's performance is due and has not been performed, X has a defense. Subsection (b) [subsection (2)].

2. Subsection (a) [subsection (1)], which defines value, has primary importance in cases in which the issue is whether the holder of an instrument is a holder in due course and particularly to cases in which the issuer of the instrument has a defense to the instrument. Suppose Buyer and Seller signed a contract on April 1 for the sale of goods to be delivered on May 1. Payment of 50% of the price of the goods was due upon signing of the contract. On April 1 Buyer delivered to Seller a check in the amount due under the contract. The check was drawn by X to Buyer as payee and was indorsed to Seller. When the check was presented for payment to the drawee on April 2, it was dishonored because X had stopped payment. At that time Seller had not taken any action to perform the contract with Buyer. If X has a defense on the check, the defense can be asserted against Seller who is not a holder in due course because Seller did not give value for the check. Subsection (a)(1) [subsection (1)(a)]. The policy basis for subsection (a)(1) [subsection (1)(a)] is that the holder who gives an executory promise of performance will not suffer an out-of-pocket loss to the extent the executory promise is unperformed at the time the holder learns of dishonor of the instrument. When Seller took delivery of the check on April 1, Buyer's obligation to pay 50% of the price on that date was suspended, but when the check was dishonored on April 2 the obligation revived. Section 3-310(b) [section 3-1310(2)]. If payment for goods is due at or before delivery and the buyer fails to make the payment, the seller is excused from performing the promise to deliver the goods. Section 2-703. Thus, Seller is protected from an out-of-pocket loss even if the check is not enforceable. Holder-in-due-course status is not necessary to protect Seller.

3. Subsection (a)(2) [subsection (1)(b)] equates value with the obtaining of a security interest or a nonjudicial lien in the instrument. The term "security interest" covers Article 9 cases in which an instrument is taken as collateral as well as bank collection cases in which a bank acquires a security interest under Section 4-210 [section 4-208]. The acquisition of a common-law or statutory banker's lien is also value under subsection (a)(2) [subsection (1)(b)]. An attaching creditor or other person who acquires a lien by judicial proceedings does not give value for the purposes of subsection (a)(2) [subsection (1)(b)].

4. Subsection (a)(3) [subsection (1)(c)] follows former Section 3-303(b) [subsection (2)] in providing that the holder takes for value if the instrument is taken in payment of or as security for an antecedent claim, even though there is no extension of time or other concession, and whether or not the claim is due. Subsection (a)(3) [subsection (1)(c)] applies to any claim against any person; there is no requirement that the claim arise out of contract. In particular the provision is intended to apply to an instrument given in payment of or as security for the debt of a third person, even though no concession is made in return.

5. Subsection (a)(4) [subsection (1)(d)] and (5) [paragraph (e)] restate former Section 3-303(c) [subsection (3)]. They state generally recognized exceptions to the rule that an executory promise is not value. A negotiable instrument is value because it carries the possibility of negotiation to a holder in due course, after which the party who gives it is obliged to pay. The same reasoning applies to any irrevocable commitment to a third person, such as a letter of credit issued when an instrument is taken.

§3-1304. Overdue instrument

(1) An instrument payable on demand becomes overdue at the earliest of the following times:

(a) On the day after the day demand for payment is duly made;

(b) If the instrument is a check, 90 days after its date; or

(c) If the instrument is not a check, when the instrument has been outstanding for a period of time after its date that is unreasonably long under the circumstances of the particular case in light of the nature of the instrument and usage of the trade.

(2) With respect to an instrument payable at a definite time the following rules apply:

(a) If the principal is payable in installments and a due date has not been accelerated, the instrument becomes overdue upon default under the instrument for nonpayment of an installment, and the instrument remains overdue until the default is cured.

(b) If the principal is not payable in installments and the due date has not been accelerated, the instrument becomes overdue on the day after the due date.

(c) If a due date with respect to principal has been accelerated, the instrument becomes overdue on the day after the accelerated due date.

(3) Unless the due date of principal has been accelerated, an instrument does not become overdue if there is default in payment of interest but no default in payment of principal.

Uniform Commercial Code Comment

1. To be a holder in due course, one must take without notice that an instrument is overdue. Section 3-302(a)(2)(iii) [section 3-1302(1)(b)(iii)]. Section 3-304 [section 3-1304] replaces subsection (3) of former Section 3-304. For the sake of clarity it treats demand and time instruments separately. Subsection (a) [subsection (1)] applies to demand instruments. A check becomes stale after 90 days.

Under former Section 3-304(3)(c), a holder that took a demand note had notice that it was overdue if it was taken "more than a reasonable length of time after its issue." In substitution for this test, subsection (a)(3) [subsection (1)(c)] requires the trier of fact to look at both the circumstances of the particular case and the nature of the instrument and trade usage. Whether a demand note is stale may vary a great deal depending on the facts of the particular case.

2. Subsections (b) [subsection (2)] and (c) [subsection (3)] cover time instruments. They follow the distinction made under former Article 3 between defaults in payment of principal and interest. In subsection (b) [subsection (2)] installment instruments and single payment instruments are treated separately. If an installment is late, the instrument is overdue until the default is cured.

§3-1305. Defenses and claims in recoupment

(1) Except as stated in subsection (2), the right to enforce the obligation of a party to pay an instrument is subject to the following:

(a) A defense of the obligor based on:

(i) Infancy of the obligor to the extent it is a defense to a simple contract;

(ii) Duress, lack of legal capacity or illegality of the transaction that, under other law, nullifies the obligation of the obligor;

(iii) Fraud that induced the obligor to sign the instrument with neither knowledge nor reasonable opportunity to learn of its character or its essential terms; or

(iv) Discharge of the obligor in insolvency proceedings;

(b) A defense of the obligor stated in another section of this Article or a defense of the obligor that would be available if the person entitled to enforce the instrument were enforcing a right to payment under a simple contract; and

(c) A claim in recoupment of the obligor against the original payee of the instrument if the claim arose from the transaction that gave rise to the instrument; but the claim of the obligor may be asserted against a transferee of the instrument only to reduce the amount owing on the instrument at the time the action is brought.

(2) The right of a holder in due course to enforce the obligation of a party to pay the instrument is subject to defenses of the obligor stated in subsection (1), paragraph (a), but is not subject to defenses of the obligor stated in subsection (1), paragraph (b) or claims in recoupment stated in subsection (1), paragraph (c) against a person other than the holder.

(3) Except as stated in subsection (4), in an action to enforce the obligation of a party to pay the instrument, the obligor may not assert against the person entitled to enforce the instrument a defense, claim in recoupment or claim to the instrument (section 3-1306) of another person, but the other person's claim to the instrument may be asserted by the obligor if the other person is joined in the action and personally asserts the claim against the person entitled to enforce the instrument. An obligor is not obliged to pay the instrument if the person seeking enforcement of the instrument does not have rights of a holder in due course and the obligor proves that the instrument is a lost or stolen instrument.

(4) In an action to enforce the obligation of an accommodation party to pay an instrument, the accommodation party may assert against the person entitled to enforce the instrument any defense or claim in recoupment under subsection (1) that the accommodated party could assert against the person entitled to enforce the instrument, except the defenses of discharge in insolvency proceedings, infancy and lack of legal capacity.

Uniform Commercial Code Comment

1. Subsection (a) [subsection (1)] states the defenses to the obligation of a party to pay the instrument. Subsection (a)(1) [subsection (1)(a)] states the "real defenses" that may be asserted against any person entitled to enforce the instrument.

Subsection (a)(1)(i) [subsection (1)(a)(i)] allows assertion of the defense of infancy against a holder in due course, even though the effect of the defense is to render the instrument voidable but not void. The policy is one of protection of the infant even at the expense of occasional loss to an innocent purchaser. No attempt is made to state when infancy is available as a defense or the conditions under which it may be asserted. In some jurisdictions it is held that an infant cannot rescind the transaction or set up the defense unless the holder is restored to the position held before the instrument was taken which, in the case of a holder in due course, is normally impossible. In other states an infant who has misrepresented age may be estopped to assert infancy. Such questions are left to other law, as an integral part of the policy of each state as to the protection of infants.

Subsection (a)(1)(ii) [subsection (1)(a)(ii)] covers mental incompetence, guardianship, ultra vires acts or lack of corporate capacity to do business, or any other incapacity apart from infancy. Such incapacity is largely statutory. Its existence and effect is left to the law of each state. If under the state law the effect is to render the obligation of the instrument entirely null and void, the defense may be asserted against a holder in due course. If the effect is merely to render the obligation voidable at the election of the obligor, the defense is cut off.

Duress, which is also covered by subsection (a)(ii) [subsection (1)(b)], is a matter of degree. An instrument signed at the point of a gun is void, even in the hands of a holder in due course. One signed under threat to prosecute the son of the maker for theft may be merely voidable, so that the defense is cut off. Illegality is most frequently a matter of gambling or usury, but may arise in other forms under a variety of statutes. The statutes differ in their provisions and the interpretations given them. They are primarily a matter of local concern and local policy. All such matters are therefore left to the local law. If under that law the effect of the duress or the illegality is to make the obligation entirely null and void, the defense may be asserted against a holder in due course. Otherwise it is cut off.

Subsection (a)(1)(iii) [subsection (1)(a)(iii)] refers to "real" or "essential" fraud, sometimes called fraud in the essence or fraud in the factum, as effective against a holder in due course. The common illustration is that of the maker who is tricked into signing a note in the belief that it is merely a receipt or some other document. The theory of the defense is that the signature on the instrument is ineffective because the signer did not intend to sign such an instrument at all. Under this provision the defense extends to an instrument signed with knowledge that it is a negotiable instrument, but without knowledge of its essential terms. The test of the defense is that of excusable ignorance of the contents of the writing signed. The party must not only have been in ignorance, but must also have had no reasonable opportunity to obtain knowledge. In determining what is a reasonable opportunity all relevant factors are to be taken into account, including the intelligence, education, business experience, and ability to read or understand English of the signer. Also relevant is the nature of the representations that were made, whether the signer had good reason to rely on the representations or to have confidence in the person making them, the presence or absence of any third person who might read or explain the instrument to the signer, or any other possibility of obtaining independent information, and the apparent necessity, or lack of it, for acting without delay. Unless the misrepresentation meets this test, the defense is cut off by a holder in due course.

Subsection (a)(1)(iv) [subsection (1)(a)(iv)] states specifically that the defense of discharge in insolvency proceedings is not cut off when the instrument is purchased by a holder in due course. "Insolvency proceedings" is defined in Section 1-201(22) and it includes bankruptcy whether or not the debtor is insolvent. Subsection (2)(e) of former Section 3-305 is omitted. The substance of that provision is stated in Section 3-601(b) [section 3-1601(2)].

2. Subsection (a)(2) [subsection (1)(b)] states other defenses that, pursuant to subsection (b) [subsection (2)], are cut off by a holder in due course. These defenses comprise those specifically stated in Article 3 [Article 3-A] and those based on common law contract principles. Article 3 [Article 3-A] defenses are nonissuance of the instrument, conditional issuance, and issuance for a special purpose (Section 3-105(b) [section 3-1105 (2)]); failure to countersign a traveler's check (Section 3-106(c) [section 3-1106(3)]); modification of the obligation by a separate agreement (Section 3-117 [section 3-1117]); payment that violates a restrictive indorsement (Section 3-206(f) [section 3-1206(6)]); instruments issued without consideration or for which promised performance has not been given (Section 3-303(b) [section 3-1303(2)]), and breach of warranty when a

draft is accepted (Section 3-417(b) [section 3-1417(2)]). The most prevalent common law defenses are fraud, misrepresentation or mistake in the issuance of the instrument. In most cases the holder in due course will be an immediate or remote transferee of the payee of the instrument. In most cases the holder-in-due-course doctrine is irrelevant if defenses are being asserted against the payee of the instrument, but in a small number of cases the payee of the instrument may be a holder in due course. Those cases are discussed in Comment 4 to Section 3-302 [section 3-1302].

Assume Buyer issues a note to Seller in payment of the price of goods that Seller fraudulently promises to deliver but which are never delivered. Seller negotiates the note to Holder who has no notice of the fraud. If Holder is a holder in due course, Holder is not subject to Buyer's defense of fraud. But in some cases an original party to the instrument is a holder in due course. For example, Buyer fraudulently induces Bank to issue a cashier's check to the order of Seller. The check is delivered by Bank to Seller, who has no notice of the fraud. Seller can be a holder in due course and can take the check free of Bank's defense of fraud. This case is discussed as Case #1 in Comment 4 to Section 3-302 [section 3-1302]. Former Section 3-305 stated that a holder in due course takes free of defenses of "any party to the instrument with whom the holder has not dealt." The meaning of this language was not at all clear and if read literally could have produced the wrong result. In the hypothetical case, it could be argued that Seller "dealt" with Bank because Bank delivered the check to Seller. But it is clear that Seller should take free of Bank's defense against Buyer regardless of whether Seller took delivery of the check from Buyer or from Bank. The quoted language is not included in Section 3-305 [section 3-1305]. It is not necessary. If Buyer issues an instrument to Seller and Buyer has a defense against Seller, that defense can obviously be asserted. Buyer and Seller are the only people involved. The holder-in-due-course doctrine has no relevance. The doctrine applies only to cases in which more than two parties are involved. Its essence is that the holder in due course does not have to suffer the consequences of a defense of the obligor on the instrument that arose from an occurrence with a third party.

3. Subsection (a)(3) [subsection (1)(c)] is concerned with claims in recoupment which can be illustrated by the following example. Buyer issues a note to the order of Seller in exchange for a promise of Seller to deliver specified equipment. If Seller fails to deliver the equipment or delivers equipment that is rightfully rejected, Buyer has a defense to the note because the performance that was the consideration for the note was not rendered. Section 3-303(b) [section 3-1303(2)]. This defense is

included in Section 3-305(a)(2) [section 3-1305(1)(b)]. That defense can always be asserted against Seller.

This result is the same as that reached under former Section 3-408.

But suppose Seller delivered the promised equipment and it was accepted by Buyer. The equipment, however, was defective. Buyer retained the equipment and incurred expenses with respect to its repair. In this case, Buyer does not have a defense under Section 3-303(b) [section 3-1303(2)]. Seller delivered the equipment and the equipment was accepted. Under Article 2, Buyer is obliged to pay the price of the equipment which is represented by the note. But Buyer may have a claim against Seller for breach of warranty. If Buyer has a warranty claim, the claim may be asserted against Seller as a counterclaim or as a claim in recoupment to reduce the amount owing on the note. It is not relevant whether Seller is or is not a holder in due course of the note or whether Seller knew or had notice that Buyer had the warranty claim. It is obvious that holder-in-due-course doctrine cannot be used to allow Seller to cut off a warranty claim that Buyer has against Seller. Subsection (b) [subsection (2)] specifically covers this point by stating that a holder in due course is not subject to a "claim in recoupment * * * against a person other than the holder."

Suppose Seller negotiates the note to Holder. If Holder had notice of Buyer's warranty claim at the time the note was negotiated to Holder, Holder is not a holder in due course (Section 3-302(a)(2)(iv) [section 3-1302(1)(b)(iv)]) and Buyer may assert the claim against Holder (Section 3-305(a)(3) [section 3-1305(1)(c)]) but only as a claim in recoupment, i.e. to reduce the amount owed on the note. If the warranty claim is $1,000 and the unpaid note is $10,000, Buyer owes $9,000 to Holder. If the warranty claim is more than the unpaid amount of the note, Buyer owes nothing to Holder, but Buyer cannot recover the unpaid amount of the warranty claim from Holder. If Buyer had already partially paid the note, Buyer is not entitled to recover the amounts paid. The claim can be used only as an offset to amounts owing on the note. If Holder had no notice of Buyer's claim and otherwise qualifies as a holder in due course, Buyer may not assert the claim against Holder. Section 3-305(b) [section 3-1305(2)].

The result under Section 3-305 [section 3-1305] is consistent with the result reached under former Article 3, but the rules for reaching the result are stated differently. Under former Article 3 Buyer could assert rights against Holder only if Holder was not a holder in due course, and Holder's status depended upon whether Holder had notice of a defense by Buyer.

Courts have held that Holder had that notice if Holder had notice of Buyer's warranty claim. The rationale under former Article 3 was "failure of consideration." This rationale does not distinguish between cases in which the seller fails to perform and those in which the buyer accepts the performance of seller but makes a claim against the seller because the performance is faulty. The term "failure of consideration" is subject to varying interpretations and is not used in Article 3 [Article 3-A]. The use of the term "claim in recoupment" in Section 3-305(a)(3) [section 3-1305(1)(c)] is a more precise statement of the nature of Buyer's right against Holder. The use of the term does not change the law because the treatment of a defense under subsection (a)(2) [subsection (1)(b)] and a claim in recoupment under subsection (a)(3) [subsection (1)(c)] is essentially the same.

Under former Article 3, case law was divided on the issue of the extent to which an obligor on a note could assert against a transferee who is not a holder in due course a debt or other claim that the obligor had against the original payee of the instrument. Some courts limited claims to those that arose in the transaction that gave rise to the note. This is the approach taken in Section 3-305(a)(3) [section 3-1305(1)(c)]. Other courts allowed the obligor on the note to use any debt or other claim, no matter how unrelated to the note, to offset the amount owed on the note. Under current judicial authority and non-UCC statutory law, there will be many cases in which a transferee of a note arising from a sale transaction will not qualify as a holder in due course. For example, applicable law may require the use of a note to which there cannot be a holder in due course. See Section 3-106(d) [section 3-1106(4)] and Comment 3 to Section 3-106 [section 3-1106]. It is reasonable to provide that the buyer should not be denied the right to assert claims arising out of the sale transaction. Subsection (a)(3) [subsection (1)(c)] is based on the belief that it is not reasonable to require the transferee to bear the risk that wholly unrelated claims may also be asserted. The determination of whether a claim arose from the transaction that gave rise to the instrument is determined by law other than this Article and thus may vary as local law varies.

4. Subsection (c) [subsection (3)] concerns claims and defenses of a person other than the obligor on the instrument. It applies principally to cases in which an obligation is paid with the instrument of a third person. For example, Buyer buys goods from Seller and negotiates to Seller a cashier's check issued by Bank in payment of the price. Shortly after delivering the check to Seller, Buyer learns that Seller had defrauded Buyer in the sale transaction. Seller may enforce the check against Bank even though Seller is not a holder in due course. Bank has

no defense to its obligation to pay the check and it may not assert defenses, claims in recoupment, or claims to the instrument of Buyer, except to the extent permitted by the "but" clause of the first sentence of subsection (c) [subsection (3)]. Buyer may have a claim to the instrument under Section 3-306 [section 3-1306] based on a right to rescind the negotiation to Seller because of Seller's fraud. Section 3-202(b) [section 3-1202(2)] and Comment 2 to Section 3-201 [section 3-1201]. Bank cannot assert that claim unless Buyer is joined in the action in which Seller is trying to enforce payment of the check. In that case Bank may pay the amount of the check into court and the court will decide whether that amount belongs to Buyer or Seller. The last sentence of subsection (c) [subsection (3)] allows the issuer of an instrument such as a cashier's check to refuse payment in the rare case in which the issuer can prove that the instrument is a lost or stolen instrument and the person seeking enforcement does not have rights of a holder in due course.

5. Subsection (d) [subsection (4)] applies to instruments signed for accommodation (Section 3-419 [section 3-1419]) and this subsection equates the obligation of the accommodation party to that of the accommodated party. The accommodation party can assert whatever defense or claim the accommodated party had against the person enforcing the instrument. The only exceptions are discharge in bankruptcy, infancy and lack of capacity. The same rule does not apply to an indorsement by a holder of the instrument in negotiating the instrument. The indorser, as transferor, makes a warranty to the indorsee, as transferee, that no defense or claim in recoupment is good against the indorser. Section 3-416(a)(4) [section 3-1416(1)(d)]. Thus, if the indorsee sues the indorser because of dishonor of the instrument, the indorser may not assert the defense or claim in recoupment of the maker or drawer against the indorsee.

§3-1306. Claims to an instrument

A person taking an instrument, other than a person having rights of a holder in due course, is subject to a claim of a property or possessory right in the instrument or its proceeds, including a claim to rescind a negotiation and to recover the instrument or its proceeds. A person having rights of a holder in due course takes free of the claim to the instrument.

Uniform Commercial Code Comment

This section expands on the reference to "claims to" the instrument mentioned in former Sections 3-305 and 3-306. Claims covered by the section include not only claims to ownership but also any other claim of a property or possessory right. It

includes the claim to a lien or the claim of a person in rightful possession of an instrument who was wrongfully deprived of possession. Also included is a claim based on Section 3-202(b) [section 3-1202(2)] for rescission of a negotiation of the instrument by the claimant. Claims to an instrument under Section 3-306 [section 3-1306] are different from claims in recoupment referred to in Section 3-305(a)(3) [section 3-1305(1)(c)].

§3-1307. Notice of breach of fiduciary duty

(1) In this section:

(a) "Fiduciary" means an agent, trustee, partner, corporate officer or director, or other representative owing a fiduciary duty with respect to an instrument; and

(b) "Represented person" means the principal, beneficiary, partnership, corporation or other person to whom the duty stated in paragraph (a) is owed.

(2) If an instrument is taken from a fiduciary for payment or collection or for value, the taker has knowledge of the fiduciary status of the fiduciary and the represented person makes a claim to the instrument or its proceeds on the basis that the transaction of the fiduciary is a breach of fiduciary duty, the following rules apply.

(a) Notice of breach of fiduciary duty by the fiduciary is notice of the claim of the represented person.

(b) In the case of an instrument payable to the represented person or the fiduciary as such, the taker has notice of the breach of fiduciary duty if the instrument is:

(i) Taken in payment of or as security for a debt known by the taker to be the personal debt of the fiduciary;

(ii) Taken in a transaction known by the taker to be for the personal benefit of the fiduciary; or

(iii) Deposited to an account other than an account of the fiduciary, as such, or an account of the represented person.

(c) If an instrument is issued by the represented person or the fiduciary as such and made payable to the fiduciary personally, the taker does not have notice of the breach of fiduciary duty unless the taker knows of the breach of fiduciary duty.

(d) If an instrument is issued by the represented person or the fiduciary as such to the taker as payee, the taker has notice of the breach of fiduciary duty if the instrument is:

(i) Taken in payment of or as security for a debt known by the taker to be the personal debt of the fiduciary;

(ii) Taken in a transaction known by the taker to be for the personal benefit of the fiduciary; or

(iii) Deposited to an account other than an account of the fiduciary as such or an account of the represented person.

Uniform Commercial Code Comment

1. This section states rules for determining when a person who has taken an instrument from a fiduciary has notice of a breach of fiduciary duty that occurs as a result of the transaction with the fiduciary. Former Section 3-304(2) and (4)(e) related to this issue, but those provisions were unclear in their meaning. Section 3-307 [section 3-1307] is intended to clarify the law by stating rules that comprehensively cover the issue of when the taker of an instrument has notice of breach of a fiduciary duty and thus notice of a claim to the instrument or its proceeds.

2. Subsection (a) [subsection (1)] defines the terms "fiduciary" and "represented person" and the introductory paragraph of subsection (b) [subsection (2)] describes the transaction to which the section applies. The basic scenario is one in which the fiduciary in effect embezzles money of the represented person by applying the proceeds of an instrument that belongs to the represented person to the personal use of the fiduciary. The person dealing with the fiduciary may be a depositary bank that takes the instrument for collection or a bank or other person that pays value for the instrument. The section also covers a transaction in which an instrument is presented for payment to a payor bank that pays the instrument by giving value to the fiduciary. Subsections (b)(2), (3), and (4) [subsections (2)(b), (c) and (d)] state rules for determining when the person dealing with the fiduciary has notice of breach of fiduciary duty. Subsection (b)(1) [subsection (2)(a)] states that notice of breach of fiduciary duty is notice of the represented person's claim to the instrument or its proceeds.

Under Section 3-306 [section 3-1306], a person taking an instrument is subject to a claim to the instrument or its

proceeds, unless the taker has rights of a holder in due course. Under Section 3-302(a)(2)(v) [section 3-1302(1)(b)(v)], the taker cannot be a holder in due course if the instrument was taken with notice of a claim under Section 3-306 [section 3-1306]. Section 3-307 [section 3-1307] applies to cases in which a represented person is asserting a claim because a breach of fiduciary duty resulted in a misapplication of the proceeds of an instrument. The claim of the represented person is a claim described in Section 3-306 [section 3-1306]. Section 3-307 [section 3-1307] states rules for determining when a person taking an instrument has notice of the claim which will prevent assertion of rights as a holder in due course. It also states rules for determining when a payor bank pays an instrument with notice of breach of fiduciary duty.

Section 3-307(b) [section 3-1307(2)] applies only if the person dealing with the fiduciary "has knowledge of the fiduciary status of the fiduciary." Notice which does not amount to knowledge is not enough to cause Section 3-307 [section 3-1307] to apply. "Knowledge" is defined in Section 1-201(25). In most cases, the "taker" referred to in Section 3-307 [section 3-1307] will be a bank or other organization. Knowledge of an organization is determined by the rules stated in Section 1-201(27). In many cases, the individual who receives and processes an instrument on behalf of the organization that is the taker of the instrument "for payment or collection or for value" is a clerk who has no knowledge of any fiduciary status of the person from whom the instrument is received. In such cases, Section 3-307 [section 3-1307] doesn't apply because, under Section 1-201(27), knowledge of the organization is determined by the knowledge of the "individual conducting that transaction," i.e. the clerk who receives and processes the instrument. Furthermore, paragraphs (2) [paragraph (b)] and (4) [paragraph (d)] each require that the person acting for the organization have knowledge of facts that indicate a breach of fiduciary duty. In the case of an instrument taken for deposit to an account, the knowledge is found in the fact that the deposit is made to an account other than that of the represented person or a fiduciary account for benefit of that person. In other cases the person acting for the organization must know that the instrument is taken in payment or as security for a personal debt of the fiduciary or for the personal benefit of the fiduciary. For example, if the instrument is being used to buy goods or services, the person acting for the organization must know that the goods or services are for the personal benefit of the fiduciary. The requirement that the taker have knowledge rather than notice is meant to limit Section 3-307 [section 3-1307] to relatively uncommon cases in which the person who deals with the fiduciary knows all the relevant facts: the fiduciary status and that the proceeds of the instrument are being used for the

personal debt or benefit of the fiduciary or are being paid to an account that is not an account of the represented person or of the fiduciary, as such. Mere notice of these facts is not enough to put the taker on notice of the breach of fiduciary duty and does not give rise to any duty of investigation by the taker.

3. Subsection (b)(2) [subsection (2)(b)] applies to instruments payable to the represented person or the fiduciary as such. For example, a check payable to Corporation is indorsed in the name of Corporation by Doe as its President. Doe gives the check to Bank as partial repayment of a personal loan that Bank had made to Doe. The check was indorsed either in blank or to Bank. Bank collects the check and applies the proceeds to reduce the amount owed on Doe's loan. If the person acting for Bank in the transaction knows that Doe is a fiduciary and that the check is being used to pay a personal obligation of Doe, subsection (b)(2) [subsection (2)(b)] applies. If Corporation has a claim to the proceeds of the check because the use of the check by Doe was a breach of fiduciary duty, Bank has notice of the claim and did not take the check as a holder in due course. The same result follows if Doe had indorsed the check to himself before giving it to Bank. Subsection (b)(2) [subsection (2)(b)] follows Uniform Fiduciaries Act § 4 in providing that if the instrument is payable to the fiduciary, as such, or to the represented person, the taker has notice of a claim if the instrument is negotiated for the fiduciary's personal debt. If fiduciary funds are deposited to a personal account of the fiduciary or to an account that is not an account of the represented person or of the fiduciary, as such, there is a split of authority concerning whether the bank is on notice of a breach of fiduciary duty. Subsection (b)(2)(iii) [subsection (2)(b)] states that the bank is given notice of breach of fiduciary duty because of the deposit. The Uniform Fiduciaries Act § 9 states that the bank is not on notice unless it has knowledge of facts that makes its receipt of the deposit an act of bad faith.

The rationale of subsection (b)(2) [subsection (2)(b)] is that it is not normal for an instrument payable to the represented person or the fiduciary, as such, to be used for the personal benefit of the fiduciary. It is likely that such use reflects an unlawful use of the proceeds of the instrument. If the fiduciary is entitled to compensation from the represented person for services rendered or for expenses incurred by the fiduciary the normal mode of payment is by a check drawn on the fiduciary account to the order of the fiduciary.

4. Subsection (b)(3) [subsection (2)(c)] is based on Uniform Fiduciaries Act § 6 and applies when the instrument is drawn by the represented person or the fiduciary as such to the fiduciary personally. The term "personally" is used as it is

used in the Uniform Fiduciaries Act to mean that the instrument is payable to the payee as an individual and not as a fiduciary. For example, Doe as President of Corporation writes a check on Corporation's account to the order of Doe personally. The check is then indorsed over to Bank as in Comment 3. In this case there is no notice of breach of fiduciary duty because there is nothing unusual about the transaction. Corporation may have owed Doe money for salary, reimbursement for expenses incurred for the benefit of Corporation, or for any other reason. If Doe is authorized to write checks on behalf of Corporation to pay debts of Corporation, the check is a normal way of paying a debt owed to Doe. Bank may assume that Doe may use the instrument for his personal benefit.

5. Subsection (b)(4) [subsection (2)(d)] can be illustrated by a hypothetical case. Corporation draws a check payable to an organization. X, an officer or employee of Corporation, delivers the check to a person acting for the organization. The person signing the check on behalf of Corporation is X or another person. If the person acting for the organization in the transaction knows that X is a fiduciary, the organization is on notice of a claim by Corporation if it takes the instrument under the same circumstances stated in subsection (b)(2) [subsection (2)(b)]. If the organization is a bank and the check is taken in repayment of a personal loan of the bank to X, the case is like the case discussed in Comment 3. It is unusual for Corporation, the represented person, to pay a personal debt of Doe by issuing a check to the bank. It is more likely that the use of the check by Doe reflects an unlawful use of the proceeds of the check. The same analysis applies if the check is made payable to an organization in payment of goods or services. If the person acting for the organization knew of the fiduciary status of X and that the goods or services were for X's personal benefit, the organization is on notice of a claim by Corporation to the proceeds of the check. See the discussion in the last paragraph of Comment 2.

§3-1308. Proof of signatures and status as holder in due course

(1) In an action with respect to an instrument, the authenticity of, and authority to make, each signature on the instrument is admitted unless specifically denied in the pleadings. If the validity of a signature is denied in the pleadings, the burden of establishing validity is on the person claiming validity, but the signature is presumed to be authentic and authorized unless the action is to enforce the liability of the purported signer and the signer is dead or incompetent at the time of trial of the issue of validity of the signature. If an action to enforce the instrument is brought against a person as the undisclosed principal of a person who signed the instrument

as a party to the instrument, the plaintiff has the burden of establishing that the defendant is liable on the instrument as a represented person under section 3-1402, subsection (1).

(2) If the validity of signatures is admitted or proved and there is compliance with subsection (1), a plaintiff producing the instrument is entitled to payment if the plaintiff proves entitlement to enforce the instrument under section 3-1301, unless the defendant proves a defense or claim in recoupment. If a defense or claim in recoupment is proved, the right to payment of the plaintiff is subject to the defense or claim, except to the extent the plaintiff proves that the plaintiff has rights of a holder in due course which are not subject to the defense or claim.

Uniform Commercial Code Comment

1. Section 3-308 [section 3-1308] is a modification of former Section 3-307. The first two sentences of subsection (a) [subsection (1)] are a restatement of former Section 3-307(1). The purpose of the requirement of a specific denial in the pleadings is to give the plaintiff notice of the defendant's claim of forgery or lack of authority as to the particular signature, and to afford the plaintiff an opportunity to investigate and obtain evidence. If local rules of pleading permit, the denial may be on information and belief, or it may be a denial of knowledge or information sufficient to form a belief. It need not be under oath unless the local statutes or rules require verification. In the absence of such specific denial the signature stands admitted, and is not in issue. Nothing in this section is intended, however, to prevent amendment of the pleading in a proper case.

The question of the burden of establishing the signature arises only when it has been put in issue by specific denial. "Burden of establishing" is defined in Section 1-201. The burden is on the party claiming under the signature, but the signature is presumed to be authentic and authorized except as stated in the second sentence of subsection (a) [subsection (1)]. "Presumed" is defined in Section 1-201 and means that until some evidence is introduced which would support a finding that the signature is forged or unauthorized, the plaintiff is not required to prove that it is valid. The presumption rests upon the fact that in ordinary experience forged or unauthorized signatures are very uncommon, and normally any evidence is within the control of, or more accessible to, the defendant. The defendant is therefore required to make some sufficient showing of the grounds for the denial before the plaintiff is required to introduce evidence. The defendant's evidence need not be sufficient to require a directed verdict, but it must be enough

to support the denial by permitting a finding in the defendant's favor. Until introduction of such evidence the presumption requires a finding for the plaintiff. Once such evidence is introduced the burden of establishing the signature by a preponderance of the total evidence is on the plaintiff. The presumption does not arise if the action is to enforce the obligation of a purported signer who has died or become incompetent before the evidence is required, and so is disabled from obtaining or introducing it. "Action" is defined in Section 1-201 and includes a claim asserted against the estate of a deceased or an incompetent.

The last sentence of subsection (a) [subsection (1)] is a new provision that is necessary to take into account Section 3-402(a) [section 3-1402 (1)] that allows an undisclosed principal to be liable on an instrument signed by an authorized representative. In that case the person enforcing the instrument must prove that the undisclosed principal is liable.

2. Subsection (b) [subsection (2)] restates former Section 3-307(2) and (3). Once signatures are proved or admitted a holder, by mere production of the instrument, proves "entitlement to enforce the instrument" because under Section 3-301 [section 3-1301] a holder is a person entitled to enforce the instrument. Any other person in possession of an instrument may recover only if that person has the rights of a holder. Section 3-301 [section 3-1301]. That person must prove a transfer giving that person such rights under Section 3-203(b) [section 3-1203(2)] or that such rights were obtained by subrogation or succession.

If a plaintiff producing the instrument proves entitlement to enforce the instrument, either as a holder or a person with rights of a holder, the plaintiff is entitled to recovery unless the defendant proves a defense or claim in recoupment. Until proof of a defense or claim in recoupment is made, the issue as to whether the plaintiff has rights of a holder in due course does not arise. In the absence of a defense or claim in recoupment, any person entitled to enforce the instrument is entitled to recover. If a defense or claim in recoupment is proved, the plaintiff may seek to cut off the defense or claim in recoupment by proving that the plaintiff is a holder in due course or that the plaintiff has rights of a holder in due course under Section 3-203(b) [section 3-1203(2)] or by subrogation or succession. All elements of Section 3-302(a) [section 3-1302(1)] must be proved.

Nothing in this section is intended to say that the plaintiff must necessarily prove rights as a holder in due course. The plaintiff may elect to introduce no further evidence, in which case a verdict may be directed for the

plaintiff or the defendant, or the issue of the defense or claim in recoupment may be left to the trier of fact, according to the weight and sufficiency of the defendant's evidence. The plaintiff may elect to rebut the defense or claim in recoupment by proof to the contrary, in which case a verdict may be directed for either party or the issue may be for the trier of fact. Subsection (b) [subsection (2)] means only that if the plaintiff claims the rights of a holder in due course against the defense or claim in recoupment, the plaintiff has the burden of proof on that issue.

§3-1309. Enforcement of lost, destroyed or stolen instrument

(1) A person not in possession of an instrument is entitled to enforce the instrument if:

(a) The person was in possession of the instrument and entitled to enforce it when loss of possession occurred;

(b) The loss of possession was not the result of a transfer by the person or a lawful seizure; and

(c) The person can not reasonably obtain possession of the instrument because the instrument was destroyed, its whereabouts can not be determined or it is in the wrongful possession of an unknown person or a person that can not be found or is not amenable to service of process.

(2) A person seeking enforcement of an instrument under subsection (1) must prove the terms of the instrument and the person's right to enforce the instrument. If that proof is made, Section 3-1308 applies to the case as if the person seeking enforcement had produced the instrument. The court may not enter judgment in favor of the person seeking enforcement unless it finds that the person required to pay the instrument is adequately protected against loss that might occur by reason of a claim by another person to enforce the instrument. Adequate protection may be provided by any reasonable means.

Uniform Commercial Code Comment

Section 3-309 [section 3-1309] is a modification of former Section 3-804. The rights stated are those of "a person entitled to enforce the instrument" at the time of loss rather than those of an "owner" as in former Section 3-804. Under subsection (b) [subsection (2)], judgment to enforce the instrument cannot be given unless the court finds that the defendant will be adequately protected against a claim to the instrument by a holder that may appear at some later time. The court is given discretion in determining how adequate protection is to be

assured. Former Section 3-804 allowed the court to "require security indemnifying the defendant against loss." Under Section 3-309 [section 3-1309] adequate protection is a flexible concept. For example, there is substantial risk that a holder in due course may make a demand for payment if the instrument was payable to bearer when it was lost or stolen. On the other hand if the instrument was payable to the person who lost the instrument and that person did not indorse the instrument, no other person could be a holder of the instrument. In some cases there is risk of loss only if there is doubt about whether the facts alleged by the person who lost the instrument are true. Thus, the type of adequate protection that is reasonable in the circumstances may depend on the degree of certainty about the facts in the case.

§3-1310. Effect of instrument on obligation for which taken

(1) Unless otherwise agreed, if a certified check, cashier's check or teller's check is taken for an obligation, the obligation is discharged to the same extent discharge would result if an amount of money equal to the amount of the instrument were taken in payment of the obligation. Discharge of the obligation does not affect any liability that the obligor may have as an indorser of the instrument.

(2) Unless otherwise agreed and except as provided in subsection (1), if a note or an uncertified check is taken for an obligation, the obligation is suspended to the same extent the obligation would be discharged if an amount of money equal to the amount of the instrument were taken and the following rules apply.

(a) In the case of an uncertified check, suspension of the obligation continues until dishonor of the check or until it is paid or certified. Payment or certification of the check results in discharge of the obligation to the extent of the amount of the check.

(b) In the case of a note, suspension of the obligation continues until dishonor of the note or until it is paid. Payment of the note results in discharge of the obligation to the extent of the payment.

(c) Except as provided in paragraph (d), if the check or note is dishonored and the obligee of the obligation for which the instrument was taken is the person entitled to enforce the instrument, the obligee may enforce either the instrument or the obligation. In the case of an instrument of a 3rd person that is negotiated to the obligee by the obligor, discharge of the obligor on the instrument also discharges the obligation.

(d) If the person entitled to enforce the instrument taken for an obligation is a person other than the obligee, the obligee may not enforce the obligation to the extent the obligation is suspended. If the obligee is the person entitled to enforce the instrument but no longer has possession of it because it was lost, stolen or destroyed, the obligation may not be enforced to the extent of the amount payable on the instrument and to that extent the obligee's rights against the obligor are limited to enforcement of the instrument.

(3) If an instrument other than one described in subsection (1) or (2) is taken for an obligation, the effect is:

(a) That effect stated in subsection (1) if the instrument is one on which a bank is liable as maker or acceptor; or

(b) That effect stated in subsection (2) in any other case.

Uniform Commercial Code Comment

1. Section 3-310 [section 3-1310] is a modification of former Section 3-802. As a practical matter, application of former Section 3-802 was limited to cases in which a check or a note was given for an obligation. Subsections (a) [subsection (1)] and (b) [subsection (2)] of Section 3-310 [section 3-1310] are therefore stated in terms of checks and notes in the interests of clarity. Subsection (c) [subsection (3)] covers the rare cases in which some other instrument is given to pay an obligation.

2. Subsection (a) [subsection (1)] deals with the case in which a certified check, cashier's check or teller's check is given in payment of an obligation. In that case the obligation is discharged unless there is an agreement to the contrary. Subsection (a) [subsection (1)] drops the exception in former Section 3-802 for cases in which there is a right of recourse on the instrument against the obligor. Under former Section 3-802(1)(a) the obligation was not discharged if there was a right of recourse on the instrument against the obligor. Subsection (a) [subsection (1)] changes this result. The underlying obligation is discharged, but any right of recourse on the instrument is preserved.

3. Subsection (b) [subsection (2)] concerns cases in which an uncertified check or a note is taken for an obligation. The typical case is that in which a buyer pays for goods or services by giving the seller the buyer's personal check, or in which the buyer signs a note for the purchase price. Subsection (b)

[subsection (2)] also applies to the uncommon cases in which a check or note of a third person is given in payment of the obligation. Subsection (b) [subsection (2)] preserves the rule under former Section 3-802(1)(b) that the buyer's obligation to pay the price is suspended, but subsection (b) [subsection (2)] spells out the effect more precisely. If the check or note is dishonored, the seller may sue on either the dishonored instrument or the contract of sale if the seller has possession of the instrument and is the person entitled to enforce it. If the right to enforce the instrument is held by somebody other than the seller, the seller can't enforce the right to payment of the price under the sales contract because that right is represented by the instrument which is enforceable by somebody else. Thus, if the seller sold the note or the check to a holder and has not reacquired it after dishonor, the only right that survives is the right to enforce the instrument.

The last sentence of subsection (b)(3) [subsection (2)(c)] applies to cases in which an instrument of another person is indorsed over to the obligee in payment of the obligation. For example, Buyer delivers an uncertified personal check of X payable to the order of Buyer to Seller in payment of the price of goods. Buyer indorses the check over to Seller. Buyer is liable on the check as indorser. If Seller neglects to present the check for payment or to deposit it for collection within 30 days of the indorsement, Buyer's liability as indorser is discharged. Section 3-415(e) [section 3-1415(5)]. Under the last sentence of Section 3-310(b)(3) [section 3-1310(2)(c)] Buyer is also discharged on the obligation to pay for the goods.

4. There was uncertainty concerning the applicability of former Section 3-802 to the case in which the check given for the obligation was stolen from the payee, the payee's signature was forged, and the forger obtained payment. The last sentence of subsection (b)(4) [subsection (2)(d)] addresses this issue. If the payor bank pays a holder, the drawer is discharged on the underlying obligation because the check was paid. Subsection (b)(1) [subsection (2)(a)]. If the payor bank pays a person not entitled to enforce the instrument, as in the hypothetical case, the suspension of the underlying obligation continues because the check has not been paid. Section 3-602(a) [section 3-1602(1)]. The payee's cause of action is against the depositary bank or payor bank in conversion under Section 3-420 [section 3-1420] or against the drawer under Section 3-309 [section 3-1309]. In the latter case, the drawer's obligation under Section 3-414(b) [section 3-1414(2)] is triggered by dishonor which occurs because the check is unpaid. Presentment for payment to the drawee is excused under Section 3-504(a)(i) [section 3-1504(1)(a)] and, under Section 3-502(e) [section 3-1502(5)], dishonor occurs without presentment if the check is not paid. The payee cannot

merely ignore the instrument and sue the drawer on the underlying contract. This would impose on the drawer the risk that the check when stolen was indorsed in blank or to bearer.

A similar analysis applies with respect to lost instruments that have not been paid. If a creditor takes a check of the debtor in payment of an obligation, the obligation is suspended under the introductory paragraph of subsection (b) [subsection (2)]. If the creditor then loses the check, what are the creditor's rights? The creditor can request the debtor to issue a new check and in many cases, the debtor will issue a replacement check after stopping payment on the lost check. In that case both the debtor and creditor are protected. But the debtor is not obliged to issue a new check. If the debtor refuses to issue a replacement check, the last sentence of subsection (b)(4) [subsection (2)(d)] applies. The creditor may not enforce the obligation of debtor for which the check was taken. The creditor may assert only rights on the check. The creditor can proceed under Section 3-309 [section 3-1309] to enforce the obligation of the debtor, as drawer, to pay the check.

5. Subsection (c) [subsection (3)] deals with rare cases in which other instruments are taken for obligations. If a bank is the obligor on the instrument, subsection (a) [subsection (1)] applies and the obligation is discharged. In any other case subsection (b) [subsection (2)] applies.

§3-1311. Accord and satisfaction by use of instrument

(1) Subsections (2) to (4) apply if a person against whom a claim is asserted proves that:

(a) The person in good faith tendered an instrument to the claimant as full satisfaction of the claim;

(b) The amount of the claim was unliquidated or subject to a bona fide dispute; and

(c) The claimant obtained payment of the instrument.

(2) Unless subsection (3) applies, the claim is discharged if the person against whom the claim is asserted proves that the instrument or an accompanying written communication contained a conspicuous statement to the effect that the instrument was tendered as full satisfaction of the claim.

(3) Subject to subsection (4), a claim is not discharged under subsection (2) if either of the following applies:

(a) The claimant, if an organization, proves that:

(i) Within a reasonable time before the tender, the claimant sent a conspicuous statement to the person against whom the claim is asserted that communications concerning disputed debts, including an instrument tendered as full satisfaction of a debt, are to be sent to a designated person, office or place; and

(ii) The instrument or accompanying communication was not received by that designated person, office or place; or

(b) The claimant, whether or not an organization, proves that within 90 days after payment of the instrument, the claimant tendered repayment of the amount of the instrument to the person against whom the claim is asserted. This paragraph does not apply if the claimant is an organization that sent a statement complying with paragraph (a), subparagraph (i).

(4) A claim is discharged if the person against whom the claim is asserted proves that within a reasonable time before collection of the instrument was initiated, the claimant, or an agent of the claimant having direct responsibility with respect to the disputed obligation, knew that the instrument was tendered in full satisfaction of the claim.

Uniform Commercial Code Comment

1. This section deals with an informal method of dispute resolution carried out by use of a negotiable instrument. In the typical case there is a dispute concerning the amount that is owed on a claim.

Case #1. The claim is for the price of goods or services sold to a consumer who asserts that he or she is not obliged to pay the full price for which the consumer was billed because of a defect or breach of warranty with respect to the goods or services.

Case #2. A claim is made on an insurance policy. The insurance company alleges that it is not liable under the policy for the amount of the claim.

In either case the person against whom the claim is asserted may attempt an accord and satisfaction of the disputed claim by tendering a check to the claimant for some amount less than the full amount claimed by the claimant. A statement will be included on the check or in a communication accompanying the check to the effect that the check is

offered as full payment or full satisfaction of the claim. Frequently, there is also a statement to the effect that obtaining payment of the check is an agreement by the claimant to a settlement of the dispute for the amount tendered. Before enactment of revised Article 3 [Article 3-A], the case law was in conflict over the question of whether obtaining payment of the check had the effect of an agreement to the settlement proposed by the debtor. This issue was governed by a common law rule, but some courts hold that the common law was modified by former Section 1-207 which they interpreted as applying to full settlement checks.

2. Comment d. to Restatement of Contracts, Section 281 discusses the full satisfaction check and the applicable common law rule. In a case like Case #1, the buyer can propose a settlement of the disputed bill by a clear notation on the check indicating that the check is tendered as full satisfaction of the bill. Under the common law rule the seller, by obtaining payment of the check accepts the offer of compromise by the buyer. The result is the same if the seller adds a notation to the check indicating that the check is accepted under protest or in only partial satisfaction of the claim. Under the common law rule the seller can refuse the check or can accept it subject to the condition stated by the buyer, but the seller can't accept the check and refuse to be bound by the condition. The rule applies only to an unliquidated claim or a claim disputed in good faith by the buyer. The dispute in the courts was whether Section 1-207 changed the common law rule. The Restatement states that section "need not be read as changing this well-established rule."

3. As part of the revision of Article 3 [Article 3-A], Section 1-207 has been amended to add subsection (2) stating that Section 1-207 "does not apply to an accord and satisfaction." Because of that amendment and revised Article 3 [Article 3-A], Section 3-311 [section 3-1311] governs full satisfaction checks. Section 3-311 [section 3-1311] follows the common law rule with some minor variations to reflect modern business conditions. In cases covered by Section 3-311 [section 3-1311] there will often be an individual on one side of the dispute and a business organization on the other. This section is not designed to favor either the individual or the business organization. In Case #1 the person seeking the accord and satisfaction is an individual. In Case #2 the person seeking the accord and satisfaction is an insurance company. Section 3-311 [section 3-1311] is based on a belief that the common law rule produces a fair result and that informal dispute resolution by full satisfaction checks should be encouraged.

4. Subsection (a) [subsection (1)] states three requirements for application of Section 3-311 [section 3-1311]. "Good faith" in subsection (a)(i) [subsection (1)(a)] is defined in Section 3-103(a)(4) [section 3-1103(1)(d)] as not only honesty in fact, but the observance of reasonable commercial standards of fair dealing. The meaning of "fair dealing" will depend upon the facts in the particular case. For example, suppose an insurer tenders a check in settlement of a claim for personal injury in an accident clearly covered by the insurance policy. The claimant is necessitous and the amount of the check is very small in relationship to the extent of the injury and the amount recoverable under the policy. If the trier of fact determines that the insurer was taking unfair advantage of the claimant, an accord and satisfaction would not result from payment of the check because of the absence of good faith by the insurer in making the tender. Another example of lack of good faith is found in the practice of some business debtors in routinely printing full satisfaction language on their check stocks so that all or a large part of the debts of the debtor are paid by checks bearing the full satisfaction language, whether or not there is any dispute with the creditor. Under such a practice the claimant cannot be sure whether a tender in full satisfaction is or is not being made. Use of a check on which full satisfaction language was affixed routinely pursuant to such a business practice may prevent an accord and satisfaction on the ground that the check was not tendered in good faith under subsection (a)(i) [subsection (1)].

Section 3-311 [section 3-1311] does not apply to cases in which the debt is a liquidated amount and not subject to a bona fide dispute. Subsection (a)(ii) [subsection (1)]. Other law applies to cases in which a debtor is seeking discharge of such a debt by paying less than the amount owed. For the purpose of subsection (a)(iii) [subsection (1)] obtaining acceptance of a check is considered to be obtaining payment of the check.

The person seeking the accord and satisfaction must prove that the requirements of subsection (a) [subsection (1)] are met. If that person also proves that the statement required by subsection (b) [subsection (2)] was given, the claim is discharged unless subsection (c) [subsection (3)] applies. Normally the statement required by subsection (b) [subsection (2)] is written on the check. Thus, the canceled check can be used to prove the statement as well as the fact that the claimant obtained payment of the check. Subsection (b) [subsection (2)] requires a "conspicuous" statement that the instrument was tendered in full satisfaction of the claim. "Conspicuous" is defined in Section 1-201(10). The statement is conspicuous if "it is so written that a reasonable person against whom it is to operate ought to have noticed it." If the claimant can

reasonably be expected to examine the check, almost any statement on the check should be noticed and is therefore conspicuous. In cases in which the claimant is an individual the claimant will receive the check and will normally indorse it. Since the statement concerning tender in full satisfaction normally will appear above the space provided for the claimant's indorsement of the check, the claimant "ought to have noticed" the statement.

5. Subsection (c)(1) [subsection (3)(a)] is a limitation on subsection (b) [subsection (2)] in cases in which the claimant is an organization. It is designed to protect the claimant against inadvertent accord and satisfaction. If the claimant is an organization payment of the check might be obtained without notice to the personnel of the organization concerned with the disputed claim. Some business organizations have claims against very large numbers of customers. Examples are department stores, public utilities and the like. These claims are normally paid by checks sent by customers to a designated office at which clerks employed by the claimant or a bank acting for the claimant process the checks and record the amounts paid. If the processing office is not designed to deal with communications extraneous to recording the amount of the check and the account number of the customer, payment of a full satisfaction check can easily be obtained without knowledge by the claimant of the existence of the full satisfaction statement. This is particularly true if the statement is written on the reverse side of the check in the area in which indorsements are usually written. Normally, the clerks of the claimant have no reason to look at the reverse side of checks. Indorsement by the claimant normally is done by mechanical means or there may be no indorsement at all. Section 4-205(a) [section 4-205(1)]. Subsection (c)(1) [subsection (3)(a)] allows the claimant to protect itself by advising customers by a conspicuous statement that communications regarding disputed debts must be sent to a particular person, office, or place. The statement must be given to the customer within a reasonable time before the tender is made. This requirement is designed to assure that the customer has reasonable notice that the full satisfaction check must be sent to a particular place. The reasonable time requirement could be satisfied by a notice on the billing statement sent to the customer. If the full satisfaction check is sent to the designated destination and the check is paid, the claim is discharged. If the claimant proves that the check was not received at the designated destination the claim is not discharged unless subsection (d) [subsection (4)] applies.

6. Subsection (c)(2) [subsection (3)(b)] is also designed to prevent inadvertent accord and satisfaction. It can be used by a claimant other than an organization or by a claimant as an alternative to subsection (c)(1) [subsection (3)(a)]. Some

organizations may be reluctant to use subsection (c)(1) [subsection (3)(a)] because it may result in confusion of customers that causes checks to be routinely sent to the special designated person, office, or place. Thus, much of the benefit of rapid processing of checks may be lost. An organization that chooses not to send a notice complying with subsection (c)(1)(i) [subsection (3)(a)(i)] may prevent an inadvertent accord and satisfaction by complying with subsection (c)(2) [subsection (3)(b)]. If the claimant discovers that it has obtained payment of a full satisfaction check, it may prevent an accord and satisfaction if, within 90 days of the payment of the check, the claimant tenders repayment of the amount of the check to the person against whom the claim is asserted.

7. Subsection (c) [subsection (3)] is subject to subsection (d) [subsection (4)]. If a person against whom a claim is asserted proves that the claimant obtained payment of a check known to have been tendered in full satisfaction of the claim by "the claimant or an agent of the claimant having direct responsibility with respect to the disputed obligation," the claim is discharged even if (i) the check was not sent to the person, office, or place required by a notice complying with subsection (c)(1) [subsection (3)(a)], or (ii) the claimant tendered repayment of the amount of the check in compliance with subsection (c)(2) [subsection (3)(b)].

A claimant knows that a check was tendered in full satisfaction of a claim when the claimant "has actual knowledge" of that fact. Section 1-201(25). Under Section 1-201(27), if the claimant is an organization, it has knowledge that a check was tendered in full satisfaction of the claim when that fact is

> "brought to the attention of the individual conducting that transaction, and in any event when it would have been brought to his attention if the organization had exercised due diligence. An organization exercises due diligence if it maintains reasonable routines for communicating significant information to the person conducting the transaction and there is reasonable compliance with the routines. Due diligence does not require an individual acting for the organization to communicate information unless such communication is part of his regular duties or unless he has reason to know of the transaction and that the transaction would be materially affected by the information."

With respect to an attempted accord and satisfaction the "individual conducting that transaction" is an employee or other agent of the organization having direct responsibility with respect to the dispute. For example, if the check and communication are received by a collection agency acting for the

claimant to collect the disputed claim, obtaining payment of the check will result in an accord and satisfaction even if the claimant gave notice, pursuant to subsection (c)(1) [subsection (3)(a)], that full satisfaction checks be sent to some other office. Similarly, if a customer asserting a claim for breach of warranty with respect to defective goods purchased in a retail outlet of a large chain store delivers the full satisfaction check to the manager of the retail outlet at which the goods were purchased, obtaining payment of the check will also result in an accord and satisfaction. On the other hand, if the check is mailed to the chief executive officer of the chain store subsection (d) [subsection (4)] would probably not be satisfied. The chief executive officer of a large corporation may have general responsibility for operations of the company, but does not normally have direct responsibility for resolving a small disputed bill to a customer. A check for a relatively small amount mailed to a high executive officer of a large organization is not likely to receive the executive's personal attention. Rather, the check would normally be routinely sent to the appropriate office for deposit and credit to the customer's account. If the check does receive the personal attention of the high executive officer and the officer is aware of the full-satisfaction language, collection of the check will result in an accord and satisfaction because subsection (d) [subsection (4)] applies. In this case the officer has assumed direct responsibility with respect to the disputed transaction.

If a full satisfaction check is sent to a lock box or other office processing checks sent to the claimant, it is irrelevant whether the clerk processing the check did or did not see the statement that the check was tendered as full satisfaction of the claim. Knowledge of the clerk is not imputed to the organization because the clerk has no responsibility with respect to an accord and satisfaction. Moreover, there is no failure of "due diligence" under Section 1-201(27) if the claimant does not require its clerks to look for full satisfaction statements on checks or accompanying communications. Nor is there any duty of the claimant to assign that duty to its clerks. Section 3-311(c) [section 3-1311(3)] is intended to allow a claimant to avoid an inadvertent accord and satisfaction by complying with either subsection (c)(1) [subsection (3)(a)] or (2) [paragraph (b)] without burdening the check-processing operation with extraneous and wasteful additional duties.

8. In some cases the disputed claim may have been assigned to a finance company or bank as part of a financing arrangement with respect to accounts receivable. If the account debtor was notified of the assignment, the claimant is the assignee of the account receivable and the "agent of the claimant" in subsection (d) [subsection (4)] refers to an agent of the assignee.

PART 4

LIABILITY OF PARTIES

§3-1401. Signature

(1) A person is not liable on an instrument unless:

(a) The person signed the instrument; or

(b) The person is represented by an agent or representative who signed the instrument and the signature is binding on the represented person under Section 3-1402.

(2) A signature may be made:

(a) Manually or by means of a device or machine; and

(b) By the use of any name, including a trade or assumed name, or by a word, mark, or symbol executed or adopted by a person with present intention to authenticate a writing.

Uniform Commercial Code Comment

1. Obligation on an instrument depends on a signature that is binding on the obligor. The signature may be made by the obligor personally or by an agent authorized to act for the obligor. Signature by agents is covered by Section 3-402 [section 3-1402]. It is not necessary that the name of the obligor appear on the instrument, so long as there is a signature that binds the obligor. Signature includes an indorsement.

2. A signature may be handwritten, typed, printed or made in any other manner. It need not be subscribed, and may appear in the body of the instrument, as in the case of "I, John Doe, promise to pay * * *" without any other signature. It may be made by mark, or even by thumbprint. It may be made in any name, including any trade name or assumed name, however false and fictitious, which is adopted for the purpose. Parol evidence is admissible to identify the signer, and when the signer is identified the signature is effective. Indorsement in a name other than that of the indorser is governed by Section 3-204(d) [section 3-1204(4)].

This section is not intended to affect any other law requiring a signature by mark to be witnessed, or any signature to be otherwise authenticated, or requiring any form of proof.

§3-1402. Signature by representative

(1) If a person acting, or purporting to act, as a representative signs an instrument by signing either the name of the represented person or the name of the signer, the represented person is bound by the signature to the same extent the represented person would be bound if the signature were on a simple contract. If the represented person is bound, the signature of the representative is the authorized signature of the represented person and the represented person is liable on the instrument, whether or not identified in the instrument.

(2) If a representative signs the name of the representative to an instrument and the signature is an authorized signature of the represented person, the following rules apply.

(a) If the form of the signature shows unambiguously that the signature is made on behalf of the represented person who is identified in the instrument, the representative is not liable on the instrument.

(b) Subject to subsection (3), if the representative is liable on the instrument to a holder in due course that took the instrument without notice that the representative was not intended to be liable on the instrument:

(i) The form of the signature does not show unambiguously that the signature is made in a representative capacity; or

(ii) The represented person is not identified in the instrument.

With respect to any other person, the representative is liable on the instrument unless the representative proves that the original parties did not intend the representative to be liable on the instrument.

(3) If a representative signs the name of the representative as drawer of a check without indication of the representative status and the check is payable from an account of the represented person who is identified on the check, the signer is not liable on the check if the signature is an authorized signature of the represented person.

Uniform Commercial Code Comment

1. Subsection (a) [subsection (1)] states when the represented person is bound on an instrument if the instrument is

signed by a representative. If under the law of agency the represented person would be bound by the act of the representative in signing either the name of the represented person or that of the representative, the signature is the authorized signature of the represented person. Former Section 3-401(1) stated that "no person is liable on an instrument unless his signature appears thereon." This was interpreted as meaning that an undisclosed principal is not liable on an instrument. This interpretation provided an exception to ordinary agency law that binds an undisclosed principal on a simple contract.

It is questionable whether this exception was justified by the language of former Article 3 and there is no apparent policy justification for it. The exception is rejected by subsection (a) [subsection (1)] which returns to ordinary rules of agency. If P, the principal, authorized A, the agent, to borrow money on P's behalf and A signed A's name to a note without disclosing that the signature was on behalf of P, A is liable on the instrument. But if the person entitled to enforce the note can also prove that P authorized A to sign on P's behalf, why shouldn't P also be liable on the instrument? To recognize the liability of P takes nothing away from the utility of negotiable instruments. Furthermore, imposing liability on P has the merit of making it impossible to have an instrument on which nobody is liable even though it was authorized by P. That result could occur under former Section 3-401(1) if an authorized agent signed "as agent" but the note did not identify the principal. If the dispute was between the agent and the payee of the note, the agent could escape liability on the note by proving that the agent and the payee did not intend that the agent be liable on the note when the note was issued. Former Section 3-403(2)(b). Under the prevailing interpretation of former Section 3-401(1), the principal was not liable on the note under former Section 3-401(1) because the principal's name did not appear on the note. Thus, nobody was liable on the note even though all parties knew that the note was signed by the agent on behalf of the principal. Under Section 3-402(a) [section 3-1402(1)] the principal would be liable on the note.

2. Subsection (b) [subsection (2)] concerns the question of when an agent who signs an instrument on behalf of a principal is bound on the instrument. The approach followed by former Section 3-403 was to specify the form of signature that imposed or avoided liability. This approach was unsatisfactory. There are many ways in which there can be ambiguity about a signature. It is better to state a general rule. Subsection (b)(1) [subsection (2)(a)] states that if the form of the signature unambiguously shows that it is made on behalf of an identified represented person (for example, "P, by A, Treasurer") the agent is not liable. This is a workable standard for a court to apply.

Subsection (b)(2) [subsection (2)(b)] partly changes former Section 3-403(2). Subsection (b)(2) [subsection (2)(b)] relates to cases in which the agent signs on behalf of a principal but the form of the signature does not fall within subsection (b)(1) [subsection (2)(a)]. The following cases are illustrative. In each case John Doe is the authorized agent of Richard Roe and John Doe signs a note on behalf of Richard Roe. In each case the intention of the original parties to the instrument is that Roe is to be liable on the instrument but Doe is not to be liable.

Case #1. Doe signs "John Doe" without indicating in the note that Doe is signing as agent. The note does not identify Richard Roe as the represented person.

Case #2. Doe signs "John Doe, Agent" but the note does not identify Richard Roe as the represented person.

Case #3. The name "Richard Roe" is written on the note and immediately below that name Doe signs "John Doe" without indicating that Doe signed as agent.

In each case Doe is liable on the instrument to a holder in due course without notice that Doe was not intended to be liable. In none of the cases does Doe's signature unambiguously show that Doe was signing as agent for an identified principal. A holder in due course should be able to resolve any ambiguity against Doe.

But the situation is different if a holder in due course is not involved. In each case Roe is liable on the note. Subsection (a) [subsection (1)]. If the original parties to the note did not intend that Doe also be liable, imposing liability on Doe is a windfall to the person enforcing the note. Under subsection (b)(2) [subsection (2)(b)] Doe is prima facie liable because his signature appears on the note and the form of the signature does not unambiguously refute personal liability. But Doe can escape liability by proving that the original parties did not intend that he be liable on the note. This is a change from former Section 3-403(2)(a).

A number of cases under former Article 3 involved situations in which an agent signed the agent's name to a note, without qualification and without naming the person represented, intending to bind the principal but not the agent. The agent attempted to prove that the other party had the same intention. Some of these cases involved mistake, and in some there was evidence that the agent may have been deceived into signing in that manner. In some of the cases the court refused to allow proof of the intention of the parties and imposed liability on the agent based on former Section 3-403(2)(a) even though both

parties to the instrument may have intended that the agent not be liable. Subsection (b)(2) [subsection (2)(b)] changes the result of those cases, and is consistent with Section 3-117 [section 3-1117] which allows oral or written agreements to modify or nullify apparent obligations on the instrument.

Former Section 3-403 spoke of the represented person being "named" in the instrument. Section 3-402 [section 3-1402 speaks of the represented person being "identified" in the instrument. This change in terminology is intended to reject decisions under former Section 3-403(2) requiring that the instrument state the legal name of the represented person.

3. Subsection (c) [subsection (3)] is directed at the check cases. It states that if the check identifies the represented person the agent who signs on the signature line does not have to indicate agency status. Virtually all checks used today are in personalized form which identify the person on whose account the check is drawn. In this case, nobody is deceived into thinking that the person signing the check is meant to be liable. This subsection is meant to overrule cases decided under former Article 3 such as Griffin v. Ellinger, 538 S.W.2d 97 (Texas 1976).

§3-1403. Unauthorized signature

(1) Unless otherwise provided in this Article or Article 4, an unauthorized signature is ineffective except as the signature of the unauthorized signer in favor of a person who in good faith pays the instrument or takes it for value. An unauthorized signature may be ratified for all purposes of this Article.

(2) If the signature of more than one person is required to constitute the authorized signature of an organization, the signature of the organization is unauthorized if one of the required signatures is lacking.

(3) The civil or criminal liability of a person who makes an unauthorized signature is not affected by any provision of this Article that makes the unauthorized signature effective for the purposes of this Article.

Uniform Commercial Code Comment

1. "Unauthorized" signature is defined in Section 1-201(43) as one that includes a forgery as well as a signature made by one exceeding actual or apparent authority. Former Section 3-404(1) stated that an unauthorized signature was inoperative as the signature of the person whose name was signed unless that person "is precluded from denying it." Under former Section 3-406 if

negligence by the person whose name was signed contributed to an unauthorized signature, that person "is precluded from asserting the * * * lack of authority." Both of these sections were applied to cases in which a forged signature appeared on an instrument and the person asserting rights on the instrument alleged that the negligence of the purported signer contributed to the forgery. Since the standards for liability between the two sections differ, the overlap between the sections caused confusion. Section 3-403(a) [section 3-1403(1)] deals with the problem by removing the preclusion language that appeared in former Section 3-404.

2. The except clause of the first sentence of subsection (a) [subsection (1)] states the generally accepted rule that the unauthorized signature, while it is wholly inoperative as that of the person whose name is signed, is effective to impose liability upon the signer or to transfer any rights that the signer may have in the instrument. The signer's liability is not in damages for breach of warranty of authority, but is full liability on the instrument in the capacity in which the signer signed. It is, however, limited to parties who take or pay the instrument in good faith; and one who knows that the signature is unauthorized cannot recover from the signer on the instrument.

3. The last sentence of subsection (a) [subsection (1)] allows an unauthorized signature to be ratified. Ratification is a retroactive adoption of the unauthorized signature by the person whose name is signed and may be found from conduct as well as from express statements. For example, it may be found from the retention of benefits received in the transaction with knowledge of the unauthorized signature. Although the forger is not an agent, ratification is governed by the rules and principles applicable to ratification of unauthorized acts of an agent.

Ratification is effective for all purposes of this Article. The unauthorized signature becomes valid so far as its effect as a signature is concerned. Although the ratification may relieve the signer of liability on the instrument, it does not of itself relieve the signer of liability to the person whose name is signed. It does not in any way affect the criminal law. No policy of the criminal law prevents a person whose name is forged to assume liability to others on the instrument by ratifying the forgery, but the ratification cannot affect the rights of the state. While the ratification may be taken into account with other relevant facts in determining punishment, it does not relieve the signer of criminal liability.

4. Subsection (b) [subsection (2)] clarifies the meaning of "unauthorized" in cases in which an instrument contains less than

all of the signatures that are required as authority to pay a check. Judicial authority was split on the issue whether the one-year notice period under former Section 4-406(4) (now Section 4-406(f)) [Maine cite unchanged; section 4-406(4)] barred a customer's suit against a payor bank that paid a check containing less than all of the signatures required by the customer to authorize payment of the check. Some cases took the view that if a customer required that a check contain the signatures of both A and B to authorize payment and only A signed, there was no unauthorized signature within the meaning of that term in former Section 4-406(4) because A's signature was neither unauthorized nor forged. The other cases correctly pointed out that it was the customer's signature at issue and not that of A; hence, the customer's signature was unauthorized if all signatures required to authorize payment of the check were not on the check. Subsection (b) [subsection (2)] follows the latter line of cases. The same analysis applies if A forged the signature of B. Because the forgery is not effective as a signature of B, the required signature of B is lacking.

Subsection (b) [subsection (2)] refers to "the authorized signature of an organization." The definition of "organization" in Section 1-201(28) is very broad. It covers not only commercial entities but also "two or more persons having a joint or common interest." Hence subsection (b) [subsection (2)] would apply when a husband and wife are both required to sign an instrument.

§3-1404. Impostors; fictitious payees

(1) If an impostor by use of the mails or otherwise induces the issuer of an instrument to issue the instrument to the impostor, or to a person acting in concert with the impostor, by impersonating the payee of the instrument or a person authorized to act for the payee, an indorsement of the instrument by any person in the name of the payee is effective as the indorsement of the payee in favor of a person who in good faith pays the instrument or takes it for value or for collection.

(2) If a person whose intent determines to whom an instrument is payable (section 3-1110(1) or (2)) does not intend the person identified as payee to have any interest in the instrument or the person identified as payee of an instrument is a fictitious person, the following rules apply until the instrument is negotiated by special indorsement:

(a) Any person in possession of the instrument is its holder.

(b) An indorsement by any person in the name of the payee stated in the instrument is effective as the indorsement of the payee in favor of a person who, in good faith, pays the instrument or takes it for value or for collection.

(3) Under subsection (1) or (2), an indorsement is made in the name of a payee if:

(a) It is made in a name substantially similar to that of the payee; or

(b) The instrument, whether or not indorsed, is deposited in a depositary bank to an account in a name substantially similar to that of the payee.

(4) With respect to an instrument to which subsection (1) or (2) applies, if a person paying the instrument or taking it for value or for collection fails to exercise ordinary care in paying or taking the instrument and that failure substantially contributes to loss resulting from payment of the instrument, the person bearing the loss may recover from the person failing to exercise ordinary care to the extent the failure to exercise ordinary care contributed to the loss.

Uniform Commercial Code Comment

1. Under former Article 3, the impostor cases were governed by former Section 3-405(1)(a) and the fictitious payee cases were governed by Section 3-405(1)(b). Section 3-404 [section 3-1404] replaces former Section 3-405(1)(a) and (b) and modifies the previous law in some respects. Former Section 3-405 was read by some courts to require that the indorsement be in the exact name of the named payee. Revised Article 3 [Article 3-A] rejects this result. Section 3-404(c) [section 3-1404(3)] requires only that the indorsement be made in a name "substantially similar" to that of the payee. Subsection (c) [subsection (3)] also recognizes the fact that checks may be deposited without indorsement. Section 4-205(a) [section 4-205(1)].

Subsection (a) [subsection (1)] changes the former law in a case in which the impostor is impersonating an agent. Under former Section 3-405(1)(a), if Impostor impersonated Smith and induced the drawer to draw a check to the order of Smith, Impostor could negotiate the check. If Impostor impersonated Smith, the president of Smith Corporation, and the check was payable to the order of Smith Corporation, the section did not apply. See the last paragraph of Comment 2 to former Section 3-405. In revised Article 3 [Article 3-A], Section 3-404(a) [section 3-1404(1)] gives Impostor the power to negotiate the check in both cases.

2. Subsection (b) [subsection (2)] is based in part on former Section 3-405(1)(b) and in part on N.I.L. § 9(3). It covers cases in which an instrument is payable to a fictitious or nonexisting person and to cases in which the payee is a real person but the drawer or maker does not intend the payee to have any interest in the instrument. Subsection (b) [subsection (2)] applies to any instrument, but its primary importance is with respect to checks of corporations and other organizations. It also applies to forged check cases. The following cases illustrate subsection (b) [subsection (2)]:

Case #1. Treasurer is authorized to draw checks in behalf of Corporation. Treasurer fraudulently draws a check of Corporation payable to Supplier Co., a non-existent company. Subsection (b) [subsection (2)] applies because Supplier Co. is a fictitious person and because Treasurer did not intend Supplier Co. to have any interest in the check. Under subsection (b)(1) [subsection (2)(a)] Treasurer, as the person in possession of the check, becomes the holder of the check. Treasurer indorses the check in the name "Supplier Co." and deposits it in Depositary Bank. Under subsection (b)(2) [subsection (2)(b)] and (c)(i) [subsection (3)(a)], the indorsement is effective to make Depositary Bank the holder and therefore a person entitled to enforce the instrument. Section 3-301 [section 3-1301].

Case #2. Same facts as Case #1 except that Supplier Co. is an actual company that does business with Corporation. If Treasurer intended to steal the check when the check was drawn, the result in Case #2 is the same as the result in Case #1. Subsection (b) [subsection (2)] applies because Treasurer did not intend Supplier Co. to have any interest in the check. It does not make any difference whether Supplier Co. was or was not a creditor of Corporation when the check was drawn. If Treasurer did not decide to steal the check until after the check was drawn, the case is covered by Section 3-405 [section 3-1405] rather than Section 3-404(b) [section 3-1404(2)], but the result is the same. See Case #6 in Comment 3 to Section 3-405 [section 3-1405].

Case #3. Checks of Corporation must be signed by two officers. President and Treasurer both sign a check of Corporation payable to Supplier Co., a company that does business with Corporation from time to time but to which Corporation does not owe any money. Treasurer knows that no money is owed to Supplier Co. and does not intend that Supplier Co. have any interest in the check. President believes that money is owed to Supplier Co. Treasurer

obtains possession of the check after it is signed. Subsection (b) [subsection (2)] applies because Treasurer is "a person whose intent determines to whom an instrument is payable" and Treasurer does not intend Supplier Co. to have any interest in the check. Treasurer becomes the holder of the check and may negotiate it by indorsing it in the name "Supplier Co."

Case #4. Checks of Corporation are signed by a check-writing machine. Names of payees of checks produced by the machine are determined by information entered into the computer that operates the machine. Thief, a person who is not an employee or other agent of Corporation, obtains access to the computer and causes the check-writing machine to produce a check payable to Supplier Co., a non-existent company. Subsection (b)(ii) [subsection (2)(b)] applies. Thief then obtains possession of the check. At that point Thief becomes the holder of the check because Thief is the person in possession of the instrument. Subsection (b)(1) [subsection (2)(a)]. Under Section 3-301 [section 3-1301] Thief, as holder, is the "person entitled to enforce the instrument" even though Thief does not have title to the check and is in wrongful possession of it. Thief indorses the check in the name "Supplier Co." and deposits it in an account in Depositary Bank which Thief opened in the name "Supplier Co." Depositary Bank takes the check in good faith and credits the "Supplier Co." account. Under subsection (b)(2) [subsection (2)(a)] and (c)(i) [subsection (3)(a)], the indorsement is effective. Depositary Bank becomes the holder and the person entitled to enforce the check. The check is presented to the drawee bank for payment and payment is made. Thief then withdraws the credit to the account. Although the check was issued without authority given by Corporation, the drawee bank is entitled to pay the check and charge Corporation's account if there was an agreement with Corporation allowing the bank to debit Corporation's account for payment of checks produced by the check-writing machine whether or not authorized. The indorsement is also effective if Supplier Co. is a real person. In that case subsection (b)(i) [subsection (2)(a)] applies. Under Section 3-110(b) [section 3-1110(2)] Thief is the person whose intent determines to whom the check is payable, and Thief did not intend Supplier Co. to have any interest in the check. When the drawee bank pays the check, there is no breach of warranty under Section 3-417(a)(1) [section 3-1417(1)(a)] or 4-208(a)(1) [section 4-207-B(1)(a)] because Depositary Bank was a person entitled to enforce the check when it was forwarded for payment.

Case #5. Thief, who is not an employee or agent of Corporation, steals check forms of Corporation. John Doe is president of Corporation and is authorized to sign checks on behalf of Corporation as drawer. Thief draws a check in the name of Corporation as drawer by forging the signature of Doe. Thief makes the check payable to the order of Supplier Co. with the intention of stealing it. Whether Supplier Co. is a fictitious person or a real person, Thief becomes the holder of the check and the person entitled to enforce it. The analysis is the same as that in Case #4. Thief deposits the check in an account in Depositary Bank which Thief opened in the name "Supplier Co." Thief either indorses the check in a name other than "Supplier Co." or does not indorse the check at all. Under Section 4-205(a) [section 4-205(1)] a depositary bank may become holder of a check deposited to the account of a customer if the customer was a holder, whether or not the customer indorses. Subsection (c)(ii) [subsection (3)(b)] treats deposit to an account in a name substantially similar to that of the payee as the equivalent of indorsement in the name of the payee. Thus, the deposit is an effective indorsement of the check. Depositary Bank becomes the holder of the check and the person entitled to enforce the check. If the check is paid by the drawee bank, there is no breach of warranty under Section 3-417(a)(1) [section 3-1417(1)(a)] or 4-208(a)(1) [section 4-207-B(1)(a)] because Depositary Bank was a person entitled to enforce the check when it was forwarded for payment and, unless Depositary Bank knew about the forgery of Doe's signature, there is no breach of warranty under Section 3-417(a)(3) [section 3-1417(1)] or 4-208(a)(3) [section 4-207-B(1)(c)]. Because the check was a forged check the drawee bank is not entitled to charge Corporation's account unless Section 3-406 [section 3-1406] or Section 4-406 applies.

3. In cases governed by subsection (a) [subsection (1)] the dispute will normally be between the drawer of the check that was obtained by the impostor and the drawee bank that paid it. The drawer is precluded from obtaining recredit of the drawer's account by arguing that the check was paid on a forged indorsement so long as the drawee bank acted in good faith in paying the check. Cases governed by subsection (b) [subsection (2)] are illustrated by Cases #1 through #5 in Comment 2. In Cases #1, #2, and #3 there is no forgery of the check, thus the drawer of the check takes the loss if there is no lack of good faith by the banks involved. Cases #4 and #5 are forged check cases. Depositary Bank is entitled to retain the proceeds of the check if it didn't know about the forgery. Under Section 3-418 [section 3-1418] the drawee bank is not entitled to recover from Depositary Bank on the basis of payment by mistake because

Depositary Bank took the check in good faith and gave value for the check when the credit given for the check was withdrawn. And there is no breach of warranty under Section 3-417(a)(1) [section 3-1417(1)] or (3) or 4-208(a)(1)] or (3). Unless Section 3-406 [section 3-1406] applies the loss is taken by the drawee bank if a forged check is paid, and that is the result in Case #5. In Case #4 the loss is taken by Corporation, the drawer, because an agreement between Corporation and the drawee bank allowed the bank to debit Corporation's account despite the unauthorized use of the check-writing machine.

If a check payable to an impostor, fictitious payee, or payee not intended to have an interest in the check is paid, the effect of subsections (a) [subsection(1)] and (b) [subsection (2)] is to place the loss on the drawer of the check rather than on the drawee or the depositary bank that took the check for collection. Cases governed by subsection (a) [subsection (1)] always involve fraud, and fraud is almost always involved in cases governed by subsection (b) [subsection (2)]. The drawer is in the best position to avoid the fraud and thus should take the loss. This is true in Case #1, Case #2, and Case #3. But in some cases the person taking the check might have detected the fraud and thus have prevented the loss by the exercise of ordinary care. In those cases, if that person failed to exercise ordinary care, it is reasonable that that person bear loss to the extent the failure contributed to the loss. Subsection (d) [subsection (4)] is intended to reach that result. It allows the person who suffers loss as a result of payment of the check to recover from the person who failed to exercise ordinary care. In Case #1, Case #2, and Case #3, the person suffering the loss is Corporation, the drawer of the check. In each case the most likely defendant is the depositary bank that took the check and failed to exercise ordinary care. In those cases, the drawer has a cause of action against the offending bank to recover a portion of the loss. The amount of loss to be allocated to each party is left to the trier of fact. Ordinary care is defined in Section 3-103(a)(7) [section 3-1103(1)(g)]. An example of the type of conduct by a depositary bank that could give rise to recovery under subsection (d) is discussed in Comment 4 to Section 3-405 [section 3-1405]. That Comment addresses the last sentence of Section 3-405(b) [section 3-1405(2)] which is similar to Section 3-404(d) [section 3-1404(4)].

In Case #1, Case #2, and Case #3, there was no forgery of the drawer's signature. But cases involving checks payable to a fictitious payee or a payee not intended to have an interest in the check are often forged check cases as well. Examples are Case #4 and Case #5. Normally, the loss in forged check cases is on the drawee bank that paid the check. Case #5 is an example. In Case #4 the risk with respect to the forgery is shifted to the

drawer because of the agreement between the drawer and the drawee bank. The doctrine that prevents a drawee bank from recovering payment with respect to a forged check if the payment was made to a person who took the check for value and in good faith is incorporated into Section 3-418 [section 3-1418] and Sections 3-417(a)(3) [section 3-1417(1)] and 4-208(a)(3) [section 4-207-B(1)(c)]. This doctrine is based on the assumption that the depositary bank normally has no way of detecting the forgery because the drawer is not that bank's customer. On the other hand, the drawee bank, at least in some cases, may be able to detect the forgery by comparing the signature on the check with the specimen signature that the drawee has on file. But in some forged check cases the depositary bank is in a position to detect the fraud. Those cases typically involve a check payable to a fictitious payee or a payee not intended to have an interest in the check. Subsection (d) [subsection (4)] applies to those cases. If the depositary bank failed to exercise ordinary care and the failure substantially contributed to the loss, the drawer in Case #4 or the drawee bank in Case #5 has a cause of action against the depositary bank under subsection (d) [subsection (4)]. Comment 4 to Section 3-405 [section 3-1405] can be used as a guide to the type of conduct that could give rise to recovery under Section 3-404(d) [section 3-1404(4)].

§3-1405. Employer's responsibility for fraudulent indorsement by employee

(1) In this section, unless the context otherwise indicates, the following terms have the following meanings.

(a) "Employee" includes an independent contractor and employee of an independent contractor retained by the employer.

(b) "Fraudulent indorsement" means:

(i) In the case of an instrument payable to the employer, a forged indorsement purporting to be that of the employer; or

(ii) In the case of an instrument with respect to which the employer is the issuer, a forged indorsement purporting to be that of the person identified as payee.

(c) "Responsibility" with respect to instruments means authority:

(i) To sign or indorse instruments on behalf of the employer;

(ii) To process instruments received by the employer for bookkeeping purposes, for deposit to an account or for other disposition;

(iii) To prepare or process instruments for issue in the name of the employer;

(iv) To supply information determining the names or addresses of payees of instruments to be issued in the name of the employer;

(v) To control the disposition of instruments to be issued in the name of the employer; or

(vi) To act otherwise with respect to instruments in a responsible capacity.

"Responsibility" does not include authority that merely allows an employee to have access to instruments or blank or incomplete instrument forms that are being stored or transported or are part of incoming or outgoing mail, or similar access.

(2) For the purpose of determining the rights and liabilities of a person who in good faith pays an instrument or takes it for value or for collection, if an employer entrusted an employee with responsibility with respect to the instrument and the employee or a person acting in concert with the employee makes a fraudulent indorsement of the instrument, the indorsement is effective as the indorsement of the person to whom the instrument is payable if it is made in the name of that person. If the person paying the instrument or taking it for value or for collection fails to exercise ordinary care in paying or taking the instrument and that failure substantially contributes to loss resulting from the fraud, the person bearing the loss may recover from the person failing to exercise ordinary care to the extent the failure to exercise ordinary care contributed to the loss.

(3) Under subsection (2), an indorsement is made in the name of the person to whom an instrument is payable if:

(a) The instrument is made in a name substantially similar to the name of that person; or

(b) The instrument, whether or not indorsed, is deposited in a depositary bank to an account in a name substantially similar to the name of that person.

Uniform Commercial Code Comment

1. Section 3-405 [section 3-1405] is addressed to fraudulent indorsements made by an employee with respect to instruments with respect to which the employer has given responsibility to the employee. It covers two categories of fraudulent indorsements: indorsements made in the name of the employer to instruments payable to the employer and indorsements made in the name of payees of instruments issued by the employer. This section applies to instruments generally but normally the instrument will be a check. Section 3-405 [section 3-1405] adopts the principle that the risk of loss for fraudulent indorsements by employees who are entrusted with responsibility with respect to checks should fall on the employer rather than the bank that takes the check or pays it, if the bank was not negligent in the transaction. Section 3-405 [section 3-1405] is based on the belief that the employer is in a far better position to avoid the loss by care in choosing employees, in supervising them, and in adopting other measures to prevent forged indorsements on instruments payable to the employer or fraud in the issuance of instruments in the name of the employer. If the bank failed to exercise ordinary care, subsection (b) [subsection (2)] allows the employer to shift loss to the bank to the extent the bank's failure to exercise ordinary care contributed to the loss. "Ordinary care" is defined in Section 3-103(a)(7) [section 3-1103(1)(g)]. The provision applies regardless of whether the employer is negligent.

The first category of cases governed by Section 3-405 [section 3-1405] are those involving indorsements made in the name of payees of instruments issued by the employer. In this category, Section 3-405 [section 3-1405] includes cases that were covered by former Section 3-405(1)(c). The scope of Section 3-405 [section 3-1405] in revised Article 3 [Article 3-A] is, however, somewhat wider. It covers some cases not covered by former Section 3-405(1)(c) in which the entrusted employee makes a forged indorsement to a check drawn by the employer. An example is Case #6 in Comment 3. Moreover, a larger group of employees is included in revised Section 3-405 [section 3-1405]. The key provision is the definition of "responsibility" in subsection (a)(1) [sic; reference probably should be subsection (1)(c)] which identifies the kind of responsibility delegated to an employee which will cause the employer to take responsibility for the fraudulent acts of that employee. An employer can insure this risk by employee fidelity bonds.

The second category of cases governed by Section 3-405 [section 3-1405] -- fraudulent indorsements of the name of the employer to instruments payable to the employer -- were covered in former Article 3 by Section 3-406 [section 3-1406]. Under

former Section 3-406, the employer took the loss only if negligence of the employer could be proved. Under revised Article 3 [Article 3-A], Section 3-406 [section 3-1406] need not be used with respect to forgeries of the employer's indorsement. Section 3-405 [section 3-1405] imposes the loss on the employer without proof of negligence.

2. With respect to cases governed by former Section 3-405(1)(c), Section 3-405 [section 3-1405] is more favorable to employers in one respect. The bank was entitled to the preclusion provided by former Section 3-405(1)(c) if it took the check in good faith. The fact that the bank acted negligently did not shift the loss to the bank so long as the bank acted in good faith. Under revised Section 3-405 [section 3-1405] the loss may be recovered from the bank to the extent the failure of the bank to exercise ordinary care contributed to the loss.

3. Section 3-404(b) [section 3-1404(2)] and Section 3-405 [section 3-1405] both apply to cases of employee fraud. Section 3-404(b) [section 3-1404(2)] is not limited to cases of employee fraud, but most of the cases to which it applies will be cases of employee fraud. The following cases illustrate the application of Section 3-405 [section 3-1405]. In each case it is assumed that the bank that took the check acted in good faith and was not negligent.

Case #1. Janitor, an employee of Employer, steals a check for a very large amount payable to Employer after finding it on a desk in one of Employer's offices. Janitor forges Employer's indorsement on the check and obtains payment. Since Janitor was not entrusted with "responsibility" with respect to the check, Section 3-405 [section 3-1405] does not apply. Section 3-406 [section 3-1406] might apply to this case. The issue would be whether Employer was negligent in safeguarding the check. If not, Employer could assert that the indorsement was forged and bring an action for conversion against the depositary or payor bank under Section 3-420 [section 3-1420].

Case #2. X is Treasurer of Corporation and is authorized to write checks on behalf of Corporation by signing X's name as Treasurer. X draws a check in the name of Corporation and signs X's name as Treasurer. The check is made payable to X. X then indorses the check and obtains payment. Assume that Corporation did not owe any money to X and did not authorize X to write the check. Although the writing of the check was not authorized, Corporation is bound as drawer of the check because X had authority to sign checks on behalf of Corporation. This result follows from

agency law and Section 3-402(a) [section 3-1402(1)]. Section 3-405 [section 3-1405] does not apply in this case because there is no forged indorsement. X was payee of the check so the indorsement is valid. Section 3-110(a) [section 3-1110(1)].

Case #3. The duties of Employee, a bookkeeper, include posting the amounts of checks payable to Employer to the accounts of the drawers of the checks. Employee steals a check payable to Employer which was entrusted to Employee and forges Employer's indorsement. The check is deposited by Employee to an account in Depositary Bank which Employee opened in the same name as Employer, and the check is honored by the drawee bank. The indorsement is effective as Employer's indorsement because Employee's duties include processing checks for bookkeeping purposes. Thus, Employee is entrusted with "responsibility" with respect to the check. Neither Depositary Bank nor the drawee bank is liable to Employer for conversion of the check. The same result follows if Employee deposited the check in the account in Depositary Bank without indorsement. Section 4-205(a) [section 4-205(1)]. Under subsection (c) [subsection (3)] deposit in a depositary bank in an account in a name substantially similar to that of Employer is the equivalent of an indorsement in the name of Employer.

Case #4. Employee's duties include stamping Employer's unrestricted blank indorsement on checks received by Employer and depositing them in Employer's bank account. After stamping Employer's unrestricted blank indorsement on a check, Employee steals the check and deposits it in Employee's personal bank account. Section 3-405 [section 3-1405] doesn't apply because there is no forged indorsement. Employee is authorized by Employer to indorse Employer's checks. The fraud by Employee is not the indorsement but rather the theft of the indorsed check. Whether Employer has a cause of action against the bank in which the check was deposited is determined by whether the bank had notice of the breach of fiduciary duty by Employee. The issue is determined under Section 3-307 [section 3-1307].

Case #5. The computer that controls Employer's check-writing machine was programmed to cause a check to be issued to Supplier Co. to which money was owed by Employer. The address of Supplier Co. was included in the information in the computer. Employee is an accounts payable clerk whose duties include entering information into the computer. Employee fraudulently changed the address of Supplier Co. in the computer data bank to an address of

Employee. The check was subsequently produced by the check-writing machine and mailed to the address that Employee had entered into the computer. Employee obtained possession of the check, indorsed it in the name of Supplier Co, and deposited it to an account in Depositary Bank which Employee opened in the name "Supplier Co." The check was honored by the drawee bank. The indorsement is effective under Section 3-405(b) [section 3-1405(2)] because Employee's duties allowed Employee to supply information determining the address of the payee of the check. An employee that is entrusted with duties that enable the employee to determine the address to which a check is to be sent controls the disposition of the check and facilitates forgery of the indorsement. The employer is held responsible. The drawee may debit the account of Employer for the amount of the check. There is no breach of warranty by Depositary Bank under Section 3-417(a)(1) [section 3-1417(1)(a)] or 4-208(a)(1) [section 4-207-B(1)(a)].

Case #6. Treasurer is authorized to draw checks in behalf of Corporation. Treasurer draws a check of Corporation payable to Supplier Co., a company that sold goods to Corporation. The check was issued to pay the price of these goods. At the time the check was signed Treasurer had no intention of stealing the check. Later, Treasurer stole the check, indorsed it in the name "Supplier Co." and obtained payment by depositing it to an account in Depositary Bank which Treasurer opened in the name "Supplier Co.". The indorsement is effective under Section 3-405(b) [section 3-1405(2)]. Section 3-404(b) [section 3-1404(2)] does not apply to this case.

Case #7. Checks of Corporation are signed by Treasurer in behalf of Corporation as drawer. Clerk's duties include the preparation of checks for issue by Corporation. Clerk prepares a check payable to the order of Supplier Co. for Treasurer's signature. Clerk fraudulently informs Treasurer that the check is needed to pay a debt owed to Supplier Co, a company that does business with Corporation. No money is owed to Supplier Co. and Clerk intends to steal the check. Treasurer signs it and returns it to Clerk for mailing. Clerk does not indorse the check but deposits it to an account in Depositary Bank which Clerk opened in the name "Supplier Co.". The check is honored by the drawee bank. Section 3-404(b)(i) [section 3-1404(2)(a)] does not apply to this case because Clerk, under Section 3-110(a) [section 3-1110(1)], is not the person whose intent determines to whom the check is payable. But Section 3-405 [section 3-1405] does apply and it treats the deposit by Clerk as an effective indorsement by Clerk because Clerk was entrusted

with responsibility with respect to the check. If Supplier Co. is a fictitious person Section 3-404(b)(ii) [section 3-1404(2)(b)] applies. But the result is the same. Clerk's deposit is treated as an effective indorsement of the check whether Supplier Co. is a fictitious or a real person or whether money was or was not owing to Supplier Co. The drawee bank may debit the account of Corporation for the amount of the check and there is no breach of warranty by Depositary Bank under Section 3-417(1)(a) [section 3-1417(1)].

4. The last sentence of subsection (b) [subsection (2)] is similar to subsection (d) [subsection (4)] of Section 3-404 [section 3-1404] which is discussed in Comment 3 to Section 3-404 [section 3-1404]. In Case #5, Case #6, or Case #7 the depositary bank may have failed to exercise ordinary care when it allowed the employee to open an account in the name "Supplier Co.," to deposit checks payable to "Supplier Co." in that account, or to withdraw funds from that account that were proceeds of checks payable to Supplier Co. Failure to exercise ordinary care is to be determined in the context of all the facts relating to the bank's conduct with respect to the bank's collection of the check. If the trier of fact finds that there was such a failure and that the failure substantially contributed to loss, it could find the depositary bank liable to the extent the failure contributed to the loss. The last sentence of subsection (b) [subsection (2)] can be illustrated by an example. Suppose in Case #5 that the check is not payable to an obscure "Supplier Co." but rather to a well-known national corporation. In addition, the check is for a very large amount of money. Before depositing the check, Employee opens an account in Depositary Bank in the name of the corporation and states to the person conducting the transaction for the bank that Employee is manager of a new office being opened by the corporation. Depositary Bank opens the account without requiring Employee to produce any resolutions of the corporation's board of directors or other evidence of authorization of Employee to act for the corporation. A few days later, the check is deposited, the account is credited, and the check is presented for payment. After Depositary Bank receives payment, it allows Employee to withdraw the credit by a wire transfer to an account in a bank in a foreign country. The trier of fact could find that Depositary Bank did not exercise ordinary care and that the failure to exercise ordinary care contributed to the loss suffered by Employer. The trier of fact could allow recovery by Employer from Depositary Bank for all or part of the loss suffered by Employer.

§3-1406. Negligence contributing to forged signature or alteration of instrument

(1) A person whose failure to exercise ordinary care substantially contributes to an alteration of an instrument or to the making of a forged signature on an instrument is precluded from asserting the alteration or the forgery against a person who, in good faith, pays the instrument or takes it for value or for collection.

(2) Under subsection (1), if the person asserting the preclusion fails to exercise ordinary care in paying or taking the instrument and that failure substantially contributes to loss, the loss is allocated between the person precluded and the person asserting the preclusion according to the extent to which the failure of each to exercise ordinary care contributed to the loss.

(3) Under subsection (1), the burden of proving failure to exercise ordinary care is on the person asserting the preclusion. Under subsection (2), the burden of proving failure to exercise ordinary care is on the person precluded.

Uniform Commercial Code Comment

1. Section 3-406(a) [section 3-1406(1)] is based on former Section 3-406. With respect to alteration, Section 3-406 [section 3-1406] adopts the doctrine of Young v. Grote, 4 Bing. 253 (1827), which held that a drawer who so negligently draws an instrument as to facilitate its material alteration is liable to a drawee who pays the altered instrument in good faith. Under Section 3-406 [section 3-1406] the doctrine is expanded to apply not only to drafts but to all instruments. It includes in the protected class any "person who, in good faith, pays the instrument or takes it for value or for collection." Section 3-406 [section 3-1406] rejects decisions holding that the maker of a note owes no duty of care to the holder because at the time the instrument is issued there is no contract between them. By issuing the instrument and "setting it afloat upon a sea of strangers" the maker or drawer voluntarily enters into a relation with later holders which justifies imposition of a duty of care. In this respect an instrument so negligently drawn as to facilitate alteration does not differ in principle from an instrument containing blanks which may be filled. Under Section 3-407 [section 3-1407] a person paying an altered instrument or taking it for value, in good faith and without notice of the alteration may enforce rights with respect to the instrument according to its original terms. If negligence of the obligor substantially contributes to an alteration, this section gives

the holder or the payor the alternative right to treat the altered instrument as though it had been issued in the altered form.

No attempt is made to define particular conduct that will constitute "failure to exercise ordinary care [that] substantially contributes to an alteration." Rather, "ordinary care" is defined in Section 3-103(a)(7) [section 3-1103(1)(g)] in general terms. The question is left to the court or the jury for decision in the light of the circumstances in the particular case including reasonable commercial standards that may apply.

Section 3-406 [section 3-1406] does not make the negligent party liable in tort for damages resulting from the alteration. If the negligent party is estopped from asserting the alteration the person taking the instrument is fully protected because the taker can treat the instrument as having been issued in the altered form.

2. Section 3-406 [section 3-1406] applies equally to a failure to exercise ordinary care that substantially contributes to the making of a forged signature on an instrument. Section 3-406 [section 3-1406] refers to "forged signature" rather than "unauthorized signature" that appeared in former Section 3-406 because it more accurately describes the scope of the provision. Unauthorized signature is a broader concept that includes not only forgery but also the signature of an agent which does not bind the principal under the law of agency. The agency cases are resolved independently under agency law. Section 3-406 [section 3-1406] is not necessary in those cases.

The "substantially contributes" test of former Section 3-406 is continued in this section in preference to a "direct and proximate cause" test. The "substantially contributes" test is meant to be less stringent than a "direct and proximate cause" test. Under the less stringent test the preclusion should be easier to establish. Conduct "substantially contributes" to a material alteration or forged signature if it is a contributing cause of the alteration or signature and a substantial factor in bringing it about. The analysis of "substantially contributes" in former Section 3-406 by the court in Thompson Maple Products v. Citizens National Bank of Corry, 234 A.2d 32 (Pa. Super. Ct. 1967), states what is intended by the use of the same words in revised Section 3-406(b) [section 3-1406(2)]. Since Section 3-404(d) [section 3-1404(4)] and Section 3-405(b) [section 3-1405(2)] also use the words "substantially contributes" the analysis of these words also applies to those provisions.

3. The following cases illustrate the kind of conduct that can be the basis of a preclusion under Section 3-406(a) [section 3-1406(1)]:

Case #1. Employer signs checks drawn on Employer's account by use of a rubber stamp of Employer's signature. Employer keeps the rubber stamp along with Employer's personalized blank check forms in an unlocked desk drawer. An unauthorized person fraudulently uses the check forms to write checks on Employer's account. The checks are signed by use of the rubber stamp. If Employer demands that Employer's account in the drawee bank be recredited because the forged check was not properly payable, the drawee bank may defend by asserting that Employer is precluded from asserting the forgery. The trier of fact could find that Employer failed to exercise ordinary care to safeguard the rubber stamp and the check forms and that the failure substantially contributed to the forgery of Employer's signature by the unauthorized use of the rubber stamp.

Case #2. An insurance company draws a check to the order of Sarah Smith in payment of a claim of a policyholder, Sarah Smith, who lives in Alabama. The insurance company also has a policyholder with the same name who lives in Illinois. By mistake, the insurance company mails the check to the Illinois Sarah Smith who indorses the check and obtains payment. Because the payee of the check is the Alabama Sarah Smith, the indorsement by the Illinois Sarah Smith is a forged indorsement. Section 3-110(a) [section 3-1110(1)]. The trier of fact could find that the insurance company failed to exercise ordinary care when it mailed the check to the wrong person and that the failure substantially contributed to the making of the forged indorsement. In that event the insurance company could be precluded from asserting the forged indorsement against the drawee bank that honored the check.

Case #3. A company writes a check for $10. The figure "10" and the word "ten" are typewritten in the appropriate spaces on the check form. A large blank space is left after the figure and the word. The payee of the check, using a typewriter with a typeface similar to that used on the check, writes the word "thousand" after the word "ten" and a comma and three zeros after the figure "10". The drawee bank in good faith pays $10,000 when the check is presented for payment and debits the account of the drawer in that amount. The trier of fact could find that the drawer failed to exercise ordinary care in writing the check and that the failure substantially contributed to the alteration. In that case the drawer is precluded from asserting the alteration against the drawee if the check was paid in good faith.

4. Subsection (b) [subsection (2)] differs from former Section 3-406 in that it adopts a concept of comparative negligence. If the person precluded under subsection (a) [subsection (1)] proves that the person asserting the preclusion failed to exercise ordinary care and that failure substantially contributed to the loss, the loss may be allocated between the two parties on a comparative negligence basis. In the case of a forged indorsement the litigation is usually between the payee of the check and the depositary bank that took the check for collection. An example is a case like Case #1 of Comment 3 to Section 3-405 [section 3-1405]. If the trier of fact finds that Employer failed to exercise ordinary care in safeguarding the check and that the failure substantially contributed to the making of the forged indorsement, subsection (a) [subsection (1)] of Section 3-406 [section 3-1406] applies. If Employer brings an action for conversion against the depositary bank that took the checks from the forger, the depositary bank could assert the preclusion under subsection (a) [subsection (1)]. But suppose the forger opened an account in the depositary bank in a name identical to that of Employer, the payee of the check, and then deposited the check in the account. Subsection (b) [subsection (2)] may apply. There may be an issue whether the depositary bank should have been alerted to possible fraud when a new account was opened for a corporation shortly before a very large check payable to a payee with the same name is deposited. Circumstances surrounding the opening of the account may have suggested that the corporation to which the check was payable may not be the same as the corporation for which the account was opened. If the trier of fact finds that collecting the check under these circumstances was a failure to exercise ordinary care, it could allocate the loss between the depositary bank and Employer, the payee.

§3-1407. Alteration

(1) "Alteration" means:

(a) An unauthorized change in an instrument that purports to modify in any respect the obligation of a party; or

(b) An unauthorized addition of words or numbers or other change to an incomplete instrument related to the obligation of a party.

(2) Except as provided in subsection (3), an alteration fraudulently made discharges a party whose obligation is affected by the alteration unless that party assents or is precluded from asserting the alteration. No other alteration discharges a party, and the instrument may be enforced according to its original terms.

(3) A payor bank or drawee paying a fraudulently altered instrument or a person taking it for value, in good faith and without notice of the alteration, may enforce rights with respect to the instrument:

(a) According to its original terms; or

(b) In the case of an incomplete instrument altered by unauthorized completion, according to its terms as completed.

Uniform Commercial Code Comment

1. This provision restates former Section 3-407. Former Section 3-407 defined a "material" alteration as any alteration that changes the contract of the parties in any respect. Revised Section 3-407 [section 3-1407] refers to such a change as an alteration. As under subsection (2) of former Section 3-407, discharge because of alteration occurs only in the case of an alteration fraudulently made. There is no discharge if a blank is filled in the honest belief that it is authorized or if a change is made with a benevolent motive such as a desire to give the obligor the benefit of a lower interest rate. Changes favorable to the obligor are unlikely to be made with any fraudulent intent, but if such an intent is found the alteration may operate as a discharge.

Discharge is a personal defense of the party whose obligation is modified and anyone whose obligation is not affected is not discharged. But if an alteration discharges a party there is also discharge of any party having a right of recourse against the discharged party because the obligation of the party with the right of recourse is affected by the alteration. Assent to the alteration given before or after it is made will prevent the party from asserting the discharge. The phrase "or is precluded from asserting the alteration" in subsection (b) [subsection (2)] recognizes the possibility of an estoppel or other ground barring the defense which does not rest on assent.

2. Under subsection (c) [subsection (3)] a person paying a fraudulently altered instrument or taking it for value, in good faith and without notice of the alteration, is not affected by a discharge under subsection (b) [subsection (2)]. The person paying or taking the instrument may assert rights with respect to the instrument according to its original terms or, in the case of an incomplete instrument that is altered by unauthorized completion, according to its terms as completed. If blanks are filled or an incomplete instrument is otherwise completed, subsection (c) [subsection (3)] places the loss upon the party

who left the instrument incomplete by permitting enforcement in its completed form. This result is intended even though the instrument was stolen from the issuer and completed after the theft.

§3-1408. Drawee not liable on unaccepted draft

A check or other draft does not of itself operate as an assignment of funds in the hands of the drawee available for its payment, and the drawee is not liable on the instrument until the drawee accepts it.

Uniform Commercial Code Comment

1. This section is a restatement of former Section 3-409(1). Subsection (2) of former Section 3-409 is deleted as misleading and superfluous. Comment 3 says of subsection (2): "It is intended to make it clear that this section does not in any way affect any liability which may arise apart from the instrument." In reality subsection (2) did not make anything clear and was a source of confusion. If all it meant was that a bank that has not certified a check may engage in other conduct that might make it liable to a holder, it stated the obvious and was superfluous. Section 1-103 is adequate to cover those cases.

2. Liability with respect to drafts may arise under other law. For example, Section 4-302 imposes liability on a payor bank for late return of an item.

§3-1409. Acceptance of draft; certified check

(1) "Acceptance" means the drawee's signed agreement to pay a draft as presented. Acceptance must be written on the draft and may consist of the drawee's signature alone. Acceptance may be made at any time and becomes effective when notification pursuant to instructions is given or the accepted draft is delivered for the purpose of giving rights on the acceptance to any person.

(2) A draft may be accepted although it has not been signed by the drawer, is otherwise incomplete, is overdue or has been dishonored.

(3) If a draft is payable at a fixed period after sight and the acceptor fails to date the acceptance, the holder may complete the acceptance by supplying a date in good faith.

(4) "Certified check" means a check accepted by the bank on which it is drawn. Acceptance may be made as stated in subsection (1) or by a writing on the check that indicates that

the check is certified. The drawee of a check has no obligation to certify the check, and refusal to certify is not dishonor of the check.

Uniform Commercial Code Comment

1. The first three subsections of Section 3-409 [section 3-1409] are a restatement of former Section 3-410. Subsection (d) [subsection (4)] adds a definition of certified check which is a type of accepted draft.

2. Subsection (a) [subsection (1)] states the generally recognized rule that the mere signature of the drawee on the instrument is a sufficient acceptance. Customarily the signature is written vertically across the face of the instrument, but since the drawee has no reason to sign for any other purpose a signature in any other place, even on the back of the instrument, is sufficient. It need not be accompanied by such words as "Accepted," "Certified," or "Good." It must not, however, bear any words indicating an intent to refuse to honor the draft. The last sentence of subsection (a) [subsection (1)] states the generally recognized rule that an acceptance written on the draft takes effect when the drawee notifies the holder or gives notice according to instructions.

3. The purpose of subsection (c) [subsection (3)] is to provide a definite date of payment if none appears on the instrument. An undated acceptance of a draft payable "thirty days after sight" is incomplete. Unless the acceptor writes in a different date the holder is authorized to complete the acceptance according to the terms of the draft by supplying a date of acceptance. Any date supplied by the holder is effective if made in good faith.

4. The last sentence of subsection (d) [subsection (4)] states the generally recognized rule that in the absence of agreement a bank is under no obligation to certify a check. A check is a demand instrument calling for payment rather than acceptance. The bank may be liable for breach of any agreement with the drawer, the holder, or any other person by which it undertakes to certify. Its liability is not on the instrument, since the drawee is not so liable until acceptance. Section 3-408 [section 3-1408]. Any liability is for breach of the separate agreement.

§3-1410. Acceptance varying draft

(1) If the terms of a drawee's acceptance vary from the terms of the draft as presented, the holder may refuse the acceptance and treat the draft as dishonored. In that case, the drawee may cancel the acceptance.

(2) The terms of a draft are not varied by an acceptance to pay at a particular bank or place in the United States, unless the acceptance states that the draft is to be paid only at that bank or place.

(3) If the holder assents to an acceptance varying the terms of a draft, the obligation of each drawer and indorser that does not expressly assent to the acceptance is discharged.

Uniform Commercial Code Comment

1. This section is a restatement of former Section 3-412. It applies to conditional acceptances, acceptances for part of the amount, acceptances to pay at a different time from that required by the draft, or to the acceptance of less than all of the drawees. It applies to any other engagement changing the essential terms of the draft. If the drawee makes a varied acceptance the holder may either reject it or assent to it. The holder may reject by insisting on acceptance of the draft as presented. Refusal by the drawee to accept the draft as presented is dishonor. In that event the drawee is not bound by the varied acceptance and is entitled to have it canceled.

If the holder assents to the varied acceptance, the drawee's obligation as acceptor is according to the terms of the varied acceptance. Under subsection (c) [subsection (3)] the effect of the holder's assent is to discharge any drawer or indorser who does not also assent. The assent of the drawer or indorser must be affirmatively expressed. Mere failure to object within a reasonable time is not assent which will prevent the discharge.

2. Under subsection (b) [subsection (2)] an acceptance does not vary from the terms of the draft if it provides for payment at any particular bank or place in the United States unless the acceptance states that the draft is to be paid only at such bank or place. Section 3-501(b)(1) [section 3-1501(2)(a)] states that if an instrument is payable at a bank in the United States presentment must be made at the place of payment (Section 3-1111) which in this case is at the designated bank.

§3-1411. Refusal to pay cashier's checks, teller's checks and certified checks

(1) In this section, "obligated bank" means the acceptor of a certified check or the issuer of a cashier's check or teller's check bought from the issuer.

(2) The person asserting the right to enforce the check is entitled to compensation for expenses and loss of interest

resulting from the nonpayment and may recover consequential damages if the obligated bank refuses to pay after receiving notice of particular circumstances giving rise to the damages and if the obligated bank wrongfully:

(a) Refuses to pay a cashier's check or certified check;

(b) Stops payment of a teller's check; or

(c) Refuses to pay a dishonored teller's check.

(3) Expenses or consequential damages under subsection (2) are not recoverable if the refusal of the obligated bank to pay occurs because:

(a) The bank suspends payments;

(b) The obligated bank asserts a claim or defense of the bank that it has reasonable grounds to believe is available against the person entitled to enforce the instrument;

(c) The obligated bank has a reasonable doubt whether the person demanding payment is the person entitled to enforce the instrument; or

(d) Payment is prohibited by law.

Uniform Commercial Code Comment

1. In some cases a creditor may require that the debt be paid by an obligation of a bank. The debtor may comply by obtaining certification of the debtor's check, but more frequently the debtor buys from a bank a cashier's check or teller's check payable to the creditor. The check is taken by the creditor as a cash equivalent on the assumption that the bank will pay the check. Sometimes, the debtor wants to retract payment by inducing the obligated bank not to pay. The typical case involves a dispute between the parties to the transaction in which the check is given in payment. In the case of a certified check or cashier's check, the bank can safely pay the holder of the check despite notice that there may be an adverse claim to the check (Section 3-602 [section 3-1602]). It is also clear that the bank that sells a teller's check has no duty to order the bank on which it is drawn not to pay it. A debtor using any of these types of checks has no right to stop payment. Nevertheless, some banks will refuse payment as an accommodation to a customer. Section 3-411 [section 3-1411] is designed to discourage this practice.

2. The term "obligated bank" refers to the issuer of the cashier's check or teller's check and the acceptor of the certified check. If the obligated bank wrongfully refuses to pay, it is liable to pay for expenses and loss of interest resulting from the refusal to pay. There is no express provision for attorney's fees, but attorney's fees are not meant to be necessarily excluded. They could be granted because they fit within the language "expenses * * * resulting from the nonpayment." In addition the bank may be liable to pay consequential damages if it has notice of the particular circumstances giving rise to the damages.

3. Subsection (c) [subsection (3)] provides that expenses or consequential damages are not recoverable if the refusal to pay is because of the reasons stated. The purpose is to limit that recovery to cases in which the bank refuses to pay even though its obligation to pay is clear and it is able to pay. Subsection (b) [subsection (2)] applies only if the refusal to honor the check is wrongful. If the bank is not obliged to pay there is no recovery. The bank may assert any claim or defense that it has, but normally the bank would not have a claim or defense. In the usual case it is a remitter that is asserting a claim to the check on the basis of a rescission of negotiation to the payee under Section 3-202 [subsection 3-1202]. See Comment 2 to Section 3-201 [subsection 3-1201]. The bank can assert that claim if there is compliance with Section 3-305(c) [section 3-1505(3)], but the bank is not protected from damages under subsection (b) [subsection (2)] if the claim of the remitter is not upheld. In that case, the bank is insulated from damages only if payment is enjoined under Section 3-602(b)(1) [section 3-1602(2)(b)]. Subsection (c)(iii) [subsection (3))c)] refers to cases in which the bank may have a reasonable doubt about the identity of the person demanding payment. For example, a cashier's check is payable to "Supplier Co." The person in possession of the check presents it for payment over the counter and claims to be an officer of Supplier Co. The bank may refuse payment until it has been given adequate proof that the presentment in fact is being made for Supplier Co., the person entitled to enforce the check.

§3-1412. Obligation of issuer of note or cashier's check

The issuer of a note or cashier's check or other draft drawn on the drawer is obliged to pay the instrument:

(1) According to its terms at the time it was issued or, if not issued, at the time it first came into possession of a holder; or

(2) If the issuer signed an incomplete instrument, according to its terms when completed, to the extent stated in sections 3-1115 and 3-1407. The obligation is owed to a person entitled to enforce the instrument or to an indorser who paid the instrument under section 3-1415.

Uniform Commercial Code Comment

1. The obligations of the maker, acceptor, drawer, and indorser are stated in four separate sections. Section 3-412 [section 3-1412] states the obligation of the maker of a note and is consistent with former Section 3-413(1). Section 3-412 [section 3-1412] also applies to the issuer of a cashier's check or other draft drawn on the drawer. Under former Section 3-118(a) [section 3-118(1)], since a cashier's check or other draft drawn on the drawer was "effective as a note," the drawer was liable under former Section 3-413(1) as a maker. Under Section 3-103(a)(6) [section 3-1103(1)(f)] and 3-104(f) [section 3-1104(6)] a cashier's check or other draft drawn on the drawer is treated as a draft to reflect common commercial usage, but the liability of the drawer is stated by Section 3-412 [section 3-1412] as being the same as that of the maker of a note rather than that of the drawer of a draft. Thus, Section 3-412 [section 3-1412] does not in substance change former law.

2. Under Section 3-105(b) [section 3-1105(2)] nonissuance of either a complete or incomplete instrument is a defense by a maker or drawer against a person that is not a holder in due course.

3. The obligation of the maker may be modified in the case of alteration if, under Section 3-406 [section 3-1406], the maker is precluded from asserting the alteration.

§3-1413. Obligation of acceptor

(1) The acceptor of a draft is obliged to pay the draft:

(a) According to its terms at the time it was accepted, even though the acceptance states that the draft is payable "as originally drawn" or equivalent terms;

(b) If the acceptance varies the terms of the draft, according to the terms of the draft as varied; or

(c) If the acceptance is of a draft that is an incomplete instrument, according to its terms when completed, to the extent stated in sections 3-1115 and 3-1407.

The obligation is owed to a person entitled to enforce the draft or to the drawer or an indorser who paid the draft under section 3-1414 or 3-1415.

(2) If the certification of a check or other acceptance of a draft states the amount certified or accepted, the obligation of the acceptor is that amount. If the certification or acceptance does not state an amount, the amount of the instrument is subsequently raised and the instrument is then negotiated to a holder in due course, the obligation of the acceptor is the amount of the instrument at the time it was taken by the holder in due course.

Uniform Commercial Code Comment

Subsection (a) [subsection (1)] is consistent with former Section 3-413(1). Subsection (b) [subsection (2)] has primary importance with respect to certified checks. It protects the holder in due course of a certified check that was altered after certification and before negotiation to the holder in due course. A bank can avoid liability for the altered amount by stating on the check the amount the bank agrees to pay. The subsection applies to other accepted drafts as well.

§3-1414. Obligation of drawer

(1) This section does not apply to cashier's checks or other drafts drawn on the drawer.

(2) When an unaccepted draft is dishonored, the drawer is obliged to pay the draft:

(a) According to its terms at the time it was issued or, if not issued, at the time it first came into possession of a holder; or

(b) If the drawer signed an incomplete instrument, according to its terms when completed, to the extent stated in sections 3-1115 and 3-1407.

The obligation is owed to a person entitled to enforce the draft or to an indorser who paid the draft under section 3-1415.

(3) If a draft is accepted by a bank, the drawer is discharged, regardless of when or by whom acceptance was obtained.

(4) When a draft is accepted and the acceptor is not a bank, the obligation of the drawer to pay the draft if the draft is dishonored by the acceptor is the same as the obligation of an indorser under section 3-1415, subsections (1) and (3).

(5) If a draft states that it is drawn without recourse or otherwise disclaims liability of the drawer to pay the draft, the drawer is not liable under subsection (2) to pay the draft when the draft is not a check. A disclaimer of the liability stated in subsection (2) is not effective if the draft is a check.

(6) The drawer, to the extent deprived of funds, may discharge its obligation to pay the check by assigning to the person entitled to enforce the check the rights of the drawer against the drawee with respect to the funds if:

(a) A check is not presented for payment or given to a depositary bank for collection within 30 days after its date;

(b) The drawee suspends payments after expiration of the 30-day period without paying the check; and

(c) Because of the suspension of payments, the drawer is deprived of funds maintained with the drawee to cover payment of the check.

Uniform Commercial Code Comment

1. Subsection (a) [subsection (1)]) excludes cashier's checks because the obligation of the issuer of a cashier's check is stated in Section 3-412 [section 3-1412].

2. Subsection (b) [subsection (2)] states the obligation of the drawer on an unaccepted draft. It replaces former Section 3-413(2). The requirement under former Article 3 of notice of dishonor or protest has been eliminated. Under revised Article 3 [Article 3-A], notice of dishonor is necessary only with respect to indorser's liability. The liability of the drawer of an unaccepted draft is treated as a primary liability. Under former Section 3-102(1)(d) the term "secondary party" was used to refer to a drawer or indorser. The quoted term is not used in revised Article 3 [Article 3-A]. The effect of a draft drawn without recourse is stated in subsection (e) [subsection (5)].

3. Under subsection (c) [subsection (3)] the drawer is discharged of liability on a draft accepted by a bank regardless of when acceptance was obtained. This changes former Section 3-411(1) which provided that the drawer is discharged only if the holder obtains acceptance. Holders that have a bank obligation do not normally rely on the drawer to guarantee the bank's solvency. A holder can obtain protection against the insolvency of a bank acceptor by a specific guaranty of payment by the drawer or by obtaining an indorsement by the drawer. Section 3-205(d) [section 3-1205(4)].

4. Subsection (d) [subsection (4)] states the liability of the drawer if a draft is accepted by a drawee other than a bank and the acceptor dishonors. The drawer of an unaccepted draft is the only party liable on the instrument. The drawee has no liability on the draft. Section 3-408 [section 3-1408]. When the draft is accepted, the obligations change. The drawee, as acceptor, becomes primarily liable and the drawer's liability is that of a person secondarily liable as a guarantor of payment. The drawer's liability is identical to that of an indorser, and subsection (d) [subsection (4)] states the drawer's liability that way. The drawer is liable to pay the person entitled to enforce the draft or any indorser that pays pursuant to Section 3-415 [section 3-1415]. The drawer in this case is discharged if notice of dishonor is required by Section 3-503 [section 3-1503] and is not given in compliance with that section. A drawer that pays has a right of recourse against the acceptor. Section 3-413(a) [section 3-1413](1)].

5. Subsection (e) [subsection (5)] does not permit the drawer of a check to avoid liability under subsection (b) [subsection (2)] by drawing the check without recourse. There is no legitimate purpose served by issuing a check on which nobody is liable. Drawing without recourse is effective to disclaim liability of the drawer if the draft is not a check. Suppose, in a documentary sale, Seller draws a draft on Buyer for the price of goods shipped to Buyer. The draft is payable upon delivery to the drawee of an order bill of lading covering the goods. Seller delivers the draft with the bill of lading to Finance Company that is named as payee of the draft. If Seller draws without recourse Finance Company takes the risk that Buyer will dishonor. If Buyer dishonors, Finance Company has no recourse against Seller but it can obtain reimbursement by selling the goods which it controls through the bill of lading.

6. Subsection (f) [subsection (6)] is derived from former Section 3-502(1)(b). It is designed to protect the drawer of a check against loss resulting from suspension of payments by the drawee bank when the holder of the check delays collection of the check. For example, X writes a check payable to Y for $1,000. The check is covered by funds in X's account in the drawee bank. Y delays initiation of collection of the check for more than 30 days after the date of the check. The drawee bank suspends payments after the 30-day period and before the check is presented for payment. If the $1,000 of funds in X's account have not been withdrawn, X has a claim for those funds against the drawee bank and, if subsection (e) [subsection (5)] were not in effect, X would be liable to Y on the check because the check was dishonored. Section 3-502(e) [section 3-1502(5)]. If the suspension of payments by the drawee bank will result in payment

to X of less than the full amount of the $1,000 in the account or if there is a significant delay in payment to X, X will suffer a loss which would not have been suffered if Y had promptly initiated collection of the check. In most cases, X will not suffer any loss because of the existence of federal bank deposit insurance that covers accounts up to $100,000. Thus, subsection (e) [subsection (5)] has relatively little importance. There might be some cases, however, in which the account is not fully insured because it exceeds $100,000 or because the account doesn't qualify for deposit insurance. Subsection (f) [subsection (6)] retains the phrase "deprived of funds maintained with the drawee" appearing in former Section 3-502(1)(b). The quoted phrase applies if the suspension of payments by the drawee prevents the drawer from receiving the benefit of funds which would have paid the check if the holder had been timely in initiating collection. Thus, any significant delay in obtaining full payment of the funds is a deprivation of funds. The drawer can discharge drawer's liability by assigning rights against the drawee with respect to the funds to the holder.

§3-1415. Obligation of indorser

(1) Subject to subsections (2), (3) and (4) and to section 3-1419, subsection (4), when an instrument is dishonored, an indorser is obliged to pay the amount due on the instrument:

(a) According to the terms of the instrument at the time it was indorsed; or

(b) If the indorser indorsed an incomplete instrument, according to its terms when completed, to the extent stated in sections 3-1115 and 3-1407.

The obligation of the indorser is owed to a person entitled to enforce the instrument or to a subsequent indorser who paid the instrument under this section.

(2) If an indorsement states that it is made "without recourse" or otherwise disclaims liability of the indorser, the indorser is not liable under subsection (1) to pay the instrument.

(3) If notice of dishonor of an instrument is required by section 3-1503 and notice of dishonor complying with that section is not given to an indorser, the liability of the indorser under subsection (1) is discharged.

(4) If a draft is accepted by a bank after an indorsement is made, the liability of the indorser under subsection (1) is discharged.

(5) If an indorser of a check is liable under subsection (1) and the check is not presented for payment, or given to a depositary bank for collection, within 30 days after the day the indorsement was made, the liability of the indorser under subsection (1) is discharged.

Uniform Commercial Code Comment

1. Subsection (a) [subsection (1)] and (b) [subsection (2)] restate the substance of former Section 3-414(1). Subsection (2) of former Section 3-414 has been dropped because it is superfluous. Although notice of dishonor is not mentioned in subsection (a) [subsection (1)], it must be given in some cases to charge an indorser. It is covered in subsection (c) [subsection (3)]. Regulation CC § 229.35(b) provides that a bank handling a check for collection or return is liable to a bank that subsequently handles the check to the extent the latter bank does not receive payment for the check. This liability applies whether or not the bank incurring the liability indorsed the check.

2. Section 3-503 [section 3-1503] states when notice of dishonor is required and how it must be given. If required notice of dishonor is not given in compliance with Section 3-503 [section 3-1503], subsection (c) [subsection (3)] of Section 3-415 [section 3-1415] states that the effect is to discharge the indorser's obligation.

3. Subsection (d) [subsection (4)] is similar in effect to Section 3-414(c) [section 3-1414(3)] if the draft is accepted by a bank after the indorsement is made. See Comment 3 to Section 3-414 [section 3-1414]. If a draft is accepted by a bank before the indorsement is made, the indorser incurs the obligation stated in subsection (a) [subsection (1)].

4. Subsection (e) [subsection (5)] modifies former Sections 3-503(2)(b) and 3-502(1)(a) by stating a 30-day rather than a seven-day period, and stating it as an absolute rather than a presumptive period.

§3-1416. Transfer warranties

(1) A person who transfers an instrument for consideration shall warrant to the transferee and, if the transfer is by indorsement, to any subsequent transferee that:

(a) The warrantor is a person entitled to enforce the instrument;

(b) All signatures on the instrument are authentic and authorized;

(c) The instrument has not been altered;

(d) The instrument is not subject to a defense or claim in recoupment of any party that may be asserted against the warrantor; and

(e) The warrantor has no knowledge of any insolvency proceeding commenced with respect to the maker or acceptor or, in the case of an unaccepted draft, the drawer.

(2) A person to whom the warranties under subsection (1) are made and who took the instrument in good faith may recover from the warrantor as damages for breach of warranty an amount equal to the loss suffered as a result of the breach, but not more than the amount of the instrument plus expenses and loss of interest incurred as a result of the breach.

(3) The warranties stated in subsection (1) may not be disclaimed with respect to checks. Unless notice of a claim for breach of warranty is given to the warrantor within 30 days after the claimant has reason to know of the breach and the identity of the warrantor, the liability of the warrantor under subsection (2) is discharged to the extent of any loss caused by the delay in giving notice of the claim.

(4) A [cause of action] for breach of warranty under this section accrues when the claimant has reason to know of the breach.

Uniform Commercial Code Comment

1. Subsection (a) [subsection (1)] is taken from subsection (2) of former Section 3-417. Subsections (3) and (4) of former Section 3-417 are deleted. Warranties under subsection (a) [subsection (1)] in favor of the immediate transferee apply to all persons who transfer an instrument for consideration whether or not the transfer is accompanied by indorsement. Any consideration sufficient to support a simple contract will support those warranties. If there is an indorsement the warranty runs with the instrument and the remote holder may sue the indorser-warrantor directly and thus avoid a multiplicity of suits.

2. Since the purpose of transfer (Section 3-203(a) [section 3-1203(1)]) is to give the transferee the right to enforce the instrument, subsection (a)(1) [subsection (1)(a)] is a warranty that the transferor is a person entitled to enforce the instrument (Section 3-301 [section 3-1301]). Under Section 3-203 (b) [section 3-1203(2)] transfer gives the transferee any right

of the transferor to enforce the instrument. Subsection (a)(1) [subsection (1)(a)] is in effect a warranty that there are no unauthorized or missing indorsements that prevent the transferor from making the transferee a person entitled to enforce the instrument.

3. The rationale of subsection (a)(4) [subsection (1)(d)] is that the transferee does not undertake to buy an instrument that is not enforceable in whole or in part, unless there is a contrary agreement. Even if the transferee takes as a holder in due course who takes free of the defense or claim in recoupment, the warranty gives the transferee the option of proceeding against the transferor rather than litigating with the obligor on the instrument the issue of the holder-in-due-course status of the transferee. Subsection (3) of former Section 3-417 which limits this warranty is deleted. The rationale is that while the purpose of a "no recourse" indorsement is to avoid a guaranty of payment, the indorsement does not clearly indicate an intent to disclaim warranties.

4. Under subsection (a)(5) [subsection (1)(e)] the transferor does not warrant against difficulties of collection, impairment of the credit of the obligor or even insolvency. The transferee is expected to determine such questions before taking the obligation. If insolvency proceedings as defined in Section 1-201(22) have been instituted against the party who is expected to pay and the transferor knows it, the concealment of that fact amounts to a fraud upon the transferee, and the warranty against knowledge of such proceedings is provided accordingly.

5. Transfer warranties may be disclaimed with respect to any instrument except a check. Between the immediate parties disclaimer may be made by agreement. In the case of an indorser, disclaimer of transferor's liability, to be effective, must appear in the indorsement with words such as "without warranties" or some other specific reference to warranties. But in the case of a check, subsection (c) [subsection (3)] of Section 3-416 [section 3-1416] provides that transfer warranties cannot be disclaimed at all. In the check collection process the banking system relies on these warranties.

6. Subsection (b) [subsection (2)] states the measure of damages for breach of warranty. There is no express provision for attorney's fees, but attorney's fees are not meant to be necessarily excluded. They could be granted because they fit within the phrase "expenses * * * incurred as a result of the breach." The intention is to leave to other state law the issue as to when attorney's fees are recoverable.

7. Since the traditional term "cause of action" may have been replaced in some states by "claim for relief" or some equivalent term, the words "cause of action" in subsection (d) [subsection (4)] have been bracketed to indicate that the words may be replaced by an appropriate substitute to conform to local practice.

§3-1417. Presentment warranties

(1) If an unaccepted draft is presented to the drawee for payment or acceptance and the drawee pays or accepts the draft, the person obtaining payment or acceptance, at the time of presentment and a previous transferor of the draft, at the time of transfer, shall warrant to the drawee making payment or accepting the draft in good faith that:

(a) The warrantor is, or was, at the time the warrantor transferred the draft, a person entitled to enforce the draft or authorized to obtain payment or acceptance of the draft on behalf of a person entitled to enforce the draft;

(b) The draft has not been altered; and

(c) The warrantor has no knowledge that the signature of the drawer of the draft is unauthorized.

(2) A drawee making payment may recover from any warrantor damages for breach of warranty equal to the amount paid by the drawee less the amount the drawee received or is entitled to receive from the drawer because of the payment. In addition, the drawee is entitled to compensation for expenses and loss of interest resulting from the breach. The right of the drawee to recover damages under this subsection is not affected by any failure of the drawee to exercise ordinary care in making payment. If the drawee accepts the draft, breach of warranty is a defense to the obligation of the acceptor. If the acceptor makes payment with respect to the draft, the acceptor is entitled to recover from any warrantor for breach of warranty the amounts stated in this subsection.

(3) If a drawee asserts a claim for breach of warranty under subsection (1) based on an unauthorized indorsement of the draft or an alteration of the draft, the warrantor may defend by proving that the indorsement is effective under section 3-1404 or 3-1405 or the drawer is precluded under section 3-1406 or 4-406 from asserting against the drawee the unauthorized indorsement or alteration.

(4) If a dishonored draft is presented for payment to the drawer or an indorser, or any other instrument is presented for

payment to a party obliged to pay the instrument and payment is received, the following rules apply.

(a) The person obtaining payment and a prior transferor of the instrument shall warrant to the person making payment in good faith that the warrantor is, or was, at the time the warrantor transferred the instrument, a person entitled to enforce the instrument or authorized to obtain payment on behalf of a person entitled to enforce the instrument.

(b) The person making payment may recover from any warrantor for breach of warranty an amount equal to the amount paid plus expenses and loss of interest resulting from the breach.

(5) The warranties stated in subsections (1) and (4) can not be disclaimed with respect to checks. Unless notice of a claim for breach of warranty is given to the warrantor within 30 days after the claimant has reason to know of the breach and the identity of the warrantor, the liability of the warrantor under subsection (2) or (4) is discharged to the extent of any loss caused by the delay in giving notice of the claim.

(6) A cause of action for breach of warranty under this section accrues when the claimant has reason to know of the breach.

Uniform Commercial Code Comment

1. This section replaces subsection (1) of former Section 3-417. The former provision was difficult to understand because it purported to state in one subsection all warranties given to any person paying any instrument. The result was a provision replete with exceptions that could not be readily understood except after close scrutiny of the language. In revised Section 3-417 [section 3-1417], presentment warranties made to drawees of uncertified checks and other unaccepted drafts are stated in subsection (a) [subsection (1)]. All other presentment warranties are stated in subsection (d) [subsection (4)].

2. Subsection (a) [subsection (1)] states three warranties. Subsection (a)(1) [subsection (1)] in effect is a warranty that there are no unauthorized or missing indorsements. "Person entitled to enforce" is defined in Section 3-301 [section 3-1301]. Subsection (a)(2) [subsection (1)] is a warranty that there is no alteration. Subsection (a)(3) [subsection (1)] is a warranty of no knowledge that there is a forged drawer's signature. Subsection (a) [subsection (1)] states that the warranties are made to the drawee and subsections (b) [subsection (2)] and (c) [subsection (3)] identify the drawee as the person

entitled to recover for breach of warranty. There is no warranty made to the drawer under subsection (a) [subsection (1)] when presentment is made to the drawee. Warranty to the drawer is governed by subsection (d) [subsection (4)] and that applies only when presentment for payment is made to the drawer with respect to a dishonored draft. In Sun 'N Sand, Inc. v. United California Bank, 582 P.2d 920 (Cal. 1978), the court held that under former Section 3-417(1) a warranty was made to the drawer of a check when the check was presented to the drawee for payment. The result in that case is rejected.

3. Subsection (a)(1) [subsection (1)] retains the rule that the drawee does not admit the authenticity of indorsements and subsection (a)(3) [subsection (1)] retains the rule of Price v. Neal, 3 Burr. 1354 (1762), that the drawee takes the risk that the drawer's signature is unauthorized unless the person presenting the draft has knowledge that the drawer's signature is unauthorized. Under subsection (a)(3) [subsection (1)] the warranty of no knowledge that the drawer's signature is unauthorized is also given by prior transferors of the draft.

4. Subsection (d) [subsection (4)] applies to presentment for payment in all cases not covered by subsection (a) [subsection (1)]. It applies to presentment of notes and accepted drafts to any party obliged to pay the instrument, including an indorser, and to presentment of dishonored drafts if made to the drawer or an indorser. In cases covered by subsection (d) [subsection (4)], there is only one warranty and it is the same as that stated in subsection (a)(1) [subsection (1)(a)]. There are no warranties comparable to subsections (a)(2) [subsection (1)] and (a)(3) [subsection (1)] because they are appropriate only in the case of presentment to the drawee of an unaccepted draft. With respect to presentment of an accepted draft to the acceptor, there is no warranty with respect to alteration or knowledge that the signature of the drawer is unauthorized. Those warranties were made to the drawee when the draft was presented for acceptance (Section 3-417(a)(2) and (3) [section 3-1417(1)]) and breach of that warranty is a defense to the obligation of the drawee as acceptor to pay the draft. If the drawee pays the accepted draft the drawee may recover the payment from any warrantor who was in breach of warranty when the draft was accepted. Section 3-417(b) [section 3-1417(2)]. Thus, there is no necessity for these warranties to be repeated when the accepted draft is presented for payment. Former Section 3-417(1)(b)(iii) and (c)(iii) are not included in revised Section 3-1417 because they are unnecessary. Former Section 3-417(1)(c)(iv) is not included because it is also unnecessary. The acceptor should know what the terms of the draft were at the time acceptance was made.

If presentment is made to the drawer or maker, there is no necessity for a warranty concerning the signature of that person or with respect to alteration. If presentment is made to an indorser, the indorser had itself warranted authenticity of signatures and that the instrument was not altered. Section 3-416(a)(2) and (3) [section 3-1416(1)(b) and (c)].

5. The measure of damages for breach of warranty under subsection (a) [subsection (1)] is stated in subsection (b) [subsection (2)]. There is no express provision for attorney's fees, but attorney's fees are not meant to be necessarily excluded. They could be granted because they fit within the language "expenses * * * resulting from the breach." Subsection (b) [subsection (2)] provides that the right of the drawee to recover for breach of warranty is not affected by a failure of the drawee to exercise ordinary care in paying the draft. This provision follows the result reached under former Article 3 in Hartford Accident & Indemnity Co. v. First Pennsylvania Bank, 859 F.2d 295 (3d Cir. 1988).

6. Subsection (c) [subsection (3)] applies to checks and other unaccepted drafts. It gives to the warrantor the benefit of rights that the drawee has against the drawer under Section 3-404 [section 3-1404], 3-405 [section 3-1405], 3-406 [section 3-1406], or 4-406. If the drawer's conduct contributed to a loss from forgery or alteration, the drawee should not be allowed to shift the loss from the drawer to the warrantor.

7. The first sentence of subsection (e) [subsection (5)] recognizes that checks are normally paid by automated means and that payor banks rely on warranties in making payment. Thus, it is not appropriate to allow disclaimer of warranties appearing on checks that normally will not be examined by the payor bank. The second sentence requires a breach of warranty claim to be asserted within 30 days after the drawee learns of the breach and the identity of the warrantor.

8. Since the traditional term "cause of action" may have been replaced in some states by "claim for relief" or some equivalent term, the words "cause of action" in subsection (f) [subsection (6)] have been bracketed to indicate that the words may be replaced by an appropriate substitute to conform to local practice.

§3-1418. Payment or acceptance by mistake

(1) Except as provided in subsection (3), the drawee may recover the amount of the draft from the person to whom or for whose benefit payment was made or, in the case of acceptance, may revoke the acceptance if the drawee of a draft pays or accepts

the draft and the drawee acted on the mistaken belief that payment of the draft had not been stopped pursuant to section 4-403 or the signature of the drawer of the draft was authorized.

Rights of the drawee under this subsection are not affected by failure of the drawee to exercise ordinary care in paying or accepting the draft.

(2) Except as provided in subsection (3), if an instrument has been paid or accepted by mistake and the case is not covered by subsection (1), the person paying or accepting may, to the extent permitted by the law governing mistake and restitution:

(a) Recover the payment from the person to whom or for whose benefit payment was made; or

(b) In the case of acceptance, revoke the acceptance.

(3) The remedies provided by subsection (1) or (2) may not be asserted against a person who took the instrument in good faith and for value or who in good faith changed position in reliance on the payment or acceptance. This subsection does not limit remedies provided by section 3-1417 or 4-407.

(4) Notwithstanding section 4-213, if an instrument is paid or accepted by mistake and the payor or acceptor recovers payment or revokes acceptance under subsection (1) or (2), the instrument is deemed not to have been paid or accepted and is treated as dishonored, and the person from whom payment is recovered has rights as a person entitled to enforce the dishonored instrument.

Uniform Commercial Code Comment

1. This section covers payment or acceptance by mistake and replaces former Section 3-418. Under former Article 3, the remedy of a drawee that paid or accepted a draft by mistake was based on the law of mistake and restitution, but that remedy was not specifically stated. It was provided by Section 1-103. Former Section 3-418 was simply a limitation on the unstated remedy under the law of mistake and restitution. Under revised Article 3 [Article 3-A], Section 3-418 [section 3-1418] specifically states the right of restitution in subsections (a) [subsection (1)] and (b) [subsection (2)]. Subsection (a) [subsection (1)] allows restitution in the two most common cases in which the problem is presented: payment or acceptance of forged checks and checks on which the drawer has stopped payment. If the drawee acted under a mistaken belief that the check was not forged or had not been stopped, the drawee is entitled to recover the funds paid or to revoke the acceptance whether or not the drawee acted negligently. But in each case,

by virtue of subsection (c) [subsection (3)], the drawee loses the remedy if the person receiving payment or acceptance was a person who took the check in good faith and for value or who in good faith changed position in reliance on the payment or acceptance. Subsections (a) [subsection (1)] and (c) [subsection (3)] are consistent with former Section 3-418 and the rule of Price v. Neal. The result in the two cases covered by subsection (a) [subsection (1)] is that the drawee in most cases will not have a remedy against the person paid because there is usually a person who took the check in good faith and for value or who in good faith changed position in reliance on the payment or acceptance.

2. If a check has been paid by mistake and the payee receiving payment did not give value for the check or did not change position in reliance on the payment, the drawee bank is entitled to recover the amount of the check under subsection (a) [subsection (1)] regardless of how the check was paid. The drawee bank normally pays a check by a credit to an account of the collecting bank that presents the check for payment. The payee of the check normally receives the payment by a credit to the payee's account in the depositary bank. But in some cases the payee of the check may have received payment directly from the drawee bank by presenting the check for payment over the counter. In those cases the payee is entitled to receive cash, but the payee may prefer another form of payment such as a cashier's check or teller's check issued by the drawee bank. Suppose Seller contracted to sell goods to Buyer. The contract provided for immediate payment by Buyer and delivery of the goods 20 days after payment. Buyer paid by mailing a check for $10,000 drawn on Bank payable to Seller. The next day Buyer gave a stop payment order to Bank with respect to the check Buyer had mailed to Seller. A few days later Seller presented Buyer's check to Bank for payment over the counter and requested a cashier's check as payment. Bank issued and delivered a cashier's check for $10,000 payable to Seller. The teller failed to discover Buyer's stop order. The next day Bank discovered the mistake and immediately advised Seller of the facts. Seller refused to return the cashier's check and did not deliver any goods to Buyer.

Under Section 4-215 [section 4-213], Buyer's check was paid by Bank at the time it delivered its cashier's check to Seller. See Comment 3 to Section 4-215 [section 4-213]. Bank is obliged to pay the cashier's check and has no defense to that obligation. The cashier's check was issued for consideration because it was issued in payment of Buyer's check. Although Bank has no defense on its cashier's check it may have a right to recover $10,000, the amount of Buyer's check, from Seller under Section 3-418(a) [section 3-1418(1)]. Bank paid Buyer's check by mistake. Seller did not give value for Buyer's check because the

promise to deliver goods to Buyer was never performed. Section 3-303(a)(1) [section 3-1303(1)(a)]. And, on these facts, Seller did not change position in reliance on the payment of Buyer's check. Thus, the first sentence of Section 3-418(c) [section 3-1418(3)] does not apply and Seller is obliged to return $10,000 to Bank. Bank is obliged to pay the cashier's check but it has a counterclaim against Seller based on its rights under Section 3-418(a) [section 3-1418(1)]. This claim can be asserted against Seller, but it cannot be asserted against some other person with rights of a holder in due course of the cashier's check. A person without rights of a holder in due course of the cashier's check would take subject to Bank's claim against Seller because it is a claim in recoupment. Section 3-305(a)(3) [section 3-1305(1)(c)].

If Bank recovers from Seller under Section 3-418(a) [section 3-1418(1)], the payment of Buyer's check is treated as unpaid and dishonored. Section 3-418(d) [section 3-1418(4)]. One consequence is that Seller may enforce Buyer's obligation as drawer to pay the check. Section 3-414 [section 3-1414]. Another consequence is that Seller's rights against Buyer on the contract of sale are also preserved. Under Section 3-310(b) [section 3-1310(2)] Buyer's obligation to pay for the goods was suspended when Seller took Buyer's check and remains suspended until the check is either dishonored or paid. Under Section 3-310(b)(2) [section 3-1310(2)(b)] the obligation is discharged when the check is paid. Since Section 3-418(d) [section 3-1418(4)] treats Buyer's check as unpaid and dishonored, Buyer's obligation is not discharged and suspension of the obligation terminates. Under Section 3-310(b)(3) [section 3-1310(2)(c)], Seller may enforce either the contract of sale or the check subject to defenses and claims of Buyer.

If Seller had released the goods to Buyer before learning about the stop order, Bank would have no recovery against Seller under Section 3-418(a) [section 3-1418(1)] because Seller in that case gave value for Buyer's check. Section 3-418(c) [section 3-1418(3)]. In this case Bank's sole remedy is under Section 4-407 by subrogation.

3. Subsection (b) [subsection (2)] covers cases of payment or acceptance by mistake that are not covered by subsection (a) [subsection (1)]. It directs courts to deal with those cases under the law governing mistake and restitution. Perhaps the most important class of cases that falls under subsection (b) [subsection (2)], because it is not covered by subsection (a) [subsection (1)], is that of payment by the drawee bank of a check with respect to which the bank has no duty to the drawer to pay either because the drawer has no account with the bank or because available funds in the drawer's account are not

sufficient to cover the amount of the check. With respect to such a case, under Restatement of Restitution § 29, if the bank paid because of a mistaken belief that there were available funds in the drawer's account sufficient to cover the amount of the check, the bank is entitled to restitution. But § 29 is subject to Restatement of Restitution § 33 which denies restitution if the holder of the check receiving payment paid value in good faith for the check and had no reason to know that the check was paid by mistake when payment was received.

The result in some cases is clear. For example, suppose Father gives Daughter a check for $10,000 as a birthday gift. The check is drawn on Bank in which both Father and Daughter have accounts. Daughter deposits the check in her account in Bank. An employee of Bank, acting under the belief that there were available funds in Father's account to cover the check, caused Daughter's account to be credited for $10,000. In fact, Father's account was overdrawn and Father did not have overdraft privileges. Since Daughter received the check gratuitously there is clear unjust enrichment if she is allowed to keep the $10,000 and Bank is unable to obtain reimbursement from Father. Thus, Bank should be permitted to reverse the credit to Daughter's account. But this case is not typical. In most cases the remedy of restitution will not be available because the person receiving payment of the check will have given value for it in good faith.

In some cases, however, it may not be clear whether a drawee bank should have a right of restitution. For example, a check-kiting scheme may involve a large number of checks drawn on a number of different banks in which the drawer's credit balances are based on uncollected funds represented by fraudulently drawn checks. No attempt is made in Section 3-418 [section 3-1418] to state rules for determining the conflicting claims of the various banks that may be victimized by such a scheme. Rather, such cases are better resolved on the basis of general principles of law and the particular facts presented in the litigation.

4. The right of the drawee to recover a payment or to revoke an acceptance under Section 3-418 [section 3-1418] is not affected by the rules under Article 4 that determine when an item is paid. Even though a payor bank may have paid an item under Section 4-215 [section 4-213], it may have a right to recover the payment under Section 3-418 [section 3-1418]. National Savings & Trust Co. v. Park Corp., 722 F.2d 1303 (6th Cir. 1983), cert. denied, 466 U.S. 939 (1984), correctly states the law on the issue under former Article 3. Revised Article 3 [Article 3-A] does not change the previous law.

§3-1419. Instruments signed for accommodation

(1) If an instrument is issued for value given for the benefit of a party to the instrument, in this section referred to as the "accommodated party," and another party to the instrument, in this section referred to as the "accommodation party," signs the instrument for the purpose of incurring liability on the instrument without being a direct beneficiary of the value given for the instrument, the instrument is signed by the accommodation party for accommodation.

(2) An accommodation party may sign the instrument as maker, drawer, acceptor or indorser and, subject to subsection (4), is obliged to pay the instrument in the capacity in which the accommodation party signs. The obligation of an accommodation party may be enforced notwithstanding any statute of frauds and whether or not the accommodation party receives consideration for the accommodation.

(3) A person signing an instrument is presumed to be an accommodation party and there is notice that the instrument is signed for accommodation if the signature is an anomalous indorsement or is accompanied by words indicating that the signer is acting as surety or guarantor with respect to the obligation of another party to the instrument. Except as provided in section 3-1605, the obligation of an accommodation party to pay the instrument is not affected by the fact that the person enforcing the obligation had notice when the instrument was taken by that person that the accommodation party signed the instrument for accommodation.

(4) If the signature of a party to an instrument is accompanied by words indicating unambiguously that the party is guaranteeing collection rather than payment of the obligation of another party to the instrument, the signer is obliged to pay the amount due on the instrument to a person entitled to enforce the instrument only if:

(a) Execution of judgment against the other party has been returned unsatisfied;

(b) The other party is insolvent or in an insolvency proceeding;

(c) The other party can not be served with process; or

(d) It is otherwise apparent that payment can not be obtained from the other party.

(5) An accommodation party who pays the instrument is entitled to reimbursement from the accommodated party and is entitled to enforce the instrument against the accommodated party. An accommodated party who pays the instrument has no right of recourse against, and is not entitled to contribution from, an accommodation party.

Uniform Commercial Code Comment

1. Section 3-419 [section 3-1419] replaces former Sections 3-415 and 3-416. An accommodation party is a person who signs an instrument to benefit the accommodated party either by signing at the time value is obtained by the accommodated party or later, and who is not a direct beneficiary of the value obtained. An accommodation party will usually be a co-maker or anomalous indorser. Subsection (a) [subsection (1)] distinguishes between direct and indirect benefit. For example, if X cosigns a note of Corporation that is given for a loan to Corporation, X is an accommodation party if no part of the loan was paid to X or for X's direct benefit. This is true even though X may receive indirect benefit from the loan because X is employed by Corporation or is a stockholder of Corporation, or even if X is the sole stockholder so long as Corporation and X are recognized as separate entities.

2. It does not matter whether an accommodation party signs gratuitously either at the time the instrument is issued or after the instrument is in the possession of a holder. Subsection (b) [subsection (2)] of Section 3-419 [section 3-1419] takes the view stated in Comment 3 to former Section 3-415 that there need be no consideration running to the accommodation party: "The obligation of the accommodation party is supported by any consideration for which the instrument is taken before it is due. Subsection (2) is intended to change occasional decisions holding that there is no sufficient consideration where an accommodation party signs a note after it is in the hands of a holder who has given value. The [accommodation] party is liable to the holder in such a case even though there is no extension of time or other concession."

3. As stated in Comment 1, whether a person is an accommodation party is a question of fact. But it is almost always the case that a co-maker who signs with words of guaranty after the signature is an accommodation party. The same is true of an anomalous indorser. In either case a person taking the instrument is put on notice of the accommodation status of the co-maker or indorser. This is relevant to Section 3-605(h) [section 3-1605(8)]. But, under subsection (c) [subsection (3)], signing with words of guaranty or as an anomalous indorser also creates a presumption that the signer is an accommodation party.

A party challenging accommodation party status would have to rebut this presumption by producing evidence that the signer was in fact a direct beneficiary of the value given for the instrument.

4. Subsection (b) [subsection (2)] states that an accommodation party is liable on the instrument in the capacity in which the party signed the instrument. In most cases that capacity will be either that of a maker or indorser of a note. But subsection (d) [subsection (4)] provides a limitation on subsection (b) [subsection (2)]. If the signature of the accommodation party is accompanied by words indicating unambiguously that the party is guaranteeing collection rather than payment of the instrument, liability is limited to that stated in subsection (d) [subsection (4)], which is based on former Section 3-416(2).

Former Article 3 was confusing because the obligation of a guarantor was covered both in Section 3-415 [section 3-1415] and in Section 3-416 [section 3-1416]. The latter section suggested that a signature accompanied by words of guaranty created an obligation distinct from that of an accommodation party. Revised Article 3 [Article 3-A] eliminates that confusion by stating in Section 3-419 [section 3-1419] the obligation of a person who uses words of guaranty. Portions of former Section 3-416 are preserved. Former Section 3-416(2) is reflected in Section 3-419(d) [section 3-1419(4)] and former Section 3-416(4) is reflected in Section 3-419(c) [section 3-1419(3)].

5. Subsection (e) [subsection (5)] restates subsection (5) of present Section 3-415 [section 3-1415]. Since the accommodation party that pays the instrument is entitled to enforce the instrument against the accommodated party, the accommodation party also obtains rights to any security interest or other collateral that secures payment of the instrument.

§3-1420. Conversion of instrument

(1) The law applicable to conversion of personal property applies to instruments. An instrument is also converted if it is taken by transfer, other than a negotiation, from a person not entitled to enforce the instrument or a bank makes or obtains payment with respect to the instrument for a person not entitled to enforce the instrument or receive payment. An action for conversion of an instrument may not be brought by the issuer or acceptor of the instrument or a payee or indorsee who did not receive delivery of the instrument either directly or through delivery to an agent or a copayee.

(2) In an action under subsection (1), the measure of liability is presumed to be the amount payable on the instrument, but recovery may not exceed the amount of the plaintiff's interest in the instrument.

(3) A representative, other than a depositary bank, who has in good faith dealt with an instrument or its proceeds on behalf of one who was not the person entitled to enforce the instrument is not liable in conversion to that person beyond the amount of any proceeds that it has not paid out.

Uniform Commercial Code Comment

1. Section 3-420 [section 3-1420] is a modification of former Section 3-419. The first sentence of Section 3-420(a) [section 3-1420(1)] states a general rule that the law of conversion applicable to personal property also applies to instruments. Paragraphs (a) and (b) of former Section 3-419(1) are deleted as inappropriate in cases of noncash items that may be delivered for acceptance or payment in collection letters that contain varying instructions as to what to do in the event of nonpayment on the day of delivery. It is better to allow such cases to be governed by the general law of conversion that would address the issue of when, under the circumstances prevailing, the presenter's right to possession has been denied. The second sentence of Section 3-420(a) [section 3-1420(1)] states that an instrument is converted if it is taken by transfer other than a negotiation from a person not entitled to enforce the instrument or taken for collection or payment from a person not entitled to enforce the instrument or receive payment. This covers cases in which a depositary or payor bank takes an instrument bearing a forged indorsement. It also covers cases in which an instrument is payable to two persons and the two persons are not alternative payees, e.g. a check payable to John and Jane Doe. Under Section 3-110(d) [section 3-1110(4)] the check can be negotiated or enforced only by both persons acting jointly. Thus, neither payee acting without the consent of the other, is a person entitled to enforce the instrument. If John indorses the check and Jane does not, the indorsement is not effective to allow negotiation of the check. If Depositary Bank takes the check for deposit to John's account, Depositary Bank is liable to Jane for conversion of the check if she did not consent to the transaction. John, acting alone, is not the person entitled to enforce the check because John is not the holder of the check. Section 3-110(d) [section 3-1110(4)] and Comment 4 to Section 3-110 [section 3-1110]. Depositary Bank does not get any greater rights under Section 4-205(1). If it acted for John as its customer, it did not become holder of the check under that provision because John, its customer, was not a holder.

Under former Article 3, the cases were divided on the issue of whether the drawer of a check with a forged indorsement can assert rights against a depositary bank that took the check. The last sentence of Section 3-420(a) [section 3-1420(1)] resolves the conflict by following the rule stated in Stone & Webster Engineering Corp. v. First National Bank & Trust Co., 184 N.E.2d 358 (Mass. 1962). There is no reason why a drawer should have an action in conversion. The check represents an obligation of the drawer rather than property of the drawer. The drawer has an adequate remedy against the payor bank for recredit of the drawer's account for unauthorized payment of the check.

There was also a split of authority under former Article 3 on the issue of whether a payee who never received the instrument is a proper plaintiff in a conversion action. The typical case was one in which a check was stolen from the drawer or in which the check was mailed to an address different from that of the payee and was stolen after it arrived at that address. The thief forged the indorsement of the payee and obtained payment by depositing the check to an account in a depositary bank. The issue was whether the payee could bring an action in conversion against the depositary bank or the drawee bank. In revised Article 3 [Article 3-A], under the last sentence of Section 3-420(a) [section 3-1420(1)], the payee has no conversion action because the check was never delivered to the payee. Until delivery, the payee does not have any interest in the check. The payee never became the holder of the check nor a person entitled to enforce the check. Section 3-301 [section 3-1301]. Nor is the payee injured by the fraud. Normally the drawer of a check intends to pay an obligation owed to the payee. But if the check is never delivered to the payee, the obligation owed to the payee is not affected. If the check falls into the hands of a thief who obtains payment after forging the signature of the payee as an indorsement, the obligation owed to the payee continues to exist after the thief receives payment. Since the payee's right to enforce the underlying obligation is unaffected by the fraud of the thief, there is no reason to give any additional remedy to the payee. The drawer of the check has no conversion remedy, but the drawee is not entitled to charge the drawer's account when the drawee wrongfully honored the check. The remedy of the drawee is against the depositary bank for breach of warranty under Section 3-417(a)(1) [section 3-1417(1)(a)] or 4-208(a)(1) [section 4-207-B(1)(a)]. The loss will fall on the person who gave value to the thief for the check.

The situation is different if the check is delivered to the payee. If the check is taken for an obligation owed to the payee, the last sentence of Section 3-310(b)(4) [section 3-1310(2)(d)] provides that the obligation may not be enforced to the extent of the amount of the check. The payee's rights are

restricted to enforcement of the payee's rights in the instrument. In this event the payee is injured by the theft and has a cause of action for conversion.

The payee receives delivery when the check comes into the payee's possession, as for example when it is put into the payee's mailbox. Delivery to an agent is delivery to the payee. If a check is payable to more than one payee, delivery to one of the payees is deemed to be delivery to all of the payees. Occasionally, the person asserting a conversion cause of action is an indorsee rather than the original payee. If the check is stolen before the check can be delivered to the indorsee and the indorsee's indorsement is forged, the analysis is similar. For example, a check is payable to the order of A. A indorses it to B and puts it into an envelope addressed to B. The envelope is never delivered to B. Rather, Thief steals the envelope, forges B's indorsement to the check and obtains payment. Because the check was never delivered to B, the indorsee, B has no cause of action for conversion, but A does have such an action. A is the owner of the check. B never obtained rights in the check. If A intended to negotiate the check to B in payment of an obligation, that obligation was not affected by the conduct of Thief. B can enforce that obligation. Thief stole A's property not B's.

2. Subsection (2) of former Section 3-419 is amended because it is not clear why the former law distinguished between the liability of the drawee and that of other converters. Why should there be a conclusive presumption that the liability is face amount if a drawee refuses to pay or return an instrument or makes payment on a forged indorsement, while the liability of a maker who does the same thing is only presumed to be the face amount? Moreover, it was not clear under former Section 3-419(2) what face amount meant. If a note for $10,000 is payable in a year at 10% interest, it is common to refer to $10,000 as the face amount, but if the note is converted the loss to the owner also includes the loss of interest. In revised Article 3 [Article 3-A], Section 3-420(b) [section 3-1420(2)], by referring to "amount payable on the instrument," allows the full amount due under the instrument to be recovered.

The "but" clause in subsection (b) [subsection (2)] addresses the problem of conversion actions in multiple payee checks. Section 3-110(d) [section 3-1110(4)] states that an instrument cannot be enforced unless all payees join in the action. But an action for conversion might be brought by a payee having no interest or a limited interest in the proceeds of the check. This clause prevents such a plaintiff from receiving a windfall. An example is a check payable to a building contractor and a supplier of building material. The check is not payable to the payees alternatively. Section 3-110(d) [section 3-1110(4)].

The check is delivered to the contractor by the owner of the building. Suppose the contractor forges supplier's signature as an indorsement of the check and receives the entire proceeds of the check. The supplier should not, without qualification, be able to recover the entire amount of the check from the bank that converted the check. Depending upon the contract between the contractor and the supplier, the amount of the check may be due entirely to the contractor, in which case there should be no recovery, entirely to the supplier, in which case recovery should be for the entire amount, or part may be due to one and the rest to the other, in which case recovery should be limited to the amount due to the supplier.

3. Subsection (3) of former Section 3-419 drew criticism from the courts, that saw no reason why a depositary bank should have the defense stated in the subsection. See Knesz v. Central Jersey Bank & Trust Co., 477 A.2d 806 (N.J. 1984). The depositary bank is ultimately liable in the case of a forged indorsement check because of its warranty to the payor bank under Section 4-208(a)(1) [section 4-207-B(1)(a)] and it is usually the most convenient defendant in cases involving multiple checks drawn on different banks. There is no basis for requiring the owner of the check to bring multiple actions against the various payor banks and to require those banks to assert warranty rights against the depositary bank. In revised Article 3 [Article 3-A], the defense provided by Section 3-420(c) [section 3-1420(3)] is limited to collecting banks other than the depositary bank. If suit is brought against both the payor bank and the depositary bank, the owner, of course, is entitled to but one recovery.

PART 5

DISHONOR

§3-1501. Presentment

(1) "Presentment" means a demand made by or on behalf of a person entitled to enforce an instrument:

(a) To pay the instrument made to the drawee or a party obliged to pay the instrument or, in the case of a note or accepted draft payable at a bank, to the bank; or

(b) To accept a draft made to the drawee.

(2) The following rules are subject to Article 4, agreement of the parties and clearing-house rules and the like:

(a) Presentment may be made at the place of payment of the instrument and must be made at the place of payment if the

instrument is payable at a bank in the United States; may be made by any commercially reasonable means, including an oral, written or electronic communication; is effective when the demand for payment or acceptance is received by the person to whom presentment is made; and is effective if made to any one of 2 or more makers, acceptors, drawees or other payors.

(b) Upon demand of the person to whom presentment is made, the person making presentment must:

(i) Exhibit the instrument;

(ii) Give reasonable identification and, if presentment is made on behalf of another person, reasonable evidence of authority to do so; and

(iii) Sign a receipt on the instrument for any payment made or surrender the instrument if full payment is made.

(c) Without dishonoring the instrument, the party to whom presentment is made may:

(i) Return the instrument for lack of a necessary indorsement; or

(ii) Refuse payment or acceptance for failure of the presentment to comply with the terms of the instrument, an agreement of the parties, or other applicable law or rule.

(d) The party to whom presentment is made may treat presentment as occurring on the next business day after the day of presentment if the party to whom presentment is made has established a cut-off hour not earlier than 2 p.m. for the receipt and processing of instruments presented for payment or acceptance and presentment is made after the cut-off hour.

Uniform Commercial Code Comment

Subsection (a) [subsection (1)] defines presentment. Subsection (b)(1) [subsection (2)(a)] states the place and manner of presentment. Electronic presentment is authorized. The communication of the demand for payment or acceptance is effective when received. Subsection (b)(2) [subsection (2)(b)] restates former Section 3-505. Subsection (b)(2)(i) [subsection (2)(b)(i)] allows the person to whom presentment is made to require exhibition of the instrument, unless the parties have

agreed otherwise as in an electronic presentment agreement. Former Section 3-507(3) is the antecedent of subsection (b)(3)(i) [subsection (2)(c)(i)]. Since a payor must decide whether to pay or accept on the day of presentment, subsection (b)(4) [subsection (2)(d)] allows the payor to set a cut-off hour for receipt of instruments presented.

§3-1502. Dishonor

(1) Dishonor of a note is governed by the following rules.

(a) If the note is payable on demand, the note is dishonored if presentment is duly made to the maker and the note is not paid on the day of presentment.

(b) If the note is not payable on demand and is payable at or through a bank or the terms of the note require presentment, the note is dishonored if presentment is duly made and the note is not paid on the day it becomes payable or the day of presentment, whichever is later.

(c) If the note is not payable on demand and paragraph (b) does not apply, the note is dishonored if it is not paid on the day it becomes payable.

(2) Dishonor of an unaccepted draft other than a documentary draft is governed by the following rules.

(a) If a check is duly presented for payment to the payor bank otherwise than for immediate payment over the counter, the check is dishonored if the payor bank makes timely return of the check or sends timely notice of dishonor or nonpayment under section 4-301 or 4-302, or becomes accountable for the amount of the check under section 4-302.

(b) If a draft is payable on demand and paragraph (a) does not apply, the draft is dishonored if presentment for payment is duly made to the drawee and the draft is not paid on the day of presentment.

(c) When a draft is payable on a date stated in the draft, the draft is dishonored if:

(i) Presentment for payment is duly made to the drawee and payment is not made on the day the draft becomes payable or the day of presentment, whichever is later; or

(ii) Presentment for acceptance is duly made before the day the draft becomes payable and the draft is not accepted on the day of presentment.

(d) If a draft is payable on elapse of a period of time after sight or acceptance, the draft is dishonored if presentment for acceptance is duly made and the draft is not accepted on the day of presentment.

(3) Dishonor of an unaccepted documentary draft occurs according to the rules stated in subsection (2), paragraphs (b), (c) and (d), except that payment or acceptance may be delayed without dishonor until no later than the close of the 3rd business day of the drawee following the day on which payment or acceptance is required by those paragraphs.

(4) Dishonor of an accepted draft is governed by the following rules.

(a) When the draft is payable on demand, the draft is dishonored if presentment for payment is duly made to the acceptor and the draft is not paid on the day of presentment.

(b) When the draft is not payable on demand, the draft is dishonored if presentment for payment is duly made to the acceptor and payment is not made on the day it becomes payable or the day of presentment, whichever is later.

(5) In any case in which presentment is otherwise required for dishonor under this section and presentment is excused under section 3-1504, dishonor occurs without presentment if the instrument is not duly accepted or paid.

(6) If a draft is dishonored because timely acceptance of the draft was not made and the person entitled to demand acceptance consents to a late acceptance, from the time of acceptance, the draft is treated as never having been dishonored.

Uniform Commercial Code Comment

1. Section 3-415 [section 3-1415] provides that an indorser is obliged to pay an instrument if the instrument is dishonored and is discharged if the indorser is entitled to notice of dishonor and notice is not given. Under Section 3-414 [section 3-1414], the drawer is obliged to pay an unaccepted draft if it is dishonored. The drawer, however, is not entitled to notice of dishonor except to the extent required in a case governed by Section 3-414(d) [section 3-1414(4)]. Part 5 tells when an instrument is dishonored (Section 3-502 [section 3-1502]) and what it means to give notice of dishonor (Section 3-503 [section 3-1503]). Often dishonor does not occur until presentment (Section 3-501 [section 3-1501]), and frequently presentment and notice of dishonor are excused (Section 3-504 [section 3-1504]).

2. In the great majority of cases presentment and notice of dishonor are waived with respect to notes. In most cases a formal demand for payment to the maker of the note is not contemplated. Rather, the maker is expected to send payment to the holder of the note on the date or dates on which payment is due. If payment is not made when due, the holder usually makes a demand for payment, but in the normal case in which presentment is waived, demand is irrelevant and the holder can proceed against indorsers when payment is not received. Under former Article 3, in the small minority of cases in which presentment and dishonor were not waived with respect to notes, the indorser was discharged from liability (former Section 3-502(1)(a)) unless the holder made presentment to the maker on the exact day the note was due (former Section 3-503(1)(c)) and gave notice of dishonor to the indorser before midnight of the third business day after dishonor (former Section 3-508(2)). These provisions are omitted from Revised Article 3 [Article 3-A] as inconsistent with practice which seldom involves face-to-face dealings.

3. Subsection (a) [subsection (1)] applies to notes. Subsection (a)(1) [subsection (1)(a)] applies to notes payable on demand. Dishonor requires presentment, and dishonor occurs if payment is not made on the day of presentment. There is no change from previous Article 3. Subsection (a)(2) [subsection (1)(b)] applies to notes payable at a definite time if the note is payable at or through a bank or, by its terms, presentment is required. Dishonor requires presentment, and dishonor occurs if payment is not made on the due date or the day of presentment if presentment is made after the due date. Subsection (a)(3) [subsection (1)(c)] applies to all other notes. If the note is not paid on its due date it is dishonored. This allows holders to collect notes in ways that make sense commercially without having to be concerned about a formal presentment on a given day.

4. Subsection (b) [subsection (2)] applies to unaccepted drafts other than documentary drafts. Subsection (b)(1) [subsection (2)(a)] applies to checks. Except for checks presented for immediate payment over the counter, which are covered by subsection (b)(2) [subsection (2)(b)], dishonor occurs according to rules stated in Article 4. When a check is presented for payment through the check-collection system, the drawee bank normally makes settlement for the amount of the check to the presenting bank. Under Section 4-301 the drawee bank may recover this settlement if it returns the check within its midnight deadline (Section 4-104). In that case the check is not paid and dishonor occurs under Section 3-502(b)(1) [section 3-1502(2)(a)]. If the drawee bank does not return the check or give notice of dishonor or nonpayment within the midnight deadline, the settlement becomes final payment of the check.

Section 4-215 [section 4-213]. Thus, no dishonor occurs regardless of whether the check is retained or is returned after the midnight deadline. In some cases the drawee bank might not settle for the check when it is received. Under Section 4-302 if the drawee bank is not also the depositary bank and retains the check without settling for it beyond midnight of the day it is presented for payment, the bank becomes "accountable" for the amount of the check, i.e. it is obliged to pay the amount of the check. If the drawee bank is also the depositary bank, the bank is accountable for the amount of the check if the bank does not pay the check or return it or send notice of dishonor within the midnight deadline. In all cases in which the drawee bank becomes accountable, the check has not been paid and, under Section 3-502(b)(1) [section 3-1502(2)(a)], the check is dishonored. The fact that the bank is obliged to pay the check does not mean that the check has been paid. When a check is presented for payment, the person presenting the check is entitled to payment not just the obligation of the drawee to pay. Until that payment is made, the check is dishonored. To say that the drawee bank is obliged to pay the check necessarily means that the check has not been paid. If the check is eventually paid, the drawee bank no longer is accountable.

Subsection (b)(2) [subsection (2)(b)] applies to demand drafts other than those governed by subsection (b)(1) [subsection (2)(a)]. It covers checks presented for immediate payment over the counter and demand drafts other than checks. Dishonor occurs if presentment for payment is made and payment is not made on the day of presentment.

Subsection (b)(3) [subsection (2)(c)] and (4) [paragraph (d)] applies to time drafts. An unaccepted time draft differs from a time note. The maker of a note knows that the note has been issued, but the drawee of a draft may not know that a draft has been drawn on it. Thus, with respect to drafts, presentment for payment or acceptance is required. Subsection (b)(3) [subsection (2)(c)] applies to drafts payable on a date stated in the draft. Dishonor occurs if presentment for payment is made and payment is not made on the day the draft becomes payable or the day of presentment if presentment is made after the due date. The holder of an unaccepted draft payable on a stated date has the option of presenting the draft for acceptance before the day the draft becomes payable to establish whether the drawee is willing to assume liability by accepting. Under subsection (b)(3)(ii) [subsection (2)(c)(ii)] dishonor occurs when the draft is presented and not accepted. Subsection (b)(4) [subsection (2)(d)] applies to unaccepted drafts payable on elapse of a period of time after sight or acceptance. If the draft is payable 30 days after sight, the draft must be presented for acceptance to start the running of the 30-day period. Dishonor

occurs if it is not accepted. The rules in subsection (b)(3) [subsection (2)(c)] and (4) [paragraph (d)] follow former Section 3-501(1)(a).

5. Subsection (c) [subsection (3)] gives drawees an extended period to pay documentary drafts because of the time that may be needed to examine the documents. The period prescribed is that given by Section 5-112 in cases in which a letter of credit is involved.

6. Subsection (d) [subsection (4)] governs accepted drafts. If the acceptor's obligation is to pay on demand the rule, stated in subsection (d)(1) [subsection (4)(a)], is the same as for that of a demand note stated in subsection (a)(1) [subsection (1)(a)]. If the acceptor's obligation is to pay at a definite time the rule, stated in subsection (d)(2) [subsection (4)(b)], is the same as that of a time note payable at a bank stated in subsection (b)(2) [subsection (2)(b)].

7. Subsection (e) [subsection (5)] is a limitation on subsection (a)(1) [subsection (1)(a)] and (2) [paragraph(b)], subsection (b) [subsection (2)], subsection (c) [subsection (3)], and subsection (d) [subsection (4)]. Each of those provisions states dishonor as occurring after presentment. If presentment is excused under Section 3-504 [section 3-1504], dishonor occurs under those provisions without presentment if the instrument is not duly accepted or paid.

8. Under subsection (b)(3)(ii) [subsection (2)(c)(ii)] and (4) [paragraph (d)] if a draft is presented for acceptance and the draft is not accepted on the day of presentment, there is dishonor. But after dishonor, the holder may consent to late acceptance. In that case, under subsection (f) [subsection (6)], the late acceptance cures the dishonor. The draft is treated as never having been dishonored. If the draft is subsequently presented for payment and payment is refused dishonor occurs at that time.

§3-1503. Notice of dishonor

(1) The obligation of an indorser stated in section 3-1415, subsection (1) and the obligation of a drawer stated in section 3-1414, subsection (4) may not be enforced unless:

(a) The indorser or drawer is given notice of dishonor of the instrument complying with this section; or

(b) Notice of dishonor is excused under section 3-1504, subsection (2).

(2) Notice of dishonor may be given by any person and by any commercially reasonable means, including an oral, written or electronic communication, and is sufficient if it reasonably identifies the instrument and indicates that the instrument has been dishonored or has not been paid or accepted. Return of an instrument given to a bank for collection is sufficient notice of dishonor.

(3) Subject to section 3-1504, subsection (3), with respect to an instrument taken for collection by a collecting bank, notice of dishonor must be given:

(a) By the bank before midnight of the next banking day following the banking day on which the bank receives notice of dishonor of the instrument; or

(b) By any other person within 30 days following the day on which the person receives notice of dishonor.

With respect to any other instrument, notice of dishonor must be given within 30 days following the day on which dishonor occurs.

Uniform Commercial Code Comment

1. Subsection (a) [subsection (1)] is consistent with former Section 3-501(2)(a), but notice of dishonor is no longer relevant to the liability of a drawer except for the case of a draft accepted by an acceptor other than a bank. Comments 2 and 4 to Section 3-414 [section 3-1414]. There is no reason why drawers should be discharged on instruments they draw until payment or acceptance. They are entitled to have the instrument presented to the drawee and dishonored (Section 3-414(b) [section 3-1414(2)]) before they are liable to pay, but no notice of dishonor need be made to them as a condition of liability. Subsection (b) [subsection(2)], which states how notice of dishonor is given, is based on former Section 3-508(3).

2. Subsection (c) [subsection (3)] replaces former Section 3-508(2). It differs from that section in that it provides a 30-day period for a person other than a collecting bank to give notice of dishonor rather than the three-day period allowed in former Article 3. Delay in giving notice of dishonor may be excused under Section 3-504(c) [section 3-1504(3)].

§ 3-1504. Excused presentment and notice of dishonor

(1) Presentment for payment or acceptance of an instrument is excused if:

(a) The person entitled to present the instrument can not with reasonable diligence make presentment;

(b) The maker or acceptor has repudiated an obligation to pay the instrument or is dead or in insolvency proceedings;

(c) By the terms of the instrument presentment is not necessary to enforce the obligation of indorsers or the drawer;

(d) The drawer or indorser whose obligation is being enforced has waived presentment or otherwise has no reason to expect or right to require that the instrument be paid or accepted; or

(e) The drawer instructed the drawee not to pay or accept the draft or the drawee was not obligated to the drawer to pay the draft.

(2) Notice of dishonor is excused if:

(a) By the terms of the instrument, notice of dishonor is not necessary to enforce the obligation of a party to pay the instrument; or

(b) The party whose obligation is being enforced waived notice of dishonor. A waiver of presentment is also a waiver of notice of dishonor.

(3) Delay in giving notice of dishonor is excused if the delay was caused by circumstances beyond the control of the person giving the notice and the person giving the notice exercised reasonable diligence after the cause of the delay ceased to operate.

Uniform Commercial Code Comment

Section 3-504 [section 3-1504] is largely a restatement of former Section 3-511. Subsection (4) of former Section 3-511 is replaced by Section 3-502(f) [section 3-1502(6)].

§3-1505. Evidence of dishonor

(1) The following are admissible as evidence and create a presumption of dishonor and of any notice of dishonor stated:

(a) A document regular in form as provided in subsection (2) which purports to be a protest;

(b) A purported stamp or writing of the drawee, payor bank or presenting bank on or accompanying the instrument stating that acceptance or payment has been refused unless reasons

for the refusal are stated and the reasons are not consistent with dishonor; or

(c) A book or record of the drawee, payor bank or collecting bank, kept in the usual course of business which shows dishonor, even if there is no evidence of who made the entry.

(2) A protest is a certificate of dishonor made by a United States consul or vice-consul, or a notary public or other person authorized to administer oaths by the law of the place where dishonor occurs. It may be made upon information satisfactory to that person. The protest must identify the instrument and certify either that presentment has been made or, if not made, the reason why it was not made, and that the instrument has been dishonored by nonacceptance or nonpayment. The protest may also certify that notice of dishonor has been given to some or all parties.

Uniform Commercial Code Comment

Protest is no longer mandatory and must be requested by the holder. Even if requested, protest is not a condition to the liability of indorsers or drawers. Protest is a service provided by the banking system to establish that dishonor has occurred. Like other services provided by the banking system, it will be available if market incentives, interbank agreements, or governmental regulations require it, but liabilities of parties no longer rest on it. Protest may be a requirement for liability on international drafts governed by foreign law which this Article cannot affect.

PART 6

DISCHARGE AND PAYMENT

§3-1601. Discharge and effect of discharge

(1) The obligation of a party to pay the instrument is discharged as stated in this Article or by an act or agreement with the party that would discharge an obligation to pay money under a simple contract.

(2) Discharge of the obligation of a party is not effective against a person acquiring rights of a holder in due course of the instrument without notice of the discharge.

Uniform Commercial Code Comment

Subsection (a) [subsection (1)] replaces subsections (1) and (2) of former Section 3-601. Subsection (b) [subsection (2)]

restates former Section 3-602. Notice of discharge is not treated as notice of a defense that prevents holder in due course status. Section 3-302(b) [section 3-1302(2)]. Discharge is effective against a holder in due course only if the holder had notice of the discharge when holder in due course status was acquired. For example, if an instrument bearing a canceled indorsement is taken by a holder, the holder has notice that the indorser has been discharged. Thus, the discharge is effective against the holder even if the holder is a holder in due course.

§3-1602. Payment

(1) Subject to subsection (2), an instrument is paid to the extent payment is made:

(a) By or on behalf of a party obliged to pay the instrument; and

(b) To a person entitled to enforce the instrument.

To the extent of the payment, the obligation of the party obliged to pay the instrument is discharged even though payment is made with knowledge of a claim to the instrument under section 3-306 by another person.

(2) The obligation of a party to pay the instrument is not discharged under subsection (1) if:

(a) A claim to the instrument under section 3-1306 is enforceable against the party receiving payment and:

(i) Payment is made with knowledge by the payor that payment is prohibited by injunction or similar process of a court of competent jurisdiction; or

(ii) In the case of an instrument other than a cashier's check, teller's check or certified check, the party making payment accepted, from the person having a claim to the instrument, indemnity against loss resulting from refusal to pay the person entitled to enforce the instrument; or

(b) The person making payment knows that the instrument is a stolen instrument and pays a person that the person making payment knows is in wrongful possession of the instrument.

Uniform Commercial Code Comment

This section replaces former Section 3-603(1). The phrase "claim to the instrument" in subsection (a) [subsection (1)]

means, by reference to Section 3-306 [section 3-1306], a claim of ownership or possession and not a claim in recoupment. Subsection (b)(1)(ii) [subsection (2)(a)(ii)] is added to conform to Section 3-411 [section 3-1411]. Section 3-411 [section 3-1411] is intended to discourage an obligated bank from refusing payment of a cashier's check, certified check, or dishonored teller's check at the request of a claimant to the check who provided the bank with indemnity against loss. See Comment 1 to Section 3-411 [section 3-1411]. An obligated bank that refuses payment under those circumstances not only remains liable on the check but may also be liable to the holder of the check for consequential damages. Section 3-602(b)(1)(ii) [section 3-1602(2)(a)(ii)] and Section 3-411 [section 3-1411], read together, change the rule of former Section 3-603(1) with respect to the obligation of the obligated bank on the check. Payment to the holder of a cashier's check, teller's check, or certified check discharges the obligation of the obligated bank on the check to both the holder and the claimant even though indemnity has been given by the person asserting the claim. If the obligated bank pays the check in violation of an agreement with the claimant in connection with the indemnity agreement, any liability that the bank may have for violation of the agreement is not governed by Article 3 [Article 3-A], but is left to other law. This section continues the rule that the obligor is not discharged on the instrument if payment is made in violation of an injunction against payment. See Section 3-411(c)(iv) [section 3-1411(3)(d)].

§3-1603. Tender of payment

(1) If tender of payment of an obligation to pay an instrument is made to a person entitled to enforce the instrument, the effect of tender is governed by principles of law applicable to tender of payment under a simple contract.

(2) If tender of payment of an obligation to pay an instrument is made to a person entitled to enforce the instrument and the tender is refused, there is discharge, to the extent of the amount of the tender, of the obligation of an indorser or accommodation party having a right of recourse with respect to the obligation to which the tender relates.

(3) If tender of payment of an amount due on an instrument is made to a person entitled to enforce the instrument, the obligation of the obligor to pay interest after the due date on the amount tendered is discharged. If presentment is required with respect to an instrument and the obligor is able and ready to pay on the due date at every place of payment stated in the instrument, the obligor is deemed to have made tender of payment on the due date to the person entitled to enforce the instrument.

Uniform Commercial Code Comment

Section 3-603 [section 3-1603] replaces former Section 3-604. Subsection (a) [subsection (1)] generally incorporates the law of tender of payment applicable to simple contracts. Subsections (b) [subsection (2)] and (c) [subsection (3)] state particular rules. Subsection (b) replaces former Section 3-604(2). Under subsection (b) [subsection (2)] refusal of a tender of payment discharges any indorser or accommodation party having a right of recourse against the party making the tender. Subsection (c) [subsection (3)] replaces former Section 3-604(1) and (3).

§3-1604. Discharge by cancellation or renunciation

(1) A person entitled to enforce an instrument, with or without consideration, may discharge the obligation of a party to pay the instrument:

(a) By an intentional voluntary act, such as surrender of the instrument to the party, destruction, mutilation or cancellation of the instrument, cancellation or striking out of the party's signature or the addition of words to the instrument indicating discharge; or

(b) By agreeing not to sue or otherwise renouncing rights against the party by a signed writing.

(2) Cancellation or striking out of an indorsement pursuant to subsection (1) does not affect the status and rights of a party derived from the indorsement.

Uniform Commercial Code Comment

Section 3-604 [section 3-1604] replaces former Section 3-605.

§3-1605. Discharge of indorsers and accommodation parties

(1) In this section, the term "indorser" includes a drawer having the obligation described in section 3-1414, subsection (4).

(2) Discharge, under section 3-1604, of the obligation of a party to pay an instrument does not discharge the obligation of an indorser or accommodation party having a right of recourse against the discharged party.

(3) If a person entitled to enforce an instrument agrees, with or without consideration, to an extension of the due date of the obligation of a party to pay the instrument, the extension

discharges an indorser or accommodation party having a right of recourse against the party whose obligation is extended to the extent the indorser or accommodation party proves that the extension caused loss to the indorser or accommodation party with respect to the right of recourse.

(4) If a person entitled to enforce an instrument agrees, with or without consideration, to a material modification of the obligation of a party other than an extension of the due date, the modification discharges the obligation of an indorser or accommodation party having a right of recourse against the person whose obligation is modified to the extent the modification causes loss to the indorser or accommodation party with respect to the right of recourse. The loss suffered by the indorser or accommodation party as a result of the modification is equal to the amount of the right of recourse unless the person enforcing the instrument proves that no loss was caused by the modification or that the loss caused by the modification was an amount less than the amount of the right of recourse.

(5) If the obligation of a party to pay an instrument is secured by an interest in collateral and a person entitled to enforce the instrument impairs the value of the interest in collateral, the obligation of an indorser or accommodation party having a right of recourse against the obligor is discharged to the extent of the impairment. The value of an interest in collateral is impaired to the extent:

(a) That the value of the interest is reduced to an amount less than the amount of the right of recourse of the party asserting discharge; or

(b) That the reduction in value of the interest causes an increase in the amount by which the amount of the right of recourse exceeds the value of the interest. The burden of proving impairment is on the party asserting discharge.

(6) If the obligation of a party is secured by an interest in collateral not provided by an accommodation party and a person entitled to enforce the instrument impairs the value of the interest in collateral, the obligation of any party who is jointly and severally liable with respect to the secured obligation is discharged to the extent that the impairment causes the party asserting discharge to pay more than that party would have been obliged to pay, taking into account rights of contribution, if impairment had not occurred. If the party asserting discharge is an accommodation party not entitled to discharge under subsection (5), the party is deemed to have a right to contribution based on joint and several liability rather than a right to reimbursement. The burden of proving impairment is on the party asserting discharge.

(7) Under subsection (5) or (6), impairing value of an interest in collateral includes:

(a) Failure to obtain or maintain perfection or recordation of the interest in collateral;

(b) Release of collateral without substitution of collateral of equal value;

(c) Failure to perform a duty to preserve the value of collateral owed, under Article 9 or other law, to a debtor or surety or other person secondarily liable; or

(d) Failure to comply with applicable law in disposing of collateral.

(8) An accommodation party is not discharged under subsection (3), (4) or (5) unless the person entitled to enforce the instrument knows of the accommodation or has notice under section 3-1419, subsection (3) that the instrument was signed for accommodation.

(9) A party is not discharged under this section if:

(a) The party asserting discharge consents to the event or conduct that is the basis of the discharge; or

(b) The instrument or a separate agreement of the party provides for waiver of discharge under this section either specifically or by general language indicating that parties waive defenses based on suretyship or impairment of collateral.

Uniform Commercial Code Comment

1. Section 3-605 [section 3-1605], which replaces former Section 3-606, can be illustrated by an example. Bank lends $10,000 to Borrower who signs a note under which Borrower is obliged to pay $10,000 to Bank on a due date stated in the note. Bank insists, however, that Accommodation Party also become liable to pay the note. Accommodation Party can incur this liability by signing the note as a co-maker or by indorsing the note. In either case the note is signed for accommodation and Borrower is the accommodated party. Rights and obligations of Accommodation Party in this case are stated in Section 3-419 [section 3-1419]. Suppose that after the note is signed, Bank agrees to a modification of the rights and obligations between Bank and Borrower. For example, Bank agrees that Borrower may pay the note at some date after the due date, or that Borrower

may discharge Borrower's $10,000 obligation to pay the note by paying Bank $3,000, or that Bank releases collateral given by Borrower to secure the note. Under the law of suretyship Borrower is usually referred to as the principal debtor and Accommodation Party is referred to as the surety. Under that law, the surety can be discharged under certain circumstances if changes of this kind are made by Bank, the creditor, without the consent of Accommodation Party, the surety. Rights of the surety to discharge in such cases are commonly referred to as suretyship defenses. Section 3-605 [section 3-1605] is concerned with this kind of problem in the context of a negotiable instrument to which the principal debtor and the surety are parties. But Section 3-605 [section 3-1605] has a wider scope. It also applies to indorsers who are not accommodation parties. Unless an indorser signs without recourse, the indorser's liability under Section 3-415 (a) [section 3-1415(1)] is that of a guarantor of payment. If Bank in our hypothetical case indorsed the note and transferred it to Second Bank, Bank has rights given to an indorser under Section 3-605 [section 3-1605] if it is Second Bank that modifies rights and obligations of Borrower. Both accommodation parties and indorsers will be referred to in these Comments as sureties. The scope of Section 3-605 [section 3-1605] is also widened by subsection (e) [subsection (5)] which deals with rights of a non-accommodation party co-maker when collateral is impaired.

2. The importance of suretyship defenses is greatly diminished by the fact that they can be waived. The waiver is usually made by a provision in the note or other writing that represents the obligation of the principal debtor. It is standard practice to include a waiver of suretyship defenses in notes given to financial institutions or other commercial creditors. Section 3-605(i) [section 3-1605(9)] allows waiver. Thus, Section 3-605 [section 3-1605] applies to the occasional case in which the creditor did not include a waiver clause in the instrument or in which the creditor did not obtain the permission of the surety to take the action that triggers the suretyship defense.

3. Subsection (b) [subsection (2)] addresses the effect of discharge under Section 3-604 [section 3-1604] of the principal debtor. In the hypothetical case stated in Comment 1, release of Borrower by Bank does not release Accommodation Party. As a practical matter, Bank will not gratuitously release Borrower. Discharge of Borrower normally would be part of a settlement with Borrower if Borrower is insolvent or in financial difficulty. If Borrower is unable to pay all creditors, it may be prudent for Bank to take partial payment, but Borrower will normally insist on a release of the obligation. If Bank takes $3,000 and releases Borrower from the $10,000 debt, Accommodation Party is

not injured. To the extent of the payment Accommodation Party's obligation to Bank is reduced. The release of Borrower by Bank does not affect the right of Accommodation Party to obtain reimbursement from Borrower if Accommodation Party pays Bank. Section 3-419(e) [section 3-1419(5)]. Subsection (b) [subsection (2)] is designed to allow a creditor to settle with the principal debtor without risk of losing rights against sureties. Settlement is in the interest of sureties as well as the creditor. Subsection (b) [subsection (2)] changes the law stated in former Section 3-606 but the change relates largely to formalities rather than substance. Under former Section 3-606, Bank could settle with and release Borrower without releasing Accommodation Party, but to accomplish that result Bank had to either obtain the consent of Accommodation Party or make an express reservation of rights against Accommodation Party at the time it released Borrower. The reservation of rights was made in the agreement between Bank and Borrower by which the release of Borrower was made. There was no requirement in former Section 3-606 that any notice be given to Accommodation Party. The reservation of rights doctrine is abolished in Section 3-605 [section 3-1605] with respect to rights on instruments.

4. Subsection (c) [subsection (3)] relates to extensions of the due date of the instrument. In most cases an extension of time to pay a note is a benefit to both the principal debtor and sureties having recourse against the principal debtor. In relatively few cases the extension may cause loss if deterioration of the financial condition of the principal debtor reduces the amount that the surety will be able to recover on its right of recourse when default occurs. Former Section 3-606(1)(a) did not take into account the presence or absence of loss to the surety. For example, suppose the instrument is an installment note and the principal debtor is temporarily short of funds to pay a monthly installment. The payee agrees to extend the due date of the installment for a month or two to allow the debtor to pay when funds are available. Under former Section 3-606 surety was discharged if consent was not given unless the payee expressly reserved rights against the surety. It did not matter that the extension of time was a trivial change in the guaranteed obligation and that there was no evidence that the surety suffered any loss because of the extension. Wilmington Trust Co. v. Gesullo, 29 U.C.C. Rep. 144 (Del. Super. Ct. 1980). Under subsection (c) [subsection (3)] an extension of time results in discharge only to the extent the surety proves that the extension caused loss. For example, if the extension is for a long period the surety might be able to prove that during the period of extension the principal debtor became insolvent, thus reducing the value of the right of recourse of the surety. By putting the burden on the surety to prove loss, subsection (c) [subsection (3)] more accurately reflects what the parties would have done by agreement, and it facilitates workouts.

5. Former Section 3-606 applied to extensions of the due date of a note but not to other modifications of the obligation of the principal debtor. There was no apparent reason why former Section 3-606 did not follow general suretyship law in covering both. Under Section 3-605(d) [section 3-1605(4)] a material modification of the obligation of the principal debtor, other than an extension of the due date, will result in discharge of the surety to the extent the modification caused loss to the surety with respect to the right of recourse. The loss caused by the modification is deemed to be the entire amount of the right of recourse unless the person seeking enforcement of the instrument proves that no loss occurred or that the loss was less than the full amount of the right of recourse. In the absence of that proof, the surety is completely discharged. The rationale for having different rules with respect to loss for extensions of the due date and other modifications is that extensions are likely to be beneficial to the surety and they are often made. Other modifications are less common and they may very well be detrimental to the surety. Modification of the obligation of the principal debtor without permission of the surety is unreasonable unless the modification is benign. Subsection (d) [subsection (4)] puts the burden on the person seeking enforcement of the instrument to prove the extent to which loss was not caused by the modification.

6. Subsection (e) [subsection (5)] deals with discharge of sureties by impairment of collateral. It generally conforms to former Section 3-606(1)(b). Subsection (g) [subsection (7)] states common examples of what is meant by impairment. By using the term "includes," it allows a court to find impairment in other cases as well. There is extensive case law on impairment of collateral. The surety is discharged to the extent the surety proves that impairment was caused by a person entitled to enforce the instrument. For example, suppose the payee of a secured note fails to perfect the security interest. The collateral is owned by the principal debtor who subsequently files in bankruptcy. As a result of the failure to perfect, the security interest is not enforceable in bankruptcy. If the payee obtains payment from the surety, the surety is subrogated to the payee's security interest in the collateral. In this case the value of the security interest is impaired completely because the security interest is unenforceable. If the value of the collateral is as much or more than the amount of the note there is a complete discharge.

In some states a real property grantee who assumes the obligation of the grantor as maker of a note secured by the real property becomes by operation of law a principal debtor and the grantor becomes a surety. The meager case authority was split on whether former Section 3-606 applied to release the grantor if

the holder released or extended the obligation of the grantee. Revised Article 3 [Article 3-A] takes no position on the effect of the release of the grantee in this case. Section 3-605(e) [section 3-1605(5)] does not apply because the holder has not discharged the obligation of a "party," a term defined in Section 3-103(a)(8) [section 3-1103(1)(h)] as "party to an instrument." The assuming grantee is not a party to the instrument.

7. Subsection (f) [subsection (6)] is illustrated by the following case. X and Y sign a note for $1,000 as co-makers. Neither is an accommodation party. X grants a security interest in X's property to secure the note. The collateral is worth more than $1,000. Payee fails to perfect the security interest in X's property before X files in bankruptcy. As a result the security interest is not enforceable in bankruptcy. Had Payee perfected the security interest, Y could have paid the note and gained rights to X's collateral by subrogation. If the security interest had been perfected, Y could have realized on the collateral to the extent of $500 to satisfy its right of contribution against X. Payee's failure to perfect deprived Y of the benefit of the collateral. Subsection (f) [subsection (6)] discharges Y to the extent of its loss. If there are no assets in the bankruptcy for unsecured claims, the loss is $500, the amount of Y's contribution claim against X which now has a zero value. If some amount is payable on unsecured claims, the loss is reduced by the amount receivable by Y. The same result follows if Y is an accommodation party but Payee has no knowledge of the accommodation or notice under Section 3-419(c) [section 3-1419(3)]. In that event Y is not discharged under subsection (e) [subsection (5)], but subsection (f) [subsection (6)] applies because X and Y are jointly and severally liable on the note. Under subsection (f) [subsection (6)], Y is treated as a co-maker with a right of contribution rather than an accommodation party with a right of reimbursement. Y is discharged to the extent of $500. If Y is the principal debtor and X is the accommodation party subsection (f) [subsection (6)] doesn't apply. Y, as principal debtor, is not injured by the impairment of collateral because Y would have been obliged to reimburse X for the entire $1,000 even if Payee had obtained payment from sale of the collateral.

8. Subsection (i) [subsection (9)] is a continuation of former law which allowed suretyship defenses to be waived.

Sec. A-3. Legislative intent. This Act is the Maine enactment of the Uniform Commercial Code, Article 3 as revised by the National Conference of Commissioners on Uniform State Laws. The text of that uniform act has been changed to conform to Maine statutory conventions and the article is enacted as Article 3-A. Unless otherwise noted in a Maine comment, the changes are

technical in nature and it is the intent of the Legislature that this Act be interpreted as substantively the same as the revised Article 3 of the uniform act.

PART B

Sec. B-1. 11 MRSA §1-201, sub-§(20), as amended by PL 1987, c. 625, §1, is repealed and the following enacted in its place:

(20) Holder. "Holder" with respect to a negotiable instrument means the person in possession if the instrument is payable to bearer or, in the case of an instrument payable to an identified person, if the identified person is in possession. "Holder" with respect to a document of title means the person in possession if the goods are deliverable to bearer or to the order of the person in possession.

Sec. B-2. 11 MRSA §1-201, sub-§(24) is amended to read:

(24) Money. "Money" means a medium of exchange authorized or adopted by a domestic or foreign government ~~as a part of its currency~~ and includes a monetary unit of account established by an intergovernmental organization or by agreement between 2 or more nations.

Sec. B-3. 11 MRSA §1-201, sub-§(43) is amended to read:

(43) Unauthorized. "Unauthorized" signature ~~or indorsement~~ means one made without actual, implied or apparent authority and includes a forgery.

Uniform Commercial Code Comment

43. Under the former version of § 1-201(43), it was not clear whether a reference to an "unauthorized signature" in Articles 3 and 4 applied to indorsements. The words "or indorsement" are deleted so that references to "unauthorized signature" in § 3-406 and elsewhere will unambiguously refer to any signature.

Sec. B-4. 11 MRSA §1-207 is repealed and the following enacted in its place:

§1-207. Performance or acceptance under reservation of rights

(1) A party who, with explicit reservation of rights, performs or promises performance or assents to performance in a manner demanded or offered by the other party does not thereby prejudice the rights reserved. Such words as "without prejudice", "under protest" or the like are sufficient.

(2) Subsection (1) does not apply to an accord and satisfaction.

Uniform Commercial Code Comment

1. This section provides machinery for the continuation of performance along the lines contemplated by the contract despite a pending dispute, by adopting the mercantile device of going ahead with delivery, acceptance, or payment "without prejudice," "under protest," "under reserve," "with reservation of all our rights," and the like. All of these phrases completely reserve all rights within the meaning of this section. The section therefore contemplates that limited as well as general reservations and acceptance by a party may be made "subject to satisfaction of our purchaser," "subject to acceptance by our customers," or the like.

2. This section does not add any new requirement of language of reservation where not already required by law, but merely provides a specific measure on which a party can rely as that party makes or concurs in any interim adjustment in the course of performance. It does not affect or impair the provisions of this Act such as those under which the buyer's remedies for defect survive acceptance without being expressly claimed if notice of the defects is given within a reasonable time. Nor does it disturb the policy of those cases which restrict the effect of a waiver of a defect to reasonable limits under the circumstances, even though no such reservation is expressed.

The section is not addressed to the creation or loss of remedies in the ordinary course of performance but rather to a method of procedure where one party is claiming as of right something which the other believes to be unwarranted.

3. Judicial authority was divided on the issue of whether former Section 1-207 (present subsection (1)) applied to an accord and satisfaction. Typically the cases involved attempts to reach an accord and satisfaction by use of a check tendered in full satisfaction of a claim. Subsection (2) of revised Section 1-207 resolves this conflict by stating that Section 1-207 does not apply to an accord and satisfaction. Section 3-311 [section 3-1311] of revised Article 3 [Article 3-A] governs if an accord and satisfaction is attempted by tender of a negotiable instrument as stated in that section. If Section 3-311 [section 3-1311] does not apply, the issue of whether an accord and satisfaction has been effected is determined by the law of contract. Whether or not Section 3-311 [section 3-1311] applies, Section 1-207 has no application to an accord and satisfaction.

Sec. B-5. 11 MRSA §2-511, sub-§(3) is amended to read:

(3) Subject to the provisions of this Title on the effect of an instrument on an obligation (section ~~3-802~~ 3-1310), payment by check is conditional and is defeated as between the parties by dishonor of the check on due presentment.

Sec. B-6. 11 MRSA §4-101 is amended to read:

§~~4~~-101. Short title

This Article ~~shall be known and~~ may be cited as "Uniform Commercial Code -- Bank Deposits and Collections."

Uniform Commercial Code Comment

1. The great number of checks handled by banks and the country-wide nature of the bank collection process require uniformity in the law of bank collections. There is needed a uniform statement of the principal rules of the bank collection process with ample provision for flexibility to meet the needs of the large volume handled and the changing needs and conditions that are bound to come with the years. This Article meets that need.

2. In 1950 at the time Article 4 was drafted, 6.7 billion checks were written annually. By the time of the 1990 revision of Article 4 annual volume was estimated by the American Bankers Association to be about 50 billion checks. The banking system could not have coped with this increase in check volume had it not developed in the late 1950s and early 1960s an automated system for check collection based on encoding checks with machine-readable information by Magnetic Ink Character Recognition (MICR). An important goal of the 1990 revision of Article 4 is to promote the efficiency of the check collection process by making the provisions of Article 4 more compatible with the needs of an automated system and, by doing so, increase the speed and lower the cost of check collection for those who write and receive checks. An additional goal of the 1990 revision of Article 4 is to remove any statutory barriers in the Article to the ultimate adoption of programs allowing the presentment of checks to payor banks by electronic transmission of information captured from the MICR line on the checks. The potential of these programs for saving the time and expense of transporting the huge volume of checks from depositary to payor banks is evident.

3. Article 4 defines rights between parties with respect to bank deposits and collections. It is not a regulatory statute.

It does not regulate the terms of the bank-customer agreement, nor does it prescribe what constraints different jurisdictions may wish to impose on that relationship in the interest of consumer protection. The revisions in Article 4 are intended to create a legal framework that accommodates automation and truncation for the benefit of all bank customers. This may raise consumer problems which enacting jurisdictions may wish to address in individual legislation. For example, with respect to Section 4-401(c), jurisdictions may wish to examine their unfair and deceptive practices laws to determine whether they are adequate to protect drawers who postdate checks from unscrupulous practices that may arise on the part of persons who induce drawers to issue postdated checks in the erroneous belief that the checks will not be immediately payable. Another example arises from the fact that under various truncation plans customers will no longer receive their cancelled checks and will no longer have the cancelled check to prove payment. Individual legislation might provide that a copy of a bank statement along with a copy of the check is prima facie evidence of payment.

Sec. B-7. 11 MRSA §4-102, is amended to read:

§~~4~~-102. Applicability

(1) To the extent that items within this Article are also within ~~the scope of~~ Articles ~~3~~ 3-A and 8, they are subject to ~~the provisions of~~ those Articles. ~~In the event of~~ If there is conflict ~~the provisions of,~~ this Article ~~govern these of~~ governs Article ~~3~~ 3-A, but ~~the provisions of~~ Article 8 ~~govern these of~~ governs this Article.

(2) The liability of a bank for action or nonaction with respect to ~~any~~ an item handled by it for purposes of presentment, payment or collection is governed by the law of the place where the bank is located. In the case of action or nonaction by or at a branch or separate office of a bank, its liability is governed by the law of the place where the branch or separate office is located.

Uniform Commercial Code Comment

1. The rules of Article 3 [Article 3-A] governing negotiable instruments, their transfer, and the contracts of the parties thereto apply to the items collected through banking channels wherever no specific provision is found in this Article. In the case of conflict, this Article governs. See Section 3-102(b) [section 3-1102(2)].

Bonds and like instruments constituting investment securities under Article 8 may also be handled by banks for

collection purposes. Various sections of Article 8 prescribe rules of transfer some of which (see Sections 8-304 and 8-306) may conflict with provisions of this Article (Sections 4-205, 4-207 [section 4-207-A], and 4-208 [section 4-207-B]). In the case of conflict, Article 8 governs.

Section 4-210 [section 4-208] deals specifically with overlapping problems and possible conflicts between this Article and Article 9. However, similar reconciling provisions are not necessary in the case of Articles 5 and 7. Sections 4-301 and 4-302 are consistent with Section 5-112. In the case of Article 7 documents of title frequently accompany items but they are not themselves items. See Section 4-104(a)(9) [section 4-104(1)(g)].

In Clearfield Trust Co. v. United States, 318 U.S. 363 (1943), the Court held that if the United States is a party to an instrument, its rights and duties are governed by federal common law in the absence of a specific federal statute or regulation. In United States v. Kimbell Foods, Inc., 440 U.S. 715 (1979), the Court stated a three-pronged test to ascertain whether the federal common-law rule should follow the state rule. In most instances courts under the Kimbell test have shown a willingness to adopt UCC rules in formulating federal common law on the subject. In Kimbell the Court adopted the priorities rules of Article 9.

In addition, applicable federal law may supersede provisions of this Article. One federal law that does so is the Expedited Funds Availability Act, 12 U.S.C. § 4001 et seq., and its implementing Regulation CC, 12 CFR Pt. 229. In some instances this law is alluded to in the statute, e.g., Section 4-215(e) and (f) [section 4-213(4) and (5)]. In other instances, although not referred to in this Article, the provisions of the EFAA and Regulation CC control with respect to checks. For example, except between the depositary bank and its customer, all settlements are final and not provisional (Regulation CC, Section 229.36(d)), and the midnight deadline may be extended (Regulation CC, Section 229.30(c)). The Comments to this Article suggest in most instances the relevant Regulation CC provisions.

2. Subsection (b) [subsection (2)] is designed to state a workable rule for the solution of otherwise vexatious problems of the conflicts of laws:

a. The routine and mechanical nature of bank collections makes it imperative that one law govern the activities of one office of a bank. The requirement found in some cases that to hold an indorser notice must be given in accordance with the law of the place of indorsement, since that method of notice became an implied term of the indorser's contract, is more theoretical than practical.

b. Adoption of what is in essence a tort theory of the conflict of laws is consistent with the general theory of this Article that the basic duty of a collecting bank is one of good faith and the exercise of ordinary care. Justification lies in the fact that, in using an ambulatory instrument, the drawer, payee, and indorsers must know that action will be taken with respect to it in other jurisdictions. This is especially pertinent with respect to the law of the place of payment.

c. The phrase "action or non-action with respect to any item handled by it for purposes of presentment, payment, or collection" is intended to make the conflicts rule of subsection (b) [subsection (2)] apply from the inception of the collection process of an item through all phases of deposit, forwarding, presentment, payment and remittance or credit of proceeds. Specifically the subsection applies to the initial act of a depositary bank in receiving an item and to the incidents of such receipt. The conflicts rule of Weissman v. Banque de Bruxelles, 254 N.Y. 488, 173 N.E. 835 (1930), is rejected. The subsection applies to questions of possible vicarious liability of a bank for action or non-action of sub-agents (see Section 4-202(c) [section 4-202(3)]), and tests these questions by the law of the state of the location of the bank which uses the sub-agent. The conflicts rule of St. Nicholas Bank of New York v. State Nat. Bank, 128 N.Y. 26, 27 N.E. 849, 13 L.R.A. 241 (1891), is rejected. The subsection applies to action or non-action of a payor bank in connection with handling an item (see Sections 4-215(a) [section 4-213(1)], 4-301, 4-302, 4-303) as well as action or non-action of a collecting bank (Sections 4-201 through 4-216 [sections 4-201 through 4-214]); to action or non-action of a bank which suspends payment or is affected by another bank suspending payment (Section 4-216 [section 4-214]); to action or non-action of a bank with respect to an item under the rule of Part 4 of Article 4.

d. In a case in which subsection (b) [subsection (2)] makes this Article applicable, Section 4-103(a) [section 4-103(1)] leaves open the possibility of an agreement with respect to applicable law. This freedom of agreement follows the general policy of Section 1-105.

Sec. B-8. 11 MRSA §4-103 is amended to read:

§4-103. Variation by agreement; measure of damages; action constituting ordinary care

(1) The effect of the provisions of this Article may be varied by agreement, ~~except that no agreement can~~ but the parties to the agreement can not disclaim a bank's responsibility for its ~~own~~ lack of good faith or failure to exercise ordinary care or ~~can~~ limit the measure of damages for ~~such~~ the lack or failure; ~~but~~. However, the parties may determine by agreement ~~determine~~ the standards by which ~~such~~ the bank's responsibility is to be measured, if ~~such~~ those standards are not manifestly unreasonable.

(2) Federal ~~reserve~~ Reserve regulations and operating ~~letters, clearing house~~ circulars, clearinghouse rules, and the like, have the effect of agreements under subsection (1), whether or not specifically assented to by all parties interested in items handled.

(3) Action or nonaction approved by this Article or pursuant to federal reserve regulations or operating ~~letters constitutes~~ circulars is the exercise of ordinary care and, in the absence of special instructions, action or nonaction consistent with ~~clearing house~~ clearinghouse rules and the like or with a general banking usage not disapproved by this ~~article~~ Article, is prima facie ~~constitutes~~ the exercise of ordinary care.

(4) The specification or approval of certain procedures by this ~~article does not constitute~~ Article is not disapproval of other procedures ~~which~~ that may be reasonable under the circumstances.

(5) The measure of damages for failure to exercise ordinary care in handling an item is the amount of the item reduced by an amount ~~which~~ that could not have been realized by the ~~use~~ exercise of ordinary care, ~~and where~~. If there is also bad faith it includes any other damages, ~~if any suffered by~~ the party suffered as a proximate consequence.

Uniform Commercial Code Comment

1. Section 1-102 states the general principles and rules for variation of the effect of this Act by agreement and the limitations to this power. Section 4-103 states the specific rules for variation of Article 4 by agreement and also certain standards of ordinary care. In view of the technical complexity of the field of bank collections, the enormous number of items handled by banks, the certainty that there will be variations from the normal in each day's work in each bank, the certainty of changing conditions and the possibility of developing improved

methods of collection to speed the process, it would be unwise to freeze present methods of operation by mandatory statutory rules. This section, therefore, permits within wide limits variation of the effect of provisions of the Article by agreement.

2. Subsection (a) [subsection (1)] confers blanket power to vary all provisions of the Article by agreements of the ordinary kind. The agreements may not disclaim a bank's responsibility for its own lack of good faith or failure to exercise ordinary care and may not limit the measure of damages for the lack or failure, but this subsection like Section 1-102(3) approves the practice of parties determining by agreement the standards by which the responsibility is to be measured. In the absence of a showing that the standards manifestly are unreasonable, the agreement controls. Owners of items and other interested parties are not affected by agreements under this subsection unless they are parties to the agreement or are bound by adoption, ratification, estoppel or the like.

As here used "agreement" has the meaning given to it by Section 1-201(3). The agreement may be direct, as between the owner and the depositary bank; or indirect, as in the case in which the owner authorizes a particular type of procedure and any bank in the collection chain acts pursuant to such authorization. It may be with respect to a single item; or to all items handled for a particular customer, e.g., a general agreement between the depositary bank and the customer at the time a deposit account is opened. Legends on deposit tickets, collection letters and acknowledgments of items, coupled with action by the affected party constituting acceptance, adoption, ratification, estoppel or the like, are agreements if they meet the tests of the definition of "agreement." See Section 1-201(3). First Nat. Bank of Denver v. Federal Reserve Bank, 6 F.2d 339 (8th Cir. 1925) (deposit slip); Jefferson County Bldg. Ass'n v. Southern Bank & Trust Co., 225 Ala. 25, 142 So. 66 (1932) (signature card and deposit slip); Semingson v. Stock Yards Nat. Bank, 162 Minn. 424, 203 N.W. 412 (1925) (passbook); Farmers State Bank v. Union Nat. Bank, 42 N.D. 449, 454, 173 N.W. 789, 790 (1919) (acknowledgment of receipt of item).

3. Subsection (a) [subsection (1)] (subject to its limitations with respect to good faith and ordinary care) goes far to meet the requirements of flexibility. However, it does not by itself confer fully effective flexibility. Since it is recognized that banks handle a great number of items every business day and that the parties interested in each item include the owner of the item, the drawer (if it is a check), all nonbank indorsers, the payor bank and from one to five or more collecting banks, it is obvious that it is impossible, practically, to obtain direct agreements from all of these parties on all items.

In total, the interested parties constitute virtually every adult person and business organization in the United States. On the other hand they may become bound to agreements on the principle that collecting banks acting as agents have authority to make binding agreements with respect to items being handled. This conclusion was assumed but was not flatly decided in Federal Reserve Bank of Richmond v. Malloy, 264 U.S. 160, at 167, 44 S.Ct. 296, at 298, 68 L.Ed. 617, 31 A.L.R. 1261 (1924).

To meet this problem subsection (b) [subsection (2)] provides that official or quasi-official rules of collection, that is Federal Reserve regulations and operating circulars, clearing-house rules, and the like, have the effect of agreements under subsection (a) [subsection (1)], whether or not specifically assented to by all parties interested in items handled. Consequently, such official or quasi-official rules may, standing by themselves but subject to the good faith and ordinary care limitations, vary the effect of the provisions of Article 4.

Federal Reserve regulations. Various sections of the Federal Reserve Act (12 U.S.C. § 221 et seq.) authorize the Board of Governors of the Federal Reserve System to direct the Federal Reserve banks to exercise bank collection functions. For example, Section 16 (12 U.S.C. § 248(o)) authorizes the Board to require each Federal Reserve bank to exercise the functions of a clearing house for its members and Section 13 (12 U.S.C. § 342) authorizes each Federal Reserve bank to receive deposits from nonmember banks solely for the purposes of exchange or of collection. Under this statutory authorization the Board has issued Regulation J (Subpart A -- Collection of Checks and Other Items). Under the supremacy clause of the Constitution, federal regulations prevail over state statutes. Moreover, the Expedited Funds Availability Act, 12 U.S.C. Section 4007(b) provides that the Act and Regulation CC, 12 CFR 229, supersede "any provision of the law of any State, including the Uniform Commercial Code as in effect in such State, which is inconsistent with this chapter or such regulations." See Comment 1 to Section 4-102.

Federal Reserve operating circulars. The regulations of the Federal Reserve Board authorize the Federal Reserve banks to promulgate operating circulars covering operating details. Regulation J, for example, provides that "Each Reserve Bank shall receive and handle items in accordance with this subpart, and shall issue operating circulars governing the details of its handling of items and other matters deemed appropriate by the Reserve Bank." This Article recognizes that "operating circulars" issued pursuant to the regulations and concerned with operating details as appropriate may, within their proper sphere, vary the effect of the Article.

Clearing-House Rules. Local clearing houses have long issued rules governing the details of clearing; hours of clearing, media of remittance, time for return of mis-sent items and the like. The case law has recognized these rules, within their proper sphere, as binding on affected parties and as appropriate sources for the courts to look to in filling out details of bank collection law. Subsection (b) [subsection (2)] in recognizing clearing-house rules as a means of preserving flexibility continues the sensible approach indicated in the cases. Included in the term "clearing houses" are county and regional clearing houses as well as those within a single city or town. There is, of course, no intention of authorizing a local clearing house or a group of clearing houses to rewrite the basic law generally. The term "clearing-house rules" should be understood in the light of functions the clearing houses have exercised in the past.

And the like. This phrase is to be construed in the light of the foregoing. "Federal Reserve regulations and operating circulars" cover rules and regulations issued by public or quasi-public agencies under statutory authority. "Clearing-house rules" cover rules issued by a group of banks which have associated themselves to perform through a clearing house some of their collection, payment and clearing functions. Other agencies or associations of this kind may be established in the future whose rules and regulations could be appropriately looked on as constituting means of avoiding absolute statutory rigidity. The phrase "and the like" leaves open possibilities for future development. An agreement between a number of banks or even all the banks in an area simply because they are banks, would not of itself, by virtue of the phrase "and the like," meet the purposes and objectives of subsection (b) [subsection (2)].

4. Under this Article banks come under the general obligations of the use of good faith and the exercise of ordinary care. "Good faith" is defined in Section 3-103(a)(4) [section 3-1103(1)(d)]. The term "ordinary care" is defined in Section 3-103(a)(7) [section 3-1103(1)(g)]. These definitions are made to apply to Article 4 by Section 4-104(c) [section 4-104(3)]. Section 4-202 states respects in which collecting banks must use ordinary care. Subsection (c) [subsection (3)] of Section 4-103 provides that action or non-action approved by the Article or pursuant to Federal Reserve regulations or operating circulars constitutes the exercise of ordinary care. Federal Reserve regulations and operating circulars constitute an affirmative standard of ordinary care equally with the provisions of Article 4 itself.

Subsection (c) [subsection (3)] further provides that, absent special instructions, action or non-action consistent with clearing-house rules and the like or with a general banking usage not disapproved by the Article, prima facie constitutes the exercise of ordinary care. Clearing-house rules and the phrase "and the like" have the significance set forth above in these Comments. The term "general banking usage" is not defined but should be taken to mean a general usage common to banks in the area concerned. See Section 1-205(2). In a case in which the adjective "general" is used, the intention is to require a usage broader than a mere practice between two or three banks but it is not intended to require anything as broad as a country-wide usage. A usage followed generally throughout a state, a substantial portion of a state, a metropolitan area or the like would certainly be sufficient. Consistently with the principle of Section 1-205(3), action or non-action consistent with clearing-house rules or the like or with banking usages prima facie constitutes the exercise of ordinary care. However, the phrase "in the absence of special instructions" affords owners of items an opportunity to prescribe other standards and although there may be no direct supervision or control of clearing houses or banking usages by official supervisory authorities, the confirmation of ordinary care by compliance with these standards is prima facie only, thus conferring on the courts the ultimate power to determine ordinary care in any case in which it should appear desirable to do so. The prima facie rule does, however, impose on the party contesting the standards to establish that they are unreasonable, arbitrary or unfair as used by the particular bank.

5. Subsection (d) [subsection (4)], in line with the flexible approach required for the bank collection process is designed to make clear that a novel procedure adopted by a bank is not to be considered unreasonable merely because that procedure is not specifically contemplated by this Article or by agreement, or because it has not yet been generally accepted as a bank usage. Changing conditions constantly call for new procedures and someone has to use the new procedure first. If this procedure is found to be reasonable under the circumstances, provided, of course, that it is not inconsistent with any provision of the Article or other law or agreement, the bank which has followed the new procedure should not be found to have failed in the exercise of ordinary care.

6. Subsection (e) [subsection (5)] sets forth a rule for determining the measure of damages for failure to exercise ordinary care which, under subsection (a) [subsection (1)], cannot be limited by agreement. In the absence of bad faith the maximum recovery is the amount of the item concerned. The term "bad faith" is not defined; the connotation is the absence of

good faith (Section 3-103 [section 3-1103]). When it is established that some part or all of the item could not have been collected even by the use of ordinary care the recovery is reduced by the amount that would have been in any event uncollectible. This limitation on recovery follows the case law. Finally, if bad faith is established the rule opens to allow the recovery of other damages, whose "proximateness" is to be tested by the ordinary rules applied in comparable cases. Of course, it continues to be as necessary under subsection (e) [subsection (5)] as it has been under ordinary common law principles that, before the damage rule of the subsection becomes operative, liability of the bank and some loss to the customer or owner must be established.

Sec. B-9. 11 MRSA §4-104 is amended to read:

§4-104. Definitions and index of definitions

(1) In this Article, unless the context otherwise ~~requires,~~ indicates, the following terms have the following meanings.

(a) Account. "Account" means any deposit or credit account with a bank ~~and--includes~~, including a ~~checking,--time,~~ ~~interest-or-savings-account~~ demand, time, savings, passbook, share draft or like account, other than an account evidenced by a certificate of deposit.

(b) Afternoon. "Afternoon" means the period of a day between noon and midnight.

(c) Banking day. "Banking day" means ~~that~~ the part of ~~any~~ a day on which a bank is open to the public for carrying on substantially all of its banking functions.

(d) ~~Clearing---house~~ Clearinghouse. ~~"Clearing---house"~~ "Clearinghouse" means ~~any~~ an association of banks or other payors regularly clearing items.

(e) Customer. "Customer" means ~~any~~ a person having an account with a bank or for whom a bank has agreed to collect items ~~and-includes~~, including a bank ~~carrying~~ that maintains an account ~~with~~ at another bank.

(f) Documentary draft. "Documentary draft" means ~~any negotiable---or---nonnegotiable---draft---with---accompanying documents,--securities--or--other--papers--to--be--delivered against--honor--of--the--draft~~ a draft to be presented for acceptance or payment if specified documents, certificated securities as defined in section 8-102, instructions for uncertificated securities as defined in section 8-308, or

other certificates, statements or the like are to be received by the drawee or other payor before acceptance or payment of the draft.

(f-1) Draft. "Draft" means a draft as defined in section 3-1104 or an item, other than an instrument, that is an order.

(f-2) Drawee. "Drawee" means a person ordered in a draft to make payment.

(g) Item. "Item" means ~~any instrument for the payment of money even though it is not negotiable but does not include money~~ an instrument, promise or order to pay money handled by a bank for collection or payment. The term does not include a payment order governed by Article 4-A or a credit or debit card slip.

(h) Midnight deadline. "Midnight deadline" with respect to a bank is midnight on its next banking day following the banking day on which it receives the relevant item or notice or from which the time for taking action commences to run, whichever is later.

~~(i) Properly payable. "Properly payable" includes the availability of funds for payment at the time of decision to pay or dishonor.~~

(j) Settle. "Settle" means to pay in cash, by ~~clearing house~~ clearinghouse settlement, in a charge or credit or by remittance, or otherwise as ~~instructed~~ agreed. A settlement may be either provisional or final.

(k) Suspends payments. "Suspends payments" with respect to a bank means that it has been closed by order of the supervisory authorities, that a public officer has been appointed to take it over, or that it ceases or refuses to make payments in the ordinary course of business.

(2) Other definitions applying to this Article and the sections in which they appear are:

"Agreement for electronic presentment."	Section 4-110.
"Bank."	Section 4-105.
"Collecting bank."	Section 4-105.
"Depositary bank."	Section 4-105.
"Intermediary bank."	Section 4-105.
"Payor bank."	Section 4-105.
"Presenting bank."	Section 4-105.

"Presentment notice."	Section 4-110.
~~"Remitting bank."~~	~~Section 4-105.~~

(3) The following definitions in other Articles apply to this Article:

"Acceptance."	Section ~~3-410~~ 3-1409.
"Alteration."	Section 3-1407.
"Cashier's check."	Section 3-1104.
"Certificate of deposit."	Section ~~3-104~~ 3-1104.
~~"Certification."~~	~~Section 3-411.~~
"Certified Check."	Section 3-1409.
"Check."	Section ~~3-104~~ 3-1104.
"Draft."	Section ~~3-104~~ 3-1104.
"Good faith."	Section 3-1103.
"Holder in due course."	Section ~~3-302~~ 3-1102.
"Instrument."	Section 3-1104.
"Notice of dishonor."	Section ~~3-508~~ 3-1503.
"Order."	Section 3-1103.
"Ordinary care."	Section 3-1103.
"Person entitled to enforce."	Section 3-1301.
"Presentment."	Section ~~3-504~~ 3-1501.
"Promise."	Section 3-1103.
~~"Protest."~~	~~Section 3-509.~~
"Prove."	Section 3-1103.
~~"Secondary party."~~	~~Section 3-102.~~
"Teller's check."	Section 3-1104.
"Unauthorized signature."	Section 3-1403.

(4) In addition, Article 1 contains general definitions and principles of construction and interpretation applicable throughout this Article.

Uniform Commercial Code Comment

1. Paragraph (a)(1) [subsection (1)(a)]: "Account" is defined to include both asset accounts in which a customer has deposited money and accounts from which a customer may draw on a line of credit. The limiting factor is that the account must be in a bank.

2. Paragraph (a)(3) [subsection (1)(c)]: "Banking day." Under this definition that part of a business day when a bank is open only for limited functions, e.g., to receive deposits and cash checks, but with loan, bookkeeping and other departments closed, is not part of a banking day.

3. Paragraph (a)(4) [subsection (1)(d)]: "Clearing house." Occasionally express companies, governmental agencies and other nonbanks deal directly with a clearing house; hence the definition does not limit the term to an association of banks.

4. Paragraph (a)(5) [subsection (1)(e)]: "Customer." It is to be noted that this term includes a bank carrying an account with another bank as well as the more typical nonbank customer or depositor.

5. Paragraph (a)(6) [subsection (1)(f)]: "Documentary draft" applies even though the documents do not accompany the draft but are to be received by the drawee or other payor before acceptance or payment of the draft.

6. Paragraph (a)(7) [subsection (1)(f-1)]: "Draft" is defined in Section 3-104 [section 3-1104] as a form of instrument. Since Article 4 applies to items that may not fall within the definition of instrument, the term is defined here to include an item that is a written order to pay money, even though the item may not qualify as an instrument. The term "order" is defined in Section 3-103 [section 3-1103].

7. Paragraph (a)(8) [subsection (1)(f-2)]: "Drawee" is defined in Section 3-103 [section 3-1103] in terms of an Article 3 [Article 3-A] draft which is a form of instrument. Here "drawee" is defined in terms of an Article 4 draft which includes items that may not be instruments.

8. Paragraph (a)(9) [subsection (1)(g)]: "Item" is defined broadly to include an instrument, as defined in Section 3-104 [section 3-1104], as well as promises or orders that may not be within the definition of "instrument." The terms "promise" and "order" are defined in Section 3-103 [section 3-1103]. A promise is a written undertaking to pay money. An order is a written instruction to pay money. But see Section 4-110(c). Since bonds and other investment securities under Article 8 may be within the term "instrument" or "promise," they are items and when handled by banks for collection are subject to this Article. See Comment 1 to Section 4-102. The functional limitation on the meaning of this term is the willingness of the banking system to handle the instrument, undertaking or instruction for collection or payment.

9. Paragraph (a)(10) [subsection (1)(h)]: "Midnight deadline." The use of this phrase is an example of the more mechanical approach used in this Article. Midnight is selected as a termination point or time limit to obtain greater uniformity and definiteness than would be possible from other possible terminating points, such as the close of the banking day or business day.

10. Paragraph (a)(11) [subsection (1)(j)]: The term "settle" has substantial importance throughout Article 4. In the American Bankers Association Bank Collection Code, in deferred

posting statutes, in Federal Reserve regulations and operating circulars, in clearing-house rules, in agreements between banks and customers and in legends on deposit tickets and collection letters, there is repeated reference to "conditional" or "provisional" credits or payments. Tied in with this concept of credits or payments being in some way tentative, has been a related but somewhat different problem as to when an item is "paid" or "finally paid" either to determine the relative priority of the item as against attachments, stop-payment orders and the like or in insolvency situations. There has been extensive litigation in the various states on these problems. To a substantial extent the confusion, the litigation and even the resulting court decisions fail to take into account that in the collection process some debits or credits are provisional or tentative and others are final and that very many debits or credits are provisional or tentative for awhile but later become final. Similarly, some cases fail to recognize that within a single bank, particularly a payor bank, each item goes through a series of processes and that in a payor bank most of these processes are preliminary to the basic act of payment or "final payment."

The term "settle" is used as a convenient term to characterize a broad variety of conditional, provisional, tentative and also final payments of items. Such a comprehensive term is needed because it is frequently difficult or unnecessary to determine whether a particular action is tentative or final or when a particular credit shifts from the tentative class to the final class. Therefore, its use throughout the Article indicates that in that particular context it is unnecessary or unwise to determine whether the debit or the credit or the payment is tentative or final. However, if qualified by the adjective "provisional" its tentative nature is intended, and if qualified by the adjective "final" its permanent nature is intended.

Examples of the various types of settlement contemplated by the term include payments in cash; the efficient but somewhat complicated process of payment through the adjustment and offsetting of balances through clearing houses; debit or credit entries in accounts between banks; the forwarding of various types of remittance instruments, sometimes to cover a particular item but more frequently to cover an entire group of items received on a particular day.

11. Paragraph (a)(12) [subsection (1)(k)]: "Suspends payments." This term is designed to afford an objective test to determine when a bank is no longer operating as a part of the banking system.

Sec. B-10. 11 MRSA §4-105 is amended to read:

§4-105. "Depositary bank"; "bank"; "payor bank"; "intermediary bank"; "collecting bank"; "presenting bank"

In this Article, unless the context otherwise ~~requires~~ indicates, the following terms have the following meanings.

(1) Depositary bank. "Depositary bank" means the first bank to ~~which~~ take an item ~~is transferred for collection~~ even though it is also the payor bank, unless the item is presented for immediate payment over the counter.

(1-A) Bank. "Bank" means a person engaged in the business of banking, including a savings bank, savings and loan association, credit union or trust company.

(2) Payor bank. "Payor bank" means a bank ~~by which an item is payable as drawn or accepted~~ that is the drawee of a draft.

(3) Intermediary bank. "Intermediary bank" means ~~any~~ a bank to which an item is transferred in course of collection, except the depositary or payor bank.

(4) Collecting bank. "Collecting bank" means ~~any~~ a bank handling ~~the~~ an item for collection, except the payor bank.

(5) Presenting bank. "Presenting bank" means ~~any~~ a bank presenting an item except a payor bank.

~~(6) Remitting bank. "Remitting bank" means any payor or intermediary bank remitting for an item.~~

Uniform Commercial Code Comment

1. The definitions in general exclude a bank to which an item is issued, as this bank does not take by transfer except in the particular case covered in which the item is issued to a payee for collection, as in the case in which a corporation is transferring balances from one account to another. Thus, the definition of "depositary bank" does not include the bank to which a check is made payable if a check is given in payment of a mortgage. This bank has the status of a payee under Article 3 [Article 3-A] on Negotiable Instruments and not that of a collecting bank.

2. Paragraph (1) [subsection (1-A)]: "Bank" [sic] is defined in Section 1-201(4) as meaning "any person engaged in the business of banking." The definition in paragraph (1) [subsection (1-A)] makes clear that "bank" includes savings banks, savings and loan associations, credit unions and trust

companies, in addition to the commercial banks commonly denoted by use of the term "bank."

3. Paragraph (2) [subsection (1)]: A bank that takes an "on us" item for collection, for application to a customer's loan, or first handles the item for other reasons is a depositary bank even though it is also the payor bank. However, if the holder presents the item for immediate payment over the counter, the payor bank is not a depositary bank.

4. Paragraph (3) [subsection (2)]: The definition of "payor bank" is clarified by use of the term "drawee." That term is defined in Section 4-104 as meaning "a person ordered in a draft to make payment." An "order" is defined in Section 3-103 [section 3-1103] as meaning "a written instruction to pay money ... . An authorization to pay is not an order unless the person authorized to pay is also instructed to pay." The definition of order is incorporated into Article 4 by Section 4-104(c) [section 4-104(3)]. Thus a payor bank is one instructed to pay in the item. A bank does not become a payor bank by being merely authorized to pay or by being given an instruction to pay not contained in the item.

5. Paragraph (4) [subsection (3)]: The term "intermediary bank" includes the last bank in the collection process if the drawee is not a bank. Usually the last bank is also a presenting bank.

Sec. B-11. 11 MRSA §4-105-A is enacted to read:

§4-105-A. Payable through or payable at bank; collecting bank

(1) If an item states that it is "payable through" a bank identified in the item:

(a) The item designates the bank as a collecting bank and does not by itself authorize the bank to pay the item; and

(b) The item may be presented for payment only by or through the bank.

(2) If an item states that it is "payable at" a bank identified in the item, the item is equivalent to a draft drawn on that bank.

(3) If a draft names a nonbank drawee and it is unclear whether a bank named in the draft is a co-drawee or a collecting bank, the bank is a collecting bank.

Uniform Commercial Code Comment

1. This section replaces former Sections 3-120 and 3-121. Some items are made "payable through" a particular bank. Subsection (a) [subsection (1)] states that such language makes the bank a collecting bank and not a payor bank. An item identifying a "payable through" bank can be presented for payment to the drawee only by the "payable through" bank. The item cannot be presented to the drawee over the counter for immediate payment or by a collecting bank other than the "payable through" bank.

2. Subsection (b) [subsection (2)] retains the alternative approach of the present law. Under Alternative A a note payable at a bank is the equivalent of a draft drawn on the bank and the midnight deadline provisions of Sections 4-301 and 4-302 apply. Under Alternative B a "payable at" bank is in the same position as a "payable through" bank under subsection (a) [subsection (1)].

3. Subsection (c) [subsection (3)] rejects the view of some cases that a bank named below the name of a drawee is itself a drawee. The commercial understanding is that this bank is a collecting bank and is not accountable under Section 4-302 for holding an item beyond its deadline. The liability of the bank is governed by Sections 4-202(a) [section 4-202(1)] and 4-103(e) [section 4-103(5)].

Sec. B-12. 11 MRSA §4-106 is amended to read:

§4-106. Separate office of a bank

A branch or separate office of a bank ~~maintaining its own deposit ledgers~~ is a separate bank for the purpose of computing the time within which and determining the place at or to which action may be taken or notices or orders ~~shall~~ must be given under this Article and under Article ~~3~~ 3-A.

Uniform Commercial Code Comment

1. A rule with respect to the status of a branch or separate office of a bank as a part of any statute on bank collections is highly desirable if not absolutely necessary. However, practices in the operations of branches and separate offices vary substantially in the different states and it has not been possible to find any single rule that is logically correct, fair in all situations and workable under all different types of practices. The decision not to draft the section with greater specificity leaves to the courts the resolution of the issues arising under this section on the basis of the facts of each case.

2. In many states and for many purposes a branch or separate office of the bank should be treated as a separate bank. Many branches function as separate banks in the handling and payment of items and require time for doing so similar to that of a separate bank. This is particularly true if branch banking is permitted throughout a state or in different towns and cities. Similarly, if there is this separate functioning a particular branch or separate office is the only proper place for various types of action to be taken or orders or notices to be given. Examples include the drawing of a check on a particular branch by a customer whose account is carried at that branch; the presentment of that same check at that branch; the issuance of an order to the branch to stop payment on the check.

3. Section 1 of the American Bankers Association Bank Collection Code provided simply: "A branch or office of any such bank shall be deemed a bank." Although this rule appears to be brief and simple, as applied to particular sections of the ABA Code it produces illogical and, in some cases, unreasonable results. For example, under Section 11 of the ABA Code it seems anomalous for one branch of a bank to have charged an item to the account of the drawer and another branch to have the power to elect to treat the item as dishonored. Similar logical problems would flow from applying the same rule to Article 4. Warranties by one branch to another branch under Sections 4-207 [section 4-207-A] and 4-208 [section 4-207-B] (each considered a separate bank) do not make sense.

4. Assuming that it is not desirable to make each branch a separate bank for all purposes, this section provides that a branch or separate office is a separate bank for certain purposes. In so doing the single legal entity of the bank as a whole is preserved, thereby carrying with it the liability of the institution as a whole on such obligations as it may be under. On the other hand, in cases in which the Article provides a number of time limits for different types of action by banks, if a branch functions as a separate bank, it should have the time limits available to a separate bank. Similarly if in its relations to customers a branch functions as a separate bank, notices and orders with respect to accounts of customers of the branch should be given at the branch. For example, whether a branch has notice sufficient to affect its status as a holder in due course of an item taken by it should depend upon what notice that branch has received with respect to the item. Similarly the receipt of a stop-payment order at one branch should not be notice to another branch so as to impair the right of the second branch to be a holder in due course of the item, although in circumstances in which ordinary care requires the communication of a notice or order to the proper branch of a bank, the notice

or order would be effective at the proper branch from the time it was or should have been received. See Section 1-201(27).

5. The bracketed language ("maintaining its own deposit ledger") in former Section 4-106 is deleted. Today banks keep records on customer accounts by electronic data storage. This has led most banks with branches to centralize to some degree their record keeping. The place where records are kept has little meaning if the information is electronically stored and is instantly retrievable at all branches of the bank. Hence, the inference to be drawn from the deletion of the bracketed language is that where record keeping is done is no longer an important factor in determining whether a branch is a separate bank.

Sec. B-13. 11 MRSA §4-107, as amended by PL 1979, c. 541, Pt. A, §106, is further amended to read:

§4-107. Time of receipt of items

(1) For the purpose of allowing time to process items, prove balances and make the necessary entries on its books to determine its position for the day, a bank may fix an afternoon hour of 2 p.m. or later as a cutoff hour for the handling of money and items and the making of entries on its books.

(2) ~~Any~~ An item or deposit of money received on any day after a ~~cut-off~~ cutoff hour so fixed or after the close of the banking day may be treated as being received at the opening of the next banking day.

Uniform Commercial Code Comment

1. Each of the huge volume of checks processed each day must go through a series of accounting procedures that consume time. Many banks have found it necessary to establish a cutoff hour to allow time for these procedures to be completed within the time limits imposed by Article 4. Subsection (a) [subsection (1)] approves a cutoff hour of this type provided it is not earlier than 2 P.M. Subsection (b) [subsection (2)] provides that if such a cutoff hour is fixed, items received after the cutoff hour may be treated as being received at the opening of the next banking day. If the number of items received either through the mail or over the counter tends to taper off radically as the afternoon hours progress, a 2 P.M. cutoff hour does not involve a large portion of the items received but at the same time permits a bank using such a cutoff hour to leave its doors open later in the afternoon without forcing into the evening the completion of its settling and proving process.

2. The provision in subsection (b) [subsection (2)] that items or deposits received after the close of the banking day may be treated as received at the opening of the next banking day is important in cases in which a bank closes at twelve or one o'clock, e.g., on a Saturday, but continues to receive some items by mail or over the counter if, for example, it opens Saturday evening for the limited purpose of receiving deposits and cashing checks.

Sec. B-14. 11 MRSA §4-108 is amended to read:

§4-108. Delays

(1) Unless otherwise instructed, a collecting bank in a good faith effort to secure payment ~~may, in the case of~~ a specific ~~items~~ item drawn on a payor other than a bank and with or without the approval of any person involved, may waive, modify or extend time limits imposed or permitted by this Title for a period not ~~in excess of an~~ exceeding 2 additional banking ~~day~~ days without discharge of ~~secondary parties and without~~ drawers or indorsers or liability to its transferor or ~~any~~ a prior party.

(2) Delay by a collecting bank or payor bank beyond time limits prescribed or permitted by this Title, or by instructions is excused, if ~~caused by interruption of communication facilities, suspension of payments by another bank, war, emergency conditions or other circumstances beyond the control of the bank, provided it exercises such diligence as the circumstances require.~~:

(a) The delay is caused by interruption of communication or computer facilities, suspension of payments by another bank, war, emergency conditions, failure of equipment or other circumstances beyond the control of the bank; and

(b) The bank exercises such diligence as the circumstances require.

Uniform Commercial Code Comment

1. Sections 4-202(b) [section 4-202(2)], 4-214 [section 4-212], 4-301, and 4-302 prescribe various time limits for the handling of items. These are the limits of time within which a bank, in fulfillment of its obligation to exercise ordinary care, must handle items entrusted to it for collection or payment. Under Section 4-103 they may be varied by agreement or by Federal Reserve regulations or operating circular, clearing-house rules, or the like. Subsection (a) [subsection (1)] permits a very limited extension of these time limits. It authorizes a collecting bank to take additional time in attempting to collect

drafts drawn on nonbank payors with or without the approval of any interested party. The right of a collecting bank to waive time limits under subsection (a) [subsection (1)] does not apply to checks. The two-day extension can only be granted in a good faith effort to secure payment and only with respect to specific items. It cannot be exercised if the customer instructs otherwise. Thus limited the escape provision should afford a limited degree of flexibility in special cases but should not interfere with the overall requirement and objective of speedy collections.

2. An extension granted under subsection (a) [subsection (1)] is without discharge of drawers or indorsers. It therefore extends the times for presentment or payment as specified in Article 3 [Article 3-A].

3. Subsection (b) [subsection (2)] is another escape clause from time limits. This clause operates not only with respect to time limits imposed by the Article itself but also time limits imposed by special instructions, by agreement or by Federal regulations or operating circulars, clearing-house rules or the like. The latter time limits are "permitted" by the Code. For example, a payor bank that fails to make timely return of a dishonored item may be accountable for the amount of the item. Subsection (b) [subsection (2)] excuses a bank from this liability when its failure to meet its midnight deadline resulted from, for example, a computer breakdown that was beyond the control of the bank, so long as the bank exercised the degree of diligence that the circumstances required. In Port City State Bank v. American National Bank, 486 F.2d 196 (10th Cir. 1973), the court held that a bank exercised sufficient diligence to be excused under this subsection. If delay is sought to be excused under this subsection, the bank has the burden of proof on the issue of whether it exercised "such diligence as the circumstances require." The subsection is consistent with Regulation CC, Section 229.38(e).

Sec. B-15. 11 MRSA §4-109 is repealed.

Sec. B-16. 11 MRSA §4-110 is enacted to read:

§4-110. Electronic presentment

(1) "Agreement for electronic presentment" means an agreement, clearinghouse rule or Federal Reserve regulation or operating circular that provides that presentment of an item may be made by transmission of an image of an item or information describing that item, that is, a "presentment notice," rather than by delivery of the item itself. The "agreement for electronic presentment" may provide procedures governing

retention, presentment, payment, dishonor and other matters concerning items subject to the agreement.

(2) Presentment of an item pursuant to an "agreement for electronic presentment" is made when the presentment notice is received.

(3) If presentment is made by presentment notice, a reference to "item" or "check" in this Article means the presentment notice unless the context otherwise indicates.

Uniform Commercial Code Comment

1. "An agreement for electronic presentment" refers to an agreement under which presentment may be made to a payor bank by a presentment notice rather than by presentment of the item. Under imaging technology now under development, the presentment notice might be an image of the item. The electronic presentment agreement may provide that the item may be retained by a depositary bank, other collecting bank, or even a customer of the depositary bank, or it may provide that the item will follow the presentment notice. The identifying characteristic of an electronic presentment agreement is that presentment occurs when the presentment notice is received. "An agreement for electronic presentment" does not refer to the common case of retention of items by payor banks because the item itself is presented to the payor bank in these cases. Payor bank check retention is a matter of agreement between payor banks and their customers. Provisions on payor bank check retention are found in Section 4-406(b) [section 4-406(1-B)].

2. The assumptions under which the electronic presentment amendments are based are as follows: No bank will participate in an electronic presentment program without an agreement. These agreements may be either bilateral (Section 4-103(a) [section 4-103(1)]), under which two banks that frequently do business with each other may agree to depositary bank check retention, or multilateral (Section 4-103(b) [section 4-103(2)]), in which large segments of the banking industry may participate in such a program. In the latter case, federal or other uniform regulatory standards would likely supply the substance of the electronic presentment agreement, the application of which could be triggered by the use of some form of identifier on the item. Regulation CC, Section 229.36(c) authorizes truncation agreements but forbids them from extending return times or otherwise varying requirements of the part of Regulation CC governing check collection without the agreement of all parties interested in the check. For instance, an extension of return time could damage a depositary bank which must make funds available to its customers under mandatory availability schedules. The Expedited Funds

Availability Act, 12 U.S.C. Section 4008(b)(2), directs the Federal Reserve Board to consider requiring that banks provide for check truncation.

3. The parties affected by an agreement for electronic presentment, with the exception of the customer, can be expected to protect themselves. For example, the payor bank can probably be expected to limit its risk of loss from drawer forgery by limiting the dollar amount of eligible items (Federal Reserve program), by reconcilement agreements (ABA Safekeeping program), by insurance (credit union share draft program), or by other means. Because agreements will exist, only minimal amendments are needed to make clear that the UCC does not prohibit electronic presentment.

Sec. B-17. 11 MRSA §4-111 is enacted to read:

§4-111. Statute of limitations

An action to enforce an obligation, duty or right arising under this Article must be commenced within 3 years after the cause of action accrues.

Uniform Commercial Code Comment

This section conforms to the period of limitations set by Section 3-118(g) [section 3-1118(7)] for actions for breach of warranty and to enforce other obligations, duties or rights arising under Article 3 [Article 3-A]. Bracketing "cause of action" recognizes that some states use a different term, such as "claim for relief."

Sec. B-18. 11 MRSA §4-201, as amended by PL 1979, c. 541, Pt. A, §107, is further amended to read:

§4-201. Status of collecting bank as agent and provisional status of credits; applicability of Article; item indorsed "pay any bank"

(1) Unless a contrary intent clearly appears and ~~prior to~~ before the time that a settlement given by a collecting bank for an item is or becomes final ~~(section 4-211, subsection (3) and sections 4-212 and 4-213)~~, the bank, with respect to the item, is an agent or subagent of the owner of the item and any settlement given for the item is provisional. This provision applies regardless of the form of indorsement or lack of indorsement and even though credit given for the item is subject to immediate withdrawal as of right or is in fact withdrawn; but the continuance of ownership of an item by its owner and any rights of the owner to proceeds of the item are subject to rights of a

collecting bank, such as those resulting from outstanding advances on the item and ~~valid~~ rights of recoupment or setoff. ~~When~~ If an item is handled by banks for purposes of presentment, payment ~~and~~, collection or return, the relevant provisions of this Article apply even though action of the parties clearly establishes that a particular bank has purchased the item and is the owner of it.

(2) After an item has been indorsed with the words "pay any bank" or the like, only a bank may acquire the rights of a holder until the item has been:

(a) ~~Until the item has been returned~~ Returned to the customer initiating collection; or

(b) ~~Until the item has been specially~~ Specially indorsed by a bank to a person who is not a bank.

Uniform Commercial Code Comment

1. This section states certain basic rules of the bank collection process. One basic rule, appearing in the last sentence of subsection (a) [subsection (1)], is that, to the extent applicable, the provisions of the Article govern without regard to whether a bank handling an item owns the item or is an agent for collection. Historically, much time has been spent and effort expended in determining or attempting to determine whether a bank was a purchaser of an item or merely an agent for collection. See discussion of this subject and cases cited in 11 A.L.R. 1043, 16 A.L.R. 1084, 42 A.L.R. 492, 68 A.L.R. 725, 99 A.L.R. 486. See also Section 4 of the American Bankers Association Bank Collection Code. The general approach of Article 4, similar to that of other articles, is to provide, within reasonable limits, rules or answers to major problems known to exist in the bank collection process without regard to questions of status and ownership but to keep general principles such as status and ownership available to cover residual areas not covered by specific rules. In line with this approach, the last sentence of subsection (a) [subsection (1)] says in effect that Article 4 applies to practically every item moving through banks for the purpose of presentment, payment or collection.

2. Within this general rule of broad coverage, the first two sentences of subsection (a) [subsection (1)] state a rule of agency status. "Unless a contrary intent clearly appears" the status of a collecting bank is that of an agent or sub-agent for the owner of the item. Although as indicated in Comment 1 it is much less important under Article 4 to determine status than has been the case heretofore, status may have importance in some residual areas not covered by specific rules. Further, since

status has been considered so important in the past, to omit all reference to it might cause confusion. The status of agency "applies regardless of the form of indorsement or lack of indorsement and even though credit given for the item is subject to immediate withdrawal as of right or is in fact withdrawn." Thus questions heretofore litigated as to whether ordinary indorsements "for deposit," "for collection" or in blank have the effect of creating an agency status or a purchase, no longer have significance in varying the prima facie rule of agency. Similarly, the nature of the credit given for an item or whether it is subject to immediate withdrawal as of right or is in fact withdrawn, does not alter the agency status. See A.L.R. references supra in Comment 1.

A contrary intent can change agency status but this must be clear. An example of a clear contrary intent would be if collateral papers established or the item bore a legend stating that the item was sold absolutely to the depositary bank.

3. The prima facie agency status of collecting banks is consistent with prevailing law and practice today. Section 2 of the American Bankers Association Bank Collection Code so provided. Legends on deposit tickets, collection letters and acknowledgments of items and Federal Reserve operating circulars consistently so provide. The status is consistent with rights of charge-back (Section 4-214 [section 4-212] and Section 11 of the ABA Code) and risk of loss in the event of insolvency (Section 4-216 [section 4-214] and Section 13 of the ABA Code). The right of charge-back with respect to checks is limited by Regulation CC, Section 226.36(d).

4. Affirmative statement of a prima facie agency status for collecting banks requires certain limitations and qualifications. Under current practices substantially all bank collections sooner or later merge into bank credits, at least if collection is effected. Usually, this takes place within a few days of the initiation of collection. An intermediary bank receives final collection and evidences the result of its collection by a "credit" on its books to the depositary bank. The depositary bank evidences the results of its collection by a "credit" in the account of its customer. As used in these instances the term "credit" clearly indicates a debtor-creditor relationship. At some stage in the bank collection process the agency status of a collecting bank changes to that of debtor, a debtor of its customer. Usually at about the same time it also becomes a creditor for the amount of the item, a creditor of some intermediary, payor or other bank. Thus the collection is completed, all agency aspects are terminated and the identity of the item has become completely merged in bank accounts, that of the customer with the depositary bank and that of one bank with another.

Although Section 4-215(a) [section 4-213(1)] provides that an item is finally paid when the payor bank takes or fails to take certain action with respect to the item, the final payment of the item may or may not result in the simultaneous final settlement for the item in the case of all prior parties. If a series of provisional debits and credits for the item have been entered in accounts between banks, the final payment of the item by the payor bank may result in the automatic firming up of all these provisional debits and credits under Section 4-215(c) [section 4-213(2)], and the consequent receipt of final settlement for the item by each collecting bank and the customer of the depositary bank simultaneously with such action of the payor bank. However, if the payor bank or some intermediary bank accounts for the item with a remittance draft, the next prior bank usually does not receive final settlement for the item until the remittance draft finally clears. See Section 4-213(c) [section 4-211-A(3)]. The first sentence of subsection (a) [subsection (1)] provides that the agency status of a collecting bank (whether intermediary or depositary) continues until the settlement given by it for the item is or becomes final. In the case of the series of provisional credits covered by Section 4-215(c) [section 4-213(2)], this could be simultaneously with the final payment of the item by the payor bank. In cases in which remittance drafts are used or in straight noncash collections, this would not be until the times specified in Sections 4-213(c) [section 4-211-A(3)] and 4-215(d) [section 4-213(3)]. With respect to checks Regulation CC Sections 229.31(c), 229.32(b), and 229.36(d) provide that all settlements between banks are final in both the forward collection and return of checks.

Under Section 4-213(a) [section 4-211-A(1)] settlements for items may be made by any means agreed to by the parties. Since it is impossible to contemplate all the kinds of settlements that will be utilized, no attempt is made in Article 4 to provide when settlement is final in all cases. The guiding principle is that settlements should be final when the presenting person has received usable funds. Section 4-213(c) and (d) [section 4-211-A(3) and (4)] and Section 4-215(c) [section 4-213(2)] provide when final settlement occurs with respect to certain kinds of settlement, but these provisions are not intended to be exclusive.

A number of practical results flow from the rule continuing the agency status of a collecting bank until its settlement for the item is or becomes final, some of which are specifically set forth in this Article. One is that risk of loss continues in the owner of the item rather than the agent bank. See Section 4-214 [section 4-212]. Offsetting rights favorable to the owner are

that pending such final settlement, the owner has the preference rights of Section 4-216 [section 4-214] and the direct rights of Section 4-302 against the payor bank. It also follows from this rule that the dollar limitations of Federal Deposit Insurance are measured by the claim of the owner of the item rather than that of the collecting bank. With respect to checks, rights of the parties in insolvency are determined by Regulation CC Section 229.39 and the liability of a bank handling a check to a subsequent bank that does not receive payment because of suspension of payments by another bank is stated in Regulation CC Section 229.35(b).

5. In those cases in which some period of time elapses between the final payment of the item by the payor bank and the time that the settlement of the collecting bank is or becomes final, e.g., if the payor bank or an intermediary bank accounts for the item with a remittance draft or in straight noncash collections, the continuance of the agency status of the collecting bank necessarily carries with it the continuance of the owner's status as principal. The second sentence of subsection (a) [subsection (1)] provides that whatever rights the owner has to proceeds of the item are subject to the rights of collecting banks for outstanding advances on the item and other valid rights, if any. The rule provides a sound rule to govern cases of attempted attachment of proceeds of a noncash item in the hands of the payor bank as property of the absent owner. If a collecting bank has made an advance on an item which is still outstanding, its right to obtain reimbursement for this advance should be superior to the rights of the owner to the proceeds or to the rights of a creditor of the owner. An intentional crediting of proceeds of an item to the account of a prior bank known to be insolvent, for the purpose of acquiring a right of setoff, would not produce a valid setoff. See 8 Zollman, Banks and Banking (1936) Sec. 5443.

6. This section and Article 4 as a whole represent an intentional abandonment of the approach to bank collection problems appearing in Section 4 of the American Bankers Association Bank Collection Code. Because the tremendous volume of items handled makes impossible the examination by all banks of all indorsements on all items and thus in fact this examination is not made, except perhaps by depositary banks, it is unrealistic to base the rights and duties of all banks in the collection chain on variations in the form of indorsements. It is anomalous to provide throughout the ABA Code that the prima facie status of collecting banks is that of agent or sub-agent but in Section 4 to provide that subsequent holders (sub-agents) shall have the right to rely on the presumption that the bank of deposit (the primary agent) is the owner of the item. It is unrealistic, particularly in this background, to base rights and

duties on status of agent or owner. Thus Section 4-201 makes the pertinent provisions of Article 4 applicable to substantially all items handled by banks for presentment, payment or collection, recognizes the prima facie status of most banks as agents, and then seeks to state appropriate limits and some attributes to the general rules so expressed.

7. Subsection (b) [subsection (2)] protects the ownership rights with respect to an item indorsed "pay any bank or banker" or in similar terms of a customer initiating collection or of any bank acquiring a security interest under Section 4-210 [section 4-208], in the event the item is subsequently acquired under improper circumstances by a person who is not a bank and transferred by that person to another person, whether or not a bank. Upon return to the customer initiating collection of an item so indorsed, the indorsement may be cancelled (Section 3-207 [section 3-1207]). A bank holding an item so indorsed may transfer the item out of banking channels by special indorsement; however, under Section 4-103(e) [section 4-103(5)], the bank would be liable to the owner of the item for any loss resulting therefrom if the transfer had been made in bad faith or with lack of ordinary care. If briefer and more simple forms of bank indorsements are developed under Section 4-206 (e.g., the use of bank transit numbers in lieu of present lengthy forms of bank indorsements), a depositary bank having the transit number "X100" could make subsection (b) [subsection (2)] operative by indorsements such as "Pay any bank--X100." Regulation CC Section 229.35(c) states the effect of an indorsement on a check by a bank.

Sec. B-19. 11 MRSA §4-202 is amended to read:

§4-202. Responsibility for collection or return; when action timely

(1) A collecting bank must ~~use~~ exercise ordinary care in:

(a) Presenting an item or sending it for presentment; ~~and~~

(b) Sending notice of dishonor or nonpayment or returning an item other than a documentary draft to the bank's transferor ~~or directly to the depositary bank under section 4-212, subsection (2)~~ after learning that the item has not been paid or accepted, as the case may be; ~~and~~

(c) Settling for an item when the bank receives final settlement; ~~and~~

~~(d) Making or providing for any necessary protest; and~~

(e) Notifying its transferor of any loss or delay in transit within a reasonable time after discovery thereof.

(2) A collecting bank ~~taking proper action before its midnight deadline following receipt of an item, notice or payment acts seasonably; taking proper action within a reasonably longer time may be seasonable but the bank has the burden of so establishing~~ exercises ordinary care under subsection (1) by taking proper action before its midnight deadline following receipt of an item, notice or settlement. Taking proper action within a reasonably longer time may constitute the exercise of ordinary care, but the bank has the burden of establishing timeliness.

(3) Subject to subsection (1), paragraph (a), a bank is not liable for the insolvency, neglect, misconduct, mistake or default of another bank or person or for loss or destruction of an item in the possession of others or in transit ~~or in the possession of others~~.

Uniform Commercial Code Comment

1. Subsection (a) [subsection (1)] states the basic responsibilities of a collecting bank. Of course, under Section 1-203 a collecting bank is subject to the standard requirement of good faith. By subsection (a) [subsection (1)] it must also use ordinary care in the exercise of its basic collection tasks. By Section 4-103(a) [section 4-103(1)] neither requirement may be disclaimed.

2. If the bank makes presentment itself, subsection (a)(1) [subsection (1)(a)] requires ordinary care with respect both to the time and manner of presentment. (Sections 3-501 [section 3-1501] and 4-212 [section 4-210].) If it forwards the item to be presented the subsection requires ordinary care with respect to routing (Section 4-204), and also in the selection of intermediary banks or other agents.

3. Subsection (a) [subsection (1)] describes types of basic action with respect to which a collecting bank must use ordinary care. Subsection (b) [subsection (2)] deals with the time for taking action. It first prescribes the general standard for timely action, namely, for items received on Monday, proper action (such as forwarding or presenting) on Monday or Tuesday is timely. Although under current "production line" operations banks customarily move items along on regular schedules substantially briefer than two days, the subsection states an outside time within which a bank may know it has taken timely action. To provide flexibility from this standard norm, the subsection further states that action within a reasonably longer

time may be timely but the bank has the burden of proof. In the case of time items, action after the midnight deadline, but sufficiently in advance of maturity for proper presentation, is a clear example of a "reasonably longer time" that is timely. The standard of requiring action not later than Tuesday in the case of Monday items is also subject to possibilities of variation under the general provisions of Section 4-103, or under the special provisions regarding time of receipt of items (Section 4-108 [section 4-107]), and regarding delays (Section 4-109 [section 4-108]). This subsection (b) [subsection (2)] deals only with collecting banks. The time limits applicable to payor banks appear in Sections 4-301 and 4-302.

4. At common law the so-called New York collection rule subjected the initial collecting bank to liability for the actions of subsequent banks in the collection chain; the so-called Massachusetts rule was that each bank, subject to the duty of selecting proper intermediaries, was liable only for its own negligence. Subsection (c) [subsection (3)] adopts the Massachusetts rule. But since this is stated to be subject to subsection (a)(1) [subsection (1)(a)] a collecting bank remains responsible for using ordinary care in selecting properly qualified intermediary banks and agents and in giving proper instructions to them. Regulation CC Section 229.36(d) states the liability of a bank during the forward collection of checks.

Sec. B-20. 11 MRSA §4-203 is amended to read:

§4-203. Effect of instructions

Subject to ~~the provisions of~~ Article 3 concerning conversion of instruments (section 3-419) and ~~the provisions of both Article 3 and this Article concerning~~ restrictive indorsements (section 3-206) only a collecting bank's transferor can give instructions ~~which~~ that affect the bank or constitute notice to it and a collecting bank is not liable to prior parties for any action taken pursuant to ~~such~~ the instructions or in accordance with any agreement with its transferor.

Uniform Commercial Code Comment

This section adopts a "chain of command" theory which renders it unnecessary for an intermediary or collecting bank to determine whether its transferor is "authorized" to give the instructions. Equally the bank is not put on notice of any "revocation of authority" or "lack of authority" by notice received from any other person. The desirability of speed in the collection process and the fact that, by reason of advances made, the transferor may have the paramount interest in the item requires the rule.

The section is made subject to the provisions of Article 3 [Article 3-A] concerning conversion of instruments (Section 3-420) and restrictive indorsements (Section 3-206 [section 3-1206]). Of course instructions from or an agreement with its transferor does not relieve a collecting bank of its general obligation to exercise good faith and ordinary care. See Section 4-103(a) [section 4-103(1)]. If in any particular case a bank has exercised good faith and ordinary care and is relieved of responsibility by reason of instructions of or an agreement with its transferor, the owner of the item may still have a remedy for loss against the transferor (another bank) if such transferor has given wrongful instructions.

The rules of the section are applied only to collecting banks. Payor banks always have the problem of making proper payment of an item; whether such payment is proper should be based upon all of the rules of Articles 3 [Article 3-A] and 4 and all of the facts of any particular case, and should not be dependent exclusively upon instructions from or an agreement with a person presenting the item.

Sec. B-21. 11 MRSA §4-204 is amended to read:

§4-204. Methods of sending and presenting; sending directly to payor bank

(1) A collecting bank ~~must~~ shall send items by a reasonably prompt method, taking into consideration ~~any~~ relevant instructions, the nature of the item, the number of ~~such~~ those items on hand, ~~and~~ the cost of collection involved and the method generally used by it or others to present ~~such~~ those items.

(2) A collecting bank may send:

(a) ~~Any~~ An item ~~direct~~ directly to the payor bank;

(b) ~~Any~~ An item to ~~any~~ a nonbank payor if authorized by its transferor; and

(c) ~~Any~~ An item other than documentary drafts to ~~any~~ a ~~non-bank~~ nonbank payor, if authorized by federal reserve regulation or operating ~~letter~~ circular, ~~clearing--house~~ clearinghouse rule or the like.

(3) Presentment may be made by a presenting bank at a place where the payor bank or other payor has requested that presentment be made.

Uniform Commercial Code Comment

1. Subsection (a) [subsection (1)] prescribes the general standards applicable to proper sending or forwarding of items. Because of the many types of methods available and the desirability of preserving flexibility any attempt to prescribe limited or precise methods is avoided.

2. Subsection (b)(1) [subsection (2)(a)] codifies the practice of direct mail, express, messenger or like presentment to payor banks. The practice is now country-wide and is justified by the need for speed, the general responsibility of banks, Federal Deposit Insurance protection and other reasons.

3. Full approval of the practice of direct sending is limited to cases in which a bank is a payor. Since nonbank drawees or payors may be of unknown responsibility, substantial risks may be attached to placing in their hands the instruments calling for payments from them. This is obviously so in the case of documentary drafts. However, in some cities practices have long existed under clearing-house procedures to forward certain types of items to certain nonbank payors. Examples include insurance loss drafts drawn by field agents on home offices. For the purpose of leaving the door open to legitimate practices of this kind, subsection (b)(3) [subsection (2)(c)] affirmatively approves direct sending of any item other than documentary drafts to any nonbank payor, if authorized by Federal Reserve regulation or operating circular, clearing-house rule or the like.

On the other hand subsection (b)(2) [subsection (2)(b)] approves sending any item directly to a nonbank payor if authorized by a collecting bank's transferor. This permits special instructions or agreements out of the norm and is consistent with the "chain of command" theory of Section 4-203. However, if a transferor other than the owner of the item, e.g., a prior collecting bank, authorizes a direct sending to a nonbank payor, such transferor assumes responsibility for the propriety or impropriety of such authorization.

4. Section 3-501(b) [section 3-1501(2)] provides where presentment may be made. This provision is expressly subject to Article 4. Section 4-204(c) [section 4-204(3)] specifically approves presentment by a presenting bank at any place requested by the payor bank or other payor. The time when a check is received by a payor bank for presentment is governed by Regulation CC Section 229.36(b).

Sec. B-22. 11 MRSA §4-205 is repealed and the following enacted in its place:

§4-205. Depositary bank holder of unindorsed item

If a customer delivers an item to a depositary bank for collection:

(1) The depositary bank becomes a holder of the item at the time it receives the item for collection if the customer at the time of delivery was a holder of the item, whether or not the customer indorses the item, and, if the bank satisfies the other requirements of section 3-1302, it is a holder in due course; and

(2) The depositary bank warrants to collecting banks, the payor bank or other payor and the drawer that the amount of the item was paid to the customer or deposited to the customer's account.

Uniform Commercial Code Comment

Section 3-201(b) [section 3-1201(2)] provides that negotiation of an instrument payable to order requires indorsement by the holder. The rule of former Section 4-205(1) was that the depositary bank may supply a missing indorsement of its customer unless the item contains the words "payee's indorsement required" or the like. The cases have differed on the status of the depositary bank as a holder if it fails to supply its customer's indorsement. Marine Midland Bank, N.A. v. Price, Miller, Evans & Flowers, 446 N.Y.S.2d 797 (N.Y.Apo. Div.4th Dept. 1981), rev'd, 455 N.Y.S.2d 565 (N.Y. 1982). [sic] It is common practice for depositary banks to receive unindorsed checks under so-called "lock-box" agreements from customers who receive a high volume of checks. No function would be served by requiring a depositary bank to run these items through a machine that would supply the customer's indorsement except to afford the drawer and the subsequent banks evidence that the proceeds of the item reached the customer's account. Paragraph (1) [subsection (1)] provides that the depositary bank becomes a holder when it takes the item for deposit if the depositor is a holder. Whether it supplies the customer's indorsement is immaterial. Paragraph (2) [subsection (2)] satisfies the need for a receipt of funds by the depositary bank by imposing on that bank a warranty that it paid the customer or deposited the item to the customer's account. This warranty runs not only to collecting banks and to the payor bank or nonbank drawee but also to the drawer, affording protection to these parties that the depositary bank received the item and applied it to the benefit of the holder.

Sec. B-23. 11 MRSA §4-206 is amended to read:

§4-206. Transfer between banks

Any agreed method ~~which~~ that identifies the transferor bank is sufficient for the item's further transfer to another bank.

Uniform Commercial Code Comment

This section is designed to permit the simplest possible form of transfer from one bank to another, once an item gets in the bank collection chain, provided only identity of the transferor bank is preserved. This is important for tracing purposes and if recourse is necessary. However, since the responsibilities of the various banks appear in the Article it becomes unnecessary to have liability or responsibility depend on more formal indorsements. Simplicity in the form of transfer is conducive to speed. If the transfer is between banks, this section takes the place of the more formal requirements of Section 3-201 [section 3-1201].

Sec. B-24. 11 MRSA §4-207 is repealed.

Sec. B-25. 11 MRSA §4-207-A is enacted to read:

§4-207-A. Transfer warranties

(1) A customer or collecting bank that transfers an item and receives a settlement or other consideration warrants to the transferee and to any subsequent collecting bank that:

(a) The warrantor is a person entitled to enforce the item;

(b) All signatures on the item are authentic and authorized;

(c) The item has not been altered;

(d) The item is not subject to a defense or claim in recoupment (section 3-1305, subsection (1)) of any party that can be asserted against the warrantor; and

(e) The warrantor has no knowledge of any insolvency proceeding commenced with respect to the maker or acceptor or, in the case of an unaccepted draft, the drawer.

(2) If an item is dishonored, a customer or collecting bank transferring the item and receiving settlement or other consideration is obliged to pay the amount due on the item:

(a) According to the terms of the item at the time it was transferred; or

(b) If the transfer was of an incomplete item, according to its terms when completed as stated in sections 3-1115 and 3-1407.

The obligation of a transferor is owed to the transferee and to any subsequent collecting bank that takes the item in good faith. A transferor can not disclaim its obligation under this subsection by an indorsement stating that it is made "without recourse" or otherwise disclaiming liability.

(3) A person to whom the warranties under subsection (1) are made and who took the item in good faith may recover from the warrantor as damages for breach of warranty an amount equal to the loss suffered as a result of the breach, but not more than the amount of the item plus expenses and loss of interest incurred as a result of the breach.

(4) The warranties stated in subsection (1) can not be disclaimed with respect to checks. Unless notice of a claim for breach of warrant is given to the warrantor within 30 days after the claimant has reason to know of the breach and the identity of the warrantor, the warrantor is discharged to the extent of any loss caused by the delay in giving notice of the claim.

(5) A cause of action for breach of warranty under this section accrues when the claimant has reason to know of the breach.

Uniform Commercial Code Comment

Except for subsection (b) [subsection (2)], this section conforms to Section 3-416 [section 3-1416] and extends its coverage to items. The substance of this section is discussed in the Comment to Section 3-416 [section 3-1416]. Subsection (b) [subsection (2)] provides that customers or collecting banks that transfer items, whether by indorsement or not, undertake to pay the item if the item is dishonored. This obligation cannot be disclaimed by a "without recourse" indorsement or otherwise. With respect to checks, Regulation CC Section 229.34 states the warranties made by paying and returning banks.

Sec. B-26. 11 MRSA §4-207-B is enacted to read:

§4-207-B. Presentment warranties

(1) If an unaccepted draft is presented to the drawee for payment or acceptance and the drawee pays or accepts the draft, the person obtaining payment or acceptance, at the time of presentment and a previous transferor of the draft, at the time of transfer, warrant to the drawee that pays or accepts the draft in good faith that:

(a) The warrantor is, or was, at the time the warrantor transferred the draft, a person entitled to enforce the draft or authorized to obtain payment or acceptance of the draft on behalf of a person entitled to enforce the draft;

(b) The draft has not been altered; and

(c) The warrantor has no knowledge that the signature of the purported drawer of the draft is unauthorized.

(2) A drawee making payment may recover from a warrantor damages for breach of warranty equal to the amount paid by the drawee less the amount the drawee received or is entitled to receive from the drawer because of the payment. In addition, the drawee is entitled to compensation for expenses and loss of interest resulting from the breach. The right of the drawee to recover damages under this subsection is not affected by any failure of the drawee to exercise ordinary care in making payment. If the drawee accepts the draft:

(a) Breach of warranty is a defense to the obligation of the acceptor; and

(b) If the acceptor makes payment with respect to the draft, the acceptor is entitled to recover from a warrantor for breach of warranty the amounts stated in this subsection.

(3) If a drawee asserts a claim for breach of warranty under subsection (1) based on an unauthorized indorsement of the draft or an alteration of the draft, the warrantor may defend by proving that the indorsement is effective under section 3-1404 or 3-1405 or the drawer is precluded under section 3-1406 or 4-406 from asserting against the drawee the unauthorized indorsement or alteration.

(4) If a dishonored draft is presented for payment to the drawer or an indorser or any other item is presented for payment to a party obliged to pay the item, and the item is paid, the person obtaining payment and a prior transferor of the item warrant to the person making payment in good faith that the warrantor is, or was, at the time the warrantor transferred the item, a person entitled to enforce the item or authorized to obtain payment on behalf of a person entitled to enforce the item. The person making payment may recover from any warrantor for breach of warranty an amount equal to the amount paid plus expenses and loss of interest resulting from the breach.

(5) The warranties stated in subsections (1) and (4) can not be disclaimed with respect to checks. Unless notice of a

claim for breach of warranty is given to the warrantor within 30 days after the claimant has reason to know of the breach and the identity of the warrantor, the warrantor is discharged to the extent of any loss caused by the delay in giving notice of the claim.

(6) A cause of action for breach of warranty under this section accrues when the claimant has reason to know of the breach.

Uniform Commercial Code Comment

This section conforms to Section 3-417 [section 3-1417] and extends its coverage to items. The substance of this section is discussed in the Comment to Section 3-417 [section 3-1417]. "Draft" is defined in Section 4-104 as including an item that is an order to pay so as to make clear that the term "draft" in Article 4 may include items that are not instruments within Section 3-104 [section 3-1104].

Sec. B-27. 11 MRSA §4-207-C is enacted to read:

§4-207-C. Encoding and retention warranties

(1) A person who encodes information on or with respect to an item after issue warrants to any subsequent collecting bank and to the payor bank or other payor that the information is correctly encoded. If the customer of a depositary bank encodes, that bank also makes the warranty.

(2) A person who undertakes to retain an item pursuant to an agreement for electronic presentment warrants to any subsequent collecting bank and to the payor bank or other payor that retention and presentment of the item comply with the agreement. If a customer of a depositary bank undertakes to retain an item, that bank also makes this warranty.

(3) A person to whom warranties are made under this section and who took the item in good faith may recover from the warrantor as damages for breach of warranty an amount equal to the loss suffered as a result of the breach, plus expenses and loss of interest incurred as a result of the breach.

Uniform Commercial Code Comment

1. Encoding and retention warranties are included in Article 4 because they are unique to the bank collection process. These warranties are breached only by the person doing the encoding or retaining the item and not by subsequent banks handling the item. Encoding and check retention may be done by

customers who are payees of a large volume of checks; hence, this section imposes warranties on customers as well as banks. If a customer encodes or retains, the depositary bank is also liable for any breach of this warranty.

2. A misencoding of the amount on the MICR line is not an alteration under Section 3-407(a) [section 3-1407(1)] which defines alteration as changing the contract of the parties. If a drawer wrote a check for $2,500 and the depositary bank encoded $25,000 on the MICR line, the payor bank could debit the drawer's account for only $2,500. This subsection would allow the payor bank to hold the depositary bank liable for the amount paid out over $2,500 without first pursuing the person who received payment. Intervening collecting banks would not be liable to the payor bank for the depositary bank's error. If a drawer wrote a check for $25,000 and the depositary bank encoded $2,500, the payor bank becomes liable for the full amount of the check. The payor bank's rights against the depositary bank depend on whether the payor bank has suffered a loss. Since the payor bank can debit the drawer's account for $25,000, the payor bank has a loss only to the extent that the drawer's account is less than the full amount of the check. There is no requirement that the payor bank pursue collection against the drawer beyond the amount in the drawer's account as a condition to the payor bank's action against the depositary bank for breach of warranty. See Georgia Railroad Bank & Trust Co. v. First National Bank & Trust, 229 S.E.2d 482 (Ga. App. 1976), aff'd, 235 S.E.2d 1 (Ga. 1977), and First National Bank of Boston v. Fidelity Bank, National Association, 724 F.Supp. 1168 (E.D. Pa. 1989).

3. A person retaining items under an electronic presentment agreement (Section 4-110) warrants that it has complied with the terms of the agreement regarding its possession of the item and its sending a proper presentment notice. If the keeper is a customer, its depositary bank also makes this warranty.

Sec. B-28. 11 MRSA §4-208 is amended to read:

§4-208. Security interest of collecting bank in items, accompanying documents and proceeds

(1) A collecting bank has a security interest in an item and any accompanying documents or the proceeds of either~~,~~:

(a) In case of an item deposited in an account, to the extent to which credit given for the item has been withdrawn or applied;

(b) In case of an item for which it has given credit available for withdrawal as of right, to the extent of the

credit given whether or not the credit is drawn upon ~~and~~ ~~whether~~ or ~~not~~ there is a right of charge-back; or

(c) If it makes an advance on or against the item.

(2) ~~When~~ If credit ~~which has been given~~ for several items received at one time or pursuant to a single agreement is withdrawn or applied in part, the security interest remains upon all the items, any accompanying documents or the proceeds of either. For the purpose of this section, credits first given are first withdrawn.

(3) Receipt by a collecting bank of a final settlement for an item is a realization on its security interest in the item, accompanying documents and proceeds. ~~To the extent and so~~ So long as the bank does not receive final settlement for the item or give up possession of the item or accompanying documents for purposes other than collection, the security interest continues to that extent and is subject to ~~the provisions of~~ Article 9, ~~except that~~ but:

(a) No security agreement is necessary to make the security interest enforceable (section 9-203, subsection (1), paragraph (b)); and

(b) No filing is required to perfect the security interest; and

(c) The security interest has priority over conflicting perfected security interests in the item, accompanying documents or proceeds.

Uniform Commercial Code Comment

1. Subsection (a) [subsection (1)] states a rational rule for the interest of a bank in an item. The customer of the depositary bank is normally the owner of the item and the several collecting banks are agents of the customer (Section 4-201). A collecting agent may properly make advances on the security of paper held for collection, and acquires at common law a possessory lien for these advances. Subsection (a) [subsection (1)] applies an analogous principle to a bank in the collection chain which extends credit on items in the course of collection. The bank has a security interest to the extent stated in this section. To the extent of its security interest it is a holder for value (Sections 3-303 [section 3-1303], 4-211) and a holder in due course if it satisfies the other requirements for that status (Section 3-302 [section 3-1302]). Subsection (a) [subsection (1)] does not derogate from the banker's general common law lien or right of setoff against indebtedness owing in

deposit accounts. See Section 1-103. Rather subsection (a) [subsection (1)] specifically implements and extends the principle as a part of the bank collection process.

2. Subsection (b) [subsection (2)] spreads the security interest of the bank over all items in a single deposit or received under a single agreement and a single giving of credit. It also adopts the "first-in, first-out" rule.

3. Collection statistics establish that the vast majority of items handled for collection are in fact collected. The first sentence of subsection (c) [subsection (3)] reflects the fact that in the normal case the bank's security interest is self-liquidating. The remainder of the subsection correlates the security interest with the provisions of Article 9, particularly for use in the cases of noncollection in which the security interest may be important.

Sec. B-29. 11 MRSA §4-209 is amended to read:

§4-209. When bank gives value for purposes of holder in due course

For purposes of determining its status as a holder in due course, ~~the~~ a bank has given value to the extent ~~that~~ it has a security interest in an item, ~~provided that~~ if the bank otherwise complies with the requirements of section ~~3-302~~ 3-1302 on what constitutes a holder in due course.

Uniform Commercial Code Comment

The section completes the thought of the previous section and makes clear that a security interest in an item is "value" for the purpose of determining the holder's status as a holder in due course. The provision is in accord with the prior law (N.I.L. Section 27) and with Article 3 [Article 3-A] (Section 3-303 [section 3-1303]). The section does not prescribe a security interest under Section 4-210 [section 4-208] as a test of "value" generally because the meaning of "value" under other Articles is adequately defined in Section 1-201.

Sec. B-30. 11 MRSA §4-210, as amended by PL 1979, c. 541, Pt. A, §108, is further amended to read:

§4-210. Presentment by notice of item not payable by, through or at a bank; liability of drawer or indorser

(1) Unless otherwise instructed, a collecting bank may present an item not payable by, through or at a bank by sending to the party to accept or pay a written notice that the bank holds the item for acceptance or payment. The notice must be

sent in time to be received on or before the day when presentment is due and the bank must meet any requirement of the party to accept or pay under section ~~3-505~~ 3-1501 by the close of the bank's next banking day after it knows of the requirement.

(2) ~~Where~~ If presentment is made by notice and ~~neither honor nor~~ payment, acceptance or request for compliance with a requirement under section ~~3-505~~ 3-1501 is not received by the close of business on the day after maturity or in the case of demand items by the close of business on the 3rd banking day after notice was sent, the presenting bank may treat the item as dishonored and charge any ~~secondary party~~ drawer or indorser by sending ~~him~~ it notice of the facts.

Uniform Commercial Code Comment

1. This section codifies a practice extensively followed in presentation of trade acceptances and documentary and other drafts drawn on nonbank payors. It imposes a duty on the payor to respond to the notice of the item if the item is not to be considered dishonored. Notice of such a dishonor charges drawers and indorsers. Presentment under this section is good presentment under Article 3 [Article 3-A]. See Section 3-501 [section 3-1501].

2. A drawee not receiving notice is not, of course, liable to the drawer for wrongful dishonor.

3. A bank so presenting an instrument must be sufficiently close to the drawee to be able to exhibit the instrument on the day it is requested to do so or the next business day at the latest.

Sec. B-31. 11 MRSA §4-211 is repealed.

Sec. B-32. 11 MRSA §4-211-A is enacted to read:

~~§4-211-A.~~ Medium and time of ~~settlement~~ by bank

(1) With respect to settlement by a bank, the medium and time of settlement may be prescribed by Federal Reserve regulations or circulars, clearing-house rules and the like or agreement. In the absence of such prescription:

(a) The medium of settlement is cash or credit to an account in a Federal Reserve bank of or specified by the person to receive settlement; and

(b) The time of settlement is:

(i) With respect to tender of settlement by cash, a cashier's check or teller's check, when the cash or check is sent or delivered;

(ii) With respect to tender of settlement by credit in an account in a Federal Reserve bank, when the credit is made;

(iii) With respect to tender of settlement by a credit or debit to an account in a bank, when the credit or debit is made or, in the case of tender of settlement by authority to charge an account, when the authority is sent or delivered; or

(iv) With respect to tender of settlement by a funds transfer, when payment is made pursuant to section 4-1406, subsection (1) to the person receiving settlement.

(2) If the tender of settlement is not by a medium authorized by subsection (1) or the time of settlement is not fixed by subsection (1), no settlement occurs until the tender of settlement is accepted by the person receiving settlement.

(3) If settlement for an item is made by cashier's check or teller's check and, before its midnight deadline, the person receiving settlement:

(a) Presents or forwards the check for collection, settlement is final when the check is finally paid; or

(b) Fails to present or forward the check for collection, settlement is final at the midnight deadline of the person receiving settlement.

(4) If settlement for an item is made by giving authority to charge the account of the bank giving settlement in the bank receiving settlement, settlement is final when the charge is made by the bank receiving settlement if there are funds available in the account for the amount of the item.

Uniform Commercial Code Comment

1. Subsection (a) [subsection (1)] sets forth the medium of settlement that the person receiving settlement must accept. In nearly all cases the medium of settlement will be determined by agreement or by Federal Reserve regulations and circulars, clearing-house rules, and the like. In the absence of regulations, rules or agreement, the person receiving settlement may demand cash or credit in a Federal Reserve bank. If the

person receiving settlement does not have an account in a Federal Reserve bank, it may specify the account of another bank in a Federal Reserve bank. In the unusual case in which there is no agreement on the medium of settlement and the bank making settlement tenders settlement other than cash or Federal Reserve bank credit, no settlement has occurred under subsection (b) [subsection (2)] unless the person receiving settlement accepts the settlement tendered. For example, if a payor bank, without agreement, tenders a teller's check, the bank receiving the settlement may reject the check and return it to the payor bank or it may accept the check as settlement.

2. In several provisions of Article 4 the time that a settlement occurs is relevant. Subsection (a) [subsection (1)] sets out a general rule that the time of settlement, like the means of settlement, may be prescribed by agreement. In the absence of agreement, the time of settlement for tender of the common agreed media of settlement is that set out in subsection (a)(2) [subsection (1)(b)]. The time of settlement by cash, cashier's or teller's check or authority to charge an account is the time the cash, check or authority is sent, unless presentment is over the counter in which case settlement occurs upon delivery to the presenter. If there is no agreement on the time of settlement and the tender of settlement is not made by one of the media set out in subsection (a) [subsection (1)], under subsection (b) [subsection (2)] the time of settlement is the time the settlement is accepted by the person receiving settlement.

3. Subsections (c) and (d) [subsections (3) and (4)] are special provisions for settlement by remittance drafts and authority to charge an account in the bank receiving settlement. The relationship between final settlement and final payment under Section 4-215 [section 4-213] is addressed in subsection (b) [subsection (1-A)] of Section 4-215 [section 4-213]. With respect to settlement by cashier's checks or teller's checks, other than in response to over-the-counter presentment, the bank receiving settlement can keep the risk that the check will not be paid on the bank tendering the check in settlement by acting to initiate collection of the check within the midnight deadline of the bank receiving settlement. If the bank fails to initiate settlement before its midnight deadline, final settlement occurs at the midnight deadline, and the bank receiving settlement assumes the risk that the check will not be paid. If there is no agreement that permits the bank tendering settlement to tender a cashier's or teller's check, subsection (b) [subsection (2)] allows the bank receiving the check to reject it, and, if it does, no settlement occurs. However, if the bank accepts the check, settlement occurs and the time of final settlement is governed by subsection (c) [subsection (3)].

With respect to settlement by tender of authority to charge the account of the bank making settlement in the bank receiving settlement, subsection (d) [subsection (4)] provides that final settlement does not take place until the account charged has available funds to cover the amount of the item. If there is no agreement that permits the bank tendering settlement to tender an authority to charge an account as settlement, subsection (b) [subsection (2)] allows the bank receiving the tender to reject it. However, if the bank accepts the authority, settlement occurs and the time of final settlement is governed by subsection (d) [subsection (4)].

Sec. B-33. 11 MRSA §4-212 is amended to read:

§4-212. Right of charge-back or refund; liability of collecting bank; return of item

(1) If a collecting bank has made provisional settlement with its customer for an item and ~~itself~~ fails by reason of dishonor, suspension of payments by a bank or otherwise to receive a settlement for the item which is or becomes final, the bank may revoke the settlement given by it, charge back the amount of any credit given for the item to its customer's account or obtain refund from its customer whether or not it is able to return the item, if by its midnight deadline or within a longer reasonable time after it learns the facts it returns the item or sends notification of the facts. If the return or notice is delayed beyond the bank's midnight deadline or a longer reasonable time after it learns the facts, the bank may revoke the settlement, charge back the credit or obtain refund from its customer, but it is liable for any loss resulting from the delay. These rights to revoke, ~~charge-back~~ charge back and obtain refund terminate if, and when a settlement for the item received by the bank is or becomes final ~~(section 4-211, subsection (3), and section 4-213, subsections (2) and (3))~~.

~~(2) Within the time and manner prescribed by this section and section 4-301, an intermediary or payor bank, as the case may be, may return an unpaid item directly to the depositary bank and may send for collection a draft on the depositary bank and obtain reimbursement. In such case, if the depositary bank has received provisional settlement for the item, it must reimburse the bank drawing the draft and any provisional credits for the item between banks shall become and remain final.~~

(2-A) A collecting bank returns an item when it is sent or delivered to the bank's customer or transferor or pursuant to its instructions.

(3) A depositary bank ~~which~~ that is also the payor may ~~charge-back~~ charge back the amount of an item to its customer's account or obtain refund in accordance with the section governing return of an item received by a payor bank for credit on its books (section 4-301).

(4) The right to ~~charge-back~~ charge back is not affected by:

(a) ~~Prior~~ Previous use of ~~the~~ a credit given for the item; or

(b) Failure by any bank to exercise ordinary care with respect to the item, but ~~any~~ a bank so failing remains liable.

(5) A failure to ~~charge-back~~ charge back or claim refund does not affect other rights of the bank against the customer or any other party.

(6) If credit is given in dollars as the equivalent of the value of an item payable in a foreign ~~currency~~ money, the dollar amount of any charge-back or refund ~~shall~~ must be calculated on the basis of the ~~buying--sight~~ bank-offered spot rate for the foreign ~~currency~~ money prevailing on the day when the person entitled to the charge-back or refund learns that it will not receive payment in ordinary course.

Uniform Commercial Code Comment

1. Under current bank practice, in a major portion of cases banks make provisional settlement for items when they are first received and then await subsequent determination of whether the item will be finally paid. This is the principal characteristic of what are referred to in banking parlance as "cash items." Statistically, this practice of settling provisionally first and then awaiting final payment is justified because the vast majority of such cash items are finally paid, with the result that in this great preponderance of cases it becomes unnecessary for the banks making the provisional settlements to make any further entries. In due course the provisional settlements become final simply with the lapse of time. However, in those cases in which the item being collected is not finally paid or if for various reasons the bank making the provisional settlement does not itself receive final payment, provision is made in subsection (a) [subsection (1)] for the reversal of the provisional settlements, charge-back of provisional credits and the right to obtain refund.

2. Various causes of a bank's not receiving final payment, with the resulting right of charge-back or refund, are stated or

suggested in subsection (a) [subsection (1)]. These include dishonor of the original item; dishonor of a remittance instrument given for it; reversal of a provisional credit for the item; suspension of payments by another bank. The causes stated are illustrative; the right of charge-back or refund is stated to exist whether the failure to receive final payment in ordinary course arises through one of them "or otherwise."

3. The right of charge-back or refund exists if a collecting bank has made a provisional settlement for an item with its customer but terminates if and when a settlement received by the bank for the item is or becomes final. If the bank fails to receive such a final settlement the right of charge-back or refund must be exercised promptly after the bank learns the facts. The right exists (if so promptly exercised) whether or not the bank is able to return the item. The second sentence of subsection (a) [subsection (1)] adopts the view of Appliance Buyers Credit Corp. v. Prospect National Bank, 708 F.2d 290 (7th Cir. 1983), that if the midnight deadline for returning an item or giving notice is not met, a collecting bank loses its rights only to the extent of damages for any loss resulting from the delay.

4. Subsection (b) [subsection (2-A)] states when an item is returned by a collecting bank. Regulation CC, Section 229.31 preempts this subsection with respect to checks by allowing direct return to the depositary bank. Because a returned check may follow a different path than in forward collection, settlement given for the check is final and not provisional except as between the depositary bank and its customer. Regulation CC Section 229.36(d). See also Regulations CC Sections 229.31(c) and 229.32(b). Thus owing to the federal preemption, this subsection applies only to noncheck items.

5. The rule of subsection (d) [subsection (4)] relating to charge-back (as distinguished from claim for refund) applies irrespective of the cause of the nonpayment, and of the person ultimately liable for nonpayment. Thus charge-back is permitted even if nonpayment results from the depositary bank's own negligence. Any other rule would result in litigation based upon a claim for wrongful dishonor of other checks of the customer, with potential damages far in excess of the amount of the item. Any other rule would require a bank to determine difficult questions of fact. The customer's protection is found in the general obligation of good faith (Sections 1-203 and 4-103). If bad faith is established the customer's recovery "includes other damages, if any, suffered by the party as a proximate consequence" (Section 4-103(e) [section 4-103(5)]; see also Section 4-402).

6. It is clear that the charge-back does not relieve the bank from any liability for failure to exercise ordinary care in handling the item. The measure of damages for such failure is stated in Section 4-103(e) [section 4-103(5)].

7. Subsection (f) [subsection (6)] states a rule fixing the time for determining the rate of exchange if there is a charge-back or refund of a credit given in dollars for an item payable in a foreign currency. Compare Section 3-107 [section 3-1107]. Fixing such a rule is desirable to avoid disputes. If in any case the parties wish to fix a different time for determining the rate of exchange, they may do so by agreement.

Sec. B-34. 11 MRSA §4-213, as amended by PL 1979, c. 541, Pt. A, §§109 and 110, is further amended to read:

§4-213. Final payment of item by payor bank; when provisional debits and credits become final; when certain credits become available for withdrawal

(1) An item is finally paid by a payor bank when the bank has first done any of the following~~,-whichever-happens-first~~:

(a) Paid the item in cash; ~~or~~

(b) Settled for the item without ~~reserving~~ having a right to revoke the settlement ~~and-without-having-such-right~~ under statute, ~~clearinghouse~~ clearing-house rule or agreement; or

~~(c)---Completed--the--process--of--posting--the--item--to--the indicated-account-of-the-drawer,-maker-or-other-person-to-be charged-therewith;-or~~

(d) Made a provisional settlement for the item and failed to revoke the settlement in the time and manner permitted by statute, ~~clearinghouse~~ clearing-house rule or agreement.

~~Upon--a--final-payment--under--paragraphs--(b),--(c)--or--(d)--the payor-bank-shall-be-accountable-for-the-amount-of-the-item.~~

(1-A) If provisional settlement for an item does not become final, the item is not finally paid.

(2) If provisional settlement for an item between the presenting and payor banks is made through a clearinghouse or by debits and credits in an account between them, then to the extent that provisional debits or credits for the ~~time~~ item are entered in accounts between the presenting and payor banks or between the presenting and successive prior collecting banks seriatim, they become final upon final payment of the item by the payor bank.

(3) If a collecting bank receives a settlement for an item which is or becomes final ~~(section 4-211, subsection (3), section 4-213, subsection (2))~~, the bank is accountable to its customer for the amount of the item and any provisional credit given for the item in an account with its customer becomes final.

(4) Subject to applicable law stating a time for availability of funds and any right of the bank to apply the credit to an obligation of the customer, credit given by a bank for an item in ~~an account with its customer~~ a customer's account becomes available for withdrawal as of right:

(a) ~~In any case where~~ If the bank has received a provisional settlement for the item, when ~~such~~ the settlement becomes final and the bank has had a reasonable time to ~~learn that the settlement is final~~ receive return of the item and the item has not been received within that time; or

(b) ~~In any case where~~ If the bank is both a the depositary bank and a the payor bank and the item is finally paid, at the opening of the bank's ~~second~~ 2nd banking day following receipt of the item.

(5) ~~A deposit of money in a bank is final when made, but, subject~~ Subject to applicable law stating a time for availability of funds and any right of ~~the~~ a bank to apply ~~the~~ a deposit to an obligation of the ~~customer~~ depositor, ~~the~~ a deposit of money becomes available for withdrawal as of right at the opening of the bank's next banking day ~~following~~ after receipt of the deposit.

Uniform Commercial Code Comment

1. By the definition and use of the term "settle" (Section 4-104(a)(11) [section 4-104(1)(j)]) this Article recognizes that various debits or credits, remittances, settlements or payments given for an item may be either provisional or final, that settlements sometimes are provisional and sometimes are final and sometimes are provisional for awhile but later become final. Subsection (a) [subsection (1)] defines when settlement for an item constitutes final payment.

Final payment of an item is important for a number of reasons. It is one of several factors determining the relative priorities between items and notices, stop-payment orders, legal process and setoffs (Section 4-303). It is the "end of the line" in the collection process and the "turn around" point commencing the return flow of proceeds. It is the point at which many

provisional settlements become final. See Section 4-215(c) [section 4-213(2)]. Final payment of an item by the payor bank fixes preferential rights under Section 4-216 [section 4-214].

2. If an item being collected moves through several states, e.g., is deposited for collection in California, moves through two or three California banks to the Federal Reserve Bank of San Francisco, to the Federal Reserve Bank of Boston, to a payor bank in Maine, the collection process involves the eastward journey of the item from California to Maine and the westward journey of the proceeds from Maine to California. Subsection (a) [subsection (1)] recognizes that final payment does not take place, in this hypothetical case, on the journey of the item eastward. It also adopts the view that neither does final payment occur on the journey westward because what in fact is journeying westward are proceeds of the item.

3. Traditionally and under various decisions payment in cash of an item by a payor bank has been considered final payment. Subsection (a)(1) [subsection (1)(a)] recognizes and provides that payment of an item in cash by a payor bank is final payment.

4. Section 4-104(a)(11) [section 4-104(1)(j)] defines "settle" as meaning "to pay in cash, by clearing-house settlement, in a charge or credit or by remittance, or otherwise as agreed. A settlement may be either provisional or final." Subsection (a)(2) [subsection (1)(b)] of Section 4-215 [section 4-213] provides that an item is finally paid by a payor bank when the bank has "settled for the item without having a right to revoke the settlement under statute, clearing-house rule or agreement." Former subsection (1)(b) is modified by subsection (a)(2) [subsection (1)(b)] to make clear that a payor bank cannot make settlement provisional by unilaterally reserving a right to revoke the settlement. The right must come from a statute (e.g., Section 4-301), clearing-house rule or other agreement. Subsection (a)(2) [subsection (1)(b)] provides in effect that if the payor bank finally settles for an item this constitutes final payment of the item. The subsection operates if nothing has occurred and no situation exists making the settlement provisional. If under statute, clearing-house rule or agreement, a right of revocation of the settlement exists, the settlement is provisional. Conversely, if there is an absence of a right to revoke under statute, clearing-house rule or agreement, the settlement is final and such final settlement constitutes final payment of the item.

A primary example of a statutory right on the part of the payor bank to revoke a settlement is the right to revoke conferred by Section 4-301. The underlying theory and reason for

deferred posting statutes (Section 4-301) is to require a settlement on the date of receipt of an item but to keep that settlement provisional with the right to revoke prior to the midnight deadline. In any case in which Section 4-301 is applicable, any settlement by the payor bank is provisional solely by virtue of the statute, subsection (a)(2) [subsection (1)(b)] of Section 4-215 [section 4-213] does not operate, and such provisional settlement does not constitute final payment of the item. With respect to checks, Regulation CC Section 229.36(d) provides that settlement between banks for the forward collection of checks is final. The relationship of this provision to Article 4 is discussed in the Commentary to that section.

A second important example of a right to revoke a settlement is that arising under clearing-house rules. It is very common for clearing-house rules to provide that items exchanged and settled for in a clearing (e.g., before 10:00 a.m. on Monday) may be returned and the settlements revoked up to but not later than 2:00 p.m. on the same day (Monday) or under deferred posting at some hour on the next business day (e.g., 2:00 p.m. Tuesday). Under this type of rule the Monday morning settlement is provisional and being provisional does not constitute a final payment of the item.

An example of an agreement allowing the payor bank to revoke a settlement is a case in which the payor bank is also the depositary bank and has signed a receipt or duplicate deposit ticket or has made an entry in a passbook acknowledging receipt, for credit to the account of A, of a check drawn on it by B. If the receipt, deposit ticket, passbook or other agreement with A is to the effect that any credit so entered is provisional and may be revoked pending the time required by the payor bank to process the item to determine if it is in good form and there are funds to cover it, the agreement keeps the receipt or credit provisional and avoids its being either final settlement or final payment.

The most important application of subsection (a)(2) [subsection (1)(b)] is that in which presentment of an item has been made over the counter for immediate payment. In this case Section 4-301(a) [section 4-301(1)] does not apply to make the settlement provisional, and final payment has occurred unless a rule or agreement provides otherwise.

5. Former Section 4-213(1)(c) provided that final payment occurred when the payor bank completed the "process of posting." The term was defined in former Section 4-109. In the present Article, Section 4-109 has been deleted and the process-of-posting test has been abandoned in Section 4-215(a)

[section 4-213(1)] for determining when final payment is made. Difficulties in determining when the events described in former Section 4-109 take place make the process-of-posting test unsuitable for a system of automated check collection or electronic presentment.

6. The last sentence of former Section 4-213(1) is deleted as an unnecessary source of confusion. Initially the view that payor bank may be accountable for, that is, liable for the amount of, an item that it has already paid seems incongruous. This is particularly true in the light of the language formerly found in Section 4-302 stating that the payor bank can defend against liability for accountability by showing that it has already settled for the item. But, at least with respect to former Section 4-213(1)(c), such a provision was needed because under the process-of-posting test a payor bank may have paid an item without settling for it. Now that Article 4 has abandoned the process-of-posting test, the sentence is no longer needed. If the payor bank has neither paid the item nor returned it within its midnight deadline, the payor bank is accountable under Section 4-302.

7. Subsection (a)(3) [subsection (1)(d)] covers the situation in which the payor bank makes a provisional settlement for an item, and this settlement becomes final at a later time by reason of the failure of the payor bank to revoke it in the time and manner permitted by statute, clearing-house rule or agreement. An example of this type of situation is the clearing-house settlement referred to in Comment 4. In the illustration there given if the time limit for the return of items received in the Monday morning clearing is 2:00 p.m. on Tuesday and the provisional settlement has not been revoked at that time in a manner permitted by the clearing-house rules, the provisional settlement made on Monday morning becomes final at 2:00 p.m. on Tuesday. Subsection (a)(3) [subsection (1)(d)] provides specifically that in this situation the item is finally paid at 2:00 p.m. Tuesday. If on the other hand a payor bank receives an item in the mail on Monday and makes some provisional settlement for the item on Monday, it has until midnight on Tuesday to return the item or give notice and revoke any settlement under Section 4-301. In this situation subsection (a)(3) [subsection (1)(d)] of Section 4-215 [section 4-213] provides that if the provisional settlement made on Monday is not revoked before midnight on Tuesday as permitted by Section 4-301, the item is finally paid at midnight on Tuesday. With respect to checks, Regulation CC Section 229.30 (c) allows an extension of the midnight deadline under certain circumstances. If a bank does not expeditiously return a check liability may accrue under Regulation CC Section 229.38. For the relationship of that liability to responsibility under this Article, see Regulation CC Sections 229.30 and 229.38.

8. Subsection (b) [subsection (1-A)] relates final settlement to final payment under Section 4-215 [section 4-213]. For example, if a payor bank makes provisional settlement for an item by sending a cashier's or teller's check and that settlement fails to become final under Section 4-213(c) [section 4-211-A(3)], subsection (b) [subsection (1-A)] provides that final payment has not occurred. If the item is not paid, the drawer remains liable, and under Section 4-302(a) [section 4-302(1)] the payor bank is accountable unless it has returned the item before its midnight deadline. In this regard, subsection (b) [subsection (1-A)] is an exception to subsection (a)(3) [subsection (1)(d)]. Even if the payor bank has not returned an item by its midnight deadline there is still no final payment if provisional settlement had been made and settlement failed to become final. However, if presentment of the item was over the counter for immediate payment, final payment has occurred under Section 4-215(a)(2) [section 4-213(1)(b)]. Subsection (b) [subsection (1-A)] does not apply because the settlement was not provisional. Section 4-301(a) [section 4-301(1)]. In this case the presenting person, often the payee of the item, has the right to demand cash or the cash equivalent of federal reserve credit. If the presenting person accepts another medium of settlement such as a cashier's or teller's check, the presenting person takes the risk that the payor bank may fail to pay a cashier's check because of insolvency or that the drawee of a teller's check may dishonor it.

9. Subsection (c) [subsection (2)] states the country-wide usage that when the item is finally paid by the payor bank under subsection (a) [subsection (1)] this final payment automatically without further action "firms up" other provisional settlements made for it. However, the subsection makes clear that this "firming up" occurs only if the settlement between the presenting and payor banks was made either through a clearing house or by debits and credits in accounts between them. It does not take place if the payor bank remits for the item by sending some form of remittance instrument. Further, the "firming up" continues only to the extent that provisional debits and credits are entered seriatim in accounts between banks which are successive to the presenting bank. The automatic "firming up" is broken at any time that any collecting bank remits for the item by sending a remittance draft, because final payment to the remittee then usually depends upon final payment of the remittance draft.

10. Subsection (d) [subsection (3)] states the general rule that if a collecting bank receives settlement for an item which is or becomes final, the bank is accountable to its customer for the amount of the item. One means of accounting is to remit to its customer the amount it has received on the item. If

previously it gave to its customer a provisional credit for the item in an account its receipt of final settlement for the item "firms up" this provisional credit and makes it final. When this credit given by it so becomes final, in the usual case its agency status terminates and it becomes a debtor to its customer for the amount of the item. See Section 4-201(a) [section 4-201(1)]. If the accounting is by a remittance instrument or authorization to charge further time will usually be required to complete its accounting (Section 4-213 [section 4-211-A]).

11. Subsection (e) [subsection (4)] states when certain credits given by a bank to its customer become available for withdrawal as of right. Subsection (e)(1) [subsection (4)(a)] deals with the situation in which a bank has given a credit (usually provisional) for an item to its customer and in turn has received a provisional settlement for the item from an intermediary or payor bank to which it has forwarded the item. In this situation before the provisional credit entered by the collecting bank in the account of its customer becomes available for withdrawal as of right, it is not only necessary that the provisional settlement received by the bank for the item becomes final but also that the collecting bank has a reasonable time to receive return of the item and the item has not been received within that time. How much time is "reasonable" for these purposes will of course depend on the distance the item has to travel and the number of banks through which it must pass (having in mind not only travel time by regular lines of transmission but also the successive midnight deadlines of the several banks) and other pertinent facts. Also, if the provisional settlement received is some form of a remittance instrument or authorization to charge, the "reasonable" time depends on the identity and location of the payor of the remittance instrument, the means for clearing such instrument, and other pertinent facts. With respect to checks Regulation CC Sections 229.10-229.13 or similar applicable state law (Section 229.20) control. This is also time for the situation described in Comment 12.

12. Subsection (e)(2) [subsection (4)(b)] deals with the situation of a bank that is both a depositary bank and a payor bank. The subsection recognizes that if A and B are both customers of a depositary-payor bank and A deposits B's check on the depositary-payor in A's account on Monday, time must be allowed to permit the check under the deferred posting rules of Section 4-301 to reach the bookkeeper for B's account at some time on Tuesday, and, if there are insufficient funds in B's account, to reverse or charge back the provisional credit in A's account. Consequently this provisional credit in A's account does not become available for withdrawal as of right until the opening of business on Wednesday. If it is determined on Tuesday that there are insufficient funds in B's account to pay the

check, the credit to A's account can be reversed on Tuesday. On the other hand if the item is in fact paid on Tuesday, the rule of subsection (e)(2) [subsection (4)(b)] is desirable to avoid uncertainty and possible disputes between the bank and its customer as to exactly what hour within the day the credit is available.

Sec. B-35. 11 MRSA §4-214 is amended to read:

§4-214. Insolvency and preference

(1) ~~Any~~ If an item is in or ~~coming~~ comes into the possession of a payor or collecting bank ~~which~~ that suspends payment and ~~which~~ the item ~~is~~ has not been finally paid ~~shall~~ , the item must be returned by the receiver, trustee or agent in charge of the closed bank to the presenting bank or the closed bank's customer.

(2) If a payor bank finally pays an item and suspends payments without making a settlement for the item with its customer or the presenting bank which settlement is or becomes final, the owner of the item has a preferred claim against the payor bank.

(3) If a payor bank gives or a collecting bank gives or receives a provisional settlement for an item and thereafter suspends payments, the suspension does not prevent or interfere with the ~~settlement~~ settlement's becoming final if ~~such~~ the finality occurs automatically upon the lapse of certain time or the happening of certain events ~~(section 4-211, subsection (3), section 4-213, subsection (1), paragraph (d), subsections (2) and (3))~~.

(4) If a collecting bank receives from subsequent parties settlement for an item, which settlement is or becomes final and the bank suspends payments without making a settlement for the item with its customer which settlement is or becomes final, the owner of the item has a preferred claim against ~~such~~ the collecting bank.

Uniform Commercial Code Comment

1. The underlying purpose of the provisions of this section is not to confer upon banks, holders of items or anyone else preferential positions in the event of bank failures over general depositors or any other creditors of the failed banks. The purpose is to fix as definitely as possible the cut-off point of time for the completion or cessation of the collection process in the case of items that happen to be in the process at the time a particular bank suspends payments. It must be remembered that in

bank collections as a whole and in the handling of items by an individual bank, items go through a whole series of processes. It must also be remembered that at any particular point of time a particular bank (at least one of any size) is functioning as a depositary bank for some items, as an intermediary bank for others, as a presenting bank for still others and as a payor bank for still others, and that when it suspends payments it will have close to its normal load of items working through its various processes. For the convenience of receivers, owners of items, banks, and in fact substantially everyone concerned, it is recognized that at the particular moment of time that a bank suspends payment, a certain portion of the items being handled by it have progressed far enough in the bank collection process that it is preferable to permit them to continue the remaining distance, rather than to send them back and reverse the many entries that have been made or the steps that have been taken with respect to them. Therefore, having this background and these purposes in mind, the section states what items must be turned backward at the moment suspension intervenes and what items have progressed far enough that the collection process with respect to them continues, with the resulting necessary statement of rights of various parties flowing from this prescription of the cut-off time.

2. The rules stated are similar to those stated in the American Bankers Association Bank Collection Code, but with the abandonment of any theory of trust. On the other hand, some law previous to this Act may be relevant. See Note, Uniform Commercial Code: Stopping Payment of an Item Deposited with an Insolvent Depositary Bank, 40 Okla. L. Rev. 689 (1987). Although for practical purposes Federal Deposit Insurance affects materially the result of bank failures on holders of items and banks, no attempt is made to vary the rules of the section by reason of such insurance.

3. It is recognized that in view of Jennings v. United States Fidelity & Guaranty Co., 294 U.S. 216, 55 S.Ct. 394, 79 L.Ed. 869, 99 A.L.R. 1248 (1935), amendment of the National Bank Act would be necessary to have this section apply to national banks. But there is no reason why it should not apply to others. See Section 1-108.

Sec. B-36. 11 MRSA §4-301 is amended to read:

§4-301. Deferred posting; recovery of payment by return of items; time of dishonor; return of items by payor bank

(1) ~~Where an authorized settlement~~ If a payor bank settles for a demand item ~~(~~other than a documentary draft~~)~~ ~~received by a payor bank~~ presented otherwise than for immediate payment over

the counter ~~has been made~~ before midnight of the banking day of receipt, the payor bank may revoke the settlement and recover ~~any payment~~ the settlement, if, before it has made final payment ~~(section 4-213, subsection (1))~~ and before its midnight deadline, it:

(a) Returns the item; or

(b) Sends written notice of dishonor or nonpayment, if the item is ~~held for protest or is otherwise~~ unavailable for return.

(2) If a demand item is received by a payor bank for credit on its books, it may return ~~such~~ the item or send notice of dishonor and may revoke any credit given or recover the amount thereof withdrawn by its customer, if it acts within the time limit and in the manner specified in subsection (1).

(3) Unless previous notice of dishonor has been sent, an item is dishonored at the time when for purposes of dishonor it is returned or notice sent in accordance with this section.

(4) An item is returned:

(a) As to an item ~~received~~ presented through a clearing house, when it is delivered to the presenting or last collecting bank or to the clearing house or is sent or delivered in accordance with ~~its~~ clearing-house rules; or

(b) In all other cases, when it is sent or delivered to the bank's customer or transferor or pursuant to ~~his~~ instructions.

Uniform Commercial Code Comment

1. The term "deferred posting" appears in the caption of Section 4-301. This refers to the practice permitted by statute in most of the states before the UCC under which a payor bank receives items on one day but does not post the items to the customer's account until the next day. Items dishonored were then returned after the posting on the day after receipt. Under Section 4-301 the concept of "deferred posting" merely allows a payor bank that has settled for an item on the day of receipt to return a dishonored item on the next day before its midnight deadline, without regard to when the item was actually posted. With respect to checks Regulation CC Section 229.30(c) extends the midnight deadline under the UCC under certain circumstances. See the Commentary to Regulation CC Section 229.38(d) on the relationship between the UCC and Regulation CC on settlement.

2. The function of this section is to provide the circumstances under which a payor bank that has made timely settlement for an item may return the item and revoke the settlement so that it may recover any settlement made. These circumstances are: (1) the item must be a demand item other than a documentary draft; (2) the item must be presented otherwise than for immediate payment over the counter; and (3) the payor bank must return the item (or give notice if the item is unavailable for return) before its midnight deadline and before it has paid the item. With respect to checks, see Regulation CC Section 229.31(f) on notice in lieu of return and Regulation CC Section 229.33 as to the different requirement of notice of nonpayment. An instance of when an item may be unavailable for return arises under a collecting bank check retention plan under which presentment is made by a presentment notice and the item is retained by the collecting bank. Subsection 4-215(a)(2) [section 4-213(1)(b)] provides that final payment occurs if the payor bank has settled for an item without a right to revoke the settlement under statute, clearing-house rule or agreement. In any case in which Section 4-301(a) [section 4-301(1)] is applicable, the payor bank has a right to revoke the settlement by statute; therefore, Section 4-215(a)(2) [section 4-213(1)(b)] is inoperable, and the settlement is provisional. Hence, if the settlement is not over the counter and the payor bank settles in a manner that does not constitute final payment, the payor bank can revoke the settlement by returning the item before its midnight deadline.

3. The relationship of Section 4-301(a) [section 4-301(1)] to final settlement and final payment under Section 4-215 [section 4-213] is illustrated by the following case. Depositary Bank sends by mail an item to Payor Bank with instructions to settle by remitting a teller's check drawn on a bank in the city where Depositary Bank is located. Payor Bank sends the teller's check on the day the item was presented. Having made timely settlement, under the deferred posting provisions of Section 4-301(a) [section 4-301(1)], Payor Bank may revoke that settlement by returning the item before its midnight deadline. If it fails to return the item before its midnight deadline, it has finally paid the item if the bank on which the teller's check was drawn honors the check. But if the teller's check is dishonored there has been no final settlement under Section 4-213(c) [section 4-211-A(3)] and no final payment under Section 4-215(b) [section 4-213(1-A)]. Since the Payor Bank has neither paid the item nor made timely return, it is accountable for the item under Section 4-302(a) [section 4-302(1)].

4. The time limits for action imposed by subsection (a) [subsection (1)] are adopted by subsection (b) [subsection (2)] for cases in which the payor bank is also the depositary bank,

but in this case the requirement of a settlement on the day of receipt is omitted.

5. Subsection (c) [subsection (3)] fixes a base point from which to measure the time within which notice of dishonor must be given. See Section 3-503 [section 3-1503].

6. Subsection (d) [subsection (4)] leaves banks free to agree upon the manner of returning items but establishes a precise time when an item is "returned." For definition of "sent" as used in paragraphs (1) and (2) [paragraphs (a) and (b)] see Section 1-201(38). Obviously the subsection assumes that the item has not been "finally paid" under Section 4-215(a) [section 4-213(1)]. If it has been, this provision has no operation.

7. The fact that an item has been paid under proposed Section 4-215 [section 4-213] does not preclude the payor bank from asserting rights of restitution or revocation under Section 3-418 [section 3-1418]. National Savings and Trust Co. v. Park Corp., 722 F.2d 1303 (6th Cir. 1983), cert. denied, 466 U.S. 939 (1984), is the correct interpretation of the present law on this issue.

Sec. B-37. 11 MRSA §4-302 is repealed and the following enacted in its place:

§4-302. Payor bank's responsibility for late return of item

(1) If an item is presented to and received by a payor bank, the bank is accountable for the amount of:

(a) A demand item, other than a documentary draft, whether properly payable or not, if the bank, in any case in which it is not also the depositary bank, retains the item beyond midnight of the banking day of receipt without settling for it or, whether or not it is also the depositary bank, does not pay or return the item or send notice of dishonor until after its midnight deadline; or

(b) Any other properly payable item, unless, within the time allowed for acceptance or payment of that item, the bank either accepts or pays the item or returns it and accompanying documents.

(2) The liability of a payor bank to pay an item pursuant to subsection (1) is subject to defenses based on breach of a presentment warrant (section 4-207-B) or proof that the person seeking enforcement of the liability presented or transferred the item for the purpose of defrauding the payor bank.

Uniform Commercial Code Comment

1. Subsection (a)(1) [subsection (1)(a)] continues the former law distinguishing between cases in which the payor bank is not also the depositary bank and those in which the payor bank is also the depositary bank ("on us" items). For "on us" items the payor bank is accountable if it retains the item beyond its midnight deadline without settling for it. If the payor bank is not the depositary bank it is accountable if it retains the item beyond midnight of the banking day of receipt without settling for it. It may avoid accountability either by settling for the item on the day of receipt and returning the item before its midnight deadline under Section 4-301 or by returning the item on the day of receipt. This rule is consistent with the deferred posting practice authorized by Section 4-301 which allows the payor bank to make provisional settlement for an item on the day of receipt and to revoke that settlement by returning the item on the next day. With respect to checks, Regulation CC Section 229.36(d) provides that settlements between banks for forward collection of checks are final when made. See the Commentary on that provision for its effect on the UCC.

2. If the settlement given by the payor bank does not become final, there has been no payment under Section 4-215(b) [section 4-213(1-A)], and the payor bank giving the failed settlement is accountable under subsection (a)(1) [subsection (1)(a)] of Section 4-302. For instance, the payor bank makes provisional settlement by sending a teller's check that is dishonored. In such a case settlement is not final under Section 4-213(c) [section 4-211-A(3)] and no payment occurs under Section 4-215(b) [section 4-213(1-A)]. Payor bank is accountable on the item. The general principle is that unless settlement provides the presenting bank with usable funds, settlement has failed and the payor bank is accountable for the amount of the item.

3. Subsection (b) [subsection (2)] is an elaboration of the deleted introductory language of former Section 4-302: "In the absence of a valid defense such as breach of a presentment warranty (subsection (1) of Section 4-207 [section 4-207-A]), settlement effected or the like ... ." A payor bank can defend an action against it based on accountability by showing that the item contained a forged indorsement or a fraudulent alteration. Subsection (b) [subsection (2)] drops the ambiguous "or the like" language and provides that the payor bank may also raise the defense of fraud. Decisions that hold an accountable bank's liability to be "absolute" are rejected. A payor bank that makes a late return of an item should not be liable to a defrauder operating a check kiting scheme. In Bank of Leumi Trust Co. v. Bally's Park Place Inc., 528 F.Supp. 349 (S.D.N.Y. 1981), and American National Bank v. Foodbasket, 497 P.2d 546 (Wyo. 1972),

banks that were accountable under Section 4-302 for missing their midnight deadline were successful in defending against parties who initiated collection knowing that the check would not be paid. The "settlement effected" language is deleted as unnecessary. If a payor bank is accountable for an item it is liable to pay it. If it has made final payment for an item, it is no longer accountable for the item.

Sec. B-38. 11 MRSA §4-303, as amended by PL 1979, c. 541, Pt. A, §111 is further amended to read:

§4-303. When items subject to notice, stop-payment order, legal process or setoff; order in which items may be charged or certified

(1) Any knowledge, notice or ~~stop~~ stop-payment order received by, legal process served upon or setoff exercised by a payor bank~~, whether or not effective under other rules of law~~ comes too late to terminate, suspend or modify the bank's right or duty to pay an item or to charge its customer's account for the item~~, comes too late to so terminate, suspend or modify such right or duty~~ if the knowledge, notice, ~~stop~~ stop-payment order or legal process is received or served and a reasonable time for the bank to act thereon expires or the setoff is exercised after the ~~bank has done any~~ earliest of the following:

(a) ~~Accepted or certified~~ The bank accepts or certifies the item;

(b) ~~Paid~~ The bank pays the item in cash;

(c) ~~Settled~~ The bank settles for the item without ~~reserving~~ having a right to revoke the settlement ~~and without having such right~~ under statute, ~~clearing-house~~ clearing-house rule or agreement;

~~(d) Completed the process of posting the item to the indicated account of the drawer, maker or other person to be charged therewith or otherwise has evidenced by examination of such indicated account and by action its decision to pay the item, or~~

(e) ~~Become~~ The bank becomes accountable for the amount of the item under ~~section 4-213, subsection (1), paragraph (d) and under~~ section 4-302 dealing with the payor bank's responsibility for late return of items~~,~~; or

(f) With respect to checks, a cutoff hour no earlier that on hours after the opening of the next banking day after the banking day on which the bank received the check and no

later than the close of that next banking day or, if no cutoff hour is fixed, the close of the next banking day after the banking day on which the bank received the check.

(2) Subject to ~~the provisions of~~ subsection (1), items may be accepted, paid, certified or charged to the indicated account of its customer in any order ~~convenient to the bank~~.

Uniform Commercial Code Comment

1. While a payor bank is processing an item presented for payment, it may receive knowledge or a legal notice affecting the item, such as knowledge or a notice that the drawer has filed a petition in bankruptcy or made an assignment for the benefit of creditors; may receive an order of the drawer stopping payment on the item; may have served on it an attachment of the account of the drawer; or the bank itself may exercise a right of setoff against the drawer's account. Each of these events affects the account of the drawer and may eliminate or freeze all or part of whatever balance is available to pay the item. Subsection (a) [subsection (1)] states the rule for determining the relative priorities between these various legal events and the item.

2. The rule is that if any one of several things has been done to the item or if it has reached any one of several stages in its processing at the time the knowledge, notice, stop-payment order or legal process is received or served and a reasonable time for the bank to act thereon expires or the setoff is exercised, the knowledge, notice, stop-payment order, legal process or setoff comes too late, the item has priority and a charge to the customer's account may be made and is effective. With respect to the effect of the customer's bankruptcy, the bank's rights are governed by Bankruptcy Code Section 542(c) which codifies the result of Bank of Marin v. England, 385 U.S. 99 (1966). Section 4-405 applies to the death or incompetence of the customer.

3. Once a payor bank has accepted or certified an item or has paid the item in cash, the event has occurred that determines priorities between the item and the various legal events usually described as the "four legals." Paragraphs (1) and (2) [paragraphs (a) and (b)] of subsection (a) [subsection (1)] so provide. If a payor bank settles for an item presented over the counter for immediate payment by a cashier's check or teller's check which the presenting person agrees to accept, paragraph (3) [paragraph (c)] of subsection (a) [subsection (1)] would control and the event determining priority has occurred. Because presentment was over the counter, Section 4-301(a) [subsection 4-301(1)] does not apply to give the payor bank the statutory right to revoke the settlement. Thus the requirements of

paragraph (3) [paragraph (c)] have been met unless a clearing-house rule or agreement of the parties provides otherwise.

4. In the usual case settlement for checks is by entries in bank accounts. Since the process-of-posting test has been abandoned as inappropriate for automated check collection, the determining event for priorities is a given hour on the day after the item is received. (Paragraph (5) [paragraph (f)] of subsection (a) [subsection (1)].) The hour may be fixed by the bank no earlier than one hour after the opening on the next banking day after the bank received the check and no later than the close of that banking day. If an item is received after the payor bank's regular Section 4-108 [section 4-107] cutoff hour, it is treated as received the next banking day. If a bank receives an item after its regular cutoff hour on Monday and an attachment is levied at noon on Tuesday, the attachment is prior to the item if the bank had not before that hour taken the action described in paragraphs (1), (2), and (3) [paragraphs (a), (b) and (c)] of subsection (a) [subsection (1)]. The Commentary to Regulation CC Section 229.36(d) explains that even though settlement by a paying bank for a check is final for Regulation CC purposes, the paying bank's right to return the check before its midnight deadline under the UCC is not affected.

5. Another event conferring priority for an item and a charge to the customer's account based upon the item is stated by the language "become accountable for the amount of the item under Section 4-302 dealing with the payor bank's responsibility for late return of items." Expiration of the deadline under Section 4-302 with resulting accountability by the payor bank for the amount of the item, establishes priority of the item over notices, stop-payment orders, legal process or setoff.

6. In the case of knowledge, notice, stop-payment orders and legal process the effective time for determining whether they were received too late to affect the payment of an item and a charge to the customer's account by reason of such payment, is receipt plus a reasonable time for the bank to act on any of these communications. Usually a relatively short time is required to communicate to the accounting department advice of one of these events but certainly some time is necessary. Compare Sections 1-201(27) and 4-403. In the case of setoff the effective time is when the setoff is actually made.

7. As between one item and another no priority rule is stated. This is justified because of the impossibility of stating a rule that would be fair in all cases, having in mind the almost infinite number of combinations of large and small checks in relation to the available balance on hand in the

drawer's account; the possible methods of receipt; and other variables. Further, the drawer has drawn all the checks, the drawer should have funds available to meet all of them and has no basis for urging one should be paid before another; and the holders have no direct right against the payor bank in any event, unless of course, the bank has accepted, certified or finally paid a particular item, or has become liable for it under Section 4-302. Under subsection (b) [subsection (2)] the bank has the right to pay items for which it is itself liable ahead of those for which it is not.

Sec. B-39. 11 MRSA §4-401 is amended to read:

§4-401. ~~When bank~~ may charge customer's account

(1) ~~As against its customer,~~ a A bank may charge against ~~his~~ the account ~~any~~ of a customer an item ~~which~~ that is ~~otherwise~~ properly payable from that account even though the charge creates an overdraft. An item is properly payable if it is authorized by the customer and is in accordance with any agreement between the customer and bank.

(1-A) A customer is not liable for the amount of an overdraft if the customer neither signed the item nor benefited from the proceeds of the item.

(1-B) A bank may charge against the account of a customer a check that is otherwise properly payable from the account, even though payment was made before the date of the check, unless the customer has given notice to the bank of the postdating describing the check with reasonable certainty. The notice is effective for the period stated in section 4-403, subsection (2) for stop-payment orders and must be received at such time and in such manner as to afford the bank a reasonable opportunity to act on it before the bank takes any action with respect to the check described in section 4-303. If a bank charges against the account of a customer a check before the date stated in the notice of postdating, the bank is liable for damages for the loss resulting from its act. The loss may include damages for dishonor of subsequent items under section 4-402.

(2) A bank ~~which~~ that in good faith makes payment to a holder may charge the indicated account of its customer according to:

(a) The original ~~tenor~~ terms of ~~his~~ the altered item; or

(b) The ~~tenor~~ terms of ~~his~~ the completed item, even though the bank knows the item has been completed unless the bank has notice that the completion was improper.

Uniform Commercial Code Comment

1. An item is properly payable from a customer's account if the customer has authorized the payment and the payment does not violate any agreement that may exist between the bank and its customer. For an example of a payment held to violate an agreement with a customer, see Torrance National Bank v. Enesco Federal Credit Union, 285 P.2d 737 (Cal.App. 1955). An item drawn for more than the amount of a customer's account may be properly payable. Thus under subsection (a) [subsection (1)] a bank may charge the customer's account for an item even though payment results in an overdraft. An item containing a forged drawer's signature or forged indorsement is not properly payable. Concern has arisen whether a bank may require a customer to execute a stop-payment order when the customer notifies the bank of the loss of an unindorsed or specially indorsed check. Since such a check cannot be properly payable from the customer's account, it is inappropriate for a bank to require stop-payment order in such a case.

2. Subsection (b) [subsection (1-A)] adopts the view of case authority holding that if there is more than one customer who can draw on an account, the nonsigning customer is not liable for an overdraft unless that person benefits from the proceeds of the item.

3. Subsection (c) [subsection (1-B)] is added because the automated check collection system cannot accommodate postdated checks. A check is usually paid upon presentment without respect to the date of the check. Under the former law, if a payor bank paid a postdated check before its stated date, it could not charge the customer's account because the check was not "properly payable." Hence, the bank might have been liable for wrongfully dishonoring subsequent checks of the drawer that would have been paid had the postdated check not been prematurely paid. Under subsection (c) [subsection (1-B)] a customer wishing to postdate a check must notify the payor bank of its postdating in time to allow the bank to act on the customer's notice before the bank has to commit itself to pay the check. If the bank fails to act on the customer's timely notice, it may be liable for damages for the resulting loss which may include damages for dishonor of subsequent items. This Act does not regulate fees that banks charge their customers for a notice of postdating or other services covered by the Act, but under principles of law such as unconscionability or good faith and fair dealing, courts have reviewed fees and the bank's exercise of a discretion to set fees. Perdue v. Crocker National Bank, 38 Cal.3d 913 (1985) (unconscionability); Best v. United Bank of Oregon, 739 P.2d 554, 562-566 (1987) (good faith and fair dealing). In addition,

Section 1-203 provides that every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.

4. Section 3-407(c) [section 3-1407(3)] states that a payor bank or drawee which pays a fraudulently altered instrument in good faith and without notice of the alteration may enforce rights with respect to the instrument according to its original terms or, in the case of an incomplete instrument altered by unauthorized completion, according to its terms as completed. Section 4-401(d) [section 4-401(2)] follows the rule stated in Section 3-407(c) [section 3-1407(3)] by applying it to an altered item and allows the bank to enforce rights with respect to the altered item by charging the customer's account.

Sec. B-40. 11 MRSA §4-402 is repealed and the following enacted in its place:

§4-402. Bank's liability to customer for wrongful dishonor; time of determining insufficiency of account

(1) Except as otherwise provided in this Article, a payor bank wrongfully dishonors an item if it dishonors an items that is properly payable, but a bank may dishonor an item that would create an overdraft unless it has agreed to pay the overdraft.

(2) A payor bank is liable to its customer for damages approximately caused by the wrongful dishonor of an item. Liability is limited to actual damages proved and may include damages for an arrest or prosecution of the customer or other consequential damages. Whether any consequential damages are approximately caused by the wrongful dishonor is a question of fact to be determined in each case.

(3) A payor bank's determination of the customer's account balance on which a decision to dishonor for insufficiency of available funds is based may be made at any time between the time the item is received by the payor bank and the time that the payor bank returns the item or gives notice in lieu of return, and no more than one determination need be made. If, at the election of the payor bank, a subsequent balance determination is made for the purpose of reevaluating the bank's decision to dishonor the item, the account balance at that time is determinative of whether a dishonor for insufficiency of available funds is wrongful.

Uniform Commercial Code Comment

1. Subsection (a) [subsection (1)] states positively what has been assumed under the original Article: that if a bank

fails to honor a properly payable item it may be liable to its customer for wrongful dishonor. Under subsection (b) [subsection (2)] the payor bank's wrongful dishonor of an item gives rise to a statutory cause of action. Damages may include consequential damages. Confusion has resulted from the attempts of courts to reconcile the first and second sentences of former Section 4-402. The second sentence implied that the bank was liable for some form of damages other than those approximately caused by the dishonor if the dishonor was other than by mistake. But nothing in the section described what these noncompensatory damages might be. Some courts have held that in distinguishing between mistaken dishonors and nonmistaken dishonors, the so-called "trader" rule has been retained that allowed a "merchant or trader" to recover substantial damages for wrongful dishonor without proof of damages actually suffered. Comment 3 to former Section 4-402 indicated that this was not the intent of the drafters. White & Summers, Uniform Commercial Code, Section 18-4 (1988), states: "The negative implication is that when wrongful dishonors occur not 'through mistake' but willfully, the court may impose damages greater than 'actual damages' ... . Certainly the reference to 'mistake' in the second sentence of 4-402 invites a court to adopt the relevant pre-Code distinction." Subsection (b) [subsection (2)] by deleting the reference to mistake in the second sentence precludes any inference that Section 4-402 retains the "trader" rule. Whether a bank is liable for noncompensatory damages, such as punitive damages, must be decided by Section 1-103 and Section 1-106 ("by other rule of law").

2. Wrongful dishonor is different from "failure to exercise ordinary care in handling an item," and the measure of damages is that stated in this section, not that stated in Section 4-103(e) [section 4-103(5)]. By the same token, if a dishonor comes within this section, the measure of damages of this section applies and not another measure of damages. If the wrongful refusal of the beneficiary's bank to make funds available from a funds transfer causes the beneficiary's check to be dishonored, no specific guidance is given as to whether recovery is under this section or Article 4A. In each case this issue must be viewed in its factual context, and it was thought unwise to seek to establish certainty at the cost of fairness.

3. The second and third sentences of the subsection (b) [subsection (2)] reject decisions holding that as a matter of law the dishonor of a check is not the "proximate cause" of the arrest and prosecution of the customer and leave to determination in each case as a question of fact whether the dishonor is or may be the "proximate cause."

4. Banks commonly determine whether there are sufficient funds in an account to pay an item after the close of banking hours on the day of presentment when they post debit and credit items to the account. The determination is made on the basis of credits available for withdrawal as of right or made available for withdrawal by the bank as an accommodation to its customer. When it is determined that payment of the item would overdraw the account, the item may be returned at any time before the bank's midnight deadline the following day. Before the item is returned new credits that are withdrawable as of right may have been added to the account. Subsection (c) [subsection (3)] eliminates uncertainty under Article 4 as to whether the failure to make a second determination before the item is returned on the day following presentment is a wrongful dishonor if new credits were added to the account on that day that would have covered the amount of the check.

5. Section 4-402 has been construed to preclude an action for wrongful dishonor by a plaintiff other than the bank's customer. Loucks v. Albuquerque National Bank, 418 P.2d 191 (N.Mex. 1966). Some courts have allowed a plaintiff other than the customer to sue when the customer is a business entity that is one and the same with the individual or individuals operating it. Murdaugh Volkswagen, Inc. v. First National Bank, 801 F.2d 719 (4th Cir. 1986) and Karsh v. American City Bank, 113 Cal.App.3d 419, 169 Cal.Rptr. 851 (1980). However, where the wrongful dishonor impugns the reputation of an operator of the business, the issue is not merely, as the court in Koger v. East First National Bank, 443 So.2d 141 (Fla.App. 1983), put it, one of a literal versus a liberal interpretation of Section 4-402. Rather the issue is whether the statutory cause of action in Section 4-402 displaces, in accordance with Section 1-103, any cause of action that existed at common law in a person who is not the customer whose reputation was damaged. See Marcum v. Security Trust and Savings Co., 221 Ala. 419, 129 So.74 (1930). While Section 4-402 should not be interpreted to displace the latter cause of action, the section itself gives no cause of action to other than a "customer," however that definition is construed, and thus confers no cause of action on the holder of a dishonored item. First American National Bank v. Commerce Union Bank, 692 S.W.2d 642 (Tenn.App. 1985).

Sec. B-41. 11 MRSA §4-403 is amended to read:

§4-403. Customer's right to stop payment; burden of proof of loss

(1) A customer ~~may by order to his bank stop payment of any item payable for his account but the order must be~~ or any person authorized to draw on the account if there is more than one person may stop payment of any item drawn on the customer's

account or close the account by an order to the bank describing the item or account with reasonable certainty received at ~~such~~ a time and in ~~such~~ a manner ~~as to afford~~ that affords the bank a reasonable opportunity to act on it ~~prior to~~ before any action by the bank with respect to the item described in section 4-303. If the signature of more than one person is required to draw on an account, any of these persons may stop payment or close the account.

(2) ~~An oral~~ stop-payment order is ~~binding upon the bank only for 14 calendar days unless confirmed in writing within that period~~ effective for 6 months, but it lapses after 14 calendar days if the original order was oral and was not confirmed in writing within that period. A ~~written~~ stop-payment order ~~is effective for only 6 months, unless renewed in writing~~ may be renewed for additional 6-month periods by a writing given to the bank within a period during which the stop-payment order is effective.

(3) The burden of establishing the fact and amount of loss resulting from the payment of an item contrary to a ~~binding stop payment~~ stop-payment order or order to close an account is on the customer. The loss from payment of an item contrary to a stop-payment order may include damages for dishonor of subsequent items under section 4-402.

Uniform Commercial Code Comment

1. The position taken by this section is that stopping payment or closing an account is a service which depositors expect and are entitled to receive from banks notwithstanding its difficulty, inconvenience and expense. The inevitable occasional losses through failure to stop or close should be borne by the banks as a cost of the business of banking.

2. Subsection (a) [subsection (1)] follows the decisions holding that a payee or indorsee has no right to stop payment. This is consistent with the provision governing payment or satisfaction. See Section 3-602 [section 3-1602]. The sole exception to this rule is found in Section 4-405 on payment after notice of death, by which any person claiming an interest in the account can stop payment.

3. Payment is commonly stopped only on checks; but the right to stop payment is not limited to checks, and extends to any item payable by any bank. If the maker of a note payable at a bank is in a position analogous to that of a drawer (Section 4-106 [section 4-105-A]) the maker may stop payment of the note. By analogy the rule extends to drawees other than banks.

4. A cashier's check or teller's check purchased by a customer whose account is debited in payment for the check is not a check drawn on the customer's account within the meaning of subsection (a) [subsection (1)]; hence, a customer purchasing a cashier's check or teller's check has no right to stop payment of such a check under subsection (a) [subsection (1)]. If a bank issuing a cashier's check or teller's check refuses to pay the check as an accommodation to its customer or for other reasons, its liability on the check is governed by Section 3-411 [section 3-1411]. There is no right to stop payment after certification of a check or other acceptance of a draft, and this is true no matter who procures the certification. See Sections 3-411 [section 3-1411] and 4-303. The acceptance is the drawee's own engagement to pay, and it is not required to impair its credit by refusing payment for the convenience of the drawer.

5. Subsection (a) [subsection (1)] makes clear that if there is more than one person authorized to draw on a customer's account any one of them can stop payment of any check drawn on the account or can order the account closed. Moreover, if there is a customer, such as a corporation, that requires its checks to bear the signatures of more than one person, any of these persons may stop payment on a check. In describing the item, the customer, in the absence of a contrary agreement, must meet the standard of what information allows the bank under the technology then existing to identify the item with reasonable certainty.

6. Under subsection (b) [subsection (2)], a stop-payment order is effective after the order, whether written or oral, is received by the bank and the bank has a reasonable opportunity to act on it. If the order is written it remains in effect for six months from that time. If the order is oral it lapses after 14 days unless there is written confirmation. If there is written confirmation within the 14-day period, the six-month period dates from the giving of the oral order. A stop-payment order may be renewed any number of times by written notice given during a six-month period while a stop order is in effect. A new stop-payment order may be given after a six-month period expires, but such a notice takes effect from the date given. When a stop-payment order expires it is as though the order had never been given, and the payor bank may pay the item in good faith under Section 4-404 even though a stop-payment order had once been given.

7. A payment in violation of an effective direction to stop payment is an improper payment, even though it is made by mistake or inadvertence. Any agreement to the contrary is invalid under Section 4-103(a) [section 4-103(1)] if in paying the item over the stop-payment order the bank has failed to exercise ordinary care. An agreement to the contrary which is imposed upon a

customer as part of a standard form contract would have to be evaluated in the light of the general obligation of good faith. Sections 1-203 and 4-104(c) [section 4-104(3)]. The drawee is, however, entitled to subrogation to prevent unjust enrichment (Section 4-407); retains common law defenses, e.g., that by conduct in recognizing the payment the customer has ratified the bank's action in paying over a stop-payment order (Section 1-103); and retains common law rights, e.g., to recover money paid under a mistake under Section 3-418 [section 3-1418]. It has sometimes been said that payment cannot be stopped against a holder in due course, but the statement is inaccurate. The payment can be stopped but the drawer remains liable on the instrument to the holder in due course (Sections 3-305, 3-414 [sections 3-1305, 3-1414]) and the drawee, if it pays, becomes subrogated to the rights of the holder in due course against the drawer. Section 4-407. The relationship between Sections 4-403 and 4-407 is discussed in the Comments to Section 4-407. Any defenses available against a holder in due course remain available to the drawer, but other defenses are cut off to the same extent as if the holder were bringing the action.

Sec. B-42. 11 MRSA §4-405 is amended to read:

§4-405. Death or incompetence of customer

(1) A payor or collecting bank's authority to accept, pay or collect an item or to account for proceeds of its collection, if otherwise effective, is not rendered ineffective by incompetence of a customer of either bank existing at the time the item is issued or its collection is undertaken, if the bank does not know of an adjudication of incompetence. Neither death nor incompetence of a customer revokes ~~such~~ the authority to accept, pay, collect or account until the bank knows of the fact of death or of an adjudication of incompetence and has reasonable opportunity to act on it.

(2) Even with knowledge, a bank may for 10 days after the date of death pay or certify checks drawn on or ~~prior to~~ before that date unless ordered to stop payment by a person claiming an interest in the account.

Uniform Commercial Code Comment

1. Subsection (a) [subsection (1)] follows existing decisions holding that a drawee (payor) bank is not liable for the payment of a check before it has notice of the death or incompetence of the drawer. The justice and necessity of the rule are obvious. A check is an order to pay which the bank must obey under penalty of possible liability for dishonor. Further, with the tremendous volume of items handled any rule that

required banks to verify the continued life and competency of drawers would be completely unworkable.

One or both of these same reasons apply to other phases of the bank collection and payment process and the rule is made wide enough to apply to these other phases. It applies to all kinds of "items"; to "customers" who own items as well as "customers" who draw or make them; to the function of collecting items as well as the function of accepting or paying them; to the carrying out of instructions to account for proceeds even though these may involve transfers to third parties; to depositary and intermediary banks as well as payor banks; and to incompetency existing at the time of the issuance of an item or the commencement of the collection or payment process as well as to incompetency occurring thereafter. Further, the requirement of actual knowledge makes inapplicable the rule of some cases that an adjudication of incompetency is constructive notice to all the world because obviously it is as impossible for banks to keep posted on such adjudications (in the absence of actual knowledge) as it is to keep posted as to death of immediate or remote customers.

2. Subsection (b) [subsection (2)] provides a limited period after death during which a bank may continue to pay checks (as distinguished from other items) even though it has notice. The purpose of the provision, as of the existing statutes, is to permit holders of checks drawn and issued shortly before death to cash them without the necessity of filing a claim in probate. The justification is that these checks normally are given in immediate payment of an obligation, that there is almost never any reason why they should not be paid, and that filing in probate is a useless formality, burdensome to the holder, the executor, the court and the bank.

This section does not prevent an executor or administrator from recovering the payment from the holder of the check. It is not intended to affect the validity of any gift causa mortis or other transfer in contemplation of death, but merely to relieve the bank of liability for the payment.

3. Any surviving relative, creditor or other person who claims an interest in the account may give a direction to the bank not to pay checks, or not to pay a particular check. Such notice has the same effect as a direction to stop payment. The bank has no responsibility to determine the validity of the claim or even whether it is "colorable." But obviously anyone who has an interest in the estate, including the person named as executor in a will, even if the will has not yet been admitted to probate, is entitled to claim an interest in the account.

Sec. B-43. 11 MRSA §4-406 is amended to read:

§4-406. Customer's duty to discover and report unauthorized signature or alteration

~~(1) When a bank sends to its customer a statement of account accompanied by items paid in good faith in support of the debit entries or holds the statement and items pursuant to a request for instructions of its customer or otherwise in a reasonable manner makes the statement and items available to the customer, the customer must exercise reasonable care and promptness to examine the statement and items to discover his unauthorized signature or any alteration on an item and must notify the bank promptly after discovery thereof.~~

(1-A) A bank that sends or makes available to a customer a statement of account showing payment of items for the account shall either return or make available to the customer the items paid or provide information in the statement of account sufficient to allow the customer reasonably to identify the items paid. The statement of account provides sufficient information if the item is described by item number, amount and date of payment.

(1-B) If the items are not returned to the customer, the person retaining the items shall either retain the items or, if the items are destroyed, maintain the capacity to furnish legible copies of the items until the expiration of 7 years after receipt of the items. A customer may request an item from the bank that paid the item, and that bank must provide in a reasonable time either the item or, if the item has been destroyed or is not otherwise obtainable, a legible copy of the item.

(1-C) If a bank sends or makes available a statement of account or items pursuant to subsection (1-A), the customer must exercise reasonable promptness in examining the statement or the items to determine whether any payment was not authorized because of an alternation of an item or because a purported signature by or on behalf of the customer was not authorized. If, based on the statement or items provided, the customer should reasonably have discovered the unauthorized payment, the customer must promptly notify the bank of the relevant facts.

(2) If the bank ~~establishes~~ proves that the customer failed, with respect to an item, to comply with the duties imposed on the customer by subsection ~~(1)~~ (1-C), the customer is precluded from asserting against the bank:

(a) ~~His~~ The customer's unauthorized signature or any alteration on the item, if the bank also ~~establishes~~ proves that it suffered a loss by reason of ~~such~~ the failure; and

(b) ~~An~~ The customer's unauthorized signature or alteration by the same wrongdoer on any other item paid in good faith by the bank ~~after the first item and statement was available to the customer for a reasonable period not exceeding 14 calendar days and before the bank receives notification from the customer of any such unauthorized signature or alteration~~ if the payment was made before the bank received notice from the customer of the unauthorized signature or alteration and after the customer had been afforded a reasonable period of time, not exceeding 30 days, in which to examine the item or statement of account and notify the bank.

(3) The preclusion under subsection (2) does not apply, if the customer establishes lack of ordinary care on the part of the bank in paying the item(s).

(3-A) If subsection (2) applies and the customer proves that the bank failed to exercise ordinary care in paying the item and that the failure substantially contributed to loss, the loss is allocated between the customer precluded and the bank asserting the preclusion according to the extent to which the failure of the customer to comply with subsection (1-C) and the failure of the bank to exercise ordinary care contributed to the loss. If the customer proves that the bank did not pay the item in good faith, the preclusion under subsection (2) does not apply.

(4) Without regard to care or lack of care of either the customer or the bank, a customer, who does not within one year ~~from the time~~ after the statement and or items are made available to the customer (subsection ~~(1)~~ (1-A)) discover and report ~~his~~ the customer's unauthorized signature on or any alteration ~~on the face or back of the item or does not within 3 years from that time discover and report any unauthorized indorsement~~ on the item; is precluded from asserting against the bank ~~such~~ the unauthorized signature ~~or indorsement~~ or ~~such~~ alteration. If there is a preclusion under this subsection, the payor bank may not recover for breach of warranty under section 4-207-B with respect to the unauthorized signature or alternation to which the preclusion applies.

~~(5) If under this section a payor bank has a valid defense against a claim of a customer upon or resulting from payment of an item and waives or fails upon request to assert the defense, the bank may not assert against any collecting bank or other prior party presenting or transferring the item a claim based upon the unauthorized signature or alteration giving rise to the customer's claim.~~

Uniform Commercial Code Comment

1. Under subsection (a) [subsection (1-A)], if a bank that has paid a check or other item for the account of a customer makes available to the customer a statement of account showing payment of the item, the bank must either return the item to the customer or provide a description of the item sufficient to allow the customer to identify it. Under subsection (c) [subsection (1-C)], the customer has a duty to exercise reasonable promptness in examining the statement or the returned item to discover any unauthorized signature of the customer or any alteration and to promptly notify the bank if the customer should reasonably have discovered the unauthorized signature or alteration.

The duty stated in subsection (c) [subsection (1-C)] becomes operative only if the "bank sends or makes available a statement of account or items pursuant to subsection (a) [subsection (1-A)]." A bank is not under a duty to send a statement of account or the paid items to the customer; but, if it does not do so, the customer does not have any duties under subsection (c) [subsection (1-C)].

Under subsection (a) [subsection (1-A)], a statement of account must provide information "sufficient to allow the customer reasonably to identify the items paid." If the bank supplies its customer with an image of the paid item, it complies with this standard. But a safe harbor rule is provided. The bank complies with the standard of providing "sufficient information" if "the item is described by item number, amount, and date of payment." This means that the customer's duties under subsection (c) [subsection (1-C)] are triggered if the bank sends a statement of account complying with the safe harbor rule without returning the paid items. A bank does not have to return the paid items unless it has agreed with the customer to do so. Whether there is such an agreement depends upon the particular circumstances. See Section 1-201(3). If a bank has not agreed to return paid items, the customer may obtain particular paid items by requesting them pursuant to subsection (b) [subsection (1-B)] which is discussed in Comment 3.

The provision in subsection (a) [subsection (1-A)] that a statement of account contains "sufficient information if the item is described by item number, amount, and date of payment" is based upon the existing state of technology. This information was chosen because it can be obtained by the bank's computer from the check's MICR line without examination of the items involved. The other two items of information that the customer would normally want to know - the name of the payee and the date of the item - cannot currently be obtained from the MICR line. The safe harbor rule is important in determining the feasibility of payor

or collecting bank check retention plans. A customer who keeps a record of checks written, e.g., on the check stubs or carbonized copies of the checks supplied by the bank in the checkbook, will usually have sufficient information to identify the items on the basis of item number, amount, and date of payment. But customers who do not utilize these record-keeping methods may not. The policy decision is that accommodating customers who do not keep adequate records is not as desirable as accommodating customers who keep more careful records. This policy results in less cost to the check collection system and thus to all customers of the system. It is expected that technological advances such as image processing may make it possible for banks to give customers more information in the future in a manner that is fully compatible with automation or truncation systems. At that time the Permanent Editorial Board may wish to make recommendations for an amendment revising the safe harbor requirements in the light of those advances.

2. Subsection (d) [subsection (2)] states the consequences of a failure by the customer to perform its duty under subsection (c) [subsection (1-C)] to report an alteration or the customer's unauthorized signature. Subsection (d)(1) [subsection (2)(a)] applies to the unauthorized payment of the item to which the duty to report under subsection (c) [subsection (1-C)] applies. If the bank proves that the customer "should reasonably have discovered the unauthorized payment" and did not notify the bank, the customer is precluded from asserting against the bank the alteration or the customer's unauthorized signature if the bank proves that it suffered a loss as a result of the failure of the customer to perform its subsection (c) [subsection (1-C)] duty. Subsection (d)(2) [subsection (2)(b)] applies to cases in which the customer fails to report an unauthorized signature or alteration with respect to an item in breach of the subsection (c) [subsection (1-C)] duty and the bank subsequently pays others items of the customer with respect to which there is an alteration or unauthorized signature of the customer and the same wrongdoer is involved. If the payment of the subsequent items occurred after the customer has had a reasonable time (not exceeding 30 days) to report with respect to the first item and before the bank received notice of the unauthorized signature or alteration of the first item, the customer is precluded from asserting the alteration or unauthorized signature with respect to the subsequent items.

If the bank does not return the paid items and, as a consequence, the customer could not "reasonably have discovered the unauthorized payment," there is no preclusion under subsection (d) [subsection (2)]. If the customer made a record of the issued checks on the check stub or carbonized copies furnished by the bank in the checkbook, the customer should

usually be able to verify the paid items shown on the statement of account and discover any unauthorized or altered checks. But there could be exceptional circumstances. For example, if a check is altered by changing the name of the payee, the customer could not normally detect the fraud unless the customer is given the paid check or the statement of account discloses the name of the payee of the altered check. If the customer could not "reasonably have discovered the unauthorized payment" under subsection (c) [subsection (1-C)] there would not be a preclusion under subsection (d) [subsection (2)].

The "safe harbor" provided in subsection (a) [subsection (1-A)] serves to permit a bank, based on the state of existing technology, to trigger the customer's duties under subsection (c) [subsection (1-C)] by providing a "statement of account showing payment of items" without having to return the paid items, in any case in which the bank has not agreed with the customer to return the paid items. The "safe harbor" does not, however, necessarily preclude a customer under subsection (d) [subsection (2)] from asserting its unauthorized signature or an alteration against a bank in those circumstances in which under subsection (c) [subsection (1-C)] the customer should not "reasonably have discovered the unauthorized payment." Whether the customer has failed to comply with its duties under subsection (c) [subsection (1-C)] is determined on a case-by-case basis.

Subsection (d)(2) [subsection (2)(b)] changes former subsection (2)(b) by adopting a 30-day period in place of a 14-day period. Although the 14-day period may have been sufficient when the original version of Article 4 was drafted in the 1950s, given the much greater volume of checks at the time of the revision, a longer period was viewed as more appropriate. The rule of subsection (d)(2) [subsection (2)(b)] follows pre-Code case law that payment of an additional item or items bearing an unauthorized signature or alteration by the same wrongdoer is a loss suffered by the bank traceable to the customer's failure to exercise reasonable care in examining the statement and notifying the bank of objections to it. One of the most serious consequences of failure of the customer to comply with the requirements of subsection (c) [subsection (1-C)] is the opportunity presented to the wrongdoer to repeat the misdeeds. Conversely, one of the best ways to keep down losses in this type of situation is for the customer to promptly examine the statement and notify the bank of an unauthorized signature or alteration so that the bank will be alerted to stop paying further items. Hence, the rule of subsection (d)(2) [subsection (2)(b)] is prescribed, and to avoid dispute a specific time limit, 30 days, is designated for cases to which the subsection applies. These considerations are not present if there are no losses resulting from the payment of additional items. In these

circumstances, a reasonable period for the customer to comply with its duties under subsection (c) [subsection (1-C)] would depend on the circumstances (Section 1-204(2)) and the subsection (d)(2) [subsection (2)(b)] time limit should not be imported by analogy into subsection (c) [subsection (1-C)].

3. Subsection (b) [subsection 1-B)] applies if the items are not returned to the customer. Check retention plans may include a simple payor bank check retention plan or the kind of check retention plan that would be authorized by a truncation agreement in which a collecting bank or the payee may retain the items. Even after agreeing to a check retention plan, a customer may need to see one or more checks for litigation or other purposes. The customer's request for the check may always be made to the payor bank. Under subsection (b) [subsection (1-B)] retaining banks may destroy items but must maintain the capacity to furnish legible copies for seven years. A legible copy may include an image of an item. This Act does not define the length of the reasonable period of time for a bank to provide the check or copy of the check. What is reasonable depends on the capacity of the bank and the needs of the customer. This Act does not specify sanctions for failure to retain or furnish the items or legible copies; this is left to other laws regulating banks. See Comment 3 to Section 4-101. Moreover, this Act does not regulate fees that banks charge their customers for furnishing items or copies or other services covered by the Act, but under principles of law such as unconscionability or good faith and fair dealing, courts have reviewed fees and the bank's exercise of a discretion to set fees. Perdue v. Crocker National Bank, 38 Cal.3d 913 (1985) (unconscionability); Best v. United Bank of Oregon, 739 P.2d 554, 562-566 (1987) (good faith and fair dealing). In addition, Section 1-203 provides that every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.

4. Subsection (e) [subsection (3-A)] replaces former subsection (3) and poses a modified comparative negligence test for determining liability. See the discussion on this point in the Comments to Sections 3-404, 3-405, and 3-406 [sections 3-1404, 3-1405 and 3-1406]. The term "good faith" is defined in Section 3-103(a)(4) [section 3-1103(1)(d)] as including "observance of reasonable commercial standards of fair dealing." The connotation of this standard is fairness and not absence of negligence.

The term "ordinary care" used in subsection (e) [subsection (3-A)] is defined in Section 3-103(a)(7) [section 3-1103(1)(g)], made applicable to Article 4 by Section 4-104(c) [section 4-104(3)], to provide that sight examination by a payor bank is not required if its procedure is reasonable and is commonly

followed by other comparable banks in the area. The case law is divided on this issue. The definition of "ordinary care" in Section 3-103 [section 3-1103] rejects those authorities that hold, in effect, that failure to use sight examination is negligence as a matter of law. The effect of the definition of "ordinary care" on Section 4-406 is only to provide that in the small percentage of cases in which a customer's failure to examine its statement or returned items has led to loss under subsection (d) [subsection (2)] a bank should not have to share that loss solely because it has adopted an automated collection or payment procedure in order to deal with the great volume of items at a lower cost to all customers.

5. Several changes are made in former Section 4-406(5). First, former subsection (5) is deleted and its substance is made applicable only to the one-year notice preclusion in former subsection (4) (subsection (f) [subsection (4)]). Thus if a drawer has not notified the payor bank of an unauthorized check or material alteration within the one-year period, the payor bank may not choose to recredit the drawer's account and pass the loss to the collecting banks on the theory of breach of warranty. Second, the reference in former subsection (4) to unauthorized indorsements is deleted. Section 4-406 imposes no duties on the drawer to look for unauthorized indorsements. Section 4-111 sets out a statute of limitations allowing a customer a three-year period to seek a credit to an account improperly charged by payment of an item bearing an unauthorized indorsement. Third, subsection (c) [subsection (3)] is added to Section 4-208 [section 4-207-B] to assure that if a depositary bank is sued for breach of a presentment warranty, it can defend by showing that the drawer is precluded by Section 3-406 [section 3-1406] or Section 4-406(c) and (d) [section 4-406(1-C) and (2)].

Sec. B-44. 11 MRSA §4-407 is amended to read:

§4-407. Payor bank's right to subrogation on improper payment

If a payor bank has paid an item over the ~~stop-payment~~ order of the drawer or maker <u>to stop payment, or after an account has been closed,</u> or otherwise under circumstances giving a basis for objection by the drawer or maker, to prevent unjust enrichment and only to the extent necessary to prevent loss to the bank by reason of its payment of the item, the payor bank ~~shall be~~ <u>is</u> subrogated to the rights<u>:</u>

(1) Of any holder in due course on the item against the drawer or maker; ~~and~~

(2) Of the payee or any other holder of the item against the drawer or maker either on the item or under the transaction out of which the item arose; and

(3) Of the drawer or maker against the payee or any other holder of the item with respect to the transaction out of which the item arose.

Uniform Commercial Code Comment

1. Section 4-403 states that a stop-payment order or an order to close an account is binding on a bank. If a bank pays an item over such an order it is prima facie liable, but under subsection (c) [subsection (3)] of Section 4-403 the burden of establishing the fact and amount of loss from such payment is on the customer. A defense frequently interposed by a bank in an action against it for wrongful payment over a stop-payment order is that the drawer or maker suffered no loss because it would have been liable to a holder in due course in any event. On this argument some cases have held that payment cannot be stopped against a holder in due course. Payment can be stopped, but if it is, the drawer or maker is liable and the sound rule is that the bank is subrogated to the rights of the holder in due course. The preamble and paragraph (1) [subsection (1)] of this section state this rule.

2. Paragraph (2) [subsection (2)] also subrogates the bank to the rights of the payee or other holder against the drawer or maker either on the item or under the transaction out of which it arose. It may well be that the payee is not a holder in due course but still has good rights against the drawer. These may be on the check but also may not be as, for example, where the drawer buys goods from the payee and the goods are partially defective so that the payee is not entitled to the full price, but the goods are still worth a portion of the contract price. If the drawer retains the goods it is obligated to pay a part of the agreed price. If the bank has paid the check it should be subrogated to this claim of the payee against the drawer.

3. Paragraph (3) [subsection (3)] subrogates the bank to the rights of the drawer or maker against the payee or other holder with respect to the transaction out of which the item arose. If, for example, the payee was a fraudulent salesman inducing the drawer to issue a check for defective securities, and the bank pays the check over a stop-payment order but reimburses the drawer for such payment, the bank should have a basis for getting the money back from the fraudulent salesman.

4. The limitations of the preamble prevent the bank itself from getting any double recovery or benefits out of its subrogation rights conferred by the section.

5. The spelling out of the affirmative rights of the bank in this section does not destroy other existing rights (Section 1-103). Among others these may include the defense of a payor bank that by conduct in recognizing the payment a customer has ratified the bank's action in paying in disregard of a stop-payment order or right to recover money paid under a mistake.

Sec. B-45. 11 MRSA §4-501 is amended to read:

§4-501. Handling of documentary drafts; duty to send for presentment and to notify customer of dishonor

A bank ~~which~~ that takes a documentary draft for collection ~~must~~ shall present or send the draft and accompanying documents for presentment, and, upon learning that the draft has not been paid or accepted in due course ~~must~~, shall seasonably notify its customer of ~~such~~ the fact, even though it may have discounted or bought the draft or extended credit available for withdrawal as of right.

Uniform Commercial Code Comment

This section states the duty of a bank handling a documentary draft for a customer. "Documentary draft" is defined in Section 4-104. The duty stated exists even if the bank has bought the draft. This is because to the customer the draft normally represents an underlying commercial transaction, and if that is not going through as planned the customer should know it promptly.

Sec. B-46. 11 MRSA §4-502 is amended to read:

§4-502. Presentment of "on arrival" drafts

~~When~~ If a draft or the relevant instructions require presentment "on ~~arrival~~", arrival," "when goods arrive" or the like, the collecting bank need not present until in its judgment a reasonable time for arrival of the goods has expired. Refusal to pay or accept because the goods have not arrived is not dishonor; the bank must notify its transferor of ~~such~~ the refusal but need not present the draft again until it is instructed to do so or learns of the arrival of the goods.

Uniform Commercial Code Comment

The section is designed to establish a definite rule for "on arrival" drafts. The term includes not only drafts drawn payable "on arrival" but also drafts forwarded with instructions to present "on arrival." The term refers to the arrival of the relevant goods. Unless a bank has actual knowledge of the

arrival of the goods, as for example, when it is the "notify" party on the bill of lading, the section only requires the exercise of such judgment in estimating time as a bank may be expected to have. Commonly the buyer-drawee will want the goods and will therefore call for the documents and take up the draft when they do arrive.

Sec. B-47. 11 MRSA §4-503, as amended by PL 1965, c. 306, §13, is further amended to read:

§4-503. Responsibility of presenting bank for documents and goods; report of reasons for dishonor; referee in case of need

Unless otherwise instructed and except as provided in Article 5, a bank presenting a documentary draft:

(1) Must deliver the documents to the drawee on acceptance of the draft, if it is payable more than 3 days after presentment; otherwise, only on payment; and

(2) Upon dishonor, either in the case of presentment for acceptance or presentment for payment, may seek and follow instruction from any referee in case of need designated in the draft or, if the presenting bank does not choose to utilize ~~his~~ the referee's services, it must use diligence and good faith to ascertain the reason for dishonor, must notify its transferor of the dishonor and of the results of its effort to ascertain the reasons therefor, and must request instructions.

~~But~~ However the presenting bank is under no obligation with respect to goods represented by the documents, except to follow any reasonable instructions seasonably received; it has a right to reimbursement for any expense incurred in following instructions and to prepayment of or indemnity for ~~such~~ those expenses.

Uniform Commercial Code Comment

1. This section states the rules governing, in the absence of instructions, the duty of the presenting bank in case either of honor or of dishonor of a documentary draft. The section should be read in connection with Section 2-514 on when documents are deliverable on acceptance, when on payment.

2. If the draft is drawn under a letter of credit, Article 5 controls. See Sections 5-109 through 5-114.

Sec. B-48. 11 MRSA §4-504 is amended to read:

§4-504. Privilege of presenting bank to deal with goods; security interest for expenses

(1) A presenting bank ~~which~~ that, following the dishonor of a documentary draft, has seasonably requested instructions but does not receive them within a reasonable time may store, sell or otherwise deal with the goods in any reasonable manner.

(2) For its reasonable expenses incurred by action under subsection (1) the presenting bank has a lien upon the goods or their proceeds, which may be foreclosed in the same manner as an unpaid seller's lien.

Uniform Commercial Code Comment

The section gives the presenting bank, after dishonor, a privilege to deal with the goods in any commercially reasonable manner pending instructions from its transferor and, if still unable to communicate with its principal after a reasonable time, a right to realize its expenditures as if foreclosing on an unpaid seller's lien (Section 2-706). The provision includes situations in which storage of goods or other action becomes commercially necessary pending receipt of any requested instructions, even if the requested instructions are later received.

The "reasonable manner" referred to means one reasonable in the light of business factors and the judgment of a business man.

STATEMENT OF FACT

This bill enacts changes recommended by the National Conference of Commissioners on Uniform State Laws as revisions to the Uniform Commercial Code, Article 3, on negotiable instruments. Part A of this bill repeals the Maine Revised Statutes, Title 11, Article 3 and enacts a new Title 11, Article 3-A to accomplish those revisions. Part B of this bill makes necessary conforming amendments and recommended changes to the Uniform Commercial Code to provide consistency with the new Article 3-A.