

MAINE STATE LEGISLATURE

The following document is provided by the
LAW AND LEGISLATIVE DIGITAL LIBRARY
at the Maine State Law and Legislative Reference Library
<http://legislature.maine.gov/lawlib>



Reproduced from scanned originals with text recognition applied
(searchable text may contain some errors and/or omissions)



STATE LAW LIBRARY
AUGUSTA, MAINE

115th MAINE LEGISLATURE

SECOND REGULAR SESSION-1992

Legislative Document

No. 2357

H.P. 1680

House of Representatives, February 18, 1992

Approved for introduction by a majority of the Legislative Council pursuant to Joint Rule 26.
Reference to the Committee on Judiciary suggested and ordered printed.

EDWIN H. PERT, Clerk

Presented by Representative MARSANO of Belfast.

Cosponsored by Representative MAYO of Thomaston, Senator CONLEY of Cumberland and
Senator HOLLOWAY of Lincoln.

STATE OF MAINE

IN THE YEAR OF OUR LORD
NINETEEN HUNDRED AND NINETY-TWO

An Act to Enact a New Article on Negotiable Instruments in the Uniform
Commercial Code.

Printed on recycled paper

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

Sec. 1. 11 MRSA Art. 3, as amended, is repealed.

Sec. 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) [no comparable Maine cite] 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

2 [Article 3-A]. Thus, Article 3 [Article 3-A] and Article 4A are mutually exclusive.

4 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.

26 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.

50 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

2 instrument is subject exclusively to the requirements of Article 8. Section 8-102(1)(c) and Section 3-102(a) [section 3-1102(1)].

4 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).

32 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.

50 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
"Depository bank"	Section 4-105
"Documentary draft"	Section 4-104
"Intermediary bank"	Section 4-105
"Item"	Section 4-104
"Payor bank"	Section 4-105

(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). 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

2 addition to the payment of money, but the promise or order
4 may contain:

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

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

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

20 (2) "Instrument" means a negotiable instrument.

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

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

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

48 (6) "Check" means:

50 (a) A draft, other than a documentary draft, payable
52 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:

2 (a) Is payable on demand;

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

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

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

16 (10) "Certificate of deposit" means an instrument
18 containing an acknowledgment by a bank that a sum of money has
20 been received by the bank and a promise by the bank to repay the
22 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

2 other promise, order, obligation or power given by the maker or
3 drawer" appearing in former Section 3-104(1)(b). The words
4 "instruction" and "undertaking" are used instead of "order" and
5 "promise" that are used in the N.I.L. formulation because the
6 latter words are defined terms that include only orders or
7 promises to pay money. The three exceptions stated in Section
8 3-104(a)(3) [section 3-1104(1)(c)] are based on and are intended
9 to have the same meaning as former Section 3-112(1)(b), (c), (d),
10 and (e), as well as N.I.L. § 5(1), (2), and (3). Subsection (b)
11 [subsection (2)] states that "instrument" means a "negotiable
12 instrument." This follows former Section 3-102(1)(e) which
13 treated the two terms as synonymous.

14 2. Unless subsection (c) [subsection (3)] applies, the
15 effect of subsection (a)(1) [subsection (1)(a)] and Section
16 3-102(a) [section 3-1102(1)] is to exclude from Article 3
17 [Article 3-A] any promise or order that is not payable to bearer
18 or to order. There is no provision in revised Article 3 [Article
19 3-A] that is comparable to former Section 3-805. The Comment to
20 former Section 3-805 states that the typical example of a writing
21 covered by that section is a check reading "Pay John Doe." Such
22 a check was governed by former Article 3 but there could not be a
23 holder in due course of the check. Under Section 3-104(c)
24 [section 3-1104(3)] such a check is governed by revised Article 3
25 [Article 3-A] and there can be a holder in due course of the
26 check. But subsection (c) [subsection (3)] applies only to
27 checks. The Comment to former Section 3-805 does not state any
28 example other than the check to illustrate that section.
29 Subsection (c) [subsection (3)] is based on the belief that it is
30 good policy to treat checks, which are payment instruments, as
31 negotiable instruments whether or not they contain the words "to
32 the order of". These words are almost always pre-printed on the
33 check form. Occasionally the drawer of a check may strike out
34 these words before issuing the check. In the past some credit
35 unions used check forms that did not contain the quoted words.
36 Such check forms may still be in use but they are no longer
37 common. Absence of the quoted words can easily be overlooked and
38 should not affect the rights of holders who may pay money or give
39 credit for a check without being aware that it is not in the
40 conventional form.

41 Total exclusion from Article 3 [Article 3-A] of other
42 promises or orders that are not payable to bearer or to order
43 serves a useful purpose. It provides a simple device to clearly
44 exclude a writing that does not fit the pattern of typical
45 negotiable instruments and which is not intended to be a
46 negotiable instrument. If a writing could be an instrument
47 despite the absence of "to order" or "to bearer" language and a
48 dispute arises with respect to the writing, it might be argued
49 that the writing is a negotiable instrument because the other
50 requirements of subsection (a) [subsection (1)] are somehow met.
51 Even if the argument is eventually found to be without merit it

2 can be used as a litigation ploy. Words making a promise or
3 order payable to bearer or to order are the most distinguishing
4 feature of a negotiable instrument and such words are frequently
5 referred to as "words of negotiability." Article 3 [Article 3-A]
6 is not meant to apply to contracts for the sale of goods or
7 services or the sale or lease of real property or similar
8 writings that may contain a promise to pay money. The use of
9 words of negotiability in such contracts would be an aberration.
10 Absence of the words precludes any argument that such contracts
11 might be negotiable instruments.

12 An order or promise that is excluded from Article 3 [Article
13 3-A] because of the requirements of Section 3-104(a) [section
14 3-1104(1)] may nevertheless be similar to a negotiable instrument
15 in many respects. Although such a writing cannot be made a
16 negotiable instrument within Article 3 [Article 3-A] by contract
17 or conduct of its parties, nothing in Section 3-104 [section
18 3-1104] or in Section 3-102 [section 3-1102] is intended to mean
19 that in a particular case involving such a writing a court could
20 not arrive at a result similar to the result that would follow if
21 the writing were a negotiable instrument. For example, a court
22 might find that the obligor with respect to a promise that does
23 not fall within Section 3-104(a) [section 3-1104(1)] is precluded
24 from asserting a defense against a bona fide purchaser. The
25 preclusion could be based on estoppel or ordinary principles of
26 contract. It does not depend upon the law of negotiable
27 instruments. An example is stated in the paragraph following
28 Case #2 in Comment 4 to Section 3-302 [section 3-1302].

29 Moreover, consistent with the principle stated in Section
30 1-102(2)(b), the immediate parties to an order or promise that is
31 not an instrument may provide by agreement that one or more of
32 the provisions of Article 3 [Article 3-A] determine their rights
33 and obligations under the writing. Upholding the parties' choice
34 is not inconsistent with Article 3 [Article 3-A]. Such an
35 agreement may bind a transferee of the writing if the transferee
36 has notice of it or the agreement arises from usage of trade and
37 the agreement does not violate other law or public policy. An
38 example of such an agreement is a provision that a transferee of
39 the writing has the rights of a holder in due course stated in
40 Article 3 [Article 3-A] if the transferee took rights under the
41 writing in good faith, for value, and without notice of a claim
42 or defense.

43 Even without an agreement of the parties to an order or
44 promise that is not an instrument, it may be appropriate,
45 consistent with the principles stated in Section 1-102(2), for a
46 court to apply one or more provisions of Article 3 [Article 3-A]
47 to the writing by analogy, taking into account the expectations
48 of the parties and the differences between the writing and an
49 instrument governed by Article 3 [Article 3-A]. Whether such
50 application is appropriate depends upon the facts of each case.
51

2 3. Subsection (d) [subsection (4)] allows exclusion from
4 Article 3 [Article 3-A] of a writing that would otherwise be an
6 instrument under subsection (a) [subsection (1)] by a statement
8 to the effect that the writing is not negotiable or is not
10 governed by Article 3 [Article 3-A]. For example, a promissory
12 note can be stamped with the legend NOT NEGOTIABLE. The effect
14 under subsection (d) [subsection (4)] is not only to negate the
2 possibility of a holder in due course, but to prevent the writing
4 from being a negotiable instrument for any purpose. Subsection
6 (d) [subsection (4)] does not, however, apply to a check. If a
8 writing is excluded from Article 3 [Article 3-A] by subsection
10 (d) [subsection (4)], a court could, nevertheless, apply Article
12 3 [Article 3-A] principles to it by analogy as stated in Comment
14 2.

16 4. Instruments are divided into two general categories:
18 drafts and notes. A draft is an instrument that is an order. A
20 note is an instrument that is a promise. Section 3-104(e)
22 [section 3-1104(5)]. The term "bill of exchange" is not used in
24 Article 3 [Article 3-A]. It is generally understood to be a
26 synonym for the term "draft." Subsections (f) [subsection (6)]
28 through (j) [subsection (10)] define particular instruments that
30 fall within the categories of draft and note. The term "draft,"
32 defined in subsection (e) [subsection (5)], includes a "check"
34 which is defined in subsection (f) [subsection (6)]. "Check"
36 includes a share draft drawn on a credit union payable through a
38 bank because the definition of bank (Section 4-104) includes
40 credit unions. However, a draft drawn on an insurance company
42 payable through a bank is not a check because it is not drawn on
44 a bank. "Money orders" are sold both by banks and non-banks.
46 They vary in form and their form determines how they are treated
48 in Article 3 [Article 3-A]. The most common form of money order
50 sold by banks is that of an ordinary check drawn by the purchaser
52 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

2 that the instrument be "drawn on or payable at or through a bank"
4 may be satisfied without words on the instrument that identify a
6 bank as drawee or paying agent so long as the instrument bears an
8 appropriate routing number that identifies a bank as paying agent.

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

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

14 §3-1105. Issue of instrument

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

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

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

32 Uniform Commercial Code Comment

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

46 2. Subsection (b) [subsection (2)] continues the rule that
48 nonissuance, conditional issuance or issuance for a special
50 purpose is a defense of the maker or drawer of an instrument.
52 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.

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

2 **§3-1106. Unconditional promise or order**

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

10 (a) An express condition to payment:

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

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

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

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

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

36 (3) If a promise or order requires, as a condition to
38 payment, a countersignature by a person whose specimen signature
40 appears on the promise or order, the condition does not make the
42 promise or order conditional for the purposes of section 3-1104,
44 subsection (1). If the person whose specimen signature appears
46 on an instrument fails to countersign the instrument, the failure
48 to countersign is a defense to the obligation of the issuer, but
50 the failure does not prevent a transferee of the instrument from
52 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.

2 Uniform Commercial Code Comment

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

14 §3-1108. Payable on demand or at definite time

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

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

22 (b) Does not state any time of payment.

24 (2) A promise or order is "payable at a definite time" if
26 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
28 readily ascertainable at the time the promise or order is issued,
subject to rights of:

30 (a) Prepayment;

32 (b) Acceleration;

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

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

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

46 Uniform Commercial Code Comment

48 This section is a restatement of former Section 3-108 and
50 Section 3-109. Subsection (b) [subsection (2)] broadens former
Section 3-109 somewhat by providing that a definite time includes
52 a time readily ascertainable at the time the promise or order is

2 issued. Subsection (b)(iii) and (iv) [subsection (2)(c) and (d)]
restates former Section 3-109(1)(d). It adopts the generally
4 accepted rule that a clause providing for extension at the option
of the holder, even without a time limit, does not affect
6 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
8 definite time limit must be stated or the time of payment remains
uncertain and the order or promise is not a negotiable
10 instrument. If a definite time limit is stated, the effect upon
certainty of time of payment is the same as if the instrument
12 were made payable at the ultimate date with a term providing for
acceleration.

14 §3-1109. Payable to bearer or to order

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

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

22 (b) Does not state a payee; or

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

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

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

34 (b) To an identified person or order.

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

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

46 Uniform Commercial Code Comment

48 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)
50 [section 3-1104(3)] applies. The terms "payable to bearer" and
"payable to order" are defined in Section 3-109 [section
52 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.

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

11 **Uniform Commercial Code Comment**

12 1. Section 3-110 [section 3-110] states rules for
13 determining the identity of the person to whom an instrument is
14 initially payable if the instrument is payable to an identified
15 person. This issue usually arises in a dispute over the validity
16 of an indorsement in the name of the payee. Subsection (a)
17 [subsection (1)] states the general rule that the person to whom
18 an instrument is payable is determined by the intent of "the
19 person, whether or not authorized, signing as, or in the name or
20 behalf of, the issuer of the instrument." "Issuer" means the
21 maker or drawer of the instrument. Section 3-105(c) [section
22 3-1105(3)]. If X signs a check as drawer of a check on X's
23 account, the intent of X controls. If X, as President of
24 Corporation, signs a check as President in behalf of Corporation
25 as drawer, the intent of X controls. If X forges Y's signature
26 as drawer of a check, the intent of X also controls. Under
27 Section 3-103(a)(3) [section 3-1103(1)(c)], Y is referred to as
28 the drawer of the check because the signing of Y's name
29 identifies Y as the drawer. But since Y's signature was forged Y
30 has no liability as drawer (Section 3-403(a) [section 3-1403(1)])
31 unless some other provision of Article 3 [Article 3-A] or Article
32 4 makes Y liable. Since X, even though unauthorized, signed in
33 the name of Y as issuer, the intent of X determines to whom the
34 check is payable.

35 In the case of a check payable to "John Smith," since there
36 are many people in the world named "John Smith" it is not
37 possible to identify the payee of the check unless there is some
38 further identification or the intention of the drawer is
39 determined. Name alone is sufficient under subsection (a)
40 [subsection (1)], but the intention of the drawer determines
41 which John Smith is the person to whom the check is payable. The
42 same issue is presented in cases of misdescriptions of the
43 payee. The drawer intends to pay a person known to the drawer as
44 John Smith. In fact that person's name is James Smith or John
45 Jones or some other entirely different name. If the check
46 identifies the payee as John Smith, it is nevertheless payable to
47 the person intended by the drawer. That person may indorse the
48 check in either the name John Smith or the person's correct name
49 or in both names. Section 3-204(d) [section 3-1204(4)]. The
50 intent of the drawer is also controlling in fictitious payee
51

2 cases. Section 3-404(b) [section 3-1404(2)]. The last sentence
3 of subsection (a) [subsection (1)] refers to rare cases in which
4 the signature of an organization requires more than one signature
5 and the persons signing on behalf of the organization do not all
6 intend the same person as payee. Any person intended by a signer
7 for the organization is the payee and an indorsement by that
8 person is an effective indorsement.

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

25 2. Subsection (c) [subsection (3)] allows the payee to be
26 identified in any way including the various ways stated.
27 Subsection (c)(1) [subsection (3)(a)] relates to instruments
28 payable to bank accounts. In some cases the account might be
29 identified by name and number, and the name and number might
30 refer to different persons. For example, a check is payable to
31 "X Corporation Account No. 12345 in Bank of Podunk." Under the
32 last sentence of subsection (c)(1) [subsection (3)(a)], this
33 check is payable to X Corporation and can be negotiated by X
34 Corporation even if Account No. 12345 is some other person's
35 account or the check is not deposited in that account. In other
36 cases the payee is identified by an account number and the name
37 of the owner of the account is not stated. For example, Debtor
38 pays Creditor by issuing a check drawn on Payor Bank. The check
39 is payable to a bank account owned by Creditor but identified
40 only by number. Under the first sentence of subsection (c)(1)
41 [subsection (3)(a)] the check is payable to Creditor and, under
42 Section 1-201(20), Creditor becomes the holder when the check is
43 delivered. Under Section 3-201(b) [section 3-1201(2)], further
44 negotiation of the check requires the indorsement of Creditor.
45 But under Section 4-205(a), if the check is taken by a depository
46 bank for collection, the bank may become a holder without the
47 indorsement. Under Section 3-102(b) [section 3-1102(2)],
48 provisions of Article 4 prevail over those of Article 3 [Article
49 3-A]. The depository bank warrants that the amount of the check
50 was credited to the payee's account.
51

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 2. The purpose of subsection (b) [subsection (2)] is to
3 clarify the meaning of "interest" in the introductory clause of
4 Section 3-104(a) [section 3-1104(1)]. It is not intended to
5 validate a provision for interest in an instrument if that
6 provision violates other law.

7 §3-1113. Date of instrument

8 (1) An instrument may be antedated or postdated. The date
9 stated determines the time of payment if the instrument is
10 payable at a fixed period after date. Except as provided in
11 section 4-401, subsection (3), an instrument payable on demand is
12 not payable before the date of the instrument.

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

16 Uniform Commercial Code Comment

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

27 §3-1114. Contradictory terms of instrument

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

31 Uniform Commercial Code Comment

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

34 §3-1115. Incomplete instrument

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

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

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

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

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

53 Uniform Commercial Code Comment

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

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

68 Case #1. If the incomplete instrument is never
69 completed, the note is payable on demand. Section
70 3-108(a)(ii) [section 3-1108(1)(b)]. However, if the payee
71 and the maker agreed to a due date, the maker may have a
72 defense under Section 3-117 [section 3-1117] if demand for
73 payment is made before the due date agreed to by the parties.

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

80 Suppose Debtor pays Creditor by giving Creditor a check on
81 which the space for the name of the payee is left blank. The
82 check is an instrument but it is incomplete. The check is
83 enforceable in its incomplete form and it is payable to bearer
84 because it does not state a payee. Section 3-109(a)(2) [section
85 3-1109(1)(b)]. Thus, Creditor is a holder of the check.
86 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

2 unless Z also signs may not have been fraudulently made, a
3 subsequent attempt by Creditor to require Y to pay the note in
4 violation of the agreement is a bad faith act. Section 3-1117,
5 in treating the agreement as a defense, allows Y to assert the
6 agreement against Creditor, but the defense would not be good
7 against a subsequent holder in due course of the note that took
8 it without notice of the agreement. If there cannot be a holder
9 in due course because of Section 3-106(d) [section 3-1106(4)], a
10 subsequent holder that took the note in good faith, for value and
11 without knowledge of the agreement would not be able to enforce
12 the liability of Y. This result is consistent with the risk that
13 a holder not in due course takes with respect to fraud in
14 inducing issuance of an instrument.

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

26 §3-1118. Statute of limitations

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

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

39 (3) Except as provided in subsection (4), an action to
40 enforce the obligation of a party to an unaccepted draft to pay
41 the draft must be commenced within 3 years after dishonor of the
42 draft or 10 years after the date of the draft, whichever period
43 expires first.

44 (4) An action to enforce the obligation of the acceptor of
45 a certified check or the issuer of a teller's check, cashier's
46 check or traveler's check must be commenced within 3 years after
47

2 demand for payment is made to the acceptor or issuer, as the case
3 may be.

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

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

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

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

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

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

23 (b) For breach of warranty; or

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

26 Uniform Commercial Code Comment

27 1. Section 3-118 [section 3-1118] differs from former
28 Section 3-122, which states when a cause of action accrues on an
29 instrument. Section 3-118 [section 3-1118] does not define when
30 a cause of action accrues. Accrual of a cause of action is
31 stated in other sections of Article 3 [Article 3-A] such as those
32 that state the various obligations of parties to an instrument.
33 The only purpose of Section 3-118 [section 3-1118] is to define
34 the time within which an action to enforce an obligation, duty,
35 or right arising under Article 3 [Article 3-A] must be
36 commenced. Section 3-118 [section 3-1118] does not attempt to
37 state all rules with respect to a statute of limitations. For
38 example, the circumstances under which the running of a
39 limitations period may be tolled is left to other law pursuant to
40 Section 1-103.

41 2. The first six subsections apply to actions to enforce an
42 obligation of any party to an instrument to pay the instrument.
43

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.

§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

2 by the person giving the notice as to any determination of fact
4 common to the 2 litigations, the person notified is so bound
6 unless after reasonable receipt of the notice the person notified
8 does come in and defend.

10 **Uniform Commercial Code Comment**

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

14 **PART 2**

16 **NEGOTIATION, TRANSFER AND INDORSEMENT**

18 **§3-1201. Negotiation**

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

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

36 **Uniform Commercial Code Comment**

38 1. Subsections (a) [subsection (1)] and (b) [subsection
40 (2)] are based in part on subsection (1) of former Section
42 3-202. A person can become holder of an instrument when the
44 instrument is issued to that person, or the status of holder can
46 arise as the result of an event that occurs after issuance.
48 "Negotiation" is the term used in Article 3 [Article 3-A] to
50 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

2 involuntary transfer of possession that results in negotiation to
4 Thief or Finder.

6 2. In most cases negotiation occurs by a transfer of
8 possession by a holder or remitter. Remitter transactions
10 usually involve a cashier's or teller's check. For example,
12 Buyer buys goods from Seller and pays for them with a cashier's
14 check of Bank that Buyer buys from Bank. The check is issued by
16 Bank when it is delivered to Buyer, regardless of whether the
18 check is payable to Buyer or to Seller. Section 3-105(a)
20 [section 3-1105(1)]. If the check is payable to Buyer,
22 negotiation to Seller is done by delivery of the check to Seller
24 after it is indorsed by Buyer. It is more common, however, that
26 the check when issued will be payable to Seller. In that case
28 Buyer is referred to as the "remitter." Section 3-103(a)(11)
30 [section 3-1103(1)(k)]. The remitter, although not a party to
32 the check, is the owner of the check until ownership is
34 transferred to Seller by delivery. This transfer is a
36 negotiation because Seller becomes the holder of the check when
38 Seller obtains possession. In some cases Seller may have acted
40 fraudulently in obtaining possession of the check. In those
42 cases Buyer may be entitled to rescind the transfer to Seller
44 because of the fraud and assert a claim of ownership to the check
46 under Section 3-306 [section 3-1306] against Seller or a
48 subsequent transferee of the check. Section 3-202(b) [section
50 3-1202(2)] provides for rescission of negotiation, and that
52 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

2 to ownership of the instrument, Y is not a person entitled to
3 enforce the instrument until Y obtains possession of the
4 instrument. No transfer of the instrument occurs under Section
5 3-203(a) [section 3-1203(1)] until it is delivered to Y.

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

18 2. Subsection (b) [subsection (2)] states that transfer
19 vests in the transferee any right of the transferor to enforce
20 the instrument "including any right as a holder in due course."
21 If the transferee is not a holder because the transferor did not
22 indorse, the transferee is nevertheless a person entitled to
23 enforce the instrument under Section 3-301 [section 3-1301] if
24 the transferor was a holder at the time of transfer. Although
25 the transferee is not a holder, under subsection (b) [subsection
26 (2)] the transferee obtained the rights of the transferor as
27 holder. Because the transferee's rights are derivative of the
28 transferor's rights, those rights must be proved. Because the
29 transferee is not a holder, there is no presumption under Section
30 3-308 [section 3-1308] that the transferee, by producing the
31 instrument, is entitled to payment. The instrument, by its
32 terms, is not payable to the transferee and the transferee must
33 account for possession of the unindorsed instrument by proving
34 the transaction through which the transferee acquired it. Proof
35 of a transfer to the transferee by a holder is proof that the
36 transferee has acquired the rights of a holder. At that point
37 the transferee is entitled to the presumption under Section 3-308
38 [section 3-1308].

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

48 3. Subsection (c) [subsection (3)] applies only to a
49 transfer for value. It applies only if the instrument is payable
50

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

22 4. The operation of Section 3-203 [section 3-1302] is
23 illustrated by the following cases. In each case Payee, by
24 fraud, induced Maker to issue a note to Payee. The fraud is a
25 defense to the obligation of Maker to pay the note under Section
26 3-305(a)(2) [section 3-1305(1)(b)].

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

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

36 Case #3. Payee negotiated the note to X who took as a
37 holder in due course. X sold the note to Purchaser who
38 received possession. The note, however, was indorsed to X
39 and X failed to indorse it. Purchaser is a person entitled
40 to enforce the instrument under Section 3-301 [section
41 3-1301] and succeeds to the rights of X as holder in due
42 course. Purchaser is not a holder, however, and under
43 Section 3-308 [section 3-1308] Purchaser will have to prove
44 the transaction with X under which the rights of X as holder
45 in due course were acquired.

46 Case #4. Payee sold the note to Purchaser who took for
47 value, in good faith and without notice of the defense of
48 Maker. Purchaser received possession of the note but Payee
49

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 depository 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 depository 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 depository 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

2 full signature but accompanying words indicated that it was meant
4 as a receipt for the cash given for the check, it is not an
6 indorsement. If the signature is not qualified in any way and
8 appears in the place normally used for indorsements, it may be an
10 indorsement even though the signer intended the signature to be a
12 receipt. To take another example, suppose the drawee of a draft
14 signs the draft on the back in the space usually used for
16 indorsements. No words accompany the signature. Since the
18 drawee has no reason to sign a draft unless the intent is to
20 accept the draft, the signature is effective as an acceptance.
22 Custom and usage may be used to determine intent. For example,
24 by long-established custom and usage, a signature in the lower
26 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].

28 The last sentence of subsection (a) [subsection (1)] is
30 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.

32 2. Assume that Payee indorses a note to Creditor as
34 security for a debt. Under subsection (b) [subsection (2)] of
36 Section 3-203 [section 3-1203] Creditor takes Payee's rights to
38 enforce or transfer the instrument subject to the limitations
40 imposed by Article 9. Subsection (c) [subsection (3)] of Section
42 3-204 [section 3-1204] makes clear that Payee's indorsement to
44 Creditor, even though it mentions creation of a security
46 interest, is an unqualified indorsement that gives to Creditor
48 the right to enforce the note as its holder.

50 3. Subsection (d) [subsection (4)] is a restatement of
52 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

2 indorsement in a name different from that used in the instrument
4 may raise a question about its validity and an indorsement in a
6 name that is not the correct name of the payee may raise a
8 problem of identifying the indorser, the accepted commercial
10 practice is to indorse in both names. Subsection (d) [subsection
12 (4)] allows a person paying or taking the instrument for value or
14 collection to require indorsement in both names.

16 §3-1205. Special indorsement; blank indorsement; anomalous 18 indorsement

20 (1) If an indorsement is made by the holder of an
22 instrument, whether payable to an identified person or payable to
24 bearer, and the indorsement identifies a person to whom it makes
26 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.

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

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

46 (4) "Anomalous indorsement" means an indorsement made by a
48 person who is not the holder of the instrument. An anomalous
50 indorsement does not affect the manner in which the instrument
52 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 depository 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 depository 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 depository 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 Depository 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 Depository 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) Depository 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] 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 Depository 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;

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

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

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

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

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

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

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

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

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

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

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

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

6 (b) The person obliged to pay the instrument has a defense,
8 claim in recoupment or claim to the instrument that may be
10 asserted against the person who granted the security
12 interest.

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

18 (7) This section is subject to any law limiting status as a
20 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

2 anybody except a person having rights of a holder in due course
3 who took the instrument without notice of the discharge. Notice
4 of discharge does not disqualify a person from becoming a holder
5 in due course. For example, a check certified after it is
6 negotiated by the payee may subsequently be negotiated to a
7 holder. If the holder had notice that the certification occurred
8 after negotiation by the payee, the holder necessarily had notice
9 of the discharge of the payee as indorser. Section 3-415(d)
10 [section 3-1415(4)]. Notice of that discharge does not prevent
11 the holder from becoming a holder in due course, but the
12 discharge is effective against the holder. Section 3-601(b)
13 [section 3-1601(2)]. Notice of a defense under Section
14 3-305(a)(1) [section 3-1305(1)(a)] of a maker, drawer or acceptor
15 based on a bankruptcy discharge is different. There is no reason
16 to give holder in due course status to a person with notice of
17 that defense. The second sentence of subsection (b) [subsection
18 (2)] is from former Section 3-304(5).

20 4. Professor Britton in his treatise Bills and Notes 309
21 (1961) stated: "A substantial number of decisions before the
22 [N.I.L.] indicates that at common law there was nothing in the
23 position of the payee as such which made it impossible for him to
24 be a holder in due course." The courts were divided, however,
25 about whether the payee of an instrument could be a holder in due
26 course under the N.I.L.. Some courts read N.I.L. § 52(4) to mean
27 that a person could be a holder in due course only if the
28 instrument was "negotiated" to that person. N.I.L. § 30 stated
29 that "an instrument is negotiated when it is transferred from one
30 person to another in such manner as to constitute the transferee
31 the holder thereof." Normally, an instrument is "issued" to the
32 payee; it is not transferred to the payee. N.I.L. § 191 defined
33 "issue" as the "first delivery of the instrument * * * to a
34 person who takes it as a holder." Thus, some courts concluded
35 that the payee never could be a holder in due course. Other
36 courts concluded that there was no evidence that the N.I.L. was
37 intended to change the common law rule that the payee could be a
38 holder in due course. Professor Britton states on p.318: "The
39 typical situations which raise the [issue] are those where the
40 defense of a maker is interposed because of fraud by a [maker who
41 is] principal debtor * * * against a surety co-maker, or where
42 the defense of fraud by a purchasing remitter is interposed by
43 the drawer of the instrument against the good faith purchasing
44 payee."

46 Former Section 3-302(2) stated: "A payee may be a holder in
47 due course." This provision was intended to resolve the split of
48 authority under the N.I.L.. It made clear that there was no
49 intent to change the common-law rule that allowed a payee to
50 become a holder in due course. See Comment 2 to former Section
51 3-302. But there was no need to put subsection (2) in former
52 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

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

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

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

40 Case #1. Buyer pays for goods bought from Seller by
41 giving to Seller a cashier's check bought from Bank. Bank
42 has a defense to its obligation to pay the check because
43 Buyer bought the check from Bank with a check known to be
44 drawn on an account with insufficient funds to cover the
45 check. If Bank issued the check to Buyer as payee and Buyer
46 indorsed it over to Seller, it is clear that Seller can be a
47 holder in due course taking free of the defense if Seller
48 had no notice of the defense. Seller is a transferee of the
49 check. There is no good reason why Seller's position should
50 be any different if Bank drew the check to the order of
51 Seller as payee. In that case, when Buyer took delivery of
52 the check from Bank, Buyer became the owner of the check

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

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

32 Suppose in Case #2 that the note does not meet the
33 requirements of Section 3-104(a) [section 3-1104(1)] and thus is
34 not a negotiable instrument covered by Article 3 [Article 3-A].
35 In that case, Bank cannot be a holder in due course but the
36 result should be the same. Bank's rights are determined by
37 general principles of contract law. Restatement Second,
38 Contracts § 164(2) governs the case. If Y is induced to enter
39 into a contract with Bank by a fraudulent misrepresentation by X,
40 the contract is voidable by Y unless Bank "in good faith and
41 without reason to know of the misrepresentation either gives
42 value or relies materially on the transaction." Comment e to
43 § 164(2) states:

44 "This is the same principle that protects an innocent person
45 who purchases goods or commercial paper in good faith,
46 without notice and for value from one who obtained them from
47 the original owner by a misrepresentation. See Uniform
48 Commercial Code §§ 2-403(1), 3-305 [section 3-1305]. In the
49 cases that fall within [§ 164 (2)], however, the innocent
50 person deals directly with the recipient of the

2 misrepresentation, which is made by one not a party to the
3 contract."

4 The same result follows in Case #2 if Y had been induced to
5 sign the note as an accommodation party (Section 3-419 [section
6 3-1419]). If Y signs as co-maker of a note for the benefit of X,
7 Y is a surety with respect to the obligation of X to pay the note
8 but is liable as maker of the note to pay Bank. Section 3-419(b)
9 [section 3-1419(2)]. If Bank is a holder in due course, the
10 fraud of X cannot be asserted against Bank under Section 3-305(b)
11 [section 3-1305(2)]. But the result is the same without resort
12 to holder-in-due-course doctrine. If the note is not a
13 negotiable instrument governed by Article 3 [Article 3-A],
14 general rules of suretyship apply. Restatement, Security § 119
15 states that the surety (Y) cannot assert a defense against the
16 creditor (Bank) based on the fraud of the principal (X) if the
17 creditor "without knowledge of the fraud * * * extended credit to
18 the principal on the security of the surety's promise * * *."
19 The underlying principle of § 119 is the same as that of § 164(2)
20 of Restatement Second, Contracts.

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

38 Case #4. Employer, who owed money to X, signed a blank
39 check and delivered it to Secretary with instructions to
40 complete the check by typing in X's name and the amount owed
41 to X. Secretary fraudulently completed the check by typing
42 in the name of Y, a creditor to whom Secretary owed money.
43 Secretary then delivered the check to Y in payment of
44 Secretary's debt. Y obtained payment of the check. This
45 case is similar to Case #3. Since Secretary was authorized
46 to complete the check, Employer is bound by Secretary's act
47 in making the check payable to Y. The drawee bank properly
48 paid the check. Y received funds of Employer which were
49 used for the personal benefit of Secretary. Employer
50 asserts a claim to these funds against Y. If Y is a holder

2 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.

4 5. Subsection (c) [subsection (3)] is based on former
6 Section 3-302(3). Like former Section 3-302(3), subsection (c)
[subsection (3)] is intended to state existing case law. It
8 covers a few situations in which the purchaser takes an
instrument under unusual circumstances. The purchaser is treated
10 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
12 course, the purchaser obtains rights of a holder in due course.

14 Subsection (c) [subsection (3)] applies to a purchaser in an
execution sale or sale in bankruptcy. It applies equally to an
16 attaching creditor or any other person who acquires the
instrument by legal process or to a representative, such as an
18 executor, administrator, receiver or assignee for the benefit of
creditors, who takes the instrument as part of an estate.
20 Subsection (c) [subsection (3)] applies to bulk purchases lying
outside of the ordinary course of business of the seller. For
22 example, it applies to the purchase by one bank of a substantial
part of the paper held by another bank which is threatened with
24 insolvency and seeking to liquidate its assets. Subsection (c)
[subsection (3)] would also apply when a new partnership takes
26 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
28 corporation taking over the assets of a predecessor.

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

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

44 Case #5. Payee negotiates a \$1,000 note to Holder who
46 agrees to pay \$900 for it. After paying \$500, Holder learns
that Payee defrauded Maker in the transaction giving rise to
48 the note. Under subsection (d) [subsection (4)] Holder may
assert rights as a holder in due course to the extent of
50 \$555.55 ($\$500 / \$900 = .555 \times \$1,000 = \555.55). This
formula rewards Holder with a ratable portion of the
52 bargained for profit.

2 Case #6. Payee negotiates a note of Maker for \$1,000
4 to Holder as security for payment of Payee's debt to Holder
of \$600. Maker has a defense which is good against Payee
6 but of which Holder has no notice. Subsection (e)
[subsection (5)] applies. Holder may assert rights as a
8 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
10 any rights that Maker has against Payee. A different result
follows if the payee of a note negotiated it to a person who
12 took it as a holder in due course and that person pledged
the note as security for a debt. Because the defense cannot
14 be asserted against the pledgor, the pledgee can assert
rights as a holder in due course for the full amount of the
16 note for the benefit of both the pledgor and the pledgee.

18 7. There is a large body of state statutory and case law
restricting the use of the holder in due course doctrine in
20 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
22 similar law that may evolve in the future. Section 3-106(d)
[section 3-1106(4)] also relates to statutory or administrative
24 law intended to restrict use of the holder-in-due-course
doctrine. See Comment 3 to Section 3-106 [section 3-1106].

28 **§3-1303. Value and consideration**

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

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

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

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

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

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

50 (2) "Consideration" means any consideration sufficient to
52 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. 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

2 the apparent necessity, or lack of it, for acting without delay.
3 Unless the misrepresentation meets this test, the defense is cut
4 off by a holder in due course.

5 Subsection (a)(1)(iv) [subsection (1)(a)(iv)] states
6 specifically that the defense of discharge in insolvency
7 proceedings is not cut off when the instrument is purchased by a
8 holder in due course. "Insolvency proceedings" is defined in
9 Section 1-201(22) and it includes bankruptcy whether or not the
10 debtor is insolvent. Subsection (2)(e) of former Section 3-305
11 is omitted. The substance of that provision is stated in Section
12 3-601(b) [section 3-1601(2)].

13 2. Subsection (a)(2) [subsection (1)(b)] states other
14 defenses that, pursuant to subsection (b) [subsection (2)], are
15 cut off by a holder in due course. These defenses comprise those
16 specifically stated in Article 3 [Article 3-A] and those based on
17 common law contract principles. Article 3 [Article 3-A] defenses
18 are nonissuance of the instrument, conditional issuance, and
19 issuance for a special purpose (Section 3-105(b) [section 3-1105
20 (2)]); failure to countersign a traveler's check (Section
21 3-106(c) [section 3-1106(3)]); modification of the obligation by
22 a separate agreement (Section 3-117 [section 3-1117]); payment
23 that violates a restrictive indorsement (Section 3-206(f)
24 [section 3-1206(6)]); instruments issued without consideration or
25 for which promised performance has not been given (Section
26 3-303(b) [section 3-1303(2)]), and breach of warranty when a
27 draft is accepted (Section 3-417(b) [section 3-1417(2)]). The
28 most prevalent common law defenses are fraud, misrepresentation
29 or mistake in the issuance of the instrument. In most cases the
30 holder in due course will be an immediate or remote transferee of
31 the payee of the instrument. In most cases the
32 holder-in-due-course doctrine is irrelevant if defenses are being
33 asserted against the payee of the instrument, but in a small
34 number of cases the payee of the instrument may be a holder in
35 due course. Those cases are discussed in Comment 4 to Section
36 3-302 [section 3-1302].

37 Assume Buyer issues a note to Seller in payment of the price
38 of goods that Seller fraudulently promises to deliver but which
39 are never delivered. Seller negotiates the note to Holder who
40 has no notice of the fraud. If Holder is a holder in due course,
41 Holder is not subject to Buyer's defense of fraud. But in some
42 cases an original party to the instrument is a holder in due
43 course. For example, Buyer fraudulently induces Bank to issue a
44 cashier's check to the order of Seller. The check is delivered
45 by Bank to Seller, who has no notice of the fraud. Seller can be
46 a holder in due course and can take the check free of Bank's
47 defense of fraud. This case is discussed as Case #1 in Comment 4
48 to Section 3-302 [section 3-1302]. Former Section 3-305 stated
49 that a holder in due course takes free of defenses of "any party
50 to the instrument with whom the holder has not dealt." The
51

2 meaning of this language was not at all clear and if read
3 literally could have produced the wrong result. In the
4 hypothetical case, it could be argued that Seller "dealt" with
5 Bank because Bank delivered the check to Seller. But it is clear
6 that Seller should take free of Bank's defense against Buyer
7 regardless of whether Seller took delivery of the check from
8 Buyer or from Bank. The quoted language is not included in
9 Section 3-305 [section 3-1305]. It is not necessary. If Buyer
10 issues an instrument to Seller and Buyer has a defense against
11 Seller, that defense can obviously be asserted. Buyer and Seller
12 are the only people involved. The holder-in-due-course doctrine
13 has no relevance. The doctrine applies only to cases in which
14 more than two parties are involved. Its essence is that the
15 holder in due course does not have to suffer the consequences of
16 a defense of the obligor on the instrument that arose from an
17 occurrence with a third party.

18 3. Subsection (a)(3) [subsection (1)(c)] is concerned with
19 claims in recoupment which can be illustrated by the following
20 example. Buyer issues a note to the order of Seller in exchange
21 for a promise of Seller to deliver specified equipment. If
22 Seller fails to deliver the equipment or delivers equipment that
23 is rightfully rejected, Buyer has a defense to the note because
24 the performance that was the consideration for the note was not
25 rendered. Section 3-303(b) [section 3-1303(2)]. This defense is
26 included in Section 3-305(a)(2) [section 3-1305(1)(b)]. That
27 defense can always be asserted against Seller.
28

29 This result is the same as that reached under former Section
30 3-408.

31 But suppose Seller delivered the promised equipment and it
32 was accepted by Buyer. The equipment, however, was defective.
33 Buyer retained the equipment and incurred expenses with respect
34 to its repair. In this case, Buyer does not have a defense under
35 Section 3-303(b) [section 3-1303(2)]. Seller delivered the
36 equipment and the equipment was accepted. Under Article 2, Buyer
37 is obliged to pay the price of the equipment which is represented
38 by the note. But Buyer may have a claim against Seller for
39 breach of warranty. If Buyer has a warranty claim, the claim may
40 be asserted against Seller as a counterclaim or as a claim in
41 recoupment to reduce the amount owing on the note. It is not
42 relevant whether Seller is or is not a holder in due course of
43 the note or whether Seller knew or had notice that Buyer had the
44 warranty claim. It is obvious that holder-in-due-course doctrine
45 cannot be used to allow Seller to cut off a warranty claim that
46 Buyer has against Seller. Subsection (b) [subsection (2)]
47 specifically covers this point by stating that a holder in due
48 course is not subject to a "claim in recoupment * * * against a
49 person other than the holder."
50

2 Suppose Seller negotiates the note to Holder. If Holder had
3 notice of Buyer's warranty claim at the time the note was
4 negotiated to Holder, Holder is not a holder in due course
5 (Section 3-302(a)(2)(iv) [section 3-1302(1)(b)(iv)]) and Buyer
6 may assert the claim against Holder (Section 3-305(a)(3) [section
7 3-1305(1)(c)]) but only as a claim in recoupment, i.e. to reduce
8 the amount owed on the note. If the warranty claim is \$1,000 and
9 the unpaid note is \$10,000, Buyer owes \$9,000 to Holder. If the
10 warranty claim is more than the unpaid amount of the note, Buyer
11 owes nothing to Holder, but Buyer cannot recover the unpaid
12 amount of the warranty claim from Holder. If Buyer had already
13 partially paid the note, Buyer is not entitled to recover the
14 amounts paid. The claim can be used only as an offset to amounts
15 owing on the note. If Holder had no notice of Buyer's claim and
16 otherwise qualifies as a holder in due course, Buyer may not
17 assert the claim against Holder. Section 3-305(b) [section
18 3-1305(2)].

19 The result under Section 3-305 [section 3-1305] is
20 consistent with the result reached under former Article 3, but
21 the rules for reaching the result are stated differently. Under
22 former Article 3 Buyer could assert rights against Holder only if
23 Holder was not a holder in due course, and Holder's status
24 depended upon whether Holder had notice of a defense by Buyer.
25 Courts have held that Holder had that notice if Holder had notice
26 of Buyer's warranty claim. The rationale under former Article 3
27 was "failure of consideration." This rationale does not
28 distinguish between cases in which the seller fails to perform
29 and those in which the buyer accepts the performance of seller
30 but makes a claim against the seller because the performance is
31 faulty. The term "failure of consideration" is subject to
32 varying interpretations and is not used in Article 3 [Article
33 3-A]. The use of the term "claim in recoupment" in Section
34 3-305(a)(3) [section 3-1305(1)(c)] is a more precise statement of
35 the nature of Buyer's right against Holder. The use of the term
36 does not change the law because the treatment of a defense under
37 subsection (a)(2) [subsection (1)(b)] and a claim in recoupment
38 under subsection (a)(3) [subsection (1)(c)] is essentially the
39 same.

40 Under former Article 3, case law was divided on the issue of
41 the extent to which an obligor on a note could assert against a
42 transferee who is not a holder in due course a debt or other
43 claim that the obligor had against the original payee of the
44 instrument. Some courts limited claims to those that arose in
45 the transaction that gave rise to the note. This is the approach
46 taken in Section 3-305(a)(3) [section 3-1305(1)(c)]. Other
47 courts allowed the obligor on the note to use any debt or other
48 claim, no matter how unrelated to the note, to offset the amount
49 owed on the note. Under current judicial authority and non-UCC
50 statutory law, there will be many cases in which a transferee of
51 a note arising from a sale transaction will not qualify as a

2 holder in due course. For example, applicable law may require
3 the use of a note to which there cannot be a holder in due
4 course. See Section 3-106(d) [section 3-1106(4)] and Comment 3
5 to Section 3-106 [section 3-1106]. It is reasonable to provide
6 that the buyer should not be denied the right to assert claims
7 arising out of the sale transaction. Subsection (a)(3)
8 [subsection (1)(c)] is based on the belief that it is not
9 reasonable to require the transferee to bear the risk that wholly
10 unrelated claims may also be asserted. The determination of
11 whether a claim arose from the transaction that gave rise to the
12 instrument is determined by law other than this Article and thus
13 may vary as local law varies.

14 4. Subsection (c) [subsection (3)] concerns claims and
15 defenses of a person other than the obligor on the instrument.
16 It applies principally to cases in which an obligation is paid
17 with the instrument of a third person. For example, Buyer buys
18 goods from Seller and negotiates to Seller a cashier's check
19 issued by Bank in payment of the price. Shortly after delivering
20 the check to Seller, Buyer learns that Seller had defrauded Buyer
21 in the sale transaction. Seller may enforce the check against
22 Bank even though Seller is not a holder in due course. Bank has
23 no defense to its obligation to pay the check and it may not
24 assert defenses, claims in recoupment, or claims to the
25 instrument of Buyer, except to the extent permitted by the "but"
26 clause of the first sentence of subsection (c) [subsection (3)].
27 Buyer may have a claim to the instrument under Section 3-306
28 [section 3-1306] based on a right to rescind the negotiation to
29 Seller because of Seller's fraud. Section 3-202(b) [section
30 3-1202(2)] and Comment 2 to Section 3-201 [section 3-1201]. Bank
31 cannot assert that claim unless Buyer is joined in the action in
32 which Seller is trying to enforce payment of the check. In that
33 case Bank may pay the amount of the check into court and the
34 court will decide whether that amount belongs to Buyer or
35 Seller. The last sentence of subsection (c) [subsection (3)]
36 allows the issuer of an instrument such as a cashier's check to
37 refuse payment in the rare case in which the issuer can prove
38 that the instrument is a lost or stolen instrument and the person
39 seeking enforcement does not have rights of a holder in due
40 course.

41 5. Subsection (d) [subsection (4)] applies to instruments
42 signed for accommodation (Section 3-419 [section 3-1419]) and
43 this subsection equates the obligation of the accommodation party
44 to that of the accommodated party. The accommodation party can
45 assert whatever defense or claim the accommodated party had
46 against the person enforcing the instrument. The only exceptions
47 are discharge in bankruptcy, infancy and lack of capacity. The
48 same rule does not apply to an indorsement by a holder of the
49 instrument in negotiating the instrument. The indorser, as
50 transferor, makes a warranty to the indorsee, as transferee, that
51 no defense or claim in recoupment is good against the indorser.

2 Section 3-416(a)(4) [section 3-1416(1)(d)]. Thus, if the
4 indorsee sues the indorser because of dishonor of the instrument,
6 the indorser may not assert the defense or claim in recoupment of
8 the maker or drawer against the indorsee.

10 **§3-1306. Claims to an instrument**

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

24 **Uniform Commercial Code Comment**

26 This section expands on the reference to "claims to" the
28 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)].

32 **§3-1307. Notice of breach of fiduciary duty**

34 **(1) In this section:**

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

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

40 **(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 instrument is a breach of fiduciary duty,
the following rules apply.

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

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

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

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

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

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

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

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

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

50 **(iii) Deposited to an account other than an account of**
52 **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 depository 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.

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

11 4. Subsection (b)(3) [subsection (2)(c)] is based on
12 Uniform Fiduciaries Act § 6 and applies when the instrument is
13 drawn by the represented person or the fiduciary as such to the
14 fiduciary personally. The term "personally" is used as it is
15 used in the Uniform Fiduciaries Act to mean that the instrument
16 is payable to the payee as an individual and not as a fiduciary.
17 For example, Doe as President of Corporation writes a check on
18 Corporation's account to the order of Doe personally. The check
19 is then indorsed over to Bank as in Comment 3. In this case
20 there is no notice of breach of fiduciary duty because there is
21 nothing unusual about the transaction. Corporation may have owed
22 Doe money for salary, reimbursement for expenses incurred for the
23 benefit of Corporation, or for any other reason. If Doe is
24 authorized to write checks on behalf of Corporation to pay debts
25 of Corporation, the check is a normal way of paying a debt owed
26 to Doe. Bank may assume that Doe may use the instrument for his
27 personal benefit.

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

50 §3-1308. Proof of signatures and status as holder in due course

2 (1) In an action with respect to an instrument, the
3 authenticity of, and authority to make, each signature on the
4 instrument is admitted unless specifically denied in the
5 pleadings. If the validity of a signature is denied in the
6 pleadings, the burden of establishing validity is on the person
7 claiming validity, but the signature is presumed to be authentic
8 and authorized unless the action is to enforce the liability of
9 the purported signer and the signer is dead or incompetent at the
10 time of trial of the issue of validity of the signature. If an
11 action to enforce the instrument is brought against a person as
12 the undisclosed principal of a person who signed the instrument
13 as a party to the instrument, the plaintiff has the burden of
14 establishing that the defendant is liable on the instrument as a
15 represented person under section 3-1402, subsection (1).

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

26 **Uniform Commercial Code Comment**

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

42 The question of the burden of establishing the signature
43 arises only when it has been put in issue by specific denial.
44 "Burden of establishing" is defined in Section 1-201. The burden
45 is on the party claiming under the signature, but the signature
46 is presumed to be authentic and authorized except as stated in
47 the second sentence of subsection (a) [subsection (1)].
48 "Presumed" is defined in Section 1-201 and means that until some
49

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

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

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

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

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

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

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

26 §3-1311. Accord and satisfaction by use of instrument

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

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

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

33 (c) The claimant obtained payment of the instrument.

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

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

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

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

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

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

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

Uniform Commercial Code Comment

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

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

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

52 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

2 claimant to a settlement of the dispute for the amount
4 tendered. Before enactment of revised Article 3 [Article
6 3-A], the case law was in conflict over the question of
8 whether obtaining payment of the check had the effect of an
10 agreement to the settlement proposed by the debtor. This
12 issue was governed by a common law rule, but some courts
14 hold that the common law was modified by former Section
16 1-207 which they interpreted as applying to full settlement
18 checks.

20 2. Comment d. to Restatement of Contracts, Section 281
22 discusses the full satisfaction check and the applicable common
24 law rule. In a case like Case #1, the buyer can propose a
26 settlement of the disputed bill by a clear notation on the check
28 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."

28 3. As part of the revision of Article 3 [Article 3-A],
30 Section 1-207 has been amended to add subsection (2) stating that
32 Section 1-207 "does not apply to an accord and satisfaction."
34 Because of that amendment and revised Article 3 [Article 3-A],
36 Section 3-311 [section 3-1311] governs full satisfaction checks.
38 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.

46 4. Subsection (a) [subsection (1)] states three
48 requirements for application of Section 3-311 [section 3-1311].
50 "Good faith" in subsection (a)(i) [subsection (1)(a)] is defined
52 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

2 facts in the particular case. For example, suppose an insurer
3 tenders a check in settlement of a claim for personal injury in
4 an accident clearly covered by the insurance policy. The
5 claimant is necessitous and the amount of the check is very small
6 in relationship to the extent of the injury and the amount
7 recoverable under the policy. If the trier of fact determines
8 that the insurer was taking unfair advantage of the claimant, an
9 accord and satisfaction would not result from payment of the
10 check because of the absence of good faith by the insurer in
11 making the tender. Another example of lack of good faith is
12 found in the practice of some business debtors in routinely
13 printing full satisfaction language on their check stocks so that
14 all or a large part of the debts of the debtor are paid by checks
15 bearing the full satisfaction language, whether or not there is
16 any dispute with the creditor. Under such a practice the
17 claimant cannot be sure whether a tender in full satisfaction is
18 or is not being made. Use of a check on which full satisfaction
19 language was affixed routinely pursuant to such a business
20 practice may prevent an accord and satisfaction on the ground
21 that the check was not tendered in good faith under subsection
22 (a)(i) [subsection (1)].

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

30 The person seeking the accord and satisfaction must prove
31 that the requirements of subsection (a) [subsection (1)] are
32 met. If that person also proves that the statement required by
33 subsection (b) [subsection (2)] was given, the claim is
34 discharged unless subsection (c) [subsection (3)] applies.
35 Normally the statement required by subsection (b) [subsection
36 (2)] is written on the check. Thus, the canceled check can be
37 used to prove the statement as well as the fact that the claimant
38 obtained payment of the check. Subsection (b) [subsection (2)]
39 requires a "conspicuous" statement that the instrument was
40 tendered in full satisfaction of the claim. "Conspicuous" is
41 defined in Section 1-201(10). The statement is conspicuous if
42 "it is so written that a reasonable person against whom it is to
43 operate ought to have noticed it." If the claimant can
44 reasonably be expected to examine the check, almost any statement
45 on the check should be noticed and is therefore conspicuous. In
46 cases in which the claimant is an individual the claimant will
47 receive the check and will normally indorse it. Since the
48 statement concerning tender in full satisfaction normally will
49 appear above the space provided for the claimant's indorsement of
50 the check, the claimant "ought to have noticed" the statement.
51

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

89 Subsection (c)(2) [subsection (3)(b)] is also designed
90 to prevent inadvertent accord and satisfaction. It can be used
91 by a claimant other than an organization or by a claimant as an
92 alternative to subsection (c)(1) [subsection (3)(a)]. Some
93 organizations may be reluctant to use subsection (c)(1)
94 [subsection (3)(a)] because it may result in confusion of
95 customers that causes checks to be routinely sent to the special
96 designated person, office, or place. Thus, much of the benefit
97 of rapid processing of checks may be lost. An organization that
98 chooses not to send a notice complying with subsection (c)(1)(i)
99 [subsection (3)(a)(i)] may prevent an inadvertent accord and
100 satisfaction by complying with subsection (c)(2) [subsection
101 (3)(b)]. If the claimant discovers that it has obtained payment
102 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 (2) A signature may be made:

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

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

12 **Uniform Commercial Code Comment**

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

28 2. A signature may be handwritten, typed, printed or made
30 in any other manner. It need not be subscribed, and may appear
32 in the body of the instrument, as in the case of "I, John Doe,
34 promise to pay * * *" without any other signature. It may be
36 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)].

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

44 **§3-1402. Signature by representative**

46 (1) If a person acting, or purporting to act, as a
48 representative signs an instrument by signing either the name of
50 the represented person or the name of the signer, the represented
52 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.

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

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

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

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

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

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

48 **Uniform Commercial Code Comment**

50 1. Subsection (a) [subsection (1)] states when the
52 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

2 also prove that P authorized A to sign on P's behalf, why
3 shouldn't P also be liable on the instrument? To recognize the
4 liability of P takes nothing away from the utility of negotiable
5 instruments. Furthermore, imposing liability on P has the merit
6 of making it impossible to have an instrument on which nobody is
7 liable even though it was authorized by P. That result could
8 occur under former Section 3-401(1) if an authorized agent signed
9 "as agent" but the note did not identify the principal. If the
10 dispute was between the agent and the payee of the note, the
11 agent could escape liability on the note by proving that the
12 agent and the payee did not intend that the agent be liable on
13 the note when the note was issued. Former Section 3-403(2)(b).
14 Under the prevailing interpretation of former Section 3-401(1),
15 the principal was not liable on the note under former Section
16 3-401(1) because the principal's name did not appear on the
17 note. Thus, nobody was liable on the note even though all
18 parties knew that the note was signed by the agent on behalf of
19 the principal. Under Section 3-402(a) [section 3-1402(1)] the
20 principal would be liable on the note.

21
22 2. Subsection (b) [subsection (2)] concerns the question of
23 when an agent who signs an instrument on behalf of a principal is
24 bound on the instrument. The approach followed by former Section
25 3-403 was to specify the form of signature that imposed or
26 avoided liability. This approach was unsatisfactory. There are
27 many ways in which there can be ambiguity about a signature. It
28 is better to state a general rule. Subsection (b)(1) [subsection
29 (2)(a)] states that if the form of the signature unambiguously
30 shows that it is made on behalf of an identified represented
31 person (for example, "P, by A, Treasurer") the agent is not
32 liable. This is a workable standard for a court to apply.
33 Subsection (b)(2) [subsection (2)(b)] partly changes former
34 Section 3-403(2). Subsection (b)(2) [subsection (2)(b)] relates
35 to cases in which the agent signs on behalf of a principal but
36 the form of the signature does not fall within subsection (b)(1)
37 [subsection (2)(a)]. The following cases are illustrative. In
38 each case John Doe is the authorized agent of Richard Roe and
39 John Doe signs a note on behalf of Richard Roe. In each case the
40 intention of the original parties to the instrument is that Roe
41 is to be liable on the instrument but Doe is not to be liable.

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

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

47 Case #3. The name "Richard Roe" is written on the note
48 and immediately below that name Doe signs "John Doe" without
49 indicating that Doe signed as agent.
50
51

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

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

19
20 A number of cases under former Article 3 involved situations
21 in which an agent signed the agent's name to a note, without
22 qualification and without naming the person represented,
23 intending to bind the principal but not the agent. The agent
24 attempted to prove that the other party had the same intention.
25 Some of these cases involved mistake, and in some there was
26 evidence that the agent may have been deceived into signing in
27 that manner. In some of the cases the court refused to allow
28 proof of the intention of the parties and imposed liability on
29 the agent based on former Section 3-403(2)(a) even though both
30 parties to the instrument may have intended that the agent not be
31 liable. Subsection (b)(2) [subsection (2)(b)] changes the result
32 of those cases, and is consistent with Section 3-117 [section
33 3-1117] which allows oral or written agreements to modify or
34 nullify apparent obligations on the instrument.

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

41
42 3. Subsection (c) [subsection (3)] is directed at the check
43 cases. It states that if the check identifies the represented
44 person the agent who signs on the signature line does not have to
45 indicate agency status. Virtually all checks used today are in
46 personalized form which identify the person on whose account the
47 check is drawn. In this case, nobody is deceived into thinking
48 that the person signing the check is meant to be liable. This
49 subsection is meant to overrule cases decided under former
50 Article 3 such as Griffin v. Ellinger, 538 S.W.2d 97 (Texas
51 1976).
52

2 **§3-1403. Unauthorized signature**

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

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

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

30 **Uniform Commercial Code Comment**

32 1. "Unauthorized" signature is defined in Section 1-201(43)
34 as one that includes a forgery as well as a signature made by one
36 exceeding actual or apparent authority. Former Section 3-404(1)
38 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.

40 2. The except clause of the first sentence of subsection
42 (a) [subsection (1)] states the generally accepted rule that the
44 unauthorized signature, while it is wholly inoperative as that of
46 the person whose name is signed, is effective to impose liability
48 upon the signer or to transfer any rights that the signer may
50 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.

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

22 Ratification is effective for all purposes of this Article.
24 The unauthorized signature becomes valid so far as its effect as
26 a signature is concerned. Although the ratification may relieve
28 the signer of liability on the instrument, it does not of itself
30 relieve the signer of liability to the person whose name is
32 signed. It does not in any way affect the criminal law. No
34 policy of the criminal law prevents a person whose name is forged
36 to assume liability to others on the instrument by ratifying the
38 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.

40 4. Subsection (b) [subsection (2)] clarifies the meaning of
42 "unauthorized" in cases in which an instrument contains less than
44 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)) 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.

46 Subsection (b) [subsection (2)] refers to "the authorized
48 signature of an organization." The definition of "organization"
50 in Section 1-201(28) is very broad. It covers not only
52 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.

2 **§3-1404. Impostors: fictitious payees**

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

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

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

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

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

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

52 (b) The instrument, whether or not indorsed, is deposited
in a depository 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

2 previous law in some respects. Former Section 3-405 was read by
4 some courts to require that the indorsement be in the exact name
6 of the named payee. Revised Article 3 [Article 3-A] rejects this
8 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).

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 Depository Bank.
Under subsection (b)(2) [subsection (2)(b)] and (c)(i)
[subsection (3)(a)], the indorsement is effective to make
Depository 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)]

2 applies because Treasurer did not intend Supplier Co. to
4 have any interest in the check. It does not make any
6 difference whether Supplier Co. was or was not a creditor of
8 Corporation when the check was drawn. If Treasurer did not
10 decide to steal the check until after the check was drawn,
12 the case is covered by Section 3-405 [section 3-1405] rather
14 than Section 3-404(b) [section 3-1404(2)], but the result is
16 the same. See Case #6 in Comment 3 to Section 3-405
18 [section 3-1405].

20 Case #3. Checks of Corporation must be signed by two
22 officers. President and Treasurer both sign a check of
24 Corporation payable to Supplier Co., a company that does
26 business with Corporation from time to time but to which
28 Corporation does not owe any money. Treasurer knows that no
30 money is owed to Supplier Co. and does not intend that
32 Supplier Co. have any interest in the check. President
34 believes that money is owed to Supplier Co. Treasurer
36 obtains possession of the check after it is signed.
38 Subsection (b) [subsection (2)] applies because Treasurer is
40 "a person whose intent determines to whom an instrument is
42 payable" and Treasurer does not intend Supplier Co. to have
44 any interest in the check. Treasurer becomes the holder of
46 the check and may negotiate it by indorsing it in the name
48 "Supplier Co."

20 Case #4. Checks of Corporation are signed by a
22 check-writing machine. Names of payees of checks produced
24 by the machine are determined by information entered into
26 the computer that operates the machine. Thief, a person who
28 is not an employee or other agent of Corporation, obtains
30 access to the computer and causes the check-writing machine
32 to produce a check payable to Supplier Co., a non-existent
34 company. Subsection (b)(ii) [subsection (2)(b)] applies.
36 Thief then obtains possession of the check. At that point
38 Thief becomes the holder of the check because Thief is the
40 person in possession of the instrument. Subsection (b)(1)
42 [subsection (2)(a)]. Under Section 3-301 [section 3-1301]
44 Thief, as holder, is the "person entitled to enforce the
46 instrument" even though Thief does not have title to the
48 check and is in wrongful possession of it. Thief indorses
50 the check in the name "Supplier Co." and deposits it in an
52 account in Depository Bank which Thief opened in the name
"Supplier Co." Depository 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. Depository 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

2 entitled to pay the check and charge Corporation's account
4 if there was an agreement with Corporation allowing the bank
6 to debit Corporation's account for payment of checks
8 produced by the check-writing machine whether or not
10 authorized. The indorsement is also effective if Supplier
12 Co. is a real person. In that case subsection (b)(i)
14 [subsection (2)(a)] applies. Under Section 3-110(b)
16 [section 3-110(2)] Thief is the person whose intent
18 determines to whom the check is payable, and Thief did not
20 intend Supplier Co. to have any interest in the check. When
22 the drawee bank pays the check, there is no breach of
24 warranty under Section 3-417(a)(1) [section 3-1417(1)(a)] or
26 4-208(a)(1) because Depository Bank was a person entitled to
28 enforce the check when it was forwarded for payment.

20 Case #5. Thief, who is not an employee or agent of
22 Corporation, steals check forms of Corporation. John Doe is
24 president of Corporation and is authorized to sign checks on
26 behalf of Corporation as drawer. Thief draws a check in the
28 name of Corporation as drawer by forging the signature of
30 Doe. Thief makes the check payable to the order of Supplier
32 Co. with the intention of stealing it. Whether Supplier Co.
34 is a fictitious person or a real person, Thief becomes the
36 holder of the check and the person entitled to enforce it.
38 The analysis is the same as that in Case #4. Thief deposits
40 the check in an account in Depository Bank which Thief
42 opened in the name "Supplier Co." Thief either indorses the
44 check in a name other than "Supplier Co." or does not
46 indorse the check at all. Under Section 4-205(a) a
48 depository 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. Depository 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) because Depository
Bank was a person entitled to enforce the check when it was
forwarded for payment and, unless Depository 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). 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.

50 3. In cases governed by subsection (a) [subsection (1)] the
52 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. Depository 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 Depository Bank on the basis of payment by mistake because Depository 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 depository 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 depository 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 depository 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). This doctrine is based on the assumption that the depository 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 depository 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 depository 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 depository 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

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

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

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

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

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

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

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

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

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

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

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

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

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

8 **Uniform Commercial Code Comment**

10 1. Section 3-405 [section 3-1405] is addressed to
11 fraudulent indorsements made by an employee with respect to
12 instruments with respect to which the employer has given
13 responsibility to the employee. It covers two categories of
14 fraudulent indorsements: indorsements made in the name of the
15 employer to instruments payable to the employer and indorsements
16 made in the name of payees of instruments issued by the
17 employer. This section applies to instruments generally but
18 normally the instrument will be a check. Section 3-405 [section
19 3-1405] adopts the principle that the risk of loss for fraudulent
20 indorsements by employees who are entrusted with responsibility
21 with respect to checks should fall on the employer rather than
22 the bank that takes the check or pays it, if the bank was not
23 negligent in the transaction. Section 3-405 [section 3-1405] is
24 based on the belief that the employer is in a far better position
25 to avoid the loss by care in choosing employees, in supervising
26 them, and in adopting other measures to prevent forged
27 indorsements on instruments payable to the employer or fraud in
28 the issuance of instruments in the name of the employer. If the
29 bank failed to exercise ordinary care, subsection (b) [subsection
30 (2)] allows the employer to shift loss to the bank to the extent
31 the bank's failure to exercise ordinary care contributed to the
32 loss. "Ordinary care" is defined in Section 3-103(a)(7) [section
33 3-1103(1)(g)]. The provision applies regardless of whether the
34 employer is negligent.

36 The first category of cases governed by Section 3-405
37 [section 3-1405] are those involving indorsements made in the
38 name of payees of instruments issued by the employer. In this
39 category, Section 3-405 [section 3-1405] includes cases that were
40 covered by former Section 3-405(1)(c). The scope of Section
41 3-405 [section 3-1405] in revised Article 3 [Article 3-A] is,
42 however, somewhat wider. It covers some cases not covered by
43 former Section 3-405(1)(c) in which the entrusted employee makes
44 a forged indorsement to a check drawn by the employer. An
45 example is Case #6 in Comment 3. Moreover, a larger group of
46 employees is included in revised Section 3-405 [section 3-1405].
47 The key provision is the definition of "responsibility" in
48 subsection (a)(1) [sic] which identifies the kind of
49 responsibility delegated to an employee which will cause the
50 employer to take responsibility for the fraudulent acts of that
51 employee. An employer can insure this risk by employee fidelity
52 bonds.

2 The second category of cases governed by Section 3-405
[section 3-1405] -- fraudulent indorsements of the name of the
4 employer to instruments payable to the employer -- were covered
in former Article 3 by Section 3-406 [section 3-1406]. Under
6 former Section 3-406, the employer took the loss only if
negligence of the employer could be proved. Under revised
8 Article 3 [Article 3-A], Section 3-406 [section 3-1406] need not
be used with respect to forgeries of the employer's indorsement.
10 Section 3-405 [section 3-1405] imposes the loss on the employer
without proof of negligence.

12 2. With respect to cases governed by former Section
3-405(1)(c), Section 3-405 [section 3-1405] is more favorable to
14 employers in one respect. The bank was entitled to the
preclusion provided by former Section 3-405(1)(c) if it took the
16 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
18 good faith. Under revised Section 3-405 [section 3-1405] the
loss may be recovered from the bank to the extent the failure of
20 the bank to exercise ordinary care contributed to the loss.

22 3. Section 3-404(b) [section 3-1404(2)] and Section 3-405
[section 3-1405] both apply to cases of employee fraud. Section
24 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
26 employee fraud. The following cases illustrate the application
of Section 3-405 [section 3-1405]. In each case it is assumed
28 that the bank that took the check acted in good faith and was not
negligent.

30
32 Case #1. Janitor, an employee of Employer, steals a
check for a very large amount payable to Employer after
34 finding it on a desk in one of Employer's offices. Janitor
forges Employer's indorsement on the check and obtains
36 payment. Since Janitor was not entrusted with
"responsibility" with respect to the check, Section 3-405
38 [section 3-1405] does not apply. Section 3-406 [section
3-1406] might apply to this case. The issue would be
40 whether Employer was negligent in safeguarding the check.
If not, Employer could assert that the indorsement was
42 forged and bring an action for conversion against the
depository or payor bank under Section 3-420 [section
44 3-1420].

46 Case #2. X is Treasurer of Corporation and is
authorized to write checks on behalf of Corporation by
48 signing X's name as Treasurer. X draws a check in the name
of Corporation and signs X's name as Treasurer. The check
50 is made payable to X. X then indorses the check and obtains
payment. Assume that Corporation did not owe any money to X
52 and did not authorize X to write the check. Although the

2 writing of the check was not authorized, Corporation is
bound as drawer of the check because X had authority to sign
4 checks on behalf of Corporation. This result follows from
agency law and Section 3-402(a) [section 3-1402(1)].
6 Section 3-405 [section 3-1405] does not apply in this case
because there is no forged indorsement. X was payee of the
8 check so the indorsement is valid. Section 3-110(a)
[section 3-1110(1)].

10 Case #3. The duties of Employee, a bookkeeper, include
posting the amounts of checks payable to Employer to the
12 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
14 by Employee to an account in Depository Bank which Employee
opened in the same name as Employer, and the check is
16 honored by the drawee bank. The indorsement is effective as
Employer's indorsement because Employee's duties include
18 processing checks for bookkeeping purposes. Thus, Employee
is entrusted with "responsibility" with respect to the
20 check. Neither Depository Bank nor the drawee bank is
liable to Employer for conversion of the check. The same
22 result follows if Employee deposited the check in the
account in Depository Bank without indorsement. Section
24 4-205(a). Under subsection (c) [subsection (3)] deposit in
a depository bank in an account in a name substantially
26 similar to that of Employer is the equivalent of an
indorsement in the name of Employer.

30 Case #4. Employee's duties include stamping Employer's
unrestricted blank indorsement on checks received by
32 Employer and depositing them in Employer's bank account.
After stamping Employer's unrestricted blank indorsement on
34 a check, Employee steals the check and deposits it in
Employee's personal bank account. Section 3-405 [section
36 3-1405] doesn't apply because there is no forged
indorsement. Employee is authorized by Employer to indorse
38 Employer's checks. The fraud by Employee is not the
indorsement but rather the theft of the indorsed check.
40 Whether Employer has a cause of action against the bank in
which the check was deposited is determined by whether the
42 bank had notice of the breach of fiduciary duty by
Employee. The issue is determined under Section 3-307
44 [section 3-1307].

46 Case #5. The computer that controls Employer's
check-writing machine was programmed to cause a check to be
48 issued to Supplier Co. to which money was owed by Employer.
The address of Supplier Co. was included in the information
50 in the computer. Employee is an accounts payable clerk
whose duties include entering information into the
52 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 Depository 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 Depository Bank under Section 3-417(a)(1) [section 3-1417(1)(a)] or 4-208(a)(1).

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 Depository 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 Depository Bank which Clerk opened in the name "Supplier Co.". The check is honored by the drawee bank. Section 3-404(b)(1) [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 Depository 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 depository 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 depository 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 Depository 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. Depository 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 Depository 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 Depository 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 Depository 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

2 from asserting the alteration or the forgery against a person
3 who, in good faith, pays the instrument or takes it for value or
4 for collection.

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

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

16 Uniform Commercial Code Comment

17 1. Section 3-406(a) [section 3-1406(1)] is based on former
18 Section 3-406. With respect to alteration, Section 3-406
19 [section 3-1406] adopts the doctrine of Young v. Grote, 4 Bing.
20 253 (1827), which held that a drawer who so negligently draws an
21 instrument as to facilitate its material alteration is liable to
22 a drawee who pays the altered instrument in good faith. Under
23 Section 3-406 [section 3-1406] the doctrine is expanded to apply
24 not only to drafts but to all instruments. It includes in the
25 protected class any "person who, in good faith, pays the
26 instrument or takes it for value or for collection." Section
27 3-406 [section 3-1406] rejects decisions holding that the maker
28 of a note owes no duty of care to the holder because at the time
29 the instrument is issued there is no contract between them. By
30 issuing the instrument and "setting it afloat upon a sea of
31 strangers" the maker or drawer voluntarily enters into a relation
32 with later holders which justifies imposition of a duty of care.
33 In this respect an instrument so negligently drawn as to
34 facilitate alteration does not differ in principle from an
35 instrument containing blanks which may be filled. Under Section
36 3-407 [section 3-1407] a person paying an altered instrument or
37 taking it for value, in good faith and without notice of the
38 alteration may enforce rights with respect to the instrument
39 according to its original terms. If negligence of the obligor
40 substantially contributes to an alteration, this section gives
41 the holder or the payor the alternative right to treat the
42 altered instrument as though it had been issued in the altered
43 form.

44 No attempt is made to define particular conduct that will
45 constitute "failure to exercise ordinary care [that]
46 substantially contributes to an alteration." Rather, "ordinary
47 care" is defined in Section 3-103(a)(7) [section 3-1103(1)(g)] in
48 general terms. The question is left to the court or the jury for
49
50
51
52

2 decision in the light of the circumstances in the particular case
3 including reasonable commercial standards that may apply.

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

10 2. Section 3-406 [section 3-1406] applies equally to a
11 failure to exercise ordinary care that substantially contributes
12 to the making of a forged signature on an instrument. Section
13 3-406 [section 3-1406] refers to "forged signature" rather than
14 "unauthorized signature" that appeared in former Section 3-406
15 because it more accurately describes the scope of the provision.
16 Unauthorized signature is a broader concept that includes not
17 only forgery but also the signature of an agent which does not
18 bind the principal under the law of agency. The agency cases are
19 resolved independently under agency law. Section 3-406 [section
20 3-1406] is not necessary in those cases.

21 The "substantially contributes" test of former Section 3-406
22 is continued in this section in preference to a "direct and
23 proximate cause" test. The "substantially contributes" test is
24 meant to be less stringent than a "direct and proximate cause"
25 test. Under the less stringent test the preclusion should be
26 easier to establish. Conduct "substantially contributes" to a
27 material alteration or forged signature if it is a contributing
28 cause of the alteration or signature and a substantial factor in
29 bringing it about. The analysis of "substantially contributes"
30 in former Section 3-406 by the court in Thompson Maple Products
31 v. Citizens National Bank of Corry, 234 A.2d 32 (Pa. Super. Ct.
32 1967), states what is intended by the use of the same words in
33 revised Section 3-406(b) [section 3-1406(2)]. Since Section
34 3-404(d) [section 3-1404(4)] and Section 3-405(b) [section
35 3-1405(2)] also use the words "substantially contributes" the
36 analysis of these words also applies to those provisions.
37
38

39 3. The following cases illustrate the kind of conduct that
40 can be the basis of a preclusion under Section 3-406(a) [section
41 3-1406(1)]:

42 Case #1. Employer signs checks drawn on Employer's
43 account by use of a rubber stamp of Employer's signature.
44 Employer keeps the rubber stamp along with Employer's
45 personalized blank check forms in an unlocked desk drawer.
46 An unauthorized person fraudulently uses the check forms to
47 write checks on Employer's account. The checks are signed
48 by use of the rubber stamp. If Employer demands that
49 Employer's account in the drawee bank be recredited because
50 the forged check was not properly payable, the drawee bank
51
52

2 may defend by asserting that Employer is precluded from
3 asserting the forgery. The trier of fact could find that
4 Employer failed to exercise ordinary care to safeguard the
5 rubber stamp and the check forms and that the failure
6 substantially contributed to the forgery of Employer's
signature by the unauthorized use of the rubber stamp.

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

24 Case #3. A company writes a check for \$10. The figure
25 "10" and the word "ten" are typewritten in the appropriate
26 spaces on the check form. A large blank space is left after
27 the figure and the word. The payee of the check, using a
28 typewriter with a typeface similar to that used on the
29 check, writes the word "thousand" after the word "ten" and a
30 comma and three zeros after the figure "10". The drawee
31 bank in good faith pays \$10,000 when the check is presented
32 for payment and debits the account of the drawer in that
33 amount. The trier of fact could find that the drawer failed
34 to exercise ordinary care in writing the check and that the
35 failure substantially contributed to the alteration. In
36 that case the drawer is precluded from asserting the
37 alteration against the drawee if the check was paid in good
38 faith.

39 4. Subsection (b) [subsection (2)] differs from former
40 Section 3-406 in that it adopts a concept of comparative
41 negligence. If the person precluded under subsection (a)
42 [subsection (1)] proves that the person asserting the preclusion
43 failed to exercise ordinary care and that failure substantially
44 contributed to the loss, the loss may be allocated between the
45 two parties on a comparative negligence basis. In the case of a
46 forged indorsement the litigation is usually between the payee of
47 the check and the depository bank that took the check for
48 collection. An example is a case like Case #1 of Comment 3 to
49 Section 3-405 [section 3-1405]. If the trier of fact finds that
50 Employer failed to exercise ordinary care in safeguarding the
51

2 check and that the failure substantially contributed to the
3 making of the forged indorsement, subsection (a) [subsection (1)]
4 of Section 3-406 [section 3-1406] applies. If Employer brings an
5 action for conversion against the depository bank that took the
6 checks from the forger, the depository bank could assert the
7 preclusion under subsection (a) [subsection (1)]. But suppose
8 the forger opened an account in the depository bank in a name
9 identical to that of Employer, the payee of the check, and then
10 deposited the check in the account. Subsection (b) [subsection
11 (2)] may apply. There may be an issue whether the depository
12 bank should have been alerted to possible fraud when a new
13 account was opened for a corporation shortly before a very large
14 check payable to a payee with the same name is deposited.
15 Circumstances surrounding the opening of the account may have
16 suggested that the corporation to which the check was payable may
17 not be the same as the corporation for which the account was
18 opened. If the trier of fact finds that collecting the check
19 under these circumstances was a failure to exercise ordinary
20 care, it could allocate the loss between the depository bank and
21 Employer, the payee.

22 §3-1407. Alteration

23 (1) "Alteration" means:

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

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

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

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

39 (a) According to its original terms; or

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

42 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;

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

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

14 (d) Payment is prohibited by law.

16 **Uniform Commercial Code Comment**

18 1. In some cases a creditor may require that the debt be
20 paid by an obligation of a bank. The debtor may comply by
22 obtaining certification of the debtor's check, but more
24 frequently the debtor buys from a bank a cashier's check or
26 teller's check payable to the creditor. The check is taken by
28 the creditor as a cash equivalent on the assumption that the bank
30 will pay the check. Sometimes, the debtor wants to retract
32 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.

34 2. The term "obligated bank" refers to the issuer of the
36 cashier's check or teller's check and the acceptor of the
38 certified check. If the obligated bank wrongfully refuses to
40 pay, it is liable to pay for expenses and loss of interest
42 resulting from the refusal to pay. There is no express provision
44 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.

46 3. Subsection (c) [subsection (3)] provides that expenses
48 or consequential damages are not recoverable if the refusal to
50 pay is because of the reasons stated. The purpose is to limit
52 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

2 that it has, but normally the bank would not have a claim or
4 defense. In the usual case it is a remitter that is asserting a
6 claim to the check on the basis of a rescission of negotiation to
8 the payee under Section 3-202 [subsection 3-1202]. See Comment 2
10 to Section 3-201 [subsection 3-1201]. The bank can assert that
12 claim if there is compliance with Section 3-305(c) [section
14 3-1505(3)], but the bank is not protected from damages under
16 subsection (b) [subsection (2)] if the claim of the remitter is
18 not upheld. In that case, the bank is insulated from damages
20 only if payment is enjoined under Section 3-602(b)(1) [section
22 3-1602(2)(b)]. Subsection (c)(iii) [subsection (3)(c)] refers to
24 cases in which the bank may have a reasonable doubt about the
26 identity of the person demanding payment. For example, a
28 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.

30 **§3-1412. Obligation of issuer of note or cashier's check**

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

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

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

50 **Uniform Commercial Code Comment**

52 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

2 than that of the drawer of a draft. Thus, Section 3-412 [section
3-1412] does not in substance change former law.

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

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

14 **§3-1413. Obligation of acceptor**

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

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

24 (b) If the acceptance varies the terms of the draft,
26 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.

28 The obligation is owed to a person entitled to enforce the draft
30 or to the drawer or an indorser who paid the draft under section
32 3-1414 or 3-1415.

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

50 **Uniform Commercial Code Comment**

52 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.

54 **§3-1414. Obligation of drawer**

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

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

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

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

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

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

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

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

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

(a) A check is not presented for payment or given to a
depository 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.

54 **Uniform Commercial Code Comment**

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

2 2. Subsection (b) [subsection (2)] states the obligation of
4 the drawer on an unaccepted draft. It replaces former Section
6 3-413(2). The requirement under former Article 3 of notice of
8 dishonor or protest has been eliminated. Under revised Article 3
10 [Article 3-A], notice of dishonor is necessary only with respect
12 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)].

14 3. Under subsection (c) [subsection (3)] the drawer is
16 discharged of liability on a draft accepted by a bank regardless
18 of when acceptance was obtained. This changes former Section
20 3-411(1) which provided that the drawer is discharged only if the
22 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)].

24 4. Subsection (d) [subsection (4)] states the liability of
26 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
28 the only party liable on the instrument. The drawee has no
liability on the draft. Section 3-408 [section 3-1408]. When
30 the draft is accepted, the obligations change. The drawee, as
acceptor, becomes primarily liable and the drawer's liability is
32 that of a person secondarily liable as a guarantor of payment.
The drawer's liability is identical to that of an indorser, and
34 subsection (d) [subsection (4)] states the drawer's liability
that way. The drawer is liable to pay the person entitled to
36 enforce the draft or any indorser that pays pursuant to Section
3-415 [section 3-1415]. The drawer in this case is discharged if
38 notice of dishonor is required by Section 3-503 [section 3-1503]
and is not given in compliance with that section. A drawer that
40 pays has a right of recourse against the acceptor. Section
3-413(a) [section 3-1413](1)].

42 5. Subsection (e) [subsection (5)] does not permit the
44 drawer of a check to avoid liability under subsection (b)
[subsection (2)] by drawing the check without recourse. There is
46 no legitimate purpose served by issuing a check on which nobody
is liable. Drawing without recourse is effective to disclaim
48 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
50 of goods shipped to Buyer. The draft is payable upon delivery to
the drawee of an order bill of lading covering the goods. Seller
52 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

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

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

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

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

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

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

Uniform Commercial Code Comment

30 1. Subsection (a) [subsection (1)] and (b) [subsection (2)]
32 restate the substance of former Section 3-414(1). Subsection (2)
34 of former Section 3-414 has been dropped because it is
36 superfluous. Although notice of dishonor is not mentioned in
38 subsection (a) [subsection (1)], it must be given in some cases
40 to charge an indorser. It is covered in subsection (c)
42 [subsection (3)]. Regulation CC § 229.35(b) provides that a bank
44 handling a check for collection or return is liable to a bank
46 that subsequently handles the check to the extent the latter bank
48 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

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

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

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

26 (c) The instrument has not been altered;

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

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

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

2. (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.

3. (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

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

24 2. Since the purpose of transfer (Section 3-203(a) [section
26 3-1203(1)]) is to give the transferee the right to enforce the
28 instrument, subsection (a)(1) [subsection (1)(a)] is a warranty
30 that the transferor is a person entitled to enforce the
32 instrument (Section 3-301 [section 3-1301]). Under Section 3-203
34 (b) [section 3-1203(2)] transfer gives the transferee any right
36 of the transferor to enforce the instrument. Subsection (a)(1)
38 [subsection (1)(a)] is in effect a warranty that there are no
40 unauthorized or missing indorsements that prevent the transferor
42 from making the transferee a person entitled to enforce the
44 instrument.

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

40 4. Under subsection (a)(5) [subsection (1)(e)] the
42 transferor does not warrant against difficulties of collection,
44 impairment of the credit of the obligor or even insolvency. The
46 transferee is expected to determine such questions before taking
48 the obligation. If insolvency proceedings as defined in Section
50 1-201(22) have been instituted against the party who is expected
52 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.

50 5. Transfer warranties may be disclaimed with respect to
52 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

2 appear in the indorsement with words such as "without warranties"
4 or some other specific reference to warranties. But in the case
6 of a check, subsection (c) [subsection (3)] of Section 3-416
8 [section 3-1416] provides that transfer warranties cannot be
10 disclaimed at all. In the check collection process the banking
12 system relies on these warranties.

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

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

24 §3-1417. Presentment warranties

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

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

38 (b) the draft has not been altered; and

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

42 (2) A drawee making payment may recover from any warrantor
44 damages for breach of warranty equal to the amount paid by the
46 drawee less the amount the drawee received or is entitled to
48 receive from the drawer because of the payment. In addition, the
50 drawee is entitled to compensation for expenses and loss of
52 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

2 to recover from any warrantor for breach of warranty the amounts
3 stated in this subsection.

4 (3) If a drawee asserts a claim for breach of warranty
5 under subsection (1) based on an unauthorized indorsement of the
6 draft or an alteration of the draft, the warrantor may defend by
7 proving that the indorsement is effective under section 3-1404 or
8 3-1405 or the drawer is precluded under section 3-1406 or 4-406
9 from asserting against the drawee the unauthorized indorsement or
10 alteration.

11 (4) If a dishonored draft is presented for payment to the
12 drawer or an indorser, or any other instrument is presented for
13 payment to a party obliged to pay the instrument and payment is
14 received, the following rules apply.

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

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

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

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

35 **Uniform Commercial Code Comment**

36 1. This section replaces subsection (1) of former Section
37 3-417. The former provision was difficult to understand because
38 it purported to state in one subsection all warranties given to
39 any person paying any instrument. The result was a provision
40 replete with exceptions that could not be readily understood
41 except after close scrutiny of the language. In revised Section
42 3-417 [section 3-1417], presentment warranties made to drawees of
43 uncertified checks and other unaccepted drafts are stated in
44 subsection (a) [subsection (1)]. All other presentment
45 warranties are stated in subsection (d) [subsection (4)].
46

48 2. Subsection (a) [subsection (1)] states three
49 warranties. Subsection (a)(1) [subsection (1)] in effect is a
50 warranty that there are no unauthorized or missing indorsements.
51 "Person entitled to enforce" is defined in Section 3-301 [section
52 3-1301]. Subsection (a)(2) [subsection (1)] is a warranty that
53 there is no alteration. Subsection (a)(3) [subsection (1)] is a
54 warranty of no knowledge that there is a forged drawer's
55 signature. Subsection (a) [subsection (1)] states that the
56 warranties are made to the drawee and subsections (b) [subsection
57 (2)] and (c) [subsection (3)] identify the drawee as the person
58 entitled to recover for breach of warranty. There is no warranty
59 made to the drawer under subsection (a) [subsection (1)] when
60 presentment is made to the drawee. Warranty to the drawer is
61 governed by subsection (d) [subsection (4)] and that applies only
62 when presentment for payment is made to the drawer with respect
63 to a dishonored draft. In Sun 'N Sand, Inc. v. United California
64 Bank, 582 P.2d 920 (Cal. 1978), the court held that under former
65 Section 3-417(1) a warranty was made to the drawer of a check
66 when the check was presented to the drawee for payment. The
67 result in that case is rejected.

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

77 4. Subsection (d) [subsection (4)] applies to presentment
78 for payment in all cases not covered by subsection (a)
79 [subsection (1)]. It applies to presentment of notes and
80 accepted drafts to any party obliged to pay the instrument,
81 including an indorser, and to presentment of dishonored drafts if
82 made to the drawer or an indorser. In cases covered by
83 subsection (d) [subsection (4)], there is only one warranty and
84 it is the same as that stated in subsection (a)(1) [subsection
85 (1)(a)]. There are no warranties comparable to subsections
86 (a)(2) [subsection (1)] and (a)(3) [subsection (1)] because they
87 are appropriate only in the case of presentment to the drawee of
88 an unaccepted draft. With respect to presentment of an accepted
89 draft to the acceptor, there is no warranty with respect to
90 alteration or knowledge that the signature of the drawer is
91 unauthorized. Those warranties were made to the drawee when the
92 draft was presented for acceptance (Section 3-417(a)(2) and (3)
93 [section 3-1417(1)]) and breach of that warranty is a defense to
94 the obligation of the drawee as acceptor to pay the draft. If
95 the drawee pays the accepted draft the drawee may recover the
96 payment from any warrantor who was in breach of warranty when the
97

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 4-215, 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

2 forged checks and checks on which the drawer has stopped
3 payment. If the drawee acted under a mistaken belief that the
4 check was not forged or had not been stopped, the drawee is
5 entitled to recover the funds paid or to revoke the acceptance
6 whether or not the drawee acted negligently. But in each case,
7 by virtue of subsection (c) [subsection (3)], the drawee loses
8 the remedy if the person receiving payment or acceptance was a
9 person who took the check in good faith and for value or who in
10 good faith changed position in reliance on the payment or
11 acceptance. Subsections (a) [subsection (1)] and (c) [subsection
12 (3)] are consistent with former Section 3-418 and the rule of
13 Price v. Neal. The result in the two cases covered by subsection
14 (a) [subsection (1)] is that the drawee in most cases will not
15 have a remedy against the person paid because there is usually a
16 person who took the check in good faith and for value or who in
17 good faith changed position in reliance on the payment or
18 acceptance.

20 2. If a check has been paid by mistake and the payee
21 receiving payment did not give value for the check or did not
22 change position in reliance on the payment, the drawee bank is
23 entitled to recover the amount of the check under subsection (a)
24 [subsection (1)] regardless of how the check was paid. The
25 drawee bank normally pays a check by a credit to an account of
26 the collecting bank that presents the check for payment. The
27 payee of the check normally receives the payment by a credit to
28 the payee's account in the depository bank. But in some cases
29 the payee of the check may have received payment directly from
30 the drawee bank by presenting the check for payment over the
31 counter. In those cases the payee is entitled to receive cash,
32 but the payee may prefer another form of payment such as a
33 cashier's check or teller's check issued by the drawee bank.
34 Suppose Seller contracted to sell goods to Buyer. The contract
35 provided for immediate payment by Buyer and delivery of the goods
36 20 days after payment. Buyer paid by mailing a check for \$10,000
37 drawn on Bank payable to Seller. The next day Buyer gave a stop
38 payment order to Bank with respect to the check Buyer had mailed
39 to Seller. A few days later Seller presented Buyer's check to
40 Bank for payment over the counter and requested a cashier's check
41 as payment. Bank issued and delivered a cashier's check for
42 \$10,000 payable to Seller. The teller failed to discover Buyer's
43 stop order. The next day Bank discovered the mistake and
44 immediately advised Seller of the facts. Seller refused to
45 return the cashier's check and did not deliver any goods to Buyer.

46 Under Section 4-215, Buyer's check was paid by Bank at the
47 time it delivered its cashier's check to Seller. See Comment 3
48 to Section 4-215. Bank is obliged to pay the cashier's check and
49 has no defense to that obligation. The cashier's check was
50 issued for consideration because it was issued in payment of
51 Buyer's check. Although Bank has no defense on its cashier's
52 check it may have a right to recover \$10,000, the amount of

2 Buyer's check, from Seller under Section 3-418(a) [section
3 3-1418(1)]. Bank paid Buyer's check by mistake. Seller did not
4 give value for Buyer's check because the promise to deliver goods
5 to Buyer was never performed. Section 3-303(a)(1) [section
6 3-1303(1)(a)]. And, on these facts, Seller did not change
7 position in reliance on the payment of Buyer's check. Thus, the
8 first sentence of Section 3-418(c) [section 3-1418(3)] does not
9 apply and Seller is obliged to return \$10,000 to Bank. Bank is
10 obliged to pay the cashier's check but it has a counterclaim
11 against Seller based on its rights under Section 3-418(a)
12 [section 3-1418(1)]. This claim can be asserted against Seller,
13 but it cannot be asserted against some other person with rights
14 of a holder in due course of the cashier's check. A person
15 without rights of a holder in due course of the cashier's check
16 would take subject to Bank's claim against Seller because it is a
17 claim in recoupment. Section 3-305(a)(3) [section 3-1305(1)(c)].

18 If Bank recovers from Seller under Section 3-418(a) [section
19 3-1418(1)], the payment of Buyer's check is treated as unpaid and
20 dishonored. Section 3-418(d) [section 3-1418(4)]. One
21 consequence is that Seller may enforce Buyer's obligation as
22 drawer to pay the check. Section 3-414 [section 3-1414].
23 Another consequence is that Seller's rights against Buyer on the
24 contract of sale are also preserved. Under Section 3-310(b)
25 [section 3-1310(2)] Buyer's obligation to pay for the goods was
26 suspended when Seller took Buyer's check and remains suspended
27 until the check is either dishonored or paid. Under Section
28 3-310(b)(2) [section 3-1310(2)(b)] the obligation is discharged
29 when the check is paid. Since Section 3-418(d) [section
30 3-1418(4)] treats Buyer's check as unpaid and dishonored, Buyer's
31 obligation is not discharged and suspension of the obligation
32 terminates. Under Section 3-310(b)(3) [section 3-1310(2)(c)],
33 Seller may enforce either the contract of sale or the check
34 subject to defenses and claims of Buyer.

36 If Seller had released the goods to Buyer before learning
37 about the stop order, Bank would have no recovery against Seller
38 under Section 3-418(a) [section 3-1418(1)] because Seller in that
39 case gave value for Buyer's check. Section 3-418(c) [section
40 3-1418(3)]. In this case Bank's sole remedy is under Section
41 4-407 by subrogation.

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

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

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

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

38 4. The right of the drawee to recover a payment or to
40 revoke an acceptance under Section 3-418 [section 3-1418] is not
42 affected by the rules under Article 4 that determine when an item
44 is paid. Even though a payor bank may have paid an item under
46 Section 4-215, it may have a right to recover the payment under
48 Section 3-418 [section 3-1418]. National Savings & Trust Co. v.
50 Park Corp., 722 F.2d 1303 (6th Cir. 1983), cert. denied, 466 U.S.
52 939 (1984), correctly states the law on the issue under former
Article 3. Revised Article 3 [Article 3-A] does not change the
previous law.

50 **§3-1419. Instruments signed for accommodation**

52 (1) If an instrument is issued for value given for the
benefit of a party to the instrument, in this section referred to

2 as the "accommodated party," and another party to the instrument,
4 in this section referred to as the "accommodation party," signs
6 the instrument for the purpose of incurring liability on the
8 instrument without being a direct beneficiary of the value given
10 for the instrument, the instrument is signed by the accommodation
12 party for accommodation.

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

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

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

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

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

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

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

50 (5) An accommodation party who pays the instrument is
52 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.

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 depository 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.

2 1. Section 3-420 [section 3-1420] is a modification of
4 former Section 3-419. The first sentence of Section 3-420(a)
6 [section 3-1420(1)] states a general rule that the law of
8 conversion applicable to personal property also applies to
10 instruments. Paragraphs (a) and (b) of former Section 3-419(1)
12 are deleted as inappropriate in cases of noncash items that may
14 be delivered for acceptance or payment in collection letters that
16 contain varying instructions as to what to do in the event of
18 nonpayment on the day of delivery. It is better to allow such
20 cases to be governed by the general law of conversion that would
22 address the issue of when, under the circumstances prevailing,
24 the presenter's right to possession has been denied. The second
26 sentence of Section 3-420(a) [section 3-1420(1)] states that an
28 instrument is converted if it is taken by transfer other than a
30 negotiation from a person not entitled to enforce the instrument
32 or taken for collection or payment from a person not entitled to
34 enforce the instrument or receive payment. This covers cases in
36 which a depository or payor bank takes an instrument bearing a
38 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 3-110(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 Depository Bank takes the check for
deposit to John's account, Depository 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 3-110(4)] and Comment 4 to Section
3-110 [section 3-110]. Depository 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 depository 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 depository bank. The
issue was whether the payee could bring an action in conversion
against the depository 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 depository bank for breach of warranty
under Section 3-417(a)(1) [section 3-1417(1)(a)] or 4-208(a)(1).
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

2 B's indorsement to the check and obtains payment. Because the
3 check was never delivered to B, the indorsee, B has no cause of
4 action for conversion, but A does have such an action. A is the
5 owner of the check. B never obtained rights in the check. If A
6 intended to negotiate the check to B in payment of an obligation,
7 that obligation was not affected by the conduct of Thief. B can
8 enforce that obligation. Thief stole A's property not B's.

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

24 The "but" clause in subsection (b) [subsection (2)]
25 addresses the problem of conversion actions in multiple payee
26 checks. Section 3-110(d) [section 3-1110(4)] states that an
27 instrument cannot be enforced unless all payees join in the
28 action. But an action for conversion might be brought by a payee
29 having no interest or a limited interest in the proceeds of the
30 check. This clause prevents such a plaintiff from receiving a
31 windfall. An example is a check payable to a building contractor
32 and a supplier of building material. The check is not payable to
33 the payees alternatively. Section 3-110(d) [section 3-1110(4)].
34 The check is delivered to the contractor by the owner of the
35 building. Suppose the contractor forges supplier's signature as
36 an indorsement of the check and receives the entire proceeds of
37 the check. The supplier should not, without qualification, be
38 able to recover the entire amount of the check from the bank that
39 converted the check. Depending upon the contract between the
40 contractor and the supplier, the amount of the check may be due
41 entirely to the contractor, in which case there should be no
42 recovery, entirely to the supplier, in which case recovery should
43 be for the entire amount, or part may be due to one and the rest
44 to the other, in which case recovery should be limited to the
45 amount due to the supplier.

46 3. Subsection (3) of former Section 3-419 drew criticism
47 from the courts, that saw no reason why a depository bank should
48 have the defense stated in the subsection. See Knesz v. Central
49 Jersey Bank & Trust Co., 477 A.2d 806 (N.J. 1984). The
50 depository bank is ultimately liable in the case of a forged
51

2 indorsement check because of its warranty to the payor bank under
3 Section 4-208(a)(1) and it is usually the most convenient
4 defendant in cases involving multiple checks drawn on different
5 banks. There is no basis for requiring the owner of the check to
6 bring multiple actions against the various payor banks and to
7 require those banks to assert warranty rights against the
8 depository bank. In revised Article 3 [Article 3-A], the defense
9 provided by Section 3-420(c) [section 3-1420(3)] is limited to
10 collecting banks other than the depository bank. If suit is
11 brought against both the payor bank and the depository bank, the
12 owner, of course, is entitled to but one recovery.

13 PART 5

14 DISHONOR

15 §3-1501. Presentment

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

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

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

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

24 (a) Presentment may be made at the place of payment of the
25 instrument and must be made at the place of payment if the
26 instrument is payable at a bank in the United States; may be
27 made by any commercially reasonable means, including an
28 oral, written or electronic communication; is effective when
29 the demand for payment or acceptance is received by the
30 person to whom presentment is made; and is effective if made
31 to any one of 2 or more makers, acceptors, drawees or other
32 payors.

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

35 (i) Exhibit the instrument;

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

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

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

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

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

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

32 **Uniform Commercial Code Comment**

34 Subsection (a) [subsection (1)] defines presentment.
36 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.

38 **§3-1502. Dishonor**

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

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

48 (b) If the note is not payable on demand and is payable at
50 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.

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

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

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

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

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

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

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

50 (d) If a draft is payable on elapse of a period of time
52 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. 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

2 payment or acceptance. They are entitled to have the instrument
3 presented to the drawee and dishonored (Section 3-414(b) [section
4 3-1414(2)]) before they are liable to pay, but no notice of
5 dishonor need be made to them as a condition of liability.
6 Subsection (b) [subsection(2)], which states how notice of
dishonor is given, is based on former Section 3-508(3).

8 2. Subsection (c) [subsection (3)] replaces former Section
9 3-508(2). It differs from that section in that it provides a
10 30-day period for a person other than a collecting bank to give
11 notice of dishonor rather than the three-day period allowed in
12 former Article 3. Delay in giving notice of dishonor may be
13 excused under Section 3-504(c) [section 3-1504(3)].

14 **§ 3-1504. Excused presentment and notice of dishonor**

15 (1) Presentment for payment or acceptance of an instrument
16 is excused if:

17 (a) The person entitled to present the instrument can not
18 with reasonable diligence make presentment;

19 (b) The maker or acceptor has repudiated an obligation to
20 pay the instrument or is dead or in insolvency proceedings;

21 (c) By the terms of the instrument presentment is not
22 necessary to enforce the obligation of indorsers or the
23 drawer;

24 (d) The drawer or indorser whose obligation is being
25 enforced has waived presentment or otherwise has no reason
26 to expect or right to require that the instrument be paid or
27 accepted; or

28 (e) The drawer instructed the drawee not to pay or accept
29 the draft or the drawee was not obligated to the drawer to
30 pay the draft.

31 (2) Notice of dishonor is excused if:

32 (a) By the terms of the instrument, notice of dishonor is
33 not necessary to enforce the obligation of a party to pay
34 the instrument; or

35 (b) The party whose obligation is being enforced waived
36 notice of dishonor. A waiver of presentment is also a
37 waiver of notice of dishonor.

38 (3) Delay in giving notice of dishonor is excused if the
39 delay was caused by circumstances beyond the control of the
40 person giving the notice and the person giving the notice

2 exercised reasonable diligence after the cause of the delay
3 ceased to operate.

4 **Uniform Commercial Code Comment**

5 Section 3-504 [section 3-1504] is largely a restatement of
6 former Section 3-511. Subsection (4) of former Section 3-511 is
7 replaced by Section 3-502(f) [section 3-1502(6)].

8 **§3-1505. Evidence of dishonor**

9 (1) The following are admissible as evidence and create a
10 presumption of dishonor and of any notice of dishonor stated:

11 (a) A document regular in form as provided in subsection
12 (2) which purports to be a protest;

13 (b) A purported stamp or writing of the drawee, payor bank
14 or presenting bank on or accompanying the instrument stating
15 that acceptance or payment has been refused unless reasons
16 for the refusal are stated and the reasons are not
17 consistent with dishonor; or

18 (c) A book or record of the drawee, payor bank or
19 collecting bank, kept in the usual course of business which
20 shows dishonor, even if there is no evidence of who made the
21 entry.

22 (2) A protest is a certificate of dishonor made by a United
23 States consul or vice-consul, or a notary public or other person
24 authorized to administer oaths by the law of the place where
25 dishonor occurs. It may be made upon information satisfactory to
26 that person. The protest must identify the instrument and
27 certify either that presentment has been made or, if not made,
28 the reason why it was not made, and that the instrument has been
29 dishonored by nonacceptance or nonpayment. The protest may also
30 certify that notice of dishonor has been given to some or all
31 parties.

32 **Uniform Commercial Code Comment**

33 Protest is no longer mandatory and must be requested by the
34 holder. Even if requested, protest is not a condition to the
35 liability of indorsers or drawers. Protest is a service provided
36 by the banking system to establish that dishonor has occurred.
37 Like other services provided by the banking system, it will be
38 available if market incentives, interbank agreements, or
39 governmental regulations require it, but liabilities of parties
40 no longer rest on it. Protest may be a requirement for liability
41 on international drafts governed by foreign law which this
42 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 (2) If tender of payment of an obligation to pay an
4 instrument is made to a person entitled to enforce the instrument
6 and the tender is refused, there is discharge, to the extent of
8 the amount of the tender, of the obligation of an indorser or
10 accommodation party having a right of recourse with respect to
12 the obligation to which the tender relates.

14 (3) If tender of payment of an amount due on an instrument
16 is made to a person entitled to enforce the instrument, the
18 obligation of the obligor to pay interest after the due date on
20 the amount tendered is discharged. If presentment is required
22 with respect to an instrument and the obligor is able and ready
24 to pay on the due date at every place of payment stated in the
26 instrument, the obligor is deemed to have made tender of payment
28 on the due date to the person entitled to enforce the instrument.

30 **Uniform Commercial Code Comment**

32 Section 3-603 [section 3-1603] replaces former Section
34 3-604. Subsection (a) [subsection (1)] generally incorporates
36 the law of tender of payment applicable to simple contracts.
38 Subsections (b) [subsection (2)] and (c) [subsection (3)] state
40 particular rules. Subsection (b) replaces former Section
42 3-604(2). Under subsection (b) [subsection (2)] refusal of a
44 tender of payment discharges any indorser or accommodation party
46 having a right of recourse against the party making the tender.
48 Subsection (c) [subsection (3)] replaces former Section 3-604(1)
50 and (3).

32 **§3-1604. Discharge by cancellation or renunciation**

34 (1) A person entitled to enforce an instrument, with or
36 without consideration, may discharge the obligation of a party to
38 pay the instrument:

40 (a) By an intentional voluntary act, such as surrender of
42 the instrument to the party, destruction, mutilation or
44 cancellation of the instrument, cancellation or striking out
46 of the party's signature or the addition of words to the
48 instrument indicating discharge; or

50 (b) By agreeing not to sue or otherwise renouncing rights
52 against the party by a signed writing.

54 (2) Cancellation or striking out of an indorsement pursuant
56 to subsection (1) does not affect the status and rights of a
58 party derived from the indorsement.

50 **Uniform Commercial Code Comment**

52 Section 3-604 [section 3-1604] replaces former Section 3-605.

2 **§3-1605. Discharge of indorsers and accommodation parties**

4 (1) In this section, the term "indorser" includes a drawer
6 having the obligation described in section 3-1414, subsection (4).

8 (2) Discharge, under section 3-1604, of the obligation of a
10 party to pay an instrument does not discharge the obligation of
12 an indorser or accommodation party having a right of recourse
14 against the discharged party.

16 (3) If a person entitled to enforce an instrument agrees,
18 with or without consideration, to an extension of the due date of
20 the obligation of a party to pay the instrument, the extension
22 discharges an indorser or accommodation party having a right of
24 recourse against the party whose obligation is extended to the
26 extent the indorser or accommodation party proves that the
28 extension caused loss to the indorser or accommodation party with
30 respect to the right of recourse.

32 (4) If a person entitled to enforce an instrument agrees,
34 with or without consideration, to a material modification of the
36 obligation of a party other than an extension of the due date,
38 the modification discharges the obligation of an indorser or
40 accommodation party having a right of recourse against the person
42 whose obligation is modified to the extent the modification
44 causes loss to the indorser or accommodation party with respect
46 to the right of recourse. The loss suffered by the indorser or
48 accommodation party as a result of the modification is equal to
50 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.

52 (5) If the obligation of a party to pay an instrument is
54 secured by an interest in collateral and a person entitled to
56 enforce the instrument impairs the value of the interest in
58 collateral, the obligation of an indorser or accommodation party
60 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:

62 (a) That the value of the interest is reduced to an amount
64 less than the amount of the right of recourse of the party
66 asserting discharge; or

68 (b) That the reduction in value of the interest causes an
70 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.

2 (6) If the obligation of a party is secured by an interest
4 in collateral not provided by an accommodation party and a person
6 entitled to enforce the instrument impairs the value of the
8 interest in collateral, the obligation of any party who is
10 jointly and severally liable with respect to the secured
12 obligation is discharged to the extent that the impairment causes
14 the party asserting discharge to pay more than that party would
16 have been obliged to pay, taking into account rights of
18 contribution, if impairment had not occurred. If the party
20 asserting discharge is an accommodation party not entitled to
22 discharge under subsection (5), the party is deemed to have a
24 right to contribution based on joint and several liability rather
26 than a right to reimbursement. The burden of proving impairment
28 is on the party asserting discharge.

30 (7) Under subsection (5) or (6), impairing value of an
32 interest in collateral includes:

34 (a) Failure to obtain or maintain perfection or recordation
36 of the interest in collateral;

38 (b) Release of collateral without substitution of
40 collateral of equal value;

42 (c) Failure to perform a duty to preserve the value of
44 collateral owed, under Article 9 or other law, to a debtor
46 or surety or other person secondarily liable; or

48 (d) Failure to comply with applicable law in disposing of
50 collateral.

52 (8) An accommodation party is not discharged under
54 subsection (3), (4) or (5) unless the person entitled to enforce
56 the instrument knows of the accommodation or has notice under
58 section 3-1419, subsection (3) that the instrument was signed for
60 accommodation.

62 (9) A party is not discharged under this section if:

64 (a) The party asserting discharge consents to the event or
66 conduct that is the basis of the discharge; or

68 (b) The instrument or a separate agreement of the party
70 provides for waiver of discharge under this section either
72 specifically or by general language indicating that parties
74 wave defenses based on suretyship or impairment of
76 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. 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.

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. This bill repeals the Maine Revised Statutes, Title 11, Article 3 and enacts a new Title 11, Article 3-A to accomplish those revisions. The official Uniform Comments and the text of some new provisions refer to other conforming amendments in the Uniform Commercial Code. These amendments are not included in this bill.