B. RIGHTS OF TAKERS OF NEGOTIABLE INSTRUMENTS

1. Introduction to the Negotiability Concept - what is the big deal anyway?

Three basic advantages:
1. Waiver of defenses - Greater Rights to Holders in Due Course
2. Merger of Rights to Payment

a. Greater Rights to Holders in Due Course Waiver of Defenses

Being a negotiable instrument gives the person special rights. By negotiating to a tourist, a negotiable instrument, may pass on to the tourist greater rights than the transferor has.

If it is not negotiable, the following defenses would still be valid:

i. Property Law:

Example: Thief steals goods and checks from Victim and sells the goods and transfers the checks to Tourist for value.

1. Goods - Under common law, B steals goods and money from A and sells the goods to C for value. Can A recover from C? A may recover the goods from C because you can’t pass any greater title than the thief has. They do not have good title to the goods.
2. Negotiable instrument - But, they can’t recover the money or checks, to protect the free circulation of money, the law makes the protection of the marketplace more important.

ii. Contract Law:

Example: A buys goods on credit from B, they are defective. A may assert a defense against the contract. If the contract is assigned to C

1. Under contract law, the assignees stand in the shoes of the assignors with regard to defenses of the contract, so they still have to be liable for defenses.
2. Negotiable instrument - If the buyer paid with a check, instead of on credit, and the check was transferred to a tourist, the defense is cut off. This is done to protect the marketplace for the instrument. It is a policy choice.

b. Merger or Symbolism

Ex. A contracts for goods from B, B assigns his right to payment to C, before C notifies A of this assignment, A pays B. May C recover payment from A?

1. Contract law - No. Debtor A may safely pay his or her creditor B until A receives notification of the assignment. This discharges A’s obligation against B and C.
2. Negotiable instrument - If this was a negotiable note, which was then transferred to C. If A pays B when C has possession of the note, can C get the money from A? Yes. A has to pay twice

• The right to payment is so merged into the instrument that shows the claim that it may be treated as if it was the claim itself. (Also called symbolism)
• You can’t safely pay it off until the instrument is presented to you. This way you can insure that it is not in the hands of an innocent c. Yes.

3. 601(b), 3-602(a), 3-301, 1-201(20), 3-501(b)(2).

c. Procedural Aspects of Negotiability:

Ex. A issues note to B who indorses to C. Action is taken on the complaint

• See just attaches the note, executed by A, properly transferred to C to her complaint. See, e.g. 3-308(b). It is not necessary for the complaint to allege and prove the transaction giving rise to the note or consideration of the note generally.

MAKER (DRAWER) v. THIRD PARTY IN CHAIN

A. How to get greater Rights in General

Examples:
Generally:
The right of a holder in due course to enforce the obligation of a party to pay the instrument is subject to real defenses of the obligor, (3-305(a)(1)(b), but is not subject to the personal defenses of the obligor (305(a)(b)2(B) or claims in recoupment (3-305(a)(3)(b) against a person other than the holder.

- **Holder in due course** - the holder of an instrument, as long as it is not irregular or incomplete, and the holder took it for value good faith without notice. 3-302(a).
- **Holder** - is the person in possession of the instrument, if it is payable to bearer, or if it is held by the person identified on the instrument. 1-201(20)
- **Instrument** - means a negotiable instrument. 3-104(b)

**Does the Third Party Current Person Cut off the Maker/Drawer’s Personal Defenses.**

1. The instrument must be negotiable
2. The taker of the negotiable instrument must be a holder
3. The holder must be a holder in due course
4. The defense must not be a real defense.

1. **Is the Instrument Negotiable?**

**What do you need:**

1. A written promise or order to pay,
   a) Promises or orders the payment of money. def - 3-103(a)(6), and (9), 3-104 - Comment 1 (this details ALL the negotiability responsibilities) - Note Comment 3 also discusses all about money orders.
      i) Promise - a written promise to pay money signed by the person undertaking to pay. (not merely an IOU) 3-103(a)(9) and Comment 3
      ii) Order - written instruction to pay money signed by the person giving the instruction. to one or more persons jointly, but not in succession
         a) Ex. Drawer instructs - pay to the order of (magic words)
   b) The promise or order must be payable to bearer or to order (magic words of negotiability) (See the difference between these two - Special rule 3-108)
      a) Bearer - not payable to an identified person. 3-104(a)(1), 3-109(a), 1-201(5)
         i) Pay to the bearer
         ii) Pay to cash
         iii) Pay to the order of cash
         iv) Pay to the order of kg of nails
      b) Order - Pay to the order of (an id person), or
         i) Pay to an identified person or order
      c) If it says to order or bearer, it is bearer person. (3-109 Comment 2, 3-109(b)(Last sentence)
      d) Ex. If it says pay john doe, then is neither order or bearer. Under 3-104(a) and (c) the instrument is excluded from article 3. however, if it is a check, the check is governed by Article 3 and there can be a holder in due course. 3-104(c) + (f), Comment 2.
   c) Signed by maker or drawer with promises.
      a) Signed - includes any symbol executed or adopted by a party with present intention to authenticate a writing. 1-201(39), 3-401.
      b) On any part of the writing.
      c) Writing - includes printing, typing, gravestones, 1-201(46).
2. Does not say non-negotiable
   a) If the instrument states Non-negotiable, you can try to apply article 3 by analogy  (3-104(Comment 2, Comment 3, 1-201(10).
3. Unconditional (See 3-106)
   a) No express conditions (See example in comments)
   b) Incorporating another writing or reference to another writing - can’t be subject to another writing or governed by another writing.
      i) See examples in comment.
c) Ex. I promise to pay John Doe if he conveys title to me (this is a condition) - not negotiable. But suppose it says, In consideration of the promise I promise to pay - not an express condition and it is negotiable.
   i) Exemptions:
   ii) Limiting to a particular fund is OK: Ex. I promise to pay out of my cotton profits.

6. Must pay a fixed amount of money - with or without interest (See 3-112, 3-113)
   a) If interest is variable, or you can fill in the amount of money later, that is OK. It is complete after it is filled in. See 3-112, 3-113
   b) Examples: Pay in 36 monthly installments of 256.86 (principal) + Interest]

7. Payable on Demand or at a Definite Time.  See 3-108
   a) On demand - If it doesn’t state any time of payment.
      i) On demand, at sight, at will of the holder.
      ii) Ex. a check - 3-104(a)(2) and (f), 3-108(a)
   b) Lapse of Definite time -
      i) A certain time period lapses and the instrument becomes due (10 days after sight…)
      ii) On a certain date (Pay on June 1, 1998)
      iii) Payable at a time readily ascertainable when the promise or order is done (Not good - payable on death, payable after the war, etc.)
   c) Exceptions:
      i) Prepayment - maker can pre-pay
      ii) Acceleration - Holder can accelerate payment. § 1-208
      iii) Extension at the option of the holder
      iv) Extension of the option of the maker. 3-104(a0, 3-108(b), 3-113.
   d) Can be both, see 3-108(c).

8. Writing can’t state any other undertaking or instruction by maker or drawer to do any act in addition to the payment of money. (A courier without luggage) 3 - 104(a)(3)(III) Exceptions:
   a) Maintaining collateral
   b) Confess judgment or take the collateral
   c) Waiver of benefit of law intended for the advantage or protection of the obligor

II. Is the person taking the negotiable instrument a holder?

A. Is the person a holder? (Yes!)

Holder - 1-201(20) - “the person in possession of the instrument if the instrument is payable to bearer or, in the case of an instrument payable to an identified person, if the identified person is in possession. Holder - with respect to a document of title means the person in possession if the goods are deliverable to bearer or to the order of the person in possession.

A person can become a holder of an instrument when the instrument is issued to that person, or the status of the holder can arise as the result of an event that occurs after issuance. (This is called negotiation).

1. Was the instrument negotiated properly? 3-201 (Yes!)
   Bearer - Negotiated by transfer of possession alone. Holder is the person who is in possession of the instrument.1-201(5)
      • Merely transferring possession is all that is required.
   Order - Negotiated by transfer of possession to the person who is identified. Holder is the identified person in possession of the instrument.
      • May be negotiated only to the order of that person (indorsement) and transfer of possession.
      • Their individual writing is required to negotiate the instrument
      • A special indorsement makes something specially indorsed.
      • Indorsing in blank makes it into bearer paper.

2. If it is order paper, was the proper indorsement on the paper? 3-204, 3-205 (Yes!)
   a) Indorsements - Purpose 3-204(a) and (b), 3-205, 3-206
      i) Negotiating it (Special or in blank)
      ii) Restricting it (e.g., for deposit only
      iii) Incurring indorser’s liability (anomalous indorsement)
b) Must be indorsed by the holder - if there is an order paper.
c) If it is indorsed by the payee (needs special indorsement. 3-110 (rules for determining the identity of the payee) - done by the intent of the issuer.

**Multiple Payees: 3-110(d)**
If the instrument is made out to two payees who are not alternative payees (AND not OR) and only one signs it. Under 3-110(d) both must sign if it is not in the alternative (if ambiguous, it is in the alternative) they must BOTH sign in order for the person to become a holder.

- X and Y - neither person acting alone can be the holder. This is made out to an identified person, and the identified person is them acting jointly (3-109(b) and Section 1-102(5)(a)). Thus, under Section 1-201(2) X or Y acting alone, can not be the holder or the PETE or negotiate the instrument, because neither, acting alone can be the identified person stating in the instrument.
- X or Y - either is the payee, and if either is in possession that person is the holder and the PETE. Section 3-110.

3. **OR Is the person a former holder, who can just cancel the subsequent indorsements if it was not properly indorsed back to him? (Yes!)**

   Reacquisition: - A former holder reacquiring the instrument may cancel indorsements made after they first became a holder of the instrument. 3-207.

**B. Is the person a holder in due course?**

A. Is the person a holder? (yes!)

B. **Is the instrument not so irregular or incomplete as to call into question its authenticity? (Yes!)**

1. No apparent evidence of forgery, or alteration to call into question its authenticity. 3-302(a)(1)
   a) Ex. An apparent alteration of the amount of the check so as to cause the word void to appear on the check.

C. **Did the holder take the instrument for value: (Yes!)**

1. Did they take for basic value? - the instrument is issued or transferred for a promise or performance, to the extent that the promise has been performed. (3-303(a)(1). OR

   Note that this is different than consideration. Value is more than just consideration. Consideration is any consideration sufficient to support a simple contract.

2. Example: On April 1, X issues a check to B. b indorses the check to S as a down payment pursuant to a contract for a sale of goods to be delivered by S to B on May 1. The check is dishonored April2. S has not taken the check for value, since it had not delivered the goods to B.

   - Policy: Until S delivers the goods, he has not suffered an out of pocket loss, and under 2-703, S is excused from performing the promise to deliver the goods because B failed to make payment when due. 3-302 Comment 2.

3. OR Did the holder acquires a security interest in the instrument. OR

   - Ex. Payee borrows money from Holder and pledges the instrument to the holder as security. 3-303(a)(2), 3-302(c)(I).

4. OR - As payment for antecedent debt. -

   - Payee indorses the instrument to holder in exchange for holder’s promissory note issued to payee 3-303(a)(4) and Comment 5.

5. OR Holder takes the instrument and issues a letter of credit. See 3-303(a)(5) and Comment 5.

**Special Cases: Value**

1. If the instrument has been partially performed, see 3-303(a)(1), 3-303(d) and Comment 6 (Case #5).

   The adequacy of the consideration is not looked at by the taker of the instrument.

**Special Case: Banks Giving Value**

1. The example (when the bank gives value).

   - Payee (P) indorses and deposits a check as a credit to its account in bank A (depository bank A). (4-105(2)). Here we have a credit not drawn upon, which can be and is revoked by bank A when a claim or defense appears (reverse the accounting entry. )See former 3-303 Comment 3. Clearly bank A has not paid value merely by crediting his
account. 4-214(a). If bank A allows P to withdraw the funds relating to the check, then Bank A has paid value (ONLY THEN). How can we say when he has withdrawn the funds - the first in first out rule

- Ex: May 1, P has 500 in his account with bank A. May 2, check for 250 is deposited for collection. May 3, P deposits 800 in his account. May 4, P withdraws 500. May 5, P withdraws 250. May 5, after withdrawal, the bank has paid value. The May 4 withdrawal represented the 500 deposit on May 1, the May 5 withdrawal represented the 250 deposits on May 2.

- The UCC says this by saying that the bank is a holder to the extent that it has a security interest in the item, it has a security interest when credit is given for the deposited item that has been withdrawn using the FIFO rule. 4-211, 4-210(a)(1) and (b) last sentence and comment 2.

- If the bank has given credit available for withdrawal as of right to the extent of the credit given whether or not drawn upon, the bank has a security interest and so has value.

D. Did the holder must take the instrument without notice that it is overdue (yes!)

1. Must take it before maturity without notice that it is overdue or has been dishonored or that there is an uncured default with respect to another instrument issued as part of the same series. 3-302(a)(2)(iii). 1-201(25)-(27).

2. If the instrument is overdue, they have notice that it is overdue:

   a) Payable on demand (defined in 3-108(a)) becomes overdue at the earliest of:
      i) The day after the demand for payment is duly made
      ii) If it is a check, 90 days after its check OR
      iii) If it is not a check, when the instrument has been outstanding for a period of time which is unreasonably long. 3-304(a), 1-205

   b) Payment at a definite time:
      i) Single payment instruments - On the day after the due date (Ex. Due June 1, overdue June 2) 3-304(b)(2).
      ii) Installment instruments - when an installment is late (Ex. Installment number 5 is due June 1, and unpaid after June 2) the instrument is overdue until the default is cured. 3-304(b)(1) and Comment 2.
      iii) Accelerated payments - if the due date with respect to principal has been accelerated, it becomes overdue as to the date after the accelerated due date. 3-304(b)(3), 3-108(b)(ii).
      iv) Overdue interest - Does not become overdue if there is a default in payment of interest (but not default in payment of principal) unless the principal has been accelerated. 3-304(c). (Policy - former 3-304 Comment 6 says notice that interest is overdue is insufficient to give notice instrument is overdue on the basis of banking and commercial practice … and the frequency with which interest payments are delayed).

E. Did the holder take without notice that it has been dishonored (Yes!)

See 3-502 and Part Two C, 3,b,(1). Infra.

F. Did the holder take in good faith? (Yes!)

a. Did the person observe reasonable commercial standards of business, as well as fair dealing? (Yes!)

   - See 3-103(a)(4). Including the observance of the reasonable commercial standards of business in which the holder may be engaged.

b. Was there disparity between face value of instrument and sum paid by purchaser? (Yes!)

1. D issue check to P for 675, P negotiates the check to A who pays 50 for it. The court or jury will probably determine that A was not acting in good faith without notice. Why? A would not have purchased the check for such a low sum unless they had knowledge of something wrong. A discounted note for quicker payment is not the same thing.

c. Were the subsequent taker and negotiator unallowably close? Close-connectedness (No!)

Ex. M bought goods from car dealer P and issued to P an installment note and a security agreement which car dealer P discounted to Bank A. P used Bank A’s regular form contract for the note and security agreement. Bank A had a thorough knowledge of the nature and method of operation of P’s business and exercised extensive control over it.

   - This closeness may give notice and thereby preclude the bank from having holder in due course status.
• However, it would be desirable to have this so that banks can save money, which shouldn’t preclude holder in due course status. This usually arises in the consumer goods area, and they are more geared to consumer protection than in determining holder in due course status.

G. Was the holder without Notice of Claims or Defenses? (Yes!)

1. Were they without notice? either by: (1-201)(25) (Yes!)
   a) Actual knowledge
   b) Received a notice or notification of it (See 1-201(26) and (27), 3-302(f)
   c) From all the facts known to him or her at the time in question (not facts that should be known to a reasonable person) the individual has reason to know that it exists.
   d) Filing, recording does not of itself constitute notice of a defense, claim of recoupment, or claim to the instrument. 3-302(b) (second sentence). (Should be within the four corners of the instrument)
   i) Ex. Maker issues a note to P secured by a mortgage on land. Payee assigns the note and mortgage to A without indicating on them the fact of the assignment. A records the assignment and then gives the note to Payee for Servicing. Payee fraudulently negotiates them to B who takes them in good faith without knowledge of the assignment to A. The recording of the assignment of the mortgage does not constitute notice to B of A’s interest. See 9-309.

2. Were they without these Specific Types of notice? (Yes!)
   a) Without notice of an unauthorized signature or alteration. 3-3029(a)(2)(iv), 1-201(43), 3-407(a). This is separate because forgery and alteration are not technically defense.
   b) Without notice of a claim to the instrument. ex. Drawer issues paycheck to payee who indorses it in blank and leaves it on her dresser. Thief steals it and sells it to Holder, Payee has a claim to the instrument.
      i) You must take without notice of ANY claim to the instrument and without notice that ANY party has a defense or claim in recoupment. 3-302(a)(2)(v) and (vi). 3-305(a), 3-306,
      ii) Ex. D issues check to Payee Corporation in consideration of goods sold by Payee to Drawer. The goods are defective. Corporation pres. indorses the check to A in payment for a car President is to use personally, not for corporate purposes. A knows this. A doesn’t have notice of the defense drawer has or his claim in recoupment. Does the fact that A has notice of a claim (fiduciary breach 3-307(b)) preclude A from being a holder in due course as to Drawer’s defense (or claim) which he didn’t have notice? Yes. He is not a holder in due course? WHY - requires a thoroughly honest and fair transaction to be a HDC.
   c) Without notice that any party has a defense or claim in recoupment. See 3-302(a)(2)(vi), 3-305(a), comment 3, 3-302(b)
      i) Claims of recoupment: Ex. B issues a 10K note to the order of S in exchange for a promise of S to deliver specified equipment. If S fails to deliver the equipment or delivers defective equipment that is rightfully rejected, B has a defense to the note. 2-711. If B accepts the defective equipment, and the breach of warranty claim against S is for 1,000, B has a claim in recoupment against S for 1,000. which will reduce the amount owing on the note to 9,000. See 3-305 Comment 3, 2-606, 2-607, 2-714.
   d) Without notice of a discharge? 3-305
      i) Discharge does not prevent one from being a HDC, but taking the instrument with notice of the discharge prevents you from taking action against the person who is discharged. (This discharge is effective.) 3-302(b) first sentence, Comment 3 (see example), also 3-305(a)(1)(iv).
   e) Without notice of a breach of fiduciary duty? 3-307
      i) Where an instrument is taken from a fiduciary (agent or corporate officer) where the taker has knowledge of the fiduciary status of the fiduciary, and the represented person (principal or corporation) makes a claim to the instrument on the basis that the transaction breaches the fiduciary duty.
      ii) Ex. Check payable to corporation indorsed in the name of the corporation by Doe as its president. Doe gives the check to Bank as a partial repayment of a personal note that bank had made to Doe. Bank would have notice of the Corporation’s claim that a fiduciary breached the fiduciary relationship, per the rule: In the case of an instrument payable to the represented person
(or the fiduciary as such) the taker has notice of the breach of fiduciary duty if the instrument to be taken in payment for a debt known by the taker to be the personal debt of the fiduciary. 3-307(a), (b)(1) and (2)(I). Comment 3, see 3-306.

a) Where an instrument is issued by the represented person, see 3-307(3) and (4).

b) Where an instrument is indorsed “Pay to T in trust for B” (restrictive indorsement) see 3-206(d) and Comment 4.

**Caveats: Did they have a duty of inquiry? - generally no.**

ex. M issues note to P who indorses to A. Does A have a duty to inquire of M as to whether M has any defenses against P? Generally No.

This duty will put too great a burden on the free flow of negotiable instruments. However, knowledge of suspicious facts may give notice to A and dictate that they should make inquiry. 1-201(25)(c)

**Caveats: Forgotten Notice**

Forgotten notice or temporary amnesia doctrine can still make you a good faith purchaser. The UCC does not determine this manner. 1-201(25) and Comment 25.

Ex. Bearer bonds stolen from A. A sent printed notice of the theft along with adequate representations of the bonds to dealers throughout the country. B received such a notice. Later, B, forgetting the notice, took the bonds in good faith. Held for B: Though one has received actual notice, if by forgetfulness or negligence he does not have it in mind when he acquires the bonds, he may still be a good faith purchaser. However, he may not willfully close his eyes to the notice, or resort to trick or artifice to avoid knowledge, or purposefully forget it. *Graham v. White Phillips Co.* (Cited in 1-201) comment 25.

3. **Were they an immediate party holder? (No)**

Ex. **Payee not a HDC** - Buyer-Maker issues a note to Seller-Payee who negotiates to bank A who takes for value good faith without notice. Bank A is a HDC. But, seller-payee is not a HDC is not a HDC because he is not an immediate party to the underlying sales transaction who breached some or all of the quality warranties of 2-313, 2-315

**EXCEPTION**

Ex. **Payee is a HDC** - Buyer Maker issues the note making Bank A the payee. Seller indorses its name on the back of the note and delivers it to Bank A. Seller knew it was going to indorse to Bank A, so seller had requested that it be payable to Bank A. (While Bank A seems to be an immediate party - its name is on the check) it is really a remote party and takes it by negotiation from the seller. Consequently, the payee (Bank A) may be a HDC. See 3-302 Comment 4 and examples.

5. **Were they a specific type of person prohibited from being a HDC? (No)**

Under 3-302(c).

1. Instrument taken by legal process
2. By Purchase at an execution, bankruptcy or creditors sale
3. By purchase of a bulk transaction not in ordinary course of business.
4. Successor of interest to an estate

6. OR **Were they an FDIC taking over insolvent bank? (Yes!)**

This gives them holder in due course status, despite 3-302’s prohibition against succession transfers. 12 U.S.C.A. § 1823(e), *Campbell Leasing v. FDIC* 901 F.2d 1244 (5 Cir. 1990).

7. **If they were taking a security interest, were they asserting only the part representing the security interest as a HDC? (Yes!)**

3-302(e) - If a holder has only a security interest in the instrument and the maker has a defense, the holder (person entitled to enforce) the instrument may assert HDC rights only to an amount payable under the instrument which does not exceed the amount of the unpaid obligation secured. 3-302(e) and Comment 6. Case 6, 3-301; 3-204(c), 9-102(1) and (2), 1-201(37); c.f. 2-403(1) (First sentence).

Ex. Payee negotiates a note of Maker for 1K to H as a security for payment of Payee’s debt to H of 600. Maker has a defense which is good against Payee, but of which H has no notice. H may assert the rights of holder in due course only to the extent of the 600. 3-302

8. **Was their bad conduct or notice sheltered by title passed from an earlier HDC?**
Successors to Holders in Due Course - The Shelter Principle

1. The shelter principle. Transfer of the instrument vests in the transferee any right of the transferor to enforce the instrument (including any right of the HDC). 3-203(b).
   • Even though they know of fraud, they are sheltered by a previous HDC’s status. Ex. Payee by fraud induced maker to issue a note to Payee The fraud is a personal defense to the obligation to pay the note 3-305(a)(2). Payee negotiated it to X who takes as a HDC. After it becomes overdue, X negotiated it to Y (who had notice of Payee’s fraud) See 3-302(a)(2)(iii) and (vi). Y succeeds to X’s rights as HDC and takes free of Maker’s defense of fraud. (Policy - to assure that the HDC (x) a free maker for the instrument. 3-203(b) and Comments 2 and 4 Case #1).
2. EXCEPTION: The transferee cannot acquire rights of HDC if the transferee engaged in fraud or illegality affecting the instrument. 3-203(b).
   • Ex: In ex 1, assume payee negotiated the note to X, then repurchased it from X. Payee did not succeed to X’s rights as a HDC and is subject to Maker’s defense of fraud. (Policy: a person who is a party to fraud or illegality affecting the instrument is not permitted to wash the instrument clean by passing it into the hands of a HDC and then repurchasing it. 3-203(b) Comments 2-4 (Case 2).

Establishing Signatures and Status as a Holder in Due Course 3-308.

• Signatures are admitted unless specifically denied. 3-308(a).
• If it is denied, 3-3089a) (second sentence)
• If it is to an undisclosed principal (3-308(A) (third sentence).

Defenses or Claims in Recoupment

Persons entitled to enforce: (holders) If they are only a person entitled to enforce, and the validity of signatures is proven or admitted, the person producing the instrument is entitled to payment unless the defense proves a defense or claim in recoupment.
HDC - If they prove that they are a holder in due course, the defense or claim is barred. 3-308(b) (second sentence). SO, until the issue of a claim or defense arises, the issue 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. 3-308 Comment 2.

IF THE ANSWER TO ALL THESE IS YES - THEY ARE A HOLDER IN DUE COURSE AUTHORIZED BY 3-302 TO CUT OF CERTAIN CLAIMS AND DEFENSES!

Was the claim or defense a personal defense or claim of recoupment (can be cut off) not a real defense (can not be cut off)?

Although the holder is a PEE, the holder may be subject to claims and defenses of other parties, ALTHOUGH, if they are a HDC, they will not be subject to personal claims or claims in recoupment. 3-301, 3-305(a)(b).

Real Defenses - Subject to these even if you are a holder 3-305

(See the comments for more information. This is very detailed)
1. Infancy of the obligor (to the extent that it is a defense to a simple contract)
2. Duress which makes it void
3. Lack of legal capacity which makes it void
4. Illegally of the transaction (which makes it void)
5. Fraud in the execution when you have: neither knowledge of or reasonable opportunity to learn of: its character and essential terms. 3-305(a)(1)(iii), (b).
6. Discharge of the obligor in an insolvency proceeding. (ex. federal bankruptcy code. see 11. USCA §§ 727, 523, 524. Held: Discharge in bankruptcy is not cut off by a HDC. 3-302 Comment 3, 3-305 Comment 1 (last paragraph).
7. Alteration - to the extent altered unless negligence estops:
   a) Maker issues a note to Payee for 100. Payee skillfully alters it to 1K and negotiates it to Adams, a holder in due course. Adams recovers only 100 from Maker.
      i) An alteration fraudulently made discharges a party whose obligation is affected by the alteration HOWEVER
A person taking the note for value, in good faith, and without notice (A HDC) may enforce rights with respect to the note according to its original terms.

An incomplete instrument altered by unauthorized completion, Adams (HDC) may recover according to its terms when completed. Why? He was negligent.

If the Maker negligently completes the note to substantially contribute to the alteration, the Maker is precluded from asserting the alteration against a person who, in good faith, takes the note for value. i.e., Adams. 3-406(a), 3-103(a)(7), 3-406(b). (which adopts a comparative negligence test.)

8. Unauthorized signature (including forgery: Unless ratification or negligence estops.
   a) Forger forges Drawer’s name on a check and delivers it to Payee who negotiates it to Adams (A HDC). Adams can’t recover from Drawer, but can recover from Forger.
      i) An unauthorized signature is ineffective, wholly inoperative except as a signature of the unauthorized signer (forger) in favor of the HDC. 3-403(a)
      ii) If drawer’s negligence substantially contributes to the asking of the forgery, the drawer can’t assert against the HDC. 3-103(a)(7), 3-406(b). (comparative negligence)
      iii) For conduct that can be precluding under 3-406(a) see Comment 3 3-406.

9. Discharge is only effective if the HDC received notice of the discharge before acquiring the instrument.
   a) Discharge of the obligation of Maker to pay the note is not effective against Adams if Adams acquires rights without notice of the discharge.
      • Ex. Maker to Payee, Maker pays Payee in indeavoring to discharge his obligation on the note, but didn’t get the paper back. Paper negotiated to Adams. Held: Maker is not discharged from duty to pay Adams if Adams got the rights without notice of the discharge.
   b) Merger - the debt is so merged into the paper evidencing the debt that the paper is treated by the claim itself.
   c) A person cannot safely discharge their obligation without a presentation and surrender of the paper to the obligor. This will insure it is not in possession of a HDC.

Personal Defenses and Claims in Recoupment

The rights of a HDC are not subject to personal defenses: (listed in Comment 2 of 3-305).

1. Article Three Defenses
   a) Non-delivery, conditional issuance, issuance for a special purpose. 3-105(b) and comment 2> Ex. B steals from A’s office two signed but otherwise incomplete checks. B complete these and indorses them to C as a HDC. C cuts off A’s defense
   b) Failure to countersign a traveler’s check (3-106(c) and Comment 2
   c) Modification of the obligation by separate agreement. 3-117 and Comment 1
   d) Payment that violates a restrictive indorsement. 3-206(f) and Comment 5
   e) Instruments issued without consideration or for which promised performance had not been given. 3-303(b). Ex. Buyer issues note to order of seller in exchange for promise for seller to deliver specified equipment. If S doesn’t deliver it, B has a defense of consideration. 3-303(b). 2-301, 2-601, 2-711. This can be asserted against S but not against a HDC.
   f) Breach of warranty when a draft is accepted 3-417(b)(fourth sentence)
   g) Unauthorized completion (3-115, 3-407) Ex. A hands B a check signed by A naming B as payee. The amount is left blank. A says fill in the amount up to 500, B fills in 700, indorses to C, a HDC. C cuts of A’s defense. This is different than the real defense of ALTERATION.

2. Personal Defenses by Common Law
   a) Fraud in the inducement
   b) Misrepresentation
   c) Mistake in the issuance
      • All are cut off by a HDC
      • Ex. S, selling good to B, makes fraudulent representations regarding them. B relies and buys the goods giving S a note. S indorses the note to H, a HDC, who cuts off B’s defense of fraud in the inducement. WHY? B knowingly issued a note and set it afloat in a sea of strangers. (Compare this with the real defense of fraud in the execution 3-305(a)(1)(iii)
3. Claims in Recoupment
   a) These are not enforceable against any person other than the holder.
   b) Ex. Buyer issued note to Seller in exchange for seller to deliver specific goods. Goods are accepted, but money needed to make good. 2-606. This is not a defense under 303(b) (no consideration) since it was accepted. Sp. the buyer has to pay the price of the equipment which is represented by the note. But they may have a claim against Seller for breach of warranty separate.
      i) Holder has notice - Holder is not a HDC and buyer may assert the claim in recoupment only to reduce the amount owed by the amount paid (no refunds).
      ii) If they had no notice, and was a HDC - no claim is valid for recoupment.

STOLEN, LOST, OR DESTROYED INSTRUMENTS

Stolen Instruments

Stolen Bearer Paper
Ex. A issues note or draft to B ("bearer") or designating payment to the order of B, which B indorses in blank. 1-201(5), 3-109(a), 3-201(b), 3-205(b). C steals the bearer paper and sells it to D (HDC). Can B, the true owner of the paper recover from D? No

• D, the HDC takes free from B's claim to the instrument. 3-306(Second sentence).
• The analysis is the same, D takes free of B's claim as long as he fulfills the requisites to greater rights.

Stolen Order Paper
Ex. A issues draft to the order of B. B does not indorse, but C steals and forges B's indorsement. C sells to D who takes for value good faith without notice. “An indorsement that is payable to an identified person (b) cannot be negotiated without their indorsement” 3-201(b). An instrument is payable to order is thus payable to an identified person. 3-109(b). Since they did not indorse it, D cannot become a holder, therefore they cannot become a holder in due course. They are subsequent to the property right in the instrument. 3-306

Enforcing Lost, Destroyed or Stolen Instruments

A Payee, not in possession of the check is still entitled to enforce the check IF:
1. Payee was in possession of the check and a PETE when the loss of possession occurred
2. The loss of possession was not the result of a transfer by payee or a lawful seizure AND
3. Payee cannot reasonably obtain possession of the check because the check was destroyed, lost or stolen. BUT:
   • Payee must prove the terms of the check
   • Payee must prove the right to enforce it.
   • Court may not enter a judgment against Drawer, unless it find that drawer is adequately protected against loss that might occur by reason of claim by another person (A HDC), this can be provided by any reasonable means.
   • New 3-312 says that certain claimants can notify the bank of claimant’s claim an if certain period of time has passed (eg. 90 days) the check has not been presented, the claimant is entitled to payment from the bank without providing security. See 3-312 Comments Comment 4.

Ex: D issues and delivers check to order of Payee. While in Payee’s possession, check is lost destroyed or stolen. Drawer doesn’t want to issue a new one, since if Payee indorsed it in blank, a HDC can make a claim against Drawer (if it isn’t remember no-one can be a HDC of a forgery). 3-305.

Jus Terth
You must have standing to assert claims - the obligor cannot asset rights against a person entitled to enforce the instrument a defense, claim in recoupment or claim to the instrument of another person. 3-306.

• Ex: B buys goods from S and negotiates to S a cashier’s check issued by bank in payment of the price. Shortly after delivering the check to S, B learned S has defrauded him. S may enforce the check against Bank even though S is not a holder in due course. Bank has no defense to its obligation to pay the check, and it may not assert defenses, claims in recoupment, or claims to the instrument of B. B may have a claim to the instrument under 3-306 because of S’s fraud, but the Bank cannot assert this claim unless B joins it in the action which S is trying to indorse.
C. SIGNATURE REQUIREMENTS

General Tools for Liability for All Parties

Signature:
1. A person is not liable on an instrument unless the person signed it or an agent authorized to act for the person signed it (special rules for agents and principals)
2. Signature - made by word, mark, symbol executed by a person with present intention to authenticate a writing and it may be made manually or by means of a device or machine by use of any name, including a trade or assumed name. 3-401, 1-201(39), 3-204(a).

AGENTS AND PRINCIPAL LIABILITY:

RELATIONSHIP: AGENT / PRINCIPAL - PETE

Signatures of Agents (3-402)

When is the principal bound:
1. When the person acting as a representative (Agent A) signs the instrument by signing:
   1. The name of the represented person (Principal P)
   2. The name of the signer (A) If this is authorized, P is bound whether or not they are indicated on the contract.
   - Ex: If P authorizes A 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 PEE (third party T) can also prove that P authorized A to sign on P’s behalf, P also is liable on the instrument. 3-402(a) and Comment 1, 1-201(35). This rule gives to T the election of holding P liable when discovered. Although T expects the obligation of A alone, T has that of P also. Restatement Second, Agency §§ 186 and Comment B, 322.

2. When is the agent bound:
3. If A signs the name of A to an instrument, and the signature is the authorized signature of P, the following rules apply:
   a) If the form of the signature shows unambiguously that the signature is made on behalf of P who is identified in the instrument, A is not liable on the instrument. 3-402(b)(1). 1-201(35). Ex: Peter Principal Corp., by Alice Agent, Treasurer.
   b) If the form of the signature doesn’t show unambiguously that it is made in representative capacity (Case #3 in 3-402 Comment 2) or
      i) To the first party: A is liable on the instrument without notice that A was not intended to be liable on the instrument.
      ii) To the third party: A is liable unless A proves that the original parties did not intend A to be liable on the instrument. 3-402(b)(2) and Comment 2, 1-201(35), 3-103(a)(10)
   c) P is not identified in the instrument (Case #1 #2, 3-402 Comm. 2)
      i) To the first party: A is liable on the instrument without notice that A was not intended to be liable on the instrument.
      ii) To the third party: A is liable unless A proves that the original parties did not intend A to be liable on the instrument. 3-402(b)(2) and Comment 2, 1-201(35), 3-103(a)(10), 1-201(8)
   iii) Ex. Alice is the authorized agent of Peter Principal, intention is for Peter to be liable, not Alice.
      a) Alice Agent
      b) Alice Agent, Agent
      c) Peter Principal is written on the note, and Alice signs below, Alice Agent. In each case Alice is liable to a HDC without knowledge that Alice was not intended to be liable. 3-402 Comment 2. Policy: In none of the cases does her signature unambiguously show that she was not signing as an individual. Any ambiguity should be held against Alice.
However, if no HDC is involved, Peter Principal is liable on the note. 3-402(a). Policy: If the original parties to the note did not intend that Alice also be liable, imposing liability on Alice is a windfall to the person enforcing the note. Under 3-402(b)(2) Alice is prima facie liable because her signature appears on the note and the form of the sig. doesn’t unambiguously refute personal liability. But, Alice can escape liability by proving that the original parties did not intend that she be bound on the note 3-402 Comment 2.

**Check Cases - Who is bound?**

1. If A signs the name of A as drawer of a check without indicating the representative status and the check is payable from an account of P who is identified on the check, signer A is not liable on the check if the signature is an authorized signature of P:
   a) EX: Peter Principal Corporation, Alice Agent” Simply: If the check identifies P, A who signs on the signature line does not have to indicate agency status. Policy: Virtually all checks are personalized from the account of where they are drawn. Nobody is deceived into thinking the person who signed the check is meant to be liable. 3-402(c) and Comment 3.

**Unauthorized Signature: 3-403**

Suppose Alice signs:
Peter Principal Corporation
by Alice Agent, Treasurer

- This clearly binds Principal, as long as Alice is an authorized representative. 3-204(b)(1).
- If Alice signature is unauthorized (A signature made without actual, implied, or apparent authority and includes forgery) is the principal bound, agent?
  1. Principal - No. An unauthorized signature is ineffective as principal’s signature.
  2. Agent - Yes. It is effective as the signature of the unauthorized signer, Alice Agent, in favor of a person who in good faith pays the instrument or takes it for value. 3-403(a) and Comment 2. 1-201(43)
  3. For signatures of more than one person, ratification of unauthorized signatures, preclusion from asserting forgeries, see 3-403(a) (Last sentence) and (b) (See 1-201(28)), 3-406.

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**MAKERS OF NOTES AND ISSUERS OF CASHIER’S CHECKS**

**RELATIONSHIP: MAKER - PETE**

**OBLIGATION**

**Obligation of Maker of Note or Issuer of Cashier’s Check (3-412)**

**What is the Duty**

1. Maker of a note or issuer of a cashier’s check is obliged to pay an instrument according to its terms at the time it was issued.
2. If they signed an incomplete instrument, the obligation is to be paid according to its terms when completed.
3. If a bank refuses to pay a cashier’s check, including recovery of consequential damages, see 3-411 and Comment 1, 3-302 Comment 4 (Case #1, 3-305(c) and Comment 4.

**Who is it owed to?**

1. A person entitled to enforce the instrument (3-301), ex. holder, or to an indorser who paid the instrument.
   - EX: On June 11 I promise to pay to the order of Paula Payee, One Thousand Dollars. On demand I promise to pay Bearer ________. Jones fills in 1,000 in the blank.
   - Jones must pay the person who is entitled to enforce the instrument 1,000.
   - Regardless of the intent of the signer, a signature is an indorsement unless the circumstances UNAMBIGUOUSLY indicate that a signature was made for purposes other than an indorsement. 3-204(a) and Comment 1.

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**INDORSERS**
**RELATIONSHIP: INENDORSE - PETE**

**OBLIGATIONS**

**How can an Indorser be liable?**
1. Indorser’s Contract of Secondary Liability
2. Transfer Warranty

*Indorser’s Contract of Secondary Liability: Obligation of the Indorser (3-415) (note - Indorsers also have transfer liability)*

**Who owes a duty of an indorser?**
1. Unless you sign unambiguously on the document, you are an indorser 3-204(a) and comment 1.
2. By custom and usage a signature on the back of an instrument indicates an intent to sign as an indorser. 3-204(a).

**What are the indorser’s responsibilities 3-415(a) & (b)**
1. To pay the amount due on the instrument according to the terms of the instrument at the time it was indorsed.
2. If the indorser indorsed an incomplete instrument, to pay according to terms when completed.
3. If the indorsement says without recourse, the indorser is NOT liable to pay the instrument. 3-116(a), 3-117.

**Who is the duty owed to? (3-415(a)**
1. A person entitled to enforce the instrument - a holder (Or a subsequent indorser who paid the instrument).
2. Generally they are liable to one another (if multiple) in the order in which their signatures appear on the instrument.

**Triggering the liability:**

*GENERALY - 3-415(c) - When does the duty arise (Secondary liability)*
I. Obligee presents to maker (if a note) or drawee (if a draft) (See Presentment Checklist)
II. Maker or drawee dishonors the draft or note (See dishonor checklist)
III. Obligee gives notice of dishonor to the indorser. 3-415(c)(see notice checklist)

**I. Presentment Checklist**

a. If presentment is required for dishonor (as above), was it performed properly? 3-501

i. **What? (See 3-501)**
A demand made by a PETE an instrument
1. To pay the instrument made to the drawee or a party obliged to pay the instrument (Maker)
2. A demand to accept a draft made to the drawee (3-501(a).
• As to a note or accepted draft payable to a bank, the demand must be paid to the bank.

ii. **Place**
1. May or must be at the place of payment
2. May be made at any commercially reasonable means (e.g. oral, written, electronic).
3. Is effective when the demand for payment or acceptance is received. 3-501(b)(1). See also 3-111, 4-110, 4-212

iii. **Time**
See 3-502(a)(1) and (2)(b-d). “The day the instrument becomes payable.
Since the payor may decide whether to pay or accept on the day of presentment, 3-501(b)(4) allows the payor to set a cut off hour (not earlier than 2 p.m. for receipt of instruments presented.

b. **Was the procedure followed (Procedure) 3-501(b)(2)**
Upon the demand of the person it was made to:
1. Person must exhibit the instrument
2. Give reasonable identification
3. Sign a receipt on the instrument for any payment made, or surrender the instrument if full payment is made. 3-501(b)(2).

c. **Did the PETE make a properly available response without dishonoring: 3-501(b)(3)**
1. Pay the instrument
2. Return the instrument for lack of necessary indorsement
3. Refuse payment for failure of complying with applicable law or rule
**d. If presentment was required, was it excused? 3-504**

1. The person entitled to present cannot with reasonable diligence make presentment
2. The maker or acceptor has repudiated an obligation to pay, or is dead or insolvent. (See 1-201(22) for definition)
3. By the terms of the instrument - no presentment required
4. Drawer or indorser being enforced has waived presentment 3-504(b)
5. The drawer instructed the drawee not to pay or accept the draft, or the drawee was not obligated to the drawee to pay the draft. 3-504(a), 3-502(e).
   - In the great majority of cases, presentment and notice of dishonor are waived with respect to notes. 3-502 Comment 2.

**e. Are they discharged by a failure to timely present?**

**Indorser:**

1. If they are liable under her contract of secondary liability (3-415(a)) and the check is not presented for payment, or given to a depository bank for collection, within **30 days** after the day the indorsement is made, the liability of the indorser is discharged. 3-415(e).
2. Policy - Indorser who pays will have recourse against prior Indorsers and the drawer. 3-414(b)(Last sentence), 3-415(a)(last sentence). Indorsee’s failure timely to present or initiate bank collection may prejudice indorser’ chances for recovery.

**Drawer:**

1. Simply: after passage of the 30 day period, the risk of drawee’s insolvency passes from the drawee to the payee (or other PETE).
   a) If: a check is not presented for payment or given to a depository bank for collection within 30 days of its date
      i) the drawee suspends payments after expiration of the 30 day period without paying the check, and
      ii) because of the suspension of payments, the drawer is deprived of funds maintained with the drawee to cover payment of the check
   b) The drawer to the extent deprived of funds may discharge the obligation to pay the check (if it is dishonored) by assigning to the PETE the check the rights of the drawer against the drawee with respect to the funds. 3-414(f), 3-301.
   - Federal bank deposit insurance minimizes this risk. See example at 3-414 Comment 5.

**II. Dishonor Checklist**

**a. Was the instrument dishonored? Dishonor: 3-500 (depends on what type)**

1. **Notes:**
   - **Demand Notes**
     Ex. Note says “On demand I promise to pay to the order of Paula Payee…” Dishonored if presentment is duly made to the maker and the note is not paid on the date of presentment. 3-502(a)(1).
   - **Time Note:**
     Ex. On June 1 1995 I promise to pay to the order of Paula Payee… Notes payable at a definite time are dishonored if they are not paid on the due date. See 3-502(a)(3). And Comment 3. If a time draft is payable at or through a bank or by its terms, presentment is required. 3-502(a)(2).

2. **Unaccepted Drafts:**
   - **Demand Draft -**
     i. **Check presented for immediate payment over the counter**
     EX. Drawer issues a uncertified check to Payee, who at 11:am personally presents it to drawee bank for immediate payment over the counter. Check is dishonored if the presentment is duly made to the drawee and the draft is not made on the date of presentment. 3-502(b)(2), 3-501(b)(4).
     ii. **Check presented through the check collection process**
The check is dishonored if the payor bank makes timely return of the check or sends timely notice of dishonor or nonpayment (or becomes accountable for the amount of the check). 3-502(b)(1) and Comment 4. See comment for detailed illustrations of various responsibilities.

b. **Time Draft - payable on date stated on draft**

Ex. Drawer issues draft on March 1 stating, On June 1, 1998 pay to the order of…Dishonor occurs if presentment for payment is made and payment is not made on either:
1. The day the draft becomes payable (June 1) OR
2. The day of presentment is 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 draft becomes payable to establish whether the drawee is willing to assume liability by accepting. Dishonor occurs when the draft is presented and not accepted. 3-502(b)(3) and Comment 4.

c. **Time Draft - payable on elapse of time after acceptance or sight.**

See 3-502(b)(4).

d. **Documentary Draft**

See 3-502(c), 3-103(c) (4-104(a)(6).

3. **Accepted Drafts**

A certified check is dishonored if presentment is duly made to the drawee-acceptor and the draft is not paid on the day of presentment. 3-502(d) and Comment 6.

**III. Notice of Dishonor Checklist**

A. Are they discharged by a failure to receive notice of dishonor?

1. **Is notice of dishonor required?**

   **Indorser**
   1. the obligation of an indorser may not be enforced without notice of dishonor. 3-503(a)(I), 3-415(a), 3-415(c).
   2. If notice of dishonor is required, and it is not given to the indorser, the liability of the indorser is discharged. 3-415(c) and Comments 1 & 2.

   **Drawer**
   1. Notice of dishonor is not relevant to the liability of the drawer. Drawers are entitled to have the draft presented to the drawee and dishonored before they are liable to pay, but no notice of dishonor need be made to them as a condition of liability. 3-503(a)(I). and Comment 1.
   2. Exception: The obligation of the drawer stated in 3-414(d). (the obligation to pay after it has been accepted by a party not a bank). See 3-414 Comment 4.
     • Ex: S sells goods to B. As a collection device S draws a draft on B payable to the order of Bank. B accepts the draft. The obligation of S to pay the draft if the draft is dishonored by B is the same as the obligation of an indorser. i.e., S’s obligation may not be enforced unless S is given notice of dishonor.
   3. If the drawer is acting as an indorser because it has been accepted by someone not a bank, failure to give timely notice of dishonor discharges the drawer.

2. **Was notice of dishonor properly given? (3-503)(b)**

   Notice of dishonor:
   1. May be given by any person
   2. May be given by any commercially reasonable means (e.g. oral, written, electronic means)
   3. Is sufficient if it reasonably identifies the instrument and indicates that the instrument has been dishonored (or has not been paid or accepted).
   • NOTE: Return of an instrument given to a bank for collection is sufficient notice of dishonor. 3-503(b).
     • Ex: Bank returns to its customer a check with a ticket attached stating “The attached check was submitted to the drawee on 11/1/98 for payment. Payment was refused. Signed, depository bank.

3. **Was the notice of dishonor done on time? 3-503**

   **Instrument taken for collection by collecting bank** - Notice of dishonor must be given before midnight of the next banking day following the banking day on which the bank receives notice of dishonor of the instrument or by any other
person within 30 days following the day on which the person receives notice of dishonor. 3-503(c). (This replaces the former 3 day period rule in former 3-508(2), 3-503 Comment 2.

Any other instrument - Notice of dishonor must be given within 30 days following the day on which dishonor occurs. 3-503(c) (second sentence)

4. If the notice of dishonor was not done, was it excused? 3-504(b)
either;
1. BY the terms of the instrument, no notice of dishonor is necessary or
2. the party waives notice of dishonor, or waives presentment

5. If the notice of dishonor was delayed, was it excused? 3-504(c)
1. If the delay was caused by circumstances beyond the control of the person giving notice AND
2. The person giving notice exercised reasonable diligence after the cause of the delay ended 3-504(c). 3-503(c).s

6. Was there evidence of a notice of dishonor?
This can be done by protest, (A certificate of dishonor), but this is no longer mandatory. 3-505 and Comment. For definition of protest, see 3-102, Comment 5.

DISCHARGE 3-600

Make sure that the party has not been discharged from their obligation:

MASTER DISCHARGE LIST:
1. Simple Contract Discharge - Discharged by an act or agreement with the party which would discharge an obligation to pay money under a simple contract. 3-601(a).
   a) EX: accord and satisfaction, novation, running of S of L, discharge in bankruptcy.
2. Discharge by Payment 3-602 - An instrument is paid to the extent payment is made by or behalf of a party obliged to pay the instrument to the PETE.
   a) A party is discharged to the extent of payment (despite knowledge of a claim to the instrument by another person)
   b) Payment Does not Discharge You in These Situations: (3-602)
      i) Where payor knows of an injunction against payment
      ii) Where payment has accepted indemnity against loss
      iii) Where the person making payment knows the instrument has been stolen, and knows the PETE is in wrongful possession of the instrument.
      iv) Against a holder in due course, without notice of the discharge.
3. Discharge by tender of payment 3-603(c) - If tender of an amount due is made to a person entitled to enforce the instrument, the obligation of the person to pay interest after the due date on the amount tendered.
4. Discharge by refusal of tender by an indorser or accommodation party. Refusal of tender of payment discharges any indorser or accommodation party having recourse against the party making the tender. 3-603(c) and Comment.
   • EX: A issues a note to B who indorses it to C who indorses it to D. B tenders payment to D who refuses the tender. C is discharged. 3-415(a).
5. Discharge by cancellation or renunciation 3-604(a) - A PETE can discharge the obligation of a party by:
   a) An intentional voluntary act (surrender of the instrument, destruction)
   b) Agreeing not to sue (or otherwise renouncing the rights against that person)
6. Discharge by impairment of right or recourse of collateral (indorsers and accommodation parties) 3-605
7. Discharge by reacquisition of the instrument - A former holder A who reacquires the note may cancel indorsements (B of C) made after, the canceled indorsements are discharged and the discharge is effective against any subsequent holder. 3-207.
   • EX: A note payable to A which is indorsed in blank by A who delivers it to B who indorses in blank and delivers to C, C indorses in blank and delivers to A. Are B and C discharged from their obligation against A?
8. Discharge by accord and satisfaction by use of instrument: 3-311
9. **Discharge by Alteration of the instrument**
   a) A issues a draft or note to B for 100, B raises it to 1,000. Will B recover on the instrument? 1,000, 100 or nothing?
   b) An alteration fraudulently made discharges a party A whose obligation whose obligation is affected by the alteration (unless A assents or is precluded from asserting the alteration). B recovers nothing if his alteration is fraudulent and not estopped.
   c) If B’s action is not fraudulent, the code states that any other alteration discharges a party and it can be enforced according to its original terms. 100.
   d) If the person took it for value, in good faith, without notice (HDC) then see 3-407(c).

10. **Discharge by acceptance varying a draft** (Bank varies the terms when accepting) 3-410(c)

11. **Discharge by acceptance of a draft by a bank** - certification of a check 3-411

12. **Discharge of drawer of check when holder delays collection.** 3-414(f), Comment 6 3-501

13. **Discharge of indorser of check where check not presented for payment within 30 days after indorsement was made** - 3-415(c) and Comment 4.

14. **Discharge of Indorser if required notice of dishonor is not given** 3-415(c) and Comments 1 & 2, 3-414(d), 3-503 (c).

15. **Discharge of Warrantors for Untimely notice of claim for breach of warranty** (presentment and transfer) - 3-416(c).

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**TRANSFERORS**

**Who can be a transferor:**
- Indorsers (also have indorser secondary liability)
- Subsequent Indorsers (also have indorser secondary liability)
- People transferring bearer notes without indorsement

**Who are they warranting to? 3-416**
1. The next transferor of a transfer of bearer paper
2. If it is indorsed, they are warranting to all subsequent transferors, since the warranty runs with the instrument, and the remote holder may sue the indorser-warrantor directly and avoid a multiplicity of suits. 3-416(A) and Comment 1.

*Be sure that the statute of limitation has not run to enforce a warranty agreement.*
See the checklist in 3-118 and comments.

**What are they warranting? 3-416**
1. The warrantor is a PETE (a holder - there are no unauthorized or missing indorsements that prevent the transferor from making the transferee a PETE 3-416 (Transferor warrants that he has good title to the instrument) See Comment 2.
2. All signatures on the instrument are authorized and authentic.
3. The instrument has not been altered (A warranty that the amount has not been raised. 3-416(a)(3).
4. The instrument is not subject to a defense or claim in recoupment of any party which can be asserted against the warrantor. See 3-416(a)(4). See Comment 3.

- Even if the transferee takes as a HDC who takes free of the defense or claim, the warranty gives the transferee the option of going against the transferor rather than litigating with the obligor on the instrument the issue of the holder in due course status. 3-416 Comment 3, see 3-305(A) and (B)
- Ex. A issues to B a draft or note payable to the order of B, which B indorses and delivers to C. B sells defective goods to A who rejects the goods. A’s defense on the draft or note would be cut off by C if he takes as a HDC. If A accepts the defective goods, A is obliged to pay the price but A has a claim against B for breach of warranty: the claim may be asserted against B as a claim in recoupment to reduce the amount owing on the draft or the note. If C qualifies as a HDC, A may not assert against C. However, the warranty against defenses and claims in recoupment gives C the option of going against B rather than litigating with A on the draft the issue of the HDC status of C.
5. The warrantor has no knowledge of any insolvency proceedings commenced with respect to the maker or the acceptor or the drawer (of an unaccepted draft). Policy: Concealment of known institution of insolvency proceedings is a fraud on the transferee. 3-416(a)(5) and Comment 4.

What measures the damages? See 3-416B

When can transfer warranties be disclaimed (never for checks) - See 3-416(c)

For warranties that are similar to this in the collection of items,
- see 4-207(a), (c) and (d), but note 4-207(b)
- NOTE: 4-207(b) - “If an item is dishonored, a customer or collecting bank transferring the item and receiving settlement . . . is obligated to pay the amount due on the item.”

ACCOMODATION PARTIES - SURETYS

What is a Surety?
Involves three contracts:
- Between seller and buyer (contract for sale),
- Between surety and seller - surety will pay if buyer does not,
- Right of reimbursement - Between buyer and surety to whom - the buyer expressly or impliedly promises to reimburse Surety if Surety is called upon to pay. Restatement Third, Suretyship § 1.
- Right of subrogation - Further if Surety pays Seller, equity dictates that Surety be equitably substituted to Seller’s rights against Buyer under the sales contract (derivative) Restatement, Third Suretyship.

Accommodation Parties 3-419
1. Surety is called an accommodation party if the Buyer and Surety are parties to a note.
2. 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.

Obligation
Generally
1. An accommodation party may sign as maker, drawer, acceptor or indorser and is so obliged to pay the instrument in the capacity in which they sign. 3-4019(b).
2. They will usually be a co-maker or anomalous indorser
   - Ex: Buyer and surety sign as co-makers, a note naming Seller as payee. Surety is obliged to pay the note according to its terms. (Contract of primary liability). 3-412
   - Ex: Buyer signs a note naming Seller as payee. Surety indorses the back of the note and it is delivered to Seller. Surety, a an anomalous indorser, is obliged to pay the note according to its terms if it is dishonored (contract of secondary liability). 3-419.
   - NOTE: The Surety’s obligation may be enforced notwithstanding any statute of frauds and whether any consideration was received from the obligation.
   - The obligation of the Surety is not effected by the fact that Seller had notice when the note was taken that Surety signed the note for Accommodation. 3-419(c)

Restricting your surety obligation
1. Words ambiguously indicating guaranteeing collection rather than payment of the obligation of another party on the note - the surety is liable to pay the PETE only if execution of judgment against Buyer has been returned unsatisfied or it is otherwise apparent that Buyer is uncollectible. 3-419(d)
2. Just to guarantee payment - the surety can sign the back of the note as an indorsement.

Be sure that the statute of limitation has not run to enforce a warranty agreement.
See the checklist in 3-118 and comments.

Rights
A. Right to Contribution from Cosureties
Ex. Maker issues a note. On the reverse side of the note are the anomalous indorsements of A, then B, then C, then D. Normally, an earlier indorser has liability to a later indorser, BUT Indorsers can have joint and several liability in the case of two anomalous Indorsers. 3-116(a), (def. of anomalous Indorsers - see 3-205(d)).

- 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. 3-116(a).
- “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.” 3-116 Comment 2.
- Ex: A, B, C, D, in the above facts agreed to be cosureties for Maker and to contribute pro rata for the common loss caused by maker’s default. This is called a surety’s right of contribution against the sureties cosureties. Thus, if A pays all of Maker’s obligation on the note, A is entitled to receive 25% contribution from B, C, and D.

DEFENSES

1. Accommodation Party asserts Principal Debtor’s Defenses or Claims in Recoupment against a PETE
Ex. the normal non-conforming goods example.) May the surety (cosigner) assert the claim in recoupment against a PETE? Yes
- In an action to enforce the obligation of the PETE to pay the instrument, the surety may assert against Seller any defense or claim in recoupment the original debtor had against Seller.
- However, the Surety cannot assert Buyer’s defenses of discharge in bankruptcy, infancy, lack of legal capacity. 3-305(d) and Comment 5.

2. Accommodation Parties Special Defenses

a. No liability of Surety to the Principal Debtor
1. If accomodated party who pays the instrument has no right o recourse against and is not entitled to contribution from an accomodation party. 3-419(e).
2. An accomodation party is entitled to enforce the instrument against the accomodated party (Buyer) - the right of subrogation. And is entitled to reimbursement.

b. Discharge of Indorsers and Accomodation Parties 3-605

i. Impairment of Recourse -
1. Discharge of S by C renouncing rights against P. The release of P by C (a discharge under 3-604 (a)(ii), does ot discharge S (Why - this would be partial payment and help surety along). Settlement is in the isnterest of sureties as well as creditors. 3-605 Comment 3.
2. Discharge of S by C’s Extension of Due Date - The extension discharges S to the extent that the extension caused loss to S with respect to S’s right of recourse against P. 3-605(c) and Comment 4.
3. Discharge of S by material modification of P’s obligation to C - modification discharges S to the extent that it causes loss to S with respect to S’s right to recourse.

ii. Impairment of Collateral
1. C impairs the value of the collateral (ex. not filing a lien, etc.) - S is discharged to the extent of the impairment of the collateral. Look at the 3-605(e) comments 6 to find this illustrated.

When can’t the Surety be discharged for impairment?

a. Lack of Knowledge or Notice that Instrument was Signed for Accomodation
1. S is not discharged under 3-605(c)-(e) unless:
   a) C knows of the accomodation OR
   b) has notice that the note was signed by accomodation
2. S is presumed an accomodation party and there IS notice that the note is signed for accomodation if the signature:
   a) is an anomalous indorsement or
   b) it is accompanied by words indicating that they are acting as a surety or guarantor with respect to P’s obligation on the note 3-419 and Comment 3
   - EX: S is an accomodation maker and there is nothing on the note to show that S has signed for accomodation. C negotiates to X who is ignorant on that fact. He proceeds as to what he knows, and S is not discharged as stated above.
b. Consent to Event or Waiver of Discharge
If the surety waives generally the surety defenses, they can’t have these impairment defenses. This is usually in a standard principal obligation agreement.

c. PETE is a HDC
If the person entitled to enforce the instrument is a HDC, the discharge is worthless, unless the HDC had notice of the discharge. 3-601(b), 3-302(b) (first sentence).

CASHIER’S CHECK ISSUING BANKS

OBLIGATIONS

Who is obligated? (Obligated banks) 3-411(a)
1. Acceptors of certified checks or
2. the issuer of a cashier’s check or
3. issuer of a tellers check bought from the issuer.

When are they Obligated
1. If the obligated bank wrongfully: 3-411(b)
   a) refuses to pay a cashier’s check or certified check
   b) stops payment of a teller’s check
   c) refuses to pay a dishonored teller’s check
2. The PETE is entitled to compensation for expenses and loss of interest resulting from the non-payment, and may also get consequential damages (see comment 3) if the refusal to pay after receiving notice of the particular circumstances giving rise to the damages
3. Expenses or damages are not recoverable if the failure to pay was due to:
   a) The bank suspending payment
   b) the obligated bank asserts a claim or defense
   c) the obligated bank has a reasonable doubt that the person is the PETE (see ex. Comment 4).
   d) Payment is prohibited by law.

What is their obligation? 3-412
To pay the instrument:
1. According to its terms at the time it was issued or, if it was not issued, at the time it first came into possession of a holder
2. if the issuer signed an incomplete instrument, according to its terms when completed, to the extent of 3-115 and 3-407 (contributory neg.)

Who is the obligation owed to?
1. A PETE (3-301)
2. An indorser who paid the instrument under 3-415.

Types of Negotiable Instruments

Traveler’s Checks
defined - 3-104 Comment 3
Discussed - 3 -106 (Co-signtaure requirement, comment 2.
Special rule for indorsement - 3-205(Comment 1)
If taken for obligations - same as cash - 3-310
Lost, destroyed or stolen - 3-312

Money Orders
Defined - 3-104 Comment 3

Cashier’s Checks
Special circumstances involving how they are negotiated, how they are issued. Etc. 3-201 (Comment 2).
If taken, same as cash. 3-310
Lost, Destroyed or Stolen 3-312

**Certified Checks**
Lost destroyed or stolen - 3-312

**Corporations:**
See 3-302 Comment 4 - ex. of corporate officer running off and cashing check meant to pay corporate debt.

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**D. DRAWERS**

**RELATIONSHIP:** **DRAWER - PETE**

**OBLIGATION OF DRAWER (3-413)**

**Who owes the duty:**
1. The person signing on the draft
2. The person responsible by agency principles (see agency if applicable)
3. By custom and usage, a signature in the lower right hand corner of a draft indicates an intent to sign as drawer. 3-204(a) and Comment 1.

**When does the duty arise:** *(Secondary Liability)*
1. When the obligee presents the draft to drawee
2. The drawee dishonors the draft (See Dishonor Checklist)
3. Obligee gives notice of dishonor to the drawer.

**What duty owed:**
1. If an unaccepted draft is dishonored, the drawer is obliged to pay the draft according to its terms at the time it was issued.
2. If the drawer signed an incomplete instrument, the obligation to pay is according to its terms when completed.
3. They may not have a duty if the draft is drawn “without recourse” 3-414(b) and (e). 3-301, 1-201(2), 3-116(a), 3-419(b),

**Who is owed a duty:**
1. The person entitled to enforce (e.g. a holder - or to an indorser who paid the draft).
2. They may

**Triggering the Liability:**
1. Obligee presents to maker (if a note) or drawee (if a draft) (See Presentment Checklist (under Indorser)
2. Maker or drawee dishonors the draft or note (See dishonor checklist (under indorser))
3. III. Obligee gives notice of dishonor to the indorser. 3-415(c)(see notice checklist - this is not required for most drawers - only where they are a drawer with a check accepted by a person other than a bank, which, for my money, makes it an indorser.)

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**DRAWERS AS CUSTOMERS**

**RELATIONSHIP:** **DRAWER V. DRAWEE**

**II. DUTIES OWED BY THE CUSTOMER (DRAWER)**

1. **Preparation and Issuance of Instruments**
   a. **Negligence Contributing to Forged Signature or Alteration - Duty to Exercise Ordinary Care In Preparing and Issuing Instruments.** 3-406(a)-(b).

   1. Customer’s who fail to exercise ordinary care and who’s failure substantially contributes to an alteration of an instrument, or the making of a forged signature CAN NOT assert the alteration or the forgery against the bank, who in good faith pays the instrument.
2. BUT - If the bank fails to exercise ordinary care in paying the instrument, and the failure substantially contributes to the loss, the loss is allocated between the customer, the party precluded and the bank (entity asserting to the preclusion) by percentages. 3-406(a)(b) Comment 4.

3. A negligent customer may also not assert the real defenses of forged drawer and alteration against a person who, in good faith takes it for value. (HDC)
   - EX: Leaving a large blank space and using a typewriter, where someone fills in extra 000s. Bank pays in good faith. The trier of fact could find that the drawer failed to exercise ordinary care & that it substantially contributed to the loss. So, they would be precluded from asserting against drawee who paid in good faith (however, if the bank also was negligent, comparative negligence would apply).
   - Ex: Employer uses a rubber stamp that he leaves in an unlocked drawer with blank check forms. 3-406 Comment 3 Case #1

b. Completion of Incomplete Instruments 4-401(d)(2)
A bank (in good faith made payment) can charge the account according to the terms of the completed item (1,000) even though the bank knows it has been completed, as long as they don’t know it was improperl. 4-401(d)(2) and Comment 4.
   - Ex: Cal issues a check to Payee with the amount blank. Payee was authorized to fill in 100, but fills in 1,000. May bank charge 1,000 to customer’s account? YES

c. Instruments Payable to Imposters or Fictitious Payees
i. Imposters
Ex: Evil Man impersonates Smith and gets customer to write him a check as Smith, which he deposits. Customer wants bank to recredit his account. as not “properly payable” as paid by a forged indorsement. Must bank recredit?
   - If the imposter induces them to issue a check to Imposter, an indorsement of the check by any person (even an imposter) in the name of the payee (smith) is effective as the indorsement of Smith in favor of the bank, who in good faith, pays the instrument. So, they can’t get recredit arguing a forged indorsement as long as the bank acted in good faith. 3-404 Comment 3.
   - BUT, if the bank fails to exercise ordinary care, they may be comparatively negligent. 3-404(d).
   - Certain behavior (issuing a check to an imposter) is negligent and renders signatures resulting from the behavior effective against the negligent party. 3-404 (codified negligence liability).0.
   - NOTE: This indorsement is also effective for purposes of transferring a HDC status to a HDC. (even though a person taking through a forged indorsement can’t be a “holder”.)

ii. Fictitious Payees
Ex: Treasurer who is authorized to draw checks on behalf of Corp writes one to Supplier, who they made up. Indorses Supplier and deposits in Dep. Bank. This is paid by drawee bank. Corp discovers fraud, and wants to recredit account. Will corporation win? NO
1. If the person identified as payee is a fictitious person any person in possesion of the check is its holder. An indorsement of any person is effective as the indorsement of the payee to any person who in good faith pays the check. 3-404(b)(2) and (ci) and Comment 2(Case #1.)
2. But, if the bank doesn’t exercise ordinary care, they may be comparatively negligent. 3-404(d).
3. If Supplier was an actual company doing business with Corporation and Treasurer intended to steal the check when it was drawn, the result is the same (the test is the intent when the check was drawn by the authorized issuer).
4. The indorsement is equally effective for a HDC and a collecting bank (Depository Bank) 3-404(b) and Comments 2 (Cases #1 - #5) and 3.

d. Fraudulent Indorsements by Employees of Instruments Issued by Employers 3-405
Ex: Checks are signed by Treasurer, clerk prepares them, so he prepares an extra check for a real company. He steals it and deposits in a Depository Bank withotu indorsing (doesn’t need to - social exception for DB). Must the bank recredit the Corporation’s account? NO
1. If corporation entrusted the clerk with responsibility to prepare the instruments and he makes a fraudulent indorsement to whom the check is payable, and indorses in the name of that person, the corporation is liable and the bank doesn’t have to recredit. (not withstanding comparative negligence).
2. Indorsement is also effective against a HDC, or person taking it for collection.
3. WHY? Employer is in a better position to avoid the loss

2. Bank Statement Duties - Duty to Discover and Report

a. Requisites to Impose this Duty on the Customer: 4-406
1. Bank sends or makes available a statement of account that either gives them the checks or makes them available, or gives them the information sufficient to allow the customer reasonably to identify the checks paid.
2. Banks doesn’t have to return the checks - need only give safe harbor - check number, amount and date of payment.
4-406(a). Comments 1-3.

b. Customer’s Duty to Discover and Report Unauthorized Signature of Customer and Any Alteration 4-406

Customer Does Their Duty
1. If the customer gets the statement, they must exercise reasonable promptness in examining the staetment or checks to determine whether any payment was not authorized;
   • because of alteration or forgery (unauthorized signature)
2. If the customer should reasonably have discovered the unauthorized signature with the information they were given, the customer must promptly notify the Bank of the relevant facts. 4-406(c)

Customer Fails to Do their Duty 4-406(d)
1. IF Bank proves they failed to comply with their duties, customer is precluded from asserting he unauthorized signature or any alternatin of the check IF
2. the bank also proves they suffered a loss by the failure 4-406(d)(1).
3. If bank proves that they could have discovered unauthoized signature or alteration by the same wrongdoer paid in good faith by the bank See 4-406(d)(2) - If the customer doesn’t notify within 30 days and the same one does it again, they can’t assert the defenses against these further checks. 4-406 Comment 2.

c. Customer has no duty to look for or report unauthorized indorsements, 4-406 Comment 5.
   Why? How can they know the signatures?

d. Time Limit on Customer’s Right to Assert Forgery & Alteration & Unauthorized Indorsement
   • Unauthorized signatures & Forgery - Customer must discover and report within one year. 4-406(a)(f),
   • Unauthorized indorsements - three years for a customer to seek a credit to an account improperly charged by payment of a check with an unauthorized indorsement. 4-111, 4-406 Comment 5.

DRAWEE BANKS AND PETES

OBLIGATIONS
Ways banks can get liability to PETES
1. Accepting a draft
2. Conversion (Tort Liability)
No obligation to pay unless they accept a draft. 3-408
1. Remember - a drawee bank is not liable unless it accepts the draft. 3-408. The drawee has no contract liability on the instrument unless it accepts it. Although they have broken their contract if the customer has sufficient funds and they refuse to pay, it is not an assignment of drawer’s rights against drawee. No. a check or other draft does not operate as an assignment of funds in the hands of Drawee available for payment.

I. PRIMARY LIABILITY OBLIGATION AS ACCEPTOR OF AN ACCEPTED DRAFT 3-413, 3-414(D)
   RELATIONSHIP: DRAWEE (ACCEPTOR) & HDC OR PETE

Primary liability - 3-409
1. the draft need not be dishonored by anyone else to trigger the liability.
2. An acceptor is a drawee, a person who is not liable on the draft since they have not signed it - who becomes an acceptor by signing the draft agreeing to pay it. 3-408.

What:
1. Acceptors have the obligation to pay a draft according to its terms at the time it was accepted. 3-413(A)(I).
2. If the acceptance varies the terms of the draft, they must pay after the term of the draft as altered.
3. If the acceptance is made of an incomplete instrument, (or an altered instrument) they must pay under the terms of when it was completed (altered. 3-115, 3-407, 3-413.
- Ex. Draft is issued for 1K. X alters it to read 10K. Acceptor accepts it, and is obliged to pay 10K. 3-413(a)(I).
- If the acceptance varies the terms of the draft See 3-410 or the draft is an incomplete instrument, see 3-413(a)(ii) and (iii).
4. If the certification of a check (or other acceptance of a draft) does not state an amount and the amount is raised see 3-413(b) and Comment.

Who:
The obligation is owed to a PETE (a holder - or to a drawer or indorser who paid the draft). 3-413.

Where must acceptance be written (3-409 Comment 4):
1. Acceptance must be written on the draft and may consist of the drawee’s signature alone.
2. It need not have words along with it like certified, accepted, good, etc.
3. It must not have any words stating an intent to refuse the draft.

When (3-409(a) (third sentence):
- Acceptance may be made at any time and becomes effective when the drawee notifies the holder or gives notice according to the instructions, or the accepted draft is delivered.
- May be made when the draft has not been signed by the drawer, is otherwise incomplete, is overdue, or has been dishonored. (3-409(b)).

Examples of Acceptance
1. Buyer seeks to pay Seller by check for sold goods. Seller wants more than Buyer-Drawer’s contract of secondary liability on the check. Thus, Seller has Drawee Bank certify the check. No Drawee as Acceptor has agreed to pay the check.
2. Manufacturer seller Contracts for sale of goods to Dealer-Buyer. Seller wants cash terms. buyer wants sixty day credit terms so that Buyer may resell the goods and pay the Seller out of the proceeds of the resale. Thus, Seller draws a draft on Buyer (sometimes called a trade acceptance) payable in sixty days, naming Seller or Bank A as Payee. Seller discounts (sells) the draft with Bank A. Buyer accepts the draft - that is buyer engages to pay it in sixty days. Seller gets cash from Bank A in consideration of the discounting of the draft with Bank A. Net effect of the transaction: Seller gets cash no later than delivery of the goods to the Buyer; Buyer gets sixty day credit terms; Buyer discharges the obligation to pay by paying Bank A at the end of the sixty days. For a discussion of the draft with bill of lading attached see part 3 B infra.

Finality of Acceptance 3-418
These paralel the finality of payement rule. If the drawee bank accepts the check, may they then refuse to pay or is its acceptance final?

Acceptance by Mistake 3-418
Drawee may withdraw acceptance if:
1. Payment had not been stopped
2. Signature of the drawer was authorized
3. In other cases of mistake, (no account, NSF) the drawee may revoke the acceptance.
Drawee may not withdraw the acceptance if:
1. A person who took the draft in good faith and for value (or who in good faith changed position in reliance)
2. In most cases, this will be in good faith for value.

Does the bank have a defense in the breach of a Presentment warrantees 3-409
If a person presents an uncertified check to bank for certification, then the presenter warrants at time of presentment:
1. the presentor is a PETE (No forged endorsements)
2. Check has not been altered
3. Presenter has no knowledge of an unauthorized drawer signature
- Breach of presentment warranty is a defense to the obligation of the drawee bank. 3-417(a)
- If a check is altered prior to acceptance they are obligated to pay according to its terms when presented. 3-413(a), if it is subsequently raised see 3-413(b).
Section 4-17 gives to the warrantor the benefit of rights that the drawee has against the drawer under 4-406, so the drawer’s conduct contributes to the loss, the drawee can shift the loss from the drawer to the warrantor. 3-417(c).

**II. Conversion Liability of Drawee or Acceptor**

**How can they get liability?**

*Be sure that the statute of limitation has not run to enforce a warranty agreement.*

See the checklist in 3-118 and comments.

1. **Paying on a forged indorsement**

   *Ex. Drawer issues to Payee a check to order of Payee. Forger steals the check from Payee and forges Payee’s name on the check. Forger presents the check to Drawee who pays Forger. Does the Payee have rights against the Drawee?*

   **Yes**

   1. An instrument is converted if a bank makes or obtains payment with respect to the instrument for a person not entitled to enforce the instrument or receive payment (Forger).
   2. This covers case when a depository bank or payor bank (drawee) takes an instrument bearing a forged indorsement. 3-420(a)(second sentence) and Comment 1.

   **Who is this owed to?**

   The person entitled to enforce, they must have received delivery.

   This does not apply to:

   1. The issuer or acceptor of the instrument
   2. A payee or indorses who did not receive delivery of the instrument either directly or through delivery to an agent or co-payee.

   **How much liability?**

   Presumed the amount payable on the instrument, but it can’t be more than the rest.

   **Special Situations - The Bank Collection Process. Note**

   If Forger had deposited the check with Depository Bank for collection, this bank would be liable in conversion, although other collecting banks would normally not be liable in conversion (beyond the amount of proceeds it has not paid out). 3-402(a) and (comment 1) and (c) and Comment 3.

2. **Where Instrument is Delivered for Payment or Acceptance and Instrument is not Accepted, Paid or Returned on Demand**

   *Ex. Drawer issues a check to Payee who in turn presents it to Drawee for payment. Drawee takes the check, but subsequently refuses on demand by Payee either to pay or return it. Does Payee have rights against Drawee? YES*

   1. “An instrument is converted when Drawee refuses on demand either to pay it or return it - it is the property of the holder. It is a mercantile specialty which embodies rights against other parties and is a thing of value. (The law of personal property also applies to instruments. This law governs the issues of when the presenter’s right of possession has been denied. 3-402(a) (Comment).
   2. Even without a demand for an item, a payor will have a responsibility for the late return of the item.)

3. **Constructive Acceptance or Conversion (4-302, 4-104(a)(3))**

4. **Paying on a Restrictive Indorsement - Conversion and Restrictive Indorsements**

   *Ex. X indorses, for deposit only, check is stolen by thief and cashed at grocery store by T. Grocery store indorses and deposits at depository bank. Grocery store account credited, check forwarded to intermediary bank, which forwards it to drawee payor bank who pays the check? who is liable in conversion to X?*

   1. A person other than a bank who purchases the check indorsed “deposit only” converts the instrument (unless the amount paid for the instrument is:
      - Received by the indorser, or
      - applied for deposit only.
      - Since it wasn’t the grocery store is a converter and liable to X. 3-206(c)(1) and Comment 3.
   2. A depository bank that takes the check for collection when indorsed “for deposit only” converts the check (unless the amount paid by the bank is received by the indorser, or applied consistently. Since this didn’t happen, depository bank is a converter and liable to X 3-206(c)(2) and Comment (3)
   3. Payor Bank or intermediary bank may disregard the indorsement and is not liable if the proceeds of the check are not received by indorser X or applied consistently with the indorsement. 3-206(c)(4) and comment 3. For policy
considerations, these banks are allowed to ignore restrictive indorsements to allow things to be more easily collectible. 
The presence of an indorsement that is restrictive does not prevent a purchaser of the instrument from becoming a holder in due course.  3-206(e).

**AS ISSUER OF A CASHIER’S CHECK**  (3-414(a), 3-412)

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**DRAWEES AND CUSTOMERS**

**RELATIONSHIP: DRAWEE (PAYOR) - DRAWER (CUSTOMER)**

**I. DUTIES OWED BY THE BANK (DRAWEE)**

**When can a bank charge a customer’s account? 4-401**
- When the item is “properly payable”. If the item is not properly payable, they cannot charge their account.
- Banks have to follow the drawer-depositor’s genuine order. Aigler & Steinheimer. Therefore, only pay properly payable items.

**When is an item properly payable? 4-401(a)**
1. If it is authorized by the customer AND
2. It is in accordance with any agreement between the customer and the bank.
- Ex: An item is not properly payable if it contains a forged drawer’s signature or forged indorsement. 4-401(Comment 1)
- Payment without authority also includes payment made on checks which are altered after issuance. “Here the bank may charge the indicated account of the instrument according to the original terms of the altered item (not the terms as altered)  4-401(d)(1).
- ex: If you get a forged check, a check stolen out of the payee’s mailbox and then forged indorsement, and an alteration not caused by your negligence (100 to 1000) and you timely notify the bank, the bank can’t charge your account.
- Bank must re-credit: 1. for the amount of the forged indorsement check, (not properly payable), 2) for the amount altered raised (900), and may charge only for the 100, and must also recredit the amount of the stolen fraudulent check.

**RIGHTS OF THE BANK**

**Overdrafts - (4-401(a)&(b))**
- The bank may charge the customer’s account even if it makes an overdraft.
- If you didn’t receive the benefit of the overdraft, and you didn’t write the check, but you are on the account, you are not liable for the overdraft. 4-401(a) and (b).

**Postdated Checks 4-401(c)**
Bank may charge against account of customer a check that is otherwise properly payable, even though it was postdated. UNLESS
1. Customer has given notice to bank and described the check with reasonable certainty
2. Policy: The automated check collection system can’t accommodate postdated checks.

**Order in which items may be charged: 4-303(b)**
Generally - items may be accepted, paid, certified, or charged to your account in ANY order. 4-303(b) and Comment 7.

**EVENTS OR CIRCUMSTANCES TERMINATING OR SUSPENDING BANK AUTHORITY TO PAY:**

**I. Customers Right to Stop Payment 4-403**
Ex. Customer by phone orders bank to stop payment. Ten days later Payyee presents and bank pays - is bank liable for its payment against the stop payment order? Yes - prima facie liable:

**How a customer stop payment? 4-403(a) and Comment 1 and 2.**
- By an order to the bank describing the check or account with reasonable certainty.
How long is the order effective? 4-403(b)
Written - 6 months, but can be renewed at any time.
Oral - 14 days, if not reconfirmed in writing, then goes 6 months from date of oral.

Who has the right to stop payment
1. Drawers (payees and indorsees DO NOT have this right)
2. Other people on the drawer’s account.

When must it be received? 4-403(a)
At a time and in a manner that affords the bank a reasonable opportunity to act on it before any action by Bank with respect to the check. e.g., before the bank certifies the check or pays it in cash. 4-403(a) and Comment 4.

WHAT IS THE EFFECT OF A BANK’S FAILURE TO STOP PAYMENT? 4-403(c)
Prima facie liability, but the customer must also show the fact and amount of loss resulting from the payment of the check contrary to the stop-payment order. 4-403(c), 1-201(8) 4-407 Comment 1.

Ex 1: Buyer buys goods, accepts them for $1,000. Buyer writes a check on bank payable to Seller. Buyer orders stop payment. Bank improperly pays. Must the bank recredit the customer’s account? NO. Buyer can’t establish the fact that it had a legal injury caused by the bank’s payment contrary. Even if the payment had been stopped, the Buyer still had a liability to the Seller per its drawer’s contract of secondary liability. 4-403(a) and (c), 3-414.

Ex 2: Same as Ex1, but goods are defective. Value of goods accepted is $600. Buyer’s damages are $400. Must bank recredit? Yes - for $400, the value of the loss from the payment of the check, OR the bank subrogated to the rights of payee-seller against drawer buyer on the check or the transaction.

Ex 3: Payee seller indorses the check to Adams a HDC who takes free of Buyer’s personal defense. 3-305(a)(2) Must bank recredit? NO.
1. Buyer can’t establish that the loss was resulting from the payment of the check. Its defense would be cut of by the HDC. Drawer would still have drawer liability. OR
2. Bank is subrogated to the rights of the HDC on the check against Drawer (he stands in his shoes), so the bank can use his HDC status as a defense against Buyer.

2. Checks Presented More than Six Months Old 4-404
Bank is under no obligation to pay checks more than six months old. But they charge the customer’s account for payment made in good faith after six months where the bank is in the position to know that the drawer wants the payment made. 4-404 and Comment.

3. Death or Incompetence of the Customer 4-405(a).
- Bank’s authority to pay is not rendered ineffective by incompetence when issued or death during collection if the bank doesn’t know of the adjudication or death.
- It doesn’t revoke authority until the bank knows of the fact and has a reasonable opportunity to act on it.
- Death - even with knowledge, the bank may pay on checks for 10 days after receipt of notice. UNLESS ordered to stop payment by a person claiming an interest in the account.
- This is different with the agency rule that death terminates the agency relationship. Restatement Second, Agency § 120(1) 1958.

4. Customer’s Bankruptcy 4-303
Absent revocation by the drawer or his trustee, or absent knowledge or notice of bankruptcy by the bank, the contract between the bank and customer remains unaffected by bankruptcy and the right and duty of the bank to pay duly presented checks remains as before. 4-303 Comment 1, Bankruptcy Code 11 USCA § 542(c).

Bank’s Wrongful Dishonor: 4-402
When the bank breaches its duty to properly pay items, the customer will have an action for wrongful dishonor. Banks wrongfully dishonor a check when it dishonors a check that is properly payable (However, a bank may dishonor a check that would create an overdraft unless it agreed to pay the overdraft) 4-402(a), 4-401(a).
EX: Cal deposited $1,000 in his account with bank, which gave him $2.5K balance. $1,000 not credited because of a clerical error. Several days later, Cal writes a check for $2K which was dishonored by the bank for NSF. Cal’s credit was shot, he was arrested, booked, fingerprinted, held for bail, and criminal charges. What is the bank’s liability?
1. Bank is liable for damages proximately caused by the wrongful dishonor of the check.
2. Liability is limited to actual damages proved and may include damages for arrest or prosecution or other consequential damages.
3. Whether any consequential damages are proximately caused by the wrongful dishonor is a question of fact to be determined in each case. 4-402(b) and Comment 3.

4. How the bank determines whether the customer has sufficient funds, see 4-402(c).

**DID THE BANK IMPROPERLY DISHONOR OR PAY A CHECK**

**When items subject to (1) Notice, (2) Stop Order (3) Legal Process, (4) Setoff.**

While a payor bank is processing an item presented for payment, it:

1. May receive knowledge or legal notice affecting the item, such as knowledge or notice that a the drawer has filed a petition in bankruptcy or made an assignment for the benefit of creditors.
2. May receive an order of the drawer stopping payment of the item.
3. May have served on it an attachment of the account of the drawer.
4. The bank itself may exercise a right of setoff against the drawer’s account.

**What does these events do?**

1. Affects the account of the drawer.
2. May eliminate or freeze all or part of whatever balance is available to pay the item.

**Was the item effected by a legal process or stop payment when it was paid?**

**Rule for determining the relative priorities between these legal items: 4-303 Comment 1.**

1. If any one of several things has been done to the item or
   a) if it has reached any one of several stages in processing
      i) Payor bank accepts or certifies the item, or pays the item in cash. 4-303(a)(1) & (2) and Comment 2, 3, 6.
      ii) Payor bank settles for the item without having the right to revoke the settlement) 4-303(a)(3) and Comment 3.
      iii) Payor bank becomes accountable for the amount of the item under 4-302 dealing with payor bank’s responsibility for the late return of items. 4-303(a)(4) and Comment 5. (If the payor bank is not the Dep bank it is accountable if it retains the item beyond midnight of the banking day of receipt without settling for it. 4-302(a)(1) and Comment 1.
      iv) Checks: The determining event for priorities is the cut off hour on the day after the check is received. The hour may be fixed by the payor bank no earlier than one hour after opening and no later than close of banking day, if it received after cut off, it is treated as the next banking day. 4-303(a)(5) and Comment 4.

2. at the time the knowledge, notice, stop-payment order or legal process is received or served
3. and a reasonable time for the bank to act thereon expires or the setoff is exercised, (or cut off time is before a reasonable time is exercised)
4. the knowledge, notice, stop payment order, legal process or set off comes too late.
5. The item has priority and a charge to the customer’s account may be made and is effective.
6. Thus, at the time the reasonable time expires (or the set off is exercised) the payor IF THE PAYOR BANK has done any of the following, or if any one of the above stages in the processing of the item has been reached, the item has priority.

EX: Dr issues a check to Payee who deposits it with DB who forwards it to Collecting bank. On Monday Morning Collecting bank presents it to drawee payor bank for collection. A provisional settlement is made by midnight on Monday and by 2 pm Tuesday the internal process of posting the check is completed. At 2:30 PM on Tuesday Payor Bank is served by legal process (A writ of garnishment) to collect a judgment obtained by creditor in a suit against Drawer. There are NSF to cover both the check and the garnishment. Who has priority? The payee, the owner of the check has priority. Since the cut off hour is 2pm Tuesday, the expiration of the reasonable time for the garnishment is somewhere after 2:30 pm on Tuesday, when it was served on the bank. Ti comes too late.
They make provisional credits (customers) or settlements (other banks) and wait for payment to be subsequently
determined of whether item will be finally paid. Normally, these become final by lapse of time. But, if they aren’t, they
can reverse the provisional settlements by a charge back, and obtain refunds under 4-214 Comment 1.

When is an item finally paid by a Payor Bank? 4-215

When a payor bank has first done any of the following:
1. paid the item in cash (Payee of check gives it to teller, teller pays cash) 215(a)(1).
2. finally settled for the item (i.e., Settled for the item without a right to remove the settlement under statute, clearing
   house rule, or agreement. 4-215(a)
3. Made a provisional settlement for the item and failed to revoke the settlement in the time and manner permitted by
   statute. (Ex. the time limit for Monday could be 2pm on Tuesday). The process of posting test has been
   abandoned. 4-215 Comment 5, see former 4-109.

Why is final payment important?
1. It is one of several factors in determining the relative priorities between items and notices, stop payment orders, legal
   process and setoffs. (4-303).
2. It is the end of the line in the collection process and the turn around point commencing the return flow of proceeds
3. It is the point when provisional settlements become final. 4-215(c). See also 4-214 Comment 1.
4. Final payment of an item by the payor bank fixes preferential rights under Section 4-216.

When credits available for withdrawal as of right See 4-215(e), (f), comm 11-12

PAYOR BANKS - BANKS REMEDIES AGAINST PAYEES (PRESENTERS)

RELATIONSHIP: DRAWEE & PRESENTER (PAYEE)

1. Go against them for money paid by mistake

Finality of Payment
Drawee has paid a check drawn upon it, then it is determined by Drawer that the Drawer’s signature was forged, or
indorsement forged, amount altered. Now, Drawee bank seeks to recover the monies paid from the person who
presented the check for payment. May Drawee (payor) bank recover the amount paid from the presenter of the check
(Presenter) or is payment final?

Common Law Rule
1. General Rule - Money paid by mistake is recoverable back from the presenter by the payor (drawee) This is a quasi-
contract rule intended to prevent unjust inrichment.
2. EXCEPTION - Price v. Neal - a drawee thata pays an instrument on which the signature of the drawer is forged (not
the indorser) CANNOT recoverback from the presenter the payment, notwithstanding the general rule allowing
recovery of moneys paid by mistake. Reason for the rule: Drawee Bank is in a superior position to detect a forgery
because it has drawer’s signature on file. (Drawer signed signature card when drawer opened checking account with
Drawee) and is expected to know and compare it.
3. Limitation - Such payor can recover from a bad faith presenter or a presenter who was a mere donee. If presenter
was the forger of the note or had knowledge of the forgery when Presenter received payment, then Drawee may
recover the monies paid.

Old UCC - if the drawee was not in a superior position to detect certain facts (forged indorsement, alteration)
drawee may recover back from the presenter. If the drawee was in a superior position to detect (forged drawer) they
can’t recover unless the presenter was not in good faith.

UCC 3 - 4 Rules 3-418(a)
The remedy is specifically staken: If a drawee pays a draft on the mistaken belief that:
1. Payment had not been stopped or
2. The signature of the drawer was authorized (the drawee may recover the amount of the draft from the presenter.
3. If it has been paid by mistake and is not covered by (a) the person paying may recover from the presenter consistent
   with law on mistake and restitution. (Common examples - drawer has no account with drawee, available funds not
   sufficient to cover, etc.)
4. Remedies may not be asserted against a HC or a person who changed position in reliance on the payment.
5. Also consider presentment warranties. 3-417.
2. Go After them for Breach of a Presentment Warranty

   a. Presentment warrants made to drawees of unaccepted drafts  3-417(a)

Ex: An uncertified check is presented to Drawee Bank for payment and the bank pays the check, the person obtaining payment (Presenter) at the time of presentment warrants to the drawee bank making payment in good faith that:
   1. Warrantor is a PETE (no missing or unauthorized indorsements)
   • Remember - a person cannot be a “holder” after a forged indorsement. 3-109 Comment 1 (last sentence)
   2. The check hasn’t been altered. 3-417(a)(2).
   3. The warrantor has no knowledge that the signature of the drawer of the check is unauthorized. (See Comment 3 - this retains the Price v. Neal Rule)
   4. Measure of damages see 3-417(b).

   b. Presentment warranties in all other cases 3-417(d)

Who:
Presented for payment to a drawer or indorser, or to any other party obliged to pay the instrument when payment is received.

What:
1. Warrants only that they are a PETE the instrument (a warranty of no forged indorsements)

Examples
1. Maker issues a note to Payee. The note is eventually taken by Presenter who receives payment from Maker. Presenter warrants only that there are no forged indorsements. There is no warranty with respect to alteration or knowledge that the signature of the Maker is unauthorized. The maker should know this himself. Comment 4.
2. Drawer issues a check for 100 to Payee. Payee skillfully raises it to 1,000. Drawee bank certifies it for 1,000. See 3-409(a)(d). Payee negotiates it to Presenter who presents it to Drawee Bank who pays. Drawee Bank cannot recover the payment. Drawee bank is obliged to pay the check according to its terms when accepted. 3-413(a)(1). If the amount of the check is raised after the certification see 3-413(b), 3-417 Comment 4.

When made in the bank collection process. 4-208.
Be sure that the statute of limitation has not run to enforce a warranty agreement.
See the checklist in 3-118 and comments.

E. THE BANK COLLECTION PROCESS

1. The process explained.
Ex. Buyer writes a check for 500 on Drawee bank and issues to Seller as Payee. Seller deposits in Dep Bank and it is forwarded to the payor bank.
1. Depository bank - he fills out a deposit slip, and the bank gives him a “provisional credit” to his account. If this is not collected, the credit will be revoked.
2. “On Us Items” If the DB is also the Payor, they will determine whether it s not forged and there is sufficient funds, which the 500 is paid from (Deducts 500 from Buyer’s account and credits Seller’s account) 4-401(a). Provisional credit is now final and Payee-Seller may withdraw the funds.
3. “City” or “Clearing House Items” - Same vicinity. They forward checks to eachother and provisionally settle by striking a balance. They figure out how much they owe each other in total, and that is a provisional settlement,”
4. “County or transit items” - the banks may need to go through different banks to the federal system to go across the country. Each bank may provisionally credit the account of the transferor along the collection chain.
   • Depository bank - first bank to take the time
   • Collecting bank - bank handling it for collection, not the payor
   • Presenting bank - bank presenting item, not a payor bank
   • Payor bank - drawee
5. On receipt of the item, payor decides whether to “finally pay” it. 4-215.
COLLECTING BANKS

RELATIONSHIP: COLLECTING BANK V. DEPOSITORY OR PAYOR BANK

1. Status of Collecting Bank as Agent 4-201(b).
   • Agency is presumed - the collecting bank is presumed to be an agent or sub-agent of the owner of the item (the payee who deposited the item in the depository bank for collection). This applies regardless of the form of indorsement or lack of indorsement.
   • BUT, the continuance of ownership of an item and any rights of the owner to proceeds of the item are subject to the rights of a collecting bank, such as outstanding advances on the item, and rights of recoupment and setoff. 4-201(a), Comment 5.
   • UCC provisions apply even though the action of the parties establishes that a bank has purchased the item and is the owner of it. 4-101 and comment 1.

2. Rights, Obligations and Responsibilities of Collecting Banks

OBLIGATIONS:

Ordinary Care - 4-202(a)
Banks must exercise Ordinary care in these types of basic action:
1. presenting or sending an item for presentment
2. sending notice of dishonor or nonpayment or returning an item
3. settling for an item
4. notifying its transferor of any loss or delay in transit.

Time for taking proper action:
Before its midnight deadline following receipt of an item, notice or settlement. 4-202(a) and (b) and comments 1-3.
As to presentment, dishonor and notice of dishonor, see 3-501 et seq.
As to non-liability for insolvency, neglect of others, see 4-202(c) and Comment 4.

Transfer, presentment, encoding and retention warranties. 4-207, 4-208, 4-209

RIGHTS

1. Collecting bank’s right to charge back 4-214, 4-201 Comment 3
They can charge back an account that they gave provisional credit for when they discover that an item has been dishonored.

Risk of loss in the event of insolvency 4-216, 4-201 Comment 3

Collecting bank as HDC

Value
Value is given for purposes of HDC when a collecting bank makes an advance on the security of the paper held for collection. 4-211 (depository banks).

Effect of a Restrictive Indorsement
See above, 3-206(c), (e), 3-402(c), 4-201(b),

REVIEW PROBLEMS

Altered Instruments
a. Drawer issues a check to payee for $100. Payee raises to $1,000 and endorses to a holder who takes for value in good faith without notice. Holder presents to drawee for payment. Drawee pays.
   (1) Drawer v. Drawee? Drawer will have his account recredited to the extent of the alteration under ‘4-401(d) (absent any breach of the drawer=s duty)

   (2) Drawee v. Holder? Drawee may recover from holder for breach of his presentment warranty under ‘3-417(a)(2).
(3) **Holder v. Payee?**  
Hold may recover for a breach of payee=s transfer warrant under ‘3-416(a)(3), the warranty of no alteration.

b. **Now suppose that instead of drawee paying the check, the drawer stops payment on the check.**

(4) **Holder v. Drawer**  
Holder may recover $100 from the drawer under ’3-407(c)(i); this defense is not cut off by a holder in due course, it is treated as a real defense.

(5) **Holder v. Drawee**  
No, holder cannot recover from the drawee because drawee is under no obligation until they accept under ’3-408.

(6) **Holder v. Payee**  
Yes, holder will recover from the payee under either ’3-416 for a breach of transfer warranties or under ’3-415 for payee=s obligation as indorser.

**Forged indorsement**

**Drawer issues a check Ato the order of payee@ for $1,000. Forger steals the check steals the check from the payee. Forges payee=s name and sells the check to Adams who deposits it in his account with depository bank. The check goes trough collection where it is paid by drawee.**

**Payee v. Drawer?** Under ‘3-309 the payee may have the drawer reissue the check, if the payee provides indemnity agreement, bond, affidavit, etc.

**Drawer v. Drawee?** The drawer will be able to recover under ‘4-401(a) because the item was not properly payable. (Assuming drawer did not breach any of his duties)

**Payee v. Drawee?** Payee may recover for conversion (a tort) against the drawee for paying the item under ’3-420.

**Drawee v. Depository bank?** The drawee may recover under a breach of presentment warranties ’3-417(a)(1), because there was a forged indorsement.

**Depository bank v. Adams?** The bank may collect for a breach of an transfer warranty under ’3-416(a)(1).

**Adams v. Forger**  
Adams could collect for a breach of forger=s transfer warranty under ’3-416(a)(1), or on the indorser=s contract of secondary liability under ’3-415.

**Payee v. Depository bank?** Under ’3-420 payee will recover from depository bank. The policy is the payee may recover from the drawee under ’3-420(a), and the drawee, in turn, may recover from depository bank for breach of presentment warranty of no forged indorsement ’4-208(a)(1) (’3-417). See comment 3 to ’3-420.

**Drawer v. Depository bank?** An action for conversion may not be brought by the issuer of the instrument ’3-420(a)(i). The policy is that the drawer does not possess property to be converted, it only becomes property when it is issued to the payee. It is an obligation of the drawer not the property of the drawer and the drawer has adequate remedy against the drawee bank. See ’3-420 comment 1 paragraph 2.

**Forged drawer**

**Forger forges drawer=s name to a $1,000 check and issues it to payee ho indorses and delivers it to Adams who takes for value in good faith without notice. Adams presents the drawee for payment. Drawee pays.**

**Drawer v. Drawee?** The drawee will prevail under ’4-401(a) because the check was not properly payable.

**Drawee v. Adams?** Drawee may not recover from Adams for a breach of presentment warranty under ’3-417(a)(3) because Adams **did not have knowledge** of the forged drawer, and under ’3-418(c) there is no restitution because Adams is a holder in due course. **Price v. Neal**

**Drawee v. Forger?** Drawee may recover from the forger under ’3-403(a) because the forger=s signature is effective as the signature of the forger to a person who in good faith pays.

**Now suppose that instead of drawee paying, drawer stops payment on the check.**

**Adams v. Drawer?** No ’3-403(a) signature of a drawer is wholly inoperative as that of the forged drawer. ( Forgery is a real defense against Adams)

**Adams v. Drawee?** Under ’3-408 a bank is not liable on a check until it accepts it, and therefore, Adams cannot recover from the drawee.
Adams v. Payee? Yes, Adams may recover from payee under §3-416 breach of transfer warranty or under §3-415 the
indorsers contract of secondary liability.
Payee v. Forger? The payee may recover under §3-403(a) because the unauthorized signature is effective against the
forger.

DOCUMENTS OF TITLE

- **Documents of Title** include bills of lading, . . . warehouse receipts, . . . and any other documents which in the
ordinary course of business or financing is treated as adequately evidencing that the person in possession of it is
entitled to receive, hold, and dispose of the documents and the goods it covers. To be a document of title a
document must purport to be issued by or addressed to a bailee and purport to cover goods in the bailee=s possession
which are either identified or are fungible portions of an identified mass. §1-201(15)

- **Bill of Lading** means a document evidencing the receipt of goods for shipment issued by a person engaged in the
business of transporting or forwarding goods, and includes an airbill. §1-201(6)

- **Warehouse Receipt** means a receipt issued by a person engaging in the business of storing goods for hire. §1-
201(45)

- **Warehouse Receipts and Bills of Lading** are like promissory notes.

- **Delivery Order** means a written order to deliver goods directed to warehouseman, carrier of other person who in
the ordinary course of business issues warehouse receipts of bills of lading. §7-102(d)(1)

- **Delivery Orders** are like checks or drafts (three party paper)

Three Characteristics of a Bailment:

1. Generally the Bailee owes a duty of ordinary care of the goods to the bailor, (except common carriers have a
hightened requirement)
2. Only transfer of possession passes and not title.
3. At the end of the bailment relationship, the bailee is under a duty to deliver a goods to the bailor to to a third
person as the bailor designates.

**Negotiable and Non Negotiable . . . Documents of Title**  §7-104

(1) A warehouse receipt or bill of lading or other document of title is negotiable
   (a) if by its terms the goods are to be deliver to bearer or to order of named person.
(2) Any other document is non negotiable. A bill of lading in which it is stated that the goods are consigned to a
named person is not made negotiable by a provision that the goods are to be delivered only against a written
order signed by the same or another named.

**Obligation of warehouseman or carrier to deliver; excuse**  §7-403

(1) The bailee (carrier or warehouse) must deliver the goods to a person entitled under the document, who complies
with (2) and (3), unless and to the extent that the bailee establishes any of the following:
   (a) delivery of the goods to a person who=s receipt was rightful as against the claimant;
   (b) damage or delay, loss or destruction of the goods for which the bailee is not liable [, but the burden of
establishing negligence in such cases is on the person entitled under the document.]
   (c) previous sale in enforcement of a lien;
   (d) exercise by seller to stop delivery;
   (f) release, satisfaction or any other personal defense against the claimant
(2) A person claiming goods covered by a document of title must satisfy the bailee=s lien where the bailee so
requests or where the bailee is prohibited by law from delivering the goods until the charges is paid.
(3) Unless the person claiiming is one against whom the document confers no right . . . he must surrender for
cancellation or notation of partial deliveries any outstanding negotiable document covering the goods, and the
bailee must cancel the document or conspicuously note the partial delivery thereon or be liable to any person to
whom the document is duly negotiated.
(4) **Person Entitled Under the Document** means holder in the case of a negotiable document, or the person to
whom delivery is to be made by the terms of or pursuant to written instructions under a non negotiable
document.
Indorser not a Guarantor for Other Parties. '7-505

The indorsement of a document of title issued by a bailee does not make the indorser liable for any default by the bailee or previous indorser.

*Note:* Interstate Transactions and shipments (if they cross state lines in the least bit) is controlled by the Federal Bills of Lading Act, which is substantially similar to Article 7, but if goods are transported completely intrastate=> Article 7 of the UCC applies.

**Form of Negotiation and Requirements of A Due Negotiation** '7-501

1. A negotiable document of title running to the order of a named person is negotiated by his indorsement and delivery. After his indorsement in blank or to bearer any person can negotiate it by delivery alone.

2. (a) A negotiable document of title is also negotiated by delivery alone when by it original terms it runs to bearer.
   (b) When a document running to the order of a named person is delivered to him the effect is the same as if the document had been negotiated.

3. Negotiation of a negotiable document of title after it has been indorsed to a specified person requires indorsement by the special indorsee as well as delivery.

4. A negotiable document of title is Adulty negotiated® when it is negotiated in the manner specified in this section to a holder who purchases it in good faith without notice of any defense against or a claim to it on the part of any person and for value, unless it is established that the negotiation is not in the regular course of business or financing or involves receiving the document in settlement or payment of a money obligation.

5. Indorsement of a non negotiable document neither makes it negotiable nor add’s to the transferee’s rights.

6. The naming in a negotiable bill of a person to be notified of the arrival of the goods does not limit the negotiability of the bill nor constitute notice to a purchaser thereof of any interest of such person in the goods.

**Comment 1:** No commercial purpose is served by allowing a tramp or a professor to Adulty negotiate® an order bill of lading for hides or cotton not his own, and since such a transfer is obviously not in the regular course of business, it is excluded from the scope of the protection.

**Rights Acquired by Due Negotiation** '7-502

1. Subject to the following section and to the provisions of '7-205 on fungible goods, a holder to whom negotiable document of title has been Adulty negotiated® acquires thereby:
   (a) title to the document;
   (b) title to the goods;
   (c) all rights accruing under the law of agency or estoppel, including rights to goods delivered to the bailee after the document was issued; and
   (d) the direct obligation of the issuer to hold or deliver the goods according to the terms of the document free of any defenses or claim by him except those arising under the terms of the document or under this Article. . . .

2. Subject to the following section, title and rights so acquired are not defeated by any stoppage of the goods represented by the document or by the surrender of such goods by the bailee, and are not impaired even though the negotiation or any prior negotiation constituted a breach of duty or even though any person has been deprived of possession of the document by misrepresentation, fraud, mistake, duress, loss, theft or conversion, or even though a previous sale or other transfer of the goods or document has been made to a third person.

**Document of Title of Goods Defeated in Certain Cases** '7-503

1. A document of title confers no right in goods against a person who before issuance of the document had a legal interest or a perfected security interest in them and who neither
   (a) delivered or entrusted them or any document of title covering them to the bailor or his nominee with actual or apparent authority to ship, store or sell or with power to obtain delivery under this Article ('7-403) or with power of disposition under this Act ('2-403 and 9-307) or other statute or rule of law; nor
   (b) acquiesced in the procurement by the bailor or his nominee of any document of title.

**Title Under Warehouse Receipt Defeated in Certain Cases** '7-205
A buyer in the ordinary course of business of fungible goods sold and delivered by a warehouseman who is also in the business of buying and selling such goods takes free of any claim under a warehouse receipt even though it has been duly negotiated (7-501(4)).

**Seller’s Shipment Under Reservation '2-505**

(1) Where the seller has identified goods to the contract by or before shipment;

(a) his procurement of a negotiable bill of lading to his own order or otherwise reserves in him a security interest in the goods. His procurement of the bill to the order of a financing agency or of the buyer indicates in addition only the seller’s expectation of transferring that interest to the person named.

(b) a non-negotiable bill of lading to himself or his nominee reserves possession of the goods as security but except in a case of conditional delivery . . . a non-negotiable bill of lading naming the buyer as consignee reserves no security interest even though the seller retains possession of the bill of lading.

Hypo: EX: Seller delivers goods to a carrier for non-negotiable warehouse receipt deliver to seller, notify buyer. This is not negotiable, but the person entitled under the document was the seller and when the carrier delivered to the buyer it was misdelivered because the carrier must deliver to the person entitled under the document.

**Two excuses for bailees non-delivery:**

1. Delivery to the true owner, or
2. Damage to the goods for which bailee is not liable because he exercised ordinary care.

**Liability for nonreceipt or misdescription. '7-203**

A party to or purchaser for value in good faith of a document of title other than a bill of lading relying in either case upon the description therein of the goods may recover from the issuer damages caused by the nonreceipt or misdescription of the goods, except to the extent . . .

3-411 does not apply because not a certified check, cashier’s check, or teller’s check.

4. The first question to be asked is whether the BOL are negotiable, (7-104) tells us that a BOL is negotiable if by its terms the goods are to be delivered to the order of a named person. These BOL’s are negotiable.

Under (7-403) the carriers (A) obligation is to deliver the goods to the bearer. Person entitled under the document (7-403(4)) who is the holder in case of a negotiable instr. Or the person to whom delivery is to be made in the case of a Neg. Instr. It is not a PEUD under (7-501(4)) because he did not acquire doc by due negotiation. To acquire by due negotiation one must be a holder who purchased doc in good faith for value without notice of defense or claim. Since L was not a PEUD, A could not follow Larrys’ delivery instructions, and even though it did, it did not require B to surrender bill, (7-404) provides a defense to A; if a bailee in good faith including the observance of reasonable commercial standards disposes of goods according to the terms of the Doc, they are not liable, therefore, the Rule applies to instructions of Liability(2\textsuperscript{nd} sentence) However, A is going to be able to L for the misdelivery. Because the observance of Commercial standards, A knows or should know that neg. Bol must be surrendered upon delivery to be canceled and sent through the collection process.

In the case of the 2d shipment, A may again be liable for not following reasonable commercial standards under 7-404 for not requiring surrender of BOL. However, A may have an action against U in subrogation for U not requiring the payment of the sight draft upon delivery of the BOL, and U can then act against P.

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