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Revised Articles 3 and 4 of the Uniform Commercial Code: A Friendly Critique

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Revised Articles 3 and 4 of the Uniform Commercial Code: A Friendly Critique

DANIEL E. MURRAY*

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I. INTRODUCTION

The Florida Legislature enacted Revised Articles 3 and 4 (of the, by-now, non-Uniform Commercial Code) to be effective January 1, 1993.¹ Revised Article 3 is a substantial revision of former Article 3, while Revised Article 4 is primarily a stylistic, grammatical, and cosmetic revision of former Article 4. This article will summarize and critique the more significant changes in the two Articles; not every revision can be discussed within the limited scope of this article.²

In light of the dramatic changes to Revised Article 3, lawyers should not wait to become acquainted with its revisions until a case is brought into the office. That first case could involve the lawyer's employees embezzling by forging the lawyer's name as payee on her income checks and by forging the payees' names on checks drawn by the lawyer. As we will see, the losses will fall on the lawyer and not on the banks.³

I suggest that many of the revisions are well done: a few, however, are so complicated that the cure is worse than the disease, and still others are unnecessary codifications of current case law. Law professors may have the luxury of leisure to learn and digest large

1. Act effective January 1, 1993, Ch. 92-82, 1992 Fla. Sess. Law Serv. 631 (West). The Florida version makes some changes from the "U.C.C. version" which will be discussed in this article.

2. West Publishing Company's 1991 edition of Articles 3 and 4 covers approximately 160 pages of fine print.

3. See U.C.C. § 3-405 (1991), discussed *infra* notes 48-65 and accompanying text.

codifications, but busy practitioners simply do not have the time. In the future, gradual changes in the U.C.C. might be more desirable.⁴

II. REVISED ARTICLE 3

A. *General Provisions and Definitions*

1. GOOD FAITH

Revised Section 3-103(a)(4) has redefined the notion of good faith: “[g]ood faith” means honesty in fact and the observance of reasonable commercial standards of fair dealing.” The definition is now consistent within Articles 2, 2A, 4, and 4A.⁵ It is somewhat ironic that the Revised Article 3 definition strongly resembles the 1952 definition which required the holder to take the instrument “in good faith including observance of the reasonable commercial standards of any business in which the holder may be engaged”⁶ The New York Bar vigorously protested this definition, and the commercial standards concept was deleted from the U.C.C.⁷ Sometimes, it becomes necessary to reinvent the wheel.

2. ORDINARY CARE

Revised Section 3-103(7) has added a detailed definition of ordinary care:

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

Comment 5 notes that the first sentence applies both to banks and to business people.⁸ Comment 4 to Revised Section 4-406 notes that

sight examination by a payor bank is not required if its procedure

4. New Articles 2A and 4A are enough to digest, and now Revised Articles 2 and 9 are on the horizon.

5. See U.C.C. §§ 2-103(1)(b), 2A-103(3), 4-104(c), 4A-105(a)(6) (1991).

6. AMERICAN LAW INSTITUTE U.C.C. § 3-302(1)(b) (1952) (amended 1991).

7. WILLIAM D. HAWKLAND, CASES ON COMMERCIAL PAPER AND BANK DEPOSITS AND COLLECTIONS 199-200 (1967).

8. U.C.C. § 3-103(7) cmt. 5 (1991).

is reasonable and is commonly followed by other comparable banks in the area The definition of 'ordinary care' in Section 3-103 rejects those authorities that hold, in effect, that failure to use sight examination is negligence as a matter of law.

The question of "ordinary care" by banks is particularly important when the term is used to assess comparative fault in Revised Sections 3-404, 3-405, 3-406, and 4-406. This definition and its comments may well cause numerous banks to modify their "Operations Manuals" because of the wording "prescribed procedures" in the text of Revised Section 3-103(7). Moreover, bankers may end up meeting and discussing their community procedures with respect to signature examinations.

3. NEGOTIABILITY

a. Unconditional Promise or Order—The Particular Fund Doctrine

Under former Article 3, a promise to pay was not made conditional (thereby destroying negotiability) by the fact that the promise was limited to payment out of a particular fund or source, if the instrument was issued by a government or governmental agency or unit.⁹ Similarly, if the promise was to pay out of the entire assets of a partnership, unincorporated association, trust or estate that issued the instrument, the promise was not made conditional. In contrast, a corporation's or individual's promise to pay that is limited to a particular fund would be conditional and thereby destroy negotiability.¹⁰ Revised Article 3 rejects this approach, and states that a promise or order is not made conditional "because payment is limited to resort to a particular fund or source."¹¹

This new rule may come as a surprise to many real property lawyers who, in the past, have been able to return purchase money notes and mortgages (to unsuspecting lawyers for sellers) in real estate financing, thereby limiting payment to the value of the financed real estate, and simultaneously limiting the liability of the purchaser and destroying the negotiability of the notes.¹²

The Federal Trade Commission's Holder-in-Due-Course Regulations¹³ require most consumer finance promissory notes to contain

9. U.C.C. § 3-105(1)(g) (1989) (amended 1991).

10. U.C.C. § 3-105(1)(h) (1989) (amended 1991).

11. U.C.C. § 3-106(b) (1991).

12. *United Nat'l Bank of Miami v. Airport Plaza Ltd. Partnership*, 537 So. 2d 608 (Fla. 3d DCA 1988), *reh'g denied*, 547 So. 2d 1209 (Fla. 1989).

13. 16 C.F.R. §§ 433.1-433.3 (1992).

conspicuous language that makes the holder subject to claims and defenses the debtor could assert against the seller of goods. This language serves to destroy negotiability; however, Revised Section 3-106(d) provides that this legend does not render the promise to pay conditional and thereby deprive these notes of coverage under Revised Article 3.

b. Special Rules Governing Checks

Revised Article 3 introduces some novel ideas for checks. First, there is no way to destroy the negotiability of a check. Under Revised Section 3-104, a check need not be payable to order or to bearer.¹⁴ Even if a drawer prints or types the words "not negotiable" or adds a statement that the check is not to be governed by Article 3, it is still negotiable.¹⁵

A drawer of a draft can, pursuant to Revised Section 3-414, draw the draft "without recourse" and she will not be liable if the drawee refuses to accept. In contrast, the drawer of a check cannot validly draw a check "without recourse" because the drawer will be liable despite the "without recourse" statement.¹⁶

c. Variable Rate Interest Instruments

The general rule prior to the adoption of Revised Article 3 was that any variable interest rate note that required the holder to look outside the instrument for the interest rate was not negotiable.¹⁷ In an apparent effort to save many attorneys from malpractice liability, some states, including Florida, legislated that variable interest rate instruments were negotiable in a retroactive fashion.¹⁸

Revised Section 3-112 has followed this trend:

(b) Interest may be stated in an instrument as a fixed or variable amount of money or it may be expressed as a fixed or variable rate or rates. The amount or rate of interest may be stated or described in the instrument in any manner and may require reference to information not contained in the instrument. If an instrument provides for interest, but the amount of interest payable

14. U.C.C. § 3-104(a), (c) (1991).

15. See U.C.C. § 3-104(d) (1991).

16. U.C.C. § 3-414(e) (1991).

17. See *Amberboy v. Societe de Banque Privee*, 35 Tex. Sup. Ct. J. 621 (1992), for a review of the cases on this issue. The *Amberboy* court adopted the minority view that the note was negotiable.

18. See FLA. STAT. § 673.106(2) (1991) (as amended by Ch. 91-70(4), Laws of Fla., repealed by 1992 Fla. Sess. Law Serv. 92-82 (West)). The statement in section 5 that "the Legislature intends to clarify and confirm existing law" is contrary to most case law decisions delivered under original section 673.106.

cannot be ascertained from the description, interest is payable at the judgment rate in effect at the place of payment of the instrument and at the time interest first accrues.

d. Money Orders

Former Article 3 devoted no special attention to the use of money orders, and case law had to deal with money orders by analogizing them to personal checks, cashier's checks, or similar instruments. The courts were concerned with distinctions between personal money orders and bank money orders, and the cases are difficult to reconcile. Problems arise when one tries to determine whether the purchaser of a money order or bank money order has the right to stop payment and whether an issuer (a bank or convenience store) has the right to stop payment because of its own defenses to payment.¹⁹ One glance at the typical mail order catalogue or newspaper and magazine advertisements for mail order merchandise shows that merchants typically equate money orders with certified and cashier's checks; merchants who will not accept personal checks are happy to accept money orders. To their misfortune, this confidence is misplaced.

Revised Article 3 has devoted very little textual treatment to money orders: "[a]n instrument may be a check even though it is described on its face by another term, such as 'money order.'"²⁰ Comment 4 to Section 3-104 discusses the two different kinds of money orders. It explains that the money order sold by a bank, with the bank as the drawee, is simply a check and the purchaser has the right to stop payment. On the other hand, if the money order resembles a "teller's check," which is either drawn by one bank on another bank or is payable at or through a bank, then, in accordance with Revised Section 4-403(4), the purchaser has no right to stop payment. Revised Article 3 simply preserves the existing chaos and defeats the reasonable expectations of merchants with regard to money orders.

4. OTHER AGREEMENTS AFFECTING INSTRUMENTS

Former Section 3-119, which was a rather innocuous statement of the "contemporaneous document rule," has been replaced by Revised Section 3-117, which may place some strains on the parol evidence rule and merger and integration clauses in agreements:

Subject to applicable law regarding exclusion of proof of con-

19. See HENRY J. BAILEY, *BRADY ON BANK CHECKS* §§ 23.15-23.16 (6th ed. 1987 & Supp. 1992); BARKLEY CLARK, *THE LAW OF BANK DEPOSITS, COLLECTIONS AND CREDIT CARDS* § 206(3)(d) (3rd ed. 1990 & Supp. 1992).

20. U.C.C. § 3-104(f) (1991).

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

B. *Restrictive Endorsements*

Under former Section 3-206, if a promissory note or check was indorsed by the payee to a holder under an indorsement that stated "pay Holder when he sells Blackacre to me," the maker of the note could not pay Holder until he ascertained that the event had occurred. Likewise, the depository bank under such an indorsement could not credit the account of the holder until it had ascertained that the holder had performed. Occasional use of the conditional indorsement might not be too burdensome to makers of notes, but its use on checks was an anachronism in the day of automated handling. Consequently, conditional indorsements have been abandoned under Revised Section 3-206(b). Now a person may pay or take the instrument under such an indorsement and disregard the condition. Of course, the conditional indorser retains any underlying cause of action against the indorsee in the event of non-performance of the condition.²¹

C. *Enforcement of Instruments*

1. PERSONS ENTITLED TO ENFORCE INSTRUMENTS

Revised Section 3-301 greatly expands the group of persons entitled to enforce an instrument. The group now includes the holder, a non-holder who is in possession of the instrument and has the rights of a holder, a former holder who has lost the instrument or had it stolen, and a non-holder who has rights of subrogation to a holder.

2. HOLDER IN DUE COURSE

Revised Section 3-302 has rejected the notion that a holder can take an instrument in due course if she witnesses the completion of the instrument by the transferor. Now, after the revisions, a holder takes in due course if the instrument, when issued or negotiated to the

21. U.C.C. § 3-206 cmt. 2 (1991).

holder, does not bear apparent evidence of forgery or alteration "or is not otherwise so irregular or incomplete as to call into question its authenticity."²² Revised Section 3-302 has extensive comments addressing situations in which a payee may be a holder in due course of an instrument.²³

In many cases, payees could not be holders in due course because of the wording of former Section 3-305, which stated that, to the extent a holder is holder in due course, he takes the instrument free from all defenses of any party to the instrument "with whom the holder has not dealt."²⁴ A typical transaction illustrates the problem: a customer of a bank issues a personal check to the bank in return for a cashier's check to the payee. The check is then delivered by the bank to the payee. When the check is presented for payment, the bank discovers that the customer's personal check was drawn on insufficient funds. Some courts would hold that the bank dealt with the payee, and the bank could raise the issue of failure or lack of consideration against the payee. Revised Section 3-305 does not contain this language and thus improves protection accorded to payees.

In a case where a holder has paid only partial consideration for the transfer of the instrument, and where the maker or drawer asserts a defense against the payee, the holder is entitled to recover only a rateable portion of the bargained for profit. Comment 6 to Revised Section 3-302 explains that if a holder agrees to pay only \$900 for a \$1,000 note and the holder has paid only \$500 when she learned of the maker's defense, then the \$500 is divided by \$900, equaling .555 x \$1,000, or \$555.55. This is the amount the holder is entitled to. Similarly, the holder of a security interest in the instrument is entitled to a claim "only to an amount payable under the instrument which, at the time of enforcement of the instrument, does not exceed the amount of the unpaid obligation secured."²⁵

3. DEMAND NOTES

It is familiar law that for a holder to qualify as a holder in due course, he must take the instrument without notice that it is overdue.²⁶ A potential holder of a check knows that it is overdue 90 days after its date;²⁷ but when is a demand note overdue? Former Article 3 provided that it was overdue if it was taken "more than a reasonable

22. U.C.C. § 3-302(a)(1) (1991).

23. See U.C.C. § 3-302 cmts. 1-7 (1991).

24. U.C.C. § 3-305(1)(a) (1989) (amended 1991).

25. U.C.C. § 3-302(e) (1991).

26. See U.C.C. § 3-302(a)(2) (1991); U.C.C. § 3-302(1)(c) (1989) (amended 1991).

27. U.C.C. § 3-304(a)(2) (1991).

length of time after its issue.”²⁸ Revised Article 3-304(a)(3) provides that an instrument other than a check is overdue: “when the instrument has been outstanding for a period of time after its date which is unreasonably long under the circumstances of the particular case in light of the nature of the instrument and usage of the trade.” The official comment to this section states that “[w]hether a demand note is stale may vary a great deal depending on the facts of the particular case.”²⁹ The drafters have thus added a further dose of uncertainty.

Revised Article 3 in Florida has deleted Section 3-118 and has re-adopted Chapter 95 for the statute of limitations. Chapter 95 provides that in Florida the statute of limitations on a demand promissory note begins to run upon the delivery of the first written demand by the holder.³⁰ Accordingly, an instrument may be overdue under Section 3-304 of Article 3 but not under Chapter 95. What objection would there be to the statutory establishment of a fixed date of maturity for a demand promissory note? Codifying uncertainty seems a splendid way of destroying the marketability of demand notes.

4. DEFENSES AND CLAIMS IN RECOUPMENT

Former Section 3-305, which dealt with the rights of a holder in due course, has been closely followed by Revised Section 3-305. The Revised Section, however, has introduced the notion of “recoupment” into the U.C.C. Recoupment becomes an issue when an obligor (e.g., the maker of a promissory note) who is sued by a third party non-holder in due course has a defense against the payee growing out of the instrument (and/or the underlying transaction for which the instrument was given). The obligor ought to be able to assert this defense to reduce the amount of the payee’s claim, although the obligor is not allowed to assert a totally unrelated claim as a deduction against the third party non-holder in due course. As expressed in the Revised Section 3-305, the right to enforce the obligation of a party to pay an instrument is subject to:

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

A claim in recoupment under 3-305 is illustrated by the following example. Bill Buyer purchases an automobile from Dick Dealer

28. U.C.C. § 3-304(3)(c) (1989) (amended 1991).

29. U.C.C. § 3-304 cmt. 1 (1991).

30. See FLA. STAT. § 95.031(1) (1991).

and gives back a note and a security agreement that provides that any holder of the security agreement is subject to all claims and defenses that Buyer could assert against Dealer. Dealer assigns the security agreement to the local bank. Buyer then fails to pay and the bank sues him. Buyer can assert recoupment damages from the bank for a breach of warranty by Dealer, but the amount of damages may not exceed the balance on the note, nor may it include any claim for damages growing out of a separate assault and battery committed on Buyer by an irate mechanic of Dealer after Buyer's affair with the mechanic's wife.³¹

5. NOTICE OF BREACH OF FIDUCIARY DUTY

In revising Section 3-307, the drafters incorporated some of the provisions contained in the Uniform Fiduciaries Act ("U.F.A.").³² For example, Section 3-307(b)(2) follows Section 4 of the U.F.A., providing that when an instrument is payable to the represented person or to the fiduciary, the taker is deemed to have notice of a breach of fiduciary duty, if the instrument is taken as payment of, or as security for, a debt known by the taker to be the personal debt of the fiduciary; taken in a transaction known by the taker to be for the personal benefit of the fiduciary; or, deposited either in a non-fiduciary account or in an account not of the represented person.

Section 6 of the U.F.A. is incorporated in Section 3-307(b)(3): "If an instrument is issued by the represented person or the fiduciary as such, and made payable to the fiduciary personally, the taker does not have notice of the breach of fiduciary duty unless the taker knows of the breach of fiduciary duty." For example, if a guardian of an estate issues a check to herself and then uses the check to purchase property for herself, there is nothing on the face of the check giving the transferee notice of wrongdoing. The check might well be payment for services rendered by the guardian. Of course, if the taker knows of a breach of fiduciary duty, he cannot be a holder in due course.

Revised Section 3-307(b)(4) provides that if an instrument is issued by the represented person or by the fiduciary as such to the taker as payee, the taker has notice of the breach of fiduciary duty in three possible situations: if the instrument is taken in payment of or as security for a debt which the taker knows to be the personal debt of the fiduciary; if it is taken in a transaction which the taker knows to be for the personal benefit of the fiduciary; or if it is deposited in an

31. U.C.C. § 3-305 cmt. 3 (1991).

32. UNIF. FIDUCIARIES ACT, 7A U.L.A. (1985).

account that is not an account of the fiduciary or a represented person.

One can only wonder whether lawyers can meaningfully instruct clients as to all the niceties inherent in accepting the delivery of checks from fiduciaries. Perhaps the best advice to give a client is not to take any checks signed by fiduciaries when their status appears on the checks.

6. EFFECT OF INSTRUMENT ON THE UNDERLYING OBLIGATION

Revised Section 3-310 provides in part:

(a) Unless otherwise agreed, if a certified check, cashier's check, or teller's check is taken for an obligation, the obligation is discharged to the same extent discharge would result if an amount of money equal to the amount of the instrument were taken in payment of the obligation. *Discharge of the obligation does not affect any liability that the obligor may have as an indorser of the instrument.*³³

Under this subsection, if Bill Buyer purchases a cashier's check from his bank with Sam Seller as the payee and gives the check to Seller at the closing of a real estate transaction, and the bank fails before the check is cashed, Buyer has purchased Blackacre with a check that might be worthless to the extent it exceeds the FDIC insurance limits.³⁴ If Seller has Buyer indorse the cashier's check, the wording emphasized above would impose secondary liability upon Buyer. In a sense, the first portion of the subsection is a trap for the unwary seller and the italicized wording is a trap for the unwary buyer.

Revised Section 3-310(b)(3) can also be troublesome. It states that "[i]n the case of an instrument of a third person which is negotiated to the obligee by the obligor, discharge of the obligor on the instrument also discharges the obligation." As an illustration, assume that Buyer is the payee of a check and she indorses the check over to Seller for payment of a purchase. If the check clears, then Seller has received payment, Buyer has her purchase, and there are no complications. Assume, however, that Seller forgets to deposit the check within 30 days of the indorsement by Buyer. At that point, Buyer's liability is discharged on the check³⁵ and on the underlying obligation of the purchase price.³⁶ If the check is eventually paid, Seller has suffered no loss; but if the check is dishonored, he bears all the loss.

33. (emphasis added).

34. See, e.g., *Chen v. Roosevelt & Main Street Realty Corp.*, 1 U.C.C. Rep. Serv. 2d (Callaghan) 161 (N.Y. Sup. Ct. April 15, 1986).

35. See U.C.C. § 3-415(e) (1991).

36. See U.C.C. § 3-310(b)(3) (1991).

7. ACCORD AND SATISFACTION BY USE OF INSTRUMENTS

Former Section 1-207, which was used in accord and satisfaction cases involving notations on checks such as "payment in full" and attempts by payees to strike out similar phrases and insert "without prejudice" or "reserving all rights," has been deleted. Now, under Revised Section 1-207(2), this provision no longer applies to an accord and satisfaction claim. In a way, it is sad to see the demise of what was a "full-employment" statute for lawyers.³⁷

Perhaps a sad attitude is premature, though, because the drafters have made another attempt to handle accord and satisfaction. Revised Section 3-311 may be the new source of employment for countless lawyers. Subsection 3-311(a) attempts to define accord and satisfaction. If an alleged debtor is sued and claims an accord and satisfaction, she must prove that she was in good faith when she tendered the instrument to the claimant as full satisfaction of the claim. Second, she has to show that the amount of the claim was unliquidated or subject to a good faith dispute. Third, she must prove that the claimant obtained payment for the instrument; and fourth, under Subsection (b), that the payment instrument or an accompanying written communication contained a "conspicuous statement to the effect that the instrument was tendered as full satisfaction of the claim."

Two exceptions can defeat the defense of accord and satisfaction. The first exception applies when the claimant is an organization. The organization must show that within a reasonable time before the tender of the instrument, the organization sent a conspicuous statement to the person contesting the claim. The statement must have expressed that communications concerning the disputed debt, including an instrument tendered as full payment, were sent to a designated office, person, or place, and that the communications were not received by that designated person, office, or place.³⁸ The second exception lies where the claimant, whether or not an organization, proves that within 90 days after the payment of the instrument, the claimant tendered repayment of the instrument to the alleged debtor.³⁹

To further complicate things, the above two exceptions to the

37. The U.C.C. Case Digest has 38 pages of cases decided under § 1-207, 17 pages of which deal with accord and satisfaction. See 1A U.C.C. Case Dig. (Callaghan) ¶ 1207 (1986 & Supp. 1991).

38. U.C.C. § 3-311(c)(1) (1991).

39. U.C.C. § 3-311(c)(2) (1991).

general rule are, in turn, also subject to an exception under Section 3-311:

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

Only a Russian chess master could appreciate the drafting of Section 3-311.

8. ENFORCEMENT OF LOST, DESTROYED, OR STOLEN INSTRUMENTS

Former Section 3-804 articulated a rather terse remedy for the owner of lost, destroyed, or stolen instruments.⁴⁰ This section has been replaced by Revised Sections 3-309 and 3-312, which focus each on different aspects of similar problems.

Revised Section 3-309(a) provides that a person who has lost possession of an instrument has the right to enforce it if (i) the loss of possession was not the result of a transfer or a lawful seizure, and (ii) the claimant cannot reasonably obtain possession because the instrument was destroyed, its location cannot be determined, or it is in the wrongful possession of either an unknown person, a person who cannot be found, or a person who is not amenable to service of process. Under Subsection (b), the claimant must prove the terms of the instrument and his right to enforce it. The court may not enter judgment for the claimant unless it finds that the obligor on the instrument is adequately protected against loss by a third party. The statute ends by noting that "[a]dequate protection may be provided by any reasonable means." If the instrument is an order paper (not bearer paper) and the court finds that the claimant did not indorse the instrument, the comment suggests a court might dispense with any indemnity bond or, at most, require a relatively small one.

Revised Section 3-312 is designed to give the claimant, as the drawer or payee of a lost certified check, or as the remitter or payee of

40. Former Florida Statute 673.804 provided as follows:

The owner of an instrument which is lost, whether by destruction, theft or otherwise may maintain an action in his own name and recover from any party liable thereon upon due proof of his ownership, the facts which prevent his production of the instrument and its terms. The court may require security indemnifying the defendant against loss by reason of further claims on the instrument.

FLA. STAT. § 673.106(2) (1991).

a lost cashier's check or teller's check, a reasonably quick method of obtaining the amount of the lost items from a bank without posting a bond.⁴¹ An affidavit of the claimant is required instead of the former bond, and the indemnity affidavit runs to the bank and to any third party who has superior rights to these checks.⁴² The value of an indemnity affidavit, when given by a later insolvent affiant, is questionable. Space limitations preclude a full analysis of this section, which is accompanied by a lengthy Official Comment.

D. *Liabilities of Parties*

1. JOINT SIGNATURES

Like former Section 4-406(4), Revised Section 4-406(f) requires, as condition precedent to a suit, that customers must report unauthorized drawers' signatures to the drawee bank within one year after the checks are made available to the customer. Former Section 4-406 made no provision for cases involving missing signatures when the customers' contracts with the bank required that checks had to be co-signed. The case law is split as to whether a missing signature is to be equated with an unauthorized signature.⁴³ Revised Section 3-403(b) wisely provides: "If the signature of more than one person is required to constitute the authorized signature of an organization, the signature of the organization is unauthorized if one of the required signatures is lacking."

2. SIGNATURE BY REPRESENTATIVES

Former Section 3-403 implied that if a principal's name was not disclosed on a negotiable instrument, he could not be liable on the instrument. The courts generally agreed with this interpretation.⁴⁴ Under Revised Section 3-402(a), if the agent signs a negotiable instrument on behalf of a principal (even though the agent does not disclose this to the payee) and the payee is later able to prove the agency, the principal can be held liable. In addition, because the agent never disclosed that a principal was involved, the payee can hold the agent liable if the principal cannot pay.⁴⁵

Under former Section 3-403, some cases held that if a corporate

41. U.C.C. § 3-312 cmt. 1 (1991).

42. U.C.C. § 3-312 cmt. 2 (1991).

43. The conflicting cases are nicely analyzed in *Provident Savings Bank v. United Jersey Bank*, 1 U.C.C. Rep. Serv. 2d (Callaghan) 184 (N.J. Super. July 3, 1985).

44. See JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE 549-56 (3d ed. 1988).

45. U.C.C. § 3-402(b)(2) (1991).

officer signed a corporate check but failed to indicate his agency status, he would be liable individually in the event the corporation failed to pay the check.⁴⁶ Some courts created an exception to personal liability where the checks recited that they were payroll checks.⁴⁷ Fortunately, Revised Section 3-402(c) seems to put the matter to rest:

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

The phrase "represented person" seems to encompass not only a corporation, but any business entity such as partnership, unincorporated association, trust, or estate.

Under former Section 3-403, if the agent failed to disclose the name of the principal and failed to indicate his representative status, she could not introduce parol evidence, even as against an immediate party, to defeat personal liability. Now, under Revised Section 3-402, the agent can introduce parol evidence against an immediate party to prove she is not liable. Of course, if the agent was authorized to sign, the principal can be held liable, and there is no hardship suffered by the immediate party.

a. Impostors and Fictitious Payees

Under former Section 3-405, someone who impersonated another person and obtained a check made payable to the impersonated person could forge the check and pass good title. The courts agreed that if the impersonator pretended to be an agent of a principal (e.g., a corporation) and induced the victim to issue a check made payable to the corporation, the impersonator had no power to indorse the name of the corporation. The indorsement with the name of the payee-corporation would be a forgery, and therefore ineffective under former Section 3-405.⁴⁸

The drafters of Revised Section 3-404 chose to reverse this long-standing rule by stating:

(a) If an imposter, by use of the mails or otherwise, induces the issuer of an instrument to issue the instrument to the imposter,

46. See, e.g., *Griffin v. O.B. Ellinger*, 538 S.W.2d 97 (Tex. 1976); see also U.C.C. § 3-402 cmt. 3 (1991).

47. See, e.g., *Polin v. Mindy Mfg. Co.*, 236 A.2d 542 (Pa. 1967).

48. See BARKLEY CLARKE, *THE LAW OF BANK DEPOSITS, COLLECTIONS AND CREDIT CARDS* § 8.04[8][a] (3d ed. 1990).

or to a person acting in concert with the imposter, by impersonating the payee of the instrument *or a person authorized to act for the payee*, an indorsement of the instrument by any person in the name of the payee is effective as the indorsement of the payee in favor of a person who, in good faith, pays the instrument or takes it for value or for collection.⁴⁹

Under the emphasized language, if an imposter represents to a client that she is the agent of a law firm, and if the client makes a check payable to the law firm, the impersonator can effectively indorse the check to a holder in due course or can collect from the drawee bank. Note that the issuer took the precaution to make the check payable to the law firm, not the alleged agent; this precaution, however, would protect the issuer under the old law, but not under Revised Article 3.

b. The Mirror Image Rule

Under former Section 3-405, an indorsement by any person "in the name of a named payee" was effective. Some courts focused on this language, requiring that the indorsement be an exact replication of the name on the face of the check. Any deviation in spelling or use of different initials or symbols for a corporation would not be sufficient compliance, so the loss would not fall upon the drawer.⁵⁰ Whether the courts' interpretations represent a conveyancer's approach to the statute or a simple distaste for putting these embezzlement losses on employers was a problematic issue. Revised Section 3-404 rejected this approach and substituted the following:

(c) Under Subsection (a) or (b), an indorsement is made in the name of a payee if (i) it is made in a name substantially similar to that of the payee or (ii) the instrument, whether or not indorsed, is deposited in a depository bank to an account in a name substantially similar to that of the payee.

This language is consistent with the idea that "[t]he instrument is payable to the person intended by the signer even if that person is identified in the instrument by a name or other identification that is not that of the intended person."⁵¹ Further, "[i]f an instrument is payable to a holder under a name that is not the name of the holder, indorsement may be made by the holder in the name stated in the instrument or in the holder's name or both."⁵² So long as the holder

49. (emphasis added).

50. BAILEY, *supra* note 19, § 28.15.

51. U.C.C. § 3-110(a) (1991).

52. U.C.C. § 3-204(d) (1991).

is legitimate, the question of identification presents no real problems. On the other hand, when the holder is illegitimate and when the name of the payee on the face of the check varies from that on the reverse side, the problem of what "substantially similar" means arises.

Assume that you are the attorney for either the customer or for the drawee bank, and that you are presented with copies of checks issued to "Sumner Motors, Inc." but indorsed "Sumner Motors." The checks were deposited in an account opened by an embezzling employee.⁵³ The drawee bank claims that the two names are "substantially similar," and, of course, the customer claims they are not. Under the "mirror image" rule, a court held that the names were not the same and refused to place the loss on the customer.⁵⁴ The result might seem arbitrary, but at least it has the virtue of certainty. Under today's "substantially similar" approach, the lawyers for both sides must weigh the cost of litigation against the risk inherent in trial and appellate court decisions based upon the one word, "Inc."

If a negotiable instrument is issued in the name of "Grater Mesilla Valley Sanitation District" but is correctly indorsed in the name of "Greater Mesilla Valley Sanitation District," are these names substantially similar? The Tenth Circuit held that the spelling difference was not significant enough to overcome the protections of the fictitious payee rule.⁵⁵ That Court would undoubtedly reach the same conclusion under the "substantially similar" rule of today.

As previously noted, Revised Section 3-404(c) somewhat facilitates embezzlement under the fictitious payee rule by allowing the employee to deposit embezzled checks without indorsement "to an account in a name substantially similar to that of the payee." If the embezzler is careful to open the account in the name of the payee, she need not worry about correctly indorsing the checks later. In fact, neither she nor the depository bank must indorse the checks at all.⁵⁶

Under former Section 9 of the Amended Negotiable Instruments Law and former Section 3-405 of the U.C.C., if a non-signing employee of the drawer of a check furnished the name of a payee to the employer and if the non-signing employee intended that the named payee would have no interest in the check, the non-signing employee could indorse the check to withdraw money from the drawer's account. Revised Section 3-404(b) has added a needless

53. See *Seattle-First Nat'l Bank v. Pacific Nat'l Bank of Wash.*, 587 P.2d 617 (Wash. Ct. App. 1978).

54. *Id.* at 623.

55. See *Western Casualty & Surety Co. v. Citizens Bank of Las Cruces*, 676 F.2d 1344, 1346 (10th Cir. 1982).

56. See U.C.C. § 4-205 (1991).

complication. Now, one must disregard the non-signing employee's intention and focus upon the signing person "whose intent determines to whom an instrument is payable."⁵⁷ If the signing person intends the payee to be paid, then the fictitious payee rule of Revised Section 3-404 does not apply. Instead, we are directed to Section 3-405. Under Revised Section 3-405, if the employee has responsibility "to supply information determining the names or addresses of payees of instruments to be issued in the name of the employer," the employee has the power to make a fraudulent indorsement which is effective as the indorsement of the real payee. In short, the "name supplying payee" often has the power to cheat her employer out of the proceeds of the check, just like in the past—the drafters merely have made the legal untangling a little more complicated.

c. Co-signed Checks

Many business entities require that all of their checks be indorsed by at least two co-signers as a way of preventing the unauthorized issuance of checks to fictitious payees or payees who are not intended to have an interest in the checks. Too often, a signer takes the word of his dishonest co-signer and blindly signs the check without investigation. Under former Section 3-405, the intent of the innocent co-signer was disregarded and the intent of the dishonest co-signer was said to govern.⁵⁸ Revised Section 3-110(a) takes a more indirect path: "If more than one person signs in the name or behalf of the issuer of an instrument and all the signers do not intend the same person as payee, the instrument is payable to any person intended by one or more of the signers."

The Official Comment states that "[a]ny person intended by a signer for the organization is the payee and an indorsement by that person is an effective indorsement."⁵⁹ The purpose of Section 3-110(a) and the Comment becomes clear when one refers to Case #3 of Official Comment 2 to Section 3-404, which demonstrates that the intent of the dishonest signer controls when he gains possession of the check. The "old" approach was a much simpler and clearer way of answering a common problem the drafters call a "rare" case.⁶⁰

57. See U.C.C. § 3-110(a) (1991).

58. See U.C.C. § 3-405 cmts. 3(f), 3(g) (1989) (amended 1991).

59. U.C.C. § 3-310 cmt. 1 (1991).

60. See *id.*

3. FRAUDULENT INDORSEMENT OF THE EMPLOYER'S NAME (AS PAYEE) AND FRAUDULENT INDORSEMENT OF THE EMPLOYER'S PAYEES NAMES

One of the most dramatic changes in Revised Article 3 is its approach to business embezzlement by employees who have been given responsibility in the processing and issuing of checks. Perhaps a simple example will illustrate the change. Assume a moderate size firm employs an office manager who has exclusive responsibility for the preparation of deposits of income checks and the preparation and mailing of checks to creditors. The office manager embarks upon a scheme of forging her employer's name on income checks and forging the name of payees after her employer has signed the checks. The office manager opens accounts in the name of her employer and the payees of the checks in various banks. She withdraws the funds after the checks have cleared. Let us further assume that the office manager was very skillful in opening the bank accounts. Eventually, however, the employer learns of the embezzlements and makes claim upon the drawee bank and the depositary banks.

Under former Section 3-406, the drawee-depositary banks would have defended themselves by asserting that the employer was negligent in the hiring and/or supervising of the office manager, and that this negligence substantially contributed to the forgeries. In addition, the banks might have been able to show that the employer was careless in examining the bank statements and cancelled checks, and that he was therefore precluded from recovery under former Section 4-406. The "substantially contributed" language invited protracted litigation regarding the alleged negligence of the employer.

If we consider the same embezzlement scheme today under Revised Article 3, the initial determination is whether the embezzler was given "responsibility" with respect to the preparation of instruments by her employer.⁶¹ It seems obvious that an office manager with "exclusive responsibility" for the preparation and mailing of checks would come within the statutory language. What is even more disturbing is that if a clerk under the direction of the office manager has the responsibility listed in any of the six definitions under the statute, the clerk would come within the definition of "responsibility." Revised Section 3-405 reads as follows:

- (3) "Responsibility" with respect to instruments means authority
 - (i) to sign or indorse instruments on behalf of the employer, (ii) to process instruments received by the employer for bookkeeping pur-

61. U.C.C. § 3-405(a)(3) (1991).

poses, for deposit to an account, or for other disposition, (iii) to prepare or process instruments for issue in the name of the employer, (iv) to supply information determining the names or addresses of payees of instruments to be issued in the name of the employer, (v) to control the disposition of instruments to be issued in the name of the employer, or (vi) to act otherwise with respect to instruments in a responsible capacity. "Responsibility" does not include authority that merely allows an employee to have access to instruments or blank or incomplete instrument forms that are being stored or transported or are part of incoming or outgoing mail, or similar access.

Note that the disjunctive word "or" appears before the sixth definition. The word "or" is interpolated before each of the standards, with the result that an employee given any one of the responsibilities is in a position to embezzle and place the loss on the employer. The Official Comment states that employers must now have their employees bonded.⁶² When embezzling losses mount and as bonding costs skyrocket, this might be a frivolous suggestion.

The Revised Code totally ignores the issue of the employer's possible negligence in the hiring and/or supervising process. It also does not hold the employer liable for any indorsements of his name as payee of income checks and for any indorsements of the payees' names on checks the employer issued. In this latter case, the concept of the fictitious payee has been disregarded; the law is simply saying that under agency concepts the employer is liable for the fraudulent acts of his employees in stealing payment checks issued by the employer. On the other hand, in some narrow situations, Revised Section 3-405 might supplement Section 3-404. For example, if the office manager has authority to sign on behalf of the employer, and if she has the intention while signing that the check be paid to the named payee but the office manager subsequently decides to steal the check, then the fictitious payee rule does not apply. Instead, Section 3-405 applies. As a result, the loss falls upon the employer.

Section 3-405(c) of the Revised Code replicates the approach of Section 3-404 by providing that:

an indorsement is made in the name of the person to whom an instrument is payable if (i) it is made in a name substantially similar to the name of that person or (ii) the instrument, whether or not indorsed, is deposited in a depository bank to an account in a name substantially similar to the name of that person.

Former Section 3-405 (the fictitious payee rule) did not explicitly

62. U.C.C. § 3-405 cmt. 1 (1991).

state that the possible negligence of a depositary bank had any affect in the allocation of risk between drawer and depositary bank, and case law generally rejected the assertion of negligence by drawers against the depositary banks.⁶³ Revised Section 3-405(b) introduces the negligence of the bank for the first time:

If the person paying the instrument or taking it for value or for collection fails to exercise ordinary care in paying or taking the instrument and that failure substantially contributes to loss resulting from the fraud, the person bearing the loss may recover from the person failing to exercise ordinary care to the extent the failure to exercise ordinary care contributed to the loss.

This subsection refers to the taking of the check; the text says nothing about the failure of the bank to exercise "ordinary care" in the opening of the account. In turn, the Official Comment does not talk about the taking of the check but instead discusses the failure of the bank to exercise ordinary care in opening the account, which may pre-date the taking of the check.⁶⁴ It is also noteworthy that the new definition of "ordinary care" in Section 3-103(7) stresses the taking of the instrument rather than the opening of the account, and that Official Comment 5 seems to be in accord. Of course, this is not the first time that the enthusiasm of the commentators has exceeded the breadth of the statute.⁶⁵

4. NEGLIGENCE CONTRIBUTING TO FORGED SIGNATURES OR ALTERATIONS

Former Section 3-406 succinctly stated that:

Any person who by his negligence substantially contributes to a material alteration of the instrument or to the making of an unauthorized signature is precluded from asserting the alteration or lack of authority against a holder in due course or against a drawee or other payor who pays the instrument in good faith and in accordance with the reasonable commercial standards of the drawee or payor's business.

Revised Section 3-406 has introduced comparative fault to the above concept:

(b) Under subsection (a), if the person asserting the preclusion fails to exercise ordinary care in paying or taking the instrument and that failure substantially contributes to loss, the loss is allocated between the person precluded and the person asserting

63. See BAILEY, *supra* note 19, § 28.17.

64. See U.C.C. § 3-103 cmt. 5 (1991).

65. See JOHN HONNOLD, CASES AND MATERIALS ON THE LAW OF SALES AND SALES FINANCING 14 (5th ed. 1984).

the preclusion according to the extent to which the failure of each to exercise ordinary care contributed to the loss.

Official Comment 4 to Section 3-406 stresses situations in which a bank is negligent in the opening of a corporate account by an employee in the name of the employer. It would seem that any reasonably prudent employee-embezzler could procure forged corporate resolutions, which could deceive most bank employees in the opening of the account. The bank has the burden to prove the customer's lack of ordinary care, and the customer has the burden to prove lack of ordinary care by the bank.⁶⁶

5. BANKS' REFUSAL TO PAY CASHIER'S CHECKS, TELLER'S CHECKS AND CERTIFIED CHECKS

Under Revised Section 3-411(b), if banks refuse to honor any cashier's checks, teller's checks, or certified checks without legal excuse, "the person asserting the right to enforce the check is entitled to compensation for expenses and loss of interest resulting from the nonpayment and may recover consequential damages if the obligated bank refuses to pay after receiving notice of particular circumstances giving rise to the damages."

The remitter of any of the checks has no right to stop payment; but in the event that a bank stops payment as a courtesy to its customer-remitter at his request, Section 3-411 is designed as a sanction against the bank. Query whether this section precludes the bank from conditioning its stop payment on a customer's indemnity to protect the bank. The drafters took a rather coy approach to the question of attorneys fees and consequential damages:

There is no express provision for attorney's fees, but attorney's fees are not meant to be necessarily excluded. They could be granted because they fit within the language "expenses . . . resulting from the nonpayment." In addition the bank may be liable to pay consequential damages if it has notice of the particular circumstances giving rise to the damages.⁶⁷

If the state law prohibits the awarding of attorneys fees except when provided for by contract or by statute,⁶⁸ this comment will be of no use. It is questionable whether the potential liability for interest will be enough of a deterrent for banks.

Revised Section 3-411(c) allows banks to refuse payment of the

66. See U.C.C. § 3-406(c) (1991).

67. U.C.C. § 3-411 cmt. 2 (1991) (ellipses in original).

68. See, e.g., *Bidon v. Department of Professional Regulation*, Fla. Real Estate Comm'n, 596 So. 2d 450 (Fla. 1992).

above checks on four occasions: if the bank suspends payments; if it asserts a defense on reasonable grounds; or, if the bank has reasonable doubt that the person demanding payment is entitled to enforce the instrument or payment is prohibited by law.

6. CERTIFICATION OF CHECKS AND ACCEPTANCE OF DRAFTS

Under Revised Section 3-413 of the U.C.C.:

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

Due to the infrequent use of certified checks in Florida, the imposition of liability upon banks that fail to indicate the amount the check is certified for will have little impact in this state.⁶⁹ However, the imposition of liability on unsophisticated drawees of other drafts will be dramatic.

7. BANK ACCEPTANCES OF DRAFTS AND DISCHARGES OF THE DRAWERS AND INDORSERS

Under former Section 3-411, when the holder of a check procured certification by the drawee bank, the drawer and all prior indorsers were discharged. Under Revised Article Section 3-414(c), "[i]f a draft is accepted by a bank, the drawer is discharged regardless of when or by whom acceptance was obtained." The language of the revised section appears broad enough to encompass not only certified checks, but also drafts drawn on a bank. Under Revised Section 3-415(d) if a draft is accepted by a bank after an indorsement is made, the liability of the indorser is also discharged.

8. TRANSFER AND PRESENTMENT WARRANTIES

Former Section 3-417 of the U.C.C. has been replaced by Revised Section 3-416, which covers transfer warranties, and Revised Section 3-417, which covers presentment warranties. Under Revised Section 3-416, a warrantor, in addition to warranting that all signatures are authentic and authorized and that the instrument has not been altered, now warrants that he is entitled to enforce the instru-

69. FLA. STAT. § 201.08 (1992) imposes an excise tax of \$3.20 per \$1,000 on certified checks, while there is no tax on cashier's checks.

ment and that "the instrument is not subject to a defense or claim in recoupment of any party which can be asserted against the warrantor."⁷⁰ The comment to this section notes that if the holder is a holder in due course, who would take free of the recoupment claim, he can elect to sue the warrantor on the breach of warranty rather than litigating the holder in due course issue with the obligor.⁷¹

The warranties under 3-416 can be disclaimed on every negotiable instrument except checks. Any claim for a breach of warranty must be given to the warrantor within thirty days after the claimant has reason to know of the breach. The warrantor is discharged to the extent of any loss caused by delay in giving notice of the breach.⁷²

A transferee of a warranty who took the instrument in good faith "may recover from the warrantor as damages for breach of warranty an amount equal to the loss suffered as a result of the breach, but not more than the amount of the instrument plus expenses and loss of interest incurred as a result of the breach."⁷³ The Official Comment notes that the word "expenses" might include attorneys fees, but the intention is to let the state laws govern the awarding of attorneys fees.⁷⁴ It is unfortunate that the drafters did not give a more complete definition of what could be included in "expenses."

Revised Section 3-417 deals with presentment warranties. It is divided into two main subdivisions: the first deals with presentment to the drawee of unaccepted drafts for payment or acceptance; the second subdivision deals with presentment of dishonored drafts for payment to the drawers or indorsers and presentment of any other instrument to a party obliged to pay the instrument.

When an unaccepted draft is presented to a drawee for payment or acceptance and is paid or accepted, the presenter and prior transferors warrant three things: (i) that they are entitled to enforce the draft or authorized to obtain payment or acceptance; (ii) that the draft has not been altered; and (iii) that the warrantor has no knowledge that the signature of the drawer is unauthorized.⁷⁵ The subsection of 3-417 that addresses damages is quite extensive and calls for printing in full:

(b) A drawee making payment may recover from any warrantor damages for breach of warranty equal to the amount paid by the drawee less the amount the drawee received or is entitled to

70. U.C.C. § 3-416(a)(4) (1991).

71. See U.C.C. § 3-416 cmt. 3 (1991). Recoupment is discussed *supra* part II.C.4.

72. See U.C.C. § 3-416(c) (1991).

73. U.C.C. § 3-416(b) (1991).

74. See U.C.C. § 3-416 cmt. 6 (1991).

75. U.C.C. § 3-417(a) (1991).

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

The comment notes that this subsection is a codification of a case decided under former Article 3 which held that lack of care has no effect on a drawee's right to damages.⁷⁶

The second subdivision addresses the presentment for payment of a dishonored draft to a drawer or an indorser and the presentment for payment of promissory notes and accepted drafts to any party who can be compelled to pay. In these situations, the presenter merely warrants that she is entitled to enforce payment or is authorized to collect for a person entitled to enforce the instrument.⁷⁷ Note that the presenter does not warrant the signature of the drawer to the drawee of an accepted draft; nor does she warrant that there are no alterations, because these warranties were previously given at the presentment stage. Likewise, there is no warranty that the maker's signature on a note is genuine and free of alterations, because the maker would already know of these facts. As previously noted, these implied warranties cannot be disclaimed with respect to a check.⁷⁸

9. CONVERSION OF NEGOTIABLE INSTRUMENTS

Revised Section 3-420 replaces former Section 3-419(3). The changes are a welcome improvement. For example, former Section 3-419(3) provided that when a depositary bank, in good faith and in observance of reasonable commercial standards, had dealt with a forged payee or special indorsee, the bank would not be "liable in conversion or otherwise to the true owner beyond the amount of any proceeds remaining in his hands." Under this provision, if a payee of numerous checks was unfortunate enough to have his name forged on checks drawn all over the country and deposited in a bank in the same area as the payee, he could sue the depositary bank only for the proceeds remaining in its hands. In the typical case, there were no pro-

76. See U.C.C. § 3-417 cmt. 5 (1991) (citing *Hartford Accident & Indem. Co. v. First Pa. Bank*, 859 F.2d 295 (3d Cir. 1988)).

77. See U.C.C. § 3-417(d) (1991).

78. U.C.C. § 3-417(e) (1991).

ceeds left. Therefore, the payee was forced to sue drawee banks all over the country and the costs of litigation were often prohibitive. Revised Section 3-420 deleted this "proceeds remaining" clause, and now the depository bank is fully liable.

Revised Section 3-420 also deals with the situation in which one joint payee wrongfully collects without the signature of her joint tenant. An illustration is the case where an insurance company issues a check or draft to an attorney and her client or where a construction lender issues a check to a contractor and subcontractor as joint payees and one of the payees wrongfully collects. Former Section 3-419 was silent on how to measure the right of the aggrieved payee to collect on the check. Revised Section 3-420 addresses this situation by stating that in an action for conversion "the measure of liability is presumed to be the amount payable on the instrument, but recovery may not exceed the amount of the plaintiff's interest in the instrument."⁷⁹ As regards the lawyer-client example, if the lawyer forges her client's name on an insurance check or draft, the client is entitled only to the amount he would have received if the lawyer had properly collected and disbursed the proceeds.

Revised Section 3-420 is a codification of the leading case of *Stone & Webster Engineering Corp. v. First National Bank & Trust Co.*⁸⁰ It provides that neither the issuer nor the acceptor of an instrument has a cause of action for conversion of a forged instrument. Instead, the cause of action vests in the payee or special indorsee. Additionally, "a payee or indorsee who did not receive delivery of the instrument either directly or through delivery to an agent or a co-payee" cannot bring an action for conversion.⁸¹ The Official Comment appears to reject old case law holding that delivery to a public mailbox was sufficient constructive delivery to the payee or indorsee. Now, there must be delivery to the mailbox of the payee or indorsee.⁸² In addition to the "no delivery-no property" theory, the drafters point out that when a check is not delivered, the underlying debt is not being paid and the payee retains his cause of action on the debt against the drawer. The drawer, in turn, has a cause of action against the wrongfully paying drawee bank.⁸³

79. U.C.C. § 3-420(b) (1991).

80. 184 N.E. 2d 358 (Mass. 1962).

81. U.C.C. § 3-420(a) (1991).

82. See U.C.C. § 3-420 cmt. 1 (1991).

83. See *id.*

10. PAYMENT OR ACCEPTANCE BY MISTAKE

Under Revised Section 3-418, if the drawee of a draft pays or accepts a draft because the drawee either overlooked a stop payment order, did not discover the forgery of the drawer's signature, did not realize that the drawer's account was insufficient, or failed to notice the drawer had no account with the drawee, then the drawee can recover the amount of payment or revoke the acceptance as against any person who did not take the instrument for value and in good faith, or against any person who did not in good faith change his position in reliance on the payment or acceptance. If the instrument is paid or accepted by mistake, as previously mentioned, and the drawee recovers payment or revokes acceptance, "the instrument is deemed not to have been paid or accepted and is treated as dishonored, and the person from whom payment is recovered has rights as a person entitled to enforce the dishonored instrument."⁸⁴

Revised Section 3-418 has adopted Section 33 of the Restatement of Restitution, which denies a drawee's right of restitution from a person who has changed her position in good faith reliance upon payment or acceptance of a draft.⁸⁵ A classic illustration of Section 33 is *First National Bank of Portland v. Noble*.⁸⁶ In *Noble*, a real estate transaction was rescinded and the broker issued a refund check to the buyers. The check was dishonored, and the payees redeposited the check. A bank employee mistook the rejection symbol on the check for an approval symbol, and issued a cashier's check to the payees, who did not know of the mistake. When the bank discovered the error, it refused payment on the cashier's check. Using Section 33 as authority, the court treated the check as though it was a cash payment, and held that the surrender of the personal check in return for the cashier's check might constitute a change in position so as to make restitution inequitable.⁸⁷

Revised Section 3-418 is a tremendous improvement over former Section 3-418, which failed to provide any remedies when payment was made by mistake. The text of the section and its comments are a welcome addition.

11. ACCOMMODATION INDORSERS AND MAKERS

Revised Section 3-419 is a consolidation of former Sections 3-415 and 3-416. It also introduces some new language into the Code:

84. U.C.C. § 3-418(d) (1991).

85. U.C.C. § 3-418 cmt. 3 (1991).

86. 168 P.2d 354 (Or. 1946).

87. *Id.* at 368.

(c) A person signing an instrument is presumed to be an accommodation party and there is notice that the instrument is signed for accommodation if the signature is an anomalous indorsement or is accompanied by words indicating that the signer is acting as surety or guarantor with respect to the obligation of another party to the instrument.

Comment 3 to this section makes a subtle and incomplete reference to subsection (c); therefore its meaning is not entirely clear. For example, the term "anomalous indorsement" is defined as "an indorsement made by a person who is not the holder of the instrument."⁸⁸ This enlightening definition is the equivalent of the former definition that an anomalous indorsement is one "that is not in the chain of title."⁸⁹ Neither definition answers the more important question, given that *X* is an accommodation party: for whom is he acting as an accommodation party? This is a question of more than mere academic interest. To illustrate: assume Max Maker signs a note payable to Pat Payee, and Sam Surety signs the back of the note. Maker subsequently dies with an insolvent estate. Payee then presents the note to Surety for payment. Surety defends nonpayment on the basis that he signed the note as an accommodation indorser for Payee. If Surety's perjury is more convincing than Payee's truthful testimony, Surety wins. This unjust result also might occur if Surety signs his name followed by the word "surety" or "guarantor" because, again, these words would not show for whom he had signed.

An even more common example is the situation where two people sign as co-makers and give the note to the payee. The makers default and are then sued by the payee. Both makers testify that they signed the note for the benefit of the payee, who told them he would discount the note at the local bank. With the two perjurious makers contradicting the one truthful payee, the result is foreseeable.⁹⁰

Surely, a modern codification of negotiable instruments could provide for a rule under which accommodation parties would have to indicate in writing next to their signatures for whom they are acting as accommodation parties. Any such rule should clearly spell out that parol testimony could not be used to modify the effect of the writing. A similar rule is in effect in most civil law countries.⁹¹

88. U.C.C. § 3-205(d) (1991).

89. U.C.C. § 3-415(4) (1989) (amended 1991).

90. See *Gehrig v. Ray*, 332 So. 2d 703 (Fla. 1st DCA 1976). The author neither states nor implies that there was any perjury or other wrongdoing in the cited case.

91. See generally Daniel E. Murray, *Accommodation Party Pitfalls: A Statutory Change is Needed*, 15 UCC L. J. 248, 262-66 (1983).

Revised Section 3-305 wisely provides for the defenses that an accommodation party may assert:

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

The excluded defenses reflect the case law development in the law of suretyship.⁹²

Revised Section 3-116(a) provides: "*Except as otherwise provided in the instrument*, two or more persons who have the same liability on an instrument as makers, drawers, acceptors, indorsers who indorse as joint payees, or anomalous indorsers are jointly and severally liable in the capacity in which they sign."⁹³

The Official Comment to 3-116 ignores the language emphasized above and seems to say that when two or more indorsers sign for the accommodation of the maker they are joint indorsers; if one pays, he has a joint and several claim against the co-indorsers under Section 3-116(b). But what happens if there are two or more accommodation indorsers who sign at different times and places and who are not acting in concert? Are they deemed joint indorsers as a matter of law? Under the former rule, they would be deemed sub-sureties and liable to each other in the order in which they indorsed.⁹⁴ Now, it appears that unless the sub-suretyship arrangement is spelled out in the instrument itself, parol testimony cannot be used to clarify the status of the accommodation indorsers.

E. Dishonor—Presentment and Dishonor

Under Revised Section 4-108(a), banks may "fix an afternoon hour of 2 p.m. or later as a cutoff hour for the handling of money and items and the making of bookkeeping entries." Any item or deposit received after the cutoff hour can be treated as if it were received at the opening of the next banking day. Revised Section 3-501(4) gives this same right to non-bankers, allowing them to fix a cut-off hour.

Former Section 3-502(1)(a) required the holder of a note that was payable on a fixed date to make presentment on that date and

92. See generally HAWKLAND, *supra* note 7, at 127-68.

93. (emphasis added).

94. U.C.C. § 3-414(2) (1989) (amended 1991); see *Jaronko v. Czerwinski*, 166 A. 388 (Conn. 1933).

timely to notify indorsers. Presentment could be waived in the note or if there was a valid excuse for not making presentment under penalty of discharging the indorsers from liability. Now, Revised Section 3-502(a)(3) provides that if the note is payable on a fixed date and is not payable at or through a bank, the note is deemed dishonored if it is not paid on the day it becomes payable. There is no requirement of presentment, and the debtor must seek out the lender. Also, under Revised Section 3-503(c), indorsers are entitled to notice within 30 days after dishonor occurs. Of course, most modern promissory notes expressly waive the need for presentment and for notice of dishonor.

III. REVISED ARTICLE 4

A. *General Provisions and Definitions*

1. WHAT IS A BANK?

In Revised Section 4-105, the U.C.C. for the first time defines a bank: “[b]ank’ means a person engaged in the business of banking, including a savings bank, savings and loan association, credit union, or trust company.”

2. PAYABLE THROUGH OR PAYABLE AT A BANK

Former Sections 3-120 and 3-121 have been rewritten and consolidated into Revised Section 4-106. This section continues to reflect the “North-South”⁹⁵ approach to banking: “(a) If an item states that it is ‘payable through’ a bank identified in the item, (i) the item designates the bank as a collecting bank and does not by itself authorize the bank to pay the item, and (ii) the item may be presented for payment only by or through the bank.”

Alternative A of Former Section 3-121 is now Alternative A of Revised Section 4-106: “[I]f an item states that it is ‘payable at’ a bank identified in the item, the item is equivalent to a draft drawn on the bank.” This rule means that a “draft payable at a bank” is the same as a draft drawn on the bank, and the bank must pay or dishonor under the midnight deadline rule of Sections 4-301 and 4-302. Florida has deleted Alternative A from 4-106 as it had done with former Section 3-121.⁹⁶

According to Alternative B of Revised Section 4-106, if the item states that it is payable at a bank identified in the item, “(i) the item designates the bank as collecting bank and does not by itself authorize the bank to pay the item, and (ii) the item may be presented for pay-

95. See U.C.C. 3-121 cmt. (1989) (amended 1991).

96. FLA. STAT. § 674.106 (1991).

ment only by or through the bank.” As a further addition to Alternative B, subsection (c) states: “[I]f a draft names a nonbank drawee and it is unclear whether a bank named in the draft is a co-drawee or a collecting bank, the bank is a collecting bank.”

3. SEPARATE OFFICE OF A BANK

The definition of a branch or separate office has been abbreviated: “[A] branch or separate office of a bank is a separate bank for the purpose of computing the time within which and determining the place at or to which action may be taken or notice or orders must be given under this Article and under Article 3.”⁹⁷ This definition is somewhat amplified by the comments, but the reader is warned that “[t]he decision not to draft the section with greater specificity leaves to the courts the resolution of the issues arising under this section on the basis of the facts of each case.”⁹⁸ This section may turn out to be problematic when courts are required to confront stop payment orders, notices, and holders in due course status, when communications are made between branches.

4. DELAYS

Revised Section 4-109 now permits a collecting bank in a good faith effort to secure payment of a specific item drawn on a payor other than a bank, with or without the approval of any person, to extend the time for payment. The extension may not exceed two additional banking days without discharge of drawers or indorsers or liability to any person. Of course, if a customer directs otherwise, the bank has no authority to extend the time.⁹⁹

Banks ought to welcome this additional provision. It states that delays by a collecting or payor bank beyond the time limits provided by the Code or by instructions are excused if “the delay is caused by interruption of communication or computer facilities, suspension of payments by another bank, war, emergency conditions, failure of equipment, or other circumstances beyond the control of the bank” provided that “the bank exercises such diligence as the circumstances require.”¹⁰⁰ The bank has the burden of proof on its exercise of due diligence.¹⁰¹

97. U.C.C. § 4-107 (1991).

98. U.C.C. § 4-107 cmt. 1 (1991).

99. U.C.C. § 4-109 cmt. 1 (1991).

100. U.C.C. § 4-109(b) (1991).

101. U.C.C. § 4-109 cmt. 3 (1991).

5. STATUTE OF LIMITATIONS

Revised Section 4-111 provides that any action brought under Article 4 must be commenced within three years from the accrual of the cause of action. Again, Florida has deleted this section and Chapter 95 of the Florida Statutes governs.¹⁰²

B. *Collection of Items: Depositary and Collecting Banks*

1. DEPOSITARY BANK AS HOLDER OF UNINDORSED ITEMS

Former Section 4-205(1) permitted depositary banks to supply missing indorsements of their customers. Revised Section 4-205(1) now makes the depositary bank a holder if its non-indorsing customer was a holder. No indorsement by the bank is needed.¹⁰³ Under 4-205(2), the bank warrants to collecting banks and to the payor bank or other payor that the item was either paid to the customer or deposited to her account.

2. TRANSFER WARRANTIES

As mentioned previously, Revised Section 3-416(c) prohibits the use of "without recourse" indorsements on checks, but it does seem to allow their use on other items.¹⁰⁴ Revised Section 4-207 on transfer warranties, however, forbids the use of "without recourse" indorsements on an "item," defined in Revised Section 4-104(9) as "an instrument or a promise or order to pay money handled by a bank for collection or payment. The term does not include a payment order governed by Article 4A or a credit or debit card slip." This prohibition on the use of "without recourse" indorsements on drafts and notes payable at or through banks is a serious restriction on the freedom of contract under Revised Section 3-416.

3. PRESENTMENT WARRANTIES

Revised Section 4-208, which deals with presentment warranties, conforms to Revised Section 3-417. It repeats the rule that "without recourse" indorsements are not effective as to checks.¹⁰⁵

4. ENCODING AND RETENTION WARRANTIES

Former Article 4 did not address the issue of who should bear the loss for encoding errors made by a depositary bank or by a cus-

102. See FLA. STAT. § 674.111 (1991).

103. U.C.C. § 4-205 cmt. (1991).

104. See U.C.C. § 3-416 cmt. 5 (1991); see also *supra* note 72 and accompanying text.

105. U.C.C. § 4-208(e) cmt. (1991).

tomers who encoded checks. Revised Section 4-209(a) now states that: "A person who encodes information on or with respect to an item after issue warrants to any subsequent collecting bank and to the payor bank or other payor that the information is correctly encoded. If the customer of a depository bank encodes, that bank also makes the warranty."

A good faith recipient of a warranty may recover from the warrantor as damages for breach of warranty the loss suffered as a result of the breach plus expenses and loss of interest incurred as a result of the breach.¹⁰⁶ The comments indicate that in the event of over-encoding or under-encoding, the drawee bank can sue the depository bank for its error without suing the customer of the drawee or the payee of the item.¹⁰⁷ The language in the comment, however, should have been incorporated into the statute in order to be more effective.

C. Collection of Items: Payor Banks—Payor Bank's Responsibility for Late Return of Item

Revised Section 4-302(a) retains the rule of former Section 4-302(a) that a payor bank is responsible for an item if it keeps the item without settling it beyond midnight of the day of receipt or it does not pay or return the item or send notice of dishonor until after its midnight deadline, that is midnight of the banking day following the banking day of receipt. Revised Section 4-302(b) adds that this liability of the payor bank for not meeting the midnight deadlines is subject to defenses based on breach of presentment warranties under Section 4-208 or on proof that the presenter is attempting to defraud the bank. For example, a presenter who knows that a drawer's account is insufficient would be barred under this rule from claiming a breach of the midnight deadline rule by the payor bank.

D. Relationship Between Payor Bank and Its Customer

1. WHEN BANK MAY CHARGE CUSTOMER'S ACCOUNT

Former Section 4-401(1) provided that a bank may charge properly payable items from a customer's account even though the charges created an overdraft. Revised Section 4-401(a) defines the phrase "properly payable" to mean that the item "is authorized by the customer and is in accordance with any agreement between the customer and bank." Under Revised Section 4-401(b), a customer is not liable for the amount of an overdraft if she "neither signed the item nor

106. U.C.C. § 4-209(c) (1991).

107. U.C.C. § 4-209 cmt. 2 (1991).

benefited from the proceeds of the item." This revision implies that if a non-signing customer (e.g., a spouse) is the innocent beneficiary of some of the proceeds, he or she will incur liability.¹⁰⁸

2. POST-DATED CHECKS

The drafters added a provision respecting post-dated checks. The wording of the new section greatly resembles an old Florida statute.¹⁰⁹ A bank is no longer liable for paying a post-dated check ahead of the post-dated date unless the customer has given the bank notice that describes the check with reasonable certainty. Under 4-401(c), "the notice is effective for the period stated in Section 4-403(b) for stop-payment orders." Revised Uniform Section 4-403(b) provides for two periods: one oral period of 14 days and a written period of six months. The Florida version, however, omits the oral stop payment period.¹¹⁰

Under 4-401(c) the notice of the post-dated check must be received by the bank so as to afford the bank a reasonable opportunity to act before the bank pays or accepts the item pursuant to Section 4-303. The bank that pays a post-dated item before its date, but after it receives notice, will be liable for damages. The liability might include damages for dishonor of subsequent items under 4-402.¹¹¹

3. BANK'S LIABILITY TO CUSTOMER FOR WRONGFUL DISHONOR

Under Revised Section 4-402(a) a payor bank wrongfully dishonors an item if the item is properly payable. A bank can dishonor an item, though, that would create an overdraft unless it has agreed to pay the overdraft.

Subsection (b) of Revised Section 4-402 has been carefully drafted to read:

A payor bank is liable to its customer for damages proximately caused by the wrongful dishonor of an item. Liability is limited to actual damages proved and may include damages for an arrest or prosecution of the customer or other consequential damages. Whether any consequential damages are proximately caused by the wrongful dishonor is a question of fact to be determined in each case.

Comment 3 to this section notes that the second and third sentences of subsection (b) are designed to reject the view that the dishonor of a

108. See U.C.C. § 4-401 cmt. 2 (1991).

109. Compare U.C.C. 4-401(c) (1991) with FLA. STAT. § 658.64 (1991).

110. See FLA. STAT. § 673.403 (1991).

111. U.C.C. § 4-403(c) (1991).

check is not the "proximate cause" of the arrest and prosecution of the customer. Instead, the question of "proximate cause" is a question of fact for determination in each case. The Official Comment also notes that some courts found the wording of former Section 4-402 to imply that punitive damages could be awarded in a case of deliberate wrongful dishonor. Now punitive damages are permitted "by other rule of law" under Sections 1-103 and 1-106 of the Code.¹¹²

New subsection (c) is designed to aid banks when they consider making two determinations regarding the balance of a customer's account:

A payor bank's determination of the customer's account balance on which a decision to dishonor for insufficiency of available funds is based may be made at any time between the time the item is received by the payor bank and the time that the payor bank returns the item or gives notice in lieu of return, and no more than one determination need be made. *If, at the election of the payor bank*, a subsequent balance determination is made for the purpose of reevaluating the bank's decision to dishonor the item, the account balance at that time is determinative of whether the dishonor for insufficiency of available funds is wrongful.¹¹³

4. CUSTOMER'S RIGHT TO STOP PAYMENT

Revised Section 4-403(a) states that "[a] customer or any person authorized to draw on the account if there is more than one person may stop payment on any item drawn on the customer's account" or close the account by describing the item with reasonable certainty at a time and in a manner allowing the bank a reasonable opportunity to act before it takes other action with respect to the item. The revised section continues the former view that oral stop-payment orders are effective for only fourteen days, while written stop-payment orders last six months.¹¹⁴ Florida acted consistently with its past practice by deleting the oral stop-payment provision from Section 4-403.¹¹⁵ The loss from payment of an item that is contrary to a stop-payment order may now include damages for dishonor of subsequent items under Section 4-402.¹¹⁶

112. U.C.C. § 4-402 cmt. 1 (1991).

113. (emphasis added).

114. U.C.C. § 4-403(b) (1991).

115. See *supra* note 110 and accompanying text.

116. U.C.C. § 4-403(c) (1991).

5. CUSTOMER'S DUTY TO DISCOVER AND REPORT UNAUTHORIZED SIGNATURES OR ALTERATIONS

Revised Section 4-406 received extensive additions regarding the duty of banks to furnish statements of accounts and to return to customers or retain items in the bank's records. Under the revised section, the banks now have a duty to retain items or legible copies of items for seven years after receipt.¹¹⁷ Customers, on the other hand, must examine returned statements and items with "reasonable promptness," and if the customer reasonably should have discovered an unauthorized signature of the drawer or an unauthorized alteration, she must promptly notify the bank.¹¹⁸ If the customer fails to discern the unauthorized signature or alteration or fails to notify the bank, she cannot recover from the bank if the bank proves that it suffered a loss due to the customer's failure. In the event that one wrongdoer has continued to forge or alter items, the customer has a reasonable period of time, not to exceed thirty days, from the receipt of the item or statement to examine it and to report the wrongdoing. If the customer fails to do so, she cannot recover from the bank.¹¹⁹ Former Section 4-406(2) provided for a fourteen day period, which proved to be too short in practice.

The concept of comparative fault also has been added to 4-406:

(e) If subsection (d) [the customer's duty to examine and report] applies and the customer proves that the bank failed to exercise ordinary care in paying the item and that the failure substantially contributed to loss, the loss is allocated between the customer precluded and the bank asserting the preclusion according to the extent to which the failure of the customer to comply with subsection (c) [prompt examination and report by the customer] and the failure of the bank to exercise ordinary care contributed to the loss. If the customer proves that the bank did not pay the item in good faith, the preclusion under subsection (d) does not apply.

Revised Section 4-406(f) retains the notion that regardless of care or lack thereof by either the customer or the bank, a customer who does not within one year discover and report an unauthorized signature or an unauthorized alteration is precluded from asserting a claim against the bank. In addition, if the customer is precluded from asserting the forgery or alteration against the drawee bank, the bank may not assert a breach of warranty against any prior parties pursuant to Revised Section 4-208. Former Section 4-406(4) provided that

117. U.C.C. § 4-406(b) (1991).

118. U.C.C. § 4-406(c) (1991).

119. U.C.C. § 4-406(d) (1991).

a customer had to discover and report an unauthorized payee's signature to the drawee bank within three years after the customer received the item. This concept has been deleted from the Revised Code.

It is questionable how much practical application Revised Section 4-406 will have. People who are continually able to forge the same signatures are typically employees of the victims, and Revised Section 3-405 makes most of these forgeries effective against the employer. Employees who opt for the more creative approach of using fictitious payees as a means of supplementing their incomes will also collect against the employer under Revised Section 3-404.