

U.C.C. - ARTICLE 3 - NEGOTIABLE INSTRUMENTS

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PART 1. GENERAL PROVISIONS AND DEFINITIONS

§ 3-101. SHORT TITLE.

This Article may be cited as Uniform Commercial Code -- Negotiable Instruments.

[\[Comment\]](#)

§ 3-102. SUBJECT MATTER.

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

(b) If there is conflict between this Article and Article 4 or 9, Articles 4 and 9 govern.

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

[\[Comment\]](#)

§ 3-103. DEFINITIONS.

(a) In this Article:

- (1) "**Acceptor**" means a [drawee](#) who has accepted a draft.
- (2) "**Drawee**" means a person ordered in a draft to make payment.
- (3) "**Drawer**" means a person who signs or is identified in a [draft](#) as a person ordering payment.
- (4) [reserved]
- (5) "**Maker**" means a person who signs or is identified in a [note](#) as a person undertaking to pay.
- (6) "**Order**" means a written instruction to pay money signed by the person giving the instruction. The instruction may be addressed to any person, including the person giving the instruction, or to one or more persons jointly or in the alternative but not in succession. An authorization to pay is not an order unless the person authorized to pay is also instructed to pay.
- (7) "**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.
- (8) "**Party**" means a party to an [instrument](#).
- (9) "**Promise**" means a written undertaking to pay money signed by the person undertaking to pay. An acknowledgment of an obligation by the obligor is not a promise unless the obligor also undertakes to pay the obligation.
- (10) "**Prove**" with respect to a fact means to meet the burden of establishing the fact (Section [1-201\(b\)\(8\)](#)).
- (11) "**Remitter**" means a person who purchases an [instrument](#) from its [issuer](#) if the instrument is payable to an identified person other than the purchaser.

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

"Acceptance" Section [3-409](#)

"Accommodated party" Section [3-419](#)

"Accommodation party"	Section 3-419
"Alteration"	Section 3-407
"Anomalous indorsement"	Section 3-205
"Blank indorsement"	Section 3-205
"Cashier's check"	Section 3-104
"Certificate of deposit"	Section 3-104
"Certified check"	Section 3-409
"Check"	Section 3-104
"Consideration"	Section 3-303
"Draft"	Section 3-104
"Holder in due course"	Section 3-302
"Incomplete instrument"	Section 3-115
"Indorsement"	Section 3-204
"Indorser"	Section 3-204
"Instrument"	Section 3-104
"Issue"	Section 3-105
"Issuer"	Section 3-105
"Negotiable instrument"	Section 3-104
"Negotiation"	Section 3-201
"Note"	Section 3-104
"Payable at a definite time"	Section 3-108
"Payable on demand"	Section 3-108
"Payable to bearer"	Section 3-109
"Payable to order"	Section 3-109
"Payment"	Section 3-602

"Person entitled to enforce"	Section 3-301
"Presentment"	Section 3-501
"Reacquisition"	Section 3-207
"Special indorsement"	Section 3-205
"Teller's check"	Section 3-104
"Transfer of instrument"	Section 3-203
"Traveler's check"	Section 3-104
"Value"	Section 3-303

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

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

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

[\[Comment\]](#)

§ 3-104. NEGOTIABLE INSTRUMENT.

(a) Except as provided in subsections (c) and (d), "**negotiable instrument**" means an unconditional [promise](#) or [order](#) to pay a fixed amount of money, with or without interest or other charges described in the promise or order, if it:

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

(2) is payable on demand or at a definite time; and

(3) does not state any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money, but the [promise](#) or [order](#) may contain (i) an undertaking or power to give, maintain, or protect collateral to secure payment, (ii) an authorization or power to the holder to confess judgment or realize on or dispose of collateral, or (iii) a waiver of the benefit of any law intended for the advantage or protection of an obligor.

(b) "**Instrument**" means a [negotiable instrument](#).

(c) An [order](#) that meets all of the requirements of subsection (a), except paragraph (1), and otherwise falls within the definition of "check" in subsection (f) is a [negotiable instrument](#) and a [check](#).

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

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

(f) "**Check**" means (i) a [draft](#), other than a documentary draft, payable on demand and drawn on a bank or (ii) a [cashier's check](#) or [teller's check](#). An [instrument](#) may be a [check](#) even though it is described on its face by another term, such as "money order."

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

(h) "**Teller's check**" means a [draft](#) drawn by a bank (i) on another bank, or (ii) payable at or through a bank.

(i) "**Traveler's check**" means an [instrument](#) that (i) is payable on demand, (ii) is drawn on or payable at or through a bank, (iii) is designated by the term "traveler's check" or by a substantially similar term, and (iv) requires, as a condition to payment, a countersignature by a person whose specimen signature appears on the instrument.

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

[[Comment](#)]

§ 3-105. ISSUE OF INSTRUMENT.

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

(b) An unissued [instrument](#), or an unissued [incomplete instrument](#) that is completed, is binding on the [maker](#) or [drawer](#), but nonissuance is a defense. An instrument that is conditionally issued or is issued for a special purpose is binding on the maker or drawer, but failure of the condition or special purpose to be fulfilled is a defense.

(c) "**Issuer**" applies to [issued](#) and unissued [instruments](#) and means a [maker](#) or [drawer](#) of an instrument.

[[Comment](#)]

§ 3-106. UNCONDITIONAL PROMISE OR ORDER.

(a) Except as provided in this section, for the purposes of Section [3-104\(a\)](#), a [promise](#) or [order](#) is unconditional unless it states (i) an express condition to payment, (ii) that the promise or order is subject to or governed by another writing, or (iii) that rights or obligations with respect to the promise or order are stated in another writing. A reference to another writing does not of itself make the promise or order conditional.

(b) A [promise](#) or [order](#) is not made conditional (i) by a reference to another writing for a statement of rights with respect to collateral, prepayment, or acceleration, or (ii) because payment is limited to resort to a particular fund or source.

(c) If a [promise](#) or [order](#) requires, as a condition to payment, a countersignature by a person whose specimen signature appears on the promise or order, the condition does not make the promise or order conditional for the purposes of Section [3-104\(a\)](#). If the person whose specimen signature appears on an [instrument](#) fails to countersign the instrument, the failure to countersign is a defense to the obligation of the [issuer](#), but the failure does not prevent a transferee of the instrument from becoming a holder of the instrument.

(d) If a [promise](#) or [order](#) at the time it is [issued](#) or first comes into possession of a holder contains a statement, required by applicable statutory or administrative law, to the effect that the rights of a holder or transferee are subject to claims or defenses that the [issuer](#) could assert against the original payee, the promise or order is not thereby made conditional for the purposes of Section [3-104\(a\)](#); but if the promise or order is an [instrument](#), there cannot be a [holder in due course](#) of the instrument.

[[Comment](#)]

§ 3-107. INSTRUMENT PAYABLE IN FOREIGN MONEY.

Unless the [instrument](#) otherwise provides, an instrument that states the amount payable in foreign money may be paid in the foreign money or in an equivalent

amount in dollars calculated by using the current bank-offered spot rate at the place of payment for the purchase of dollars on the day on which the instrument is paid.

[[Comment](#)]

§ 3-108. PAYABLE ON DEMAND OR AT DEFINITE TIME.

(a) A [promise](#) or [order](#) is "**payable on demand**" if it (i) states that it is payable on demand or at sight, or otherwise indicates that it is payable at the will of the holder, or (ii) does not state any time of payment.

(b) A [promise](#) or [order](#) is "**payable at a definite time**" if it is payable on elapse of a definite period of time after sight or [acceptance](#) or at a fixed date or dates or at a time or times readily ascertainable at the time the promise or order is [issued](#), subject to rights of (i) prepayment, (ii) acceleration, (iii) extension at the option of the holder, or (iv) extension to a further definite time at the option of the [maker](#) or [acceptor](#) or automatically upon or after a specified act or event.

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

[[Comment](#)]

§ 3-109. PAYABLE TO BEARER OR TO ORDER.

(a) A [promise](#) or [order](#) is payable to bearer if it:

(1) states that it is payable to bearer or to the [order](#) of bearer or otherwise indicates that the person in possession of the [promise](#) or order is entitled to payment;

(2) does not state a payee; or

(3) states that it is payable to or to the [order](#) of cash or otherwise indicates that it is not payable to an identified person.

(b) A [promise](#) or [order](#) that is not payable to bearer is payable to order if it is payable (i) to the order of an identified person or (ii) to an identified person or order. A promise or order that is payable to order is payable to the identified person.

(c) An [instrument](#) payable to bearer may become payable to an identified person if it is specially indorsed pursuant to Section [3-205\(a\)](#). An instrument payable to an identified person may become payable to bearer if it is indorsed in blank pursuant to Section [3-205\(b\)](#).

[[Comment](#)]

§ 3-110. IDENTIFICATION OF PERSON TO WHOM INSTRUMENT IS PAYABLE.

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

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

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

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

(2) If an [instrument](#) is payable to:

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

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

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

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

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

[\[Comment\]](#)

§ 3-111. PLACE OF PAYMENT.

Except as otherwise provided for items in Article 4, an [instrument](#) is payable at the place of payment stated in the instrument. If no place of payment is stated, an instrument is payable at the address of the [drawee](#) or [maker](#) stated in the instrument. If no address is stated, the place of payment is the place of business of the drawee or maker. If a drawee or maker has more than one place of business, the place of payment is any place of business of the drawee or maker chosen by the [person entitled to enforce](#) the instrument. If the drawee or maker has no place of business, the place of payment is the residence of the drawee or maker.

[\[Comment\]](#)

§ 3-112. INTEREST.

(a) Unless otherwise provided in the [instrument](#), (i) an instrument is not payable with interest, and (ii) interest on an interest-bearing instrument is payable from the date of the instrument.

(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 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.

[\[Comment\]](#)

§ 3-113. DATE OF INSTRUMENT.

(a) An [instrument](#) may be antedated or postdated. The date stated determines the time of payment if the instrument is payable at a fixed period after date. Except as provided in Section [4-401\(c\)](#), an instrument payable on demand is not payable before the date of the instrument.

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

[\[Comment\]](#)

§ 3-114. CONTRADICTORY TERMS OF INSTRUMENT.

If an [instrument](#) contains contradictory terms, typewritten terms prevail over printed terms, handwritten terms prevail over both, and words prevail over numbers.

[\[Comment\]](#)

§ 3-115. INCOMPLETE INSTRUMENT.

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

(b) Subject to subsection (c), if an incomplete instrument is an [instrument](#) under Section [3-104](#), it may be enforced according to its terms if it is not completed, or according to its terms as augmented by completion. If an incomplete instrument is not an instrument under Section [3-104](#), but, after completion, the requirements of Section [3-104](#) are met, the instrument may be enforced according to its terms as augmented by completion.

(c) If words or numbers are added to an incomplete instrument without authority of the signer, there is an [alteration](#) of the incomplete instrument under Section [3-407](#).

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

[[Comment](#)]

§ 3-116. JOINT AND SEVERAL LIABILITY; CONTRIBUTION.

(a) 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.

(b) Except as provided in Section [3-419\(e\)](#) or by agreement of the affected parties, a [party](#) having joint and several liability who pays the [instrument](#) is entitled to receive from any party having the same joint and several liability contribution in accordance with applicable law.

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

[[Comment](#)]

[[Permanent Editorial Board Commentary](#)]

§ 3-117. OTHER AGREEMENTS AFFECTING INSTRUMENT.

Subject to applicable law regarding exclusion of proof of contemporaneous or previous agreements, the obligation of a [party](#) to an [instrument](#) to pay the instrument may be modified, supplemented, or nullified by a separate agreement of the obligor and a [person entitled to enforce](#) the instrument, if the instrument is

[issued](#) or the obligation is incurred in reliance on the agreement or as part of the same transaction giving rise to the agreement. To the extent an obligation is modified, supplemented, or nullified by an agreement under this section, the agreement is a defense to the obligation.

[[Comment](#)]

§ 3-118. STATUTE OF LIMITATIONS.

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

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

(c) Except as provided in subsection (d), an action to enforce the obligation of a [party](#) to an unaccepted [draft](#) to pay the draft must be commenced within three years after dishonor of the draft or 10 years after the date of the draft, whichever period expires first.

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

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

(f) An action to enforce the obligation of a [party](#) to pay an accepted [draft](#), other than a [certified check](#), must be commenced (i) within six years after the due date or dates stated in the draft or [acceptance](#) if the obligation of the [acceptor](#) is payable at a definite time, or (ii) within six years after the date of the acceptance if the obligation of the acceptor is payable on demand.

(g) Unless governed by other law regarding claims for indemnity or contribution, an action (i) for conversion of an [instrument](#), for money had and received, or like action based on conversion, (ii) for breach of warranty, or (iii) to enforce an obligation, duty, or right arising under this Article and not governed by this section must be commenced within three years after the [cause of action] accrues.

[[Comment](#)]

§ 3-119. NOTICE OF RIGHT TO DEFEND ACTION.

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

[\[Comment\]](#)

PART 2. NEGOTIATION, TRANSFER, AND INDORSEMENT

§ 3-201. NEGOTIATION.

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

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

[\[Comment\]](#)

§ 3-202. NEGOTIATION SUBJECT TO RESCISSION.

(a) Negotiation is effective even if obtained (i) from an infant, a corporation exceeding its powers, or a person without capacity, (ii) by fraud, duress, or mistake, or (iii) in breach of duty or as part of an illegal transaction.

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

[\[Comment\]](#)

§ 3-203. TRANSFER OF INSTRUMENT; RIGHTS ACQUIRED BY TRANSFER.

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

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

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

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

[\[Comment\]](#)

§ 3-204. INDORSEMENT.

(a) "**Indorsement**" means a signature, other than that of a signer as [maker](#), [drawer](#), or [acceptor](#), that alone or accompanied by other words is made on an [instrument](#) for the purpose of (i) negotiating the instrument, (ii) restricting payment of the instrument, or (iii) incurring [indorser's](#) liability on the instrument, but regardless of the intent of the signer, a signature and its accompanying words is an indorsement unless the accompanying words, terms of the instrument, place of the signature, or other circumstances unambiguously indicate that the signature was made for a purpose other than indorsement. For the purpose of determining whether a signature is made on an instrument, a paper affixed to the instrument is a part of the instrument.

(b) "**Indorser**" means a person who makes an [indorsement](#).

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

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

[\[Comment\]](#)

§ 3-205. SPECIAL INDORSEMENT; BLANK INDORSEMENT; ANOMALOUS INDORSEMENT.

(a) If an [indorsement](#) is made by the holder of an [instrument](#), whether payable to an identified person or payable to bearer, and the indorsement identifies a person to whom it makes the instrument payable, it is a "**special indorsement.**" When specially indorsed, an instrument becomes payable to the identified person and may be negotiated only by the indorsement of that person. The principles stated in Section [3-110](#) apply to special indorsements.

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

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

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

[[Comment](#)]

§ 3-206. RESTRICTIVE INDORSEMENT.

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

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

(c) If an [instrument](#) bears an [indorsement](#) (i) described in Section [4-201\(b\)](#), or (ii) in blank or to a particular bank using the words "for deposit," "for collection," or other words indicating a purpose of having the instrument collected by a bank for the [indorser](#) or for a particular account, the following rules apply:

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

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

(3) A payor bank that is also the depository bank or that takes the [instrument](#) for immediate payment over the counter from a person other than a collecting

bank converts the instrument unless the proceeds of the instrument are received by the [indorser](#) or applied consistently with the [indorsement](#).

(4) Except as otherwise provided in paragraph (3), a payor bank or intermediary bank may disregard the [indorsement](#) and is not liable if the proceeds of the [instrument](#) are not received by the [indorser](#) or applied consistently with the indorsement.

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

(1) Unless there is notice of breach of [fiduciary](#) duty as provided in Section [3-307](#), a person who purchases the [instrument](#) from the indorsee or takes the instrument from the indorsee for collection or payment may pay the proceeds of payment or the value given for the instrument to the indorsee without regard to whether the indorsee violates a fiduciary duty to the [indorser](#).

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

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

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

[\[Comment\]](#)

§ 3-207. REACQUISITION.

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

[\[Comment\]](#)

PART 3. ENFORCEMENT OF INSTRUMENTS

§ 3-301. PERSON ENTITLED TO ENFORCE INSTRUMENT.

"Person entitled to enforce" an [instrument](#) means (i) the holder of the instrument, (ii) a nonholder in possession of the instrument who has the rights of a holder, or (iii) a person not in possession of the instrument who is entitled to enforce the instrument pursuant to Section 3-309 or [3-418\(d\)](#). A person may be a person entitled to enforce the instrument even though the person is not the owner of the instrument or is in wrongful possession of the instrument.

[[Comment](#)]

§ 3-302. HOLDER IN DUE COURSE.

(a) Subject to subsection (c) and Section [3-106\(d\)](#), "**holder in due course**" means the holder of an [instrument](#) if:

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

(2) the holder took the [instrument](#) (i) for value, (ii) in [good faith](#), (iii) without notice that the instrument is overdue or has been dishonored or that there is an uncured default with respect to payment of another instrument [issued](#) as part of the same series, (iv) without notice that the instrument contains an unauthorized signature or has been altered, (v) without notice of any claim to the instrument described in Section [3-306](#), and (vi) without notice that any [party](#) has a defense or claim in recoupment described in Section [3-305\(a\)](#).

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

(c) Except to the extent a transferor or predecessor in interest has rights as a [holder in due course](#), a person does not acquire rights of a holder in due course of an [instrument](#) taken (i) by legal process or by purchase in an execution, bankruptcy, or creditor's sale or similar proceeding, (ii) by purchase as part of a bulk transaction not in ordinary course of business of the transferor, or (iii) as the successor in interest to an estate or other organization.

(d) If, under Section [3-303\(a\)](#)(1), the [promise](#) of performance that is the [consideration](#) for an [instrument](#) has been partially performed, the holder may assert rights as a [holder in due course](#) of the instrument only to the fraction of the amount payable under the instrument equal to the value of the partial performance divided by the value of the promised performance.

(e) If (i) the [person entitled to enforce](#) an [instrument](#) has only a security interest in the instrument and (ii) the person obliged to pay the instrument has a defense, claim in recoupment, or claim to the instrument that may be asserted against the person who granted the security interest, the person entitled to enforce the instrument may assert rights as a [holder in due course](#) only to an amount payable under the

instrument which, at the time of enforcement of the instrument, does not exceed the amount of the unpaid obligation secured.

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

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

[[Comment](#)]

§ 3-303. VALUE AND CONSIDERATION.

(a) An [instrument](#) is [issued](#) or transferred for value if:

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

(2) the transferee acquires a security interest or other lien in the [instrument](#) other than a lien obtained by judicial proceeding;

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

(4) the [instrument](#) is [issued](#) or transferred in exchange for a [negotiable instrument](#); or

(5) the [instrument](#) is [issued](#) or transferred in exchange for the incurring of an irrevocable obligation to a third [party](#) by the person taking the instrument.

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

[[Comment](#)]

§ 3-304. OVERDUE INSTRUMENT.

(a) An [instrument](#) payable on demand becomes overdue at the earliest of the following times:

(1) on the day after the day demand for payment is duly made;

(2) if the [instrument](#) is a [check](#), 90 days after its date; or

(3) if the [instrument](#) is not a [check](#), 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.

(b) With respect to an [instrument](#) payable at a definite time the following rules apply:

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

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

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

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

[[Comment](#)]

§ 3-305. DEFENSES AND CLAIMS IN RECOURPMENT.

(a) Except as stated in subsection (b), the right to enforce the obligation of a [party](#) to pay an [instrument](#) is subject to the following:

(1) a defense of the obligor based on (i) infancy of the obligor to the extent it is a defense to a simple contract, (ii) duress, lack of legal capacity, or illegality of the transaction which, under other law, nullifies the obligation of the obligor, (iii) fraud that induced the obligor to sign the [instrument](#) with neither knowledge nor reasonable opportunity to learn of its character or its essential terms, or (iv) discharge of the obligor in insolvency proceedings;

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

(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.

(b) The right of a [holder in due course](#) to enforce the obligation of a [party](#) to pay the [instrument](#) is subject to defenses of the obligor stated in subsection (a)(1), but is not subject to defenses of the obligor stated in subsection (a)(2) or claims in recoupment stated in subsection (a)(3) against a person other than the holder.

(c) Except as stated in subsection (d), in an action to enforce the obligation of a [party](#) to pay the [instrument](#), the obligor may not assert against the [person entitled to enforce](#) the instrument a defense, claim in recoupment, or claim to the instrument (Section [3-306](#)) of another person, but the other person's claim to the instrument may be asserted by the obligor if the other person is joined in the action and personally asserts the claim against the person entitled to enforce the instrument. An obligor is not obliged to pay the instrument if the person seeking enforcement of the instrument does not have rights of a [holder in due course](#) and the obligor [proves](#) that the instrument is a lost or stolen instrument.

(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 under subsection (a) 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.

[\[Comment\]](#)

[\[Permanent Editorial Board Commentary\]](#)

§ 3-306. CLAIMS TO AN INSTRUMENT.

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

[\[Comment\]](#)

§ 3-307. NOTICE OF BREACH OF FIDUCIARY DUTY.

(a) In this section:

(1) "**Fiduciary**" means an agent, trustee, partner, corporate officer or director, or other representative owing a fiduciary duty with respect to an [instrument](#).

(2) "**Represented person**" means the principal, beneficiary, partnership, corporation, or other person to whom the duty stated in paragraph (1) is owed.

(b) If (i) an [instrument](#) is taken from a fiduciary for payment or collection or for value, (ii) the taker has knowledge of the fiduciary status of the fiduciary, and (iii) the represented person makes a claim to the instrument or its proceeds on the basis that the transaction of the fiduciary is a breach of fiduciary duty, the following rules apply:

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

(2) In the case of an [instrument](#) payable to the represented person or the fiduciary as such, the taker has notice of the breach of fiduciary duty if the instrument is (i) taken in payment of or as security for a debt known by the taker to be the personal debt of the fiduciary, (ii) taken in a transaction known by the taker to be for the personal benefit of the fiduciary, or (iii) deposited to an account other than an account of the fiduciary, as such, or an account of the represented person.

(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.

(4) If an [instrument](#) is [issued](#) by the represented person or the fiduciary as such, to the taker as payee, the taker has notice of the breach of fiduciary duty if the instrument is (i) taken in payment of or as security for a debt known by the taker to be the personal debt of the fiduciary, (ii) taken in a transaction known by the taker to be for the personal benefit of the fiduciary, or (iii) deposited to an account other than an account of the fiduciary, as such, or an account of the represented person.

[\[Comment\]](#)

§ 3-308. PROOF OF SIGNATURES AND STATUS AS HOLDER IN DUE COURSE.

(a) In an action with respect to an [instrument](#), the authenticity of, and authority to make, each signature on the instrument is admitted unless specifically denied in the pleadings. If the validity of a signature is denied in the pleadings, the burden of establishing validity is on the person claiming validity, but the signature is presumed to be authentic and authorized unless the action is to enforce the liability of the purported signer and the signer is dead or incompetent at the time of trial of the [issue](#) of validity of the signature. If an action to enforce the instrument is brought against a person as the undisclosed principal of a person who signed the instrument as a [party](#) to the instrument, the plaintiff has the burden of establishing that the defendant is liable on the instrument as a [represented person](#) under Section [3-402\(a\)](#).

(b) If the validity of signatures is admitted or [proved](#) and there is compliance with subsection (a), a plaintiff producing the [instrument](#) is entitled to payment if the plaintiff proves entitlement to enforce the instrument under Section [3-301](#), unless the defendant proves a defense or claim in recoupment. If a defense or claim in recoupment is proved, the right to payment of the plaintiff is subject to the defense or claim, except to the extent the plaintiff proves that the plaintiff has rights of a [holder in due course](#) which are not subject to the defense or claim.

[\[Comment\]](#)

§ 3-309. ENFORCEMENT OF LOST, DESTROYED, OR STOLEN INSTRUMENT.

(a) A person not in possession of an [instrument](#) is entitled to enforce the instrument if (i) the person was in possession of the instrument and entitled to enforce it when loss of possession occurred, (ii) the loss of possession was not the result of a transfer by the person or a lawful seizure, and (iii) the person cannot reasonably obtain possession of the instrument because the instrument was destroyed, its whereabouts cannot be determined, or it is in the wrongful possession of an unknown person or a person that cannot be found or is not amenable to service of process.

(b) A person seeking enforcement of an [instrument](#) under subsection (a) must [prove](#) the terms of the instrument and the person's right to enforce the instrument. If that proof is made, Section [3-308](#) applies to the case as if the person seeking enforcement had produced the instrument. The court may not enter judgment in favor of the person seeking enforcement unless it finds that the person required to pay the instrument is adequately protected against loss that might occur by reason of a claim by another person to enforce the instrument. Adequate protection may be provided by any reasonable means.

[\[Comment\]](#)

§ 3-310. EFFECT OF INSTRUMENT ON OBLIGATION FOR WHICH TAKEN.

(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.

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

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

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

(3) Except as provided in paragraph (4), if the [check](#) or [note](#) is dishonored and the obligee of the obligation for which the [instrument](#) was taken is the [person entitled to enforce](#) the instrument, the obligee may enforce either the instrument or the obligation. In the case of an instrument of a third person which is negotiated to the obligee by the obligor, discharge of the obligor on the instrument also discharges the obligation.

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

(c) If an [instrument](#) other than one described in subsection (a) or (b) is taken for an obligation, the effect is (i) that stated in subsection (a) if the instrument is one on which a bank is liable as [maker](#) or [acceptor](#), or (ii) that stated in subsection (b) in any other case.

[[Comment](#)]

§ 3-311. ACCORD AND SATISFACTION BY USE OF INSTRUMENT.

(a) If a person against whom a claim is asserted [proves](#) that (i) that person in [good faith](#) tendered an [instrument](#) to the claimant as full satisfaction of the claim, (ii) the amount of the claim was unliquidated or subject to a bona fide dispute, and (iii) the claimant obtained payment of the instrument, the following subsections apply.

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

(c) Subject to subsection (d), a claim is not discharged under subsection (b) if either of the following applies:

(1) The claimant, if an organization, [proves](#) that (i) within a reasonable time before the tender, the claimant sent a conspicuous statement to the person against whom the claim is asserted that communications concerning disputed debts, including an [instrument](#) tendered as full satisfaction of a debt, are to be sent to a designated person, office, or place, and (ii) the instrument or accompanying communication was not received by that designated person, office, or place.

(2) The claimant, whether or not an organization, [proves](#) that within 90 days after payment of the [instrument](#), the claimant tendered repayment of the amount of the instrument to the person against whom the claim is asserted. This paragraph does not apply if the claimant is an organization that that sent a statement complying with paragraph (1)(i).

(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.

[[Comment](#)]

§ 3-312. LOST, DESTROYED, OR STOLEN CASHIER'S CHECK, TELLER'S CHECK, OR CERTIFIED CHECK.

(a) In this section:

(1) "**Check**" means a [cashier's check](#), [teller's check](#), or [certified check](#).

(2) "**Claimant**" means a person who claims the right to receive the amount of a [cashier's check](#), [teller's check](#), or [certified check](#) that was lost, destroyed, or stolen.

(3) "**Declaration of loss**" means a written statement, made under penalty of perjury, to the effect that (i) the declarer lost possession of a check, (ii) the declarer is the [drawer](#) or payee of the check, in the case of a [certified check](#), or the remitter or payee of the check, in the case of a [cashier's check](#) or [teller's check](#), (iii) the loss of possession was not the result of a transfer by the declarer or a lawful seizure, and (iv) the declarer cannot reasonably obtain possession of the check because the check was destroyed, its whereabouts cannot be determined, or it is in the wrongful possession of an unknown person or a person that cannot be found or is not amenable to service of process.

(4) "**Obligated bank**" means the issuer of a [cashier's check](#) or [teller's check](#) or the acceptor of a [certified check](#).

(b) A claimant may assert a claim to the amount of a check by a communication to the obligated bank describing the check with reasonable certainty and requesting payment of the amount of the check, if (i) the claimant is the [drawer](#) or payee of a [certified check](#) or the [remitter](#) or payee of a [cashier's check](#) or [teller's check](#), (ii) the communication contains or is accompanied by a declaration of loss of the claimant with respect to the check, (iii) the communication is received at a time and in a manner affording the bank a reasonable time to act on it before the check is paid, and (iv) the claimant provides reasonable identification if requested by the obligated bank. Delivery of a declaration of loss is a warranty of the truth of the statements made in the declaration. If a claim is asserted in compliance with this subsection, the following rules apply:

(1) The claim becomes enforceable at the later of (i) the time the claim is asserted, or (ii) the 90th day following the date of the check, in the case of a [cashier's check](#) or [teller's check](#), or the 90th day following the date of the [acceptance](#), in the case of a [certified check](#).

(2) Until the claim becomes enforceable, it has no legal effect and the obligated bank may pay the check or, in the case of a [teller's check](#), may permit the [drawee](#) to pay the check. Payment to a [person entitled to enforce](#) the check discharges all liability of the obligated bank with respect to the check.

(3) If the claim becomes enforceable before the check is presented for payment, the obligated bank is not obliged to pay the check.

(4) When the claim becomes enforceable, the obligated bank becomes obliged to pay the amount of the check to the claimant if payment of the check has not been made to a [person entitled to enforce](#) the check. Subject to Section [4-302\(a\)\(1\)](#), payment to the claimant discharges all liability of the obligated bank with respect to the check.

(c) If the [obligated bank](#) pays the amount of a check to a claimant under subsection (b)(4) and the check is presented for payment by a person having rights of a [holder in due course](#), the claimant is obliged to (i) refund the payment to the obligated bank if the check is paid, or (ii) pay the amount of the check to the person having rights of a holder in due course if the check is dishonored.

(d) If a claimant has the right to assert a claim under subsection (b) and is also a [person entitled to enforce](#) a [cashier's check](#), [teller's check](#), or [certified check](#) which is lost, destroyed, or stolen, the claimant may assert rights with respect to the check either under this section or Section [3-309](#).

[\[Comment\]](#)

PART 4. LIABILITY OF PARTIES

§ 3-401. SIGNATURE.

(a) A person is not liable on an [instrument](#) unless (i) the person signed the instrument, or (ii) the person is represented by an agent or representative who signed the instrument and the signature is binding on the [represented person](#) under Section [3-402](#).

(b) A signature may be made (i) manually or by means of a device or machine, and (ii) by the use of any name, including a trade or assumed name, or by a word, mark, or symbol executed or adopted by a person with present intention to authenticate a writing.

[\[Comment\]](#)

§ 3-402. SIGNATURE BY REPRESENTATIVE.

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

(b) If a representative signs the name of the representative to an [instrument](#) and the signature is an authorized signature of the [represented person](#), the following rules apply:

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

(2) Subject to subsection (c), if (i) the form of the signature does not show unambiguously that the signature is made in a representative capacity or (ii) the [represented person](#) is not identified in the [instrument](#), the representative is liable on the instrument to a [holder in due course](#) that took the instrument without notice that the representative was not intended to be liable on the instrument. With respect to any other person, the representative is liable on the instrument unless the representative [proves](#) that the original parties did not intend the representative to be liable on the instrument.

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

[\[Comment\]](#)

§ 3-403. UNAUTHORIZED SIGNATURE.

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

(b) 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.

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

[\[Comment\]](#)

§ 3-404. IMPOSTORS; FICTITIOUS PAYEES.

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

(b) If (i) a person whose intent determines to whom an [instrument](#) is payable (Section [3-110\(a\)](#) or (b)) does not intend the person identified as payee to have any interest in the instrument, or (ii) the person identified as payee of an instrument is a

fictitious person, the following rules apply until the instrument is negotiated by special [indorsement](#):

(1) Any person in possession of the [instrument](#) is its holder.

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

(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.

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

[\[Comment\]](#)

§ 3-405. EMPLOYER'S RESPONSIBILITY FOR FRAUDULENT INDORSEMENT BY EMPLOYEE.

(a) In this section:

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

(2) "**Fraudulent indorsement**" means (i) in the case of an [instrument](#) payable to the employer, a forged [indorsement](#) purporting to be that of the employer, or (ii) in the case of an instrument with respect to which the employer is the [issuer](#), a forged indorsement purporting to be that of the person identified as payee.

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

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

(c) Under subsection (b), 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.

[\[Comment\]](#)

§ 3-406. NEGLIGENCE CONTRIBUTING TO FORGED SIGNATURE OR ALTERATION OF INSTRUMENT.

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

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

(c) Under subsection (a), the burden of proving failure to exercise [ordinary care](#) is on the person asserting the preclusion. Under subsection (b), the burden of proving failure to exercise ordinary care is on the person precluded.

[\[Comment\]](#)

§ 3-407. ALTERATION.

(a) "**Alteration**" means (i) an unauthorized change in an [instrument](#) that purports to modify in any respect the obligation of a [party](#), or (ii) an unauthorized addition of words or numbers or other change to an [incomplete instrument](#) relating to the obligation of a party.

(b) Except as provided in subsection (c), an alteration fraudulently made discharges a [party](#) whose obligation is affected by the alteration unless that party assents or is

precluded from asserting the [alteration](#). No other alteration discharges a party, and the [instrument](#) may be enforced according to its original terms.

(c) A payor bank or [drawee](#) paying a fraudulently altered [instrument](#) or a person taking it for value, in [good faith](#) and without notice of the alteration, may enforce rights with respect to the instrument (i) according to its original terms, or (ii) in the case of an [incomplete instrument](#) altered by unauthorized completion, according to its terms as completed.

[[Comment](#)]

§ 3-408. DRAWEE NOT LIABLE ON UNACCEPTED DRAFT.

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

[[Comment](#)]

§ 3-409. ACCEPTANCE OF DRAFT; CERTIFIED CHECK.

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

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

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

(d) "**Certified check**" means a [check](#) accepted by the bank on which it is drawn. Acceptance may be made as stated in subsection (a) or by a writing on the check which indicates that the check is certified. The [drawee](#) of a check has no obligation to certify the check, and refusal to certify is not dishonor of the check.

[[Comment](#)]

§ 3-410. ACCEPTANCE VARYING DRAFT.

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

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

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

[[Comment](#)]

§ 3-411. REFUSAL TO PAY CASHIER'S CHECKS, TELLER'S CHECKS, AND CERTIFIED CHECKS.

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

(b) If the obligated bank wrongfully (i) refuses to pay a [cashier's check](#) or [certified check](#), (ii) stops payment of a [teller's check](#), or (iii) refuses to pay a dishonored teller's check, 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.

(c) Expenses or consequential damages under subsection (b) are not recoverable if the refusal of the obligated bank to pay occurs because (i) the bank suspends payments, (ii) the obligated bank asserts a claim or defense of the bank that it has reasonable grounds to believe is available against the [person entitled to enforce the instrument](#), (iii) the obligated bank has a reasonable doubt whether the person demanding payment is the person entitled to enforce the instrument, or (iv) payment is prohibited by law.

[[Comment](#)]

§ 3-412. OBLIGATION OF ISSUER OF NOTE OR CASHIER'S CHECK.

The [issuer](#) of a [note](#) or [cashier's check](#) or other [draft](#) drawn on the [drawer](#) is obliged to pay the [instrument](#) (i) according to its terms at the time it was [issued](#) or, if not issued, at the time it first came into possession of a holder, or (ii) if the issuer signed an [incomplete instrument](#), according to its terms when completed, to the extent stated in Sections [3-115](#) and [3-407](#). The obligation is owed to a [person entitled to enforce](#) the instrument or to an [indorser](#) who paid the instrument under Section [3-415](#).

[[Comment](#)]

§ 3-413. OBLIGATION OF ACCEPTOR.

(a) The [acceptor](#) of a [draft](#) is obliged to pay the draft (i) according to its terms at the time it was accepted, even though the [acceptance](#) states that the draft is payable "as originally drawn" or equivalent terms, (ii) if the acceptance varies the terms of the draft, according to the terms of the draft as varied, or (iii) if the acceptance is of a [draft](#) that is an [incomplete instrument](#), according to its terms when completed, to the extent stated in Sections [3-115](#) and [3-407](#). The obligation is owed to a [person](#)

[entitled to enforce](#) the draft or to the [drawer](#) or an indorser who paid the draft under Section [3-414](#) or [3-415](#).

(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.

[[Comment](#)]

§ 3-414. OBLIGATION OF DRAWER.

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

(b) If an unaccepted [draft](#) is dishonored, the [drawer](#) is obliged to pay the draft (i) according to its terms at the time it was [issued](#) or, if not issued, at the time it first came into possession of a holder, or (ii) if the drawer signed an [incomplete instrument](#), according to its terms when completed, to the extent stated in Sections [3-115](#) and [3-407](#). The obligation is owed to a [person entitled to enforce](#) the draft or to an [indorser](#) who paid the draft under Section [3-415](#).

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

(d) If a [draft](#) is accepted and the [acceptor](#) is not a bank, the obligation of the [drawer](#) to pay the draft if the draft is dishonored by the acceptor is the same as the obligation of an [indorser](#) under Section [3-415\(a\)](#) and (c).

(e) If a [draft](#) states that it is drawn "without recourse" or otherwise disclaims liability of the [drawer](#) to pay the draft, the drawer is not liable under subsection (b) to pay the draft if the draft is not a [check](#). A disclaimer of the liability stated in subsection (b) is not effective if the draft is a check.

(f) If (i) a [check](#) is not presented for payment or given to a depository bank for collection within 30 days after its date, (ii) the [drawee](#) suspends payments after expiration of the 30-day period without paying the check, and (iii) because of the suspension of payments, the [drawer](#) is deprived of funds maintained with the drawee to cover payment of the check, the drawer to the extent deprived of funds may discharge its obligation to pay the check by assigning to the [person entitled to enforce](#) the check the rights of the drawer against the drawee with respect to the funds.

[[Comment](#)]

§ 3-415. OBLIGATION OF INDORSER.

(a) Subject to subsections (b), (c), and (d) and to Section [3-419\(d\)](#), if an [instrument](#) is dishonored, an [indorser](#) is obliged to pay the amount due on the instrument (i) according to the terms of the instrument at the time it was indorsed, or (ii) if the indorser indorsed an [incomplete instrument](#), according to its terms when completed, to the extent stated in Sections [3-115](#) and [3-407](#). The obligation of the indorser is owed to a [person entitled to enforce](#) the instrument or to a subsequent indorser who paid the instrument under this section.

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

(c) If notice of dishonor of an [instrument](#) is required by Section [3-503](#) and notice of dishonor complying with that section is not given to an [indorser](#), the liability of the indorser under subsection (a) is discharged.

(d) If a [draft](#) is accepted by a bank after an [indorsement](#) is made, the liability of the [indorser](#) under subsection (a) is discharged.

(e) If an [indorser](#) of a [check](#) is liable under subsection (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](#) was made, the liability of the indorser under subsection (a) is discharged.

[[Comment](#)]

[[Permanent Editorial Board Commentary](#)]

§ 3-416. TRANSFER WARRANTIES.

(a) A person who transfers an [instrument](#) for [consideration](#) warrants to the transferee and, if the transfer is by [indorsement](#), to any subsequent transferee that:

- (1) the warrantor is a [person entitled to enforce](#) the [instrument](#);
- (2) all signatures on the [instrument](#) are authentic and authorized;
- (3) the [instrument](#) has not been altered;
- (4) the [instrument](#) is not subject to a defense or claim in recoupment of any [party](#) which can be asserted against the warrantor; and
- (5) the warrantor has no knowledge of any insolvency proceeding commenced with respect to the [maker](#) or [acceptor](#) or, in the case of an unaccepted [draft](#), the [drawer](#).

(b) A person to whom the warranties under subsection (a) are made and who took the [instrument](#) in [good faith](#) may recover from the warrantor as damages for breach of warranty an amount equal to the loss suffered as a result of the breach, but not

more than the amount of the instrument plus expenses and loss of interest incurred as a result of the breach.

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

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

[\[Comment\]](#)

§ 3-417. PRESENTMENT WARRANTIES.

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

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

(2) the [draft](#) has not been altered; and

(3) the warrantor has no knowledge that the signature of the [drawer](#) of the [draft](#) is unauthorized.

(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 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.

(c) If a [drawee](#) asserts a claim for breach of warranty under subsection (a) based on an unauthorized [indorsement](#) of the [draft](#) or an [alteration](#) of the draft, the warrantor may defend by proving that the indorsement is effective under Section [3-404](#) or [3-405](#) or the [drawer](#) is precluded under Section [3-406](#) or [4-406](#) from asserting against the drawee the unauthorized indorsement or alteration.

(d) If (i) a dishonored [draft](#) is presented for payment to the [drawer](#) or an [indorser](#) or (ii) any other [instrument](#) is presented for payment to a [party](#) obliged to pay the instrument, and (iii) payment is received, the following rules apply:

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

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

(e) The warranties stated in subsections (a) and (d) cannot be disclaimed with respect to [checks](#). Unless notice of a claim for breach of warranty is given to the warrantor within 30 days after the claimant has reason to know of the breach and the identity of the warrantor, the liability of the warrantor under subsection (b) or (d) is discharged to the extent of any loss caused by the delay in giving notice of the claim.

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

[\[Comment\]](#)

§ 3-418. PAYMENT OR ACCEPTANCE BY MISTAKE.

(a) Except as provided in subsection (c), if the [drawee](#) of a [draft](#) pays or accepts the draft and the drawee acted on the mistaken belief that (i) payment of the draft had not been stopped pursuant to Section [4-403](#) or (ii) the signature of the [drawer](#) of the draft was authorized, the drawee may recover the amount of the draft from the person to whom or for whose benefit payment was made or, in the case of [acceptance](#), may revoke the acceptance. Rights of the drawee under this subsection are not affected by failure of the drawee to exercise [ordinary care](#) in paying or accepting the draft.

(b) Except as provided in subsection (c), if an [instrument](#) has been paid or accepted by mistake and the case is not covered by subsection (a), the person paying or accepting may, to the extent permitted by the law governing mistake and restitution, (i) recover the payment from the person to whom or for whose benefit payment was made or (ii) in the case of [acceptance](#), may revoke the acceptance.

(c) The remedies provided by subsection (a) or (b) may not be asserted against a person who took the [instrument](#) in [good faith](#) and for value or who in good faith changed position in reliance on the payment or [acceptance](#). This subsection does not limit remedies provided by Section [3-417](#) or [4-407](#).

(d) Notwithstanding Section [4-215](#), if an [instrument](#) is paid or accepted by mistake and the payor or [acceptor](#) recovers payment or revokes [acceptance](#) under subsection (a) or (b), 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.

[\[Comment\]](#)

§ 3-419. INSTRUMENTS SIGNED FOR ACCOMMODATION.

(a) If an [instrument](#) is [issued](#) for value given for the benefit of a [party](#) to the instrument ("**accommodated party**") and another party to the instrument ("**accommodation party**") signs the instrument for the purpose of incurring liability on the instrument without being a direct beneficiary of the value given for the instrument, the instrument is signed by the accommodation party "**for accommodation.**"

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

(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. Except as provided in Section [3-605](#), the obligation of an accommodation party to pay the instrument is not affected by the fact that the person enforcing the obligation had notice when the instrument was taken by that person that the accommodation party signed the instrument for accommodation.

(d) If the signature of a [party](#) to an [instrument](#) is accompanied by words indicating unambiguously that the party is guaranteeing collection rather than payment of the obligation of another party to the instrument, the signer is obliged to pay the amount due on the instrument to a [person entitled to enforce](#) the instrument only if (i) execution of judgment against the other party has been returned unsatisfied, (ii) the other party is insolvent or in an insolvency proceeding, (iii) the other party cannot be served with process, or (iv) it is otherwise apparent that payment cannot be obtained from the other party.

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

[\[Comment\]](#)

[\[Permanent Editorial Board Commentary\]](#)

§ 3-420. CONVERSION OF INSTRUMENT.

(a) The law applicable to conversion of personal property applies to [instruments](#). An instrument is also converted if it is taken by transfer, other than a [negotiation](#), from a person not entitled to enforce the instrument or a bank makes or obtains payment with respect to the instrument for a person not entitled to enforce the instrument or receive payment. An action for conversion of an instrument may not be brought by

(i) the [issuer](#) or [acceptor](#) of the instrument or (ii) a payee or indorsee who did not receive delivery of the instrument either directly or through delivery to an agent or a co-payee.

(b) In an action under subsection (a), 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.

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

[[Comment](#)]

PART 5. DISHONOR

§ 3-501. PRESENTMENT.

(a) "**Presentment**" means a demand made by or on behalf of a [person entitled to enforce](#) an [instrument](#) (i) to pay the instrument made to the [drawee](#) or a [party](#) obliged to pay the instrument or, in the case of a [note](#) or accepted [draft](#) payable at a bank, to the bank, or (ii) to accept a draft made to the drawee.

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

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

(2) Upon demand of the person to whom [presentment](#) is made, the person making presentment must (i) exhibit the [instrument](#), (ii) give reasonable identification and, if presentment is made on behalf of another person, reasonable evidence of authority to do so, and (iii) sign a receipt on the instrument for any payment made or surrender the instrument if full payment is made.

(3) Without dishonoring the [instrument](#), the [party](#) to whom [presentment](#) is made may (i) return the instrument for lack of a necessary [indorsement](#), or (ii) refuse payment or [acceptance](#) for failure of the presentment to comply with the terms of the instrument, an agreement of the parties, or other applicable law or rule.

(4) The [party](#) to whom [presentment](#) is made may treat presentment as occurring on the next business day after the day of presentment if the party to whom presentment is made has established a cut-off hour not earlier than 2 p.m. for

the receipt and processing of [instruments](#) presented for payment or [acceptance](#) and presentment is made after the cut-off hour.

[[Comment](#)]

§ 3-502. DISHONOR.

(a) Dishonor of a [note](#) is governed by the following rules:

- (1) If the [note](#) is payable on demand, the note is dishonored if [presentment](#) is duly made to the [maker](#) and the note is not paid on the day of presentment.
- (2) If the [note](#) is not payable on demand and is payable at or through a bank or the terms of the note require [presentment](#), the note is dishonored if presentment is duly made and the note is not paid on the day it becomes payable or the day of presentment, whichever is later.
- (3) If the [note](#) is not payable on demand and paragraph (2) does not apply, the note is dishonored if it is not paid on the day it becomes payable.

(b) Dishonor of an unaccepted [draft](#) other than a documentary draft is governed by the following rules:

- (1) If a [check](#) is duly presented for payment to the payor bank otherwise than for immediate payment over the counter, the check is dishonored if the payor bank makes timely return of the check or sends timely notice of dishonor or nonpayment under Section [4-301](#) or [4-302](#), or becomes accountable for the amount of the [check](#) under Section [4-302](#).
- (2) If a [draft](#) is payable on demand and paragraph (1) does not apply, the draft is dishonored if [presentment](#) for payment is duly made to the [drawee](#) and the draft is not paid on the day of presentment.
- (3) If a [draft](#) is payable on a date stated in the draft, the draft is dishonored if (i) [presentment](#) for payment is duly made to the [drawee](#) and payment is not made on the day the draft becomes payable or the day of presentment, whichever is later, or (ii) presentment for [acceptance](#) is duly made before the day the draft becomes payable and the draft is not accepted on the day of presentment.
- (4) If a [draft](#) is payable on elapse of a period of time after sight or [acceptance](#), the draft is dishonored if [presentment](#) for acceptance is duly made and the draft is not accepted on the day of presentment.

(c) Dishonor of an unaccepted documentary [draft](#) occurs according to the rules stated in subsection (b)(2), (3), and (4), except that payment or [acceptance](#) may be delayed without dishonor until no later than the close of the third business day of the [drawee](#) following the day on which payment or acceptance is required by those paragraphs.

(d) Dishonor of an accepted [draft](#) is governed by the following rules:

(1) If the [draft](#) is payable on demand, the draft is dishonored if [presentment](#) for payment is duly made to the [acceptor](#) and the draft is not paid on the day of presentment.

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

(e) In any case in which [presentment](#) is otherwise required for dishonor under this section and presentment is excused under Section [3-504](#), dishonor occurs without presentment if the [instrument](#) is not duly accepted or paid.

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

[[Comment](#)]

§ 3-503. NOTICE OF DISHONOR.

(a) The obligation of an [indorser](#) stated in Section [3-415\(a\)](#) and the obligation of a [drawer](#) stated in Section [3-414\(d\)](#) may not be enforced unless (i) the indorser or drawer is given notice of dishonor of the [instrument](#) complying with this section or (ii) notice of dishonor is excused under Section [3-504\(b\)](#).

(b) Notice of dishonor may be given by any person; may be given by any commercially reasonable means, including an oral, written, or electronic communication; and is sufficient if it reasonably identifies the [instrument](#) and indicates that the instrument has been dishonored or has not been paid or accepted. Return of an instrument given to a bank for collection is sufficient notice of dishonor.

(c) Subject to Section [3-504\(c\)](#), with respect to an [instrument](#) taken for collection by a collecting bank, notice of dishonor must be given (i) by the bank before midnight of the next banking day following the banking day on which the bank receives notice of dishonor of the instrument, or (ii) by any other person within 30 days following the day on which the person receives notice of dishonor. With respect to any other instrument, notice of dishonor must be given within 30 days following the day on which dishonor occurs.

[[Comment](#)]

§ 3-504. EXCUSED PRESENTMENT AND NOTICE OF DISHONOR.

(a) Presentment for payment or [acceptance](#) of an [instrument](#) is excused if (i) the person entitled to present the instrument cannot with reasonable diligence make presentment, (ii) the [maker](#) or [acceptor](#) has repudiated an obligation to pay the instrument or is dead or in insolvency proceedings, (iii) by the terms of the [instrument](#) [presentment](#) is not necessary to enforce the obligation of [indorsers](#) or the [drawer](#), (iv) the drawer or indorser whose obligation is being enforced has waived

[presentment](#) or otherwise has no reason to expect or right to require that the instrument be paid or accepted, or (v) the drawer instructed the [drawee](#) not to pay or accept the [draft](#) or the drawee was not obligated to the drawer to pay the draft.

(b) Notice of dishonor is excused if (i) by the terms of the [instrument](#) notice of dishonor is not necessary to enforce the obligation of a [party](#) to pay the instrument, or (ii) the party whose obligation is being enforced waived notice of dishonor. A waiver of [presentment](#) is also a waiver of notice of dishonor.

(c) Delay in giving notice of dishonor is excused if the delay was caused by circumstances beyond the control of the person giving the notice and the person giving the notice exercised reasonable diligence after the cause of the delay ceased to operate.

[[Comment](#)]

§ 3-505. EVIDENCE OF DISHONOR.

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

(1) a document regular in form as provided in subsection (b) which purports to be a protest;

(2) a purported stamp or writing of the [drawee](#), payor bank, or presenting bank on or accompanying the [instrument](#) stating that [acceptance](#) or payment has been refused unless reasons for the refusal are stated and the reasons are not consistent with dishonor;

(3) a book or record of the [drawee](#), payor bank, or collecting bank, kept in the usual course of business which shows dishonor, even if there is no evidence of who made the entry.

(b) A protest is a certificate of dishonor made by a United States consul or vice consul, or a notary public or other person authorized to administer oaths by the law of the place where dishonor occurs. It may be made upon information satisfactory to that person. The protest must identify the [instrument](#) and certify either that [presentment](#) has been made or, if not made, the reason why it was not made, and that the instrument has been dishonored by nonacceptance or nonpayment. The protest may also certify that notice of dishonor has been given to some or all parties.

[[Comment](#)]

PART 6. DISCHARGE AND PAYMENT

§ 3-601. DISCHARGE AND EFFECT OF DISCHARGE.

(a) The obligation of a [party](#) to pay the [instrument](#) is discharged as stated in this Article or by an act or agreement with the [party](#) which would discharge an obligation to pay money under a simple contract.

(b) Discharge of the obligation of a [party](#) is not effective against a person acquiring rights of a [holder in due course](#) of the [instrument](#) without notice of the discharge.

[[Comment](#)]

§ 3-602. PAYMENT.

(a) Subject to subsection (b), an [instrument](#) is paid to the extent payment is made (i) by or on behalf of a [party](#) obliged to pay the instrument, and (ii) to a [person entitled to enforce](#) the instrument. To the extent of the payment, the obligation of the party obliged to pay the instrument is discharged even though payment is made with knowledge of a claim to the instrument under Section [3-306](#) by another person.

(b) The obligation of a [party](#) to pay the [instrument](#) is not discharged under subsection (a) if:

(1) a claim to the [instrument](#) under Section [3-306](#) is enforceable against the [party](#) receiving payment and (i) payment is made with knowledge by the payor that payment is prohibited by injunction or similar process of a court of competent jurisdiction, or (ii) in the case of an instrument other than a [cashier's check](#), [teller's check](#), or [certified check](#), the party making payment accepted, from the person having a claim to the instrument, indemnity against loss resulting from refusal to pay the [person entitled to enforce](#) the instrument; or

(2) the person making payment knows that the [instrument](#) is a stolen instrument and pays a person it knows is in wrongful possession of the instrument.

[[Comment](#)]

§ 3-603. TENDER OF PAYMENT.

(a) If tender of payment of an obligation to pay an [instrument](#) is made to a [person entitled to enforce](#) the instrument, the effect of tender is governed by principles of law applicable to tender of payment under a simple contract.

(b) If tender of payment of an obligation to pay an [instrument](#) is made to a [person entitled to enforce](#) the instrument and the tender is refused, there is discharge, to the extent of the amount of the tender, of the obligation of an [indorser](#) or accommodation [party](#) having a right of recourse with respect to the obligation to which the tender relates.

(c) If tender of payment of an amount due on an [instrument](#) is made to a [person entitled to enforce](#) the instrument, the obligation of the obligor to pay interest after the due date on the amount tendered is discharged. If [presentment](#) is required with respect to an instrument and the obligor is able and ready to pay on the due date at every place of payment stated in the instrument, the obligor is deemed to have

made tender of payment on the due date to the person entitled to enforce the instrument.

[[Comment](#)]

§ 3-604. DISCHARGE BY CANCELLATION OR RENUNCIATION.

(a) A [person entitled to enforce](#) an [instrument](#), with or without [consideration](#), may discharge the obligation of a [party](#) to pay the instrument (i) by an intentional voluntary act, such as surrender of the instrument to the party, destruction, mutilation, or cancellation of the instrument, cancellation or striking out of the party's signature, or the addition of words to the instrument indicating discharge, or (ii) by agreeing not to sue or otherwise renouncing rights against the party by a signed writing.

(b) Cancellation or striking out of an [indorsement](#) pursuant to subsection (a) does not affect the status and rights of a [party](#) derived from the indorsement.

[[Comment](#)]

§ 3-605. DISCHARGE OF INDORSERS AND ACCOMMODATION PARTIES.

(a) In this section, the term "**indorser**" includes a [drawer](#) having the obligation described in Section [3-414\(d\)](#).

(b) Discharge, under Section [3-604](#), of the obligation of a [party](#) to pay an [instrument](#) does not discharge the obligation of an indorser or accommodation party having a right of recourse against the discharged party.

(c) If a [person entitled to enforce](#) an [instrument](#) agrees, with or without [consideration](#), to an extension of the due date of the obligation of a [party](#) to pay the instrument, the extension discharges an indorser or accommodation party having a right of recourse against the party whose obligation is extended to the extent the indorser or accommodation party [proves](#) that the extension caused loss to the indorser or accommodation party with respect to the right of recourse.

(d) If a [person entitled to enforce](#) an [instrument](#) agrees, with or without [consideration](#), to a material modification of the obligation of a [party](#) other than an extension of the due date, the modification discharges the obligation of an [indorser](#) or accommodation party having a right of recourse against the person whose obligation is modified to the extent the modification causes loss to the indorser or accommodation party with respect to the right of recourse. The loss suffered by the indorser or accommodation party as a result of the modification is equal to the amount of the right of recourse unless the person enforcing the instrument [proves](#) that no loss was caused by the modification or that the loss caused by the modification was an amount less than the amount of the right of recourse.

(e) If the obligation of a [party](#) to pay an [instrument](#) is secured by an interest in collateral and a [person entitled to enforce](#) the instrument impairs the value of the interest in collateral, the obligation of an [indorser](#) or [accommodation party](#) having a right of recourse against the obligor is discharged to the extent of the impairment. The value of an interest in collateral is impaired to the extent (i) the value of the interest is reduced to an amount less than the amount of the right of recourse of the party asserting discharge, or (ii) the reduction in value of the interest causes an increase in the amount by which the amount of the right of recourse exceeds the value of the interest. The burden of proving impairment is on the party asserting discharge.

(f) If the obligation of a [party](#) is secured by an interest in collateral not provided by an [accommodation party](#) and a [person entitled to enforce](#) the [instrument](#) impairs the value of the interest in collateral, the obligation of any party who is jointly and severally liable with respect to the secured obligation is discharged to the extent the impairment causes the party asserting discharge to pay more than that party would have been obliged to pay, taking into account rights of contribution, if impairment had not occurred. If the party asserting discharge is an accommodation party not entitled to discharge under subsection (e), the party is deemed to have a right to contribution based on joint and several liability rather than a right to reimbursement. The burden of proving impairment is on the party asserting discharge.

(g) Under subsection (e) or (f), impairing value of an interest in collateral includes (i) failure to obtain or maintain perfection or recordation of the interest in collateral, (ii) release of collateral without substitution of collateral of equal value, (iii) failure to perform a duty to preserve the value of collateral owed, under Article 9 or other law, to a debtor or surety or other person secondarily liable, or (iv) failure to comply with applicable law in disposing of collateral.

(h) An [accommodation party](#) is not discharged under subsection (c), (d), or (e) unless the [person entitled to enforce](#) the [instrument](#) knows of the accommodation or has notice under Section [3-419\(c\)](#) that the instrument was signed for accommodation.

(i) A [party](#) is not discharged under this section if (i) the party asserting discharge consents to the event or conduct that is the basis of the discharge, or (ii) the [instrument](#) or a separate agreement of the party provides for waiver of discharge under this section either specifically or by general language indicating that parties waive defenses based on suretyship or impairment of collateral.

[\[Comment\]](#)

[\[Permanent Editorial Board Commentary\]](#)

OFFICIAL COMMENTS - ARTICLE 3

Official Comment [§ 3-101](#)

None.

Official Comment [§ 3-102](#)

1. Former Article 3 had no provision affirmatively stating its scope. Former Section 3-103 was a limitation on scope. In revised Article 3, Section [3-102](#) states that Article 3 applies to "negotiable instruments," defined in Section [3-104](#). Section [3-104\(b\)](#) also defines the term "instrument" as a synonym for "negotiable instrument." In most places Article 3 uses the shorter term "instrument." This follows the convention used in former Article 3.
2. The reference in former Section 3-103(1) to "documents of title" is omitted as superfluous because these documents contain no [promise](#) to pay money. The definition of "payment order" in Section [4A-103\(a\)\(1\)\(iii\)](#) excludes [drafts](#) which are governed by Article 3. Section [3-102\(a\)](#) makes clear that a payment order governed by Article 4A is not governed by Article 3. Thus, Article 3 and Article 4A are mutually exclusive.

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

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

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

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

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

5. In 1989 the United Nations Commission on International Trade Law completed a Convention on International Bills of Exchange and International Promissory Notes. If the United States becomes a party to this Convention, the Convention will preempt state law with respect to international bills and notes governed by the Convention. Thus, an international bill of exchange or promissory note that meets the definition of [instrument](#) in Section [3-104](#) will not be governed by Article 3 if it is governed by the Convention.

Official Comment [§ 3-103](#)

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

2. The definition of "order" includes an instruction given by the signer to itself. The most common example of this kind of [order](#) is a [cashier's check](#): a [draft](#) with respect to which the [drawer](#) and [drawee](#) are the same bank or branches of the

same bank. Former Section 3-118(a) treated a cashier's check as a [note](#). It stated "a draft drawn on the drawer is effective as a note." Although it is technically more correct to treat a [cashier's check](#) as a [promise](#) by the issuing bank to pay rather than an [order](#) to pay, a cashier's check is in the form of a [check](#) and it is normally referred to as a check. Thus, revised Article 3 follows banking practice in referring to a cashier's check as both a draft and a check rather than a note. Some insurance companies also follow the practice of issuing drafts in which the drawer draws on itself and makes the draft payable at or through a bank. These [instruments](#) are also treated as drafts. The obligation of the drawer of a cashier's check or other draft drawn on the drawer is stated in Section [3-412](#).

An [order](#) may be addressed to more than one person as [drawee](#) either jointly or in the alternative. The authorization of alternative drawees follows former Section 3-102(1)(b) and recognizes the practice of [drawers](#), such as corporations issuing dividend [checks](#), who for commercial convenience name a number of drawees, usually in different parts of the country. Section [3-501\(b\)\(1\)](#) provides that [presentment](#) may be made to any one of multiple drawees. Drawees in succession are not permitted because the holder should not be required to make more than one presentment. Dishonor by any drawee named in the [draft](#) entitles the holder to rights of recourse against the drawer or [indorsers](#).

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

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

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

Official Comment [§ 3-104](#)

1. The definition of "negotiable instrument" defines the scope of Article 3 since Section [3-102](#) states: "This Article applies to negotiable instruments." The definition in Section [3-104\(a\)](#) incorporates other definitions in Article 3. An [instrument](#) is either a "promise," defined in Section [3-103\(a\)\(9\)](#), or "order," defined in Section [3-103\(a\)\(6\)](#). A [promise](#) is a written undertaking to pay money signed by the person undertaking to pay. An [order](#) is a written instruction to pay money signed by the person giving the instruction. Thus, the term "negotiable instrument" is limited to a signed writing that orders or promises payment of

money. "Money" is defined in Section [1-201\(24\)](#) and is not limited to United States dollars. It also includes a medium of exchange established by a foreign government or monetary units of account established by an intergovernmental organization or by agreement between two or more nations. Five other requirements are stated in Section [3-104\(a\)](#): First, the promise or order must be "unconditional." The quoted term is explained in Section [3-106](#). Second, the amount of money must be "a fixed amount * * * with or without interest or other charges described in the promise or order." Section [3-112\(b\)](#) relates to "interest." Third, the [promise](#) or [order](#) must be "payable to bearer or to order." The quoted phrase is explained in Section [3-109](#). An exception to this requirement is stated in subsection (c). Fourth, the promise or order must be payable "on demand or at a definite time." The quoted phrase is explained in Section [3-108](#). Fifth, the promise or order may not state "any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money" with three exceptions. The quoted phrase is based on the first sentence of N.I.L. Section 5 which is the precursor of "no other promise, order, obligation or power given by the maker or drawer" appearing in former Section 3-104(1)(b). The words "instruction" and "undertaking" are used instead of "order" and "promise" that are used in the N.I.L. formulation because the latter words are defined terms that include only [orders](#) or [promises](#) to pay money. The three exceptions stated in Section [3-104\(a\)\(3\)](#) are based on and are intended to have the same meaning as former Section 3-112(1)(b), (c), (d), and (e), as well as N.I.L. § 5(1), (2), and (3). Subsection (b) states that "instrument" means a "negotiable instrument." This follows former Section 3-102(1)(e) which treated the two terms as synonymous.

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

Total exclusion from Article 3 of other [promises](#) or [orders](#) that are not payable to bearer or to order serves a useful purpose. It provides a simple device to clearly exclude a writing that does not fit the pattern of typical [negotiable instruments](#) and which is not intended to be a negotiable instrument. If a writing could be an [instrument](#) despite the absence of "to order" or "to bearer" language and a dispute arises with respect to the writing, it might be argued that the writing is a

negotiable instrument because the other requirements of subsection (a) are somehow met. Even if the argument is eventually found to be without merit it can be used as a litigation ploy. Words making a promise or order payable to bearer or to order are the most distinguishing feature of a negotiable instrument and such words are frequently referred to as "words of negotiability." Article 3 is not meant to apply to contracts for the sale of goods or services or the sale or lease of real property or similar writings that may contain a promise to pay money. The use of words of negotiability in such contracts would be an aberration. Absence of the words precludes any argument that such contracts might be negotiable instruments.

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

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

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

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

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

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

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

Official Comment [§ 3-105](#)

1. Under former Section 3-102(1)(a) "issue" was defined as the first delivery to a "holder or a remitter" but the term "remitter" was neither defined nor otherwise used. In revised Article 3, Section [3-105\(a\)](#) defines "issue" more broadly to include the first delivery to anyone by the [drawer](#) or [maker](#) for the purpose of giving rights to anyone on the [instrument](#). "Delivery" with respect to instruments is defined in Section [1-201\(14\)](#) as meaning "voluntary transfer of possession."
2. Subsection (b) continues the rule that nonissuance, conditional issuance or issuance for a special purpose is a defense of the [maker](#) or [drawer](#) of an [instrument](#). Thus, the defense can be asserted against a person other than a [holder in due course](#). The same rule applies to nonissuance of an [incomplete instrument](#) later completed.

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

Official Comment [§ 3-106](#)

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

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

Many [notes issued](#) in commercial transactions are secured by collateral, are subject to acceleration in the event of default, or are subject to prepayment. A statement of rights and obligations concerning collateral, prepayment, or acceleration does not prevent the note from being an [instrument](#) if the statement is in the [note](#) itself. See Section [3-104\(a\)\(3\)](#) and Section [3-108\(b\)](#). In some cases it may be convenient not to include a statement concerning collateral, prepayment, or acceleration in the note, but rather to refer to an accompanying loan agreement, security agreement or mortgage for that statement. Subsection (b)(i) allows a reference to the appropriate writing for a statement of these rights. For example, a note would not be made conditional by the following

statement: "This note is secured by a security interest in collateral described in a security agreement dated April 1, 1990 between the payee and maker of this note. Rights and obligations with respect to the collateral are [stated in] [governed by] the security agreement." The bracketed words are alternatives, either of which complies.

Subsection (b)(ii) addresses the issues covered by former Section 3-105(1)(f), (g), and (h) and Section 3-105(2)(b). Under Section [3-106\(a\)](#) a [promise](#) or [order](#) is not made conditional because payment is limited to payment from a particular source or fund. This reverses the result of former Section 3-105(2)(b). There is no cogent reason why the general credit of a legal entity must be pledged to have a [negotiable instrument](#). Market forces determine the marketability of [instruments](#) of this kind. If potential buyers don't want promises or orders that are payable only from a particular source or fund, they won't take them, but Article 3 should apply.

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

3. Subsection (d) concerns the effect of a statement to the effect that the rights of a holder or transferee are subject to claims and defenses that the [issuer](#) could assert against the original payee. The subsection applies only if the statement is required by statutory or administrative law. The prime example is the Federal Trade Commission Rule (16 C.F.R. Part 433) preserving consumers' claims and defenses in consumer credit sales. The intent of the FTC rule is to make it impossible for there to be a [holder in due course](#) of a [note](#) bearing the FTC legend and undoubtedly that is the result. But, under former Article 3, the legend may also have had the unintended effect of making the note conditional, thus excluding the note from former Article 3 altogether. Subsection (d) is designed to make it possible to preclude the possibility of a holder in due course without excluding the [instrument](#) from Article 3. Most of the provisions of Article

3 are not affected by the holder-in-due-course doctrine and there is no reason why Article 3 should not apply to a note bearing the FTC legend if holder-in-due-course rights are not involved. Under subsection (d) the statement does not make the note conditional. If the note otherwise meets the requirements of Section [3-104\(a\)](#) it is a [negotiable instrument](#) for all purposes except that there cannot be a holder in due course of the note. No particular form of legend or statement is required by subsection (d). The form of a particular legend or statement may be determined by the other statute or administrative law. For example, the FTC legend required in a [note](#) taken by the seller in a consumer sale of goods or services is tailored to that particular transaction and therefore uses language that is somewhat different from that stated in subsection (d), but the difference in expression does not affect the essential similarity of the message conveyed. The effect of the FTC legend is to make the rights of a holder or transferee subject to claims or defenses that the [issuer](#) could assert against the original payee of the note.

Official Comment [§ 3-107](#)

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

Official Comment [§ 3-108](#)

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

Official Comment [§ 3-109](#)

1. Under Section [3-104\(a\)](#), a [promise](#) or [order](#) cannot be an [instrument](#) unless the instrument is payable to bearer or to order when it is [issued](#) or unless Section [3-104\(c\)](#) applies. The terms "payable to bearer" and "payable to order" are defined in Section [3-109](#). The quoted terms are also relevant in determining how an instrument is negotiated. If the instrument is payable to bearer it can be negotiated by delivery alone. Section [3-201\(b\)](#). An instrument that is payable to

an identified person cannot be negotiated without the [indorsement](#) of the identified person. Section [3-201\(b\)](#). An instrument payable to order is payable to an identified person. Section [3-109\(b\)](#). Thus, an instrument payable to order requires the indorsement of the person to whose order the instrument is payable.

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

Official Comment [§ 3-110](#)

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

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

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

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

3. Subsection (c)(2) replaces former Section 3-117 and subsections (1)(e), (f), and (g) of former Section 3-110. This provision merely determines who can deal with an [instrument](#) as a holder. It does not determine ownership of the instrument or its proceeds. Subsection (c)(2)(i) covers trusts and estates. If the instrument is payable to the trust or estate or to the trustee or representative of the trust or estate, the instrument is payable to the trustee or representative or any successor. Under subsection (c)(2)(ii), if the instrument states that it is payable to Doe, President of X Corporation, either Doe or X Corporation can be holder of the instrument. Subsection (c)(2)(iii) concerns informal organizations that are not legal entities such as unincorporated clubs and the like. Any representative of the members of the organization can act as holder. Subsection (c)(2)(iv) applies principally to instruments payable to public offices such as a [check](#) payable to County Tax Collector.

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

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

Official Comment [§ 3-111](#)

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

Official Comment [§ 3-112](#)

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

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

Official Comment [§ 3-113](#)

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

Official Comment [§ 3-114](#)

Section 3-114 replaces subsections (b) and (c) of former Section 3-118.

Official Comment [§ 3-115](#)

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

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

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

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

Suppose Debtor pays Creditor by giving Creditor a [check](#) on which the space for the name of the payee is left blank. The check is an [instrument](#) but it is incomplete. The check is enforceable in its incomplete form and it is payable to bearer because it does not state a payee. Section [3-109\(a\)](#)(2). Thus, Creditor is a holder of the check. Normally in this kind of case Creditor would simply fill in the space with Creditor's name. When that occurs the check becomes payable to the Creditor.

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

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

Official Comment [§ 3-116](#)

1. Subsection (a) replaces subsection (e) of former Section 3-118. Subsection (b) states contribution rights of parties with joint and several liability by referring to applicable law. But subsection (b) is subject to Section [3-419\(e\)](#). If one of the parties with joint and several liability is an accommodation [party](#) and the other is the accommodated party, Section [3-419\(e\)](#) applies. Subsection (c) deals with discharge. The discharge of a jointly and severally liable obligor does not affect the right of other obligors to seek contribution from the discharged obligor.

2. Indorsers normally do not have joint and several liability. Rather, an earlier [indorser](#) has liability to a later indorser. But indorsers can have joint and several liability in two cases. If an [instrument](#) is payable to two payees jointly, both payees must indorse. The [indorsement](#) is a joint indorsement and the indorsers have joint and several liability and subsection (b) applies. The other case is that of two or more anomalous indorsers. The term is defined in Section [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 and subsection (b) applies.

Official Comment [§ 3-117](#)

1. The separate agreement might be a security agreement or mortgage or it might be an agreement that contradicts the terms of the [instrument](#). For example, a person may be induced to sign an instrument under an agreement that the signer will not be liable on the instrument unless certain conditions are met. Suppose X requested credit from Creditor who is willing to give the credit only if an acceptable accommodation [party](#) will sign the [note](#) of X as co-maker. Y agrees to sign as co-maker on the condition that Creditor also obtain the signature of Z as co-maker. Creditor agrees and Y signs as co-maker with X. Creditor fails to obtain the signature of Z on the note. Under Sections [3-412](#) and [3-419\(b\)](#), Y is obliged to pay the note, but Section [3-117](#) applies. In this case, the agreement modifies the terms of the note by stating a condition to the obligation of Y to pay the note. This case is essentially similar to a case in which a [maker](#) of a note is induced to sign the note by fraud of the holder. Although the agreement that Y not be liable on the note unless Z also signs may not have been fraudulently made, a subsequent attempt by Creditor to require Y to pay the note in violation of the agreement is a bad faith act. Section [3-117](#), in

treating the agreement as a defense, allows Y to assert the agreement against Creditor, but the defense would not be good against a subsequent [holder in due course](#) of the note that took it without notice of the agreement. If there cannot be a holder in due course because of Section [3-106\(d\)](#), a subsequent holder that took the note in [good faith](#), for value and without knowledge of the agreement would not be able to enforce the liability of Y. This result is consistent with the risk that a holder not in due course takes with respect to fraud in inducing issuance of an [instrument](#).

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

Official Comment [§ 3-118](#)

1. Section [3-118](#) differs from former Section 3-122, which states when a cause of action accrues on an [instrument](#). Section [3-118](#) does not define when a cause of action accrues. Accrual of a cause of action is stated in other sections of Article 3 such as those that state the various obligations of parties to an instrument. The only purpose of Section [3-118](#) is to define the time within which an action to enforce an obligation, duty, or right arising under Article 3 must be commenced. Section [3-118](#) does not attempt to state all rules with respect to a statute of limitations. For example, the circumstances under which the running of a limitations period may be tolled is left to other law pursuant to Section [1-103](#).

2. The first six subsections apply to actions to enforce an obligation of any [party](#) to an [instrument](#) to pay the instrument. This changes present law in that [indorsers](#) who may become liable on an instrument after [issue](#) are subject to a period of limitations running from the same date as that of the [maker](#) or [drawer](#). Subsections (a) and (b) apply to [notes](#). If the note is payable at a definite time, a six-year limitations period starts at the due date of the note, subject to prior acceleration. If the note is payable on demand, there are two limitations periods. Although a note payable on demand could theoretically be called a day after it was issued, the normal expectation of the parties is that the note will remain outstanding until there is some reason to call it. If the law provides that the limitations period does not start until demand is made, the cause of action to enforce it may never be barred. On the other hand, if the limitations period starts when demand for payment may be made, i.e. at any time after the note was issued, the payee of a note on which interest or portions of principal are being paid could lose the right to enforce the note even though it was treated as a continuing obligation by the parties. Some demand notes are not enforced because the payee has forgiven the debt. This is particularly true in family and other noncommercial transactions. A demand note found after the death of the payee may be presented for payment many years after it was issued. The maker may be a relative and it may be difficult to determine whether the note represents a real or a forgiven debt. Subsection (b) is designed to bar notes that

no longer represent a claim to payment and to require reasonably prompt action to enforce [notes](#) on which there is default. If a demand for payment is made to the [maker](#), a six-year limitations period starts to run when demand is made. The second sentence of subsection (b) bars an action to enforce a demand note if no demand has been made on the note and no payment of interest or principal has been made for a continuous period of 10 years. This covers the case of a note that does not bear interest or a case in which interest due on the note has not been paid. This kind of case is likely to be a family transaction in which a failure to demand payment may indicate that the holder did not intend to enforce the obligation but neglected to destroy the note. A limitations period that bars stale claims in this kind of case is appropriate if the period is relatively long.

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

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

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

6. Subsection (g) covers warranty and conversion cases and other actions to enforce obligations or rights arising under Article 3. A three-year period is stated and subsection (g) follows general law in stating that the period runs from the time the cause of action accrues. Since the traditional term "cause of action" may have been replaced in some states by "claim for relief" or some equivalent term, the words "cause of action" have been bracketed to indicate that the words may be replaced by an appropriate substitute to conform to local practice.

Official Comment [§ 3-119](#)

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

Official Comment [§ 3-201](#)

1. Subsections (a) and (b) are based in part on subsection (1) of former Section 3-202. A person can become holder of an [instrument](#) when the instrument is [issued](#) to that person, or the status of holder can arise as the result of an event that occurs after issuance. "Negotiation" is the term used in Article 3 to describe this post-issuance event. Normally, [negotiation](#) occurs as the result of a voluntary transfer of possession of an instrument by a holder to another person who becomes the holder as a result of the transfer. Negotiation always requires a change in possession of the instrument because nobody can be a holder without possessing the instrument, either directly or through an agent. But in some cases the transfer of possession is involuntary and in some cases the person transferring possession is not a holder. In defining "negotiation" former Section 3-202(1) used the word "transfer," an undefined term, and "delivery," defined in Section [1-201\(14\)](#) to mean voluntary change of possession. Instead, subsections (a) and (b) use the term "transfer of possession" and, subsection (a) states that negotiation can occur by an involuntary transfer of possession. For example, if an instrument is payable to bearer and it is stolen by Thief or is found by Finder, Thief or Finder becomes the holder of the instrument when possession is obtained. In this case there is an involuntary transfer of possession that results in negotiation to Thief or Finder.

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

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

Official Comment [§ 3-202](#)

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

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

3. There can be no rescission or other remedy against a [holder in due course](#) or a person who pays in [good faith](#) and without notice, even though the prior [negotiation](#) may have been fraudulent or illegal in its essence and entirely void. As against any other [party](#) the claimant may have any remedy permitted by law. This section is not intended to specify what that remedy may be, or to prevent any court from imposing conditions or limitations such as prompt action or return of the [consideration](#) received. All such questions are left to the law of the particular jurisdiction. Section [3-202](#) gives no right that would not otherwise exist. The section is intended to mean that any remedies afforded by other law are cut off only by a holder in due course.

Official Comment [§ 3-203](#)

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

Although transfer of an [instrument](#) might mean in a particular case that title to the instrument passes to the transferee, that result does not follow in all cases. The right to enforce an instrument and ownership of the instrument are two different concepts. A thief who steals a [check](#) payable to bearer becomes the holder of the check and a [person entitled to enforce](#) it, but does not become the owner of the check. If the thief transfers the check to a purchaser the transferee obtains the right to enforce the check. If the purchaser is not a [holder in due course](#), the owner's claim to the check may be asserted against the purchaser. Ownership rights in instruments may be determined by principles of the law of

property, independent of Article 3, which do not depend upon whether the instrument was transferred under Section [3-203](#). Moreover, a person who has an ownership right in an [instrument](#) might not be a person entitled to enforce the instrument. For example, suppose X is the owner and holder of an instrument payable to X. X sells the instrument to Y but is unable to deliver immediate possession to Y. Instead, X signs a document conveying all of X's right, title, and interest in the instrument to Y. Although the document may be effective to give Y a claim to ownership of the instrument, Y is not a person entitled to enforce the instrument until Y obtains possession of the instrument. No transfer of the [instrument](#) occurs under Section [3-203\(a\)](#) until it is delivered to Y.

An [instrument](#) is a reified right to payment. The right is represented by the instrument itself. The right to payment is transferred by delivery of possession of the instrument "by a person other than its [issuer](#) for the purpose of giving to the person receiving delivery the right to enforce the instrument." The quoted phrase excludes [issue](#) of an instrument, defined in Section [3-105](#), and cases in which a delivery of possession is for some purpose other than transfer of the right to enforce. For example, if a [check](#) is presented for payment by delivering the check to the [drawee](#), no transfer of the check to the drawee occurs because there is no intent to give the drawee the right to enforce the check.

2. Subsection (b) states that transfer vests in the transferee any right of the transferor to enforce the [instrument](#) "including any right as a [holder in due course](#)." If the transferee is not a holder because the transferor did not indorse, the transferee is nevertheless a [person entitled to enforce](#) the instrument under Section [3-301](#) if the transferor was a holder at the time of transfer. Although the transferee is not a holder, under subsection (b) the transferee obtained the rights of the transferor as holder. Because the transferee's rights are derivative of the transferor's rights, those rights must be [proved](#). Because the transferee is not a holder, there is no presumption under Section [3-308](#) that the transferee, by producing the instrument, is entitled to payment. The instrument, by its terms, is not payable to the transferee and the transferee must account for possession of the unindorsed instrument by proving the transaction through which the transferee acquired it. Proof of a transfer to the transferee by a holder is proof that the transferee has acquired the rights of a holder. At that point the transferee is entitled to the presumption under Section [3-308](#).

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

3. Subsection (c) applies only to a transfer for value. It applies only if the [instrument](#) is payable to [order](#) or specially indorsed to the transferor. The transferee acquires, in the absence of a contrary agreement, the specifically enforceable right to the [indorsement](#) of the transferor. Unless otherwise agreed, it is a right to the general indorsement of the transferor with full liability as [indorser](#), rather than to an indorsement without recourse. The question may arise if the transferee has paid in advance and the indorsement is omitted

fraudulently or through oversight. A transferor who is willing to indorse only without recourse or unwilling to indorse at all should make those intentions clear before transfer. The agreement of the transferee to take less than an unqualified indorsement need not be an express one, and the understanding may be implied from conduct, from past practice, or from the circumstances of the transaction. Subsection (c) provides that there is no [negotiation](#) of the instrument until the indorsement by the transferor is made. Until that time the transferee does not become a holder, and if earlier notice of a defense or claim is received, the transferee does not qualify as a [holder in due course](#) under Section [3-302](#).

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

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

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

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

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

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

assignee of an instrument has rights only to the extent the applicable law gives rights, either at law or in equity, to a partial assignee.

Official Comment [§ 3-204](#)

1. Subsection (a) is a definition of "indorsement," a term which was not defined in former Article 3. Indorsement is defined in terms of the purpose of the signature. If a blank or special [indorsement](#) is made to give rights as a holder to a transferee the indorsement is made for the purpose of negotiating the [instrument](#). Subsection (a)(i). If the holder of a [check](#) has an account in the [drawee](#) bank and wants to be sure that payment of the check will be made by credit to the holder's account, the holder can indorse the check by signing the holder's name with the accompanying words "for deposit only" before presenting the check for payment to the drawee bank. In that case the purpose of the quoted words is to restrict payment of the instrument. Subsection (a)(ii). If X wants to guarantee payment of a [note](#) signed by Y as [maker](#), X can do so by signing X's name to the back of the note as an indorsement. This indorsement is known as an [anomalous indorsement](#) (Section [3-205\(d\)](#)) and is made for the purpose of incurring [indorser's](#) liability on the note. Subsection (a)(iii). In some cases an indorsement may serve more than one purpose. For example, if the holder of a check deposits it to the holder's account in a depository bank for collection and indorses the check by signing the holder's name with the accompanying words "for deposit only" the purpose of the indorsement is both to negotiate the check to the depository bank and to restrict payment of the check.

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

the [issuer's](#) obligation to pay and its purpose is to provide a means of verifying the identify of the person negotiating the traveler's check by allowing comparison of the specimen signature and the countersignature. The countersignature is not necessary for [negotiation](#) and the signer does not incur [indorser's](#) liability. See [2 to Section 3-106](#).

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

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

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

Official Comment [§ 3-205](#)

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

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

name of the payee is left blank by the [drawer](#). In that case the check is payable to bearer. See the last paragraphs of [2 to Section 3-115](#).

A blank indorsement is usually the signature of the [indorser](#) on the back of the [instrument](#) without other words. Subsection (c) is based on subsection (3) of former Section 3-204. A "restrictive indorsement" described in Section [3-206](#) can be either a blank indorsement or a special indorsement. "Pay to T, in trust for B" is a restrictive indorsement. It is also a special indorsement because it identifies T as the person to whom the instrument is payable. "For deposit only" followed by the signature of the payee of a [check](#) is a restrictive indorsement. It is also a blank indorsement because it does not identify the person to whom the instrument is payable.

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

Official Comment [§ 3-206](#)

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

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

3. The great majority of restrictive [indorsements](#) are those that fall within subsection (c) which continues previous law. The depository bank or the payor bank, if it takes the [check](#) for immediate payment over the counter, must act consistently with the indorsement, but an intermediary bank or payor bank that takes the check from a collecting bank is not affected by the indorsement. Any other person is also bound by the indorsement. For example, suppose a check is payable to X, who indorses in blank but writes above the signature the words

"For deposit only." The check is stolen and is cashed at a grocery store by the thief. The grocery store indorses the check and deposits it in Depository Bank. The account of the grocery store is credited and the check is forwarded to Payor Bank which pays the check. Under subsection (c), the grocery store and Depository Bank are converters of the check because X did not receive the amount paid for the check. Payor Bank and any intermediary bank in the collection process are not liable to X. This Article does not displace the law of waiver as it may apply to restrictive indorsements. The circumstances under which a restrictive indorsement may be waived by the person who made it is not determined by this Article.

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

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

Official Comment [§ 3-207](#)

Section [3-207](#) restates former Section 3-208. Reacquisition refers to cases in which a former holder reacquires the [instrument](#) either by [negotiation](#) from the present holder or by a transfer other than negotiation. If the reacquisition is by negotiation, the former holder reacquires the status of holder. Although Section [3-207](#) allows the holder to cancel all [indorsements](#) made after the holder first acquired holder status, cancellation is not necessary. Status of holder is not affected whether or not cancellation is made. But if the reacquisition is not the result of negotiation the former holder can obtain holder status only by striking the former holder's indorsement and any subsequent indorsements. The latter case is an exception to the general rule that if an instrument is payable to an identified person, the indorsement of that person is necessary to allow a subsequent transferee to obtain the status of holder. Reacquisition without indorsement by the person to whom the instrument is payable is illustrated by two examples:

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

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

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

Official Comment [§ 3-301](#)

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

Official Comment [§ 3-302](#)

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

2. Subsection (a)(2) restates subsection (1) of former Section 3-302. Section 3-305(a) makes a distinction between defenses to the obligation to pay an [instrument](#) and claims in recoupment by the [maker](#) or [drawer](#) that may be asserted to reduce the amount payable on the instrument. Because of this

distinction, which was not made in former Article 3, the reference in subsection (a)(2)(vi) is to both a defense and a claim in recoupment. Notice of forgery or [alteration](#) is stated separately because forgery and alteration are not technically defenses under subsection (a) of Section [3-305](#).

3. Discharge is also separately treated in the first sentence of subsection (b). Except for discharge in an insolvency proceeding, which is specifically stated to be a real defense in Section [3-305\(a\)\(1\)](#), discharge is not expressed in Article 3 as a defense and is not included in Section [3-305\(a\)\(2\)](#). Discharge is effective against anybody except a person having rights of a [holder in due course](#) who took the [instrument](#) without notice of the discharge. Notice of discharge does not disqualify a person from becoming a holder in due course. For example, a [check](#) certified after it is negotiated by the payee may subsequently be negotiated to a holder. If the holder had notice that the certification occurred after [negotiation](#) by the payee, the holder necessarily had notice of the discharge of the payee as [indorser](#). Section [3-415\(d\)](#). Notice of that discharge does not prevent the holder from becoming a holder in due course, but the discharge is effective against the holder. Section [3-601\(b\)](#). Notice of a defense under Section [3-305\(a\)\(1\)](#) of a [maker](#), [drawer](#) or [acceptor](#) based on a bankruptcy discharge is different. There is no reason to give holder in due course status to a person with notice of that defense. The second sentence of subsection (b) is from former Section 3-304(5).

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

Former Section 3-302(2) stated: "A payee may be a holder in due course." This provision was intended to resolve the split of authority under the N.I.L.. It made clear that there was no intent to change the common-law rule that allowed a payee to become a [holder in due course](#). See Comment 2 to former Section 3-302. But there was no need to put subsection (2) in former Section 3-302 because the split in authority under the N.I.L. was caused by the particular wording of N.I.L. § 52(4). The troublesome language in that section was not repeated in former Article 3 nor is it repeated in revised Article 3. Former Section 3-302(2) has been omitted in revised Article 3 because it is surplusage

and may be misleading. The payee of an [instrument](#) can be a holder in due course, but use of the holder-in-due-course doctrine by the payee of an instrument is not the normal situation.

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

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

Case #1. Buyer pays for goods bought from Seller by giving to Seller a [cashier's check](#) bought from Bank. Bank has a defense to its obligation to pay the [check](#) because Buyer bought the check from Bank with a check known to be drawn on an account with insufficient funds to cover the check. If Bank [issued](#) the check to Buyer as payee and Buyer indorsed it over to Seller, it is clear that Seller can be a [holder in due course](#) taking free of the defense if Seller had no notice of the defense. Seller is a transferee of the check. There is no good reason why Seller's position should be any different if Bank drew the check to the [order](#) of Seller as payee. In that case, when Buyer took delivery of the check from Bank, Buyer became the owner of the check even though Buyer was not the holder. Buyer was a [remitter](#). Section [3-103\(a\)](#)(11). At that point nobody was the holder. When Buyer delivered the check to Seller, ownership of the check was transferred to Seller who also became the holder. This is a [negotiation](#). Section [3-201](#). The rights of Seller should not be affected by the fact that in one case the negotiation to Seller was by a holder and in the other case the negotiation was by a remitter. Moreover, it should be irrelevant whether Bank delivered the check to Buyer and Buyer delivered it to Seller or whether Bank delivered it directly to Seller. In either case Seller can be a holder in due course that takes free of Bank's defense.

Case #2. X fraudulently induces Y to join X in a spurious venture to purchase a business. The purchase is to be financed by a bank loan for part of the price. Bank lends money to X and Y by deposit in a joint account of X and Y who sign a [note](#) payable to Bank for the amount of the loan. X then withdraws the money from the joint account and absconds. Bank acted in [good faith](#) and without

notice of the fraud of X against Y. Bank is payee of the note executed by Y, but its right to enforce the note against Y should not be affected by the fact that Y was induced to execute the note by the fraud of X. Bank can be a [holder in due course](#) that takes free of the defense of Y. Case #2 is similar to Case #1. In each case the payee of the [instrument](#) has given value to the person committing the fraud in exchange for the obligation of the person against whom the fraud was committed. In each case the payee was not [party](#) to the fraud and had no notice of it.

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

"This is the same principle that protects an innocent person who purchases goods or commercial paper in good faith, without notice and for value from one who obtained them from the original owner by a misrepresentation. See Uniform Commercial Code §§ 2-403(1), 3-305. In the cases that fall within [§ 164 (2)], however, the innocent person deals directly with the recipient of the misrepresentation, which is made by one not a party to the contract."

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

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

Case #4. Employer, who owed money to X, signed a blank [check](#) and delivered it to Secretary with instructions to complete the check by typing in X's name and the amount owed to X. Secretary fraudulently completed the check by typing in the name of Y, a creditor to whom Secretary owed money. Secretary then delivered the check to Y in payment of Secretary's debt. Y obtained payment of the check. This case is similar to Case #3. Since Secretary was authorized to complete the check, Employer is bound by Secretary's act in making the check payable to Y. The [drawee](#) bank properly paid the check. Y received funds of Employer which were used for the personal benefit of Secretary. Employer asserts a claim to these funds against Y. If Y is a [holder in due course](#), Y takes free of the claim. Whether Y is a holder in due course depends upon whether Y had notice of Employer's claim.

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

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

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

6. Subsection (d) and (e) clarify two matters not specifically addressed by former Article 3:

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

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

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

Official Comment [§ 3-303](#)

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

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

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

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

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

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

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

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

Official Comment [§ 3-304](#)

1. To be a [holder in due course](#), one must take without notice that an [instrument](#) is overdue. Section [3-302\(a\)\(2\)\(iii\)](#). Section [3-304](#) replaces subsection (3) of

former Section 3-304. For the sake of clarity it treats demand and time instruments separately. Subsection (a) applies to demand instruments. A [check](#) becomes stale after 90 days.

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

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

Official Comment [§ 3-305](#)

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

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

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

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

the duress or the illegality is to make the obligation entirely null and void, the defense may be asserted against a [holder in due course](#). Otherwise it is cut off.

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

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

2. Subsection (a)(2) states other defenses that, pursuant to subsection (b), are cut off by a [holder in due course](#). These defenses comprise those specifically stated in Article 3 and those based on common law contract principles. Article 3 defenses are nonissuance of the [instrument](#), conditional issuance, and issuance for a special purpose (Section [3-105\(b\)](#)); failure to countersign a [traveler's check](#) (Section [3-106\(c\)](#)); modification of the obligation by a separate agreement (Section [3-117](#)); payment that violates a restrictive [indorsement](#) (Section [3-206\(f\)](#)); instruments [issued](#) without [consideration](#) or for which [promised](#) performance has not been given (Section [3-303\(b\)](#)), and breach of warranty when a [draft](#) is accepted (Section [3-417\(b\)](#)). The most prevalent common law defenses are fraud, misrepresentation or mistake in the issuance of the instrument. In most cases the [holder in due course](#) will be an immediate or remote transferee of the payee of the instrument. In most cases the holder-in-due-course doctrine is irrelevant if defenses are being asserted against the payee of the instrument, but in a small number of cases the payee of the instrument may be a holder in due course. Those cases are discussed in [4 to Section 3-302](#).

Assume Buyer [issues](#) a [note](#) to Seller in payment of the price of goods that Seller fraudulently [promises](#) to deliver but which are never delivered. Seller negotiates the note to Holder who has no notice of the fraud. If Holder is a [holder in due course](#), Holder is not subject to Buyer's defense of fraud. But in some cases an

original [party](#) to the [instrument](#) is a holder in due course. For example, Buyer fraudulently induces Bank to issue a [cashier's check](#) to the [order](#) of Seller. The [check](#) is delivered by Bank to Seller, who has no notice of the fraud. Seller can be a holder in due course and can take the [check](#) free of Bank's defense of fraud. This case is discussed as Case #1 in [4 to Section 3-302](#). Former Section 3-305 stated that a holder in due course takes free of defenses of "any party to the instrument with whom the holder has not dealt." The meaning of this language was not at all clear and if read literally could have produced the wrong result. In the hypothetical case, it could be argued that Seller "dealt" with Bank because Bank delivered the check to Seller. But it is clear that Seller should take free of Bank's defense against Buyer regardless of whether Seller took delivery of the check from Buyer or from Bank. The quoted language is not included in Section [3-305](#). It is not necessary. If Buyer issues an instrument to Seller and Buyer has a defense against Seller, that defense can obviously be asserted. Buyer and Seller are the only people involved. The holder-in-due-course doctrine has no relevance. The doctrine applies only to cases in which more than two parties are involved. Its essence is that the [holder in due course](#) does not have to suffer the consequences of a defense of the obligor on the [instrument](#) that arose from an occurrence with a third party.

3. Subsection (a)(3) is concerned with claims in recoupment which can be illustrated by the following example. Buyer [issues](#) a [note](#) to the [order](#) of Seller in exchange for a [promise](#) of Seller to deliver specified equipment. If Seller fails to deliver the equipment or delivers equipment that is rightfully rejected, Buyer has a defense to the note because the performance that was the [consideration](#) for the note was not rendered. Section [3-303\(b\)](#). This defense is included in Section [3-305\(a\)\(2\)](#). That defense can always be asserted against Seller. This result is the same as that reached under former Section 3-408.

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

Suppose Seller negotiates the [note](#) to Holder. If Holder had notice of Buyer's warranty claim at the time the note was negotiated to Holder, Holder is not a [holder in due course](#) (Section [3-302\(a\)\(2\)\(iv\)](#)) and Buyer may assert the claim against Holder (Section [3-305\(a\)\(3\)](#)) but only as a claim in recoupment, i.e. to reduce the amount owed on the note. If the warranty claim is \$1,000 and the unpaid note is \$10,000, Buyer owes \$9,000 to Holder. If the warranty claim is more than the unpaid amount of the note, Buyer owes nothing to Holder, but

Buyer cannot recover the unpaid amount of the warranty claim from Holder. If Buyer had already partially paid the note, Buyer is not entitled to recover the amounts paid. The claim can be used only as an offset to amounts owing on the note. If Holder had no notice of Buyer's claim and otherwise qualifies as a holder in due course, Buyer may not assert the claim against Holder. Section [3-305\(b\)](#).

The result under Section [3-305](#) is consistent with the result reached under former Article 3, but the rules for reaching the result are stated differently. Under former Article 3 Buyer could assert rights against Holder only if Holder was not a [holder in due course](#), and Holder's status depended upon whether Holder had notice of a defense by Buyer. Courts have held that Holder had that notice if Holder had notice of Buyer's warranty claim. The rationale under former Article 3 was "failure of consideration." This rationale does not distinguish between cases in which the seller fails to perform and those in which the buyer accepts the performance of seller but makes a claim against the seller because the performance is faulty. The term "failure of consideration" is subject to varying interpretations and is not used in Article 3. The use of the term "claim in recoupment" in Section [3-305\(a\)\(3\)](#) is a more precise statement of the nature of Buyer's right against Holder. The use of the term does not change the law because the treatment of a defense under subsection (a)(2) and a claim in recoupment under subsection (a)(3) is essentially the same.

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

4. Subsection (c) concerns claims and defenses of a person other than the obligor on the [instrument](#). It applies principally to cases in which an obligation is paid with the instrument of a third person. For example, Buyer buys goods from Seller and negotiates to Seller a [cashier's check issued](#) by Bank in payment of the price. Shortly after delivering the [check](#) to Seller, Buyer learns that Seller had defrauded Buyer in the sale transaction. Seller may enforce the check against Bank even though Seller is not a [holder in due course](#). Bank has no defense to its obligation to pay the check and it may not assert defenses, claims in recoupment, or claims to the instrument of Buyer, except to the extent permitted by the "but" clause of the first sentence of subsection (c). Buyer may have a claim to the instrument under Section [3-306](#) based on a right to rescind the [negotiation](#) to Seller because of Seller's fraud. Section [3-202\(b\)](#) and [2 to Section](#)

[3-201](#). Bank cannot assert that claim unless Buyer is joined in the action in which Seller is trying to enforce payment of the check. In that case Bank may pay the amount of the check into court and the court will decide whether that amount belongs to Buyer or Seller. The last sentence of subsection (c) allows the [issuer](#) of an instrument such as a cashier's check to refuse payment in the rare case in which the issuer can [prove](#) that the instrument is a lost or stolen instrument and the person seeking enforcement does not have rights of a holder in due course.

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

Section [3-305\(d\)](#) must be read in conjunction with Section [3-605](#), which provides rules (usually referred to as suretyship defenses) for determining when the obligation of an [accommodation party](#) is discharged, in whole or in part, because of some act or omission of a [person entitled to enforce](#) the [instrument](#). To the extent a rule stated in Section [3-605](#) is inconsistent with Section [3-305\(d\)](#), the Section 3-605 rule governs. For example, under Section [3-605\(b\)](#), discharge under Section [3-604](#) of the [accommodated party](#) does not discharge the accommodation party. As explained in Comment 3 to Section [3-605](#), discharge of the accommodated party is normally part of a settlement under which the holder of a [note](#) accepts partial payment from an accommodated party who is financially unable to pay the entire amount of the note. If the holder then brings an action against the accommodation party to recover the remaining unpaid amount of the note, the [accommodation party](#) cannot use Section [3-305\(d\)](#) to nullify Section [3-605\(b\)](#) by asserting the discharge of the [accommodated party](#) as a defense. On the other hand, suppose the accommodated party is a buyer of goods who issued the note to the seller who took the note for the buyer's obligation to pay for the goods. Suppose the buyer has a claim for breach of warranty with respect to the goods against the seller and the warranty claim may be asserted against the holder of the note. The warranty claim is a claim in recoupment. If the holder and the accommodated party reach a settlement under which the holder accepts payment less than the amount of the [note](#) in full satisfaction of the note and the warranty claim, the accommodation party could defend an action on the note by the holder by asserting the accord and satisfaction under Section [3-305\(d\)](#). There is no conflict with Section [3-605\(b\)](#) because that provision is not intended to apply to settlement of disputed claims. Another example of the use of Section [3-305\(d\)](#) in cases in which Section [3-605](#) applies is stated in [4 to Section 3-605](#). See [PEB Commentary No. 11](#), dated December 15, 1993.

Official Comment [§ 3-306](#)

This section expands on the reference to "claims to" the [instrument](#) mentioned in former Sections 3-305 and 3-306. Claims covered by the section include not only claims to ownership but also any other claim of a property or possessory right. It includes the claim to a lien or the claim of a person in rightful possession of an instrument who was wrongfully deprived of possession. Also included is a claim based on Section [3-202\(b\)](#) for rescission of a [negotiation](#) of the instrument by the claimant. Claims to an instrument under Section [3-306](#) are different from claims in recoupment referred to in Section [3-305\(a\)\(3\)](#).

Official Comment [§ 3-307](#)

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

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

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

Section [3-307\(b\)](#) applies only if the person dealing with the [fiduciary](#) "has knowledge of the fiduciary status of the fiduciary." Notice which does not amount to knowledge is not enough to cause Section [3-307](#) to apply. "Knowledge" is defined in Section [1-201\(25\)](#). In most cases, the "taker" referred to in Section [3-307](#) will be a bank or other organization. Knowledge of an organization is determined by the rules stated in Section [1-201\(27\)](#). In many cases, the individual who receives and processes an [instrument](#) on behalf of the

organization that is the taker of the instrument "for payment or collection or for value" is a clerk who has no knowledge of any fiduciary status of the person from whom the instrument is received. In such cases, Section [3-307](#) doesn't apply because, under Section [1-201\(27\)](#), knowledge of the organization is determined by the knowledge of the "individual conducting that transaction," i.e. the clerk who receives and processes the [instrument](#). Furthermore, paragraphs (2) and (4) each require that the person acting for the organization have knowledge of facts that indicate a breach of fiduciary duty. In the case of an instrument taken for deposit to an account, the knowledge is found in the fact that the deposit is made to an account other than that of the [represented person](#) or a fiduciary account for benefit of that person. In other cases the person acting for the organization must know that the instrument is taken in payment or as security for a personal debt of the [fiduciary](#) or for the personal benefit of the fiduciary. For example, if the instrument is being used to buy goods or services, the person acting for the organization must know that the goods or services are for the personal benefit of the fiduciary. The requirement that the taker have knowledge rather than notice is meant to limit Section [3-307](#) to relatively uncommon cases in which the person who deals with the fiduciary knows all the relevant facts: the fiduciary status and that the proceeds of the instrument are being used for the personal debt or benefit of the fiduciary or are being paid to an account that is not an account of the represented person or of the fiduciary, as such. Mere notice of these facts is not enough to put the taker on notice of the breach of fiduciary duty and does not give rise to any duty of investigation by the taker.

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

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

incurred by the fiduciary the normal mode of payment is by a [check](#) drawn on the fiduciary account to the [order](#) of the fiduciary.

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

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

Official Comment [§ 3-308](#)

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

The question of the burden of establishing the signature arises only when it has been put in issue by specific denial. "Burden of establishing" is defined in Section [1-201](#). The burden is on the [party](#) claiming under the signature, but the

signature is presumed to be authentic and authorized except as stated in the second sentence of subsection (a). "Presumed" is defined in Section [1-201](#) and means that until some evidence is introduced which would support a finding that the signature is forged or unauthorized, the plaintiff is not required to [prove](#) that it is valid. The presumption rests upon the fact that in ordinary experience forged or unauthorized signatures are very uncommon, and normally any evidence is within the control of, or more accessible to, the defendant. The defendant is therefore required to make some sufficient showing of the grounds for the denial before the plaintiff is required to introduce evidence. The defendant's evidence need not be sufficient to require a directed verdict, but it must be enough to support the denial by permitting a finding in the defendant's favor. Until introduction of such evidence the presumption requires a finding for the plaintiff. Once such evidence is introduced the burden of establishing the signature by a preponderance of the total evidence is on the plaintiff. The presumption does not arise if the action is to enforce the obligation of a purported signer who has died or become incompetent before the evidence is required, and so is disabled from obtaining or introducing it. "Action" is defined in Section [1-201](#) and includes a claim asserted against the estate of a deceased or an incompetent.

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

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

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

Nothing in this section is intended to say that the plaintiff must necessarily [prove](#) rights as a [holder in due course](#). The plaintiff may elect to introduce no further evidence, in which case a verdict may be directed for the plaintiff or the defendant, or the issue of the defense or claim in recoupment may be left to the trier of fact, according to the weight and sufficiency of the defendant's evidence. The plaintiff may elect to rebut the defense or claim in recoupment by proof to the contrary, in which case a verdict may be directed for either [party](#) or the issue

may be for the trier of fact. Subsection (b) means only that if the plaintiff claims the rights of a holder in due course against the defense or claim in recoupment, the plaintiff has the burden of proof on that issue.

Official Comment [§ 3-309](#)

Section [3-309](#) is a modification of former Section 3-804. The rights stated are those of "a [person entitled to enforce the instrument](#)" at the time of loss rather than those of an "owner" as in former Section 3-804. Under subsection (b), judgment to enforce the instrument cannot be given unless the court finds that the defendant will be adequately protected against a claim to the instrument by a holder that may appear at some later time. The court is given discretion in determining how adequate protection is to be assured. Former Section 3-804 allowed the court to "require security indemnifying the defendant against loss." Under Section [3-309](#) adequate protection is a flexible concept. For example, there is substantial risk that a [holder in due course](#) may make a demand for payment if the instrument was payable to bearer when it was lost or stolen. On the other hand if the instrument was payable to the person who lost the instrument and that person did not indorse the instrument, no other person could be a holder of the instrument. In some cases there is risk of loss only if there is doubt about whether the facts alleged by the person who lost the instrument are true. Thus, the type of adequate protection that is reasonable in the circumstances may depend on the degree of certainty about the facts in the case.

Official Comment [§ 3-310](#)

1. Section [3-310](#) is a modification of former Section 3-802. As a practical matter, application of former Section 3-802 was limited to cases in which a [check](#) or a [note](#) was given for an obligation. Subsections (a) and (b) of Section [3-310](#) are therefore stated in terms of checks and notes in the interests of clarity. Subsection (c) covers the rare cases in which some other [instrument](#) is given to pay an obligation.
2. Subsection (a) deals with the case in which a [certified check](#), [cashier's check](#) or [teller's check](#) is given in payment of an obligation. In that case the obligation is discharged unless there is an agreement to the contrary. Subsection (a) drops the exception in former Section 3-802 for cases in which there is a right of recourse on the [instrument](#) against the obligor. Under former Section 3-802(1)(a) the obligation was not discharged if there was a right of recourse on the instrument against the obligor. Subsection (a) changes this result. The underlying obligation is discharged, but any right of recourse on the instrument is preserved.
3. Subsection (b) concerns cases in which an uncertified [check](#) or a [note](#) is taken for an obligation. The typical case is that in which a buyer pays for goods or services by giving the seller the buyer's personal check, or in which the buyer signs a note for the purchase price. Subsection (b) also applies to the uncommon cases in which a check or note of a third person is given in payment of the obligation. Subsection (b) preserves the rule under former Section 3-802(1)(b) that the buyer's obligation to pay the price is suspended, but subsection (b) spells out the effect more precisely. If the check or note is

dishonored, the seller may sue on either the dishonored [instrument](#) or the contract of sale if the seller has possession of the instrument and is the [person entitled to enforce](#) it. If the right to enforce the instrument is held by somebody other than the seller, the seller can't enforce the right to payment of the price under the sales contract because that right is represented by the instrument which is enforceable by somebody else. Thus, if the seller sold the note or the check to a holder and has not reacquired it after dishonor, the only right that survives is the right to enforce the instrument.

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

4. There was uncertainty concerning the applicability of former Section 3-802 to the case in which the [check](#) given for the obligation was stolen from the payee, the payee's signature was forged, and the forger obtained payment. The last sentence of subsection (b)(4) addresses this [issue](#). If the payor bank pays a holder, the [drawer](#) is discharged on the underlying obligation because the check was paid. Subsection (b)(1). If the payor bank pays a person not entitled to enforce the instrument, as in the hypothetical case, the suspension of the underlying obligation continues because the check has not been paid. Section [3-602\(a\)](#). The payee's cause of action is against the depository bank or payor bank in conversion under Section [3-420](#) or against the [drawer](#) under Section [3-309](#). In the latter case, the drawer's obligation under Section [3-414\(b\)](#) is triggered by dishonor which occurs because the check is unpaid. Presentment for payment to the drawee is excused under Section [3-504\(a\)](#)(i) and, under Section [3-502\(e\)](#), dishonor occurs without [presentment](#) if the check is not paid. The payee cannot merely ignore the [instrument](#) and sue the drawer on the underlying contract. This would impose on the drawer the risk that the check when stolen was indorsed in blank or to bearer.

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

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

Official Comment [§ 3-311](#)

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

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

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

In either case the person against whom the claim is asserted may attempt an accord and satisfaction of the disputed claim by tendering a [check](#) to the claimant for some amount less than the full amount claimed by the claimant. A statement will be included on the check or in a communication accompanying the check to the effect that the check is offered as full payment or full satisfaction of the claim. Frequently, there is also a statement to the effect that obtaining payment of the check is an agreement by the claimant to a settlement of the dispute for the amount tendered. Before enactment of revised Article 3, the case law was in conflict over the question of whether obtaining payment of the check had the effect of an agreement to the settlement proposed by the debtor. This issue was governed by a common law rule, but some courts hold that the common law was modified by former Section 1-207 which they interpreted as applying to full settlement checks.

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

3. As part of the revision of Article 3, Section [1-207](#) has been amended to add subsection (2) stating that Section [1-207](#) "does not apply to an accord and satisfaction." Because of that amendment and revised Article 3, Section [3-311](#) governs full satisfaction checks. Section [3-311](#) follows the common law rule with some minor variations to reflect modern business conditions. In cases covered

by Section [3-311](#) there will often be an individual on one side of the dispute and a business organization on the other. This section is not designed to favor either the individual or the business organization. In Case #1 the person seeking the accord and satisfaction is an individual. In Case #2 the person seeking the accord and satisfaction is an insurance company. Section [3-311](#) is based on a belief that the common law rule produces a fair result and that informal dispute resolution by full satisfaction checks should be encouraged.

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

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

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

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

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

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

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

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

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

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

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

Official Comment [§ 3-312](#)

1. This section applies to cases in which a [cashier's check](#), [teller's check](#), or [certified check](#) is lost, destroyed, or stolen. In one typical case a customer of a bank closes his or her account and takes a cashier's check or teller's check of the bank as payment of the amount of the account. The customer may be moving to a new area and the [check](#) is to be used to open a bank account in that area. In such a case the check will normally be payable to the customer. In another typical case a cashier's check or teller's check is bought from a bank for the purpose of paying some obligation of the buyer of the check. In such a case the check may be made payable to the customer and then negotiated to the creditor by [indorsement](#). But often, the payee of the check is the creditor. In the latter case the customer is a [remitter](#). The section covers loss of the check by either the remitter or the payee. The section also covers loss of a certified check by either the [drawer](#) or payee.

Under Section [3-309](#) a person seeking to enforce a lost, destroyed, or stolen [cashier's check](#) or [teller's check](#) may be required by the court to give adequate protection to the issuing bank against loss that might occur by reason of the claim by another person to enforce the [check](#). This might require the posting of an expensive bond for the amount of the check. Moreover, Section [3-309](#) applies only to a [person entitled to enforce](#) the check. It does not apply to a [remitter](#) of a cashier's check or teller's check or to the [drawer](#) of a [certified check](#). Section [3-312](#) applies to both. The purpose of Section [3-312](#) is to offer a person who loses such a check a means of getting refund of the amount of the check within a reasonable period of time without the expense of posting a bond and with full protection of the [obligated bank](#).

2. A claim to the amount of a lost, destroyed, or stolen [cashier's check](#), [teller's check](#), or [certified check](#) may be made under subsection (b) if the following requirements of that subsection are met. First, a claim may be asserted only by the [drawer](#) or payee of a certified check or the [remitter](#) or payee of a cashier's check or teller's check. An indorsee of a [check](#) is not covered because the indorsee is not an original [party](#) to the check or a remitter. Limitation to an original party or remitter gives the obligated bank the ability to determine, at the time it becomes obligated on the check, the identity of the person or persons who can assert a claim with respect to the check. The bank is not faced with having to determine the rights of some person who was not a party to the check at that time or with whom the bank had not dealt. If a cashier's check is [issued](#) to the [order](#) of the person who purchased it from the bank and that person indorses it over to a third person who loses the check, the third person may assert rights to enforce the check under Section [3-309](#) but has no rights under Section [3-312](#).

Second, the claim must be asserted by a communication to the [obligated bank](#) describing the [check](#) with reasonable certainty and requesting payment of the

amount of the check. "Obligated bank" is defined in subsection (a)(4). Third, the communication must be received in time to allow the obligated bank to act on the claim before the check is paid, and the claimant must provide reasonable identification if requested. Subsections (b)(iii) and (iv). Fourth, the communication must contain or be accompanied by a declaration of loss described in subsection (b). This declaration is an affidavit or other writing made under penalty of perjury alleging the loss, destruction, or theft of the [check](#) and stating that the declarer is a person entitled to assert a claim, i.e. the [drawer](#) or payee of a [certified check](#) or the [remitter](#) or payee of a [cashier's check](#) or [teller's check](#).

A claimant who delivers a declaration of loss makes a warranty of the truth of the statements made in the declaration. The warranty is made to the [obligated bank](#) and anybody who has a right to enforce the [check](#). If the declaration of loss falsely alleges loss of a [cashier's check](#) that did not in fact occur, a holder of the check who was unable to obtain payment because subsection (b)(3) and (4) caused the obligated bank to dishonor the check would have a cause of action against the declarer for breach of warranty.

The [obligated bank](#) may not impose additional requirements on the claimant to assert a claim under subsection (b). For example, the obligated bank may not require the posting of a bond or other form of security. Section [3-312\(b\)](#) states the procedure for asserting claims covered by the section. Thus, procedures that may be stated in other law for stating claims to property do not apply and are displaced within the meaning of Section [1-103](#).

3. A claim asserted under subsection (b) does not have any legal effect, however, until the date it becomes enforceable, which cannot be earlier than 90 days after the date of a [cashier's check](#) or [teller's check](#) or 90 days after the date of [acceptance](#) of a [certified check](#). Thus, if a lost [check](#) is presented for payment within the 90-day period, the bank may pay a [person entitled to enforce](#) the check without regard to the claim and is discharged of all liability with respect to the check. This ensures the continued utility of cashier's checks, teller's checks, and certified checks as cash equivalents. Virtually all such checks are presented for payment within 90 days.

If the claim becomes enforceable and payment has not been made to a [person entitled to enforce](#) the [check](#), the bank becomes obligated to pay the amount of the check to the claimant. Subsection (b)(4). When the bank becomes obligated to pay the amount of the check to the claimant, the bank is relieved of its obligation to pay the check. Subsection (b)(3). Thus, any person entitled to enforce the check, including even a [holder in due course](#), loses the right to enforce the check after a claim under subsection (b) becomes enforceable.

If the [obligated bank](#) pays the claimant under subsection (b)(4), the bank is discharged of all liability with respect to the [check](#). The only exception is the unlikely case in which the obligated bank subsequently incurs liability under Section [4-302\(a\)](#)(1) with respect to the check. For example, Obligated Bank is the [issuer](#) of a [cashier's check](#) and, after a claim becomes enforceable, it pays the claimant under subsection (b)(4). Later the check is presented to Obligated Bank for payment over the counter. Under subsection (b)(3), Obligated Bank is not obliged to pay the check and may dishonor the check by returning it to the

person who presented it for payment. But the normal rules of check collection are not affected by Section [3-312](#). If Obligated Bank retains the check beyond midnight of the day of [presentment](#) without settling for it, it becomes accountable for the amount of the check under Section [4-302\(a\)](#)(1) even though it had no obligation to pay the check.

An [obligated bank](#) that pays the amount of a [check](#) to a claimant under subsection (b)(4) is discharged of all liability on the check so long as the assertion of the claim meets the requirements of subsection (b) discussed in Comment 2. This is important in cases of fraudulent declarations of loss. For example, if the claimant falsely alleges a loss that in fact did not occur, the bank, subject to Section [1-203](#), may rely on the declaration of loss. On the other hand, a claim may be asserted only by a person described in subsection (b)(i). Thus, the bank is discharged under subsection (a)(4) only if it pays such a person. Although it is highly unlikely, it is possible that more than one person could assert a claim under subsection (b) to the amount of a check. Such a case could occur if one of the claimants makes a false declaration of loss. The obligated bank is not required to determine whether a claimant who complies with subsection (b) is acting wrongfully. The bank may utilize procedures outside this Article, such as interpleader, under which the conflicting claims may be adjudicated.

Although it is unlikely that a lost [check](#) would be presented for payment after the claimant was paid by the bank under subsection (b)(4), it is possible for it to happen. Suppose the declaration of loss by the claimant fraudulently alleged a loss that in fact did not occur. If the claimant negotiated the check, [presentment](#) for payment would occur shortly after [negotiation](#) in almost all cases. Thus, a fraudulent declaration of loss is not likely to occur unless the check is negotiated after the 90-day period has already expired or shortly before expiration. In such a case the holder of the check, who may not have noticed the date of the check, is not entitled to payment from the [obligated bank](#) if the check is presented for payment after the claim becomes enforceable. Subsection (b)(3). The remedy of the holder who is denied payment in that case is an action against the claimant under subsection (c) if the holder is a [holder in due course](#), or for breach of warranty under subsection (b). The holder would also have common law remedies against the claimant under the law of restitution or fraud.

4. The following cases illustrate the operation of Section [3-312](#):

Case #1. Obligated Bank (OB) certified a [check](#) drawn by its customer, Drawer (D), payable to Payee (P). Two days after the check was certified, D lost the check and then asserted a claim pursuant to subsection (b). The check had not been presented for payment when D's claim became enforceable 90 days after the check was certified. Under subsection (b)(4), at the time D's claim became enforceable OB became obliged to pay D the amount of the check. If the check is later presented for payment, OB may refuse to pay the check and has no obligation to anyone to pay the check. Any obligation owed by D to P, for which the check was intended as payment, is unaffected because the check was never delivered to P.

Case #2. Obligated Bank (OB) [issued](#) a [teller's check](#) to Remitter (R) payable to Payee (P). R delivered the [check](#) to P in payment of an obligation. P lost

the check and then asserted a claim pursuant to subsection (b). To carry out P's [order](#), OB issued an order pursuant to Section [4-403\(a\)](#) to the [drawee](#) of the teller's check to stop payment of the check effective on the 90th day after the date of the teller's check. The check was not presented for payment. On the 90th day after the date of the teller's check P's claim becomes enforceable and OB becomes obliged to pay P the amount of the check. As in Case #1, OB has no further liability with respect to the check to anyone. When R delivered the check to P, R's underlying obligation to P was discharged under Section [3-310](#). Thus, R suffered no loss. Since P received the amount of the check, P also suffered no loss except with respect to the delay in receiving the amount of the check.

Case #3. Obligated Bank (OB) [issued](#) a [cashier's check](#) to its customer, Payee (P). Two days after issue, the [check](#) was stolen from P who then asserted a claim pursuant to subsection (b). Ten days after issue, the check was deposited by X in an account in Depository Bank (DB). X had found the check and forged the [indorsement](#) of P. DB promptly presented the check to OB and obtained payment on behalf of X. On the 90th day after the date of the check P's claim becomes enforceable and P is entitled to receive the amount of the check from OB. Subsection (b)(4). Although the check was presented for payment before P's claim became enforceable, OB is not discharged. Because of the forged indorsement X was not a holder and neither was DB. Thus, neither is a [person entitled to enforce](#) the check (Section [3-301](#)) and OB is not discharged under Section [3-602\(a\)](#). Thus, under subsection (b)(4), because OB did not pay a person entitled to enforce the check, OB must pay P. OB's remedy is against DB for breach of warranty under Section [4-208\(a\)](#)(1). As an alternative to the remedy under Section [3-312](#), P could recover from DB for conversion under Section [3-420\(a\)](#).

Case #4. Obligated Bank (OB) [issued](#) a [cashier's check](#) to its customer, Payee (P). P made an unrestricted blank [indorsement](#) of the [check](#) and mailed the check to P's bank for deposit to P's account. The check was never received by P's bank. When P discovered the loss, P asserted a claim pursuant to subsection (b). X found the check and deposited it in X's account in Depository Bank (DB) after indorsing the check. DB presented the check for payment before the end of the 90-day period after its date. OB paid the check. Because of the unrestricted blank indorsement by P, X became a holder of the check. DB also became a holder. Since the check was paid before P's claim became enforceable and payment was made to a person entitled to enforce the check, OB is discharged of all liability with respect to the check. Subsection (b)(2). Thus, P is not entitled to payment from OB. Subsection (b)(4) doesn't apply.

Case #5. Obligated Bank (OB) [issued](#) a [cashier's check](#) to its customer, Payee (P). P made an unrestricted blank [indorsement](#) of the [check](#) and mailed the check to P's bank for deposit to P's account. The check was never received by P's bank. When P discovered the loss, P asserted a claim pursuant to subsection (b). At the end of the 90-day period after the date of the check, OB paid the amount of the check to P under subsection (b)(4). X then found the check and deposited it to X's account in Depository Bank (DB). DB presented the check to OB for payment. OB is not obliged to pay the check. Subsection (b)(4). If OB dishonors the check, DB's remedy is to charge back

X's account. Section [4-214\(a\)](#). Although P, as an [indorser](#), would normally have liability to DB under Section [3-415\(a\)](#) because the check was dishonored, P is released from that liability under Section [3-415\(e\)](#) because collection of the check was initiated more than 30 days after the indorsement. DB has a remedy only against X. A depository bank that takes a cashier's check that cannot be presented for payment before expiration of the 90-day period after its date is on notice that the check might not be paid because of the possibility of a claim asserted under subsection (b) which would excuse the [issuer](#) of the check from paying the check. Thus, the depository bank cannot safely release funds with respect to the check until it has assurance that the check has been paid. DB cannot be a [holder in due course](#) of the [check](#) because it took the check when the check was overdue. Section [3-304\(a\)\(2\)](#). Thus, DB has no action against P under subsection (c).

Case #6. Obligated Bank (OB) [issued](#) a [cashier's check](#) payable to bearer and delivered it to its customer, Remitter (R). R held the [check](#) for 90 days and then wrongfully asserted a claim to the amount of the check under subsection (b). The declaration of loss fraudulently stated that the check was lost. R received payment from OB under subsection (b)(4). R then negotiated the check to X for value. X presented the check to OB for payment. Although OB, under subsection (b)(2), was not obliged to pay the check, OB paid X by mistake. OB's teller did not notice that the check was more than 90 days old and was not aware that OB was not obliged to pay the check. If X took the check in [good faith](#), OB may not recover from X. Section [3-418\(c\)](#). OB's remedy is to recover from R for fraud or for breach of warranty in making a false declaration of loss. Subsection (b).

Official Comment [§ 3-401](#)

1. Obligation on an [instrument](#) depends on a signature that is binding on the obligor. The signature may be made by the obligor personally or by an agent authorized to act for the obligor. Signature by agents is covered by Section [3-402](#). It is not necessary that the name of the obligor appear on the instrument, so long as there is a signature that binds the obligor. Signature includes an [indorsement](#).
2. A signature may be handwritten, typed, printed or made in any other manner. It need not be subscribed, and may appear in the body of the [instrument](#), as in the case of "I, John Doe, [promise](#) to pay " without any other signature. It may be made by mark, or even by thumbprint. It may be made in any name, including any trade name or assumed name, however false and fictitious, which is adopted for the purpose. Parol evidence is admissible to identify the signer, and when the signer is identified the signature is effective. Indorsement in a name other than that of the [indorser](#) is governed by Section [3-204\(d\)](#).

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

Official Comment [§ 3-402](#)

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

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

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

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

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

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

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

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

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

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

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

Official Comment [§ 3-403](#)

1. "Unauthorized" signature is defined in Section [1-201\(43\)](#) as one that includes a forgery as well as a signature made by one exceeding actual or apparent authority. Former Section 3-404(1) stated that an unauthorized signature was inoperative as the signature of the person whose name was signed unless that person "is precluded from denying it." Under former Section 3-406 if negligence by the person whose name was signed contributed to an unauthorized signature, that person "is precluded from asserting the lack of authority." Both of these sections were applied to cases in which a forged signature appeared on an [instrument](#) and the person asserting rights on the instrument alleged that the negligence of the purported signer contributed to the forgery. Since the standards for liability between the two sections differ, the overlap between the sections caused confusion. Section [3-403\(a\)](#) deals with the problem by removing the preclusion language that appeared in former Section 3-404.

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

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

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

4. Subsection (b) clarifies the meaning of "unauthorized" in cases in which an [instrument](#) contains less than all of the signatures that are required as authority to pay a [check](#). Judicial authority was split on the issue whether the one-year notice period under former Section 4-406(4) (now Section [4-406\(f\)](#)) barred a customer's suit against a payor bank that paid a check containing less than all of the signatures required by the customer to authorize payment of the check. Some cases took the view that if a customer required that a check contain the signatures of both A and B to authorize payment and only A signed, there was no unauthorized signature within the meaning of that term in former Section 4-406(4) because A's signature was neither unauthorized nor forged. The other

cases correctly pointed out that it was the customer's signature at issue and not that of A; hence, the customer's signature was unauthorized if all signatures required to authorize payment of the check were not on the check. Subsection (b) follows the latter line of cases. The same analysis applies if A forged the signature of B. Because the forgery is not effective as a signature of B, the required signature of B is lacking.

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

Official Comment [§ 3-404](#)

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

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

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

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

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

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

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

Case #5. Thief, who is not an employee or agent of Corporation, steals [check](#) forms of Corporation. John Doe is president of Corporation and is authorized to

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

3. In cases governed by subsection (a) the dispute will normally be between the [drawer](#) of the [check](#) that was obtained by the impostor and the [drawee](#) bank that paid it. The drawer is precluded from obtaining recredit of the drawer's account by arguing that the check was paid on a forged [indorsement](#) so long as the drawee bank acted in [good faith](#) in paying the check. Cases governed by subsection (b) are illustrated by Cases #1 through #5 in Comment 2. In Cases #1, #2, and #3 there is no forgery of the check, thus the drawer of the check takes the loss if there is no lack of good faith by the banks involved. Cases #4 and #5 are forged check cases. Depository Bank is entitled to retain the proceeds of the check if it didn't know about the forgery. Under Section [3-418](#) the drawee bank is not entitled to recover from Depository Bank on the basis of payment by mistake because Depository Bank took the check in good faith and gave value for the check when the credit given for the check was withdrawn. And there is no breach of warranty under Section [3-417\(a\)\(1\)](#) or (3) or [4-208\(a\)\(1\)](#) or (3). Unless Section [3-406](#) applies the loss is taken by the drawee bank if a forged check is paid, and that is the result in Case #5. In Case #4 the loss is taken by Corporation, the drawer, because an agreement between Corporation and the drawee bank allowed the bank to debit Corporation's account despite the unauthorized use of the check-writing machine.

If a [check](#) payable to an impostor, fictitious payee, or payee not intended to have an interest in the check is paid, the effect of subsections (a) and (b) is to place the loss on the [drawer](#) of the check rather than on the [drawee](#) or the depository bank that took the check for collection. Cases governed by subsection (a) always involve fraud, and fraud is almost always involved in cases governed by subsection (b). The drawer is in the best position to avoid the fraud and thus should take the loss. This is true in Case #1, Case #2, and Case #3. But in some cases the person taking the check might have detected the fraud and thus have prevented the loss by the exercise of [ordinary care](#). In those cases, if that person failed to exercise ordinary care, it is reasonable that that person bear loss to the extent the failure contributed to the loss. Subsection (d) is intended to

reach that result. It allows the person who suffers loss as a result of payment of the check to recover from the person who failed to exercise ordinary care. In Case #1, Case #2, and Case #3, the person suffering the loss is Corporation, the drawer of the check. In each case the most likely defendant is the depository bank that took the check and failed to exercise ordinary care. In those cases, the drawer has a cause of action against the offending bank to recover a portion of the loss. The amount of loss to be allocated to each [party](#) is left to the trier of fact. Ordinary care is defined in Section [3-103\(a\)\(7\)](#). An example of the type of conduct by a depository bank that could give rise to recovery under subsection (d) is discussed in [4 to Section 3-405](#). That Comment addresses the last sentence of Section [3-405\(b\)](#) which is similar to Section [3-404\(d\)](#).

In Case #1, Case #2, and Case #3, there was no forgery of the [drawer's](#) signature. But cases involving [checks](#) payable to a fictitious payee or a payee not intended to have an interest in the check are often forged check cases as well. Examples are Case #4 and Case #5. Normally, the loss in forged check cases is on the [drawee](#) bank that paid the check. Case #5 is an example. In Case #4 the risk with respect to the forgery is shifted to the drawer because of the agreement between the drawer and the drawee bank. The doctrine that prevents a drawee bank from recovering payment with respect to a forged check if the payment was made to a person who took the check for value and in [good faith](#) is incorporated into Section [3-418](#) and Sections [3-417\(a\)\(3\)](#) and [4-208\(a\)\(3\)](#). This doctrine is based on the assumption that the depository bank normally has no way of detecting the forgery because the drawer is not that bank's customer. On the other hand, the drawee bank, at least in some cases, may be able to detect the forgery by comparing the signature on the check with the specimen signature that the drawee has on file. But in some forged check cases the depository bank is in a position to detect the fraud. Those cases typically involve a check payable to a fictitious payee or a payee not intended to have an interest in the [check](#). Subsection (d) applies to those cases. If the depository bank failed to exercise [ordinary care](#) and the failure substantially contributed to the loss, the [drawer](#) in Case #4 or the drawee bank in Case #5 has a cause of action against the depository bank under subsection (d). [4 to Section 3-405](#) can be used as a guide to the type of conduct that could give rise to recovery under Section [3-404\(d\)](#).

Official Comment [§ 3-405](#)

1. Section [3-405](#) is addressed to [fraudulent indorsements](#) made by an employee with respect to [instruments](#) with respect to which the employer has given [responsibility](#) to the employee. It covers two categories of fraudulent indorsements: [indorsements](#) made in the name of the employer to instruments payable to the employer and indorsements made in the name of payees of instruments [issued](#) by the employer. This section applies to instruments generally but normally the instrument will be a [check](#). Section [3-405](#) adopts the principle that the risk of loss for fraudulent indorsements by employees who are entrusted with [responsibility](#) with respect to checks should fall on the employer rather than the bank that takes the check or pays it, if the bank was not negligent in the transaction. Section [3-405](#) is based on the belief that the employer is in a far better position to avoid the loss by care in choosing employees, in supervising them, and in adopting other measures to prevent forged indorsements on instruments payable to the employer or fraud in the

issuance of instruments in the name of the employer. If the bank failed to exercise [ordinary care](#), subsection (b) allows the employer to shift loss to the bank to the extent the bank's failure to exercise ordinary care contributed to the loss. "Ordinary care" is defined in Section [3-103\(a\)\(7\)](#). The provision applies regardless of whether the employer is negligent.

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

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

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

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

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

Case #2. X is Treasurer of Corporation and is authorized to write [checks](#) on behalf of Corporation by signing X's name as Treasurer. X draws a check in the name of Corporation and signs X's name as Treasurer. The check is made payable to X. X then indorses the check and obtains payment. Assume that Corporation did not owe any money to X and did not authorize X to write the check. Although the writing of the check was not authorized, Corporation is bound as [drawer](#) of the check because X had authority to sign checks on behalf of Corporation. This result follows from agency law and Section [3-402\(a\)](#). Section [3-405](#) does not apply in this case because there is no forged [indorsement](#). X was payee of the check so the indorsement is valid. Section [3-110\(a\)](#).

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

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

Case #5. The computer that controls Employer's check-writing machine was programmed to cause a [check](#) to be [issued](#) to Supplier Co. to which money was owed by Employer. The address of Supplier Co. was included in the information in the computer. Employee is an accounts payable clerk whose duties include entering information into the computer. Employee fraudulently changed the address of Supplier Co. in the computer data bank to an address of Employee. The check was subsequently produced by the check-writing machine and mailed to the address that Employee had entered into the computer. Employee obtained possession of the check, indorsed it in the name of Supplier Co, and deposited it to an account in Depository Bank which Employee opened in the name "Supplier Co." The check was honored by the [drawee](#) bank. The [indorsement](#) is effective under Section [3-405\(b\)](#) because Employee's duties allowed Employee to supply information determining the address of the payee of the check. An employee that is entrusted with duties that enable the employee to determine the address to which a check is to be sent controls the disposition of the check and facilitates

forgery of the indorsement. The employer is held responsible. The drawee may debit the account of Employer for the amount of the check. There is no breach of warranty by Depository Bank under Section [3-417\(a\)\(1\)](#) or [4-208\(a\)\(1\)](#).

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

Case #7. Checks of Corporation are signed by Treasurer in behalf of Corporation as [drawer](#). Clerk's duties include the preparation of [checks](#) for [issue](#) by Corporation. Clerk prepares a check payable to the [order](#) of Supplier Co. for Treasurer's signature. Clerk fraudulently informs Treasurer that the check is needed to pay a debt owed to Supplier Co, a company that does business with Corporation. No money is owed to Supplier Co. and Clerk intends to steal the check. Treasurer signs it and returns it to Clerk for mailing. Clerk does not indorse the check but deposits it to an account in Depository Bank which Clerk opened in the name "Supplier Co.". The check is honored by the [drawee](#) bank. Section [3-404\(b\)\(i\)](#) does not apply to this case because Clerk, under Section [3-110\(a\)](#), is not the person whose intent determines to whom the check is payable. But Section [3-405](#) does apply and it treats the deposit by Clerk as an effective [indorsement](#) by Clerk because Clerk was entrusted with [responsibility](#) with respect to the check. If Supplier Co. is a fictitious person Section [3-404\(b\)\(ii\)](#) applies. But the result is the same. Clerk's deposit is treated as an effective indorsement of the check whether Supplier Co. is a fictitious or a real person or whether money was or was not owing to Supplier Co. The drawee bank may debit the account of Corporation for the amount of the check and there is no breach of warranty by Depository Bank under Section [3-417\(1\)\(a\)](#). [sic]

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

corporation. A few days later, the check is deposited, the account is credited, and the [check](#) is presented for payment. After Depository Bank receives payment, it allows Employee to withdraw the credit by a wire transfer to an account in a bank in a foreign country. The trier of fact could find that Depository Bank did not exercise [ordinary care](#) and that the failure to exercise ordinary care contributed to the loss suffered by Employer. The trier of fact could allow recovery by Employer from Depository Bank for all or part of the loss suffered by Employer.

Official Comment [§ 3-406](#)

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

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

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

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

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

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

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

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

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

drawer is precluded from asserting the alteration against the drawee if the check was paid in good faith.

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

Official Comment [§ 3-407](#)

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

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

2. Under subsection (c) a person paying a fraudulently altered [instrument](#) or taking it for value, in [good faith](#) and without notice of the [alteration](#), is not affected by a discharge under subsection (b). The person paying or taking the instrument may assert rights with respect to the instrument according to its original terms or, in the case of an [incomplete instrument](#) that is altered by unauthorized completion, according to its terms as completed. If blanks are filled or an incomplete instrument is otherwise completed, subsection (c) places the loss upon the party who left the instrument incomplete by permitting enforcement in its completed form. This result is intended even though the instrument was stolen from the [issuer](#) and completed after the theft.

Official Comment [§ 3-408](#)

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

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

Official Comment [§ 3-409](#)

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

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

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

4. The last sentence of subsection (d) states the generally recognized rule that in the absence of agreement a bank is under no obligation to certify a [check](#). A

check is a demand [instrument](#) calling for payment rather than [acceptance](#). The bank may be liable for breach of any agreement with the [drawer](#), the holder, or any other person by which it undertakes to certify. Its liability is not on the instrument, since the [drawee](#) is not so liable until acceptance. Section [3-408](#). Any liability is for breach of the separate agreement.

Official Comment [§ 3-410](#)

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

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

2. Under subsection (b) an [acceptance](#) does not vary from the terms of the [draft](#) if it provides for payment at any particular bank or place in the United States unless the acceptance states that the draft is to be paid only at such bank or place. Section [3-501\(b\)](#)(1) states that if an instrument is payable at a bank in the United States [presentment](#) must be made at the place of payment (Section [3-111](#)) which in this case is at the designated bank.

Official Comment [§ 3-411](#)

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

2. The term "obligated bank" refers to the [issuer](#) of the [cashier's check](#) or [teller's check](#) and the [acceptor](#) of the [certified check](#). If the [obligated bank](#) wrongfully

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

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

Official Comment [§ 3-412](#)

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

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

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

Official Comment [§ 3-413](#)

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

Official Comment [§ 3-414](#)

1. Subsection (a) excludes [cashier's checks](#) because the obligation of the [issuer](#) of a cashier's check is stated in Section [3-412](#).
2. Subsection (b) states the obligation of the [drawer](#) on an unaccepted [draft](#). It replaces former Section 3-413(2). The requirement under former Article 3 of notice of dishonor or protest has been eliminated. Under revised Article 3, notice of dishonor is necessary only with respect to [indorser's](#) liability. The liability of the drawer of an unaccepted draft is treated as a primary liability. Under former Section 3-102(1)(d) the term "secondary party" was used to refer to a drawer or indorser. The quoted term is not used in revised Article 3. The effect of a draft drawn without recourse is stated in subsection (e).
3. Under subsection (c) the [drawer](#) is discharged of liability on a [draft](#) accepted by a bank regardless of when [acceptance](#) was obtained. This changes former Section 3-411(1) which provided that the drawer is discharged only if the holder obtains acceptance. Holders that have a bank obligation do not normally rely on the drawer to guarantee the bank's solvency. A holder can obtain protection against the insolvency of a bank [acceptor](#) by a specific guaranty of payment by the drawer or by obtaining an [indorsement](#) by the drawer. Section [3-205\(d\)](#).
4. Subsection (d) states the liability of the [drawer](#) if a [draft](#) is accepted by a [drawee](#) other than a bank and the [acceptor](#) dishonors. The drawer of an unaccepted draft is the only [party](#) liable on the [instrument](#). The drawee has no liability on the draft. Section [3-408](#). When the [draft](#) is accepted, the obligations change. The drawee, as acceptor, becomes primarily liable and the drawer's liability is that of a person secondarily liable as a guarantor of payment. The drawer's liability is identical to that of an [indorser](#), and subsection (d) states the drawer's liability that way. The drawer is liable to pay the [person entitled to enforce](#) the draft or any indorser that pays pursuant to Section [3-415](#). The drawer in this case is discharged if notice of dishonor is required by Section [3-503](#) and is not given in compliance with that section. A drawer that pays has a right of recourse against the acceptor. Section [3-413\(a\)](#).
5. Subsection (e) does not permit the [drawer](#) of a [check](#) to avoid liability under subsection (b) by drawing the check without recourse. There is no legitimate purpose served by issuing a check on which nobody is liable. Drawing without recourse is effective to disclaim liability of the drawer if the [draft](#) is not a check. Suppose, in a documentary sale, Seller draws a draft on Buyer for the price of goods shipped to Buyer. The draft is payable upon delivery to the [drawee](#) of an [order](#) bill of lading covering the goods. Seller delivers the draft with the bill of lading to Finance Company that is named as payee of the draft. If Seller draws without recourse Finance Company takes the risk that Buyer will dishonor. If Buyer dishonors, Finance Company has no recourse against Seller but it can

obtain reimbursement by selling the goods which it controls through the bill of lading.

6. Subsection (f) is derived from former Section 3-502(1)(b). It is designed to protect the [drawer](#) of a [check](#) against loss resulting from suspension of payments by the [drawee](#) bank when the holder of the check delays collection of the check. For example, X writes a check payable to Y for \$1,000. The check is covered by funds in X's account in the drawee bank. Y delays initiation of collection of the check for more than 30 days after the date of the check. The drawee bank suspends payments after the 30-day period and before the check is presented for payment. If the \$1,000 of funds in X's account have not been withdrawn, X has a claim for those funds against the drawee bank and, if subsection (e) were not in effect, X would be liable to Y on the check because the check was dishonored. Section [3-502\(e\)](#). If the suspension of payments by the [drawee](#) bank will result in payment to X of less than the full amount of the \$1,000 in the account or if there is a significant delay in payment to X, X will suffer a loss which would not have been suffered if Y had promptly initiated collection of the [check](#). In most cases, X will not suffer any loss because of the existence of federal bank deposit insurance that covers accounts up to \$100,000. Thus, subsection (e) has relatively little importance. There might be some cases, however, in which the account is not fully insured because it exceeds \$100,000 or because the account doesn't qualify for deposit insurance. Subsection (f) retains the phrase "deprived of funds maintained with the drawee" appearing in former Section 3-502(1)(b). The quoted phrase applies if the suspension of payments by the drawee prevents the [drawer](#) from receiving the benefit of funds which would have paid the check if the holder had been timely in initiating collection. Thus, any significant delay in obtaining full payment of the funds is a deprivation of funds. The drawer can discharge drawer's liability by assigning rights against the drawee with respect to the funds to the holder.

Official Comment [§ 3-415](#)

1. Subsection (a) and (b) restate the substance of former Section 3-414(1). Subsection (2) of former Section 3-414 has been dropped because it is superfluous. Although notice of dishonor is not mentioned in subsection (a), it must be given in some cases to charge an [indorser](#). It is covered in subsection (c). Regulation CC § 229.35(b) provides that a bank handling a [check](#) for collection or return is liable to a bank that subsequently handles the check to the extent the latter bank does not receive payment for the check. This liability applies whether or not the bank incurring the liability indorsed the check.
2. Section [3-503](#) states when notice of dishonor is required and how it must be given. If required notice of dishonor is not given in compliance with Section [3-503](#), subsection (c) of Section [3-415](#) states that the effect is to discharge the [indorser's](#) obligation.
3. Subsection (d) is similar in effect to Section [3-414\(c\)](#) if the [draft](#) is accepted by a bank after the [indorsement](#) is made. See [3 to Section 3-414](#). If a draft is accepted by a bank before the indorsement is made, the [indorser](#) incurs the obligation stated in subsection (a).

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

5. As stated in subsection (a), the obligation of an indorser to pay the amount due on the [instrument](#) is generally owed not only to a [person entitled to enforce](#) the instrument but also to a subsequent indorser who paid the instrument. But if the prior indorser and the subsequent indorser are both anomalous indorsers, this rule does not apply. In that case, Section [3-116](#) applies. Under Section [3-116\(a\)](#), the anomalous indorsers are jointly and severally liable and if either pays the instrument the indorser who pays has a right of contribution against the other. Section [3-116\(b\)](#). The right to contribution in Section [3-116\(b\)](#) is subject to "agreement of the affected parties." Suppose the subsequent indorser can [prove](#) an agreement with the prior indorser under which the prior indorser agreed to treat the subsequent indorser as a guarantor of the obligation of the prior indorser. Rights of the two indorsers between themselves would be governed by the agreement. Under suretyship law, the subsequent indorser under such an agreement is referred to as a sub-surety. Under the agreement, if the subsequent indorser pays the instrument there is a right to reimbursement from the prior indorser; if the prior indorser pays the instrument, there is no right of recourse against the subsequent indorser. See [PEB Commentary No. 11](#), dated December 15, 1993.

Official Comment [§ 3-416](#)

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

2. Since the purpose of transfer (Section [3-203\(a\)](#)) is to give the transferee the right to enforce the [instrument](#), subsection (a)(1) is a warranty that the transferor is a [person entitled to enforce](#) the instrument (Section [3-301](#)). Under Section [3-203\(b\)](#) transfer gives the transferee any right of the transferor to enforce the instrument. Subsection (a)(1) is in effect a warranty that there are no unauthorized or missing [indorsements](#) that prevent the transferor from making the transferee a person entitled to enforce the instrument.

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

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

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

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

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

Official Comment [§ 3-417](#)

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

2. Subsection (a) states three warranties. Subsection (a)(1) in effect is a warranty that there are no unauthorized or missing [indorsements](#). "Person entitled to enforce" is defined in Section [3-301](#). Subsection (a)(2) is a warranty that there is no [alteration](#). Subsection (a)(3) is a warranty of no knowledge that there is a forged [drawer's](#) signature. Subsection (a) states that the warranties are made to the [drawee](#) and subsections (b) and (c) identify the drawee as the person entitled to recover for breach of warranty. There is no warranty made to the drawer under subsection (a) when [presentment](#) is made to the drawee. Warranty to the drawer is governed by subsection (d) and that applies only when presentment for payment is made to the drawer with respect to a dishonored [draft](#). In *Sun 'N Sand, Inc. v. United California Bank*, 582 P.2d 920 (Cal. 1978), the court held that under former Section 3-417(1) a warranty was made to the drawer of a check when the check was presented to the drawee for payment. The result in that case is rejected.

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

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

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

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

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

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

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

Official Comment [§ 3-418](#)

1. This section covers payment or [acceptance](#) by mistake and replaces former Section 3-418. Under former Article 3, the remedy of a [drawee](#) that paid or accepted a [draft](#) by mistake was based on the law of mistake and restitution, but that remedy was not specifically stated. It was provided by Section [1-103](#). Former Section 3-418 was simply a limitation on the unstated remedy under the law of mistake and restitution. Under revised Article 3, Section [3-418](#) specifically states the right of restitution in subsections (a) and (b). Subsection (a) allows restitution in the two most common cases in which the problem is presented: payment or acceptance of forged [checks](#) and checks on which the [drawer](#) has stopped payment. If the drawee acted under a mistaken belief that the check was not forged or had not been stopped, the drawee is entitled to recover the funds paid or to revoke the acceptance whether or not the drawee acted negligently. But in each case, by virtue of subsection (c), the drawee loses the remedy if the person receiving payment or acceptance was a person who took the check in [good faith](#) and for value or who in good faith changed position in reliance on the payment or acceptance. Subsections (a) and (c) are consistent with former Section 3-418 and the rule of *Price v. Neal*. The result in the two cases covered by subsection (a) is that the [drawee](#) in most cases will not have a remedy against the person paid because there is usually a person who took the [check](#) in good faith and for value or who in good faith changed position in reliance on the payment or [acceptance](#).

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

payment over the counter and requested a cashier's check as payment. Bank issued and delivered a cashier's check for \$10,000 payable to Seller. The teller failed to discover Buyer's stop [order](#). The next day Bank discovered the mistake and immediately advised Seller of the facts. Seller refused to return the cashier's check and did not deliver any goods to Buyer.

Under Section [4-215](#), Buyer's [check](#) was paid by Bank at the time it delivered its [cashier's check](#) to Seller. See Comment 3 to Section [4-215](#). Bank is obliged to pay the cashier's check and has no defense to that obligation. The cashier's check was [issued](#) for [consideration](#) because it was issued in payment of Buyer's check. Although Bank has no defense on its cashier's check it may have a right to recover \$10,000, the amount of Buyer's check, from Seller under Section [3-418\(a\)](#). Bank paid Buyer's check by mistake. Seller did not give value for Buyer's check because the [promise](#) to deliver goods to Buyer was never performed. Section [3-303\(a\)\(1\)](#). And, on these facts, Seller did not change position in reliance on the payment of Buyer's check. Thus, the first sentence of Section [3-418\(c\)](#) does not apply and Seller is obliged to return \$10,000 to Bank. Bank is obliged to pay the cashier's check but it has a counterclaim against Seller based on its rights under Section [3-418\(a\)](#). This claim can be asserted against Seller, but it cannot be asserted against some other person with rights of a [holder in due course](#) of the cashier's check. A person without rights of a holder in due course of the cashier's check would take subject to Bank's claim against Seller because it is a claim in recoupment. Section [3-305\(a\)\(3\)](#).

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

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

3. Subsection (b) covers cases of payment or [acceptance](#) by mistake that are not covered by subsection (a). It directs courts to deal with those cases under the law governing mistake and restitution. Perhaps the most important class of cases that falls under subsection (b), because it is not covered by subsection (a), is that of payment by the [drawee](#) bank of a [check](#) with respect to which the bank has no duty to the [drawer](#) to pay either because the drawer has no account with the bank or because available funds in the drawer's account are not sufficient to cover the amount of the check. With respect to such a case, under Restatement of Restitution § 29, if the bank paid because of a mistaken belief that there were available funds in the drawer's account sufficient to cover the amount of the

check, the bank is entitled to restitution. But § 29 is subject to Restatement of Restitution § 33 which denies restitution if the holder of the check receiving payment paid value in [good faith](#) for the check and had no reason to know that the check was paid by mistake when payment was received.

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

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

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

Official Comment [§ 3-419](#)

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

2. It does not matter whether an [accommodation party](#) signs gratuitously either at the time the [instrument](#) is [issued](#) or after the instrument is in the possession

of a holder. Subsection (b) of Section [3-419](#) takes the view stated in Comment 3 to former Section 3-415 that there need be no [consideration](#) running to the accommodation party: "The obligation of the accommodation party is supported by any consideration for which the instrument is taken before it is due. Subsection (2) is intended to change occasional decisions holding that there is no sufficient consideration where an accommodation party signs a note after it is in the hands of a holder who has given value. The [accommodation] party is liable to the holder in such a case even though there is no extension of time or other concession."

3. As stated in Comment 1, whether a person is an [accommodation party](#) is a question of fact. But it is almost always the case that a co-maker who signs with words of guaranty after the signature is an accommodation party. The same is true of an anomalous indorser. In either case a person taking the [instrument](#) is put on notice of the accommodation status of the co-maker or [indorser](#). This is relevant to Section [3-605\(h\)](#). But, under subsection (c), signing with words of guaranty or as an anomalous indorser also creates a presumption that the signer is an accommodation party. A party challenging accommodation party status would have to rebut this presumption by producing evidence that the signer was in fact a direct beneficiary of the value given for the instrument.

An [accommodation party](#) is always a surety. A surety who is not a party to the [instrument](#), however, is not an accommodation party. For example, if M [issues](#) a [note](#) payable to the [order](#) of P, and S signs a separate contract in which S agrees to pay P the amount of the instrument if it is dishonored, S is a surety but is not an accommodation party. In such a case, S's rights and duties are determined under the general law of suretyship. In unusual cases two parties to an instrument may have a surety relationship that is not governed by Article 3 because the requirements of Section [3-419\(a\)](#) are not met. In those cases the general law of suretyship applies to the relationship. See [PEB Commentary No. 11](#), dated December 15, 1993.

4. Subsection (b) states that an [accommodation party](#) is liable on the [instrument](#) in the capacity in which the [party](#) signed the instrument. In most cases that capacity will be either that of a [maker](#) or [indorser](#) of a [note](#). But subsection (d) provides a limitation on subsection (b). If the signature of the accommodation party is accompanied by words indicating unambiguously that the party is guaranteeing collection rather than payment of the instrument, liability is limited to that stated in subsection (d), which is based on former Section 3-416(2). Words added to an [anomalous indorsement](#) indicating that payment of the [instrument](#) is guaranteed by the indorser do not change the liability of the indorser as stated in Section [3-415](#). This is a change from former Section 3-416(5). See [PEB Commentary No. 11](#), supra.

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

5. Subsection (e) like former Section 3-415(5), provides that an [accommodation party](#) that pays the [instrument](#) is entitled to enforce the instrument against the [accommodated party](#). Since the accommodation party that pays the instrument is entitled to enforce the instrument against the accommodated party, the accommodation party also obtains rights to any security interest or other collateral that secures payment of the instrument. Subsection (e) also provides that an accommodation party that pays the instrument is entitled to reimbursement from the accommodated party. See [PEB Commentary No. 11](#), supra.

6. In occasional cases, the [accommodation party](#) might pay the [instrument](#) even though the [accommodated party](#) had a defense to its obligation that was available to the accommodation party under Section [3-305\(d\)](#). In such cases, the accommodation party's right to reimbursement may conflict with the accommodated party's right to raise its defense. For example, suppose the accommodation party pays the instrument without being aware of the defense. In that case the accommodation party should be entitled to reimbursement. Suppose the accommodation party paid the instrument with knowledge of the defense. In that case, to the extent of the defense, reimbursement ordinarily would not be justified, but under some circumstances reimbursement may be justified depending upon the facts of the case. The resolution of this conflict is left to the general law of suretyship. Section [1-103](#). See [PEB Commentary No. 11](#), supra.

7. Section [3-419](#), along with Section [3-116\(a\)](#) and [\(b\)](#), Section [3-305\(d\)](#) and Section [3-605](#), provides rules governing the rights of [accommodation parties](#). In addition, except to the extent that it is displaced by provisions of this Article, the general law of suretyship also applies to the rights of accommodation parties. Section [1-103](#). See [PEB Commentary No. 11](#), supra.

Official Comment [§ 3-420](#)

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

takes the check for deposit to John's account, Depository Bank is liable to Jane for conversion of the check if she did not consent to the transaction. John, acting alone, is not the person entitled to enforce the check because John is not the holder of the check. Section [3-110\(d\)](#) and [4 to Section 3-110](#). Depository Bank does not get any greater rights under Section [4-205\(1\)](#). If it acted for John as its customer, it did not become holder of the check under that provision because John, its customer, was not a holder.

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

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

The situation is different if the [check](#) is delivered to the payee. If the check is taken for an obligation owed to the payee, the last sentence of Section [3-310\(b\)\(4\)](#) provides that the obligation may not be enforced to the extent of the amount of the check. The payee's rights are restricted to enforcement of the payee's rights in the [instrument](#). In this event the payee is injured by the theft and has a cause of action for conversion.

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

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

The "but" clause in subsection (b) addresses the problem of conversion actions in multiple payee [checks](#). Section [3-110\(d\)](#) states that an [instrument](#) cannot be enforced unless all payees join in the action. But an action for conversion might be brought by a payee having no interest or a limited interest in the proceeds of the check. This clause prevents such a plaintiff from receiving a windfall. An example is a check payable to a building contractor and a supplier of building material. The check is not payable to the payees alternatively. Section [3-110\(d\)](#). The check is delivered to the contractor by the owner of the building. Suppose the contractor forges supplier's signature as an [indorsement](#) of the check and receives the entire proceeds of the check. The supplier should not, without qualification, be able to recover the entire amount of the check from the bank that converted the check. Depending upon the contract between the contractor and the supplier, the amount of the check may be due entirely to the contractor, in which case there should be no recovery, entirely to the supplier, in which case recovery should be for the entire amount, or part may be due to one and the rest to the other, in which case recovery should be limited to the amount due to the supplier.

3. Subsection (3) of former Section 3-419 drew criticism from the courts, that saw no reason why a depository bank should have the defense stated in the subsection. See *Knesz v. Central Jersey Bank & Trust Co.*, 477 A.2d 806 (N.J. 1984). The depository bank is ultimately liable in the case of a forged [indorsement check](#) because of its warranty to the payor bank under Section [4-](#)

[208\(a\)](#)(1) and it is usually the most convenient defendant in cases involving multiple checks drawn on different banks. There is no basis for requiring the owner of the check to bring multiple actions against the various payor banks and to require those banks to assert warranty rights against the depository bank. In revised Article 3, the defense provided by Section [3-420\(c\)](#) is limited to collecting banks other than the depository bank. If suit is brought against both the payor bank and the depository bank, the owner, of course, is entitled to but one recovery.

Official Comment [§ 3-501](#)

Subsection (a) defines [presentment](#). Subsection (b)(1) states the place and manner of presentment. Electronic presentment is authorized. The communication of the demand for payment or [acceptance](#) is effective when received. Subsection (b)(2) restates former Section 3-505. Subsection (b)(2)(i) allows the person to whom presentment is made to require exhibition of the [instrument](#), unless the parties have agreed otherwise as in an electronic presentment agreement. Former Section 3-507(3) is the antecedent of subsection (b)(3)(i). Since a payor must decide whether to pay or accept on the day of presentment, subsection (b)(4) allows the payor to set a cut-off hour for receipt of instruments presented.

Official Comment [§ 3-502](#)

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

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

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

4. Subsection (b) applies to unaccepted [drafts](#) other than documentary drafts. Subsection (b)(1) applies to [checks](#). Except for checks presented for immediate payment over the counter, which are covered by subsection (b)(2), dishonor occurs according to rules stated in Article 4. When a check is presented for payment through the check-collection system, the [drawee](#) bank normally makes settlement for the amount of the check to the presenting bank. Under Section [4-301](#) the drawee bank may recover this settlement if it returns the check within its midnight deadline (Section [4-104](#)). In that case the check is not paid and dishonor occurs under Section [3-502\(b\)](#)(1). If the drawee bank does not return the check or give notice of dishonor or nonpayment within the midnight deadline, the settlement becomes final payment of the check. Section [4-215](#). Thus, no dishonor occurs regardless of whether the check is retained or is returned after the midnight deadline. In some cases the drawee bank might not settle for the check when it is received. Under Section [4-302](#) if the drawee bank is not also the depository bank and retains the check without settling for it beyond midnight of the day it is presented for payment, the bank becomes "accountable" for the amount of the check, i.e. it is obliged to pay the amount of the [check](#). If the [drawee](#) bank is also the depository bank, the bank is accountable for the amount of the check if the bank does not pay the check or return it or send notice of dishonor within the midnight deadline. In all cases in which the drawee bank becomes accountable, the check has not been paid and, under Section [3-502\(b\)](#)(1), the check is dishonored. The fact that the bank is obliged to pay the check does not mean that the check has been paid. When a check is presented for payment, the person presenting the check is entitled to payment not just the obligation of the drawee to pay. Until that payment is made, the check is dishonored. To say that the drawee bank is obliged to pay the check necessarily means that the check has not been paid. If the check is eventually paid, the drawee bank no longer is accountable.

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

Subsection (b)(3) and (4) applies to time [drafts](#). An unaccepted time draft differs from a time [note](#). The [maker](#) of a note knows that the note has been [issued](#), but the [drawee](#) of a draft may not know that a draft has been drawn on it. Thus, with respect to drafts, [presentment](#) for payment or [acceptance](#) is required. Subsection (b)(3) applies to drafts payable on a date stated in the draft. Dishonor occurs if presentment for payment is made and payment is not

made on the day the draft becomes payable or the day of presentment if presentment is made after the due date. The holder of an unaccepted draft payable on a stated date has the option of presenting the draft for acceptance before the day the draft becomes payable to establish whether the drawee is willing to assume liability by accepting. Under subsection (b)(3)(ii) dishonor occurs when the draft is presented and not accepted. Subsection (b)(4) applies to unaccepted drafts payable on elapse of a period of time after sight or acceptance. If the draft is payable 30 days after sight, the draft must be presented for acceptance to start the running of the 30-day period. Dishonor occurs if it is not accepted. The rules in subsection (b)(3) and (4) follow former Section 3-501(1)(a).

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

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

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

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

Official Comment [§ 3-503](#)

1. Subsection (a) is consistent with former Section 3-501(2)(a), but notice of dishonor is no longer relevant to the liability of a [drawer](#) except for the case of a [draft](#) accepted by an [acceptor](#) other than a bank. Comments 2 and 4 to Section [3-414](#). There is no reason why drawers should be discharged on [instruments](#) they draw until payment or [acceptance](#). They are entitled to have the instrument presented to the [drawee](#) and dishonored (Section [3-414\(b\)](#)) before they are liable to pay, but no notice of dishonor need be made to them as a condition of liability. Subsection (b), which states how notice of dishonor is given, is based on former Section 3-508(3).

2. Subsection (c) replaces former Section 3-508(2). It differs from that section in that it provides a 30-day period for a person other than a collecting bank to

give notice of dishonor rather than the three-day period allowed in former Article 3. Delay in giving notice of dishonor may be excused under Section [3-504\(c\)](#).

Official Comment [§ 3-504](#)

Section [3-504](#) is largely a restatement of former Section 3-511. Subsection (4) of former Section 3-511 is replaced by Section [3-502\(f\)](#).

Official Comment [§ 3-505](#)

Protest is no longer mandatory and must be requested by the holder. Even if requested, protest is not a condition to the liability of [indorsers](#) or [drawers](#). Protest is a service provided by the banking system to establish that dishonor has occurred. Like other services provided by the banking system, it will be available if market incentives, interbank agreements, or governmental regulations require it, but liabilities of parties no longer rest on it. Protest may be a requirement for liability on international [drafts](#) governed by foreign law which this Article cannot affect.

Official Comment [§ 3-601](#)

Subsection (a) replaces subsections (1) and (2) of former Section 3-601. Subsection (b) restates former Section 3-602. Notice of discharge is not treated as notice of a defense that prevents [holder in due course](#) status. Section [3-302\(b\)](#). Discharge is effective against a holder in due course only if the holder had notice of the discharge when holder in due course status was acquired. For example, if an [instrument](#) bearing a canceled [indorsement](#) is taken by a holder, the holder has notice that the [indorser](#) has been discharged. Thus, the discharge is effective against the holder even if the holder is a holder in due course.

Official Comment [§ 3-602](#)

This section replaces former Section 3-603(1). The phrase "claim to the instrument" in subsection (a) means, by reference to Section [3-306](#), a claim of ownership or possession and not a claim in recoupment. Subsection (b)(1)(ii) is added to conform to Section [3-411](#). Section [3-411](#) is intended to discourage an [obligated bank](#) from refusing payment of a [cashier's check](#), [certified check](#), or dishonored [teller's check](#) at the request of a claimant to the [check](#) who provided the bank with indemnity against loss. See [1 to Section 3-411](#). An obligated bank that refuses payment under those circumstances not only remains liable on the check but may also be liable to the holder of the check for consequential damages. Section [3-602\(b\)\(1\)\(ii\)](#) and Section [3-411](#), read together, change the rule of former Section 3-603(1) with respect to the obligation of the obligated bank on the check. Payment to the holder of a cashier's check, teller's check, or certified check discharges the obligation of the obligated bank on the check to both the holder and the claimant even though indemnity has been given by the person asserting the claim. If the obligated bank pays the check in violation of an agreement with the claimant in connection with the indemnity agreement, any liability that the bank may have for violation of the agreement is not governed by Article 3, but is left to other law. This section continues the rule that the obligor

is not discharged on the [instrument](#) if payment is made in violation of an injunction against payment. See Section [3-411\(c\)](#)(iv).

Official Comment [§ 3-603](#)

Section [3-603](#) replaces former Section 3-604. Subsection (a) generally incorporates the law of tender of payment applicable to simple contracts. Subsections (b) and (c) state particular rules. Subsection (b) replaces former Section 3-604(2). Under subsection (b) refusal of a tender of payment discharges any [indorser](#) or [accommodation party](#) having a right of recourse against the [party](#) making the tender. Subsection (c) replaces former Section 3-604(1) and (3).

Official Comment [§ 3-604](#)

Section [3-604](#) replaces former Section 3-605.

Official Comment [§ 3-605](#)

1. Section [3-605](#), which replaces former Section 3-606, can be illustrated by an example. Bank lends \$10,000 to Borrower who signs a [note](#) under which Borrower is obliged to pay \$10,000 to Bank on a due date stated in the note. Bank insists, however, that [Accommodation Party](#) also become liable to pay the [note](#). Accommodation Party can incur this liability by signing the note as a co-maker or by indorsing the note. In either case the note is signed for accommodation and Borrower is the [accommodated party](#). Rights and obligations of Accommodation Party in this case are stated in Section [3-419](#). Suppose that after the note is signed, Bank agrees to a modification of the rights and obligations between Bank and Borrower. For example, Bank agrees that Borrower may pay the note at some date after the due date, or that Borrower may discharge Borrower's \$10,000 obligation to pay the note by paying Bank \$3,000, or that Bank releases collateral given by Borrower to secure the note. Under the law of suretyship Borrower is usually referred to as the principal debtor and Accommodation Party is referred to as the surety. Under that law, the surety can be discharged under certain circumstances if changes of this kind are made by Bank, the creditor, without the consent of Accommodation Party, the surety. Rights of the surety to discharge in such cases are commonly referred to as suretyship defenses. Section [3-605](#) is concerned with this kind of problem in the context of a [negotiable instrument](#) to which the principal debtor and the surety are parties. But Section [3-605](#) has a wider scope. It also applies to [indorsers](#) who are not [accommodation parties](#). Unless an indorser signs without recourse, the indorser's liability under Section [3-415\(a\)](#) is that of a guarantor of payment. If Bank in our hypothetical case indorsed the [note](#) and transferred it to Second Bank, Bank has rights given to an indorser under Section [3-605](#) if it is Second Bank that modifies rights and obligations of Borrower. Both accommodation parties and indorsers will be referred to in these Comments as sureties. The scope of Section [3-605](#) is also widened by subsection (e) which deals with rights of a non-accommodation party co-maker when collateral is impaired.

2. The importance of suretyship defenses is greatly diminished by the fact that they can be waived. The waiver is usually made by a provision in the [note](#) or other writing that represents the obligation of the principal debtor. It is standard practice to include a waiver of suretyship defenses in notes given to financial institutions or other commercial creditors. Section [3-605\(i\)](#) allows waiver. Thus, Section [3-605](#) applies to the occasional case in which the creditor did not include a waiver clause in the [instrument](#) or in which the creditor did not obtain the permission of the surety to take the action that triggers the suretyship defense.

3. Subsection (b) addresses the effect of discharge under Section [3-604](#) of the principal debtor. In the hypothetical case stated in Comment 1, release of Borrower by Bank does not release [Accommodation Party](#). As a practical matter, Bank will not gratuitously release Borrower. Discharge of Borrower normally would be part of a settlement with Borrower if Borrower is insolvent or in financial difficulty. If Borrower is unable to pay all creditors, it may be prudent for Bank to take partial payment, but Borrower will normally insist on a release of the obligation. If Bank takes \$3,000 and releases Borrower from the \$10,000 debt, Accommodation Party is not injured. To the extent of the payment Accommodation Party's obligation to Bank is reduced. The release of Borrower by Bank does not affect the right of Accommodation Party to obtain reimbursement from Borrower or to enforce the [note](#) against Borrower if Accommodation Party pays Bank. Section [3-419\(e\)](#). Subsection (b) is designed to allow a creditor to settle with the principal debtor without risk of losing rights against sureties. Settlement is in the interest of sureties as well as the creditor. Subsection (b), however, is not intended to apply to a settlement of a disputed claim which discharges the obligation.

Subsection (b) changes the law stated in former Section 3-606 but the change relates largely to formalities rather than substance. Under former Section 3-606, Bank in the hypothetical case stated in Comment 1 could settle with and release Borrower without releasing [Accommodation Party](#), but to accomplish that result Bank had to either obtain the consent of Accommodation Party or make an express reservation of rights against Accommodation Party at the time it released Borrower. The reservation of rights was made in the agreement between Bank and Borrower by which the release of Borrower was made. There was no requirement in former Section 3-606 that any notice be given to Accommodation Party. Section [3-605](#) eliminates the necessity that Bank formally reserve rights against Accommodation Party in [order](#) to retain rights of recourse against Accommodation Party. See [PEB Commentary No. 11](#), dated December 15, 1993.

4. Subsection (c) relates to extensions of the due date of the [instrument](#). In most cases an extension of time to pay a [note](#) is a benefit to both the principal debtor and sureties having recourse against the principal debtor. In relatively few cases the extension may cause loss if deterioration of the financial condition of the principal debtor reduces the amount that the surety will be able to recover on its right of recourse when default occurs. Former Section 3-606(1)(a) did not take into account the presence or absence of loss to the surety. For example, suppose the instrument is an installment note and the principal debtor is temporarily short of funds to pay a monthly installment. The payee agrees to extend the due date of the installment for a month or two to allow the debtor to pay when funds are available. Under former Section 3-606 surety was discharged if consent was not given unless the payee expressly reserved rights

against the surety. It did not matter that the extension of time was a trivial change in the guaranteed obligation and that there was no evidence that the surety suffered any loss because of the extension. *Wilmington Trust Co. v. Gesullo*, 29 U.C.C. Rep. 144 (Del. Super. Ct. 1980). Under subsection (c) an extension of time results in discharge only to the extent the surety [proves](#) that the extension caused loss. For example, if the extension is for a long period the surety might be able to prove that during the period of extension the principal debtor became insolvent, thus reducing the value of the right of recourse of the surety. By putting the burden on the surety to prove loss, subsection (c) more accurately reflects what the parties would have done by agreement, and it facilitates workouts.

Under other provisions of Article 3, what is the effect of an extension agreement between the holder of a [note](#) and the [maker](#) who is an [accommodated party](#)? The question is illustrated by the following case:

Case #1. A borrows money from Lender and [issues](#) a [note](#) payable on April 1, 1992. B signs the note for accommodation at the request of Lender. B signed the note either as co-[maker](#) or as an anomalous indorser. In either case Lender subsequently makes an agreement with A extending the due date of A's obligation to pay the note to July 1, 1992. In either case B did not agree to the extension.

What is the effect of the extension agreement on B? Could Lender enforce the [note](#) against B if the note is not paid on April 1, 1992? A's obligation to Lender to pay the note on April 1, 1992 may be modified by the agreement of Lender. If B is an anomalous indorser Lender cannot enforce the note against B unless the note has been dishonored. Section [3-415\(a\)](#). Under Section [3-502\(a\)\(3\)](#) dishonor occurs if it is not paid on the day it becomes payable. Since the agreement between A and Lender extended the due date of A's obligation to July 1, 1992 there is no dishonor because A was not obligated to pay Lender on April 1, 1992. If B is a co-[maker](#) the analysis is somewhat different. Lender has no power to amend the terms of the note without the consent of both A and B. By an agreement with A, Lender can extend the due date of A's obligation to Lender to pay the note but B's obligation is to pay the note according to the terms of the note at the time of [issue](#). Section [3-412](#). However, B's obligation to pay the note is subject to a defense because B is an [accommodation party](#). B is not obliged to pay Lender if A is not obliged to pay Lender. Under Section [3-305\(d\)](#), B as an accommodation party can assert against Lender any defense of A. A has a defense based on the extension agreement. Thus, the result is that Lender could not enforce the [note](#) against B until July 1, 1992. This result is consistent with the right of B if B is an anomalous indorser.

As a practical matter an extension of the due date will normally occur when the [accommodated party](#) is unable to pay on the due date. The interest of the accommodation party normally is to defer payment to the holder rather than to pay right away and rely on an action against the [accommodated party](#) that may have little or no value. But in unusual cases the accommodation party may prefer to pay the holder on the original due date. In such cases, the accommodation party may do so. This is because the extension agreement between the accommodated party and the holder cannot bind the accommodation party to a change in its obligation without the accommodation party's consent. The effect

on the recourse of the accommodation party against the accommodated party of performance by the accommodation party on the original due date is not addressed in [§ 3-419](#) and is left to the general law of suretyship.

Even though an [accommodation party](#) has the option of paying the [instrument](#) on the original due date, the accommodation party is not precluded from asserting its rights to discharge under Section [3-605\(c\)](#) if it does not exercise that option. The critical issue is whether the extension caused the accommodation party a loss by increasing the difference between its cost of performing its obligation on the instrument and the amount recoverable from the [accommodated party](#) pursuant to Section [3-419\(e\)](#). The decision by the accommodation party not to exercise its option to pay on the original due date may, under the circumstances, be a factor to be considered in the determination of that issue. See [PEB Commentary No. 11](#), supra.

5. Former Section 3-606 applied to extensions of the due date of a [note](#) but not to other modifications of the obligation of the principal debtor. There was no apparent reason why former Section 3-606 did not follow general suretyship law in covering both. Under Section [3-605\(d\)](#) a material modification of the obligation of the principal debtor, other than an extension of the due date, will result in discharge of the surety to the extent the modification caused loss to the surety with respect to the right of recourse. The loss caused by the modification is deemed to be the entire amount of the right of recourse unless the person seeking enforcement of the [instrument](#) [proves](#) that no loss occurred or that the loss was less than the full amount of the right of recourse. In the absence of that proof, the surety is completely discharged. The rationale for having different rules with respect to loss for extensions of the due date and other modifications is that extensions are likely to be beneficial to the surety and they are often made. Other modifications are less common and they may very well be detrimental to the surety. Modification of the obligation of the principal debtor without permission of the surety is unreasonable unless the modification is benign. Subsection (d) puts the burden on the person seeking enforcement of the instrument to prove the extent to which loss was not caused by the modification.

The following is an illustration of the kind of case to which Section [3-605\(d\)](#) would apply:

Case #2. Corporation borrows money from Lender and [issues](#) a [note](#) payable to Lender. X signs the note as an [accommodation party](#) for Corporation. The loan agreement under which the note was issued states various events of default which allow Lender to accelerate the due date of the note. Among the events of default are breach of covenants not to incur debt beyond specified limits and not to engage in any line of business substantially different from that currently carried on by Corporation. Without consent of X, Lender agrees to modify the covenants to allow Corporation to enter into a new line of business that X considers to be risky, and to incur debt beyond the limits specified in the loan agreement to finance the new venture. This modification releases X unless Lender proves that the modification did not cause loss to X or that the loss caused by the modification was less than X's right of recourse.

Sometimes there is both an extension of the due date and some other modification. In that case both subsections (c) and (d) apply. The following is an example:

Case #3. Corporation was indebted to Lender on a [note](#) payable on April 1, 1992 and X signed the note as an [accommodation party](#) for Corporation. The interest rate on the note was 12 percent. Lender and Corporation agreed to a six-month extension of the due date of the note to October 1, 1992 and an increase in the interest rate to 14 percent after April 1, 1992. Corporation defaulted on October 1, 1992. Corporation paid no interest during the six-month extension period. Corporation is insolvent and has no assets from which unsecured creditors can be paid. Lender demanded payment from X.

Assume X is an anomalous indorser. First consider Section [3-605\(c\)](#) alone. If there had been no change in the interest rate, the fact that Lender gave an extension of six months to Corporation would not result in discharge unless X could [prove](#) loss with respect to the right of recourse because of the extension. If the financial condition of Corporation on April 1, 1992 would not have allowed any recovery on the right of recourse, X can't show any loss as a result of the extension with respect to the amount due on the [note](#) on April 1, 1992. Since the note accrued interest during the six-month extension, is there a loss equal to the accrued interest? Since the interest rate was not raised, only Section [3-605\(c\)](#) would apply and X probably could not prove any loss. The obligation of X includes interest on the note until the note is paid. To the extent payment was delayed X had the use of the money that X otherwise would have had to pay to Lender. X could have prevented the running of interest by paying the debt. Since X did not do so, X suffered no loss as the result of the extension.

If the interest rate was raised, Section [3-605\(d\)](#) also must be considered. If X is an anomalous indorser, X's liability is to pay the [note](#) according to its terms at the time of indorsement. Section [3-415\(a\)](#). Thus, X's obligation to pay interest is measured by the terms of the note (12%) rather than by the increased amount of 14 percent. The same analysis applies if X had been a co-[maker](#). Under Section [3-412](#) the liability of the [issuer](#) of a note is to pay the note according to its terms at the time it was issued. Either obligation could be changed by contract and that occurred with respect to Corporation when it agreed to the increase in the interest rate, but X did not join in that agreement and is not bound by it. Thus, the most that X can be required to pay is the amount due on the note plus interest at the rate of 12 percent.

Does the modification discharge X under Section [3-605\(d\)](#)? Any modification that increases the monetary obligation of X is material. An increase of the interest rate from 12 percent to 14 percent is certainly a material modification. There is a presumption that X is discharged because Section [3-605\(d\)](#) creates a presumption that the modification caused a loss to X equal to the amount of the right of recourse. Thus, Lender has the burden of proving absence of loss or a loss less than the amount of the right of recourse. Since Corporation paid no interest during the six-month period, the issue is like the issue presented under Section [3-605\(c\)](#) which we have just discussed. The increase in the interest rate could not have affected the right of recourse because no interest was paid by Corporation. X is in the same position as X would have been in if there had been an extension without an increase in the interest rate.

The analysis with respect to Section [3-605\(c\)](#) and [\(d\)](#) would have been different if we change the assumptions. Suppose Corporation was not insolvent on April 1, 1992, that Corporation paid interest at the higher rate during the six-month period, and that Corporation was insolvent at the end of the six-month period. In this case it is possible that the extension and the additional burden placed on Corporation by the increased interest rate may have been detrimental to X.

There are difficulties in properly allocating burden of proof when the agreement between Lender and Corporation involves both an extension under Section [3-605\(c\)](#) and a modification under Section [3-605\(d\)](#). The agreement may have caused loss to X but it may be difficult to identify the extent to which the loss was caused by the extension or the other modification. If neither Lender nor X introduces evidence on the issue, the result is full discharge because Section [3-605\(d\)](#) applies. Thus, Lender has the burden of overcoming the presumption in Section [3-605\(d\)](#). In doing so, Lender should be entitled to a presumption that the extension of time by itself caused no loss. Section [3-605\(c\)](#) is based on such a presumption and X should be required to introduce evidence on the effect of the extension on the right of recourse. Lender would have to introduce evidence on the effect of the increased interest rate. Thus both sides will have to introduce evidence. On the basis of this evidence the court will have to make a determination of the overall effect of the agreement on X's right of recourse. See [PEB Commentary No. 11](#), supra.

6. Subsection (e) deals with discharge of sureties by impairment of collateral. It generally conforms to former Section 3-606(1)(b). Subsection (g) states common examples of what is meant by impairment. By using the term "includes," it allows a court to find impairment in other cases as well. There is extensive case law on impairment of collateral. The surety is discharged to the extent the surety [proves](#) that impairment was caused by a [person entitled to enforce the instrument](#). For example, suppose the payee of a secured [note](#) fails to perfect the security interest. The collateral is owned by the principal debtor who subsequently files in bankruptcy. As a result of the failure to perfect, the security interest is not enforceable in bankruptcy. If the payee obtains payment from the surety, the surety is subrogated to the payee's security interest in the collateral. In this case the value of the security interest is impaired completely because the security interest is unenforceable. If the value of the collateral is as much or more than the amount of the note there is a complete discharge.

In some states a real property grantee who assumes the obligation of the grantor as [maker](#) of a note secured by the real property becomes by operation of law a principal debtor and the grantor becomes a surety. The meager case authority was split on whether former Section 3-606 applied to release the grantor if the holder released or extended the obligation of the grantee. Revised Article 3 takes no position on the effect of the release of the grantee in this case. Section [3-605\(b\)](#) does not apply because the holder has not discharged the obligation of a "party," a term defined in Section [3-103\(a\)\(8\)](#) as "party to an [instrument](#)." The assuming grantee is not a party to the instrument. The resolution of this question is governed by general principles of law, including the law of suretyship. See [PEB Commentary No. 11](#), supra.

7. Subsection (f) is illustrated by the following case. X and Y sign a [note](#) for \$1,000 as co-makers. Neither is an [accommodation party](#). X grants a security

interest in X's property to secure the note. The collateral is worth more than \$1,000. Payee fails to perfect the security interest in X's property before X files in bankruptcy. As a result the security interest is not enforceable in bankruptcy. Had Payee perfected the security interest, Y could have paid the note and gained rights to X's collateral by subrogation. If the security interest had been perfected, Y could have realized on the collateral to the extent of \$500 to satisfy its right of contribution against X. Payee's failure to perfect deprived Y of the benefit of the collateral. Subsection (f) discharges Y to the extent of its loss. If there are no assets in the bankruptcy for unsecured claims, the loss is \$500, the amount of Y's contribution claim against X which now has a zero value. If some amount is payable on unsecured claims, the loss is reduced by the amount receivable by Y. The same result follows if Y is an accommodation party but Payee has no knowledge of the accommodation or notice under Section [3-419\(c\)](#). In that event Y is not discharged under subsection (e), but subsection (f) applies because X and Y are jointly and severally liable on the [note](#). Under subsection (f), Y is treated as a co-maker with a right of contribution rather than an [accommodation party](#) with a right of reimbursement. Y is discharged to the extent of \$500. If Y is the principal debtor and X is the accommodation party subsection (f) doesn't apply. Y, as principal debtor, is not injured by the impairment of collateral because Y would have been obliged to reimburse X for the entire \$1,000 even if Payee had obtained payment from sale of the collateral.

8. Subsection (i) is a continuation of former law which allowed suretyship defenses to be waived. As the subsection provides, a [party](#) is not discharged under this section if the [instrument](#) or a separate agreement of the party waives discharge either specifically or by general language indicating that defenses based on suretyship and impairment of collateral are waived. No particular language or form of agreement is required, and the standards for enforcing such a term are the same as the standards for enforcing any other term in an instrument or agreement.

Subsection (i), however, applies only to a "discharge under this section." The right of an [accommodation party](#) to be discharged under Section [3-605\(e\)](#) because of an impairment of collateral can be waived. But with respect to a note secured by personal property collateral, Article 9 also applies. If an accommodation party is a "debtor" under Section [9-102\(a\)\(28\)](#), an "obligor" under Section [9-102\(59\)](#), or a "secondary obligor" under [Section 9-102\(a\)\(71\)](#), the accommodation party has rights under Article 9. Under Section [9-602](#), many rights of an Article 9 debtor or obligor under Part 6 of Article 9 cannot be waived except as provided in Article 9. These Article 9 rights are independent of rights under Section [3-605](#). Since Section [3-605\(i\)](#) is specifically limited to discharge under Section [3-605](#), a waiver of rights with respect to Section 3-605 has no effect on rights under Article 9. With respect to Article 9 rights, Section [9-602](#) controls. See [PEB Commentary No. 11](#), supra.

ADDENDUM TO REVISED ARTICLE 3

1. If revised Article 3 is adopted in your state, the reference in Section [2-511](#) to Section 3-802 should be changed to Section [3-310](#).

2. If revised Article 3 is adopted in your state and the Uniform Fiduciaries Act is also in effect in your state, you may want to consider amending Uniform Fiduciaries Act § 9 to conform to Section [3-307\(b\)\(2\)\(iii\)](#) and (4)(iii). See [Official Comment 3 to Section 3-307](#).

PERMANENT EDITORIAL BOARD COMMENTARY

PEB Commentary No. 11 (Sections 3-116, 3-305, 3-415, 3-419, and 3-605) (February 10, 1994)

Introduction

The promulgation of revised Article 3 of the Uniform Commercial Code has given rise to a number of questions concerning the provisions in that Article governing the rights and duties of [accommodation parties](#). This heightened level of interest results from many factors. In particular, the provisions in revised Article 3 concerning accommodation parties differ significantly from those in former Article 3 in ways that are complex and not always obvious. Application of these rules often raises issues that were not pertinent under prior law. In addition, the ongoing project of The American Law Institute to publish a Restatement of Suretyship has generated greater interest in the rights and duties of sureties, including, of course, accommodation parties.

As a result of this heightened interest, the suretyship rules in Article 3 have been the subject of a great deal of scrutiny, which has resulted in a recognition that the treatment of some suretyship issues in revised Article 3 should be clarified. It is the purpose of this Commentary to answer several questions that have arisen concerning the rights and duties of [accommodation parties](#). This Commentary concludes with a series of revisions and additions to the Comments to various sections in Article 3 that govern suretyship issues.

Issue 1

If another person agrees to be liable for the obligation of the [maker](#) of a [note](#), are the rights and duties of that person determined by the provisions of Article 3 governing [accommodation parties](#), by the general law of suretyship, or both?

Discussion

A person who agrees to be liable for the debt of another is clearly a surety. See Restatement of the Law Third, Suretyship § 1 (Tent. Draft No. 1, 1992). If the person effectuates the agreement by becoming a [party](#) (i.e., a co-[maker](#) or indorser) to the same [instrument](#) that creates the obligation, the surety is also an [accommodation party](#). In such a case, the rules in [§§ 3-116, 3-305, 3-415, 3-419, and 3-605](#) concerning accommodation parties are applicable. Of course, these sections will not resolve all possible issues concerning the rights and duties

of the surety. In the event that a situation is presented that is not resolved by those sections, the resolution may be provided by the general law of suretyship because, pursuant to [§ 1-103](#), that law is applicable unless displaced by provisions of this Act. If the surety does not effectuate the obligation by becoming a party to the [note](#), the surety is not an accommodation party. In that case, the surety's rights and duties are determined by the general law of suretyship.

In unusual cases, two [parties](#) to an [instrument](#) may have a surety relationship that is not governed by Article 3 because the requirements of [§ 3-419\(a\)](#) are not fulfilled. For example, assume that the payee of an instrument would like to sell it, but the potential buyer will agree to buy the instrument only if, in the event that the instrument is dishonored, the buyer has recourse not only against the [issuer](#) and the payee but also against someone more creditworthy. Accordingly, the payee produces a creditworthy person who agrees to stand behind the payee's obligations with respect to the instrument. The transfer to the buyer is then made after both the payee and the creditworthy person indorse the instrument. The creditworthy person is a party to the instrument as an indorser and is an [accommodation party](#) for the issuer who is the accommodated party. The creditworthy person is also a surety with respect to the obligation of both the issuer and the payee as indorser. The creditworthy person, however, is not an accommodation party for the payee and the payee is not an [accommodated party](#) under [§ 3-419\(a\)](#) inasmuch as the instrument was not issued for value given for the benefit of the payee. Therefore, the general law of suretyship, and not the provisions in Article 3 concerning accommodation parties, provides the rules that govern the suretyship relationship between the creditworthy person and the payee.

Issue 2

What are the differences between the rights of an [accommodation party](#) with respect to the accommodated party under revised Article 3 and former Article 3?

Discussion

Under the general law of suretyship, as between the principal obligor and the secondary obligor, it is the principal obligor who ought to bear the cost of performance. Restatement of the Law Third, Suretyship § 1 (Tent. Draft No. 1, 1992). Suretyship law provides three mechanisms to effectuate that cost allocation. First, if the principal obligor is charged with notice of the secondary obligation, the principal obligor owes the secondary obligor a duty of performance; this duty of performance can be enforced by the secondary obligor through the mechanism commonly known as exoneration. Restatement of the Law Third, Suretyship § 17 (Tent. Draft No. 1, 1992). Second, a secondary obligor who performs may be subrogated to the rights of the obligee against the principal obligor (regardless of whether the principal obligor was charged with notice of the secondary obligation). Restatement of the Law Third, Suretyship § 23 (Tent. Draft No. 2, 1993). Third, if the principal obligor is charged with notice of the secondary obligation, the principal obligor must reimburse a secondary obligor who performs the obligation. Restatement of the Law Third, Suretyship § 18 (Tent. Draft No. 2, 1993). If the principal obligor is not charged with notice of the secondary obligation, a secondary obligor who performs is nonetheless

entitled to restitution from the principal obligor. Restatement of the Law Third, Suretyship § 22 (Tent. Draft No. 2, 1993).

An [accommodation party](#) is always a surety. Former Article 3 explicitly provided in § 3-415(5) that an accommodation party who paid the [instrument](#) was entitled to enforce the instrument against the accommodated party. This right essentially codified the surety's right of subrogation. Other rights of the accommodation party against the [accommodated party](#) were left to the general law of suretyship through [§ 1-103](#). In [§ 3-419\(e\)](#), revised Article 3 also in effect sets forth subrogation rights of accommodation parties by providing that such parties are "entitled to enforce the instrument against the accommodated party." That section also codifies the accommodation party's right to be reimbursed by the accommodated party. Unlike the general law of suretyship, however, that right is not limited to situations in which the accommodated party was charged with notice of the accommodation party's obligation. Thus, it need not be determined whether the accommodated party is charged with notice of the accommodation party's obligation, and the right of restitution that is present in the general law of suretyship is superfluous. Revised Article 3, like former Article 3, leaves the accommodated party's duty of performance and the accommodation party's concomitant right of exoneration to the general law of suretyship through [§ 1-103](#).

Issue 3

Is an [accommodation party](#) entitled to reimbursement if the [accommodated party](#) had a defense to its obligation that could have been raised by the accommodation party against the [person entitled to enforce](#) the [instrument](#)?

Discussion

The juxtaposition of the [accommodated party's](#) duty to reimburse the accommodation party ([§ 3-419\(e\)](#)) with the [accommodated party's](#) right to raise defenses ([§ 3-305\(b\)](#)) raises important policy issues. If a duty to reimburse exists even when the accommodated party had a defense, that duty could be said to obviate the value of the defense. On the other hand, if no duty to reimburse exists in such circumstances, the cost of performance will be borne ultimately by the accommodation party rather than the accommodated party.

There are a number of different contexts in which the situation may arise. Generally speaking, the [accommodation party](#) may raise as a defense to its obligation the defenses of the [accommodated party](#) to *its* obligation. See [§ 3-305\(d\)](#). There are three exceptions. The accommodated party's defenses of discharge in insolvency proceedings, infancy, and lack of legal capacity are not available to the accommodation party. If the accommodation party pays the [instrument](#) when the accommodated party had one of these defenses, the accommodated party has no duty to reimburse the accommodation party. The accommodation party has, in a sense, assumed the risk that such defenses will exist.

Occasionally, an [accommodation party](#) will pay an [instrument](#) even though the [accommodated party](#) has a defense that is available to the accommodation party.

In such cases, the existence of the duty to reimburse may depend on whether the accommodation party was aware of the defense at the time it paid the instrument. If the accommodation party was unaware of the defense, there is a duty to reimburse. Thus, there is an incentive for the accommodated party to make the accommodation party aware of any defenses it may have. If the accommodation party pays the instrument while aware of a defense of the accommodated party, however, reimbursement would ordinarily not be justified but might be justified in some circumstances. Resolution of this issue is left to the general law of suretyship through [§ 1-103](#).

Issue 4

Section [3-415\(a\)](#) provides that an indorser's obligation to pay the [instrument](#) upon dishonor is owed, *inter alia*, to a subsequent indorser who pays the instrument. What if both the prior indorser and subsequent indorser are anomalous indorsers?

Discussion

In the general law of suretyship, when there are two secondary obligors for the same underlying obligation, the relationship between those two secondary obligors may be that of co-suretyship or sub-suretyship. In a co-suretyship situation, the two secondary obligors are jointly and severally liable and, as between themselves, have a right of contribution against each other. In a sub-suretyship situation, on the other hand, the second secondary obligor is, in a sense, a surety for the obligation of the first secondary obligor. Thus, as between the two secondary obligors, the first obligor occupies the position of a principal obligor while the later one occupies the position of a secondary obligor. It is often difficult to determine whether the two secondary obligors are co-sureties or sub-sureties, especially in the context of [negotiable instruments](#) when the obligations of those [parties](#) may be created by a signature alone, unaccompanied by words of explanation. Article 3 treats successive anomalous indorsers as having joint and several liability on the [instrument](#). See [§ 3-116\(a\)](#). If one of the anomalous indorsers pays the instrument, that indorser has a right to receive contribution from the other indorser. See [§ 3-116\(b\)](#). Accordingly, the general rule of [§ 3-415\(a\)](#), that a subsequent indorser who pays the instrument may recover the full amount of the instrument from a prior indorser, does not apply in such cases. Section [3-116\(b\)](#) does not recognize a distinction between a co-surety and a sub-surety, but in providing for a right to contribution, [§ 3-116\(b\)](#) has the effect of treating anomalous indorsers as though they were co-sureties. Section [3-116\(b\)](#), however, is subject to "agreement of the affected [parties](#)." If the subsequent indorser can [prove](#) an agreement with the prior indorser giving the subsequent indorser rights as a sub-surety, that agreement changes the rule of [§ 3-116\(b\)](#). If the subsequent indorser pays the instrument and has rights under the agreement as a sub-surety, the subsequent indorser has a right of recourse against the prior indorser for the amount of the payment rather than only a right to contribution; if the prior indorser pays the instrument, there is no right of recourse against the subsequent indorser.

Issue 5

What effect do words of guaranty have on the obligation of an indorser to a [person entitled to enforce](#) an [instrument](#)?

Discussion

Under former [§ 3-416](#), the obligation of an indorser who added the words "payment guaranteed" or "collection guaranteed" to the indorsement was different than that of an indorser who did not add those words. The addition of the words "payment guaranteed" (or their equivalent) meant that if the [instrument](#) was not paid when due the indorser would pay it without resort to any other [party](#). Thus, an indorser who guaranteed payment could be said to have waived [presentment](#), notice of dishonor, and protest, as well as all demand upon the [maker](#) or [drawee](#). In contrast, the addition of the words "collection guaranteed" (or their equivalent) meant that the indorser was required to pay only after the holder reduced its claim against the maker or [acceptor](#) to judgment or it was shown that such a proceeding would be useless.

Section [3-419\(d\)](#) preserves the concept of a guaranty of collection, but no provision is made for a guaranty of payment. Moreover, the preferred treatment given to a guarantor of collection is only applicable when the words accompanying the indorsement indicate "unambiguously that the [party](#) is guaranteeing collection rather than payment of the obligation of another party to the [instrument](#)." Thus, an indorser who adds the words "payment guaranteed," or the like, to the indorsement has the same liability as an indorser who added no special words to the indorsement. Such an indorser may be entitled, *inter alia*, to notice of dishonor pursuant to [§ 3-503](#).

Issue 6

May a [person entitled to enforce](#) an [instrument](#) avoid discharge of an [accommodation party](#) pursuant to [§ 3-605](#) by "reserving rights" against that party in conjunction with a release, extension, or other modification of the duty of the accommodated party?

Discussion

Under former UCC [§ 3-606\(1\)\(a\)](#), a release, extension, or other modification of the [accommodated party's](#) duty accompanied by an express "reservation of rights" against the [accommodation party](#) would not discharge that party. This provision paralleled the general law of suretyship in many jurisdictions.

Article 3 rejects the reservation of rights doctrine. The effects of a release, extension, or other modification of the [accommodated party's](#) duty cannot be changed by the incantation of a "reservation of rights." Pursuant to [§ 3-605\(b\)](#), a release of the accommodated party does not discharge the [accommodation party](#), so there is no need for the [person entitled to enforce](#) the [instrument](#) to take any action, such as a reservation of rights, to preserve recourse against the accommodation party. Pursuant to [§ 3-605\(c\)-\(d\)](#), an extension or modification of the accommodated party's duty discharges the accommodation party to the extent that the extension or modification would otherwise cause the

accommodation party a loss. This discharge cannot be avoided by a "reservation of rights" by the person entitled to enforce the instrument.

Issue 7

If a [person entitled to enforce](#) an [instrument](#) agrees to extend the due date of the [accommodated party's](#) performance and, pursuant to [§ 3-605\(c\)](#), the extension does not discharge the [accommodation party](#), what is the effect of the extension on the obligation of the accommodation party? In particular, is the due date for the accommodation party's performance extended correspondingly? May the accommodation party perform on the original due date?

Discussion

The [person entitled to enforce](#) the [instrument](#) will not be able to enforce the instrument against the [accommodation party](#) until the extended due date. If the accommodation party is an indorser, this is because an indorser is not liable until dishonor of the instrument, which, under these circumstances, cannot occur until it is unpaid on the extended due date. If the accommodation party is a co-[maker](#), this is because, under [§ 3-305\(d\)](#), until the extended due date the accommodation party will be able to assert the [accommodated party's](#) defense that, pursuant to the extension agreement, performance is not yet due.

The [accommodation party](#) may, however, perform on the original due date. The accommodation party is bound in accordance with the terms of its original engagement. The agreement between the [accommodated party](#) and the [person entitled to enforce](#) the [instrument](#) cannot bind the accommodation party to a change in its obligation without the accommodation party's consent. The effect on the recourse of the accommodation party against the accommodated party of performance by the accommodation party on the original due date is not addressed in [§ 3-419](#) and is left to the general law of suretyship.

Even though an [accommodation party](#) has the option of paying the [instrument](#) on the original due date, the accommodation party is not precluded from asserting its rights to discharge under [§ 3-605\(c\)](#) if it does not exercise that option. The critical issue is whether the extension caused the accommodation party a loss by increasing the difference between its cost of performing its obligation on the instrument and the amount recoverable from the [accommodated party](#) pursuant to [§ 3-419\(e\)](#). The decision by the accommodation party not to exercise its option to pay on the original due date may, under the circumstances, be a factor to be considered in the determination of that issue.

Issue 8

What if the [person entitled to enforce](#) the [instrument](#) agrees, in one transaction, to both an extension of time for the [accommodated party's](#) performance and another modification of the [accommodation party's](#) obligation? What if there is a dispute as to whether, as a result of these changes, the accommodation [party](#) has suffered a loss?

Discussion

This question highlights the difficulties in properly allocating the burden of persuasion when the agreement between the [person entitled to enforce the instrument](#) and the [accommodated party](#) involves both an extension governed by [§ 3-605\(c\)](#) and a modification governed by [§ 3-605\(d\)](#). The [accommodation party](#) has the burden of demonstrating loss from an extension, but the person entitled to enforce the instrument has the burden of overcoming a presumption of loss from other modifications.

If neither [party](#) introduces evidence as to loss causation, the result is full discharge of the [accommodation party](#) because [§ 3-605\(d\)](#) applies. If the [person entitled to enforce the instrument](#) seeks to overcome the presumption of loss from the modification, it is entitled to a presumption that the extension alone caused no loss. Thus, the accommodation party will have to introduce evidence as to the effect of the extension, while the person entitled to enforce the instrument will have to introduce evidence as to the effect of the modification. On the basis of this evidence, the court will make an overall determination of the effect of the changes on the accommodation party's right of recourse against the [accommodated party](#).

Issue 9

How can [§ 3-305\(d\)](#), which provides that the [accommodation party](#) can raise defenses of the [accommodated party](#), be reconciled with [§ 3-605\(b\)](#), which provides that a release of the accommodated party does not discharge the accommodation party?

Discussion

While [§ 3-305\(d\)](#) provides that an [accommodation party](#) can raise most defenses of the [accommodated party](#), that section must be read in conjunction with [§ 3-605](#), which governs the effect on the obligation of the accommodation party of an act or omission of the [person entitled to enforce the instrument](#). Section [3-605\(b\)](#) provides that a release of the accommodated party does not discharge the accommodation party. Thus, while examined in isolation, [§ 3-305\(d\)](#) might seem to allow the accommodation party to raise, as a defense to *its* obligation, a release of the accommodated party granted by the person entitled to enforce the instrument, the applicability of that section to such a release must be considered in light of [§ 3-605\(b\)](#). If the release of the accommodated party is part of a settlement pursuant to which the person entitled to enforce the instrument accepts partial payment from an accommodated party who is financially unable to pay the entire amount of the [note](#), the transaction falls within the scope of [§ 3-605\(b\)](#) and the accommodation party cannot escape liability by asserting [§ 3-305\(d\)](#) essentially to nullify [§ 3-605\(b\)](#). If, on the other hand, the release of the accommodated party is part of an accord and satisfaction settling a dispute as to the obligation of the accommodated party, the accommodation party may utilize [§ 3-305\(d\)](#) to assert that release as a defense to its obligation because [§ 3-605\(b\)](#) is not intended to apply to settlement of disputed claims.

Issue 10

What sort of language is sufficient to waive discharge under [§ 3-605](#)?

Discussion

Section [3-605\(i\)](#) provides that a [party](#) is not discharged under that section if the [instrument](#) or a separate agreement of the party waives such discharge "either specifically or by general language indicating that parties waive defenses based on suretyship or impairment of collateral." Thus, no particular language or form of agreement is required, and the standards for enforcing such a term are the same as the standards for enforcing any other term in an instrument or agreement. There is no requirement of particularity in referring to the four grounds for discharge established by [§ 3-605](#) so long as the language used indicates that suretyship defenses are waived. By allowing the use of general language, the rule recognizes that the use of lengthy provisions containing detailed waivers or even separate identification of each ground for discharge does not necessarily promote greater understanding of an instrument's terms. Yet, the requirement that the language indicate that defenses are being waived assures that a diligent indorser or [accommodation party](#) will, at the least, not be unjustly surprised when it is asserted that the terms of the instrument or agreement delete protections that would otherwise be available. In adopting this course, [§ 3-605](#) is consistent with the general law of suretyship. See Restatement of the Law Third, Suretyship § 42 (Tent. Draft No. 2, 1993).

Issue 11

As a result of [§ 3-605\(i\)](#), may an [accommodation party](#) waive whatever protections it may have pursuant to Part 5 of Article 9?

Discussion

Section [3-605\(e\)](#) provides that impairment of an interest in collateral for the obligation of the [accommodated party](#) may discharge the [accommodation party](#). Section [3-605\(g\)](#) defines impairment of an interest in collateral as including, *inter alia*, failure to comply with applicable law in disposing of collateral. In the case of personal property or fixtures, applicable law includes, of course, Article 9. Thus, failure to comply with the rules in Part 5 of Article 9 concerning disposition of collateral constitutes impairment of an interest in collateral. In addition, under Article 9, an accommodation party may qualify as a debtor. See [§ 9-105](#). In some jurisdictions, the limits placed by [§ 9-501](#) on the power of a debtor to waive the protections of [§§ 9-504](#) and [9-505](#) have been interpreted so as to limit the power of an accommodation party to waive those protections. Section [3-605\(i\)](#), on the other hand, provides that an accommodation party may waive discharge under this section (including discharge for impairment of an interest in collateral pursuant to [§ 3-605\(e\)](#)). This does not mean that the accommodation party may waive *all* protections it may have concerning disposition of collateral; rather, it provides for the waiver of protections created by [§ 3-605](#). To the extent that Article 9 also provides the accommodation party similar protections, waiver of those protections is governed by Article 9 as interpreted in each jurisdiction.

Appendix

1. Comment [5 to § 3-305](#) is amended by adding an unnumbered paragraph as follows:

Section [3-305\(d\)](#) must be read in conjunction with Section [3-605](#), which provides rules (usually referred to as suretyship defenses) for determining when the obligation of an [accommodation party](#) is discharged, in whole or in part, because of some act or omission of a [person entitled to enforce the instrument](#). To the extent a rule stated in Section [3-605](#) is inconsistent with Section [3-305\(d\)](#), the Section 3-605 rule governs. For example, under Section [3-605\(b\)](#), discharge under Section [3-604](#) of the [accommodated party](#) does not discharge the accommodation party. As explained in Comment 3 to Section [3-605](#), discharge of the accommodated party is normally part of a settlement under which the holder of a [note](#) accepts partial payment from an accommodated party who is financially unable to pay the entire amount of the note. If the holder then brings an action against the accommodation party to recover the remaining unpaid amount of the note, the [accommodation party](#) cannot use Section [3-305\(d\)](#) to nullify Section [3-605\(b\)](#) by asserting the discharge of the [accommodated party](#) as a defense. On the other hand, suppose the accommodated party is a buyer of goods who issued the note to the seller who took the note for the buyer's obligation to pay for the goods. Suppose the buyer has a claim for breach of warranty with respect to the goods against the seller and the warranty claim may be asserted against the holder of the note. The warranty claim is a claim in recoupment. If the holder and the accommodated party reach a settlement under which the holder accepts payment less than the amount of the [note](#) in full satisfaction of the note and the warranty claim, the accommodation party could defend an action on the note by the holder by asserting the accord and satisfaction under Section [3-305\(d\)](#). There is no conflict with Section [3-605\(b\)](#) because that provision is not intended to apply to settlement of disputed claims. Another example of the use of Section [3-305\(d\)](#) in cases in which Section [3-605](#) applies is stated in [4 to Section 3-605](#). See [PEB Commentary No. 11](#), dated December 15, 1993.

2. A new Comment [5 to § 3-415](#) is added as follows:

5. As stated in subsection (a), the obligation of an indorser to pay the amount due on the [instrument](#) is generally owed not only to a [person entitled to enforce](#) the instrument but also to a subsequent indorser who paid the instrument. But if the prior indorser and the subsequent indorser are both anomalous indorsers, this rule does not apply. In that case, Section [3-116](#) applies. Under Section [3-116\(a\)](#), the anomalous indorsers are jointly and severally liable and if either pays the instrument the indorser who pays has a right of contribution against the other. Section [3-116\(b\)](#). The right to contribution in Section [3-116\(b\)](#) is subject to "agreement of the affected parties." Suppose the subsequent indorser can [prove](#) an agreement with the prior indorser under which the prior indorser agreed to treat the subsequent indorser as a guarantor of the obligation of the prior indorser. Rights of the two indorsers between themselves would be governed by the agreement. Under suretyship law, the subsequent indorser under such an agreement is referred to as a sub-surety. Under the agreement, if the subsequent indorser pays the instrument there is a right to reimbursement from the prior indorser; if the prior indorser pays the instrument, there is no right of recourse against the subsequent indorser. See [PEB Commentary No. 11](#), dated December 15, 1993.

3. Comment [3 to § 3-419](#) is amended by adding an unnumbered paragraph as follows:

An [accommodation party](#) is always a surety. A surety who is not a party to the [instrument](#), however, is not an accommodation party. For example, if M [issues](#) a [note](#) payable to the [order](#) of P, and S signs a separate contract in which S agrees to pay P the amount of the instrument if it is dishonored, S is a surety but is not an accommodation party. In such a case, S's rights and duties are determined under the general law of suretyship. In unusual cases two parties to an instrument may have a surety relationship that is not governed by Article 3 because the requirements of Section [3-419\(a\)](#) are not met. In those cases the general law of suretyship applies to the relationship. See [PEB Commentary No. 11](#), dated December 15, 1993.

4. Comment [4 to § 3-419](#) is amended by adding the following sentences:

Words added to an [anomalous indorsement](#) indicating that payment of the [instrument](#) is guaranteed by the indorser do not change the liability of the indorser as stated in Section [3-415](#). This is a change from former Section 3-416(5). See [PEB Commentary No. 11](#), supra.

5. Comment [5 to § 3-419](#) is amended by deleting the struck-out words and adding the underlined words as follows:

5. Subsection (e) restates subsection (5) of present Section 3-415 like former Section 3-415(5), provides that an [accommodation party](#) that pays the [instrument](#) is entitled to enforce the instrument against the [accommodated party](#). Since the accommodation party that pays the instrument is entitled to enforce the instrument against the accommodated party, the accommodation party also obtains rights to any security interest or other collateral that secures payment of the instrument. Subsection (e) also provides that an accommodation party that pays the instrument is entitled to reimbursement from the accommodated party. See [PEB Commentary No. 11](#), supra.

6. A new Comment 6 and a new Comment [7 to § 3-419](#) are added as follows:

6. In occasional cases, the [accommodation party](#) might pay the [instrument](#) even though the [accommodated party](#) had a defense to its obligation that was available to the accommodation party under Section [3-305\(d\)](#). In such cases, the accommodation party's right to reimbursement may conflict with the accommodated party's right to raise its defense. For example, suppose the accommodation party pays the instrument without being aware of the defense. In that case the accommodation party should be entitled to reimbursement. Suppose the accommodation party paid the instrument with knowledge of the defense. In that case, to the extent of the defense, reimbursement ordinarily would not be justified, but under some circumstances reimbursement may be justified depending upon the facts of the case. The resolution of this conflict is left to the general law of suretyship. Section [1-103](#). See [PEB Commentary No. 11](#), supra.

7. Section [3-419](#), along with Section [3-116\(a\)](#) and [\(b\)](#), Section [3-305\(d\)](#) and Section [3-605](#), provides rules governing the rights of [accommodation parties](#).

In addition, except to the extent that it is displaced by provisions of this Article, the general law of suretyship also applies to the rights of accommodation parties. Section [1-103](#). See [PEB Commentary No. 11](#), supra.

7. Comment [3 to § 3-605](#) is amended by dividing it into two paragraphs, deleting the struck-out words, and adding the underlined words as follows:

3. Subsection (b) addresses the effect of discharge under Section [3-604](#) of the principal debtor. In the hypothetical case stated in Comment 1, release of Borrower by Bank does not release [Accommodation Party](#). As a practical matter, Bank will not gratuitously release Borrower. Discharge of Borrower normally would be part of a settlement with Borrower if Borrower is insolvent or in financial difficulty. If Borrower is unable to pay all creditors, it may be prudent for Bank to take partial payment, but Borrower will normally insist on a release of the obligation. If Bank takes \$3,000 and releases Borrower from the \$10,000 debt, Accommodation Party is not injured. To the extent of the payment Accommodation Party's obligation to Bank is reduced. The release of Borrower by Bank does not affect the right of Accommodation Party to obtain reimbursement from Borrower or to enforce the [note](#) against Borrower if Accommodation Party pays Bank. Section [3-419\(e\)](#). Subsection (b) is designed to allow a creditor to settle with the principal debtor without risk of losing rights against sureties. Settlement is in the interest of sureties as well as the creditor. Subsection (b), however, is not intended to apply to a settlement of a disputed claim which discharges the obligation.

Subsection (b) changes the law stated in former Section 3-606 but the change relates largely to formalities rather than substance. Under former Section 3-606, Bank in the hypothetical case stated in Comment 1 could settle with and release Borrower without releasing [Accommodation Party](#), but to accomplish that result Bank had to either obtain the consent of Accommodation Party or make an express reservation of rights against Accommodation Party at the time it released Borrower. The reservation of rights was made in the agreement between Bank and Borrower by which the release of Borrower was made. There was no requirement in former Section 3-606 that any notice be given to Accommodation Party. The reservation of rights doctrine is abolished in Section [3-605](#) with respect to rights on instruments eliminates the necessity that Bank formally reserve rights against Accommodation Party in [order](#) to retain rights of recourse against Accommodation Party. See [PEB Commentary No. 11](#), dated December 15, 1993.

8. Comment [4 to § 3-605](#) is amended by adding four unnumbered paragraphs as follows:

Under other provisions of Article 3, what is the effect of an extension agreement between the holder of a [note](#) and the [maker](#) who is an [accommodated party](#)? The question is illustrated by the following case:

Case #1. A borrows money from Lender and [issues](#) a [note](#) payable on April 1, 1992. B signs the note for accommodation at the request of Lender. B signed the note either as co-[maker](#) or as an anomalous indorser. In either case Lender subsequently makes an agreement with A extending the due

date of A's obligation to pay the note to July 1, 1992. In either case B did not agree to the extension.

What is the effect of the extension agreement on B? Could Lender enforce the [note](#) against B if the note is not paid on April 1, 1992? A's obligation to Lender to pay the note on April 1, 1992 may be modified by the agreement of Lender. If B is an anomalous indorser Lender cannot enforce the note against B unless the note has been dishonored. Section [3-415\(a\)](#). Under Section [3-502\(a\)\(3\)](#) dishonor occurs if it is not paid on the day it becomes payable. Since the agreement between A and Lender extended the due date of A's obligation to July 1, 1992 there is no dishonor because A was not obligated to pay Lender on April 1, 1992. If B is a co-[maker](#) the analysis is somewhat different. Lender has no power to amend the terms of the note without the consent of both A and B. By an agreement with A, Lender can extend the due date of A's obligation to Lender to pay the note but B's obligation is to pay the note according to the terms of the note at the time of [issue](#). Section [3-412](#). However, B's obligation to pay the note is subject to a defense because B is an [accommodation party](#). B is not obliged to pay Lender if A is not obliged to pay Lender. Under Section [3-305\(d\)](#), B as an accommodation party can assert against Lender any defense of A. A has a defense based on the extension agreement. Thus, the result is that Lender could not enforce the [note](#) against B until July 1, 1992. This result is consistent with the right of B if B is an anomalous indorser.

As a practical matter an extension of the due date will normally occur when the [accommodated party](#) is unable to pay on the due date. The interest of the accommodation party normally is to defer payment to the holder rather than to pay right away and rely on an action against the [accommodated party](#) that may have little or no value. But in unusual cases the accommodation party may prefer to pay the holder on the original due date. In such cases, the accommodation party may do so. This is because the extension agreement between the accommodated party and the holder cannot bind the accommodation party to a change in its obligation without the accommodation party's consent. The effect on the recourse of the accommodation party against the accommodated party of performance by the accommodation party on the original due date is not addressed in [§ 3-419](#) and is left to the general law of suretyship.

Even though an [accommodation party](#) has the option of paying the [instrument](#) on the original due date, the accommodation party is not precluded from asserting its rights to discharge under Section [3-605\(c\)](#) if it does not exercise that option. The critical issue is whether the extension caused the accommodation party a loss by increasing the difference between its cost of performing its obligation on the instrument and the amount recoverable from the [accommodated party](#) pursuant to Section [3-419\(e\)](#). The decision by the accommodation party not to exercise its option to pay on the original due date may, under the circumstances, be a factor to be considered in the determination of that issue. See [PEB Commentary No. 11](#), supra.

9. Comment [5 to § 3-605](#) is amended by adding seven unnumbered paragraphs as follows:

The following is an illustration of the kind of case to which Section [3-605\(d\)](#) would apply:

Case #2. Corporation borrows money from Lender and [issues](#) a [note](#) payable to Lender. X signs the note as an [accommodation party](#) for Corporation. The loan agreement under which the note was issued states various events of default which allow Lender to accelerate the due date of the note. Among the events of default are breach of covenants not to incur debt beyond specified limits and not to engage in any line of business substantially different from that currently carried on by Corporation. Without consent of X, Lender agrees to modify the covenants to allow Corporation to enter into a new line of business that X considers to be risky, and to incur debt beyond the limits specified in the loan agreement to finance the new venture. This modification releases X unless Lender proves that the modification did not cause loss to X or that the loss caused by the modification was less than X's right of recourse.

Sometimes there is both an extension of the due date and some other modification. In that case both subsections (c) and (d) apply. The following is an example:

Case #3. Corporation was indebted to Lender on a [note](#) payable on April 1, 1992 and X signed the note as an [accommodation party](#) for Corporation. The interest rate on the note was 12 percent. Lender and Corporation agreed to a six-month extension of the due date of the note to October 1, 1992 and an increase in the interest rate to 14 percent after April 1, 1992. Corporation defaulted on October 1, 1992. Corporation paid no interest during the six-month extension period. Corporation is insolvent and has no assets from which unsecured creditors can be paid. Lender demanded payment from X.

Assume X is an anomalous indorser. First consider Section [3-605\(c\)](#) alone. If there had been no change in the interest rate, the fact that Lender gave an extension of six months to Corporation would not result in discharge unless X could [prove](#) loss with respect to the right of recourse because of the extension. If the financial condition of Corporation on April 1, 1992 would not have allowed any recovery on the right of recourse, X can't show any loss as a result of the extension with respect to the amount due on the [note](#) on April 1, 1992. Since the note accrued interest during the six-month extension, is there a loss equal to the accrued interest? Since the interest rate was not raised, only Section [3-605\(c\)](#) would apply and X probably could not prove any loss. The obligation of X includes interest on the note until the note is paid. To the extent payment was delayed X had the use of the money that X otherwise would have had to pay to Lender. X could have prevented the running of interest by paying the debt. Since X did not do so, X suffered no loss as the result of the extension.

If the interest rate was raised, Section [3-605\(d\)](#) also must be considered. If X is an anomalous indorser, X's liability is to pay the [note](#) according to its terms at the time of indorsement. Section [3-415\(a\)](#). Thus, X's obligation to pay interest is measured by the terms of the note (12%) rather than by the increased amount of 14 percent. The same analysis applies if X had been a [co-maker](#). Under Section [3-412](#) the liability of the [issuer](#) of a note is to pay the

note according to its terms at the time it was issued. Either obligation could be changed by contract and that occurred with respect to Corporation when it agreed to the increase in the interest rate, but X did not join in that agreement and is not bound by it. Thus, the most that X can be required to pay is the amount due on the note plus interest at the rate of 12 percent.

Does the modification discharge X under Section [3-605\(d\)](#)? Any modification that increases the monetary obligation of X is material. An increase of the interest rate from 12 percent to 14 percent is certainly a material modification. There is a presumption that X is discharged because Section [3-605\(d\)](#) creates a presumption that the modification caused a loss to X equal to the amount of the right of recourse. Thus, Lender has the burden of proving absence of loss or a loss less than the amount of the right of recourse. Since Corporation paid no interest during the six-month period, the issue is like the issue presented under Section [3-605\(c\)](#) which we have just discussed. The increase in the interest rate could not have affected the right of recourse because no interest was paid by Corporation. X is in the same position as X would have been in if there had been an extension without an increase in the interest rate.

The analysis with respect to Section [3-605\(c\)](#) and [\(d\)](#) would have been different if we change the assumptions. Suppose Corporation was not insolvent on April 1, 1992, that Corporation paid interest at the higher rate during the six-month period, and that Corporation was insolvent at the end of the six-month period. In this case it is possible that the extension and the additional burden placed on Corporation by the increased interest rate may have been detrimental to X.

There are difficulties in properly allocating burden of proof when the agreement between Lender and Corporation involves both an extension under Section [3-605\(c\)](#) and a modification under Section [3-605\(d\)](#). The agreement may have caused loss to X but it may be difficult to identify the extent to which the loss was caused by the extension or the other modification. If neither Lender nor X introduces evidence on the issue, the result is full discharge because Section [3-605\(d\)](#) applies. Thus, Lender has the burden of overcoming the presumption in Section [3-605\(d\)](#). In doing so, Lender should be entitled to a presumption that the extension of time by itself caused no loss. Section [3-605\(c\)](#) is based on such a presumption and X should be required to introduce evidence on the effect of the extension on the right of recourse. Lender would have to introduce evidence on the effect of the increased interest rate. Thus both sides will have to introduce evidence. On the basis of this evidence the court will have to make a determination of the overall effect of the agreement on X's right of recourse. See [PEB Commentary No. 11](#), supra.

10. The second paragraph of Comment [6 to § 3-605](#) is amended to read as follows:

In some states a real property grantee who assumes the obligation of the grantor as [maker](#) of a note secured by the real property becomes by operation of law a principal debtor and the grantor becomes a surety. The meager case authority was split on whether former Section 3-606 applied to release the grantor if the holder released or extended the obligation of the grantee.

Revised Article 3 takes no position on the effect of the release of the grantee in this case. Section [3-605\(b\)](#) does not apply because the holder has not discharged the obligation of a "[party](#)," a term defined in Section [3-103\(a\)\(8\)](#) as "party to an [instrument](#)." The assuming grantee is not a party to the instrument. The resolution of this question is governed by general principles of law, including the law of suretyship. See [PEB Commentary No. 11](#), supra.

11. Comment [8 to § 3-605](#) is amended by adding the underlined words as follows:

8. Subsection (i) is a continuation of former law which allowed suretyship defenses to be waived. As the subsection provides, a [party](#) is not discharged under this section if the [instrument](#) or a separate agreement of the party waives discharge either specifically or by general language indicating that defenses based on suretyship and impairment of collateral are waived. No particular language or form of agreement is required, and the standards for enforcing such a term are the same as the standards for enforcing any other term in an instrument or agreement.

Subsection (i), however, applies only to a "discharge under this section." The right of an [accommodation party](#) to be discharged under Section [3-605\(e\)](#) because of an impairment of collateral can be waived. But with respect to a note secured by personal property collateral, Article 9 also applies. If an accommodation party is a "debtor" under Section [9-105\(1\)\(d\)](#), the accommodation party has rights under Article 9. Under Section [9-501\(3\)\(b\)](#) rights of an Article 9 debtor under Section [9-504\(3\)](#) and Section [9-505\(1\)](#), which deal with disposition of collateral, cannot be waived except as provided in Article 9. These Article 9 rights are independent of rights under Section [3-605](#). Since Section [3-605\(i\)](#) is specifically limited to discharge under Section [3-605](#), a waiver of rights with respect to Section 3-605 has no effect on rights under Article 9. With respect to Article 9 rights, Section [9-501\(3\)\(b\)](#) controls. See [PEB Commentary No. 11](#), supra.