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## Article 3: Commercial Paper

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## ARTICLE 3. COMMERCIAL PAPER

J. RICHARD SKOUBY\*

Effective July 1, 1965 the law of Commercial Paper in Missouri will be governed by Article 3 of the Uniform Commercial Code<sup>1</sup> (UCC), replacing the Uniform Negotiable Instruments Law (NIL) as it appears in Sections 401.001 to 401.196, RSMo 1959. Article 3 expressly does not apply to money, documents of title or investment securities, and is made subject to the provisions of Article 4—Bank Deposits and Collections, and Article 9—Secured Transactions.<sup>2</sup> In addition, the definitions and principles of construction and interpretation contained in Article 1, and certain definitions appearing in other articles, apply to Article 3.<sup>3</sup> Thus it is clear that Article 3 cannot be considered in isolation, but must be construed as part of the entire UCC.

Most of the substance of the NIL has been retained in the UCC, although it has been restated in almost completely different language and some important changes have been made. This paper will not attempt to investigate all of the possible effects of the departures from the NIL in substance or language, and will not attempt to annotate Article 3, but will be limited to brief discussions of the more obvious changes which will affect common commercial practices. On the other hand, an attempt will be made to construe the language of the UCC as it is written, rather than merely paraphrasing the tranquilizing official comments.

Article 3 is divided into eight parts which will serve as convenient divisions for discussion.

### I. FORM AND INTERPRETATION

The UCC, like the NIL, contains certain formal requirements which instruments must meet in order to be negotiable.<sup>4</sup> In this area the UCC

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1. §§ 400.3-101-3-805, RSMo 1963 Supp.

2. § 400.3-103, RSMo 1963 Supp. A "security," as defined in § 400.8-102, RSMo 1963 Supp., is governed by Article 8 even if it also meets the requirements of Article 3. Note also that certain negotiable instruments secured by an interest in goods are, by § 400.9-105(1)(b) and (g), RSMo 1963 Supp., defined as "chattel paper" and, by § 400.9-102, RSMo 1963 Supp., are governed by Article 9.

3. § 400.3-102(3),(4), RSMo 1963 Supp.

4. § 400.3-104, RSMo 1963 Supp. The formal requirements of Article 3 pertain to negotiability "within this Article," leaving room for negotiability under Article 8, and perhaps outside the UCC.

makes one minor change. Whereas the NIL provided that the instrument "must be payable on demand, or at a fixed or determinable future time,"<sup>5</sup> the UCC requires that it "be payable on demand or at a definite time."<sup>6</sup> This will prevent the negotiability under Article 3 of instruments which are payable at, or a certain time after, the happening of an event which is certain to occur but indefinite as to time. It appears, however, that this rule can be circumscribed under section 400.3-109(1)(c) by making the instrument payable at a distant definite date subject to acceleration upon the happening of a particular event.

The UCC considerably expands the field of provisions which an instrument may contain without destroying its negotiability. For example, under section 400.3-105 an instrument may refer to or state that it arises out of a separate agreement to which reference is made for rights as to prepayment or acceleration, or may state that it is secured by mortgage or otherwise. But, if negotiability is to be preserved the instrument cannot be "subject to or governed by" another agreement. Likewise, section 400.3-112 provides that negotiability is not destroyed by a statement that collateral has been given to secure obligations on the instrument or otherwise of an obligor, or that the collateral is to be maintained or supplemented, or that upon default the collateral may be realized upon.

The UCC thus substantially abandons the "courier without luggage" concept of negotiable instruments, and recognizes the negotiability of instruments containing provisions commonly used today in "term loan" and "collateral" notes. It must be remembered, however, that instruments to be negotiable under Article 3 may contain only provisions therein specifically authorized.<sup>7</sup>

Missouri has an interesting line of cases, culminating in *Illinois State Bank v. Pedersen*,<sup>8</sup> which hold that a negotiable note and a chattel mortgage may be embodied in one writing, containing one signature of the maker-mortgagor. In the *Pedersen* case the court concluded:

- (1) the note and mortgage are considered separate instruments, although written on one sheet of paper with a common signature,
- (2) the note and mortgage are not to be considered together but each is to be interpreted as a complete entity,
- (3) the note portion is governed by the law merchant—the mortgage part by the laws of property,
- (4) privileges in the mortgage inure to the

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5. § 401.001(3), RSMo 1959.

6. § 400.3-104(c), RSMo 1963 Supp.

7. § 400.3-104(1)(b), RSMo 1963 Supp.

8. 350 S.W.2d 102 (K.C. Mo. App. 1961).

holder *only as a mortgagee* and cannot be read into the note so as to render it nonnegotiable . . . .<sup>9</sup>

Under this decision the "courier without luggage" problem is avoided by holding that there are two separate instruments embodied in the writing, rather than viewing the writing as a note containing "an order or promise to do any act in addition to the payment of money," which under section 401.005 would render the note nonnegotiable. The provisions of UCC section 400.3-104(1)(b) that a writing to be a negotiable instrument under Article 3 may contain "no other promise, order, obligation or power given by the maker or drawer except as authorized by this Article" would not overrule the *Pedersen* case because the court there held that only the note portion of the writing was negotiable—the mortgage portion was to be construed as a separate instrument governed by the laws of property. There appears to be nothing in the UCC which would change this rule.

The UCC makes other relatively insignificant changes in the effect of certain provisions in instruments. For example, section 400.3-105 expands the field of instruments payable from a particular fund which are negotiable, and section 400.3-110 considers instruments payable to the order of an estate, trust, office or association to be order, rather than bearer, paper. Likewise, section 400.3-115 provides for the effectiveness of an incomplete instrument which has come into circulation even though not delivered by the maker or drawer, without resort to a theory of negligence or estoppel.<sup>10</sup>

A more important change from present law is made by section 400.3-121 which provides, "A note or acceptance which states that it is payable at a bank is not of itself an order or authorization to the bank to pay it." No reason is apparent for adopting this alternative section in preference to one which would have preserved the present rule of section 401.087 to the effect that such a note or draft is, in itself, authority to the bank to pay it. Under the present law, if the maker or drawer does not desire to have the bank pay the note or draft he can so advise the bank. Under the provision of section 400.3-121, as adopted, the bank would not be protected in paying the note or draft on mere informal advice from a depositor, but would need a written authorization to charge the account. In the case of a corporate depositor this would require the

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9. *Id.* at 108.

10. Compare *Clifford Banking Co. v. Donovan Comm'n Co.*, 195 Mo. 262, 94 S.W. 527 (1906); *S. S. Allen Grocer Co. v. Bank of Buchanan County*, 192 Mo. App. 188, 182 S.W. 777 (Spr. Ct. App. 1916).

signatures of persons authorized to draw on the account. This could cause delay and, in many cases, force the dishonor of the instrument. The present law is quite well understood, and frequently used, in commercial circles; it would seem desirable to preserve it by the adoption of the alternative proposal.

## II. TRANSFER AND NEGOTIATION

The UCC makes very few changes from the NIL with respect to transfer and negotiation of instruments. The most important change is rendered by section 400.3-204(1) which provides that "any instrument specially indorsed becomes payable to the order of the special indorsee and may be further negotiated only by his indorsement." This changes the rule of section 401.040 that paper payable to bearer on its face may be negotiated by delivery without regard for special indorsements. While this change might seem reasonable on the surface, on analysis it seems unjustified when it is realized that this allows third parties to change the agreement made by the issuer of the paper. The issuer of bearer paper agrees to pay the bearer without regard for the rights of intervening owners; he does not agree to determine that the bearer is the owner or is otherwise entitled to be paid. Under the UCC third parties can impose upon the issuer of bearer paper the risk of paying to a person who acquired through an unauthorized or forged indorsement.

Although very few instruments, other than those which would qualify as investment securities under Article 8, are issued in bearer form, there is an important class of paper in this category. Banks are issuing bearer certificates of deposits (usually due in one year) in large amounts with increasing frequency. These are issued in bearer form in order to facilitate negotiation between corporations which buy and sell them as a means of temporarily investing idle funds at a good return and minimum risk. A considerable additional burden will be imposed by section 400.3-204(1) upon the bank paying such an instrument if it has been specially indorsed by an intermediate holder. To an extent, the interest rate on such a certificate of deposit is governed by the risks assumed when it is issued. This section would allow a third party to increase the risks without increasing the compensation. Such an invasion of freedom of contract seems indefensible.

For all practical purposes the effect of conditional or restrictive indorsements has been eliminated by the UCC. Section 400.3-206, provides that a restrictive indorsement (which under section 400.3-205 includes a

conditional indorsement) is ineffective so far as a subsequent transferee is concerned.<sup>11</sup> The restrictive indorsement obligates the immediate transferee under such indorsement, but can be ignored by other parties.

The UCC in section 400.3-207 provides that a negotiation of an instrument by a minor, a corporation exceeding its powers, or any other person without capacity, is effective to transfer the instrument. The comparable section of the NIL, section 401.022, applied only to minors and corporations.

Where an instrument is made payable to a person under a misspelled or incorrect name, the UCC allows a person paying or giving value for the instrument to require indorsement in both the correct and erroneous names.<sup>12</sup> The NIL provides that the holder may indorse in his correct name "if he thinks fit."<sup>13</sup> It would appear safe to say that this change conforms to commercial practice.

### III. RIGHTS OF A HOLDER

Certain provisions in this part of Article 3 cut at the heart of commercial paper. The full effect of these provisions must await years of litigation. There are, however, several apparent changes.

The UCC states in considerable detail the circumstances under which a holder of an instrument can qualify as a holder in due course.<sup>14</sup> The full effect of these definitions is not clear, but it seems safe to say that at least one major change is made. It appears from section 400.3-302(1)(c) and section 400.3-304(1)(b) that a holder is a holder in due course as to the entire instrument and all parties interested therein or he is not a holder in due course at all. That is to say, the UCC appears to prevent a holder from being a holder in due course as against the maker of a note if he knows merely that some person is claiming an equitable interest in the note through a prior holder, and would prevent a holder from being a holder in due course as to one maker if he knew another maker had a defense such as minority.<sup>15</sup> There would seem to be little justification for allowing an unrelated claim or defense to prevent a holder from becoming a holder in due course, unless the person considering the matter harbors a basic dislike for the concept of holder in due course.

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11. Compare §§ 401.036, .037, .039, .047, RSMo 1959.

12. § 400.3-203, RSMo 1963 Supp.

13. § 401.043, RSMo 1959.

14. §§ 400.3-302-3-304, RSMo 1963 Supp.

15. Compare *Meyer Milling Co. v. Strohfeld*, 222 Mo. App. 1194, 4 S.W.2d 864 (Spr. Ct. App. 1928), approved in the later related case of *State ex rel. Strohfeld v. Cox*, 325 Mo. 901, 30 S.W.2d 462 (En Banc 1930).

Under section 400.3-302(2) a payee of an instrument may be a holder in due course. This changes the stated law of Missouri,<sup>16</sup> but probably on a given fact situation the same result would now be reached on a theory of estoppel.

The "real defenses" which are available against a holder in due course are codified in section 400.3-305. Whether there is a change made from the present law must be determined through litigation of the language used in the section.

The greatest departure from the NIL, and the prior common law of negotiable instruments, is found in section 400.3-307 of the UCC. This section eliminates the presumption that a holder of commercial paper is a holder in due course—in fact, this section probably is effective to create a presumption that a holder is not a holder in due course.<sup>17</sup> There are at least two major effects of this change.

Under section 400.3-307(3) the raising of any defense by a person liable on an instrument will place the burden on the holder to prove he is a holder in due course, whereas under section 401.059 the burden was placed on the holder only when it was shown that the title of any person negotiating the instrument was defective. A showing of failure of consideration did not show a defect in title to the instrument under the NIL,<sup>18</sup> but it clearly is a defense which will place the burden on the holder under the UCC.<sup>19</sup>

The other major change is that under section 400.3-307(3) the holder has the "burden of establishing" he is a holder in due course. As defined in section 400.1-201(8) "burden of establishing" means "burden of persuasion." Under the NIL the holder at most has the burden of going forward with the evidence<sup>20</sup>—if the holder puts in evidence tending to prove he is a holder in due course, and defendant puts in no evidence tending to prove the contrary, then the holder is entitled to a directed verdict.<sup>20a</sup> Until the dictum in *Andres v. Brown*<sup>20b</sup> the law of Missouri

16. *Popovsky v. Griwach*, 361 Mo. 1120, 238 S.W.2d 363 (1951); *Town & Country Shoe Fed. Credit Union v. Cramer*, 350 S.W.2d 281 (K.C. Mo. App. 1961).

17. It must be remembered that until it is shown that a defense exists it is wholly immaterial whether the holder is a holder in due course. A mere assignee can recover unless a defense is shown to exist.

18. *Wohlschlaeger v. Dorsey*, 206 S.W.2d 677 (St. L. Mo. App. 1947).

19. § 400.3-306, RSMo 1963 Supp.

20. *Tower Grove Bank & Trust Co. v. Duing*, 346 Mo. 896, 144 S.W.2d 69 (1940); *State ex rel. Stevens v. Arnold*, 326 Mo. 32, 30 S.W.2d 1015 (1930); *Local Fin. Co. v. Charlton*, 289 S.W.2d 157 (Spr. Mo. App. 1956).

20a. *Local Fin. Co. v. Charlton*, *supra* note 20, at 162.

20b. 300 S.W.2d 800, 805 (Mo. 1957).

has always been stated to be that the holder retains the benefit of the presumption even after defendant puts in evidence to the contrary.<sup>20c</sup> Even this case recognizes that only the burden of evidence shifts; it says that the presumption goes out of the case.

Certainly any purchaser of commercial paper will be forced to review his operations when the UCC becomes effective to determine how he will be able to operate under the burden of presumption that he is not a holder in due course.

#### IV. LIABILITY OF PARTIES

The UCC retains most of existing law with respect to liabilities of parties to negotiable instruments, although it makes several important changes and in some cases changes the theory upon which the party is liable.

The existing rule that no person is liable on an instrument unless his signature appears thereon is retained.<sup>21</sup> Likewise, the UCC retains the rule that an agent who signs without disclosing his principal and showing his agency is liable on the instrument.<sup>22</sup> A possible modification of this rule is made in that under the UCC, as between the immediate parties, the agent may show his representative capacity if the instrument either discloses the principal or indicates that the signature was made in a representative capacity.<sup>23</sup>

A slight change in theory is effected under the UCC in that an unauthorized signature operates as the signature of the unauthorized signer in favor of a person who pays the instrument or takes it for value.<sup>24</sup> Thus, instead of holding the unauthorized signer liable on a warranty of his authority, the UCC makes him liable on the instrument.<sup>25</sup> Under the definition of section 400.1-201(43), an unauthorized signature includes a forgery.

The UCC in section 400.3-405 makes a substantial change, the full extent of which must await litigation, in the effect of delivery of an instrument to an imposter. This section purports to abolish all distinction be-

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20c. Cases cited note 20 *supra*.

21. § 400.3-401, RSMo 1963 Supp. Compare § 401.018 RSMo 1959.

22. § 400.3-403, RSMo 1963 Supp. Compare § 401.020 RSMo 1959.

23. § 400.3-403, RSMo 1963 Supp.

24. § 400.3-404(1), RSMo 1963 Supp.

25. Compare *International Store Co. v. Barnes*, 3 S.W.2d 1039 (Spr. Mo. App. 1928).



tween face-to-face dealings and dealings through the mails or otherwise, and considers all paper *issued* to an imposter to be fictitious payee paper. The area of doubt as to the full effect of this provision is raised by the fact that the section fails to explain how it is to be determined whether the paper is issued to the imposter or whether it is issued to the named payee and merely delivered to the imposter. Perhaps there are factual situations where the paper is not *issued* at all, but is merely delivered to the imposter. Section 400.3-102(1)(a) provides, "'Issue' means the first delivery of an instrument to a holder or a remitter." (Emphasis added.) Section 400.1-201(20) provides, "'Holder' means a person who is in possession of a document of title or an instrument or an investment security drawn, issued or indorsed to him or to his order or to bearer or in blank." Perhaps through the use of the word "issue" in section 400.3-405 the intent of the maker or drawer will remain pertinent, and the present rules as to imposters will not be so drastically changed.<sup>26</sup> Certainly, if the drafters of the UCC had intended that all paper delivered to an imposter be considered fictitious payee paper, they would have used "deliver" instead of "issue" in section 400.3-405. Delivery is defined in section 400.1-201(14) to mean voluntary transfer of possession.

A further change worth noting, although one which probably will have little impact, is made by section 400.3-405 respecting fictitious payee paper. Rather than regarding this as bearer paper, as is now the rule,<sup>27</sup> the UCC provides that it is order paper, but that any person may effectively indorse the paper in the name of the named payee.

The UCC follows the present law of Missouri in including the situation where the person signing as or on behalf of a maker intends the payee to have no interest in the instrument, with the situation where the agent of the maker has supplied the name of the payee intending the named payee to have no interest in the instrument.<sup>28</sup> Thus, the risk of the "padded payroll" will continue to fall on the employer.

The rule stated in section 400.3-406 respecting negligence on the part of a party to an instrument which "substantially contributes" to the alteration or unauthorized signature, and precludes the negligent party from asserting the defense, probably places a greater burden on the maker or drawer than is placed on him by present Missouri law.<sup>29</sup> The extent of this

26. See *First Nat'l Bank v. Produce Exch. Bank*, 338 Mo. 91, 89 S.W.2d 33 (1935).

27. § 401.009(3), RSMo 1959.

28. Compare § 401.009(3), RSMo 1959 with § 400.3-405, RSMo 1963 Supp.

29. Compare *Scott v. First Nat'l Bank*, 343 Mo. 77, 119 S.W.2d 929 (En Banc 1938).

change must await court interpretation of the phrase "substantially contributes" and court determination of what is allowed (or required) under "reasonable commercial standards."

The law respecting alteration of an instrument is substantially changed by section 400.3-407 of the UCC. Whereas under the NIL any material alteration voided the instrument,<sup>30</sup> the UCC provides that the parties are discharged only if the alteration is made by a holder, is fraudulent, and is material.<sup>31</sup> Thus, alterations made by third parties, or alterations made in good faith by a holder do not affect the liability of parties to the instrument. The UCC continues the rule that a subsequent holder in due course may in all cases enforce an altered instrument in accordance with its original tenor.<sup>32</sup>

The UCC deals with the unauthorized completion of an instrument as a material alteration, and provides that if the completion is not fraudulent the instrument may be enforced in accordance with the authority given.<sup>33</sup> The subsequent holder in due course is given the right to enforce a completed instrument as completed, even though the completion is fraudulent.<sup>34</sup> This is an important change in the law when taken with section 400.3-115 which provides that an incomplete instrument can come into circulation even without delivery by the maker or drawer. This change in the law will deserve serious consideration by the person who has a practice of signing checks in blank and storing them in his safe. The holder in due course will no longer be required to prove negligence on the part of the drawer.<sup>35</sup> No amount of care exercised by the drawer will relieve him from liability on the checks as completed if they come into the hands of a holder in due course. Under the UCC, not only will the unfaithful employee who has access to the checks be able to bind the maker, but the safecracker likewise can complete and circulate the checks at the maker's expense.

Several minor changes are made by the UCC concerning acceptance and certification of drafts or checks.<sup>36</sup> Probably the most important of these is the requirement that the acceptance be written on the draft.<sup>37</sup> This eliminates the acceptance embodied in a separate writing,<sup>38</sup> and the accept-

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30. §§ 401.124, 401.125, RSMo 1959.

31. § 400.3-407, RSMo 1963 Supp.

32. § 400.3-407(3), RSMo 1963 Supp.

33. § 400.3-407, RSMo 1963 Supp.

34. § 400.3-407(3), RSMo 1963 Supp.

35. Cases cited note 10 *supra*.

36. §§ 400.3-410, .3-411, .3-412, RSMo 1963 Supp.

37. § 400.3-410, RSMo 1963 Supp.

38. § 401.134, RSMo 1959.

ance by lapse of time.<sup>39</sup> Although a draft cannot be accepted by a separate writing or by retention of the draft, caution will be required to prevent equivalent liability on a theory of tort or estoppel.<sup>40</sup>

The UCC, in section 400.3-411, codifies the rule that unless otherwise agreed a bank has no obligation to certify a check, and gives legal approval to the practice of certifying a check before returning it for lack of proper indorsement.

In section 400.3-416 the UCC clarifies the effect of using "payment guaranteed" or "collection guaranteed" in connection with the signature of a maker or indorser. A party who guarantees payment engages that he will pay the instrument when due, without resort to any other party. The guarantee of collection requires the holder to pursue the maker or acceptor before looking to the guarantor. Any words of guaranty used by a party will have the effect of waiving presentment, notice of dishonor and protest so far as that party is concerned. Also, the question of whether words of guaranty accompanying a signature prevents it from being an indorsement has been answered by section 400.3-202(4) which provides that the signature is effective as an indorsement. Whether the provisions of section 400.3-416 will supercede the provisions of sections 433.010—.220<sup>41</sup> relating to sureties, remains for court construction.

Several important changes are made by section 400.3-417 respecting warranties of parties to instruments. This section imposes warranty liability only upon those who "obtain payment or acceptance," "prior transferors" and a party who "transfers an instrument and receives consideration." This relieves accommodation parties from warranty liability. The accommodation party is liable merely in the contract capacity in which he signs.<sup>42</sup> A more significant change is the extension of warranties to the benefit of "a person who in good faith pays or accepts" the instrument. Although payment or acceptance of an instrument is final in favor of a holder in due course, the payer receives and retains the benefit of the stated warranties.<sup>43</sup>

Section 400.3-419 reverses a trend in tort law by providing that a depository or collecting bank "who has in good faith and in accordance with

39. § 401.137, RSMo 1959.

40. § 400.3-419, RSMo 1963 Supp. See *Thompson v. Main Street Bank*, 226 Mo. App. 246, 42 S.W.2d 56 (K.C. Ct. App. 1929).

41. This statute, which is not repealed by the UCC, provides that a surety may demand that the creditor bring suit against the principal debtor, and unless the statute is complied with the surety is discharged.

42. § 400.3-415, RSMo 1963 Supp.

43. § 400.3-418, RSMo 1963 Supp.

the reasonable commercial standards applicable to the business" dealt with an instrument or its proceeds on behalf of one not the true owner, is not liable in conversion or otherwise to the true owner beyond the amount of any proceeds remaining in the bank.<sup>44</sup> While the quoted language can be litigated long and hard in each case, this section should in most cases protect depository and collecting banks from liability to payees arising out of the fraud and negligence of the payee or others in handling checks. A depository or collecting bank will, however, remain liable, on its indorsement, to the payor.<sup>45</sup>

#### V. PRESENTMENT, NOTICE OF DISHONOR AND PROTEST

The rules respecting presentment, notice of dishonor and protest have been considerably simplified, and are set out in detail.<sup>46</sup> Generally the rules have been "liberalized." A person faced with a problem in this area will be well advised to read the statutes thoroughly. It appears, however, that any presentment or notice which would be adequate under present law will be adequate under the UCC.

Although no major changes in practice will be required, several provisions of the UCC are worthy of note.

A presentment can be effective even though the instrument is not exhibited to the person on whom demand is made.<sup>47</sup> The person to whom presentment is made may, however, demand exhibition of the instrument.<sup>48</sup>

Presentment may be made to one of several persons jointly liable on the instrument.<sup>49</sup>

Protest is necessary only on a draft which on its face appears to be drawn or payable outside the United States.<sup>50</sup> Protest of any other instrument is, however, admissible in evidence and creates a presumption of dishonor.<sup>51</sup>

The officer making protest need not have personal knowledge of the dishonor, but may act on "information satisfactory to" him.<sup>52</sup>

The stamp or writing of a bank, on or accompanying an instrument, stating that payment has been refused has the effect of a protest, and is

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44. Compare *Aetna Cas. & Sur. Co. v. Lindell Trust Co.*, 348 S.W.2d 558 (St. L. Mo. App. 1961).

45. § 400.3-417, RSMo 1963 Supp.

46. § 400.3-501-3-511, RSMo 1963 Supp.

47. § 400.3-504, RSMo 1963 Supp.

48. § 400.3-505(a), RSMo 1963 Supp.

49. § 400.3-504(3)(a), RSMo 1963 Supp.

50. § 400.3-501(3), RSMo 1963 Supp.

51. § 400.3-510(a), RSMo 1963 Supp.

52. § 400.3-509(1), RSMo 1963 Supp.

admissible in evidence to raise a presumption of dishonor of the instrument.<sup>53</sup>

Under the UCC the effect of delay in presentment and notice of dishonor is the same with respect to a draft payable at a bank and a note payable at a bank.<sup>54</sup> In either situation indorsers are discharged, and the drawer or maker is discharged only to the extent of his loss. Under the NIL the indorser and the drawer of a draft other than a check are fully discharged;<sup>55</sup> the drawer of a check is discharged to the extent of loss;<sup>56</sup> and the maker of a note payable at a bank is not discharged at all.<sup>57</sup>

The UCC provides an interesting method by which the drawer of a draft payable at a bank, or the maker of a note payable at a bank, may discharge his liability on the instrument when the bank has failed during a delay in presentment—the drawer or maker may discharge his liability by assigning to the holder of the draft or note his claim against the bank.<sup>58</sup>

## VI. DISCHARGE

The UCC specifically provides that the discharge of a party from liability on an instrument is a “personal defense” and is not effective against a holder in due course who took the instrument without knowledge of the discharge.<sup>59</sup>

Section 400.3-601(1) contains an index of the various provisions of the UCC relating to the discharge of a party from liability on an instrument. Some of these have been mentioned above. Some additional provisions concerning discharges will be briefly discussed.

Considerable injustice could be caused by the provisions of section 400.3-604 relating to tender of payment. It is provided that a party making tender of full payment on an instrument when it is due is discharged to the extent of all subsequent liability for interest, costs and attorney fees. It is also provided that where a maker is able and ready to pay an instrument when and where it is payable, a tender has been made. There is no requirement that the tender be kept open beyond the due date.

The injustice could arise in the situation where the holder of a note failed without excuse to present the note for payment on the due date. Suppose the maker of the note was able and ready to pay at the time and

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53. § 400.3-510(b), RSMo 1963 Supp.

54. § 400.3-502, RSMo 1963 Supp.

55. § 401.070, RSMo 1959.

56. § 401.186, RSMo 1959.

57. § 401.070, RSMo 1959.

58. § 400.3-502(1)(b), RSMo 1963 Supp.

59. § 400.3-602, RSMo 1963 Supp.

place specified. Assume further that the holder presented the note one day after it was due and the maker refused to then pay the note, citing his tender and his discharge from subsequent liability for interest, costs and attorney fees. If this section is to be taken literally, the maker could force the holder to sue on the note and, after many months of delay and much expense to the holder, the maker could satisfy the obligation by paying merely the face amount of the note with interest to its due date. Surely this result would not be justified by any social policy.

The provisions of section 400.3-606 will require considerable judicial interpretation before they become clear.<sup>60</sup> The primary point to be litigated is the interpretation of "agrees not to sue" and "agrees to suspend." If "agrees" means a legally binding agreement then the section will not be a great change from present law, but if the word is construed to include even revocable agreements then a considerable change will be made. Probably "agrees" will be construed to mean legally binding agreements because the section then says "or *otherwise* discharges." (Emphasis added.) This would make it appear that the agreement not to sue or agreement to suspend would also need to be effective as a discharge.

Another point which will be extensively litigated is the interpretation of "unjustifiably impairs" as used in section 400.3-606(b). It hardly seems proper to modify "impairs" with "unjustifiably." A person can justifiably release or dispose of collateral, but it seems doubtful that a person can justifiably impair collateral.

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60. Section 400.3-606, RSMo 1963 Supp., reads:  
Impairment of recourse or of collateral.

- (1) The holder discharges any party to the instrument to the extent that without such party's consent the holder
  - (a) without express reservation of rights releases or agrees not to sue any person against whom the party has to the knowledge of the holder a right of recourse or agrees to suspend the right to enforce against such person the instrument of collateral or otherwise discharges such person, except that failure or delay in effecting any required presentment, protest or notice of dishonor with respect to any such person does not discharge any party as to whom presentment, protest or notice of dishonor is effective or unnecessary; or
  - (b) unjustifiably impairs any collateral for the instrument given by or on behalf of the party or any person against whom he has a right of recourse.
- (2) By express reservation of rights against a party with a right of recourse the holder preserves
  - (a) all his rights against such party as of the time when the instrument was originally due; and
  - (b) the right of the party to pay the instrument as of that time; and
  - (c) all rights of such party to recourse against others.

## VII. ADVICE OF INTERNATIONAL SIGHT DRAFTS

This part is comprised of only one section containing three subsections.<sup>61</sup> The first subsection advises the public as to what a letter of advice is. The other two subsections recite some of the usual terms of an agreement under which international sight drafts are drawn and paid. Fortunately these provisions do not purport to be binding, but are effective "unless otherwise agreed."

The inclusion of section 400.3-701 in the UCC can serve only the purpose of demonstrating to the world that the drafters of the UCC were aware of some of the usual terms of agreements under which international sight drafts are drawn and paid. Unless and until the UCC is adopted worldwide an agreement with a foreign bank respecting the payment of drafts will, of necessity, cover the points mentioned in this section, and in any event many other points should be covered by such an agreement.

## VIII. MISCELLANEOUS

This part is comprised of five sections dealing with unrelated topics. Three of these are of major importance and will be mentioned here.

The effect of taking an instrument (usually a check) in payment of an obligation is dealt with in section 400.3-802. This section will be of particular interest to holders of consumer installment paper who are accustomed to receiving a volume of worthless checks in payment of installments. The section will also be of interest to other creditors even though they may be faced with the problems less frequently. The provisions of this section require a creditor to accept a check in payment of an obligation unless there is an agreement to the contrary. For an illustration of the mischief this section will cause, apply its provisions to the facts of *Gill v. Mercantile Trust Co.*<sup>62</sup> stating the present law of Missouri. Installment creditors would be well advised to deal with this matter in their contracts.

An ambitious innovation which affects both procedural and substantive law is attempted in section 400.3-803. The section provides that where a defendant is sued for breach of an obligation for which a third person is answerable over under Article 3 of the UCC, the defendant may give notice of the litigation to the third party and thus bind him with any determination of fact in the case. Thus a defendant indorser could give notice to prior indorsers and the maker and bind them with any determination of facts in the suit. The section purports to have affect without re-

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61. § 400.3-701, RSMo 1963 Supp.

62. 347 S.W.2d 420 (St. L. Mo. App. 1961).

gard for state or national borders. An analysis of constitutional and other problems raised by section 400.3-803 would be completely outside the scope of this paper.

The UCC in section 400.3-805 creates a new class of semi-negotiable instruments which will considerably vex the commercial world until they come into common use and are fully understood. This section provides that an instrument negotiable in form but not payable to order or bearer, is governed by the provisions of Article 3, except that there can be no holder in due course of such an instrument.

At present most such instruments are issued for legitimate purposes with the full understanding of the public that they are not negotiable, but there are some "money orders" which are issued in this form and pass as negotiable paper without detection. This section will benefit those who deal with this latter class of paper, but will considerably burden those who deal with the former.

An example of a non-negotiable instrument in common use today with the full understanding of the public is the certificate of deposit issued by a bank to an individual saver. These instruments are assignable so that the payee can borrow on them, but being non-negotiable the bank can pay them at maturity if it has had no notice of assignment even though the instrument cannot be surrendered for cancellation.<sup>63</sup> As anyone familiar with the business knows, many certificates of deposit are lost or destroyed. This is not surprising when the age, business experience, and other circumstances of the depositors are considered. When the UCC becomes effective, banks will be forced to make these certificates of deposit non-assignable or will be forced to require a bond as protection when the certificate is paid without its surrender.<sup>64</sup> Either alternative will be a burden on the depositor.

The probable, and perhaps the intended, effect of section 400.3-805 will be to increase the volume of paper which is issued in negotiable form except for the fact it is not payable to order or bearer. People who deal with commercial paper relying (knowingly or unknowingly) on the protection afforded holders in due course will need to be on the alert for such paper.

## IX. CONCLUSION

Article 3 of the UCC settles some minor problems, but in numerous areas of the law the new language introduced creates uncertainty where

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63. *Boyd v. Sloan*, 335 Mo. 163, 71 S.W.2d 1065 (1934).

64. *Hochrein v. Balthasar*, 361 S.W.2d 315 (St. L. Mo. App. 1962).



certainty existed for many years. With the new language of the UCC the courts will be free to completely reshape commercial law; the “white horse” case will not exist. Whether the courts will throw the law of commercial paper into an indefinite state similar to tort law where an “exception to an exception” can be devised as needed to reach subjective “justice” in each case, remains to be seen. A conservative pessimist could develop a sizeable ulcer from contemplating the possibilities.