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Corporations and Corporate Agents: Liability on Commercial Paper Contracts and Attainment of Holder Status

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Corporations and Corporate Agents: Liability on Commercial Paper Contracts and Attainment of Holder Status*

When a corporation or its agents are bound by contracts made by a negotiable instrument. Location of signature and style of signing as a determinant of liability. Rights of corporations or their agents when they obtain holder status.

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Introduction

This article focuses on two classes of commercial paper issues. Section I considers the Uniform Commercial Code ("UCC" or "Code") rules relevant to determining whether a corporation or its agents are bound by contracts made upon a negotiable instrument. Application of these rules continues to be an important and recurrent source of legal disputes. Section II considers the rights of corporations or their agents to obtain holder status prerequisite to enforcing commercial paper contracts. Problems relating to the attainment of this status can result from corporate engagement in joint-enterprise with artificial or natural persons and from the linkage of corporations through common ownership or in parent-subsidiary relationships. Enforcement problems also may arise as a consequence of corporate name changes or mergers.

I. Liability of Corporations or Their Agents on Commercial Paper Contracts

A. Commercial Paper Contracts

A brief review of the nature of commercial paper contracts may be useful before proceeding to questions of corporate and corporate agent liability. Article Three of the UCC describes the contracts that may be made by

persons who sign commercial paper.¹ The maker of a note engages to pay the instrument according to its tenor at the time of signing. This is a contract of primary liability because the holder of the note can enforce it against the maker without prior recourse against any other person. Drawers of checks engage to pay the check upon its dishonor by the drawee bank and the satisfaction of certain other conditions precedent. Indorsers make similar contracts of secondary liability. Other types of commercial paper contracts include those of acceptors and accommodation parties.

The location of a signature on an instrument and the language which accompanies it can be important in determining the nature of the contractual liability undertaken by the signer.² For example, a signature in the lower righthand corner of a note usually indicates an intent to sign as a maker.³ However, makers' contracts have been made by corporate officers whose personal signatures were placed on the back of a note (which usually indicates an intent to indorse) where language on the face of the note ("we promise to pay") suggested that the corporation and the officers intended joint primary liability.⁴ The Code resolves ambiguity as to the capacity in which a signature is made by deeming it to be an indorsement.⁵

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1. UCC §§3-410 to -411, 3-413 to -416. The UCC specifies several ways in which these contracts may be discharged. See UCC §3-601. The relationship between a commercial

paper contract and the underlying obligation is the subject of UCC §3-802.

2. UCC §3-402 Official Comment.

3. *O'Grady v. First Union Bank*, 296 N.C. 212, 250 S.E.2d 587, 26 UCC Rep. 146 (1978).

4. *Terkeltoub v. Caravan Motel, Inc.*, 40 Pa. D. & C.2d 176, 3 UCC Rep. 492 (Pa. C.P. 1968).

5. UCC §3-402.

B. The Signature Rules

The Code contains signature rules for identifying the person(s) bound by contracts written on an instrument.⁶ The principal rules with illustrative examples are as follows. In the examples Alpha Corp. is the principal and Brian Douglas is the agent.

Rule One. No person is liable on an instrument unless his signature appears thereon.⁷

Rule Two. A corporation's signature may be made by a corporate officer or other agent or representative.⁸

Rule Three. The name of a corporation preceded or followed by the name and office of the authorized agent signing on its behalf is the *correct way* to make a signature which binds the corporation but not the agent (Alpha Corp. by Brian Douglas, President).⁹

Rule Four. An authorized agent who signs his own name to an instrument is personally obligated if the instrument neither names the corporate principal nor shows that the agent signed in a representative capacity (Brian Douglas).¹⁰

Rule Five. An authorized agent who signs his own name to an instrument is personally obligated if the instrument names the corporate principal but does not show that the agent signed in a representative capacity (Alpha Corp. Brian Douglas) or if the instrument does not name the principal but does show that the agent signed in a representative capacity (Brian Douglas, President).¹¹

Rule Six. An agent personally obligated by Rule Five may escape liability through the use of parol evidence demonstrating that he signed as an agent. The Code states that this exception applies only as between the immediate parties to an instrument (such as the maker and payee of a note) and not when enforcement of the instrument is sought by a nonimmediate party (such as a holder who acquired the note from the payee).¹²

Rule Seven. An unauthorized signature on an instrument binds the unauthorized signer in favor of any person who in good faith pays the instrument or takes it for value.¹³

The remainder of Section I of this article focuses on the operation of these principal signature rules and on certain subsidiary rules.

C. Authority to Sign

Rule Two provides for signatures by agents, officers, or representatives. The power to sign for another may be established under the general law of agency which, for the most part, is not contained in the Code.¹⁴ Under agency law, an agent may be empowered to bind a corporate principal in several ways:

(1) Grant of express authority by corporate principal directly to agent through written or spoken words or other conduct.¹⁵

(2) Apparent authority through corporate principal's written or spoken words or other conduct causing a third party to believe that the agent is authorized.¹⁶

(3) Inherent agency power by virtue of agent's occupying a particular position in the corporate hierarchy.¹⁷

In addition, a corporate principal may be estopped to deny an agent's authority as against a third person who changed its position in the belief that a transaction was authorized.¹⁸ The principal may be estopped if it intentionally or carelessly caused such belief. It may also be estopped if it did not take reasonable steps to dispel this belief after obtaining knowledge that it was held by a third person who might rely on it.

The Code does not require any particular form of appointment or power of attorney to establish authority. However, persons dealing with corporate agents may require a corporate resolution, by-law, or other documentary evidence of an agent's power to bind its principal.

Many cases have considered the issue of whether an agent had authority to bind a corporate principal to a commercial paper contract. Generalizations concerning these opinions have been offered. It has been stated that an "agent is not authorized to execute a negotiable instrument . . . unless he could not perform his duties without such authorization" and that apparent authority to indorse "is not readily inferred."¹⁹ It has also been stated that an agent's authority to indorse "will be narrowly construed."²⁰ While these guidelines can be helpful, the question of whether an agent is authorized is fact specific and may require careful examination of precedent.²¹

D. Signature Binding Corporation

Rule One indicates that a corporation cannot be liable on an instrument that it has not signed. Under the Code, a

6. See generally Annot., *Construction and Application of UCC §3-403 (2) Dealing With Personal Liability of Authorized Representative Who Signs Negotiable Instrument in His Own Name*, 97 A.L.R.3d 798 (1980); Littlefield, *Corporate Signatures on Negotiable Instruments*, 55 DEN. L. J. 61 (1978); Holland, *Corporate Officers Beware—Your Signature on a Negotiable Instrument May Be Hazardous to Your Economic Health*, 13 IND. L. REV. 893 (1980); Jordan, *Just Sign Here—It's Only a Formality: Parol Evidence in the Law of Commercial Paper*, 13 CA. L. REV. 53 (1978).

7. UCC §3-401(1).

8. UCC §§3-403(1), 1-201(35).

9. UCC §3-403(3).

10. UCC §3-403(2)(a).

11. UCC §3-403(2)(b).

12. UCC §3-403(2)(b).

13. UCC §3-404(1).

14. UCC §§1-103, 3-403(1), 4-405.

15. *Restatement (Second) of Agency* §7, 26 (1958).

16. *Restatement (Second) of Agency* §8, 27 (1958).

17. *Restatement (Second) of Agency* §8A (1958).

18. *Restatement (Second) of Agency* §8B (1958).

19. *Sell, Agency* §60 (1975).

20. *Sell, Agency* §60 (1975).

21. See generally *Restatement in the Courts* (1937) (Supplemented through 1973); Annot., *Authority of Agent to Indorse and Transfer Commercial Paper*, 37 A.L.R.2d 453 (1954). Problems arising when the corporation lacks power to authorize a commercial paper contract are discussed at note 70 and accompanying text *infra*.

signature may be made by the use of any name, including a trade name or other word or mark, executed or adopted with the intention to authenticate a writing.²² Parol evidence is admissible to identify a signer (such as where a corporate maker is misnamed on a note—"Alpha Fabricators & Equipment, Inc." instead of the correct "Alpha Fabricators & Erectors, Inc.").²³ Rule One does not permit the use of parol evidence to obtain enforcement of an instrument against an undisclosed corporate principal whose signature does not appear on the instrument. This is true even though the person who signed had authority to bind the corporation and even though the payee of the instrument knew it was intended to be a corporate obligation.²⁴

It follows from Rule One that a corporation makes no contract on the personal check of a corporate agent that bears the agent's preprinted name and that is signed personally by the agent (Brian Douglas).²⁵ Nor would there be a corporate contract on a check that bears no preprinted name (such as a counter check) that is signed personally by a corporate agent.²⁶ A personally signed note not naming the corporation would not bind the corporation even though the signer was the corporation's president and sole shareholder.²⁷ Rule Four would bind the agent personally on the instrument in cases such as these.²⁸

Questions have arisen concerning whether a preprinted corporate name constitutes a corporate signature. Such a name at the top of a check has been held not to be a corporate signature, a conclusion based upon common sense and commercial experience.²⁹ However, a preprinted corporate name in the lower righthand corner of a check immediately above a signature line bearing an agent's personal signature may be binding upon the corporation ([Preprinted] Alpha Corp. [Handwritten] Brian Douglas).³⁰

The typewritten name of a corporation also can bind it on an instrument when it was intended to constitute a signature. This was the result in a case where the typed name was in the lower righthand corner of a note and the name of an authorized corporate officer was personally signed immediately below the typed corporate name ([Typed] Alpha Corp. [Handwritten] Brian Douglas).³¹ It has also been held that a typewritten corporate name

([Typed] Alpha Corp.) placed on the back of a check is a corporate indorsement if the name was placed on the check by an agent with authority to indorse.³²

Rule One is also applicable in cases of corporate asset sales. For example, suppose Alpha Manufacturing, Inc. makes a bulk transfer of all its assets to Alpha Industries, Inc., a separate entity. The transferee, Industries, will not be liable on instruments signed by the transferor, Manufacturing, unless Industries also signs them.³³ The fact that Industries might be liable to a creditor of Manufacturing on some other basis (such as under bulk transfers or under fraudulent conveyance principles) is irrelevant to the question of its liability on Manufacturing's instruments.

E. Signature Binding Agent Personally—Liability Intended

It is sometimes intended for corporate agents to have personal liability on an instrument which is also intended to bind the corporation. For example, financial institutions often insist that the shareholders of a close corporation share responsibility for the repayment of a loan intended to finance corporate operations. Joint liability is clearly accomplished through the use of a corporate signature complying with Rule Three and an individual signature by the agent. The corporation and its officers may be liable as comakers ([Front of instrument] Alpha Corp. by Brian Douglas, President [Front of instrument] Brian Douglas); as maker and indorser ([Front of instrument] Alpha Corp. by Brian Douglas, President [Back of instrument] Brian Douglas), or in other ways.

F. Signature Binding Agent Personally—Liability Not Intended

Enforcement of commercial paper contracts is frequently sought against agents who deny personal liability. Whether the agent can escape liability depends on the form of his signature and other factors.

1. Agent's Liability Through Personal Signature

Rule Four binds an agent who personally signs an instrument (Brian Douglas). The Code's official comments state that parol evidence is not admissible to prove that a representative signature was intended.³⁴ Many courts

22. UCC §1-201(39), 3-403(2).

23. UCC §3-403 Official Comment 2; *Atlas Steel Corp. v. Steel Fabricators & Erectors, Inc.*, 12 UCC Rep. 910 (Mass. App. 1973).

24. UCC §3-406 Official Comment 1.

25. *Kaminsky v. Van Dusen*, 88 Misc.2d 833, 390 N.Y.S.2d 544, 21 UCC Rep. 590 (Sup. Ct. 1976).

26. *K-Ross Bldg. Supply Center, Inc. v. Winnepesaukee Chalets, Inc.*, 121 N.H. 562, 432 A.2d 8, 32 UCC Rep. 1515 (1981) (citing Rule 4).

27. *Wiebe v. Richardson & Sons, Inc.*, 83 Wis.2d 359, 265 N.W.2d 571, 24 UCC Rep. 179 (1978). But see *Dynamic Homes, Inc. v. Rogers*, 331 So.2d 326, 19 UCC Rep. 590 (Fla. App. 1976). *Dynamic Homes* suggests that an undisclosed corporate principal can be obligated by parol evidence. The Editor's Note preceding the report of this opinion in the Uniform Commercial Code Reporting Service indicates that this is incorrect under the Code.

28. *Schwartz v. Disneyland Vista Records*, 383 So.2d 1117, 29

UCC Rep. 1321 (Fla. App. 1980).

29. *Littky & Mallon v. Michigan Nat'l Bank*, 94 Mich. App. 29, 287 N.W.2d 359, 28 UCC Rep. 715 (1979). But see *Sequoiah State Bank v. Union Nat'l Bank*, 32 UCC Rep. 213 (Ark. 1981) (Preprinted bank name constitutes signature on a money order).

30. See *Pollin v. Mindy Mfg. Co.*, 211 Pa. Super. 87, 236 A.2d 542, 4 UCC Rep. 827 (1967); *Jenkins v. Evans*, 31 App. Div. 2d 267, 295 N.Y.S.2d 226, 5 UCC Rep. 1185 (1968).

31. *First Security Bank of Brookfield v. Fastwich, Inc.*, 30 UCC Rep. 1609 (Mo. App. 1981).

32. *Fireman's Fund Ins. Co. v. Security Pacific Nat'l Bank*, 85 Cal. App. 3d 797, 149 Cal. Rptr. 883, 25 UCC Rep. 495 (1978).

33. See *Abby Fin. Corp. v. Margrove Mfg. Co.*, 5 UCC Rep. 1088 (N.Y. Sup. Ct. 1968); Model Business Corporation Act §76(e).

34. UCC §3-403 Official Comment 3. See *Schwartz v. Disneyland Vista Records*, 383 So.2d 1117, 29 UCC Rep. 1321 (Fla. App. 1980).

have adhered to this rule even though it can work a harsh result in cases where it was understood that the signature was intended to bind the corporate principal and not the agent. Rule Four might not permit agents to escape personal liability even if their personal signatures are preceded by the word "by" (by Brian Douglas) when their corporate principal is not named anywhere in the instrument. This is because "by," without more, has been held insufficient to show representative capacity.³⁵

A minority of courts have permitted the admission of parol evidence allowing an agent to avoid personal liability when the suit involved the immediate parties to an instrument. In one of these cases a corporate officer was able to avoid personal indorser's liability on a note. The note was on a preprinted form. On the maker's signature line was the typewritten name of the corporate debtor. On the line below one of the officers, Dorek, had signed his name showing representative capacity. On another line the officer whose liability was in question, Buettel, had signed in personal form. (It was conceded that this was intended to be a representative signature.) The reverse side of the note also contained Dorek's representative signature and Buettel's personal signature. The court reasoned that the presence of Dorek's representative indorsement raised the possibility that Buettel's indorsement was also intended to bind the corporation. This ambiguity opened the door to parol evidence which, though controverted, was sufficient to demonstrate that the payee had requested that Buettel sign as a representative.³⁶

Another case upheld the admission of parol evidence when the payee admitted that a corporate note had been intended and the officers who signed in personal form as makers on the face of the note had also made personal guarantees on the back of the note. The guarantees, which would have been superfluous if personal maker's liability was intended, had been discharged through the payee's failure to perfect a security interest securing payment of the note.³⁷

An agent may be at personal risk on an instrument which contains an incorrect corporate name that is not in sufficiently close proximity to the agent's individual signature. This was the result in a case involving a note which did not name the corporation as a maker in its body, but contained a hand-printed address and incorrect corporate name in the lower left hand corner on lines which were designated for an address. The agent's handwritten personal signature appeared in the lower right-hand corner in the part of the note designated for signatures. The court regarded the case as falling under Rule Four and not under Rules Five and Six, reasoning that the corporation was not sufficiently named so as to raise a question of fact as to whether the signer was acting in a representative capacity.³⁸

2. Agent's Liability Where Compliance with Rule Three Is Ambiguous

Rule Three provides that when a corporate name is preceded or followed by the name and office of the signing agent, the corporation will be liable on the instrument and the agent will not (Alpha Corp. by Brian Douglas, President). The rule permits the introduction of parol evidence.³⁹ One court has held that such evidence is appropriate when the name of the principal and signature and office of the agent are not in sufficiently close reference to each other.⁴⁰ It reasoned that reasonable men should be able to understand from the face of the instrument that the agent signed as a representative and not in an individual capacity.

Whether this requisite degree of certainty exists must be worked out on a case-by-case basis. It seems clear that Rule Three is complied with in the case of an instrument that states across its top that it is in payment of the debt of a named corporation and is signed by agents who state their offices.⁴¹ Moving toward the opposite extreme, a court has held that parol evidence was admissible to clarify the meaning of a note that contained language of joint liability both in its body ("we promise to pay") and in its signature (Alpha Corp. and/or Brian Douglas, President).⁴² Another court found ambiguity in a note made by a corporation which corporate officers had indorsed by signing their names followed by their official titles.⁴³ One of the officers had also indorsed on behalf of the corporate principal in Rule Three form. The Court permitted the introduction of parol evidence that the officers had indorsed in personal capacities because it was unlikely that the corporation would both make and indorse the same instrument. These cases illustrate the importance of careful compliance with Rule Three if personal agent liability is to be avoided. Ambiguous compliance opens the door to agent liability even if the actual intent was to bind only the corporate principal.

3. Agent's Personal Liability when Corporation Named but Representative Capacity Not Shown

A threshold issue may be whether representative capacity is shown on the face of the instrument. Such capacity may be suggested, but not conclusively established, through use of the word "by" preceding the agent's name even if the agent's office is not indicated (Alpha Corp. by Brian Douglas).⁴⁴

Corporate instruments are frequently executed so as to name the corporation but do not show the representative capacity of the signing agent (Alpha Corp. Brian Douglas). Rule Five indicates that this form of signature personally obligates the agent. Rule Six creates an exception

35. *Giacalone v. Bernstein*, 348 So.2d 679, 22 UCC Rep. 725 (Fla. App. 1977). Compare text at footnote 44 *infra*.

36. *Weather-Rite, Inc. v. Southdale Pro-Bowl, Inc.*, 301 Minn. 346, 222 N.W.2d 789, 15 UCC Rep. 664 (1974).

37. *First Bank & Trust Co. v. Post*, 10 Ill. App. 3d 127, 293 N.E.2d 907, 12 UCC Rep. 512 (1973). See UCC §3-606.

38. *Southern Oxygen Supply Co. v. DeGolian*, 230 Ga. 405, 197 S.E.2d 374, 12 UCC Rep. 916 (1973).

39. UCC §3-403(3) ("Except as otherwise established").

40. *Havatampa Corp. v. Walton Drug Co.*, 354 So.2d 1235, 1236, 24 UCC Rep. 182, 186 (Fla. App. 1978).

41. *Phoenix Air Conditioning Co. v. Pound*, 123 Ga. App. 523, 181 S.E.2d 719, 9 UCC Rep. 483 (1971).

42. *Havatampa Corp. v. Walton Drug Co.*, 354 So.2d 1235, 1236, 24 UCC Rep. 182, 186 (Fla. App. 1978).

43. *Trenton Trust Co. v. Klausman*, 222 Pa. Super. 400, 296 A.2d 275, 11 UCC Rep. 787 (1972).

44. *Main Gas & Appliances, Inc. v. Siegel*, 438 A.2d 888, 32 UCC Rep. 1534 (Me. 1981); *Chidakev v. Blonder*, 431 A.2d 594, 31 UCC Rep. 1642 (D.C. App. 1981). But compare *Giacalone v. Bernstein*, 348 So.2d 679, 22 UCC Rep. 725 (Fla. App. 1977) (Note did not name corporate principal). See footnote 51 and accompanying text *infra*.

which permits the introduction of parol evidence relevant to the issue of whether personal liability was contemplated when the dispute is between immediate parties. These rules create a two-edged sword. They authorize the use of parol evidence to enable the agent to escape personal liability. But the immediate party seeking enforcement may invoke parol evidence proving that personal liability was intended.⁴⁵

Rules Five and Six have been the subject of frequent judicial application in cases in which agents sought to escape liability on instruments signed in the manner of the example in the preceding paragraph.⁴⁶ Agents have also sought to escape liability through application of these rules to instruments which were signed in this manner, but which also contained language of joint liability in the body of the instrument. The results in the latter group of cases are inconsistent. A corporate president was permitted to introduce evidence that he signed as representative when the note stated that "the undersigned jointly and severally promise to pay."⁴⁷ On the other hand, another court did not permit the introduction of such evidence when the body of the note contained the words "we promise to pay."⁴⁸ Thus, there is a risk that joint language might cause a court to apply Rule Four even though the corporation is named and the agent's liability arguably should be determined under Rules Five and Six.

Rules Five and Six do not allow an agent to escape personal liability when a remote party such as an indorsee seeks to enforce an instrument. This has been the result when the instrument was a check imprinted with the corporate name⁴⁹ and when the instrument was a corporate note which contained language of single party liability ("I promise to pay").⁵⁰

Although Rules Five and Six would seem to leave no room for the admission of parol evidence between remote parties, agents have had some success in arguing that an instrument must be considered in its entirety and that an imprinted corporate name impliedly discloses representative capacity.⁵¹

4. Agent's Personal Liability when Representative Capacity Shown but Corporation Not Named

Rules Five and Six apply to signatures made by agents that indicate their representative capacity but do not name the corporation (Brian Douglas, President). Parol evidence relevant to the issue of whether personal liability was intended should be admissible in an action be-

tween the immediate parties.⁵² Here again, there can be an issue of whether representative capacity is shown. It has been held that it is not shown by the word "by" preceding an agent's name (by Brian Douglas).⁵³ This results in the signature binding the agent personally under Rule Four.

5. Evidence of Intent to Make Personal or Corporate Signatures

The preceding discussion indicates that in many situations courts may entertain proof of whether the parties intended an agent to be personally bound on an instrument. Some courts have found the following facts support an inference of an intent to create corporate and not personal liability:⁵⁴ (a) Knowledge that the signer was an agent or was doing business in corporate form; (b) Enforcement action against agent-indorser instituted after suit against corporation not successful or judgment against corporation proved uncollectable; (c) Instrument issued in payment for transaction billed to corporation; (d) Corporate name imprinted on check; (e) Prior course of dealing under which instruments signed by agents were accepted in payment of corporate principal's obligations; (f) Disclosure of representative capacity communicated prior to issuance of instrument; (g) Execution of note contemporaneous with execution of a corporate document such as an agreement creating a security interest in corporate assets.

On the other hand, the following facts have been viewed as suggesting an intent to create personal liability:⁵⁵ (a) Request for personal agent liability prior to issuance of the instrument or other circumstances indicating that a corporate instrument without personal agent liability would have been unacceptable; (b) Communication from payee to corporate officer prior to execution of instrument expressing the former's belief that the latter would be personally bound upon signing.

While some of these fact patterns are ambiguous or not individually persuasive, they can have cumulative weight.

6. Defenses Of Personally Liable Agents

If an agent is personally liable on an instrument, it may be possible to assert defenses such as that issuance of the instrument was induced through fraud.⁵⁶ However, a holder in due course seeking to enforce the instrument would cut off most defenses.⁵⁷

45. *Maine Gas & Appliances, Inc. v. Siegel*, 438 A.2d 888, 32 UCC Rep. 1534 (Me. 1981).

46. *Sullivan County Wholesalers, Inc. v. Sullivan County Dorns*, 59 App. Div. 2d 628, 398 N.Y.S.2d 180, 22 UCC Rep. 994 (1977); *St. Croix Eng'g Corp. v. McLay*, 304 N.W.2d 912, 31 UCC Rep. 619 (Minn. 1981).

47. *Rosedale State Bank & Trust Co. v. Stringer*, 2 Kan. App. 2d 331, 579 P.2d 158, 24 UCC Rep. 660 (1978).

48. *Colonial Film & Equip. Co. v. MacMillan Professional Magazines, Inc.*, 148 Ga. App. 632, 252 S.E.2d 61, 26 UCC Rep. 1190 (1979).

49. *Financial Assocs. v. Impact Mktg, Inc.*, 90 Misc. 2d 545, 394 N.Y.S.2d 814, 21 UCC Rep. 1369 (Civ. Ct. 1977).

50. *O. P. Ganjo, Inc. v. Tri-Urban Realty Co.*, 180 N.J. Super. 517, 261 A.2d 722, 7 UCC Rep. 302 (1969).

51. *Pollin v. Mindy Mfg. Co.*, 211 Pa. Super. 87, 236 A.2d 542, 4 UCC Rep. 827 (1967).

52. *National Bank of Georgia v. Ament*, 127 Ga. App. 311, 195 S.E.2d 202, 12 UCC Rep. 311 (1973).

53. *Giacalone v. Bernstein*, 348 So.2d 679, 22 UCC Rep. 725 (Fla. App. 1977). Compare footnote 44 and accompanying text *supra*.

54. Cases discussing the types of proof enumerated in the text would include *St. Croix Eng'g Corp. v. McLay*, 304 N.W.2d 912, 31 UCC Rep. 619 (Minn. 1981); *Seale v. Nichols*, 505 S.W.2d 251, 14 UCC Rep. 457 (Tex. 1974); *First Bank & Trust Co. v. Post*, 10 Ill. App. 3d 127, 293 N.E.2d 907, 12 UCC 512 (1973). See generally 7 Am. Jur. *Proof of Facts* 2d 675 (1975).

55. *Main Gas & Appliance, Inc. v. Siegel*, 438 A.2d 888, 32 UCC Rep. 1534 (Me. 1981).

56. *Factors & Note Buyers, Inc. v. Green Lane, Inc.*, 102 N.J. Super. 43, 245 A.2d 223, 5 UCC Rep. 611 (1968); *Malone & Hyde, Inc. v. Parson*, 642 S.W.2d 157 (Tenn. App. 1982).

57. See UCC §3-305.

C. Liability Of Unauthorized Signer

Rule Seven indicates that an unauthorized signature binds the signer on the instrument in the capacity in which he signed in favor of any person who in good faith pays the instrument or takes it for value. However, a person who knows that the signature was not authorized may be unable to recover on the instrument from the signer.⁵⁸ The Code defines unauthorized signature to include those made without actual, implied, or apparent authority including forgeries.⁵⁹

H. Liability Through Ratification, Estoppel or Negligence

An unauthorized signature may become binding on the person whose name is signed if the person ratifies it. It has been held that the Code incorporates the agency law concept of ratification described by the *Restatement (Second) of the Law of Agency*.⁶⁰ The *Restatement* provides that ratification is the affirmation by a person of a prior act which did not bind him but which was done or professedly done on his account. This results in the act being given effect as if originally authorized.⁶¹ Under agency principles, ratification requires intent to ratify plus full knowledge of all material facts. Ratification may be express or implied.⁶² The Code's official comments indicate that ratification relieves the actual signer from liability on the signature.⁶³

The question of whether an unauthorized signature was ratified is fact specific and has been litigated with some frequency.⁶⁴ A ratification may be found in the retention of benefits received in a transaction involving an unauthorized signature.⁶⁵ This would occur, for example, where a corporate officer obtains salary payments from the corporation after learning that his personal signature had been forged on a note evidencing a loan to the corporation and the corporation would have been unable to pay the salary without the loan.⁶⁶

The Code also binds a person on an unauthorized signature if that person is precluded from denying the authority on grounds of estoppel or negligence.⁶⁷ An estoppel can arise against a person who expressly or tacitly represents that his signature on an instrument is genuine. Negligence can also preclude a denial of authenticity.⁶⁸ Facts supporting ratification and estoppel may be closely related and facts justifying an estoppel may also support a finding of negligence.⁶⁹

I. Lack of Corporate Authority to Sign Instruments

The power of a corporate principal to authorize its signature on commercial paper may be limited or suspended by its charter, state statute, or in other ways. The question may then arise whether an agent who purports to sign commercial paper on behalf of the corporation is bound personally under Rule Seven. Cases dealing with this sort of issue suggest that the agent may be at personal risk.⁷⁰ However, they also indicate that personal liability may be avoided if the corporation statute in question does not expressly make officers liable for corporate obligations during the period in which the corporation's powers are suspended. Liability may also be avoided on the theory that the signature was ratified by the corporation.

II. Corporations or Their Agents as "Holders"

Corporations engage in joint enterprise with artificial or natural persons and may be linked with other corporations through common ownership or in parent-subsidiary relationships. Corporations change their names or cease to exist through merger. These facts of corporate life give rise to problems relating to the attainment of holder status by corporations or their agents. A brief review of the Code's negotiability rules provides a good starting point for analysis of these issues.

A. Negotiability

Article Three of the Code establishes two sets of requirements that must be complied with in order for a transferee to obtain holder status. They are form requirements and transfer requirements. In addition, certain purchaser requirements also must be satisfied for holder in due course standing.

1. Form Requirements

In order to be a negotiable instrument a writing must (a) be signed by a maker or drawer; (b) contain an unconditional promise or order to pay a sum certain in money and no other promise, order, obligation or power given by the maker or drawer; (c) be payable on demand or at a definite time; and (d) be payable to order or bearer.⁷¹ Each of these form requirements, which are designed to identify an instrument as negotiable and to facilitate its valuation and transfer, is the subject of extensive statutory elaboration.⁷²

58. UCC §3-404 Official Comment 2.

59. UCC §1-201(43).

60. *Thermos Contracting Corp. v. The Bank of New Jersey*, 69 N.J. 43, 354 A.2d 291, 18 UCC Rep. 1096 (1976). See generally 7 *Am. Jur. Proof of Facts* 2d 675 (1975).

61. *Restatement (Second) of Agency* §82 (1958).

62. *Thermos Contracting Corp. v. The Bank of New Jersey*, 69 N.J. 43, 354 A.2d 291, 18 UCC Rep. 1096 (1976).

63. UCC §3-404 Official Comment 3.

64. Annot., *What Constitutes Ratification of Unauthorized Signature Under UCC §3-404*, 93 A.L.R.3d 967 (1980).

65. UCC §3-404 Official Comment 3.

66. *Common Wealth Ins. Systems, Inc. v. Kersten*, 40 Cal. App. 3d 1014, 115 Cal. Rptr. 653, 15 UCC Rep. 133 (1974). See also *O'Grady v. First Union Bank*, 296 N.C. 212, 250 S.E.2d 587, 26 UCC Rep. 146 (1978).

67. UCC §3-404(1).

68. UCC §3-404 Official Comment 4. See UCC §3-406.

69. *Common Wealth Ins. Systems, Inc. v. Kersten*, 40 Cal. App.

3d 1014, 115 Cal. Rptr. 653, 15 UCC Rep. 133 (1974).

70. *Bank of America Nat'l Trust & Savings Ass'n v. Morse*, 265 Or. 72, 508 P.2d 194, 12 UCC Rep. 520 (1973); *Diener-Hauser-Greenthal Co. v. Cinecom Theatres Eastern States, Inc.*, 9 UCC Rep. 1083 (N.Y. Sup. Ct. 1971). An indorsement in excess of a corporation's powers may be effective to negotiate an instrument. See UCC §3-207(1)(a) and note 81 and accompanying text *infra*.

71. UCC §3-104(1). Form requirement (b) must be read with UCC §3-112. See generally Annot., *What Constitutes Unconditional Promise to Pay Under Uniform Commercial Code §3-104(1)(b)*, 88 A.L.R.3d 1100 (1980).

72. UCC §§3-105 to 3-117. Checks normally meet these requirements because of their spare and standardized language. They may remain negotiable even if the back of the check contains additional language, such as instructions limiting the time for deposit to a future date. *Silver Creations, Ltd. v. United Parcel Service*, 133 N.J. Super. 554, 337 A.2d 16 UCC Rep. 1299 (1975). However, form requirements can create drafting pitfalls with respect to notes.

2. Transfer Requirements

A holder is a person who has possession of a negotiable instrument and who is entitled to payment thereon. Issuance and negotiation are the forms of transfer which make it possible for the transferee to be a holder.⁷³ As the following examples demonstrate, the particular type of transfer required is controlled by the form of the instrument.

Example One: Check drawn by Alpha Corp. payable to the order of Beta Corp. This is an "order" instrument because it is payable to the order of a specified person. It may be issued merely by delivery of the instrument to Beta Corp.⁷⁴

Example Two: Check drawn by Alpha Corp. payable to cash. This is a "bearer" instrument because it does not designate a specific payee. It may be issued to Beta Corp. in the same manner as in Example One.⁷⁵

Example Three: Alpha Corp. is in possession of a check naming it as payee. If Alpha Corp. wishes to negotiate this order instrument to First Bank, it will have to indorse and deliver. Alpha Corp. may preserve the instrument in order form by making a "special" indorsement that specifies that the instrument is payable to First Bank (Pay to the Order of First Bank. Alpha Corp. by Brian Douglas, Treasurer).⁷⁶ Alternatively, Alpha Corp. may convert the instrument to bearer form by making a "blank" indorsement which specifies no particular indorsee and may consist of a mere signature (Alpha Corp. by Brian Douglas, Treasurer).⁷⁷

Example Four: Alpha Corp. is in possession of a check payable to cash. If Alpha Corp. wishes to negotiate this bearer instrument to First Bank, it can do so by delivery. Alpha Corp. may convert the instrument to order form by specially indorsing it to First Bank as shown in the preceding example.⁷⁸

Any necessary indorsement must be written by or on behalf of the holder.⁷⁹ A signature on a separate sheet of paper (called an "allonge") may serve as an indorsement if the paper is firmly affixed to an instrument so as to become a part thereof. It may also be necessary that there be no room for the indorsement on the instrument itself.⁸⁰

The Code provides that a corporate holder may effectively negotiate an instrument even if it is exceeding its statutory or charter powers so that the transaction relating to the instrument is void.⁸¹ This follows from the inherent characteristic of negotiable instruments that a holder has the right to negotiate and confer holder status on a transferee. The Code should not be read as providing that the transaction is not void, corporate charter or corporation statute to the contrary notwithstanding. If the corporation actually exceeded its powers, its indorsement contract on the instrument may not be enforceable by a holder or, in some cases, by a holder in due course.⁸² The Code does not make all corporate commercial paper contracts *intra vires*.

One consequence of this dichotomy between corporate power to negotiate and corporate liability appears to be that the maker of a note would remain liable thereon to the ultimate holder even if the indorsement by the corporate payee of the instrument was *ultra vires*. Extra-Code law might permit the corporation to rescind its negotiation, but such a right could be cut off by a holder in due course.⁸³

3. Purchaser Requirements

In order to be a holder in due course, a person must be a holder.⁸⁴ A holder in due course must also take the instrument (a) for value; (b) in good faith; and (c) without notice that it is overdue or has been dishonored or of any defense or claim to it on the part of any person.⁸⁵ Each of these requirements is the subject of statutory elaboration,⁸⁶ including provisions relating to the issue of when notice received by a corporation is effective.⁸⁷

A holder in due course takes the instrument free from all claims to it on the part of any person.⁸⁸ A holder in due course also cuts off the defenses of any party to the in-

73. UCC §§1-201(20), 3-102(1)(a), 3-202(1). A holder who meets certain additional requirements can qualify as a holder in due course. UCC §§3-302-3-304. See generally McDonnell, *Freedom From Claims and Defenses: A Study in Judicial Activism Under the Uniform Commercial Code*, 17 GA. L. REV. 569, 583-608 (1983).

74. UCC §§3-202(1), 3-110(1).

75. UCC §§3-111, 3-202(1).

76. UCC §§3-204(1).

77. UCC §§3-204(2).

78. First Bank may convert the blank indorsement into a special indorsement. See UCC §§3-204(3).

79. UCC §§3-202(2).

80. UCC §§3-202(2); See *James Talcott, Inc. v. Fred Ratowsky Assocs. Inc.*, 38 Pa. D. & C.2d 624, 2 UCC Rep. 1134 (1965); *Lamson v. Commercial Credit Corp.*, 531 P.2d 966, 16 UCC Rep. 756 (Colo. 1975). The character of an indorsement is not affected by words of assignment, condition or guarantee, or the like. UCC §§3-202(4). An indorsement may be conditional, purport to prohibit further trans-

fer of an instrument, or otherwise seek to restrict its transfer. The most important types of restrictive indorsements are those that include words such as "for collection" or "for deposit" and which are commonly placed on checks. UCC §§3-205, -206.

81. UCC §§3-207(1)(a) and Official Comment 2.

82. UCC §§3-207 Official Comment 4; 3-305(2)(b).

83. UCC §§3-207(2) and Official Comment 5. See note 90 and accompanying text *infra*.

84. UCC §1-201(20). Concerning whether a transferee may obtain holder status through application of the "shelter" doctrine, see generally B. Clark, *The Law of Bank Deposits, Collections and Credit Cards* ¶1.2(2) (1981) and note 89 *infra*.

85. UCC §§3-302(1).

86. UCC §§3-303 to -304, 1-201(19), 1-201(25) to (28), 1-201(44), 4-209. See generally Annot., *Value: Who is a Holder of an Instrument for Value Under UCC* §§3-303, 97 A.L.R.3d 1283 (1979).

87. UCC §§1-201.5(27) to (28).

88. UCC §§3-305(1).

strument with whom the holder has not dealt with certain exceptions.⁸⁹ Defenses that are cut off, sometimes referred to as "personal defenses," include failure of consideration, breach of warranty and mistake. The defenses that are not cut off are sometimes referred to as the "real" defenses. They include discharge through insolvency proceedings and lack of legal capacity if the incapacity renders the instrument null under extra-Code law. Incapacity might be the result of *ultra vires* acts or a lack of corporate authority to do business.⁹⁰

B. Corporations or Corporate Agents as "Holders"

A corporation must be the holder of an instrument in order to enforce the contracts contained therein or to negotiate it. The possessory requirement for holder status may be satisfied through possession of an instrument by an agent on behalf of the corporation.⁹¹ Whether the agent's possession was for corporate or some other purpose can raise factual issues turning on intent which may require resort to extra-Code law including the doctrine of constructive possession.⁹²

1. Instrument in Wrong Name

In order to be a holder of order paper, it is necessary for an instrument to be drawn, issued, or indorsed to the corporation or its order. Sometimes the intended holder may be in possession of an order instrument that does not state the holder's correct name. For example, a check intended for Alpha Corp. may be payable to the order of a wrong name (Alpha Ltd.) or personally to an officer of Alpha Corp. (Brian Douglas) or to a different corporation (Beta Corp.) or to a trade name of Alpha Corp. (Alpha High Tech). In these situations Alpha Corp. may indorse in the "wrong" name or its "correct" name or both.⁹³ A person giving value for the instrument (such as a bank that cashes a check) is entitled to an indorsement in both names. In order to enforce such an instrument Alpha Corp. may have to prove that the instrument was actually intended for it and not some other person with the "wrong" name.

2. Joint and Alternative Instruments

In some instances an instrument may intentionally be made payable jointly to a corporation and one of its officers (Brian Douglas and Alpha Corp.) or to multiple corporations (Alpha Corp. and Beta Corp.). In such cases, the instrument may be negotiated, discharged or enforced only by all of the named persons.⁹⁴ For example, both must indorse in order to negotiate the instrument. If the instrument is payable in the alternative (Brian Douglas or Alpha Corp.), it may be negotiated, discharged, or enforced by either named person.⁹⁵

Sometimes it is difficult to determine whether an instrument is payable jointly, in the alternative, or in some other manner. It has been held that checks payable in the form "Alpha Corp Beta Corp." and "Alpha Corp. payable to Beta Corp." are joint checks.⁹⁶ On the other hand, it has also been held that a check payable in the form "Brian Douglas, Alpha Corp." is neither a joint nor an alternative check. Rather, the court decided that the check was payable to Brian Douglas unconditionally under a Code provision, discussed below, concerning instruments payable with words of description.⁹⁷ Instruments payable in the form "Alpha Corp/Beta Corp." or to the order of "Alpha Corp. and/or Beta Corp." are payable in the alternative.⁹⁸

Caution must be exercised in the case of joint instruments. If one named person were to indorse the other's signature without authorization and obtain payment of the instrument, the indorser may be exposed to civil liability for conversion and criminal liability for forgery. A party who honors an instrument bearing such an unauthorized indorsement may also be liable for conversion or may have to pay twice because the payment did not result in a discharge.⁹⁹

3. Instrument Payable with Words of Description

Sometimes an instrument may be made payable to an individual with additional words describing him as an agent or officer of a specified corporation (Brian Douglas, President Alpha Corp.). This form of instrument is payable to the corporate principal, but the agent or officer may act as if he were the holder which means that he can

89. Payees can qualify as holders in due course. However, this will usually not be of practical significance because holders in due course may cut off only the defenses of parties with whom they did not deal. Payees typically have direct dealings with makers and drawers.

A transferee of an instrument who does not qualify as a holder in due course in its own right is essentially in the position of a mere assignee that has no better rights than its assignor. UCC §3-306. However, if the transferor was a holder in due course, then the transferee may succeed to the transferor's rights under the "shelter" doctrine. UCC §3-201(1). There may be limitations on the rights of a transferee under the "shelter doctrine." See UCC §3-201 Official Comments 1-3; *Security Pacific Nat'l Bank v. Chess*, 58 Cal. App. 3d 555, 129 Cal. Rptr. 852, 19 UCC Rep. 544 (1976).

90. UCC §3-305(2)(b) and Official Comment 5. See generally Annot., *Fraud in the Inducement and Fraud in the Factum as Defense Against Holder in Due Course*, 78 A.L.R.3d 1020 (1980).

91. *Bryan v. Bartlett*, 435 F.2d 28, 8 UCC Rep. 535 (8th Cir. 1970), cert. denied, 402 U.S. 915 (1971).

92. *Billingsley v. Kelly*, 261 Md. 116, 274 A.2d 113, 8 UCC Rep. 1063 (1971).

93. UCC §3-203; *Gabovitch v. Coolidge Bank & Trust Co.*, 29 UCC Rep. 1313 (Mass. App. 1980); *Agalioitis v. Agalioitis*, 38 N.C. App. 42, 247 S.E.2d 28 (1978).

94. UCC §3-116(b). See generally Murray, *Joint Payee Checks—Forged and Missing Indorsements*, 78 COMM. L. J. 393 (1973).

95. UCC §3-116(a).

96. See *Equipment Distributors, Inc. v. Charter Oak Bank & Trust Co.*, 20 UCC Rep. 1231 (Conn. Super. Ct. 1977); *Barden & Robeson Corp. v. Tompkins County Trust Co.*, 67 Misc.2d 587, 324 N.Y.S.2d 543, 67 Misc.2d 587, 9 UCC Rep. 1088 (N.Y. Sup. Ct. 1971).

97. *Swiss Baco Skyling Logging, Inc. v. Haliewicz*, 18 Wash. App. 21, 567 P.2d 1141, 22 UCC Rep. 441 (1977). See note 103 and accompanying text *infra*.

98. *Dynalectron Corp. v. Union First Nat'l Bank*, 488 F.Supp. 868, 29 UCC Rep. 131 (D.C. Cir. 1980); UCC §3-116 Official Comment.

99. An excellent entree into the law relating to forged indorsements will be found in Clark, *supra* note 84, at ¶6.4.

negotiate the instrument.¹⁰⁰ Thus, a transferee from the agent can be a holder and, if it lacks knowledge that the agent was violating a fiduciary duty to the corporate principal, a holder in due course.¹⁰¹

If the instrument names an individual payee and describes him as an agent or officer without designating the corporate principal (Brian Douglas, President), the instrument is payable unconditionally to the agent or officer and the additional words have no effect on subsequent parties.¹⁰² The instrument may be considered payable to the individual payee personally. The check described above payable to "Brian Douglas, Alpha Corp." was held to fall under this category.¹⁰³

An instrument made payable to the order of an officer by his title (Treasurer of Alpha Corp.) is payable to the corporate principal. However, the officer (or his successor) may act as if he is the holder of the instrument.¹⁰⁴

4. Change of Corporate Name or Form

If a corporation changes its name (Alpha Corp. to Beta Corp.) and then seeks to enforce an instrument payable under the obsolete name, it may have difficulty establishing that it is a holder. It is arguable that the obsolete name is a "wrong" name and that an effective indorsement could be made in either the obsolete name or the new name.¹⁰⁵ It would follow that the corporation should be able to enforce the instrument upon establishing the fact of the name change.¹⁰⁶ This fact might be established through production of a certificate of amended articles showing the name change.¹⁰⁷

A comparable problem may arise when a corporation seeks to enforce an order instrument as surviving corporation through merger when the instrument remains payable to the order of the merging corporation. A case decided under the UCC apparently holds that absent an indorsement by the merging corporation, the surviving corporation may not be permitted holder status in its own right.¹⁰⁸

Prudence may dictate obtaining the merging corporation's indorsement prior to the merger. However, this holding arguably confuses a merger with a transfer of corporate assets. The surviving corporation in a merger is not a transferee of the merging corporation's assets. Rather, after a merger the surviving corporation is entitled to the personal property of the merging corporation by operation of the corporation statute.¹⁰⁹ Thus, an instrument payable to the order of the merging corporation arguably

becomes payable to the surviving corporation by operation of law and no indorsement should be required to make the surviving corporation a holder. Counsel for the surviving corporation also might argue that the instrument is payable to its clients under a "wrong name" and establish the fact of the merger through production of a certificate of merger.¹¹⁰

5. Wrongful Appropriation of Instrument Intended for a Corporation

There will be many situations in which corporate officers or agents such as bookkeepers, cashiers, salesmen and others will have the opportunity to wrongfully appropriate corporate instruments (and the proceeds thereof) for noncorporate purposes. This risk is increased by the fact that corporations cannot always control the form of instruments (particularly checks) that are intended for their coffers. Fidelity bonds may be purchased in order to insure employers against the risk of employee fraud. The following examples illustrate the legal position of a corporate principal with respect to wrongfully appropriated instruments.

Example 1. Check payable to the order of Alpha Corp. deposited to the personal account of employee

Brian Douglas. This instrument can be negotiated only by an authorized signature on behalf of the corporation. An authorized signature would also be required in the case of a joint check (Alpha Corp. and Brian Douglas). In either case, the absence of an authorized signature could prevent a transferee from being a holder and, therefore, a holder in due course.¹¹¹

The transferee of a misappropriated instrument can be expected to argue that the indorsement was authorized. This argument may be successful if the agent had broad authority to administer corporate funds.¹¹² On the other hand, corporate agents may be found to have only limited authority such as to collect checks for forwarding to their principal.¹¹³ A transferee under an unauthorized signature can also claim that the corporate principal was negligent in supervising the agent or officer or might invoke ratification or estoppel doctrine.¹¹⁴ These arguments may result in an effective indorsement.

All may not be lost for the corporate principal if the indorsement on a wrongfully appropriated instrument is

100. UCC §3-117(a) and Official Comment 1.

101. UCC §3-304(2), 3-304(A)(e); *Maber, Inc. v. Factor Cab Corp.*, 19 App. Div. 2d 500, 244 N.Y.S.2d 768, 2 UCC Rep. 532 (1963).

102. UCC §3-117(c).

103. See text at note 97 *supra*.

104. UCC §3-110(1)(f).

105. See text at note 93 *supra*.

106. *Lawson v. Finance America Private Brands, Inc.*, 537 S.W.2d 483, 19 UCC Rep. 1167 (Tex. Civ. App. 1976).

107. See Model Business Corporation Act §63 (1982).

108. *Econo-Travel Motor Hotel Corp. v. Taylor*, 301 N.C. 200,

271 S.E.2d 54, 30 UCC Rep. 1319 (1980).

109. Model Business Corporation Act §76(d)(1982). See generally, W. Fletcher, *Cyclopedia of the Law of Private Corporations*, §7044, 7088, 7090 (Rev. ed. 1983).

110. See Model Business Corporation Act §74.

111. UCC §3-302(1); 3-306.

112. *Farmers Union Coop. Ass'n v. Commercial State Bank*, 187 Neb. 376, 191 N.W.2d 168, 9 UCC Rep. 1080 (1971). See UCC §3-207(1)(d).

113. *Aetna Casualty & Surety Co. v. Hepler State Bank*, 6 Kan. App. 2d 543, 630 P.2d 721, 32 UCC Rep. 187 (1981).

114. See section I.H. of this article.

binding. The transferee cannot be a holder in due course if it had knowledge at the time of transfer that the fiduciary negotiated the instrument for his own benefit or otherwise in breach of duty.¹¹⁵

Example 2. Check intended for corporation payable to Brian Douglas deposited to the personal account of Brian Douglas. The risk to the corporation is

increased in the case of checks that run to an officer or agent in a form that gives that officer the status of a holder. As a holder the agent can negotiate the instrument and make the transferee a holder. If the transferee also qualifies as a holder in due course, it will receive title to the instrument and cut off most corporate claims and defenses.¹¹⁶ As was the case in Example One, knowledge of a breach of fiduciary duty may prevent the transferee from obtaining holder in due course status. (c)(a)

115. UCC §§3-304(2), 3-304(4)(e); *Mott Grain Co. v. First Nat'l Bank & Trust Co. of Bismarck*, 259 N.W.2d 667, 23 UCC

Rep. 104 (N.D. 1977) The Code follows the policy of the Uniform Fiduciaries Act, UCC §3-304 Official Comment 5.
116. UCC §3-207(1)(d) and Official Comments.

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