

DRAFT

FOR DISCUSSION ONLY

**AMENDMENTS TO UNIFORM COMMERCIAL CODE
ARTICLES 3, 4 AND 4A**

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UNIFORM COMMERCIAL CODE ARTICLES 3, 4, AND 4A**

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§ 3–103. Definitions.

(a) In this Article:

(1) "Acceptor" means a drawee who has accepted a draft.

(1A) "Authenticate" means:

(A) to sign; or

(B) to execute or otherwise adopt a symbol, or encrypt or similarly process a record in whole or in part, with the present intent of the authenticating person to identify the person and adopt or accept a record.

(2) "Drawee" means a person ordered in a draft to make payment.

(3) "Drawer" means a person who signs or is identified in a draft as a person ordering payment.

(4) "Good faith" means honesty in fact and the observance of reasonable commercial standards of fair dealing.

(5) "Maker" means a person who signs or is identified in a note as a person undertaking to pay.

(6) "Order" means a written instruction to pay money signed by the person giving the instruction. The instruction may be addressed to any person, including the person giving the instruction, or to one or more persons jointly or in the alternative but not in succession. An authorization to pay is not an order unless the person authorized to pay is also instructed to pay.

(7) "Ordinary care" in the case of a person engaged in business means observance of reasonable commercial standards, prevailing in the area in which the person is located, with

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

(8) "Party" means a party to an instrument.

(9) "Promise" means a written undertaking to pay money signed by the person undertaking to pay. An acknowledgment of an obligation by the obligor is not a promise unless the obligor also undertakes to pay the obligation.

(10) "Prove" with respect to a fact means to meet the burden of establishing the fact (Section 1–201(8)).

(10A) "Record" means information that is inscribed on a tangible medium or which is stored in an electronic or other medium and is retrievable in perceivable form.

(11) "Remitter" means a person who purchases an instrument from its issuer if the instrument is payable to an identified person other than the purchaser.

(12) "Secondary obligor," with respect to an instrument, means an indorser, a drawer, an accommodation party, or any other party to the instrument that has a right of recourse against another party to the instrument pursuant to Section 3-116(b).

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

"Acceptance"	Section 3-409
"Accommodated party"	Section 3-419
"Accommodation party"	Section 3-419

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

"Payable to order"	Section 3–109
"Payment"	Section 3–602
"Person entitled to enforce"	Section 3–301
"Presentment"	Section 3–501
"Reacquisition"	Section 3–207
"Special indorsement"	Section 3–205
"Teller's check"	Section 3–104
"Transfer of instrument"	Section 3–203
"Traveler's check"	Section 3–104
"Value"	Section 3–303

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

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

(d) In addition, Article 1 contains general definitions and principles of construction and

interpretation applicable throughout this Article.

REPORTER'S NOTES:

1. The new definition of "authenticate" is based on UCC § 9-102(a)(7); the definition of "record" is based on UCC § 9-102(a)(69).

2. The definition of secondary obligor is added to improve the cumbersome phrasing used for that concept in the existing version of Article 3 and to bring the terminology in line with the terminology of the Restatement of Suretyship.

§ 3–106. Unconditional Promise or Order.

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

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

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

(d) If a promise or order at the time it is issued or first comes into possession of a holder

contains a statement, required by applicable statutory or administrative law, to the effect that the rights of a holder or transferee are subject to claims or defenses that the issuer could assert against the original payee, the promise or order is not thereby made conditional for the purposes of Section 3–104(a); but if the promise or order is an instrument, there cannot be a holder in due course of the instrument.

REPORTER'S NOTES:

1. *The only revisions change “writing” to “record” in several places in subsection (a).*

§ 3–119. Notice of Right to Defend Action.

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

REPORTER'S NOTES:

1. *The only revisions remove the requirement that “notice” be written to provide that notice in electronic form is satisfactory.*

§ 3–301. Person Entitled to Enforce Instrument.

"Person entitled to enforce" an instrument means (i) the holder of the instrument, (ii) a remitter in possession of the instrument, if the remitter has neither transferred nor negotiated the

instrument, (iii) a nonholder in possession of the instrument who has the rights of a holder, or (iv) a person not in possession of the instrument who is entitled to enforce the instrument pursuant to Section 3–309 or 3–418(d). A person may be a person entitled to enforce the instrument even though the person is not the owner of the instrument or is in wrongful possession of the instrument.

REPORTER'S NOTES:

1. Clause (ii) is added to clarify that a remitter is a person entitled to enforce during the period before the remitter initially parts with the instrument. The same result arguably could have been reached under the old clause (ii) by treating a remitter as a nonholder in possession who has the rights of a holder, but the revision should resolve the question definitively. A comment will indicate that the rights of the remitter to enforce the instrument should survive negotiation if the negotiation is rescinded under UCC § 3-202.

§ 3–302. Holder in Due Course.

(a) Subject to subsection (c) and Section 3–106(d), "holder in due course" means the holder of an instrument if:

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

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

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

(c) A person does not become a holder in due course in a transaction in which the obligor issues or transfers the instrument directly to that party without the participation of a remitter or other intermediary. Furthermore, except to the extent a transferor or other predecessor in interest has rights as a holder in due course, a person does not acquire rights of a holder in due course of an instrument taken (i) by legal process or by purchase in an execution, bankruptcy, or creditor's sale or similar proceeding, (ii) by purchase as part of a bulk transaction not in ordinary course of business of the transferor, or (iii) as the successor in interest to an estate or other organization.

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

(e) If (i) the person entitled to enforce an instrument has only a security interest in the instrument and (ii) the person obliged to pay the instrument has a defense, claim in recoupment, or claim to the instrument that may be asserted against the person who granted the security interest, the person entitled to enforce the instrument may assert rights as a holder in due course only to an amount payable under the instrument which, at the time of enforcement of the instrument, does not exceed the amount of the unpaid obligation secured.

(f) To be effective, notice must be received at a time and in a manner that gives a

reasonable opportunity to act on it.

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

REPORTER'S NOTES:

1. The sentence added to the beginning of subsection (c) is an effort to address the murky possibilities of a payee becoming a holder in due course, a topic addressed at length in the existing § 3-302 cmt. 4. A comment will explain that the sentence is intended to replicate the results called for under existing law by UCC § 3-302 comment 4. The reference to "intermediary" is intended to cover the parties involved in wrongdoing in those cases, which permit holder-in-due-course status in disputes involving an original recipient of an instrument.

2. The revision of § 3-302(d) is designed to conform to the change of language in § 3-303.

§ 3–303. Value and Consideration.

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

(1) the instrument is issued or transferred for an undertaking of performance, to the extent the undertaking has been performed;

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

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

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

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

REPORTER'S NOTES:

1. Subsection (a)(1) is revised to change the reference to "promise" to "undertaking." The reason for the change is to prevent a court from construing subsection (a)(1) as limited to the meaning given the term "promise" in Section 3-103(a)(9).

§ 3–305. Defenses and Claims in Recoupment.

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

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

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

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

(b) The right of a holder in due course to enforce the obligation of a party to pay the instrument is subject to defenses of the obligor stated in subsection (a)(1). The right of a holder in due course to enforce the obligation of a party to pay the instrument also is subject to defenses of the obligor stated in subsection (a)(2) or claims in recoupment stated in subsection (a)(3), to the extent that those defenses or claims arise out of a transaction between the obligor and the

holder in which the obligor issued the instrument to the holder or transferred the instrument to the holder. The right of a holder in due course to enforce the obligation of a party to pay the instrument is not otherwise subject to defenses of the obligor stated in subsection (a)(2) or claims in recoupment stated in subsection (a)(3).

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

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

REPORTER'S NOTES:

1. *The revision to Section 3-305(b) is intended to clarify the defenses and claims from which a holder in due course takes free. It attempts to clarify what was obscure in the 1990 revisions — that a holder in due course does not automatically take free of defenses described in Section 3-305(a)(2) — without returning to the "dealt with" language that the 1990 revision rejected. The basic concept is the one described in the closing sentences of existing 3-305 cmt. 2:*

If Buyer issues an instrument to Seller and Buyer has a defense against Seller, that defense can obviously be asserted. Buyer and Seller are the only people involved. The holder-in-due-course doctrine has no relevance. The doctrine applies only to cases in which more than two parties are involved. Its essence is that the holder in due course does not have to suffer the consequences of a defense of the obligor on the instrument that arose from an occurrence with a third party.

It is intended that the revision produce results consistent with the two examples given in the existing Article 3 of circumstances in which a holder in due course that is the original payee would take free of defenses. Comment 2 to Section 3-106 discusses a traveler's check that is stolen and negotiated with a forged countersignature. The comment states that the payee should take free of the defense because it is a 3-305(a)(2) defense, implying that holders in due course always take free of those defenses. This draft takes the view that the payee should take free because the defense (forged countersignature) did not arise out of a transaction between the payee and the bank; it arose out of a transaction between the payee and the thief. Comment 4 to Section 3-302 has a number of similar cases regarding cashier's checks; this draft is intended to reach similar results in those cases.

§ 3–309. Enforcement of Lost, Destroyed, or Stolen Instrument.

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

(b) A person seeking enforcement of an instrument under subsection (a) must prove the terms of the instrument and the person's right to enforce the instrument. If that proof is made, Section 3–308 applies to the case as if the person seeking enforcement had produced the

instrument. The court may not enter judgment in favor of the person seeking enforcement unless it finds that the person required to pay the instrument is adequately protected against loss that might occur by reason of a claim by another person to enforce the instrument. Adequate protection may be provided by any reasonable means.

REPORTER'S NOTES:

1. Subsection (a) is revised to provide a definitive rejection of the reasoning of the Dennis Joslin Co. v. Robinson Broadcasting Corp., 977 F. Supp. 491 (D.D.C. 1997). A transferee of a lost instrument need prove only that its transferor was entitled to enforce, not that the transferee was in possession at the time the instrument was lost.

§ 3–310. Effect of Instrument on Obligation for Which Taken.

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

(b) Unless otherwise agreed and except as provided in subsection (a), if a note or a check that is not a certified check, cashier's check, or teller's check is taken for an obligation, the obligation is suspended to the same extent the obligation would be discharged if an amount of money equal to the amount of the instrument were taken, and the following rules apply:

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

(2) In the case of a note, suspension of the obligation continues until dishonor of

the note or until it is paid. Payment of the note results in discharge of the obligation to the extent of the payment.

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

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

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

REPORTER'S NOTES:

1. Section 3-310(b)(4) is revised to clarify that an obligee that transfers an instrument can no longer enforce the underlying obligation, even if the instrument later is dishonored (so that suspension of the underlying obligation would end under Section 3-310(b)(1)). Because the revision produces the results that seem to be called for by the existing comments, this seems to be a nonsubstantive correction. See 3-310 cmt. 3 sent. 6 ("If the right to enforce the instrument is held by somebody other than the seller, the seller can't enforce the right to payment of the price under the sales contract because that right is represented by the instrument which is enforceable by somebody else.").

2. The revision to the chapeau of § 3-310(b) is intended to prevent any suggestion that subsection 3-310(b) applies to cashier's checks or teller's checks.

§ 3–311. Accord and Satisfaction by Use of Instrument.

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

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

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

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

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

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

REPORTER'S NOTES:

1. Subsection (b) is revised to remove the requirement that the communication accompanying the instrument be in writing. It might be uncommon under current technology for an unwritten record to accompany the instrument, but terminological consistency suggests that the revision might be appropriate.

§ 3–312. Lost, Destroyed, or Stolen Cashier's Check, Teller's Check, or Certified Check.

(a) In this section:

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

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

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

(4) "Obligated bank" means the issuer of a cashier's check or teller's check or the

acceptor of a certified check.

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

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

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

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

(4) When the claim becomes enforceable, the obligated bank becomes obliged to pay the amount of the check to the claimant if payment of the check has not been made to a person entitled to enforce the check. Subject to Section 4–302(a)(1), payment to the claimant

discharges all liability of the obligated bank with respect to the check.

(c) If the obligated bank pays the amount of a check to a claimant under subsection (b)(4)

and the check is presented for payment by a person having rights of a holder in due course, the claimant is obliged to (i) refund the payment to the obligated bank if the check is paid, or (ii) pay the amount of the check to the person having rights of a holder in due course if the check is dishonored.

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

REPORTER'S NOTES:

1. Subsection (a) is revised to remove the requirement that the declaration of loss be in writing. The revision rests on the view that the policy of that subsection should be satisfied to the extent other procedures permit a statement to be made under penalty of perjury that is in an electronic form rather than in writing.

§ 3–404. Impostors; Fictitious Payees.

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

(b) If (i) a person whose intent determines to whom an instrument is payable (Section

3–110(a) or (b)) does not intend the person identified as payee to have any interest in the instrument, or (ii) the person identified as payee of an instrument is a fictitious person, the following rules apply until the instrument is negotiated by special indorsement:

- (1) Any person in possession of the instrument is its holder.
- (2) An indorsement by any person in the name of the payee stated in the instrument is effective as the indorsement of the payee in favor of a person who, in good faith, pays the instrument or takes it for value or for collection.
- (c) Under subsection (a) or (b), an indorsement is made in the name of a payee if (i) it is made in a name substantially similar to that of the payee or (ii) the instrument, whether or not indorsed, is deposited in a depositary bank to an account in a name substantially similar to that of the payee.
- (d) With respect to an instrument to which subsection (a) or (b) applies, if a person paying the instrument or taking it for value or for collection fails to exercise ordinary care in paying or taking the instrument and that failure substantially contributes to loss resulting from payment of the instrument, the person bearing the loss under this section may recover from the person failing to exercise ordinary care to the extent the failure to exercise ordinary care contributed to the loss.

REPORTER'S NOTES:

1. Subsection (d) is revised to clarify that the reference to a person "bearing the loss" indicates a party that bears responsibility for the loss under this section.

§ 3–405. Employer's Responsibility for Fraudulent Indorsement by Employee.

- (a) In this section:

- (1) "Employee" includes an independent contractor and employee of an

independent contractor retained by the employer.

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

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

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

to loss resulting from the fraud, the person bearing the loss under this section may recover from the person failing to exercise ordinary care to the extent the failure to exercise ordinary care contributed to the loss.

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

REPORTER'S NOTES:

1. The last sentence of subsection (b) is revised to clarify that the reference to a person "bearing the loss" indicates a party that bears responsibility for the loss under this section.

§ 3–406. Negligence Contributing to Forged Signature or Alteration of Instrument.

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

(b) If a person asserting the preclusion under subsection (a) fails to exercise ordinary care in paying or taking the instrument and that failure substantially contributes to loss, the loss is allocated between the person or persons precluded and the person or persons asserting the preclusion according to the extent to which the failure of each to exercise ordinary care contributed to the loss. Furthermore,

(I) to the extent any person bearing a portion of the loss under the preceding sentence otherwise would bear under that sentence a portion of the loss that exceeds the extent to

which their failure to exercise ordinary care contributed to the loss, or

(II) to the extent a drawer or purported drawer of an instrument has been prejudiced by the payment of an instrument after an alteration of the instrument or the making of a forged signature on the instrument, any such person may recover from any person failing to exercise ordinary care in paying or taking the instrument, if that failure substantially contributes to loss resulting from payment of the instrument, to the extent that the failure of that person to exercise ordinary care in paying or taking the instrument contributed to the loss.

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

REPORTER'S NOTE:

1. Subsection (b) is revised to specify that any person bearing a loss under this section is entitled to proceed directly against any person that paid or took the instrument that failed to exercise ordinary care in a way that would justify responsibility under subsection (a). The specific concern is to ensure that a drawer that is partially negligent and thus unable to recover from the payor bank can proceed directly against a depositary bank that also bears responsibility for the loss under the standard of subsection (a). The provision is intended to be analogous to Section 3-404(d) and the second sentence of Section 3-405(b).

2. Clause (II) is added to subsection (b) to clarify the rights of a drawer that believes that some other party (typically a depositary bank) is responsible for the negligent payment of an instrument. Specifically, the drawer need not engage in litigation with the drawee to the point that the drawer is "bearing a loss" on the instrument before pursuing the other party. Rather, the drawer in such a case should be able to proceed directly against the allegedly negligent party.

§ 3–416. Transfer Warranties.

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

- (1) the warrantor is a person entitled to enforce the instrument;
- (2) all signatures on the instrument are authentic and authorized;
- (3) the instrument has not been altered;
- (4) the instrument is not subject to a defense or claim in recoupment of any party

which can be asserted against the warrantor;

(4A) with respect to any item drawn on a consumer account, which does not bear a handwritten signature purporting to be the signature of the drawer, that the purported drawer of the draft has authorized the issuance of the item in the amount for which the item is drawn; and

(5) the warrantor has no knowledge of any insolvency proceeding commenced with respect to the maker or acceptor or, in the case of an unaccepted draft, the drawer.

(b) A person to whom the warranties under subsection (a) are made and who took the instrument in good faith may recover from the warrantor as damages for breach of warranty an amount equal to the loss suffered as a result of the breach, but not more than the amount of the instrument plus expenses (including reasonable attorney's fees) and loss of interest incurred as a result of the breach.

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

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

REPORTER'S NOTES:

1. New subsection (a)(4A) is added to respond to difficulties with telephonically originated checks. It is modeled on, though somewhat different from, nonuniform amendments to Article 3 enacted in several states.

2. The reference to reasonable attorney's fees is added to subsection (b) to help ensure that the recovery under that provision is fully compensatory.

§ 3–417. Presentment Warranties.

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

- (1) the warrantor is, or was, at the time the warrantor transferred the draft, a person entitled to enforce the draft or authorized to obtain payment or acceptance of the draft on behalf of a person entitled to enforce the draft;
- (2) the draft has not been altered; and
- (3) the warrantor has no knowledge that the signature of the drawer of the draft is unauthorized.

(b) A drawee making payment may recover from any warrantor damages for breach of warranty equal to the amount paid by the drawee less the amount the drawee received or is entitled to receive from the drawer because of the payment. In addition, the drawee is entitled to compensation for expenses (including reasonable attorney's fees) and loss of interest resulting from the breach. Except as provided in subsection (c), the right of the drawee to recover damages under this subsection is not affected by any failure of the drawee to exercise ordinary

care in making payment. If the drawee accepts the draft, breach of warranty is a defense to the obligation of the acceptor. If the acceptor makes payment with respect to the draft, the acceptor is entitled to recover from any warrantor for breach of warranty the amounts stated in this subsection.

(c) If a drawee asserts a claim for breach of warranty under subsection (a) based on an unauthorized indorsement of the draft or an alteration of the draft, the warrantor may defend by proving that the indorsement is effective under Section 3–404 or 3–405, that the drawer is precluded under Section 3–406 or 4–406 from asserting against the drawee the unauthorized indorsement or alteration, or that the drawer is responsible for the loss under Section 3–307. Notwithstanding the foregoing, if the warrantor failed to exercise ordinary care with regard to the instrument and that failure substantially contributed to loss, or if the warrantor is responsible for all or a portion of the loss under Section 3–307, the warrantor’s defense shall be limited so that the loss shall be allocated among the warrantor, the drawee, and any other party bearing a portion of the loss under Sections 3–307, 3–404, 3–405, 3–406, or 4–406 so that the loss is allocated among all such persons according to the extent to which each person’s failure contributed to the loss.

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

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

obtain payment on behalf of a person entitled to enforce the instrument.

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

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

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

REPORTER'S NOTES:

1. *Subsections (b) and (c) are revised to provide for a more thoroughly proportionate allocation of fault in cases in which the errors of multiple parties contribute to a loss. In particular, it responds to the difficulty that, read literally, the existing language of Sections 3-417(c) and 4-208(c) provide a complete defense whenever there is a preclusion (or giving effect to an otherwise improper indorsement) under one of the proportionate-fault provisions, even if the warrantor also failed to exercise ordinary care. Conversely, the language of Sections 3-417(b) and 4-208(b) suggests that the warrantor has no defense at all based on those proportionate-fault provisions. Because the "correct" response seems to be that the warrantor should have a defense that leaves the drawee and the warrantor each responsible for their proportionate share of the fault, revision seems appropriate.*

2. *The references to Section 3-307 added to Sections 3-417(c) and 4-208(c) reflect the extension of concepts of proportionate fault to Section 3-307.*

3. *The reference to reasonable attorney's fees is added to subsection (b) to help ensure that the recovery under that provision is fully compensatory.*

§ 3–418. Payment or Acceptance by Mistake.

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

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

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

(d) Notwithstanding Section 4–215, if an instrument is paid or accepted by mistake and the payor or acceptor recovers payment or revokes acceptance under subsection (a) or (b), the instrument is deemed not to have been paid or accepted and is treated as dishonored, and the person from whom payment is recovered has rights as a person entitled to enforce the dishonored instrument.

REPORTER'S NOTES:

1. Section 3-418(c) is revised to clarify that a person whose protection from relief under Section 3-418(a) and (b) is based on good-faith reliance is entitled to protection only to the extent of that reliance.

§ 3-419. Instruments Signed for Accommodation.

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

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

(c) A person signing an instrument is presumed to be an accommodation party and there is notice that the instrument is signed for accommodation if the signature is an anomalous indorsement or is accompanied by words indicating that the signer is acting as surety or guarantor with respect to the obligation of another party to the instrument. Except as provided in Section 3-605, the obligation of an accommodation party to pay the instrument is not affected by the fact that the person enforcing the obligation had notice when the instrument was taken by that person that the accommodation party signed the instrument for accommodation.

(d) If the signature of a party to an instrument is accompanied by words indicating unambiguously that the party is guaranteeing collection rather than payment of the obligation of

another party to the instrument, the signer is obliged to pay the amount due on the instrument to a person entitled to enforce the instrument only if (i) execution of judgment against the other party has been returned unsatisfied, (ii) the other party is insolvent or in an insolvency proceeding, (iii) the other party cannot be served with process, or (iv) it is otherwise apparent that payment cannot be obtained from the other party. If the signature of a party to an instrument is accompanied by words indicating that the party is guaranteeing payment, or if the signer signs the instrument as an accommodation party in some other manner that does not unambiguously indicate an intention to guarantee collection rather than payment, the signer is obliged to pay the amount due on the instrument to a person entitled to enforce the instrument in the same circumstances as the accommodated party would be obliged, without prior resort to the accommodated party by the person entitled to enforce the instrument.

(e) An accommodation party who pays the instrument is entitled to reimbursement from the accommodated party and is entitled to enforce the instrument against the accommodated party. An accommodation party also, in proper circumstances, is entitled to relief that requires the accommodated party to perform its obligations on the instrument. An accommodated party who pays the instrument has no right of recourse against, and is not entitled to contribution from, an accommodation party.

REPORTER'S NOTES:

1. The last sentence of Section 3-419(d) is based on old UCC § 3-416(1). This reflects the Committee's determination at the last meeting that payment guaranties are sufficiently significant to warrant specific statutory attention.

2. The revisions to Section 3-419(e) are intended to codify the accommodated party's duty of exoneration, to preclude the negative implication that the codification of the duties of performance and reimbursement was intended to bar any duty of exoneration.

§ 3-502. Dishonor.

* * * * *

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

(1) If a check is duly presented for payment to the payor bank otherwise than for immediate payment over the counter, the check is dishonored if the payor bank makes timely return of the check or sends timely notice of dishonor or nonpayment under Section 4-301 or 4-302, or becomes accountable for the amount of the check under Section 4-302.

* * * * *

Official Comment

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4. Subsection (b) applies to unaccepted drafts other than documentary drafts. Subsection (b)(1) applies to checks. Except for checks presented for immediate payment over the counter, which are covered by subsection (b)(2), dishonor occurs according to rules stated in Article 4. Those rules contemplate four separate situations that warrant discussion. The first two situations arise in the normal course of affairs, in which the drawee bank makes settlement for the amount of the check to the presenting bank. In the first situation, the drawee bank under Section 4-301 recovers this settlement if it returns the check by its midnight deadline (Section 4-104). In that case the check is not paid and dishonor occurs under Section 3-502(b)(1). The second situation arises if the drawee bank has made such a settlement and does not return the check or give notice of dishonor or nonpayment within the midnight deadline. In that case, the settlement becomes final payment of the check under Section 4-215. Thus, no dishonor occurs regardless of whether the drawee bank retains the check indefinitely or for some reason returns the check after its midnight deadline.

The third and fourth situations arise less commonly, in cases in which the drawee bank does not settle for the check when it is received. Under Section 4-302 if the drawee bank is not also the depositary bank and retains the check without settling for it beyond midnight of the day it is presented for payment, the bank at that point becomes "accountable" for the amount of the check, i.e., it is obliged to pay the amount of the check. If the drawee bank is also the depositary bank, the bank becomes accountable for the amount of the check if the bank does not pay the check or return it or send notice of dishonor by its midnight deadline. Hence, if the drawee bank

is also the depositary bank and does not either settle for the check when it is received (a settlement that would ripen into final payment if the drawee bank failed to take action to recover the settlement by its midnight deadline) or return the check or an appropriate notice by its midnight deadline, the drawee bank will become accountable for the amount of the check under Section 4–302. Thus, in all cases in which the drawee bank becomes accountable under Section 4–302, the check has not been paid (either by a settlement that became unrecoverable or otherwise) and thus, under Section 3–502(b)(1), the check is dishonored.

The fact that the bank is obliged to pay the check under Section 4–302 does not mean that the check has been paid. Indeed, because each of the paragraphs of Section 4–302(b) is limited by its terms to situations in which a bank has not paid the item, a drawee bank will be accountable under Section 4–302 only in situations in which it has not previously paid the check. Section 3–502(b)(1) reflects the view that a person presenting a check is entitled to payment, not just the ability to hold the drawee accountable under Section 4–302. If that payment is not made in a timely manner, the check is dishonored.

* * * * *

§ 3–602. Payment.

(a) (1) Subject to subsection (b), an instrument is paid to the extent payment is made by or on behalf of a party obliged to pay the instrument, and to a person entitled to enforce the instrument.

(2) A note also is paid to the extent payment is made by or on behalf of a party obliged to pay the note to a person that (i) formerly was entitled to enforce the note and (ii) had not at the time the payment was made provided adequate notification to the party obliged to pay that the note had been transferred. A notification is adequate only if it (A) is authenticated by the transferor or the transferee; (B) reasonably identifies the transferred note; and (C) identifies the name of the transferee and the address at which payments subsequently can be made.

(3) To the extent of a payment under this subsection, the obligation of the party obliged to pay the instrument is discharged even though payment is made with knowledge of a claim to the instrument under Section 3–306 by another person. Furthermore, a transferee is

deemed to have notice of any payment that is made under clause (2) of this section after the date that the note is transferred to the transferee but before receipt by the party obliged to pay the note of adequate notification of the transfer.

(b) The obligation of a party to pay the instrument is not discharged under subsection (a)

if:

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

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

REPORTER'S NOTES:

1. Subsection (a) is revised to bring Section 3-602 into conformity with Restatement of Mortgages § 5.5 and Restatement of Contracts § 338(1).

2. Subsection (b)(2) is revised to add a reference to lost instruments. There is no obvious reason that the rule of that provision should not apply to lost instruments.

§ 3–604. Discharge by Cancellation or Renunciation.

(a) A person entitled to enforce an instrument, with or without consideration, may discharge the obligation of a party to pay the instrument (i) by an intentional voluntary act, such as surrender of the instrument to the party, destruction, mutilation, or cancellation of the instrument, cancellation or striking out of the party's signature, or the addition of words to the

instrument indicating discharge, or (ii) by agreeing not to sue or otherwise renouncing rights against the party by an authenticated record.

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

REPORTER'S NOTES:

1. The only revisions change "signed writing" to "authenticated record" in subsection (a).

§ 3–605. Discharge of Secondary Obligors.

(a) To the extent that a person entitled to enforce an instrument releases the obligation of a party to pay the instrument, and another party to the instrument is a secondary obligor with respect to the released obligation:

(i) Any obligations of the released party to the secondary obligor with respect to any previous payment by the secondary obligor are not affected but, unless the terms of the discharge or release effect a preservation of the secondary obligor's recourse, the principal obligor is discharged from any other duties to the secondary obligor under this Article.

(ii) Unless the language or circumstances of the release demonstrate that the intent of the person entitled to enforce the instrument was to retain rights against that secondary obligor, the secondary obligor is discharged to the same extent as the released party from any unperformed portion of its obligation on the instrument and the secondary obligor's right of recourse against the released party is to that extent discharged. If the instrument is a check and the obligation of the secondary obligor is based on an indorsement of the check, the secondary obligor is released without regard to the language or circumstances of the discharge or other release.

(iii) if the secondary obligor is not discharged under subsection (ii), the secondary obligor is discharged to the extent (I) of the value of the consideration for the release; and (II) that the release would otherwise cause the secondary obligor a loss.

(b) If a person entitled to enforce an instrument grants a party obligated to pay an instrument an extension of the time at which one or more payments are due on the instrument:

(i) unless the terms of the extension preserve the right of recourse of the secondary obligor under subsection (j), the extension also extends the time for performance of any corresponding duties owed to the secondary obligor by the party whose obligation is extended.

(ii) The secondary obligor is discharged

(A) entirely, if the instrument is a check and the obligation of the secondary obligor is based on an indorsement of the check; and

(B) in all other cases, to the extent that the extension would otherwise cause the secondary obligor a loss.

(iii) to the extent that the secondary obligor is not discharged under subsection (ii), the secondary obligor may (A) perform its obligations to any person entitled to enforce the instrument as though the time for payment had not been extended or, (B) unless the extension preserves the right of recourse of the secondary obligor, treat the time for performance of its obligations as having been extended correspondingly.

(c) If a person entitled to enforce an instrument agrees, with or without consideration, to a modification of the obligation of a party other than an extension of the due date or a complete or partial release:

(i) the modification correspondingly modifies any corresponding duties owed to

the secondary obligor by the party whose obligation is modified.

(ii) The secondary obligor is discharged from any unperformed portion of its obligation

(A) entirely, if the instrument is a check and the obligation of the secondary obligor is based on an indorsement of the check; and

(B) in all other cases, to the extent that the modification would otherwise cause the secondary obligor a loss.

(iii) to the extent that the secondary obligor is not discharged under subsection (ii), the secondary obligor may (A) satisfy its obligation on the instrument as though the modification had not occurred; or (B) treat its obligation on the instrument as having been modified correspondingly.

(d) If (i) the obligation of a party to pay the instrument is secured by an interest in collateral, (ii) another party to the instrument is a secondary obligor with respect to that obligation, and (iii) a person entitled to enforce the instrument impairs the value of the interest in collateral, the obligation of the secondary obligor is discharged to the extent of the impairment.

The value of an interest in collateral is impaired to the extent (i) the value of the interest is reduced to an amount less than the amount of the right of recourse of the party asserting discharge, or (ii) the reduction in value of the interest causes an increase in the amount by which the amount of the right of recourse exceeds the value of the interest. For purposes of this subsection, impairing the value of an interest in collateral includes (i) failure to obtain or maintain perfection or recordation of the interest in collateral, (ii) release of collateral without substitution of collateral of equal value or equivalent reduction of the underlying obligation, (iii) failure to

perform a duty to preserve the value of collateral owed, under Article 9 or other law, to a debtor or other person secondarily liable, or (iv) failure to comply with applicable law in disposing of collateral.

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

(f) A party is not discharged under this section if (i) the party asserting discharge consents to the event or conduct that is the basis of the discharge, or (ii) the instrument or a separate agreement of the party provides for waiver of discharge under this section either specifically or by general language indicating that parties waive defenses based on suretyship or impairment of collateral; provided, however, that no such waiver shall waive a defense that is not permitted to be waived by the law that creates the defense in question. Unless the circumstances indicate otherwise, consent by the party obligated to pay the instrument to an act that would lead to a discharge under this section constitutes consent to that act by the secondary obligor whenever the secondary obligor either controls the party obligated to pay the instrument or deals with the person entitled to enforce the instrument on behalf of the party obligated to pay the instrument.

(g) A release or extension preserves the right of recourse of a secondary obligor if the express terms of the release or extension provide [in writing] that (i) the person entitled to enforce the instrument retains the right to enforce the instrument against the secondary obligor; and (ii) the right of recourse of the secondary obligor continues as though the release or extension had not been granted.

(h) A secondary obligor asserting discharge under this section has the burden of

persuasion both with respect to the occurrence of the acts alleged to harm the secondary obligor and also as to loss or prejudice caused by those acts. Notwithstanding the foregoing, if

- (i) the secondary obligor demonstrates prejudice caused by an impairment of its right of recourse; and
- (ii) the circumstances of the case indicate that the amount of loss is not reasonably susceptible of calculation or requires proof of facts that are not ascertainable; then it is presumed that the act impairing recourse caused a loss or impairment equal to the liability of the secondary obligor on the instrument. In that event, the burden of persuasion as to any lesser amount of such loss is on the person entitled to enforce the instrument.

REPORTER'S NOTES:

- 1. *Section 3-605(a) is based on Restatement of Suretyship § 39.*
- 3. *Section 3-605(b) is based on Restatement of Suretyship § 40.*
- 4. *Section 3-605(c) is based on Restatement of Suretyship § 41.*
- 5. *Subsection (d) is based on Restatement of Suretyship § 42.*
- 6. *Section 3-605(e) is based on old Section 3-605(h), but is revised to change the requirement of "knowledge" of the accommodation to a requirement of "notice" of the accommodation. This returns the law to its status under old Article 3 and more closely parallels the provisions of Section 3-419(c) (which uses notice rather than knowledge to regulate relations between an accommodation party and a person entitled to enforce).*
- 7. *The proviso at the end of the first sentence of Section 3-605(f) clarifies the ineffectiveness of such a waiver to waive unwaivable defenses such as improper disposition of collateral. See PEB Commentary No. 11 (Issue 11) & 3-605 cmt. 8. The notice requirement is designed to be consistent with Restatement of Suretyship § 32(2). The last sentence of Section 3-605(f) is based on Restatement of Suretyship § 48(2).*
- 8. *Section 3-605(g) is based on Restatement of Suretyship § 38.*

9. Section 3-605(h) is based on Restatement of Suretyship § 49.

§ 4–104. Definitions and Index of Definitions.

(a) In this Article, unless the context otherwise requires:

(1) "Account" means any deposit or credit account with a bank, including a demand, time, savings, passbook, share draft, or like account, other than an account evidenced by a certificate of deposit;

(2) "Afternoon" means the period of a day between noon and midnight;

(3) "Banking day" means the part of a day on which a bank is open to the public for carrying on substantially all of its banking functions;

(4) "Clearing house" means an association of banks or other payors regularly clearing items;

(4A) "Consumer account" means an account established by a natural person primarily for personal, family, or household purposes;

(5) "Customer" means a person having an account with a bank or for whom a bank has agreed to collect items, including a bank that maintains an account at another bank;

(6) "Documentary draft" means a draft to be presented for acceptance or payment if (a) specified documents, certificated securities (Section 8–102) or instructions for uncertificated securities (Section 8–102), or other certificates, statements, or the like are to be received by the drawee or other payor before acceptance or payment of the draft; or (b) the draft seeks payment of an instrument that accompanies the draft, if the draft does not present the instrument for payment;

(7) "Draft" means a draft as defined in Section 3–104 or an item, other than an

instrument, that is an order;

(8) "Drawee" means a person ordered in a draft to make payment;

(9) "Item" means an instrument or a promise or order to pay money handled by a bank for collection or payment. The term does not include a payment order governed by Article 4A or a credit or debit card slip;

(10) "Midnight deadline" with respect to a bank is midnight on its next banking day following the banking day on which it receives the relevant item or notice or from which the time for taking action commences to run, whichever is later;

(11) "Settle" means to pay in cash, by clearing-house settlement, in a charge or credit or by remittance, or otherwise as agreed. A settlement may be either provisional or final;

(12) "Suspends payments" with respect to a bank means that it has been closed by order of the supervisory authorities, that a public officer has been appointed to take it over, or that it ceases or refuses to make payments in the ordinary course of business.

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

"Agreement for electronic presentment"	Section 4–110.
"Bank"	Section 4–105.
"Collecting bank"	Section 4–105.
"Depository bank"	Section 4–105.
"Intermediary bank"	Section 4–105.
"Payor bank"	Section 4–105.
"Presenting bank"	Section 4–105.
"Presentment notice"	Section 4–110.

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

"Acceptance"	Section 3–409.
"Alteration"	Section 3–407.
"Cashier's check"	Section 3–104.
"Certificate of deposit"	Section 3–104.
"Certified check"	Section 3–409.
"Check"	Section 3–104.
"Good faith"	Section 3–103.
"Holder in due course"	Section 3–302.
"Instrument"	Section 3–104.
"Notice of dishonor"	Section 3–503.
"Order"	Section 3–103.
"Ordinary care"	Section 3–103.
"Person entitled to enforce"	Section 3–301.
"Presentment"	Section 3–501.
"Promise"	Section 3–103.
"Prove"	Section 3–103.
"Record"	Section 3–103.
"Teller's check"	Section 3–104.
"Unauthorized signature"	Section 3–403.

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

REPORTER'S NOTES:

1. *The revision to the definition of documentary draft is designed to provide for noncash treatment for drafts submitted on a noncash basis, such as a draft seeking payment on a noncash basis of a check.*

§ 4–207. Transfer Warranties.

(a) A customer or collecting bank that transfers an item and receives a settlement or other consideration warrants to the transferee and to any subsequent collecting bank that:

- (1) the warrantor is a person entitled to enforce the item;
- (2) all signatures on the item are authentic and authorized;
- (3) the item has not been altered;
- (4) the item is not subject to a defense or claim in recoupment (Section 3–305(a))

of any party that can be asserted against the warrantor;

(4A) with respect to any item drawn on a consumer account, which does not bear a handwritten signature purporting to be the signature of the drawer, that the purported drawer of the draft has authorized the issuance of the item in the amount for which the item is drawn; and

(5) the warrantor has no knowledge of any insolvency proceeding commenced with respect to the maker or acceptor or, in the case of an unaccepted draft, the drawer.

(b) If an item is dishonored, a customer or collecting bank transferring the item and receiving settlement or other consideration is obliged to pay the amount due on the item (i) according to the terms of the item at the time it was transferred, or (ii) if the transfer was of an incomplete item, according to its terms when completed as stated in Sections 3–115 and 3–407. The obligation of a transferor is owed to the transferee and to any subsequent collecting bank that takes the item in good faith. A transferor cannot disclaim its obligation under this subsection by

an indorsement stating that it is made "without recourse" or otherwise disclaiming liability.

(c) A person to whom the warranties under subsection (a) are made and who took the item in good faith may recover from the warrantor as damages for breach of warranty an amount equal to the loss suffered as a result of the breach, but not more than the amount of the item plus expenses (including reasonable attorney's fees) and loss of interest incurred as a result of the breach.

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

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

REPORTER'S NOTES:

1. *New subsection (a)(4A) is added to respond to difficulties with telephonically originated checks. It is modeled on, though somewhat different from, nonuniform amendments to Article 3 enacted in several states.*

2. *The reference to reasonable attorney's fees is added to subsection (c) to help ensure that the recovery under that provision is fully compensatory.*

§ 4–208. Presentment Warranties.

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

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

(2) the draft has not been altered;

(3) the warrantor has no knowledge that the signature of the purported drawer of the draft is unauthorized; and

(4) with respect to any item drawn on a consumer account, which does not bear a handwritten signature purporting to be the signature of the drawer, that the purported drawer of the draft has authorized the issuance of the item in the amount for which the item is drawn.

(b) A drawee making payment may recover from a warrantor damages for breach of warranty equal to the amount paid by the drawee less the amount the drawee received or is entitled to receive from the drawer because of the payment. In addition, the drawee is entitled to compensation for expenses (including reasonable attorney's fees) and loss of interest resulting from the breach. Except as provided in subsection (c), the right of the drawee to recover damages under this subsection is not affected by any failure of the drawee to exercise ordinary care in making payment. If the drawee accepts the draft (i) breach of warranty is a defense to the obligation of the acceptor, and (ii) if the acceptor makes payment with respect to the draft, the acceptor is entitled to recover from a warrantor for breach of warranty the amounts stated in this subsection.

(c) If a drawee asserts a claim for breach of warranty under subsection (a) based on an unauthorized indorsement of the draft or an alteration of the draft, the warrantor may defend by proving that the indorsement is effective under Section 3-404 or 3-405, that the drawer is

precluded under Section 3–406 or 4–406 from asserting against the drawee the unauthorized indorsement or alteration, or that the drawer is responsible for the loss under Section 3-307. Notwithstanding the foregoing, if the warrantor failed to exercise ordinary care with regard to the instrument and that failure substantially contributed to loss, or if the warrantor is responsible for all or a portion of the loss under Section 3–307, the warrantor’s defense shall be limited so that the loss shall be allocated among the warrantor, the drawee, and any other party bearing a portion of the loss under Sections 3–307, 3–404, 3–405, 3–406, or 4–406 so that the loss is allocated among all such persons according to the extent to which each person’s failure contributed to the loss.

(d) If (i) a dishonored draft is presented for payment to the drawer or an indorser or (ii) any other item is presented for payment to a party obliged to pay the item, and the item is paid, the person obtaining payment and a prior transferor of the item warrant to the person making payment in good faith that the warrantor is, or was, at the time the warrantor transferred the item, a person entitled to enforce the item or authorized to obtain payment on behalf of a person entitled to enforce the item. The person making payment may recover from any warrantor for breach of warranty an amount equal to the amount paid plus expenses and loss of interest resulting from the breach.

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

(f) A cause of action for breach of warranty under this section accrues when the claimant

has reason to know of the breach.

REPORTER'S NOTES:

1. New subsection (a)(4) is added to respond to difficulties with telephonically originated checks. It is modeled on, though somewhat different from, nonuniform amendments to Article 3 enacted in several states.

2. Subsections (b) and (c) are revised to provide for a more thoroughly proportionate allocation of fault in cases in which the errors of multiple parties contribute to a loss. In particular, it responds to the difficulty that, read literally, the existing language of Sections 3-417(c) and 4-208(c) provide a complete defense whenever there is a preclusion (or giving effect to an otherwise improper indorsement) under one of the proportionate-fault provisions, even if the warrantor also failed to exercise ordinary care. Conversely, the language of Sections 3-417(b) and 4-208(b) suggests that the warrantor has no defense at all based on those proportionate-fault provisions. Because the "correct" response seems to be that the warrantor should have a defense that leaves the drawee and the warrantor each responsible for their proportionate share of the fault, revision seems appropriate.

3. The references to Section 3-307 added to Sections 3-417(c) and 4-208(c) reflect the extension of concepts of proportionate fault to Section 3-307.

4. The reference to reasonable attorney's fees is added to subsection (b) to help ensure that the recovery under that provision is fully compensatory.

§ 4–212. Presentment by Notice of Item Not Payable by, Through, or at Bank; Liability of Drawer or Indorser.

(a) Unless otherwise instructed, a collecting bank may present an item not payable by, through, or at a bank by sending to the party to accept or pay a record providing notice that the bank holds the item for acceptance or payment. The notice must be sent in time to be received on or before the day when presentment is due and the bank must meet any requirement of the party to accept or pay under Section 3–501 by the close of the bank's next banking day after it knows of the requirement.

(b) If presentment is made by notice and payment, acceptance, or request for compliance

with a requirement under Section 3–501 is not received by the close of business on the day after maturity or, in the case of demand items, by the close of business on the third banking day after notice was sent, the presenting bank may treat the item as dishonored and charge any drawer or indorser by sending it notice of the facts.

REPORTER'S NOTES:

1. The only revisions remove the requirement in subsection (a) that “notice” be written to provide that notice in electronic form is satisfactory.

§ 4–214. Right of Charge–Back or Refund; Liability of Collecting Bank: Return of Item.

(a) If a collecting bank has made provisional settlement with its customer for an item and fails by reason of dishonor, suspension of payments by a bank, or otherwise to receive settlement for the item which is or becomes final, the bank may revoke the settlement given by it, charge back the amount of any credit given for the item to its customer's account, or obtain refund from its customer, whether or not it is able to return the item, if by its midnight deadline or within a longer reasonable time after it learns the facts it returns the item or sends notification of the facts (such as an image of the item). If the return or notice is delayed beyond the bank's midnight deadline or a longer reasonable time after it learns the facts, the bank may revoke the settlement, charge back the credit, or obtain refund from its customer, but it is liable for any loss resulting from the delay. These rights to revoke, charge back, and obtain refund terminate if and when a settlement for the item received by the bank is or becomes final.

(b) A collecting bank returns an item when it is sent or delivered to the bank's customer or transferor or pursuant to its instructions.

(c) A depositary bank that is also the payor may charge back the amount of an item to its

customer's account or obtain refund in accordance with the section governing return of an item received by a payor bank for credit on its books (Section 4–301).

(d) The right to charge back is not affected by:

- (1) previous use of a credit given for the item; or
- (2) failure by any bank to exercise ordinary care with respect to the item, but a bank so failing remains liable.

(e) A failure to charge back or claim refund does not affect other rights of the bank against the customer or any other party.

(f) If credit is given in dollars as the equivalent of the value of an item payable in foreign money, the dollar amount of any charge-back or refund must be calculated on the basis of the bank-offered spot rate for the foreign money prevailing on the day when the person entitled to the charge-back or refund learns that it will not receive payment in ordinary course.

(g) (1) If a bank provides the customer an image of the item rather than the item, the bank warrants that without the consent of the customer the item will neither

- (A) be presented to the payor bank for payment, nor
- (B) enforced against the drawer or any other party obligated on the item.

(2) Any such image of the item shall be deemed to be the item for purposes of enforcement of the item, so that the customer's right to enforce the item shall not be diminished solely because the customer possess an image of the item rather than the original item itself.

REPORTER'S NOTES:

1. The references added to subsection (a) with respect to images are intended to accommodate the return of images and to provide protection for customers that receive images rather than the actual items.

2. The new subsection (g) is intended to facilitate enforcement of returned items that are truncated at some point during the check-collection process so that the original item is not returned to the customer of the depository bank.

§ 4–301. Deferred Posting; Recovery of Payment by Return of Items; Time of Dishonor;

Return of Items by Payor Bank.

(a) If a payor bank settles for a demand item other than a documentary draft presented otherwise than for immediate payment over the counter before midnight of the banking day of receipt, the payor bank may revoke the settlement and recover the settlement if, before it has made final payment and before its midnight deadline, it

(1) returns the item; or

(2) sends a record providing notice of dishonor or nonpayment if the item is unavailable for return.

(b) If a demand item is received by a payor bank for credit on its books, it may return the item or send notice of dishonor and may revoke any credit given or recover the amount thereof withdrawn by its customer, if it acts within the time limit and in the manner specified in subsection (a).

(c) Unless previous notice of dishonor has been sent, an item is dishonored at the time when for purposes of dishonor it is returned or notice sent in accordance with this section.

(d) An item is returned:

(1) as to an item presented through a clearing house, when it is delivered to the presenting or last collecting bank or to the clearing house or is sent or delivered in accordance with clearing-house rules; or

(2) in all other cases, when it is sent or delivered to the bank's customer or

transferor or pursuant to instructions.

REPORTER'S NOTES:

1. Subsection (a) is revised to remove the requirement that the notice of return must be in writing.

§ 4–402A. Bank's Obligation to Recredit Pending Investigation of Certain Warranty

Claims.

(a) If a customer that is the drawer on a consumer account provides a payor bank notice that reasonably identifies an item drawn on the customer's account that does not bear a handwritten signature purporting to be the signature of the drawer, and if the customer alleges with reasonable specificity that the customer did not authorize the issuance of the item in the amount for which the item was drawn, then the payor bank within 10 business days must either (i) provisionally credit the customer's account in the amount of the alleged error (including interest if applicable); or (ii) complete a reasonably thorough investigation that concludes that the customer's allegation is unfounded.

(b) The payor bank must accord the customer full use of any funds credited to a customer's account under subsection (a) until and unless the bank completes a reasonably thorough investigation that concludes that the customer's allegation is unfounded.

(c) The payor bank shall report the results of any such investigation to the customer within three business days after completing the investigation (including, if applicable, notice of any credit given as a result of the payor bank's assessment of the merits of the customer's allegation). Upon request by the customer, the payor bank shall provide the customer at no charge a copy of any documents on which the payor bank relied in making its determination of the merits of the

customer's allegation.

(d) The payor bank and the customer may determine by agreement the requirements for a notice that reasonably identifies an item and an allegation that is reasonably specific, so long as those requirements are not manifestly unreasonable. Except as described in the preceding sentence, the rights and obligations arising under this section may not be varied by agreement.

REPORTER'S NOTES:

1. This provision is modeled on Regulation E, § 205.11. This provision is on hold pending further development of possible coverage of the same topic directly under Regulation E. It responds to the Committee's request that we investigate various methods of ensuring that consumers have effective recourse with respect to fraudulently issued telephonically generated checks. It is considerably simplified from Regulation E, and would have to be much more detailed before it could be included in the UCC. It should, however, be adequate to serve as a basis for discussion of the basic concept.

2. One particular simplification that warrants comment is the absence of any provision permitting the payor bank to recover funds from the depositary bank during the pendency of the investigation. Such a provision raises some complicated policy questions. For one thing, the absence of the provision does not obviously harm the payor bank in a serious way, because the payor bank should be able to recover any applicable interest losses under Section 4-208(b). On the other hand, a device (like the credit-card charge-back system) for retrieving the funds more promptly from the depositary bank might actually be beneficial for the depositary bank if it caused the depositary bank to move more promptly to recover from its miscreant depositors (thus limiting the number of cases in which the depositary bank cannot recover because the miscreant depositor has absconded or otherwise become financially irresponsible). Of course, depositary banks could protect against absconding customers even without such a provision if they simply required reserves from customers that deposit such checks. The topic warrants further discussion by the Committee.

3. We anticipate that the comment to this provision would offer some guidance as to the types of situations in which Regulation E does and does not apply (because the provision is superfluous or preempted in the cases in which Regulation E applies).

§ 4–403. Customer's Right to Stop Payment; Burden of Proof of Loss.

(a) A customer or any person authorized to draw on the account if there is more than one person may stop payment of any item drawn on the customer's account or close the account by an

order to the bank describing the item or account with reasonable certainty received at a time and in a manner that affords the bank a reasonable opportunity to act on it before any action by the bank with respect to the item described in Section 4–303. If the signature of more than one person is required to draw on an account, any of these persons may stop payment or close the account.

(b) A stop-payment order is effective for six months, but it lapses after 14 calendar days if the original order was oral and was not confirmed in a record within that period. A stop-payment order may be renewed for additional six-month periods by a record given to the bank within a period during which the stop-payment order is effective.

(c) The burden of establishing the fact and amount of loss resulting from the payment of an item contrary to a stop-payment order or order to close an account is on the customer. The loss from payment of an item contrary to a stop-payment order may include damages for dishonor of subsequent items under Section 4–402.

REPORTER'S NOTES:

1. *Subsection (b) is revised to permit records to satisfy the rules that previously required written notices.*
2. *The revisions will include a comment pointing out that customers need not obtain a stop-payment order to prevent payment of unauthorized items, at least in cases where the customers have no responsibility for the item under loss-allocation provisions. Even in those cases, a bank might be negligent if it failed to stop payment after notice from the customer, based on the customer's unwillingness to satisfy the procedures and fees necessary to stop payment under the customer's agreement with its bank.*

§ 4–406. Customer's Duty to Discover and Report Unauthorized Signature or Alteration.

(a) A bank that sends or makes available to a customer a statement of account showing payment of items for the account shall either return or make available to the customer the items

paid or provide information in the statement of account sufficient to allow the customer reasonably to identify the items paid. The statement of account provides sufficient information if the item is described by item number, amount, and date of payment.

(b) If the items are not returned to the customer, the person retaining the items shall either retain the items or, if the items are destroyed, maintain the capacity to furnish legible copies of the items until the expiration of seven years after receipt of the items. A customer may request an item from the bank that paid the item, and that bank must provide in a reasonable time either the item or, if the item has been destroyed or is not otherwise obtainable, a legible copy of both sides of the item. Notwithstanding any agreement to the contrary, the bank upon request shall provide without charge at least three items (or legible copies of both sides of those items) per statement period, but shall have no obligation to provide more than twelve such items without charge during any twelve consecutive statement periods.

(c) If a bank acting pursuant to subsection (b) provides the customer a copy of the item rather than the item, the copy of the item, together with a statement of account showing payment of the item, shall constitute prima facie evidence that the customer has made payment in the amount of the item.

(d) If a bank sends or makes available a statement of account or items pursuant to subsection (a), the customer must exercise reasonable promptness in examining the statement or the items to determine whether any payment was not authorized because of an alteration of an item or because a purported signature by or on behalf of the customer was not authorized. If, based on the statement or items provided, the customer should reasonably have discovered the unauthorized payment, the customer must promptly notify the bank of the relevant facts.

(e) If the bank proves that the customer failed, with respect to an item, to comply with the duties imposed on the customer by subsection (d), the customer is precluded from asserting against the bank:

(1) the customer's unauthorized signature or any alteration on the item, if the bank also proves that it suffered a loss by reason of the failure; and

(2) the customer's unauthorized signature or alteration by the same wrongdoer on any other item paid in good faith by the bank if the payment was made before the bank received notice from the customer of the unauthorized signature or alteration and after the customer had been afforded a reasonable period of time, not exceeding 30 days, in which to examine the item or statement of account and notify the bank.

(f) If subsection (e) applies and the customer proves that the bank failed to exercise ordinary care in paying the item and that the failure substantially contributed to loss, the loss is allocated between the customer precluded and the bank asserting the preclusion according to the extent to which the failure of the customer to comply with subsection (d) and the failure of the bank to exercise ordinary care contributed to the loss. If the customer proves that the bank did not pay the item in good faith, the preclusion under subsection (e) does not apply.

(g) Without regard to care or lack of care of either the customer or the bank, a customer who does not within one year after the statement or items are made available to the customer under subsection (a) discover and report the customer's unauthorized signature on or any alteration on the item is precluded from asserting against the bank the unauthorized signature or alteration. If there is a preclusion under this subsection, the payor bank may not recover for breach of warranty under Section 4–208 with respect to the unauthorized signature or alteration

to which the preclusion applies.

REPORTER'S NOTES:

1. The revisions of Section 4-406(b) are intended to ensure adequate accommodation of the interests of customers adversely affected by a bank's decision not to return items with monthly statements.

2. The new subsection (c) is intended to ensure that customers are not prejudiced in proof of payment by the bank's decision not to return items to its customers. The final revision would include a legislative note related to state evidence codes.

§ 4–407. Payor Bank's Right to Subrogation on Improper Payment.

If a payor bank has paid an item over the order of the drawer or maker to stop payment, or after an account has been closed, or otherwise under circumstances giving a basis for objection by the drawer or maker, to prevent unjust enrichment and only to the extent necessary to prevent loss to the bank by reason of its payment of the item, the payor bank is subrogated to the rights

- (1) of any holder in due course on the item against the drawer or maker;
- (2) of the payee or any other holder of the item against the drawer or maker either on the item or under the transaction out of which the item arose; and
- (3) of the drawer or maker against the payee or any other holder of the item with respect to the transaction out of which the item arose.

For purposes of the payor bank's rights under this section, the item is deemed not to have been paid and is treated as dishonored.

REPORTER'S NOTES:

1. The last sentence is added to make it clear that the rights to which the payor bank is subrogated on the instrument and in the underlying transaction should not be treated as discharged under Sections 3-602 and 3-310 because of the bank's payment of the item. The sentence is modeled on Section 3-418(d). A comment will point out that the revision clarifies current law.