

DRAFT

FOR DISCUSSION ONLY

Proposed Revisions to UCC Articles 3, 4, and 4A

**NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS**

Prepared for December 2001 Drafting Committee

WITH PREFATORY NOTE AND REPORTER'S NOTES

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By
THE AMERICAN LAW INSTITUTE
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ON UNIFORM STATE LAWS

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Draft of UCC ARTICLES 3, 4, and 4A

TABLE OF CONTENTS

Section 3–103. Definitions.	4
Section 3-106. Unconditional Promise or Order.	9
Section 3-119. Notice of Right to Defend Action.	11
Section 3-305. Defenses and Claims in Recoupment.	12
Section 3-309. Enforcement of Lost, Destroyed, or Stolen Instrument.	14
Section 3-311. Accord and Satisfaction by Use of Instrument.	15
Section 3–312. Lost, Destroyed, or Stolen Cashier’s Check, Teller’s Check, or Certified Check.	17
Section 3–416. Transfer Warranties.	20
Section 3–417. Presentment Warranties.	22
Section 3-419. Instruments Signed for Accommodation.	25
Section 3-602. Payment.	27
Section 3-604. Discharge by Cancellation or Renunciation.	29
Section 3-605. Discharge of Secondary Obligors.	30
Section 4-104. Definitions and Index of Definitions.	36
Section 4–207. Transfer Warranties.	40
Section 4–208. Presentment Warranties.	42
Section 4-212. Presentment by Notice of Item Not Payable by, Through, or at Bank; Liability of Drawer or Indorser.	44
Section 4-301. Deferred Posting; Recovery of Payment by Return of Items; Time of Dishonor; Return of Items by Payor Bank.	45
Section 4-403. Customer's Right to Stop Payment; Burden of Proof of Loss.	47

Section 3–103. Definitions.

(a) In this Article:

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

(1A) "Consumer account" means an account established by a natural person primarily for personal, family, or household purposes;

(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.

(9A) "Principal obligor," with respect to an instrument, means either the accommodated party or any other party to the instrument against whom a secondary obligor has recourse under this article.

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

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

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

(13) "Sign" means:

(A) to execute or adopt a tangible symbol with the present intent to authenticate a record; or

(B) to attach or logically associate an electronic symbol, sound, or process to or with a record with the present intent to authenticate a record.

(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

"Record" Section 1-201

"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 definition of "sign" is new, based on the definition of "authenticate" in Section 9-102(a)(7). Presumably that definition ultimately will appear in the revisions to Article 1. The related definition of "record" is incorporated from the existing proposed revisions to Article 1.

2. The definition of "consumer account" is related to the revisions in the warranty sections related to telephonically created drafts.

3. The definitions of principal obligor and secondary obligor are added to improve the cumbersome phrasing used for those concepts in the existing version of Article 3 and to bring the terminology in line with the terminology of the Restatement of Suretyship.

Section 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).*

Section 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 seasonable 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.

Section 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), but is not subject to defenses of the obligor stated in subsection (a)(2) or claims in recoupment stated in subsection (a)(3) against a person other than the holder.

(c) Except as stated in subsection (d), in an action to enforce the obligation of a party to pay the instrument, the obligor may not assert against the person entitled to enforce the instrument a defense, claim in recoupment, or claim to the instrument (Section 3-306) of another

person, but the other person's claim to the instrument may be asserted by the obligor if the other person is joined in the action and personally asserts the claim against the person entitled to enforce the instrument. An obligor is not obliged to pay the instrument if the person seeking enforcement of the instrument does not have rights of a holder in due course and the obligor proves that the instrument is a lost or stolen instrument.

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

(e) In a consumer transaction, if law other than this article requires that the instrument include a statement 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, and the instrument does not include such a statement:

- (1) the instrument shall be deemed to include such a statement;
- (2) the issuer may assert against the holder or transferee those claims and defenses that would have been available if the instrument included such a statement; and
- (3) the extent to which claims in recoupment may be asserted against the holder or transferee is determined as if the instrument included such a statement.

REPORTER'S NOTES:

1. The new subsection (e) is added to clarify the treatment of an instrument that omits the notice currently required by the Federal Trade Commission Rule related to consumer credit sales (16 C.F.R. Part 433). It is based on the language describing that rule in UCC § 3-106(d) and the analogous provision in UCC § 9-404(d).

Section 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 which 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 more clearly for a result that is contrary to the result in 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.

Section 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.

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.

Section 3–312. Lost, Destroyed, or Stolen Cashier’s Check, Teller’s Check, or Certified Check.

(a) In this section:

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

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

(3) "Declaration of loss" means a written statement, made in a record 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.

Section 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 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 Section 3-416(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. Parallel revisions appear in Sections 3-417, 4-207, and 4-208.

Section 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;

(3) the warrantor has no knowledge that the signature of the 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 any warrantor damages for breach of warranty equal to the amount paid by the drawee less the amount the drawee received or is entitled to receive from the drawer because of the payment. In addition, the drawee is entitled to compensation for expenses and loss of interest resulting from the breach. The right of the drawee to recover damages under this subsection is not affected by any failure of the drawee to exercise ordinary care in making payment. If the drawee accepts the draft, breach of warranty is a defense to the obligation of the acceptor. If the acceptor makes payment with respect to the draft, the

acceptor is entitled to recover from any warrantor for breach of warranty the amounts stated in this subsection.

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

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

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

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

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

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

REPORTER'S NOTES:

1. New Section 3-417(a)(4) is added to respond to difficulties with telephonically originated checks. Parallel revisions appear in Sections 3-416, 4-207, and 4-208.

Section 3-419. Instruments Signed for Accommodation.

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

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

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

(d) If the signature of a party to an instrument is accompanied by words indicating unambiguously that the party is guaranteeing collection rather than payment of the obligation of another party to the instrument, the signer is obliged to pay the amount due on the instrument to a person entitled to enforce the instrument only if (i) execution of judgment against the other party

has been returned unsatisfied, (ii) the other party is insolvent or in an insolvency proceeding, (iii) the other party cannot be served with process, or (iv) it is otherwise apparent that payment cannot be obtained from the other party.

(e) 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.

(f) 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. In proper circumstances, an accommodation party may obtain relief that requires the accommodated party to perform its obligations on the instrument. An accommodated party that 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 subsection (e) is based on pre-1990 Section 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 subsection (f) 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.

Section 3-602. Payment.

(a) Subject to subsection (b), the following rules apply:

(1) An draft or a note 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 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 (i) is signed by the transferor or the transferee; (ii) reasonably identifies the transferred note; and (iii) identifies the name of the transferee and the address at which payments subsequently can be made. Upon request, a transferee shall seasonably furnish reasonable proof that the note has been transferred.

(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.

(4) A transferee is deemed to have notice of any payment that is made under paragraph (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 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). To reflect the circumstances of servicing agreements, an Official Comment will indicate that the provision is not intended to affect determinations under the law of agency regarding the party to whom a payment actually is made.

Section 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 signed 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 "writing" to "record" in subsection (a).

Section 3-605. Discharge of Secondary Obligors.

(a) If 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, the following rules apply:

(1) Any obligations of the released party to the secondary obligor with respect to any previous payment by the secondary obligor are not affected. However, unless the terms of the discharge or release preserve the secondary obligor's right of recourse, the principal obligor is discharged, to the extent of the release, from any other duties to the secondary obligor under this article.

(2) Unless [(i)] the terms of the release preserve the secondary obligor's right of recourse, [or (ii) *express language or circumstances of the release demonstrate that the parties intended both that the person entitled to enforce the instrument would retain rights against the secondary obligor and that the secondary obligor would retain a right of recourse against the released party,*] 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 discharged without regard to the language or circumstances of the discharge or other release.

(3) If the secondary obligor is not discharged under paragraph (2), the secondary obligor is discharged (i) to the extent of the value of the consideration for the release; and (ii) to the extent 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, the following rules apply:

(1) Unless the terms of the extension preserve the secondary obligor's right of recourse, the extension also extends the time for performance of any corresponding duties owed to the secondary obligor by the party whose obligation is extended.

(2) The secondary obligor is discharged to the extent that the extension would otherwise cause the secondary obligor a loss.

(3) To the extent that the secondary obligor is not discharged under paragraph (2), the secondary obligor may (i) perform its obligations to any person entitled to enforce the instrument as if the time for payment had not been extended or (ii) unless the extension preserves the secondary obligor's right of recourse, 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, the following rules apply:

(1) The modification correspondingly modifies any corresponding duties owed to the secondary obligor by the party whose obligation is modified.

(2) The secondary obligor is discharged from any unperformed portion of its obligation to the extent that the modification would otherwise cause the secondary obligor a loss.

(3) To the extent that the secondary obligor is not discharged under subsection (ii), the secondary obligor may (i) satisfy its obligation on the instrument as if the modification had not occurred; or (ii) 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, and (iv) failure to comply with applicable law in disposing of or otherwise enforcing the interest in 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. This waiver shall not be effective to waive a defense that is not permitted to be waived by the law that creates the defense. 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 if 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 a secondary obligor's right of recourse if the express terms of the release or extension provide 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) Except as otherwise provided in subsection (i), 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.

(i) 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 the loss is on the person entitled to enforce the instrument.

REPORTER'S NOTES:

1. Subsection (a) is based on Restatement of Suretyship § 39. Subsection (a) includes a special rule granting a complete discharge to the indorser of a check, without requiring the indorser to prove harm. That rule rests on the rationale that the indorser of a check is not lending credit on a check in the same way as an accommodation party on other types of instruments.

2. Section 3-605(a)(2)(ii) continues to be a source of difficulty. This is intended to mirror Restatement of Suretyship § 39(b)(ii). To the average UCC-sensitized reader, however, it has become quite cumbersome, if not confusing. Moreover, as the Reporter for the Restatement has pointed out, the section in its current form needs an additional provision that specifies the effect on the principal obligor of a situation in which a secondary obligor retains a right of recourse under clause (ii). The Reporter suggests that 3-605(a)(2)(ii) be omitted in its entirety. This would reflect a departure from the Restatement policy. The reasons that support that departure would be (a) simplification of the text, and thus increased likelihood that courts will interpret the text correctly; (b) the sense that the context of instruments is more centered on documents than other contexts governed by the Restatement, which can justify a more document-centered rule; and (c) the impression that in its current form Section 3-605(a)(2)(ii) will apply quite rarely (so any prejudice from omitting it will be small). The benefits of retaining the provision are that it improves the similarity of rules between the Restatement and the UCC.

3. Subsection (b) is based on Restatement of Suretyship § 40.

4. Subsection(c) is based on Restatement of Suretyship § 41.

5. Subsection (d) is based on Restatement of Suretyship § 42.

6. Subsection (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 second sentence of subsection (f) clarifies the ineffectiveness of a waiver of suretyship defenses to waive unwaivable defenses such as improper disposition of collateral. See PEB Commentary No. 11 (Issue 11) & Section 3-605 cmt. 8. The notice requirement is designed to be consistent with Restatement of Suretyship § 32(2). The last sentence of subsection (f) is based on Restatement of Suretyship § 48(2).

8. Subsection (g) is based on Restatement of Suretyship § 38.

9. Subsection (h) is based on Restatement of Suretyship § 49.

10. Most of the revisions from the last draft reflect suggestions from the Committee on Style.

Section 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;

(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 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;

(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"<COL>Section 4-110.

"Bank"<COL>Section 4-105.

"Collecting bank"<COL>Section 4-105.

"Depository bank"<COL>Section 4-105.

"Intermediary bank"<COL>Section 4-105.

"Payor bank"<COL>Section 4-105.

"Presenting bank"<COL>Section 4-105.

"Presentment notice"<COL>Section 4-110.

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

"Acceptance"<COL>Section 3-409.

"Alteration"<COL>Section 3-407.

"Cashier's check"<COL>Section 3-104.

"Certificate of deposit"<COL>Section 3-104.

"Certified check"<COL>Section 3-409.

"Check"<COL>Section 3-104.

"Consumer Account"<COL>Section 3-103.

"Good faith"<COL>Section 3-103.

"Holder in due course"<COL>Section 3-302.

"Instrument"<COL>Section 3-104.

"Notice of dishonor"<COL>Section 3-503.

"Order"<COL>Section 3-103.

"Ordinary care"<COL>Section 3-103.

"Person entitled to enforce"<COL>Section 3-301.

"Presentment"<COL>Section 3-501.

"Promise"<COL>Section 3-103.

"Prove"<COL>Section 3-103.

"Record"<COL>Section 1-201.

"Teller's check"<COL>Section 3-104.

"Unauthorized signature"<COL>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 only revision is to add cross-references to new definitions.*

Section 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 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 Section 4-207(a)(4A) is added to respond to difficulties with telephonically originated checks. Parallel revisions appear in Sections 3-416, 3-417, and 4-208.

Section 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 and loss of interest resulting from the breach. The right of the drawee to recover damages under this subsection is not affected by any failure of the drawee to exercise ordinary care in making payment. If the drawee accepts the draft (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 or the drawer is precluded under Section 3–406 or 4–406 from asserting against the drawee the unauthorized indorsement or alteration.

(d) If (i) a dishonored draft is presented for payment to the drawer or an indorser or (ii) any other 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 Section 4-208(a)(4) is added to respond to difficulties with telephonically originated checks. Parallel revisions appear in Sections 3-416, 3.417, and 4-207.

**Section 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.

Section 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;

(2) returns an image of the item, if (i) the party to which the return is made has entered into an agreement to accept an image as a return of the item; and (ii) the image is returned in accordance with that agreement; or

(3) 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.*
- 2. Subsection (a) also is revised to accommodate the return of images of items in cases in which the party to which the return is made has agreed to accept image returns.*

Section 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.