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Demand Promissory Notes and Commercial Loans: Balancing Freedom of Contract & Good Faith

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I. INTRODUCTION

Promissory notes are ubiquitous in commercial lending.[1] The promissory note represents the borrower's promise to repay.[2] The Uniform Commercial Code's Article 3 (Article 3) governs promissory notes.[3] Under Article 3, promissory notes are either demand instru-

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1. *See* THOMAS S. HEMMENDINGER, HILLMAN ON COMMERCIAL LOAN DOCUMENTATION, ch. 9 (5th ed. 2004) (discussing the use of promissory notes in commercial lending and noting that "[m]ost loan transactions will include a promissory note."); *id.* at 9:1.
2. *See* U.C.C. § 3-104 (2002); HEMMENDINGER, *supra* note 1 at 9:1–9:10.
3. *See* U.C.C. § 3-102, cmt. 2 (2002) (discussing the relevance of Article 3 to non-negotiable instruments); *see also id.* § 3-104 (2002).

ments or time instruments.[4] In general, the holder of a demand instrument may decide to demand payment at any time and for any reason,[5] while the holder of a time note must wait for payment until the arrival of the specific repayment date or dates included in the note.[6] For this reason, time notes usually contain an acceleration clause.[7] An acceleration clause allows the holder to accelerate—move forward in time—the maturity date of the note if certain events occur.[8] These events, usually defined as "events of default," typically indicate a decline in the borrower's credit rating.[9] An acceleration clause allows the lender to require (demand) payment of the loan early, but only if an event of default occurs.[10] Given the fact that most commercial borrowers plan an illiquid use of the borrowed funds it may seem odd that demand notes are also often used in the commercial lending context.[11] However, many lenders see advantages in using demand notes.[12] These advantages usually relate to perceived

4. *See id.* § 3-108(a)–(b) (2002) (defining "payable on demand" and "payable at a definite time").
5. *See infra* notes 130–40 and accompanying text.
6. A time note gives the borrower the right to the borrowed funds until maturity. *See* U.C.C. § 3-108.
7. *See* HEMMENDINGER, *supra* note 1, § 9:11; George A. Nation III, *Recognition and Enforcement of Demandable Notes*, 23 UCC L.J. 51 (1990) [hereinafter Nation, *Recognition*] at 97–100.
8. *See* HEMMENDINGER, *supra* note 1, § 9:11; Nation, *Recognition*, *supra* note 7 at 97–100.
9. HEMMENDINGER, *supra* note 1, § 9:11; Nation, *Recognition*, *supra* note 7 at 99–100.
10. *See* HEMMENDINGER, *supra* note 1, § 9:11.
11. *See* U.C.C. § 3-108; George A. Nation III, *Prepayment Fees in Commercial Promissory Notes: Applicability to Payments Made Because of Acceleration*, 72 TENN. L. REV. 613, 624 (2005) [hereinafter Nation, *Prepayment*] ("Thus, holders of time notes must wait for either the payment date provided for in the note or the occurrence of an event of default before they have a right to repayment of the note. The holder of a time note does not have the right to decide unilaterally to accelerate the note; the occurrence of an event of default is either beyond the holder's direct control or must be an event that would give rise to a good faith belief that the prospect of payment has been impaired. It is important to note that the occurrence of an event of default may also be beyond the borrower's control." (footnote omitted)).
12. *See generally* George A. Nation III, *Commercial Loans Payable on Demand: Poor Note Drafting Continues to Cause Problems for Lenders*, 116 BANKING L.J. 313, 320–21 (1999) [hereinafter Nation, *Commercial*] ("Many of a lender's most important remedies, such as set-off and foreclosure, are only available after the loan becomes due and payable. Thus, lenders often desire as much flexibility as possible to make the loan due and payable. As discussed, if the loan is documented with a time note, the only way to make it due and payable early is to accelerate the note. However, a prudent lender should only accelerate a loan if it is convinced that it can demonstrate that it reasonably believed that the repayment of the loan was in jeopardy. Some lenders believe that the burden of establishing to a jury, in the context of a lender liability law suit, that the lender reasonably believed that repayment of the loan was in jeopardy, is a significant burden. For

enforcement flexibility;[13] that is, many lenders believe, sometimes incorrectly, that if they use a demand note to document the loan they not only have the right to demand payment at any time, but they also have the right to receive repayment of the loan as soon as they demand payment.[14] Borrowers, on the other hand, may interpret the "payable on demand" language as similar to an acceleration clause; that is, some borrowers may believe, sometimes incorrectly, that the lender will demand payment only if the borrower's credit worthiness declines.[15]

Article 3 was substantially revised in 1990,[16] and some minor revisions were made in 2002.[17] The 1990 revisions, *inter alia*, clarified in some respects the treatment of demand notes, however the revisions also created some confusion as to the difference between time and demand notes.[18] The purpose of this Article is to discuss the proper way to balance freedom of contract and good faith when demand notes are used in the commercial lending context. In other words, how should courts accommodate the different interpretations that lenders and borrowers often have of demand notes?

II. BACKGROUND

A. The *Reger* Case

A good illustration of the use of a demand note by a commercial lender and the potential problems associated with such use can be found in the case of *Reger Development, LLC v. National City Bank,*[19] which was decided by the Seventh Circuit Court of Appeals in 2010. Reger Development, an Illinois LLC, was involved in real estate development and Kevin Reger was Reger Development's principal and sole member.[20] In June 2007, Reger and National City Bank ("National City") entered into discussions concerning the possibility of a loan

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lenders who wish to avoid this burden, time notes are not acceptable." (footnotes omitted)).

13. *Id.*
14. Some courts have held, based on the legal fiction that demand notes are mature from the moment of their execution, that a pure/traditional demand note (not a demandable note) can be collected at any moment by the holder. *See* discussion *infra* at notes 68, 85 and accompanying text.
15. *See* Nation, *Recognition*, *supra* note 7, at 86–87 nn.136–39 (discussing cases where borrowers alleged lenders could not demand payment unless a default occurred).
16. *See* UCC Article 3, *in* SELECTED COMMERCIAL STATUTES 228, 228 (West Academic Publishing 2013) ("Article 3 was revised in 1990 and amended in 2002.").
17. *Id.*
18. *See* U.C.C. § 3-108(c) (2002) (a new provision specifically defining demandable notes, which is discussed *infra* at notes 141–61 and accompanying text).
19. 592 F.3d 759 (7th Cir. 2010).
20. *Id.*

from the bank to Reger for the purpose of financing potential development opportunities.[21] National City had lent funds to Reger Development for similar purposes on a number of previous occasions.[22] That is, the parties had an established course of dealing.[23] Kevin Reger met with National City's representative to discuss the loan and asked about changing the terms of form documents that had been suggested by the bank to document the proposed line of credit.[24] The suggested form documents purported to create a demand obligation.[25] Kevin Reger was told that the form documents presented by National City were nonnegotiable.[26] Kevin Reger, on behalf of Reger Development, executed the form documents, which consisted of a promissory note and a commercial personal guarantee signed by Kevin Reger in his individual capacity, guaranteeing the debt of Reger Development.[27] Reger Development also paid a $5,000 closing fee for the line of credit.[28] The promissory note provided that Reger will pay "on demand" the principal amount of the loan. Interest payments were to be made monthly based on the outstanding principal amount.[29] In addition, the note provided the following: "Payment: Borrower will pay this loan in full immediately upon Lender's demand."[30] However, the note also provided:

> Notwithstanding any other provisions set forth in this Note, if (a) any principal owing under this note remains unpaid after Lender shall have given Borrower notice of demand for payment thereof or after the commencement of any proceeding under any bankruptcy or insolvency laws by or against Borrower or (b) any accrued interest under this note remains unpaid after the due date of that Interest, then, and in each such case, all unpaid principal of this Note shall bear Interest at a rate equal to three percent (3%) per annum above the rate that would otherwise be applicable.[31]

Also, notwithstanding the $5,000 closing fee paid by Reger Development, the note stated in bold the following: "NO COMMITMENT . . . NOTWITHSTANDING ANY PROVISION OR INFERENCE TO THE CONTRARY, LENDER SHALL HAVE NO OBLIGATION TO EXTEND ANY CREDIT TO OR FOR THE ACCOUNT

21. *Id.*
22. *Id.*
23. *See* U.C.C. § 1-303 (2001) (defining "course of dealing" as "a sequence of conduct concerning previous transactions between the parties to a particular transaction that is fairly to be regarded a establishing a common basis of understanding for interpreting their expressions and other conduct.").
24. *Reger*, 592 F.3d at 762.
25. *Id.*
26. *Id.*
27. *Id.*
28. *Id.* at 763.
29. *Id.* at 762.
30. *Id.*
31. *Id.*

OF BORROWER BY REASON OF THIS NOTE."[32] The note also included an integration clause, stating that the documents were the complete agreement between the parties.[33]

In June 2008, a year after the documents were executed, the bank requested updated personal financial statements and tax returns, which the note gave the bank the right to request.[34] The borrower provided the requested documents.[35] On August 19, 2008, notwithstanding the fact that Reger Development was in full compliance with all of the terms of the loan documents, including being fully up-to-date in the payment of all interest charges due, National City asked the company to pay down $125,000 of the principle of the line of credit, which the borrower did the next business day.[36] On September 9, 2008, at which time Reger Development continued to be in full compliance with all of its obligations under the loan documents, National City requested that "Reger Development 'term out' $300,000 of the Note by having one of Kevin Reger's other businesses agree to take out a three-year loan in that amount secured by a second mortgage on some real estate."[37] The bank also notified the borrower that it would be reducing the amount of money available under the line of credit to between $400,000–$500,000, down from the original $750,000.[38] Kevin Reger was surprised by the bank's actions and requests and asked if National City would call the line of credit if Reger Development did not agree to the Bank's "requests."[39] The bank acknowledged that Reger Development was not in default but stated, "there is a possibility that we may demand payment of the line."[40] Reger Development then sued the bank, filing a complaint in Illinois state court accusing National City of breaching the terms of the note.[41] "The company also alleged that National City used the form promissory note contracts to perpetuate a fraudulent scheme in which the bank fooled people into taking out loans by concealing the fact that the principal could be called on demand."[42] The bank was headquartered in Cleveland, Ohio, and removed the case to the Northern District of Illinois under diversity jurisdiction.[43] The bank successfully moved to dismiss the complaint for failure to state a cause of action.[44] The district court

32. *Id.*
33. *Id.*
34. *Id.* at 763.
35. *Id.*
36. *Id.*
37. *Id.*
38. *Id.*
39. *Id.*
40. *Id.*
41. *Id.*
42. *Id.*
43. *Id.*
44. *Id.*

rejected Reger Development's motion for reconsideration and Reger Development appealed to the Seventh Circuit Court of Appeals.[45]

With regard to the breach of contract claim, Reger Development alleged that National City breached the loan contract by arbitrarily and capriciously demanding payment under the line of credit even though Reger Development was in good standing and by unilaterally changing, and attempting to change the fundamental terms of the contract documents without Reger Development's consent.[46] In this connection Reger Development identified several provisions in the note that it claimed were "fundamentally inconsistent with the nature of a demand instrument."[47] These provisions included a default interest provision, a prepayment clause (that allowed Reger Development to pay "all or a portion of the amount owed earlier than it is due") and a provision that granted National City the right to access Reger Development's financial information, which Reger Development characterized as a financial insecurity provision.[48]

As a result of these provisions, Reger Development argued that the note, notwithstanding its payable-on-demand language, created an obligation that allowed National City to demand payment only if Reger Development suffered some type of economic adversity.[49] That is, Reger claimed the note should be interpreted as a time note and the demand provision should be interpreted as a type of acceleration clause.[50] Moreover, under this interpretation, Section 1-309 of Article 1 of the U.C.C.[51] would apply to the note.[52] U.C.C. Section 1-309 provides that a clause that says the holder may accelerate "at will" or "when [it] deems itself insecure" or uses "words of similar import" means that the holder has the right to do so only if it in good faith believes that the prospect of payment or performance is impaired.[53] Under Reger Development's interpretation of the note, National City could call the note—that is, demand payment/accelerate the note—only if it believed in good faith that the prospect of payment or performance was impaired.[54] Thus, when National City threatened to call the note and demanded a change in the terms of the line of credit agreement, it breached the contract because it had no right to call the

45. *Id.*
46. *Id.* at 764.
47. *Id.* at 765.
48. *Id.*
49. *Id.*
50. *Id.* at 766.
51. Note that U.C.C. Section 1-309 was formerly Section 1-208. Throughout the course of this Article, any time [Section 1-309] appears within a citation or within a direct quote in the body of the text, the original source or quote was referencing prior Section 1-208.
52. *See* U.C.C. § 1-309 (2001).
53. *Id.*
54. *Reger,* 592 F.3d at 765.

loan since Reger Development was not in default with respect to any obligations under the documents and had not suffered any economically adverse event which would have led National City to believe in good faith that the prospect of payment or performance had been impaired.[55]

Reger Development also alleged fraud on the part of National City.[56] Reger Development essentially alleged that National City created the impression that Reger Development would have the use of the loan proceeds unless it suffered some type of economic adversity, which would give National City the right to demand payment.[57] Whether National City could have, upon appropriate notice, terminated the lending relationship even if Reger Development had not suffered any economically adverse event was not the focus of the case, but is an important issue discussed *infra*.[58] One of the most important facts that led Reger Development to allege fraud was the payment of the $5,000 closing fee.[59] As Reger Development argued to the court, no reasonable borrower would have paid $5,000 to enter into a line of credit if the borrower had been clearly informed that the lender had no obligation to fund the line and that if the line was funded, the lender could demand and collect payment immediately.[60] Reger Development argued that National City intentionally and fraudulently created the impression that it had made a commitment to make a loan rather than an illusory promise. That promise, according to Reger Development, essentially required National City to do nothing in exchange for the payment of the closing fee.[61] Reger Development was under the impression—based on its payment of the $5,000 closing fee, its obligation to provide financial information to be reviewed and approved by National City, its established course of dealing with National City, and the signing of the loan documents—that it had received a commitment from National City to make the loan, notwithstanding the language in the note quoted above.[62] Reger Development might be forgiven for thinking so given that, for example as noted *supra*, the U.C.C. provides that a note that declares it may be accelerated "at will," etc., really does not mean that at all; what it means is that the holder may accelerate only if the holder believes in good faith that the prospect of payment or performance has been im-

55. *Id.* at 766.
56. *Id.*
57. *Id.*
58. *See infra* notes 130–40 and accompanying text.
59. *Reger*, 592 F.3d at 767.
60. *Id.*
61. *Id.* at 766.
62. *Id.*

paired.[63] Moreover, both the U.C.C.[64] and the common law[65] impose an obligation of good faith in the performance and enforcement of every contract, and also prevent the enforcement of contracts based on illusory promises.[66] Thus, Reger Development, or any borrower, might reasonably conclude that the bank at least had to act in good faith in order to terminate or unilaterally modify the loan.[67]

B. The Problems Associated with Using Demand Notes in Commercial Loans

The *Reger* case illustrates the crux of the matter, which is: How should the law balance freedom of contract and good faith in the context of a demand note given by a commercial borrower? According to many courts, when the magic legal words "payable on demand" appear in a note, good faith is not relevant to the holder's demand for payment of the note because the holder is not causing the note to mature by demanding payment, but rather is merely demanding payment of an obligation that technically is already mature.[68] This reasoning is based on the fact that courts have traditionally interpreted a pure/

63. *See* U.C.C. § 1-309 (2001) (discussed *infra* at notes 216–30 and accompanying text).
64. *See id.* § 1-304 ("Every contract or duty within [the Uniform Commercial Code] imposes an obligation of good faith in its performance and enforcement.").
65. *See* RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981) (imposing a duty of good faith between the parties to a contract).
66. *Id.* § 77 (stating illusory promises are unenforceable for lack of consideration).
67. *See infra* notes 216–30 and accompanying text.
68. *See* Nation, *Recognition*, *supra* note 7, at 55–56 (noting that since the holder of a pure-traditional demand note takes no action to mature the note, "good faith is not an issue as there is no duty or act to which the obligation of good faith could be applied"); *see, e.g.*, Fulton Nat'l Bank v. Willis Denney Ford, Inc., 269 S.E.2d 916 (Ga. Ct. App. 1980) (noting that a demand instrument is due immediately after its execution and "[t]hus, the only 'duty' under the U.C.C. on a holder of a demand instrument is to seek enforcement of the instrument which is on its face 'immediately' due and payable within the applicable statute of limitation"); Centerre Bank v. Distrib., Inc., 705 S.W.2d 42, 47 (Mo. Ct. App. 1985) (noting that a demand note is mature on its date of issue and that "[t]he good-faith requirement of [Section 1-304] is in the performance or enforcement of a contract or duty," thus concluding that [Section 1-304] "has no application because it does not relate to the performance or enforcement of any right under the demand note. . . "); Allied Sheet Metal Fabricators, Inc. v. Peoples Nat'l Bank, 518 P.2d 734 (Wash. Ct. App. 1974); *see also* Glen D. West & Michael P. Haggerty, *The "Demandable" Note and the Obligation of Good Faith*, 21 UCC L.J. 99, 118 (1988) (discussing how courts considering this issue readily determine that no concept of good faith should apply). *But see*, Julian B. McDonnell, *Problems with Notes: Accrual, Acceleration, and Suretyship*, 18 UCC L.J. 40, 41–42 (1985) (suggesting that the obligation of good faith be applied to demand notes "but, unfortunately, the rule [stated in U.C.C. Section 3-122 (1)(b), that a demand note is due and payable upon its date or, if no date is stated, on the date of issue] is applied in other contexts [than the statute of limitations]. Thus, there are cases under the code indicating that the holder may sue, foreclose, or set off as against the maker

traditional demand note as becoming due immediately upon its execution by the maker.[69] Under this interpretation, the holder does not exercise any discretion in calling for payment of a demand note because the note is already due and payable.[70] The policy of fairness and commercial reasonableness that underlies Section 1-309's recognition that there should be a limitation on the holder/lender's ability to exercise its discretion in a way that obviously and predictably disadvantages the borrower does not apply to a demand note under this traditional interpretation. This is so because the holder exercises no discretion in making the note due and payable, since the note became due as soon as it was signed.[71] However, from the perspective of the borrower there is no difference at all between a demand for payment and acceleration.[72] A similar issue, also illustrated by *Reger*, concerns how courts should interpret contract language that states, as the note did in *Reger*, the lender has no obligation to lend any money.[73] Is this language sufficient to overcome a compelling conclusion to the contrary created by the nature of commercial loans, the payment of various fees to the lender, repayment schedules, default interest rates, the

before demanding payment and that the decision of such a holder to press his claim is not subject to good-faith restraints" (footnotes omitted)).

69. *See infra* notes 85–129 and accompanying text.

70. *See supra* note 68.

71. *See supra* note 68.

72. From the maker's perspective, regardless of whether the precipitating event is acceleration or demand, he must pay the note. Moreover, while under the traditional legal interpretation of a pure/traditional demand note the holder does nothing to mature the note, practically, the holder does make a decision to, and does take action to enforce the note; in fact, if the holder did not, a demand note might never be paid. *See* U.C.C. § 3-118, cmt. 2 (2002) ("Although a note payable on demand could theoretically be called a day after it was issued, the normal expectation of the parties is that the note will remain outstanding until there is some reason to call it."). Thus, making the decision to enforce, as well as taking enforcement action, might be considered a duty of the holder of a demand note and U.C.C. Section 1-304 might be interpreted as imposing an obligation of good faith on the holder of a demand note. *Cf.* Bank of Nev. v. United States, 251 F.2d 820 (9th Cir. 1958) ("Although the maker of a demand note is not in default until he refused payment until after demand therefor, it is generally held that a note payable on demand is due immediately, so that suit may be maintained on it at any time after delivery. . . . " (quoting 10 C.J.S. *Bills and Notes* § 247(b), at 744 (1938))). *See* U.C.C. § 3-304 (2002) (stating a demand instrument is overdue, at the earliest, the day after the day demand for payment is duly made). If this interpretation were adopted, good faith would be applied to demand notes in the same general way that it is to demandable notes. *See infra* notes 216–30 and accompanying text. One obvious difference would be that, because of the nature of the transactions where a demand note would logically be used, the time between demand and maturity would be generally shorter than in the case of a demandable note.

73. *See* Reger Dev. v. Nat'l City Bank, 592 F.3d 759, 762 (7th Cir. 2010).

credit approval process, etc.?[74] How are the courts, borrowers and borrowers' counsel to harmonize these competing viewpoints when even the U.C.C. seems to confuse the issue?[75] For example, Section 3-108(a) provides that a promise or order is payable on demand if it states that it is "payable on demand or sight, or otherwise indicates that it is *payable at the will of the holder*," while Section 1-309 provides that the term providing that a party may accelerate *payment at will* means that the party has the power to do so only if that party in good faith believes the prospect of payment performance is impaired.[76] The Official Comment to Section 1-309 states that this section does not apply "to demand instruments or obligations whose very nature permits call at anytime with or without reason," rather it "applies only to an obligation of payment which in the first instance is due at a future date."[77] But why not simply interpret a time note with an "at will" acceleration clause as a demand note under Section 3-108(a)? Why is a time note with an "at will" acceleration clause deemed to be payable in the first instance at a future date, but a note that provides for payment "at the will of the holder" is deemed a demand note?[78]

Moreover, U.C.C. Section 3-117 recognizes that the obligation of a party to an instrument to pay the instrument may be "modified, supplemented, or nullified by a separate agreement of the obligor and a person entitled to enforce the instrument, if the instrument is issued or the obligation is incurred in reliance on the agreement or as part of the same transaction giving rise to the agreement."[79] Section 1-201(b)(3) defines "agreement," as distinguished from "contract," as the "bargain of the parties in fact, as found in their language or inferred from other circumstances, including course of performance, course of dealing, or usage of trade."[80] Thus, the agreement between the borrower and the lender as determined by the nature of commercial lending, the prior course of dealing between the parties, the borrowers planned use of the loan proceeds, as well as the specific provisions of

74. *See e.g.,* Wood v. Lucy, Lady Duff-Gordon, 118 N.E. 214, 214–15 (1917) ("A promise may be lacking, and yet the whole writing may be 'instinct with an obligation,' imperfectly expressed. If this is so there is a contract. . . . The acceptance of the exclusive agency was an assumption of its duties. We are not to suppose that one party was to be placed at the mercy of the other. . . . Without an implied promise, the transaction cannot have such business 'efficacy as both parties must have intended that at all events it should have." (citations omitted)). *See* discussion *infra* at notes 178–215 and accompanying text.

75. *See infra* notes 141–61 and accompanying text.

76. *See* U.C.C. § 3-108(a) (2002); *id.* § 1-309 (2001).

77. *Id.* § 1-309, cmt. 1.

78. *See* discussion *infra* at notes 141–61 and accompanying text.

79. U.C.C. § 3-117 (2002).

80. *Id.* § 1-201(b)(3) (2001).

the note and the other loan documents may be used to determine the obligation of the maker/borrower to the holder/lender.[81]

Interestingly, the Seventh Circuit's opinion states that the main question in *Reger* is whether the note entitles National City to demand payment from Reger Development at will.[82] But answering that question doesn't solve the real dilemma, which is: Should National City's exercise of discretion in setting the repayment terms of the loan, especially the due date, be subject to a general obligation of good faith?[83] That is, how should we accommodate freedom of contract, and the general obligation to act in good faith in the performance or enforcement of a contract, in context of the enforcement of a demand promissory note documenting a commercial loan?[84]

III. ANALYSIS

A. Old and Continuing Problems

Demand notes have always been somewhat ambiguous. Even though these notes state that they are payable "on demand," early courts decided that no demand other than the bringing of a lawsuit was necessary in order for the holder to maintain an action on the note.[85] Subsequent courts ruled that no actual demand *or commencement of legal action* was necessary in order to receive payment on a demand note, erroneously citing the earlier decisions that held commencement of the law suit constituted sufficient demand.[86] Eventually, the rule developed that a demand note, notwithstanding its express statement that it is "payable on demand," is in fact a mature

81. *Id.*
82. Reger Dev. v. Nat'l City Bank, 592 F.3d 759, 762 (7th Cir. 2010).
83. *See infra* notes 216–30 and accompanying text.
84. *See infra* notes 178–215 and accompanying text.
85. By the early 1700s, the basic rule had developed that no demand other than the action brought was necessary to enforce payment of a demand note. *See* J. MILNES HOLDEN, THE HISTORY OF NEGOTIABLE INSTRUMENTS IN ENGLISH LAW 109 (1955). The action itself was deemed sufficient demand to make the note due and payable. *Id.*
86. Ironically, subsequent courts developed the rule that demand notes were mature from the moment of their execution without either the bringing of a lawsuit or a prior demand by the holder. *See, e.g.,* Spencer Cos. v. Chase Manhattan Bank, 81 B.R. 194, 198 (Bankr. D. Mass. 1987) ("Generally, demand notes are considered due and payable immediately upon their execution with or without a prior demand."); Jenkins v. Karlton, 620 A.2d 894, 897 (Md. 1993) ("[I]t has long been well settled that demand notes are payable immediately, without demand."); Shawmut Bank, N.A. v. Miller, 614 N.E.2d 668, 669 (Mass. 1993) ("[I]t is the general rule that a note unconditionally payable on demand is payable immediately without demand."); Allied Sheet Metal Fabricators, Inc. v. Peoples Nat'l Bank, 518 P.2d 734, 738 (Wash. Ct. App. 1974) ("It is elementary that a demand note is payable immediately on the date of its execution.").

note due and payable from the moment of its execution.[87] As a result, the name "demand" note is itself misleading.[88] A better name for a demand note, at least based on the traditional analysis, is "mature note."[89] In addition, even though Article 3 technically provides for presentment and demand for payment of notes, these requirements are virtually always waived with regard to notes used in commercial lending.[90] This anomalous and ambiguous treatment of demand notes has led to a number of problems, as illustrated by *Reger*, with the en-

87. In fact, it would seem that a note payable "on demand" should, on the basis of logic, the plain meaning of the language used, and general business practice (indeed based on all but legal precedent), require an actual demand for payment and a breach of the obligation to pay as prerequisites to enforcement.

88. *See, e.g., Shawmut*, 614 N.E.2d at 669 ("The label 'demand note' can be somewhat misleading [and] a sort of tolerated mislabeling . . . ."); Shapleigh Hardware Co. v. Spiro, 106 So. 209, 210 (Miss. 1925) (noting that the general interpretation of demand notes is "subject to the just criticism that it makes the provision that the instrument shall be payable on demand mean the opposite of what the language indicates"); William D. Hawkland & Larry Larence, Hawkland Uniform Commercial Code Series § 3-122:3 (2002) ("Since there is no requirement that the holder make demand before commencing an action, the name 'demand' instrument is a misnomer."). The application of the rule that a demand note is mature at the moment of its execution should be confined to the context for which the rule was designed—the statute of limitations. *See* Palmer v. Palmer, 36 Mich. 487, 491 (1877) ("If the judgment [of the lower court] is correct, it can only be so because, by the terms of the contract the holder had a right to postpone the maturity of the debt as long as he chose to do so. For if the debt did not become payable until fixed by demand, and the demand was optional with the creditor, no tender could be made which would bind him, and he could keep the debt alive in spite of the debtor, for an indefinite period. If there was an infirmity in the consideration, or any defect in the binding character of the obligation, he might retain it until all testimony was lost, and defeat the defense. This is the mischief which the statutes of limitation were intended to remedy."). *See* West and Haggerty, *supra* note 68, at 108–09 (discussing *Palmer*). Other courts that have held U.C.C. Section 1-304 does not apply to demand notes have cited with approval the notion that Section 1-304 cannot be applied to override the express terms of a contract. *See, e.g.*, Flagship Nat'l Bank v. Gray Distrib. Sys., Inc., 485 So. 2d 1336 (Fla. Ct. App. 1986). This analysis disregards the plain language of Section 1-304, which refers to "*every contract or duty*" and violates the plain language of Section 1-302, which prohibits the elimination of the obligation of good faith even by agreement of the parties. U.C.C. § 3-304 (2002) (emphasis added); *id.* § 1-302 (2001).

89. *See supra* note 88.

90. *See* U.C.C. § 3-501 (2002); *id.* § 3-502 (2002) (providing for presentment and dishonor). The Official Comment to U.C.C. Section 3-502 states, "In the great majority of cases presentment and notice of dishonor are waived with respect to notes." *Id.* § 3-502, cmt. 2. Also, Section 3-502(a)(1) provides that a note payable on demand is dishonored if presentment is *duly* made to the maker and the note is not paid on the day of presentment. *Id.* (emphasis added). However, U.C.C. Section 3-501 provides that the maker may refuse payment for failure of the presentment to comply with the terms of the instrument, an *agreement* of the parties, or other applicable law or rule. *Id.* § 3-501(b)(3) (emphasis added).

forcement of demand notes especially in the commercial lending context.[91]

Moreover, further ambiguities surrounding the distinction between time and demand notes resulted from the definitions contained in Prior Article 3. Prior Article 3 provided that an instrument was "payable at a definite time if by its terms it [was] payable on or before a stated date or at a . . . definite time subject to acceleration."[92] Instruments payable on demand were defined as instruments payable at sight or on presentation and those in which no time for payment was stated.[93] These definitions resulted in a number of potential problems when a demand note was used to document a commercial loan. For example, should a note that provides that it is payable on demand, but if no demand is sooner made then in installments on specific dates, be interpreted as a time or demand note?[94] This note does not seem to fit the earlier definition of a demand note because it contains specific repayment dates.[95] On the other hand, the note does state that it is payable on demand.[96] Other provisions such as default interest rates, late charges, acceleration clauses, and prepayment provisions all have created problems.[97] All of these provisions, which are extremely com-

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91. *See, e.g.*, M.S.V., Inc. v. Bank of Bos., 87 B.R. 752 (D. Mass. 1988) (regarding foreclosure on collateral pursuant to a demand type instrument); Spencer Cos. V. Chase Manhattan Bank, 81 B.R. 194, 198 (D. Mass. 1987) (regarding set off and demand type notes); Stebens v. Wilkinson, 87 N.W.2d 16 (Iowa 1957) (regarding the running of the statute of limitation and demand type notes); Merrimack River Sav. Bank v. Higgins, 195 A. 369 (N.H. 1937) (regarding foreclosure on collateral pursuant to a demand type instrument); Allied Sheet Metal Fabricators, Inc. v. People's Nat'l Bank, 518 P.2d 734, 738 (Wash. Ct. App. 1974) (regarding set off and demand type notes).
92. PRIOR UNIF. COMMERCIAL CODE § 3-109(1) (1990).
93. *Id.* § 3-108 (1990).
94. *See, e.g.*, Shaughnessy v. Mark Twain State Bank, 715 S.W.2d 944, 950–51 (Mo. Ct. App. 1986) (holding a note provided for payment "On demand but if no demand is made then . . . . " was not a demand note, but rather implied to be a time note because the requirement of an actual demand meant that the parties did not intend the note to be due when executed); Reese v. First Mo. Bank & Trust Co., 664 S.W.2d 530, 531 (Mo. Ct. App. 1984) (holding a note providing for payment "On demand but if no demand be made then . . . ." was a time note because the requirement of an actual demand indicated that the parties did not intend the note to mature upon issue); *cf.* Todd v. Third Nat'l Bank, 113 S.W.2d 740 (Tenn. 1938) (holding that a note stating it was payable on demand but also providing for periodic interest payments was a demand note because there was no indication the parties did not intend the note to mature upon issue); Nation, *Recognition*, *supra* note 7, at 65–76 (discussing this issue). Revised U.C.C. Article 3 has resolved this issue and such instruments are demand instruments. *See* U.C.C. § 3-108(c).
95. *See supra* notes 92–94.
96. *See supra* notes 92–94.
97. *See* Nation, *Recognition*, *supra* note 7, at 86–88 (discussing the fact that the courts that treat notes providing for payment on demand, but including specific repayment dates, as time notes do so in part because of references to maturity, an

mon in the commercial lending context, are inconsistent with an obligation that is already due and payable; remember many courts interpret demand notes to be due and payable from the moment they are signed.[98] If a demand note is always past due, how can there be a default interest rate that is higher than the stated interest rate when technically a demand note is always in default?[99] How can late charges apply when payment on a demand note is always made after maturity?[100] What is the point of telling the maker of a demand note that he may prepay the note without penalty? Under the traditional legal theory of demand notes, the maker can undoubtedly prepay without a penalty because the note is already mature.[101] Worse would be a demand note that tells the maker he cannot prepay the note without penalty. Obviously, under the traditional legal theory of demand notes, such a provision makes no sense. And, of course, an acceleration clause also makes absolutely no sense in a demand note because it is not possible to accelerate a due date that has already arrived.[102]

Finally, these earlier definitions of time and demand notes also led to confusion concerning the application of the obligation of good faith contained in former Section 1-208 (current Section 1-309) mentioned *supra*.[103] In the commercial lending context borrowers usually plan an illiquid use of the loan proceeds.[104] As a result, a time note would make the most sense.[105] That is, if everything goes as planned, the borrower would be able to repay the principal and interest over time as the borrower received revenue from its use of the loan proceeds.[106] However, the possibility that things will not go as planned puts the

increased interest rate after maturity, statements that failure to pay at maturity constitute an event of default, or any such combination). Any reference inconsistent with an obligation due on issue may create a problem.

98. *See supra* note 85.
99. Note that Revised Article 3 provides a demand instrument is "overdue at the earliest . . . the day after the demand for payment is duly made." U.C.C. § 3-304 (2002). Does "after default" mean the same thing as "overdue?" It may not under the traditional reasoning that no demand need be made by the holder of a pure/traditional demand note, and thus reference to default is inconsistent with a pure demand note.
100. *See supra* text accompanying note 85.
101. *See* Nation, *Prepayment*, *supra* note 11, at 625 (stating no prepayment fee would be owed for prepayment of a demand note).
102. *See supra* note 85.
103. *See supra* notes 75–78 and accompanying text.
104. See Nation, *Commercial*, *supra* note 12, at 322; George A. Nation III, *Demand Notes and Good Faith in Commercial Lending: The Impact of Revised Article 3*, 27 UCC L.J. 382, 392 (1995) [hereinafter Nation, *Demand Notes*].
105. A time note gives the borrow assurance that it will have the use of the funds until maturity unless its credit worthiness declines or it allows a default to occur. *See* U.C.C. § 3-188(b) (2002).
106. *Id.*

lender in a risky situation. If the borrower suffers economic difficulty the lender may have trouble recovering its loan.[107] Moreover, the longer the lender waits to take action the worse the situation is likely to become from the lender's perspective.[108] Therefore, it is very important to the lender that it can move quickly to recover its loan if the borrower's economic situation deteriorates.[109] This is the reason that acceleration clauses are so important and so common.[110] Without one, a lender who has used a time note providing for installment payments would have to sue for each missed installment.[111] An acceleration clause allows the lender to bring one lawsuit and recover the entire principal and all earned interest in one action.[112] As a way to further reduce risk, lenders typically condition their right to accelerate upon the occurrence of an "event of default," which is a defined term in either the note or the loan agreement and often other loan documents.[113] At a minimum an "event of default" is defined to include a missed payment of principal or interest, but the definition typically includes much more than that.[114] In fact, any event that would indicate a deterioration of the borrower's financial position is usually defined as an event of default.[115] Moreover, rather than relying on a specific definition of every event which could result in the deterioration of the borrower's financial position, most lenders also include some very broad, generic language to cover anything they might have forgotten or overlooked.[116] For example, typically the event of default definition includes the occurrence of any "material adverse change" in the borrower's financial position.[117] Broader still is the inclusion of a provision that allows the lender to accelerate payment "at will" or "whenever the lender deems itself insecure."[118]

As noted *supra*, the U.C.C. has placed a specific good-faith limitation on the latter type of provisions.[119] That is, the lender may only use these broad, generic provisions to accelerate the loan if the lender in good faith believes that the prospect of payment or performance has

107. *See* Nation, *Recognition*, *supra* note 7, at 57–61.
108. *Id.*
109. *Id.*
110. *Id.*; *see also*, HEMMENDINGER, *supra* note 1, § 9:11.
111. *See* sources cited *supra* notes 107–10.
112. *See* sources cited *supra* notes 107–10.
113. *See* HEMMENDINGER, *supra* note 1, § 9:11; Nation, *Recognition*, *supra* note 7, at 99–100.
114. *See* HEMMENDINGER, *supra* note 1, § 9:11; Nation, *Recognition*, *supra* note 7, at 99–100.
115. *See* HEMMENDINGER, *supra* note 1, § 9:11; Nation, *Recognition*, *supra* note 7, at 99–100.
116. *See* Nation, *Demand Notes*, *supra* note 104, at 385–86.
117. *Id.* at 386.
118. *Id.*
119. *See supra* notes 76–77 and accompanying text (discussing U.C.C. Section 1-309).

become impaired.[120] However, this limitation did not, and under the revised Article 1 does not, apply to a demand note.[121] But does this limitation apply to a note that provides it is payable on demand, but if demand is not sooner made it is then payable in installments?[122] If such a note were interpreted as a time note, then the demand provision would be a type of acceleration clause to which the specific good-faith limitation would apply.[123] There has been significant litigation concerning these issues.[124] In response, some courts and commentators have categorized demand notes as either "demandable" or "pure/traditional demand" notes.[125] The distinction is that a demandable note requires an actual demand in order to become mature, while a pure/traditional demand note does not.[126] For example, a note like the one mentioned above, providing that it is "payable on demand but if demand is not sooner made it is then payable in installments," has been treated by some courts as demandable.[127] Such a note, unlike a

120. *Id.*
121. *Id.* (discussing the Official Comment to U.C.C. Section 1-209 and noting that section does not apply to demand notes).
122. Under former Article 3 it was not clear how such notes should be treated. *See* PRIOR U.C.C. § 3-108 (1990); *id.* § 3-109 (discussed *supra* at notes 92–93 and accompanying text).
123. *See, e.g.*, Shaughnessy v. Mark Twain State Bank, 715 S.W.2d 944, 950–51 (Mo. Ct. App. 1986) (holding a note providing for payment "On demand but if no demand is made then . . . . " was not a demand note, but rather impliedly a time note, because the requirement of an actual demand meant that the parties did not intend the note to be due when executed); Reese v. First Mo. Bank & Trust Co., 664 S.W.2d 530 (Mo. Ct. App. 1984) (holding a note providing for payment "On demand but if no demand be made then . . . ." was a time note because the requirement of an actual demand indicated that the parties did not intend the note to mature upon issue); Todd v. Third Nat'l Bank, 113 S.W.2d 740 (Tenn. 1938) (holding that a note stating it was payable on demand, but also providing for periodic interest payments was a demand note because there was no indication the parties did not intend the note to mature upon issue); *see also* Nation, *Demand Notes*, *supra* note 104, at 384–90 (citing cases where courts felt constrained to interpret ambiguous notes as either time or demand notes instead of adopting the demandable note option).
124. *See supra* note 123.
125. *See generally* Carolyn M. Edwards, *Article 3 Demand Notes and the Doctrine of Good Faith*, 74 MARQ. L. REV. 481 (1991) (discussing the holder of a notes' ability to call for payment at any time, with or without reason, sometimes in bad faith); Nation, *Demand Notes*, *supra* note 104 (distinguishing demand notes from demandable notes); Nation, *Recognition*, *supra* note 7 (arguing that demandable notes are unique from time notes and demand notes); West & Haggerty, *supra* note 68 (considering the implications of a "demandable note" on the statute of limitations and the requirement of good faith).
126. *See* Nation, *Demand Notes*, *supra* note 104, at 389.
127. *See, e.g.*, Exch. Nat'l Bank v. Crest Fin. Co., 203 N.E.2d 58, 60 (Ill. Ct. App. 1964) (citing *Brown*, *infra*, and stating, "The note in the instant case, like the note in the *Brown* case, could be matured prior to its due date by the making of a demand upon the maker" where the note stated, "[o]n Demand, and if no demand is made then 91 days after date"); Brown v. Maguire's Real Est. Agency, 101 S.W.2d 41,

pure/traditional demand note, is not mature from execution, but requires an actual demand by the holder to become mature.[128] Moreover, since the holder exercises discretion in making an actual demand for payment and in setting repayment terms, the general obligation to act in good faith may be applied to the holder's exercise of this discretion.[129]

B. Recognition of Demandable Notes: A Step Toward a Solution

Recognizing the distinction between pure/traditional demand notes and demandable notes is crucial to finding a solution to the problems associated with the use of demand notes in commercial lending.[130] Distinguishing between demand, demandable, and time notes is very important in order to protect the reasonable expectations of the lender/holder and the borrower/maker.[131] That is, it allows courts to

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49 (Mo. Ct. App. 1937), *rev'd on other grounds*, 121 S.W.2d 754 (Mo. 1938) (stating "[w]e think the intent of the note is that it does not mature, so that an action may be maintained upon it, prior to February 1, 1933, *without demand for its payment first having been made*" where the note provided that "[o]n demand and if no demand be made, then on the 1st day of February, 1933" (emphasis added)). For a more recent statement of the same rule, see Spencer Cos. v. Chase Manhattan Bank, 81 B.R. 194, 198 (Bankr. D. Mass. 1987) ("Although formal demand is not required to mature an obligation evidenced by a demand note, the parties to a lending arrangement can agree that a note will become due and payable only after a formal demand is made. Moreover, the mere fact that the parties choose to label the instruments which evidence their obligations as demand notes does not automatically mean that no prior demand is required. Where the terms and conditions of a so-called demand note indicate that the parties intended the obligation to become due and payable upon the happening of a future event, the debt is not mature upon execution of the note. The obligation matures only when the agreed-upon event occurs." (citations omitted)).

128. *See supra* notes 85, 127.

129. *See* sources cited *supra* note 68.

130. *See supra* note 125.

131. By characterizing a note as demandable, the lender's/holder's right to call the loan at any time and for any reason—that is, the holder may start the clock running on the borrower's reasonable time to refinance at any time the holder chooses—is preserved and the borrower/maker is treated fairly because he is given a reasonable time to arrange refinancing before he is in default under a demandable note. The requirement that the holder/lender of the demandable note give the borrower a reasonable time to arrange refinancing comports with general commercial practice. Most lenders, as a matter of policy, give the maker some notice of their desire to terminate the financial relationship prior to actually requiring repayment, unless doing so would jeopardize repayment of the loan. During this notice period the maker often, with the help of the holder, seeks alternate financing. *See, e.g.*, Bank One, Tex. v. Taylor, 970 F.2d 16, 32 (5th Cir. 1992) ("[T]he former president of MBank, Ed Evans, testified at trial that the bank could not simply demand payment on an 'unreasonable basis,' but was obligated to consider, in good faith, all the facts and circumstances before accelerating the note."); K.M.C. Co. v. Irving Trust Co., 757 F.2d 752, 759–61 (6th

avoid treating a demandable note as a time note and then applying the specific Section 1-309 good faith obligation to the holder's decision to demand payment.[132] Such an interpretation is in error because it misses the fundamental distinction between time and demand (pure/traditional demand notes and demandable notes) obligations.[133] A demand obligation—whether pure/traditional or demandable—allows the holder/lender to decide to demand payment at any time and for any reason and the obligation to act in good faith does not apply to the holder's decision to demand payment because the fundamental nature of a demand obligation is that it allows the holder to decide to demand payment at any time for any reason.[134] However, as discussed *infra*, this does not mean that every demand obligation becomes due and

Cir. 1985) ("Logically, at such time as Irving might wish to curtail financing K.M.C., as was its right under the agreement, this obligation to act in good faith would require a period of notice to K.M.C. [maker] to allow it a reasonable opportunity to seek alternate financing, absent valid business reasons precluding Irving from doing so. . . . James Kuharski was executive vice president and manager of secured lending activities for Irving [Trust], and two levels above Sarokin [loan officer] in Irving's management hierarchy. Kuharski acknowledged that Irving owed its clients [borrowers] a duty of good faith, *that it was not a policy of Irving to terminate financing without notice*, and that if Sarokin believed that Irving was adequately secured he would not have been acting in accordance with that duty of good faith to have refused *without notice* to advance funds to K.M.C. [borrower]." (emphasis added)). Obviously, this notice period is not given if the lender's desire to terminate the financial relationship is due to a good faith belief that the prospect of payment or performance has become impaired. But if this is the case, the termination is more in the nature of an acceleration, not the result of the use of the demand provision that is included to allow the lender to mature the note for *internal* reasons. *See* Rogers v. Sec. Bank, 658 F.2d 638 (8th Cir. 1981) (involving a case where the bank made demand but gave maker time to pay; no enforcement action taken); Taggart & Taggart Seed, Inc. v. First Tenn. Bank N.A., 684 F. Supp 230 (E.D. Ark. 1988) (involving a case where the bank made demand in 1984 and extended the repayment date until April 1986); Peterson v. Valley Nat'l Bank, 432 P.2d 446 (Sup. Ct. Ariz. 1967) (involving a case where the bank demanded payment giving maker sixty days to pay).

132. *See supra* notes 94, 123 (discussing courts that held demandable notes to be time notes because their provisions did not adhere to the definition of a demand note as being due on issue); *Spencer Cos.*, 81 B.R. at 198; *see also* Nation, *Recognition*, *supra* note 7, at 84 (noting that many courts have felt compelled to construe notes as either time notes or demand notes and citing cases). However, when the parties intend to create a demandable obligation, the application of either a time note or demand note interpretation by the court interferes with the reasonable expectations of the parties.

133. *See* Nation, *Demand Notes*, *supra* note 104, at 387–88 ("The holder of a demand or demandable note does not have to wait for an event of default to demand payment."); Nation, *Recognition*, *supra* note 7, at 61–65 ("Holders of both demandable and demand notes can unilaterally determine the time for payment.").

134. Nation, *Recognition*, *supra* note 7, at 77 ("The holder's [of a demandable note] right to demand payment should not be burdened with a good-faith obligation."); Nation, *Demand Notes*, *supra* note 104, at 395–96 ("The holder of a demand or demandable note can demand payment of the note at any time for any reason . . . and is not subject to act in good faith.").

payable immediately upon the holder's demand for payment.[135] Moreover, it also does not mean that the general obligation of good faith (formerly found in Section 1-203, and now in Section 1-304) does not apply to the aspects of the holder's demand for payment other than his decision of when to make the demand.[136] That is, the general obligation of good faith does apply to both the way in which the holder communicates the demand and, importantly, to the holder's setting of the repayment date applicable to the demand.[137] However, while the recognition of demandable notes better reflects the commercial lending situation, problems still persist.[138] In addition, while the revisions to Article 3 provide some clarification, they also provide new ambiguity.[139] The difficulty is trying to balance the nature of commercial lending and the likely understanding between the borrower and the loan officer with the drafting of the lender's lawyers.[140]

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135. *See infra* notes 162–78 and accompanying text.
136. *See* Nation, *Recognition*, *supra* note 7, at 78–80 (concluding that the general good faith obligation under [Section 1-309] should apply to both the setting of the amount of time the maker has to respond to the demand before the note is in default, and to the making of the demand for payment).
137. *See infra* notes 162–78 and accompanying text.
138. *See, e.g.*, Reger Dev. v. Nat'l City Bank, 592 F.3d 759 (7th Cir. 2010); Nation, *Demand supra* note 104, at 400 ("Notes used in commercial lending that provide for payment on demand have been the source of a significant amount of litigation." (citation omitted)).
139. See *infra* notes 141–61 and accompanying text.
140. *See, e.g.*, Shawmut Bank, N.A. v. Miller, 614 N.E.2d 668 (Mass. 1993) (applying demandable note analysis in the commercial lending context); Bottrell v. Am. Bank, 773 P.2d 694 (Mont. 1989) (using demandable note analysis and intimating that a period of notice is required to be given to the maker before the note matures). Both *Bottrell* and *Shawmut* are discussed in Nation, *Demand Notes*, supra note 104, at 401–06. *See also* Simon v. N.H. Sav. Bank, 296 A.2d 913 (N.H. 1972) (applying demandable note analysis). In *Simon*, the plaintiff applied to the bank for a twenty-year construction loan repayable at the rate of $144 per month. *Id.* at 914. The bank lent the borrower money; however, the mortgage provided for "the mortgager's note or notes . . . payable to the order of the . . . bank, on demand, with interest payable monthly." *Id.* The mortgage then provided, "It is further agreed without the mortgagee waiving the right to demand payment in full at any time that One Hundred Forty-Four . . . Dollars be paid monthly beginning [7 months after the date of the note]." *Id.* The note contained similar provisions. *Id.* The majority held the note and mortgage to be demand obligations. *Id.* at 915. The dissent by Justice Grimes found that the obligation was payable on demand only in the event of default, stating: "Here there was an application for a loan for a term of 20 years. The bank's investment committee recommended a loan for a term of 20 years. Both the note and mortgage provide for monthly payments which are consistent with a twenty-year installment debt." *Id.* at 916. Under the U.C.C., a demand provision should not be interpreted as making the note a pure demand note because given the context of commercial lending, such an interpretation is quite likely to result in an unfair surprise to the maker. *See* Dennis M. Patterson, *Good Faith, Lender Liability, and Discretionary Acceleration: Of Llewellyn, Wittgenstein, and the Uniform Commercial Code*, 68 TEX. L. REV. 169 (1989).

C. Revised Article 3—More Ambiguities

The drafters of Revised Article 3 attempted to clear up some of the ambiguity surrounding demand notes in Section 3-108(c), which provides that "If an instrument, payable at a fixed date, is also payable upon demand made before the fixed date, the instrument is payable on demand until the fixed date and, if demand for payment is not made before that date, becomes payable at a definite time on the fixed date."[141] Thus, it is clear under Section 3-108(c) that a note providing that it is payable on demand but if demand is not sooner made then in installments, is a demand note; one that requires the holder to make an actual demand for payment is a demandable note.[142] In addition, 3-108(a) provides that "A promise or order is 'payable on demand' if it (i) states that it is payable on demand or at sight, or otherwise indicates that it is payable at the will of the holder, or (ii) does not state any time of payment."[143] As noted, this definition unfortunately creates some new ambiguity regarding whether a time note that includes an "at will" acceleration provision should be treated as a demand note.[144] Certainly one could consider such a note to be payable at the will of the holder. However, such an interpretation would seem to render Section 1-309 at least partially irrelevant.[145]

Revised Article 3 leaves us with a conundrum: Are demand notes the same as time notes subject to at will acceleration?[146] Or, to rephrase the same question with dramatically different results, are time notes subject to at will acceleration demand notes?[147] If the answer to the first question is yes, then why do the courts treat these instruments so differently?[148] If the answer to the second question is yes, then Section 1-309 is a dead letter.[149] But, if we answer no to either

141. U.C.C. § 3-108(c) (2002).

142. *Id.* Prior to these revisions some courts had trouble classifying notes of these types. *See supra* note 94.

143. U.C.C. § 3-108(a).

144. *Id.*

145. *See id.* § 3-109, cmt. 1 (2002) (this section does not apply to demand instruments).

146. According to the express terms of both notes, the time when the maker must pay the note is subject to the discretion of the holder. *See supra* note 72.

147. That is, according to the express language of a time note with an "at will" acceleration clause, it is payable at the will of the holder.

148. That is, the holder of a demand note may demand payment at any time for any reason, but the holder of a time note subject to "at will" acceleration may only demand payment when he in good faith believes that the prospect of payment or performance has been impaired. *See supra* notes 50–55 and accompanying text.

149. Section 1-309 applies to acceleration pursuant to an "at will" or similar discretionary right to accelerate, but does not apply to demand notes. U.C.C. § 1-309 (2001). Thus, if a note providing the holder with the right to accelerate "at will" is a demand note, then Section 1-309 would apply to nothing.

or both questions, what is the basis for that conclusion?[150] Is there any real difference between a demand note and a time note that provides for at will acceleration? If there is, what is the nature of that difference and how does that inform our treatment of demand notes in the commercial lending context?

Consider two notes: One provides that it is payable on demand but if demand is not sooner made then in monthly installments of principal and interest over three years. The other provides that it is payable in thirty-six monthly installments of principal and interest and includes an acceleration clause that provides that the holder may accelerate at will. What is the real difference between these two notes? They both, at least according to their terms, represent a three-year loan subject to the discretion of the holder to call the note at any time. In one case calling the loan is considered a demand for payment and in the other it is considered acceleration. Is this a distinction without a difference? Legally, of course, there is an important difference; the holder of the second note may accelerate only if he in good faith believes that the prospect of payment or performance has been impaired pursuant to U.C.C. Section 1-309,[151] while the holder of the first note arguably has the unfettered discretion to arbitrarily and capriciously call the note at any time for any reason, good or bad, and is expressly not subject to any good-faith obligation in making his decision to demand payment.[152] Why do the policies underlying Section 1-309 not apply in the case of the first note? Obviously, the technical answer is because the first note is a demand note and the second note is a time note. Such an answer, however, simply begs the question: Should the policy underlying Section 1-309, which uses an obligation of good faith to limit the contracting parties freedom, apply to demand notes used in commercial lending?[153]

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150. Perhaps there is a clue in the Official Comments to U.C.C. Section 1-309, which say that the provision does not apply to a demand instrument or to instruments whose very nature permits call at any time with or without reason. U.C.C. § 1-309, cmt. 1. Rather, Section 1-309 applies only to an agreement or to paper which in the first instance is payable at a future date. It would be possible to argue that a note providing that it is payable on demand, but if demand is not sooner made in installments, is "in the first instance" payable at a future date (because if the holder does nothing the note is not payable until the arrival of the future date, which is essentially the same as a note subject to a possible acceleration), and thus should be subject to Section 1-309. *See* cases cited *supra* note 94. However, this interpretation is noticeably flawed. *See infra* notes 162–77 and accompanying text.
151. *See* U.C.C. § 1-309.
152. *See supra* notes 162–77 and accompanying text.
153. *See* Nation, *Recognition*, *supra* note 7 at 88–95 (concluding that Section 1-309 should not apply to demand type instruments and stating that "the right to accelerate 'at will' should not be interpreted as creating . . . a demand-type obligation"). However, that does not mean that U.C.C. Section 1-304 does not apply to demandable notes. *See infra* notes 162–77 and accompanying text.

The drafters of the U.C.C. and all of the state legislatures that adopted the U.C.C. have decided, evidently, that the holder's freedom to negotiate broad discretion to accelerate is trumped by the borrower's interest in relying on the availability of the loan proceeds unless its credit worthiness deteriorates.[154] What is it about a demand note that changes this analysis? How should courts balance the interests of the borrower and the lender? In the commercial lending context, an analysis based on the assumption that an obligation to act in good faith does not apply—purportedly because the holder of a demand note does not exercise any discretion or take any action to mature the note since the note is always due and payable from the moment it is executed—is a dangerous fiction.[155] Legally, in the case of a demandable note this analysis is technically incorrect since such a note requires the holder to make an actual demand before the note matures,[156] but even in the case of a pure/traditional demand note this "mature note" analysis is incorrect.[157] The holder of a demand note—pure/traditional or demandable—always exercises discretion in deciding when to demand payment.[158] In some contexts, however, for example a check, this analysis does not create significant problems.[159] The nature of a check is such that the funds to pay the check are always in liquid form and are required to be available at the time the check is written out.[160] Thus, allowing the holder of a check to demand payment at any time does not create an unfair burden for the drawer. The commercial lending context, however, is very different and requires different rules.[161]

154. Whether the holder may accelerate pursuant to more specific events of default without having to show that it believes in good faith that the prospect of payment or performance has been impaired is unclear. *See* Nation, *Recognition*, *supra* note 7, at n.36.

155. *See supra* notes 85–89 and accompanying text.

156. *See supra* notes 127–40 and accompanying text.

157. *See supra* notes 68–72 and accompanying text.

158. *See supra* note 72.

159. *See* U.C.C. § 3-104(f) (2002).

160. If the funds are not available in the account when the check is written, then the drawer may be liable for check fraud. *See generally* Thomas E. McCurnin & Peter A. Frandsen, *Grounding Check Kiting with Check 21: The Civil and Criminal Ramifications of Check Kiting in the 21st Century*, 125 BANKING L.J. 295 (2008) (discussing check kiting, steps banks can take to prevent and discover check kiting, and how to collect loss from the customer or insurance bond); *see also* Office of the Comptroller of the Currency, *Check Fraud: A Guide to Avoiding Losses,* http://www.occ.gov/publications/publications-by-type/other-publications-reports/pub-other-check-fraud.pdf, *archived at* http://perma.unl.edu/4PDR-2XAJ (Feb. 1999).

161. *See supra* note 131 and accompanying text; *infra* notes 162–77 and accompanying text.

D. Achieving Balance

One productive approach that I have written about in the past analyzes the discretion exercised by the holder of a demand note in demanding payment as relating to three separate events:[162] first, the holder's decision to demand payment; second, the actual making/communicating of the demand for payment to the maker; and third, setting the date on which the note must be paid.[163] The advantage of this approach is that it allows for balancing the interests of both the borrower and the lender.[164] The lender's right to demand payment at any time and for any reason is preserved, and as a result, the real distinction between time and demand type notes is preserved.[165] However, the holder must make its demand to the borrower in good faith, and more importantly must set the repayment date in good faith.[166]

In some cases it may be consistent with the observance of reasonable commercial standards of fair dealing to set the repayment date on the day immediately following the holder's demand for payment.[167] However, this would usually not be the case in the commercial lending context.[168] Setting repayment terms in good faith in the commercial lending context would typically require that the maker be given a reasonable time to arrange refinancing.[169] This makes sense given that most commercial borrowers plan an illiquid use of the loan proceeds.[170] That is, in order for a commercial borrower/maker to pay the note in response to a demand for payment the borrower must arrange refinancing from another lender.[171] Thus, to be fair to the borrower, the borrower must be given the opportunity to refinance, and to be fair to the holder, the holder must have the right to "call the note"—that is, start the clock running on the refinance time—at any time and for

162. *See* Nation, *Demand Notes*, *supra* note 104, at 395–400; Nation, *Recognition*, *supra* note 7, at 77–83.

163. *See* Nation, *Demand Notes*, *supra* note 104, at 395–400; Nation, *Recognition*, *supra* note 7, at 77–83.

164. The holder's right to demand payment for any reason is preserved and the borrower will have a reasonable time to arrange refinancing in order to pay pursuant to the holder's demand.

165. *See* Nation, *Demand Notes*, *supra* note 104, at 395–400; Nation, *Recognition*, *supra* note 7, at 77–83.

166. *See* Nation, *Demand Notes*, *supra* note 104, at 395–400; Nation, *Recognition*, *supra* note 7, at 77–83.

167. *See, e.g.*, checks under U.C.C. § 3-104(f) (2002); *see also supra* notes 159–61.

168. *See supra* note 131.

169. *See* Nation, *Demand Notes*, *supra* note 104, at 395–400; Nation, *Recognition*, *supra* note 7, at 77–83.

170. *See supra* note 131.

171. *See* Nation, *Demand Notes*, *supra* note 104, at 395–400.

any reason.[172] However, it is important to note that this reasonable refinance time would be based on the time necessary for the borrower to arrange refinancing assuming the borrower is financially healthy, or at least as financially healthy as the borrower was when the loan originated.[173]

Under this analysis, since there will usually be a gap of time between when demand for payment is made and when payment is due, the note will essentially become a time note for the period after demand for payment is made, but before payment becomes due.[174] Therefore, all of those provisions that would be relevant to a time note, including an acceleration provision, would also be relevant in a demand note used in the commercial lending context under this analysis.[175] For example, a Section 3-108(c) note could be called—meaning the holder could make demand for payment at any time—but the note would not become due and payable until the expiration of a reasonable refinance time. During this refinance time the holder would need to be protected from a possible deterioration in the borrower's credit worthiness.[176] As a result, a typical acceleration provision and event of default definition would be necessary to protect the lender during this period of time.[177]

It is also important to note that under this analysis Section 1-309 is not being applied to demand notes. The holder of a demand-type note would not have to wait until the prospect of payment or performance of the note was impaired in order to call the note. However, the holder would be required to give the maker a reasonable time, refinance time, to respond to the demand for payment.

I would encourage the drafters of the U.C.C. to strongly consider revising Article 3 to provide that the holder of a demand-type promissory note may make a demand for payment at any time and for any reason, including reasons unrelated to the maker's ability to pay. However, such a demand for payment must be made in a commercially reasonable manner, and if the promissory note was given in exchange for a loan of money for a commercial purpose, then the maker must be

172. *Id.* at 398–99 ("[T]he holder's decision to demand payment is not subject to an obligation to act in good faith. However, the holder of either a demand or a demandable note should be subject to an obligation of good faith in setting the repayment terms for the note.").

173. *See* Nation, *Recognition*, *supra* note 7, at 72 ("The borrower may agree to a demand-type instrument as long as the borrower is given enough time (between the lender's demand and the borrower's obligation to pay) to arrange refinancing.").

174. *See, e.g.*, Nation, *Recognition*, *supra* note 7, at 74 (providing suggested repayment provisions for a demandable note, which include an acceleration clause).

175. *Id.*

176. *See generally supra* notes 108–27 and accompanying text (discussing acceleration clauses).

177. *See* Nation, *Recognition*, supra note 174, at 73–74.

given a reasonable time to make payment in response to the holder's demand for payment. Further, what constitutes a reasonable time shall be determined in accordance with the time necessary for the borrower, if financially healthy, to arrange refinancing of the debt represented by the note.

E. Freedom of Contract

The principle of freedom of contract stands for the idea that competent parties should be free to enter into whatever bargains they desire and on whatever terms they desire within the broad parameters established by the legal system.[178] These broad parameters include, *inter alia*, the requirement that the bargain entered into have a legal object and that there be no misrepresentation, duress, undue influence, or mistake in the contract formation process.[179] In addition, the doctrine of freedom of contract stands for the idea that a court's job is to enforce the parties' agreement as long as it falls within the parameters mentioned above, regardless of whether the court believes the agreement is wise or unwise, a good deal or a bad one.[180] The court's role is not to approve or improve the contract; it is to enforce the contract the parties created.[181]

How is it possible to square the doctrine of freedom of contract with the above interpretation of demand notes? Again, *Reger* is a good example to consider. As the Seventh Circuit noted in its opinion, the language used by National City made clear that the note created a demand-type obligation.[182] The note said it was payable "on demand."[183] Further, the note explicitly stated that the borrower "will pay this loan in full immediately upon Lender's demand."[184] Finally, there was the statement in prominent, capital letters, as noted, stating that: "NOTWITHSTANDING ANY PROVISION OR INFERENCE TO THE CONTRARY, LENDER SHALL HAVE NO OBLIGATION TO EXTEND ANY CREDIT TO OR FOR THE ACCOUNT OF BORROWER BY REASON OF THIS NOTE."[185] I argue that the plain

178. *See* JOHN D. CALAMARI & JOSEPH M. PERILLO, THE LAW OF CONTRACTS § 1-3 at 5 (2d ed. 1977) (asserting freedom of contract is "a basic principle" of the legal system); U.C.C. § 1-302 (2001) (stating parties may, except as otherwise provided, vary provisions by agreement).
179. *See* RESTATEMENT (SECOND) OF CONTRACTS ch. 6 (1981) (Mistake); *id.* ch. 7 (Misrepresentation, Duress and Undue Influence); *id.* ch. 8 (Unenforceability on Grounds of Public Policy).
180. *See* CALAMARI & PERILLO, *supra* note 178, § 1-3 at 4–6 (stating that parties' power to contract as they please for lawful purposes remains a basic principle of our legal system).
181. *Id.*
182. Reger Dev., LLC v. Nat'l City Bank, 592 F.3d 759, 765 (7th Cir. 2010).
183. *Id.* at 762.
184. *Id.*
185. *Id.*

meaning of some of this language is overcome because it is inconsistent with other language in the note, as discussed *infra*,[186] and because it is inconsistent with the nature of commercial lending[187] and the course of dealing between the parties.[188] As a result, I argue that National City could have called the loan at any time and for any reason, but unless the bank in good faith believed that the prospect of payment or performance had been impaired, the bank would have been required to allow Reger Development a reasonable time to arrange refinancing before the loan would become due and payable.[189]

Freedom of contract is not absolute[190] and there have always been limits placed on this freedom.[191] Moreover, freedom of contract is not the only important principle of contract law. Protecting the commercially reasonable expectations of the parties is also important, which is reflected in the general requirement that all contracting parties must exercise discretion in good faith.[192] The ultimate goal behind the doctrine of freedom of contract and the doctrine of good faith is to protect the commercially reasonable expectations of the parties.[193] While the parties' expectations are usually consistent with their written contract, in some instances the expectations of the parties are inconsistent with their written contract.[194] This situation most commonly occurs when the actual parties entering into the contract, for example the loan officer and borrower, have not themselves drafted, read, and understood the terms of the written contract.[195]

186. *See infra* notes 236–302 and accompanying text.
187. *See supra* note 131.
188. *See, e.g.*, *Reger*, 592 F.3d. at 762 (explaining National City had lent money to Reger for several previous projects).
189. *See infra* notes 216–30 and accompanying text.
190. *See* Restatement (Second) of Contracts ch. 6 (1981) (Mistake); *id.* ch. 7 (Misrepresentation, Duress and Undue Influence); *id.* ch. 8 (Unenforceability on Grounds of Public Policy); *see, e.g.*, U.C.C. § 1-302 (2001) (freedom of contract subject to specific exclusions).
191. *See* Restatement (Second) of Contracts ch. 6 (Mistake); *id.* ch. 7 (Misrepresentation, Duress and Undue Influence); *id.* ch. 8 (Unenforceability on Grounds of Public Policy).
192. *See* sources cited *supra* notes 64–65.
193. The U.C.C. defines good faith as "honesty in fact and the observance of reasonable commercial standards of fair dealing." U.C.C. § 1-201(20) (2001). This definition is in part objective and is intended to protect the reasonable expectations of the parties. *Id.* cmt. 20 (noting that this standard is concerned with fairness of conduct).
194. *See, e.g.*, cases discussed *supra* note 131. For example, in *Reid v. Key Bank of S. Me., Inc.*, 821 F.2d 9 (1st Cir. 1987), the note stated that it was payable on demand but also contained an acceleration clause. The court concluded the note was a time note and could be called only if the holder in good faith believed the prospect of payment or performance had been impaired. *Id.* at 13–15. *Reid* is discussed *infra* notes 257–78 and accompanying text.
195. *See, e.g.*, Reger Dev., LLC v. Nat'l City Bank, 592 F.3d 759, 762–63 (7th Cir. 2010) (noting that borrower expressed surprise at lender's actions and loan office

The use of demand notes to document commercial loans often represents just such a situation.[196]

A lender may legitimately desire the ability to call a loan at any time and for reasons unrelated to the borrower's ability to repay.[197] In this case the bank may desire the right to call the loan, even though it was not concerned about the prospect of repayment.[198] Moreover, in some cases the bank may need repayment very quickly and therefore desire the right to receive payment immediately upon demand.[199] The question is not whether contracting parties in general should have the freedom to agree to such terms—they should.[200] The question is: What is necessary to create such an agreement? I argue here that in the commercial lending context, the phrase "payable on demand" gives the holder the right to decide to demand payment at any time and for any reason, but the holder/lender must give the maker/borrower a reasonable time to respond to the demand for payment.[201] In essence, the phrase "payable on demand" gives the holder/lender the right to start the clock running on the maker/borrower's reasonable time to respond to the demand—the refinance time—at any time and for any reason, but it is not sufficient to give the holder/lender the right to make the loan immediately due and payable upon demand.[202] As noted above, the phrase "payable on demand" may, in the appropriate context, create a demand-type obligation that would become due and payable immediately upon demand for payment, but this will rarely, if ever, be the case in the commercial lending context.[203]

The commercial lending context, as noted, typically contemplates that the borrower will use the funds in a manner that makes them illiquid.[204] That is, it would be very difficult if not impossible for the borrower to immediately repay the loan once the borrower has in-

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stated the form documents were nonnegotiable); *see also*, Nation, *Demand Notes*, *supra* note 104, at 391–95 (noting that lenders often use their superior bargaining power to include a demand repayment provision to try to "have it both ways" by creating specific repayment dates to please the borrower, but retaining the enforcement flexibility of a demand obligation).

196. *See* Nation, *Demand Notes*, *supra* note 104, at 392–94 ("The use of demand notes in commercial lending is illogical because most borrowers plan an illiquid use of the loan proceeds and could not repay the loan on short notice, let alone with no notice.").

197. *See* Nation, *Demand Notes*, supra note 104, at 391 (noting that a lender may have internal reasons unrelated to the borrower's financial health for calling the loan).

198. *Id.*

199. *Id.*

200. *See* sources cited *supra* note 178.

201. *See infra* notes 216–29 and accompanying text.

202. *See infra* notes 221–27 and accompanying text.

203. *See, e.g.*, *supra* notes 159–60 (discussing checks, which are demand instruments by definition).

204. *See* Nation, *Demand Notes*, *supra* note 104, at 392–94.

vested the loan proceeds.[205] The unthinking, rote application of the doctrine of freedom of contract would suggest no sympathy for the borrower since the borrower did not spell out in the agreement what it needed—that the borrower should have insisted on a time note. Nevertheless, both the lender and the borrower know that the borrower cannot pay immediately upon demand.[206] Further, Section 1-309 recognizes that, in the context of acceleration, there should be a limitation on the lender's ability to exercise its discretion in a way that obviously and predictably disadvantages the borrower;[207] I argue by analogy that the law should recognize a similar limitation in the context of demanding payment of a demand note.[208] Moreover, this is clearly consistent with the general obligation of good faith imposed by both the common law and the U.C.C.[209] However, it is important to note that I am not arguing for the application of a Section 1-309 limitation to the holders of demand notes. That is, I am not asserting that the holder of a demand note must in good faith believe that the prospect of payment has become impaired before he or she may call the note.[210] Quite the contrary, I am arguing that the holder of a demand note is specifically not subject to that limitation; the holder may demand payment at any time and for any reason, but the note will not mature immediately upon the making of a demand for payment, at least not in the commercial lending context.[211]

There has always been a limit to what the terms of a contract can accomplish under the law.[212] For example, assume that a contract labeled "Sales Agreement" is entered into in connection with a buyer's offer to purchase a car and that the contract contains a provision stating the following:

> Notwithstanding any other provision contained herein, including buyer's payment of the purchase price, the seller has no obligation to deliver the car, to transfer title to the car to the buyer, or to deliver possession of the car to the buyer, and further, if seller does deliver the car to the buyer the seller has the right to regain possession of the car, at buyer's expense, at any time.

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205. *Id.*
206. *Id*. at 393 n.54 (noting that the purpose for which the borrower is going to use the loan proceeds is a very important aspect of the loan transaction and is discussed by the borrower and lender).
207. *See* U.C.C. § 1-309 (2001) (discussed *infra* at notes 256–67 and accompanying text).
208. *See infra* notes 269–302 and accompanying text.
209. *See supra* notes 65–66, 193 and accompanying text.
210. *See* Nation, *Recognition*, *supra* note 7, at 77 (arguing the specific obligation of good faith found in [Section 1-309] should not apply to any demand-type instrument).
211. *See infra* notes 216–30 and accompanying text.
212. *See, e.g.*, U.C.C. § 1-302 (a)–(b) (2001) (allowing the parties to vary provisions of the U.C.C. by agreement but also limiting that power).

Assume further, as in *Reger*, that the buyer paid $5,000 to the seller at the time of signing the contract.[213] Obviously no court should enforce such a provision. It is completely inconsistent with the transaction it purports to document. The seller may like the provision and argue freedom of contract, but freedom of contract will not save it.[214] The Seventh Circuit held that as long as the buyer, in fact, gets the car, even for a short time, the contract is enforceable.[215] The Seventh Circuit is wrong.

F. Good Faith

The common law of contracts, as well as the U.C.C., create obligations of good faith.[216] For example, Section 1-304 imposes a general obligation of good faith in the performance and enforcement of every contract. In addition, Section 1-309 imposes a specific obligation of good faith on acceleration pursuant to "at will" and other similar non-specific events of default.[217] The U.C.C. defines good faith, for all purposes other than Article 5, as: "[H]onesty in fact and the observance of reasonable commercial standards of fair dealing."[218] The Official Comments make clear that fair dealing is a broad term that must be defined in context and that it is concerned with the fairness of the conduct rather than the care with which the act is performed.[219] Further, Section 1-302 provides that the obligation of good faith may not be disclaimed by agreement of the parties' freedom of contract notwithstanding.[220] Section 1-304 does not create a separate specific obligation, rather it applies to the performance or enforcement of obligations agreed to by the parties.[221]

I argue here that, in the commercial lending context, the commercially reasonable enforcement of the maker's obligation to pay on demand should usually require that the maker be given a reasonable time to respond to the lender's demand for payment before the note becomes due and payable. This interpretation, in the commercial lending context, makes sense for both demand and demandable

213. Reger Development paid a $5,000 closing fee for the line of credit. Reger Dev., LLC v. Nat'l City Bank, 592 F.3d 759, 763 (7th Cir. 2010).

214. *See supra* notes 178–79 and accompanying text.

215. *See Reger*, 592 F.3d at 766 (holding that adequate consideration passed during the transaction because Reger was, in fact, permitted to draw funds under the line).

216. *See supra* notes 64–65 and accompanying text.

217. *See supra* notes 50–54, 70–77 and accompanying text.

218. U.C.C. § 1-201(20) (2001).

219. *See id.* § 1-201(20), cmt. 20.

220. *See id.* § 1-302 (2001); *supra* notes 190–93 and accompanying text.

221. *See id.* § 1-304, cmt. 1; Nation, *Recognition*, *supra* note 7, at 56–57 n.21.

notes.[222] Even in the case of a traditional/pure demand note, the holder clearly exercises discretion when demanding payment of the note and when taking enforcement action, thus the obligation of good faith should apply to the performance of that conduct notwithstanding the legal fiction that a demand note is mature from the moment it is signed.[223] Applying this interpretation to both demand and demandable notes properly recognizes the fundamental distinction between time- and demand-type instruments by preserving, in the case of demand-type instruments, the holder's/lender's ability to call the loan at any time and for any reason.[224] That is, the lender may start the clock running on the reasonable time that the maker has to respond to the demand for payment at any time the lender desires.[225] The maker's reasonable expectations are protected because the maker will be given a reasonable time to arrange refinancing when the lender/holder demands payment.[226] Unless the lender in good faith believes that the prospect of payment or performance has become impaired, the note will not become immediately due and payable upon the holder's/lender's demand for payment.[227]

Under this interpretation any demand-type note would become, in fact, a time note once demand for payment was made, and would contain provisions such as an acceleration clause that are commonly found in time instruments.[228] Thus, for example, a U.C.C. Section 3-108(c) note would have three possible maturities: first, if everything went as planned it would become payable on the specific repayment dates included; second, if the holder desired repayment for reasons unrelated to the makers ability to pay the note it would become due and payable a reasonable time after the holder demanded payment; and finally, if the maker's ability to repay the loan deteriorated to the point that the holder in good faith believed that the prospect of payment or performance had become impaired or if a specific event of default occurred, the note would become immediately due and payable via acceleration.[229] Under the U.C.C. the parties are not permitted to disclaim the obligation of good faith, but they are permitted to define

222. The application of the general obligation of good faith to pure demand notes has been strengthened by the U.C.C. drafters' revision of former Section 3-122(1)(b), which provided that a demand note was mature on its date or date of issue for statute of limitations purposes. Today, Section 3-118, does not state when a cause of action accrues and thus avoids the extraneous issues associated with former Section 3-122(1)(b). U.C.C. § 3-118 (2002).
223. *Id.*
224. *See* Nation, *Demand Notes*, *supra* note 104, at 395–400.
225. *Id.*
226. *See supra* notes 162–77 and accompanying text.
227. *See supra* notes 162–77 and accompanying text.
228. *See supra* notes 173–77 and accompanying text.
229. *See, e.g.*, Nation, *Recognition*, *supra* note 7, at 78–79 (suggesting repayment provision for a demandable note).

it as long as their definition is not manifestly unreasonable.[230] Thus, the parties should define a reasonable refinance time in the note, and the courts should enforce such definition as long as it is, in fact, reasonable.

G. Negotiability

One issue that may arise concerning demand-type instruments and the interpretation I argue for here is how this interpretation affects the negotiability of these instruments. To be negotiable an instrument must be payable on demand or at a definite time.[231] Under the interpretation here asserted, demand notes used in commercial lending would not be payable until a reasonable time after demand for payment is made by the holder.[232] For a Section 3-108(c) demand note, this interpretation does not impair certainty of time of payment because the maximum term of the loan is stated and thus it is no different with respect to time of payment than a time note subject to acceleration.[233] In the case of a note that says only that it is payable on demand, an argument could be made that under the analysis argued for here the time of payment (being a reasonable time after the demand for payment is made) is uncertain, and therefore the instrument is not negotiable.[234] However, an argument could also be made that this amount of uncertainty is tolerable because it results from the application of the general obligation of good faith that applies throughout Article 3.[235] In any event, if negotiability is important to the parties, they should specifically define a reasonable time in the instrument or use a Section 3-108(c)-type note that provides for a definite due date unless demand for payment is sooner made.

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230. *See supra* notes 190–93, 220–21 and accompanying text.
231. U.C.C. § 3-104(a)(2) (2002).
232. *See supra* notes 162–78 and accompanying text.
233. *See* U.C.C. § 3-108 cmt. (2002) (providing that if a definite time limit is stated, negotiability is unaffected).
234. Generally, the time of payment is considered definite so long as the latest date when the holder may seek payment is clearly stated, even though the note may become payable sooner under the circumstances. However, under the interpretation argued for here, the later date is somewhat uncertain because it will be a reasonable time after the holder demands payment. If the parties agree to set a later date for payment, the note should be considered payable at a definite time. For example, if the note provides, "This note shall become due and payable no later than 120 days after the holder's demand for payment," the note would be payable at a definite time.
235. The general obligation of good faith, which applies throughout the U.C.C., should not apply to the setting of the repayment date because the note is clearly payable on demand.

IV. SEVENTH CIRCUIT'S ANALYSIS

The Seventh Circuit Court of Appeals upheld the district court's dismissal of Reger Development's complaint for failure to state a claim.[236] The court found the main question in the case to be whether the note signed by Reger Development entitled the lender, National City, to demand payment from Reger Development at will.[237] However, this was not the real issue in the case because both a pure/traditional demand note and a demandable note allow the holder to demand payment at any time.[238] The real issue was whether the note in that case, a demandable note, matures immediately upon a demand for payment, or whether the general obligation of good faith requires that the maker be given a reasonable time to respond to the demand before the note matures. Based on the court's examination of the note, and accepting as true the allegations contained in the complaint, the court found that National City did indeed have the right, unfettered by any good-faith obligation, to demand payment at any time for any reason—good or bad, arbitrary or capricious.[239] This conclusion, while accurate, does not answer the relevant question in the case, which is whether the note matures immediately upon the making of a demand or whether the obligation to act in good faith requires the holder to give the maker a reasonable time to respond to the demand before the note matures. The court confused the holder's right to demand payment at any time with the issue of whether the note matures immediately upon the making of a demand for payment. As a result, the court ultimately concluded, without ever focusing directly on the later issue, that: "[V]iewed as a whole in a light most favorable to Reger Development, the note before us is plainly a demand instrument entitling National City to collect its loan whenever it wants."[240] Under the broad standard applied to motions to dismiss for failure to state a claim, the court incorrectly held that Reger Development's complaint failed to state a claim for relief that was plausible on its face.[241] As a result, Reger Development never had the opportunity to present its case.

The court's confusion regarding demand and demandable notes played an important part in the court's erroneous conclusions. The court's reasoning is based on the questionable, if not erroneous, traditional analysis of a pure/traditional demand note, which indulges a legal fiction that considers the note due from the moment it is

236. Reger Dev., LLC v. Nat'l City Bank, 592 F.3d 759, 767 (7th Cir. 2010).
237. *Id.* at 762.
238. *See supra* notes 217–30 and accompanying text.
239. *See Reger*, 592 F.3d at 766.
240. *Id.*
241. *Id.* at 767.

signed.[242] However, the note signed by Reger Development is clearly a demandable note because it requires an actual demand by the holder in order to become mature,[243] and as a result, even under traditional analysis the *Reger* note did not become due upon signing, but required National City to make an actual demand for payment before the note became due.[244]

The court's mistake is evident, for example, in its discussion of the obligation to act in good faith. The court noted that under Illinois law, a covenant of fair dealing and good faith is implied into every contract, but concluded that the duty to act in good faith does not apply to a lender seeking payment on a demand note.[245] This conclusion is, at best, accurate with regard to a pure/traditional demand note under the traditional analysis discussed *supra*,[246] but is not true with respect to a demandable note.[247] As noted, the traditional analysis of pure/traditional demand notes indulges a legal fiction that a pure/traditional demand note is due from the moment it is signed by the maker.[248] As a result of this legal fiction, the holder of such a note does not technically need to take any action to mature the note—it is already mature. Thus, in the case of a pure/traditional demand note, the holder, at least theoretically,[249] exercises no discretion to which the obligation to act in good faith may be applied. This is not, however, the case with a demandable note; demandable notes do not, even under the traditional analysis, become due and payable until the holder makes an actual demand for payment.[250] For demandable notes, the holder exercises discretion when making an actual demand for payment.[251]

The general obligation to act in good faith found at common law and under U.C.C. Section 1-304 is designed to ensure that contracting parties exercise discretion with honesty and in a commercially reason-

242. *See supra* notes 85–129 and accompanying text.

243. *Reger*, 592 F.3d. at 762 (the note states, "Lender shall have given Borrower notice of demand for payment thereof . . . ").

244. *Id.* at 765–66; s*ee also supra* notes 130–40 and accompanying text (discussing the fundamental nature of demand obligations).

245. *Reger*, 592 F.3d at 764.

246. *See supra* notes 85–129 and accompanying text.

247. *See supra* notes 130–40 and accompanying text.

248. *See supra* notes 85–129 and accompanying text.

249. *See* Nation, *Recognition*, *supra* note 7, at 56 ("[G]ood faith is not an issue as there is no duty or act to which the obligation to act in good faith could be applied."); *cf. id.* at n.21 (arguing that the obligation of good faith should apply to demand notes).

250. *See* Nation, *Recognition*, *supra* note 7, at 62 ("[D]emandable notes require an actual demand for payment by the holder prior to maturity, and demand notes do not." (footnote omitted)).

251. *See supra* notes 162–77 and accompanying text.

able manner.[252] There is another obligation of good faith under U.C.C. Section 1-309 that applies only to the exercise of discretion under an acceleration clause.[253] This specific obligation of good faith is not applicable to either pure/traditional demand notes or to demandable notes because the holders of these instruments may decide to demand payment at any time and for any reason.[254] That is, demand-type instruments (pure/traditional demand notes and demandable notes) represent obligations whose very nature permits demand for payment to be made at any time and for any reason.[255] However, the fact that the specific obligation of good faith under Section 1-309 is not applicable to demandable notes does not mean that the general obligation to act in good faith under Section 1-304 does not apply to demandable notes.[256]

The court's confusion is further illustrated in its discussion of good faith where it incorrectly cited cases discussing pure/traditional demand notes, rather than demandable notes, and cited cases discussing the specific obligation of good faith under Section 1-309, rather than the general good faith obligation under Section 1-304. For example, the court cited *N.W.I. International Inc. v. Edgewood Bank*[257] for the position that while Illinois law generally holds that "a covenant of fair dealing and good faith is implied into every contract . . . the duty to act in good faith does not apply to lenders seeking payment on demand notes."[258] The *Edgewood* court stated, in the context of reviewing jury instructions: "[I]f, with proper instructions, the note was found to be a demand instrument . . . there would be no 'good-faith' issues."[259] The *Edgewood* court cited *Shawmut Bank, N.A. v. Miller*[260] in support of this statement.[261] But *Edgewood's* citation to *Shawmut* makes clear that *Edgewood's* statement is in reference to pure/traditional demand notes and not demandable notes, as the following quotes from the *Shawmut* decision explain:

252. *See supra* notes 216–30 and accompanying text.
253. *See supra* notes 216–30 and accompanying text.
254. *See* Nation, *Recognition*, *supra* note 7, at 61–62 ("The interpretation universally associated with the 'payable on demand' language is that the holder has the right to unilaterally determine the time for payment. . . . Holders of demand notes can do this because they can maintain suit on the instrument from its moment of issue. While holders of demandable notes . . . can initiate at any time and for any reason a process that will culminate in maturity and their right to maintain suit on the instrument." (footnotes omitted)); *supra* notes 216–30 and accompanying text.
255. Nation, *Recognition*, *supra* note 7, at 61.
256. *See supra* notes 216–30 and accompanying text.
257. 684 N.E.2d 401 (Ill. App. Ct. 1997).
258. Reger Dev., LLC v. Nat'l City Bank, 592 F.3d 759, 764 (7th Cir. 2010) (citing *Edgewood*, 684 N.E.2d at 409).
259. *Edgewood*, 684 N.E.2d at 409.
260. 614 N.E.2d 668 (Mass. 1993).
261. *Edgewood*, 684 N.E.2d at 409.

> Not only is the balance due on a traditional [pure] demand note collectible without demand, but also a holder of such a note may determine to collect the balance due for any reason, good or bad. Good faith is not a condition of a holder's decision to collect the amount due on a demand note.[262]

The *Shawmut* Court cited cases from various jurisdictions and concluded with the following: "These opinions reject any claim that [Section 1-309], imposes a duty of good faith in the enforcement of the obligation of a demand note. The Official Comment to [Section 1-309] makes clear that [Section 1-309] was not intended to apply to demand notes."[263] However, this part of the *Shawmut* decision is limited to the specific good faith obligation under Section 1-309 and does not concern the general good faith obligation under Section 1-304.[264]

The court in *Shawmut* noted that the plaintiffs made no claim concerning the general obligation of good faith under Section 1-304: "The Millers do not rely on [U.C.C. Section 1-304], which states a general obligation that '[e]very contract or duty within this chapter imposes an obligation of good faith in its performance or enforcement.'"[265] Although *Shawmut* recognized authority against applying a general obligation of good faith *to the decision* of the holder of a demand note to demand payment, this does not concern the issue of whether the general obligation of good faith applies to the determination of how soon after actual demand for payment the note matures.[266] Further, the court cited a decision from Maine that applied the general obligation of good faith in the context of a demandable note.[267]

It is clear from the opinion in *Shawmut* that the note in that case was a demandable note and not a pure/traditional demand note.[268] In *Reger*, the court discussed how in the court *Reid v. Key Bank*[269] applied the specific obligation of good faith found in Section 1-309 to a note stating that it was payable "on demand" because it found that the note was actually a time note.[270] The *Reid* note provided that it could

262. *Shawmut*, 614 N.E.2d at 669.
263. *Id.* at 670. To again clarify, when *Shawmut* was decided the specific obligation of good faith now found at U.C.C. Section 1-309 instead existed at Section 1-208, and the general obligation of good faith now required by Section 1-304 was found at 1-203. *See supra* note 51 and accompanying text.
264. *Id.*
265. *Id.* at n.7.
266. *Id.*
267. *Id.* (citing Diversified Foods, Inc. v. First Nat'l Bank, 605 A.2d 609, 613 (Me. 1992)).
268. *Id.* at 671 ("The note remained a demand note but due and payable only upon a demand actually being made.").
269. 821 F.2d 9 (1st Cir. 1987).
270. Reger Dev., LLC v. Nat'l City Bank, 592 F.3d 759, 765–66 (7th Cir. 2010); *see also* Bank One, Tex. v. Taylor, 970 F.2d 16, 31–32 (5th Cir. 1992) (finding a note with payable on demand language, when read in conjunction with other provisions in the note or other loan documents, might be payable on demand if the maker defaults in an obligation stated in the loan documents); Simon v. N.H. Sav. Bank,

be called only after a specified date or pursuant to certain events of default.[271] The *Shawmut* court acknowledged that the note in its case also defined events of default, but in contrast to *Reid,* the *Shawmut* court expressly stated that those provisions do not change its "demand" nature.[272] Thus, the *Shawmut* note was not a time note, as was the case in *Reid*, and as a result the specific obligation of good faith under Section 1-309 did not apply. The *Shawmut* note defined events of default, and upon the occurrence of one of these events the note would become immediately due and payable either automatically or at the option of the holder.[273] Thus, unlike a pure/traditional demand note, this note was not due and payable from the moment it was signed. Rather, it would become due and payable as a result of an actual demand being made by the holder or as a result of the occurrence of one of the listed events of default.[274]

Both *Shawmut* and *Edgewood* stand for the proposition that the specific obligation of good faith contained in Section 1-309 applies only to time notes.[275] Further, these decisions also stand for the proposition that the general obligation of good faith under Section 1-304 does not apply to a holder's decision to demand payment of either a pure/traditional demand note or a demandable note.[276] In other words, the very nature of demand instruments, either pure/traditional or demandable, allows the holder to decide to demand payment for any reason and at any time. It does not follow, however, that the note must be paid immediately upon demand, especially in regards to a demandable note.[277] Neither case stands for the proposition that the general obligation of good faith does not apply to the way in which the holder makes the required actual demand for payment or to the holder's setting of the terms of repayment.[278]

296 A.2d 913, 918 (N.J. 1972) (finding provision explicitly preserving right to demand payment at any time prevented provisions for installment payments of debt from converting demand note to installment note).

271. *Reid*, 821 F.2d at 13–14.

272. *Shawmut*, 614 N.E.2d at 671.

273. *Id.*

274. *Id.* ("We, therefore, give effect to this supplemental language, and conclude that the note was due and payable only on demand, unless one of the stated conditions obviating demand were to occur.").

275. *Id.* at 670 ("These opinions reject any claim that [Section 1-309] imposes a duty of good faith in the enforcement of the obligation of a demand note.").

276. *Id.* at 671 ("The parties made no agreement, however, that modified the general rule that good faith is not an essential element of a holder's decision to demand payment of the amount due on a demand note.").

277. *Id.* at n.9 ("When the bank demanded payment of the obligation represented by the note, it . . . stated the time within which [the maker] had to arrange to pay the debt or to provide a reasonable plan to repay the debt.").

278. *Id.* at 672 ("The summary judgment record is barren of any evidence tending to show the bank's post-demand bad faith in the fixing of, and insisting on, the terms under which the bank required payment of the [maker's] obligation under

The Seventh Circuit's confusion is also illustrated by its reference to the Official Comments to U.C.C. Section 1-309.[279] The Official Comments state that "[t]his section applies only to an obligation of payment or performance which in the first instance is due at a future date."[280] Clearly, the specific obligation of good faith contained in Section 1-309 is not applicable to either a pure/traditional demand note or to a demandable note.[281] But, the court's reference to the Section 1-309's comments tells us nothing regarding whether the general obligation of good faith found in U.C.C. Section 1-304 applies to a demandable note.[282] Moreover, it is clear from the provisions of the *Reger* note quoted by the court, as well as the court's analysis of various provisions of the note that Reger Development alleged are inconsistent with that of a standard demand note, that the *Reger* note was a demandable note and not a pure/traditional demand note.[283]

For example, in discussing the default interest rate provision that provided for a 3% increase in the rate *after* default and the prepayment clause that allowed the borrower to pay down all or a portion of the note *before it is due*, the court was "not persuaded by the suggestion that these references to due dates and default somehow overpower the repeated, explicit contract language setting forth the lenders right to demand payment at any time."[284] The reason for the court's conclusion is that a bank may create a note that specifies a future payment date that will apply unless a demand for payment, *an actual demand for payment*, is sooner made.[285] The court was clearly describing a demandable note.[286]

Moreover, based on the language from the *Reger* note quoted by the court, the note was undoubtedly a demandable note and not a pure/traditional demand note. The court quoted the following provisions from the note:

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the note. We, therefore, need not consider whether good faith is a necessary element of the setting of the terms of a demand for payment when dealing with a demand note having the special qualities the note [being a demandable note] in this case.").

279. Reger Dev., LLC v. Nat'l City Bank, 592 F.3d 759, 764 (7th Cir. 2010).

280. U.C.C. § 1-309, cmt. 1 (2001).

281. *See supra* note 275.

282. *See supra* notes 216–30 and accompanying text.

283. *Reger*, 592 F.3d at 765.

284. *Id.*

285. *Id.* ("A bank that wishes to call the Note can specify some future date on which it needs payment as a 'due date.'").

286. *See* Shawmut Bank, N.A. v. Miller, 614 N.E.2d. 668, 671 (noting that a "garden variety" traditional/pure demand note becomes due and payable at its inception and no demand is needed to make it due and payable, but if a note's other provisions would be superfluous under this traditional analysis then the court should recognize the parties' right to create a note that only becomes mature when the holder makes an actual demand or certain events occur).

> FAILURE TO PAY ON DEMAND. Notwithstanding any other provision set forth in this Note, if (a) any principal owing under this Note remains unpaid after Lender shall have given Borrow *notice of demand for payment thereof* or after the commencement of any proceeding under any bankruptcy or insolvency laws by or against Borrower or (b) any accrued Interest under this Note remains unpaid after the due date of that Interest, then, and in each such case, all unpaid principal of this Note shall bear Interest at a rate equal to three percent (3%) per annum above the rate that would otherwise be applicable.[287]

This provision clearly required the holder of the note to give the maker/borrower "notice of demand for payment."[288] Thus, this note was plainly a demandable note, and did not become due at the moment the maker signed it.[289] This note would have become due sometime in the future after the holder made an actual demand for payment to the maker.[290] Moreover, the fact that National City could have given notice of demand at any time does not necessarily mean that the note would have become due immediately upon the receipt by Reger Development of the notice of demand.[291] This was clearly the case—despite an earlier provision of the note quoted by the court that said the borrower will pay this loan in full immediately upon lenders demand—because the paragraph quoted above says "*notwithstanding any other provision set forth in this Note*" and therefore takes precedence over the conflicting provision.[292]

Under the "Failure To Pay on Demand" provision set forth above, the note had three possible maturities: first, failure of the maker to pay after appropriate notice of demand had been given; second, upon commencement of any proceeding under any bankruptcy or insolvency laws by or against the borrower; and finally, upon failure of borrower to pay any interest when due.[293] Under the first possible maturity, the phrase "notice of demand" certainly seems to suggest that there would be a period of notice, that is, a period of time between the making of the demand for payment and the maturity of the note.[294] This suggestion is significantly strengthened by the understanding of the contracting parties and by their course of dealing.[295] Thus, granting the motion to dismiss was clearly inappropriate.

The court's ultimate conclusion in this case is surprising given the fact that, in its opinion, the court recognized the idea that specific

287. *Reger*, 592 F.3d at 762 (emphasis added).
288. *Id.*
289. *See supra* note 286.
290. *See supra* note 286.
291. *Cf. Shawmut*, 614 N.E.2d at 671 n.9 (stating that the bank gave the borrower more time to pay the debt).
292. *Reger*, 592 F.3d at 762 (emphasis added).
293. *Id.*
294. *Cf. supra* text accompanying notes 277–78.
295. *Reger*, 592 F.3d at 763 (stating the borrower "expressed surprise" at the bank's actions).

events of default may neuter contractual language describing a loan as payable on demand.[296] The court noted that cases from other jurisdictions (*Reid*, for example) have addressed instruments with provisions that look out of place in a demand note and those courts have concluded that such notes are not demand notes.[297] However, the court incorrectly assumed that the only impact of language inconsistent with a pure/traditional demand note is that it may cause the note to be treated as a time note.[298] The court failed to appreciate the significant difference between a demand note and a demandable note.[299] Thus, the only provision that seems to have been relevant to the *Reger* court in this connection was an acceleration clause. The court stated that the *Reger* note did not contain an acceleration clause and therefore dismissed the significance of the provisions of the note that are inconsistent with a pure/traditional demand note, and further ignored the fact that the context and the course of dealing between the parties were also inconsistent with a pure/traditional demand note.[300] Finally, the court failed to recognize that the *Reger* note did contain at least the semblance of an acceleration clause.[301] That is, based on the paragraph quoted above, it would seem that this note would have become instantly mature upon the commencement of any insolvency or bankruptcy proceedings by or against the maker, even in the absence of a demand for payment by the holder, and perhaps immediately upon the failure of the maker to make timely interest payments.[302] In the end, the court's analysis is confused, erroneous, and very surprising—especially coming in the context of a dismissal for failure to state a claim.

Finally, the court's analysis regarding the illusory nature of the agreement is also in error. The court stated that a peppercorn may be considered sufficient consideration to support a contract in a court of law; a true, but irrelevant statement.[303] The important issue in the instant case was that at the time the loan documents were signed, Reger Development did not even receive a peppercorn from National City if the language "NOTWITHSTANDING ANY PROVISION OR INFERENCE TO THE CONTRARY, LENDER SHALL HAVE NO OBLIGATION TO EXTEND ANY CREDIT TO OR FOR THE ACCOUNTANT BORROWER BY REASON OF THIS NOTE" was applied as written.[304] Reger Development received exactly nothing. As

296. *Id.* at 765.
297. *Id.* at 765–66.
298. *Id.*
299. *Cf*. Shawmut Bank, N.A. v. Miller, 614 N.E.2d 668, 671; *supra* note 286.
300. *Reger*, 592 F.3d at 765–66.
301. *Id.* at 765.
302. *See supra* note 287 and accompanying text.
303. *Reger*, 592 F.3d at 766.
304. *Id.* at 762.

a result, at the time the loan documents were signed there was no consideration and therefore no contract was created.[305] The court correctly reasoned that once the loan was funded a contract existed between the parties, but that contract was implied-in-fact and based on the actions of the parties and not on the written loan documents.[306] That is, the reasonable interpretation of the parties' conduct (i.e., National City giving money to Reger Development) is that National City made a loan to Reger Development.[307] However, under this analysis, the issue became what the terms of this implied contract were—an issue the court completely missed. The terms of the contract are determined by the agreement between the parties at the time of contracting, so in this case when National City actually gave funds to Reger Development. Thus, the loan documents represent only one source of relevant information for determining the agreement of the parties. Other, perhaps more relevant sources of information would include the understanding of the parties *at the time the loan was actually funded*, which would be determined in part by objective factors such as the parties' understanding of the borrower's use of the loan proceeds and the parties' prior course of dealing.[308] Moreover, the principles underlying the obligation of good faith—the observance of reasonable commercial standards of fair dealing—would also be relevant in determining the terms of the parties implied contract.[309] Again, the court's decision to grant the lender's motion to dismiss in this case was clearly in error.

V. CONCLUSION

Commercial borrowers often invest loan proceeds in such a way that the funds are no longer liquid and cannot quickly be returned to a cash state.[310] Because of this, the needs of commercial borrowers are often fundamentally at odds with the traditional legal interpretation of demand notes that indulges the legal fiction that such notes are due from the moment they are signed.[311] As a result, when a demand note is used to document a commercial loan there is often a pervasive disconnect between the needs of the borrower and the traditional legal interpretation of demand notes.[312] I argue here that this misunderstanding does not occur between the actual negotiating parties—the

305. *See* RESTATEMENT (SECOND) CONTRACTS § 77 (1981) (Illusory and Alternative Promises).
306. *Id.* § 19 (Conduct as Manifestation of Assent).
307. *Id.* § 202 (Rules in Aid of Interpretation).
308. *Id.*
309. *Id.* § 205 (Duty of Good Faith and Fair Dealing); *see supra* at notes 216–30 and accompanying text.
310. *See supra* note 11 and accompanying text.
311. *See supra* notes 12–15 and accompanying text.
312. *See supra* notes 68–78 and accompanying text.

loan officer and the borrower—rather, the disconnect results from the drafting efforts of lenders' counsel and in fact is most likely to occur, in my experience, when lenders' form documents are used to document a loan.[313]

The *Reger* case is a good example of this phenomenon. In that case, the borrower, a real estate developer (funds invested in real estate development cannot be easily returned to cash before the project's completion), signed a demand note, promised to pay, and paid a $5,000 closing fee notwithstanding language in the documents that said the lender had no obligation to make any loan of any kind for any reason whatsoever to the borrower.[314] In *Reger*, the bank's form documents simply do not make sense in the context of the underlying transaction.[315] Moreover, this is usually the case when a demand note is used to document a commercial loan, and the traditional interpretation of demand notes is applied by a court to determine the rights and obligations of the parties.[316] I argue here that when a court is faced with such a situation, Article 3 provides the tools necessary for the court to adopt a reasonable interpretation of demand-type notes that protects the interests of both the lender and the borrower.[317]

First, Section 1-304 imposes a general obligation of good faith on the performance and enforcement of every contract under the U.C.C.[318] Article 1 also defines good faith as honesty in fact and the observance of reasonable commercial standards of fair dealing.[319] Further, Section 1-302 provides that the parties are free to vary the provisions of the U.C.C. by agreement, except, *inter alia*, the obligation of good faith,[320] while Section 3-117 says:

> [T]he obligation of a party to an instrument to pay the instrument may be modified, supplemented, or nullified by a separate agreement of the obligor and a person entitled to enforce the instrument, if the instrument is issued or the obligation is incurred in reliance on the agreement or as part of the same transaction giving rise to the agreement.[321]

In addition, Article 1 defines "agreement" broadly as "the bargain of the parties in fact as found in their language or inferred from other circumstances."[322] Finally, the use of the phrase "at will" in both Section 3-108(c) and Section 1-309 draws a linkage between demand notes used to document commercial loans and "at will" acceleration

313. *See supra* notes 19–67, 236–309 (discussing Reger Dev., LLC v. Nat'l City Bank, 592 F.3d 759 (7th Cir. 2010)).
314. *See supra* notes 19–33 and accompanying text.
315. *See supra* notes 85–129 and accompanying text.
316. *See supra* notes 70–84 and accompanying text.
317. *See supra* notes 216–30 and accompanying text.
318. *See supra* notes 216–30 and accompanying text.
319. U.C.C. § 1-201(b)(20) (2001).
320. *Id.* § 3-102 (2001); *see supra* notes 190–93 and accompanying text.
321. U.C.C. § 3-117 (2002).
322. U.C.C. § 1-201(b)(3).

clauses, the enforcement of which the U.C.C. restricts to instances where the lender in good faith believes that the prospect of payment or performance has been impaired.[323]

In this Article I argue that courts should use these tools to interpret demand notes used in commercial lending as having at least two, and often three possible maturities.[324] First, a note that simply provides that it is payable on demand could become mature a reasonable time after demand for payment was made by the lender and the lender would be free to make demand for payment at any time, for any reason, and the decision to demand payment would not be subject to any good faith obligation.[325] But such a note would not become immediately due and payable upon demand by the lender unless the lender in good faith believed that the prospect of payment performance had been impaired.[326] Rather, the note would become due and payable a reasonable time after the demand for payment was made.[327] If a Section 3-108(c)-type note is used—one that provides for scheduled payments of principal and interest if no demand is made—then an additional possible maturity would be upon the specific date or dates referred to in the agreement, assuming no prior demand was made and the borrower's creditworthiness had not deteriorated during the life of the loan.[328] I argue that such an interpretation properly balances freedom of contract and good faith, and also protects the reasonable expectations of both the lender and the borrower.[329]

323. *See supra* notes 141–61 and accompanying text.
324. *See supra* notes 162–77 and accompanying text.
325. *See supra* notes 162–65 and accompanying text.
326. *See supra* notes 166–73 and accompanying text.
327. *See supra* notes 166–73 and accompanying text.
328. *See supra* notes 174–77 and accompanying text.
329. *See supra* notes 162–77 and accompanying text.