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Rodney Shkolnick

Creighton University School of Law

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THE NEBRASKA UNIFORM COMMERCIAL CODE:

ARTICLE 3 — COMMERCIAL PAPER.

Rodney Shkolnick*

At midnight on September 1, 1965, the Uniform Commercial Code will become operative in Nebraska. The Code repeals the Nebraska version of the Uniform Negotiable Instruments Law, and Article 3 of the Code will cover the subject of "Commercial Paper." Although Article 3 largely retains the substance of the N.I.L., new language, and sometimes new approaches are apparent. While a section by section treatment of Article 3 is beyond the scope of this paper, we will here attempt to take an overall look at Article 3 with particular attention to those instances wherein the Code changes the law as it existed under the N.I.L., or attempts to settle areas of conflict which had arisen under the N.I.L.

THE SCOPE OF ARTICLE 3.

Article 3 of the Code does not purport to cover all negotiable paper. Section 3-103(1) of the Code specifically excludes money, investment securities and documents of title.¹ The instruments embraced within the provisions of Article 3 are the draft (bill of exchange), the check, the certificate of deposit, and the note.²

FORMAL REQUISITES OF NEGOTIABILITY.

Like the N.I.L., Article 3 of the Code sets forth certain formal requirements which an instrument must meet to be negotiable

*B.A., J.D., State University of Iowa; Member Nebraska and Iowa Bar; Assistant Professor of Law, Creighton University.

¹ Investment Securities are covered by Article 8 and Documents of Title by Article 7. Closely connected with the law of commercial paper is the material embraced in Article 4 of the Code—Bank Deposits and Collections. See, for example, § 4-402 covering a bank's liability for wrongful dishonor; § 4-403 covering stop payment orders and § 4-406 which covers the depositor's duty to examine his returned checks and discover and notify the bank of forged or altered items.

² UNIFORM COMMERCIAL CODE § 3-104 (hereinafter cited as U.C.C.).

³ Comment 1 to the 1958 official text of the Code indicates that Article 3 "leaves open the possibility that some other writings may be made negotiable by other statutes or by judicial decisions."

⁴ U.C.C. § 3-104.

⁵ NEB. REV. STAT. § 62-101 (Reissue 1958).

⁶ U.C.C. §§ 3-105, 3-114.

within Article 3.³ The instrument must be signed by the maker or drawer; contain an unconditional promise or order to pay a sum certain in money; be payable on demand or at a definite time, and be payable to order or to bearer.⁴ These requisites are substantially the same as those set forth in the N.I.L.,⁵ and are elaborated upon by succeeding sections of the Code.⁶

UNCONDITIONAL PROMISE OR ORDER.

In order to be negotiable, the instrument must contain an unconditional promise or order to pay a sum certain in money and "no other promise, order, obligation or power given by the maker or drawer except as authorized by this article."⁷ In connection with this requirement, the Commercial Code, as did the N.I.L.,⁸ distinguishes between notations in instruments which are merely bookkeeping references and notations which have the purpose or effect of conditioning the order or promise to pay upon the existence of a particular fund. Section 3-105(1) (f) provides that an order or promise is not made conditional by the fact that the instrument "indicates a particular account to be debited or any other fund or source from which reimbursement is expected," while section 3-105(2) (b) provides that an order or promise is not unconditional if the instrument "states that it is to be paid only out of a particular fund or source except as provided in this section." The exceptions mentioned in section 3-105(2) (b) refers to subsections which provide that the order or promise is not made conditional by the fact that payment is limited to a particular fund or source if the instrument is issued by a government or governmental agency⁹ or the "... assets of a partnership, unincorporated association, trust or estate by or on behalf of which the instrument is issued."¹⁰

The Code also provides, as did the N.I.L., that references to the transaction giving rise to the instrument, or to separate agreements, or that the obligation is secured, do not destroy the negotiability of the instrument,¹¹ but a promise or order which "states that it is subject to or governed by any other agreement," is not unconditional.¹²

⁷ U.C.C. § 3-104(1) (b). Section 3-112 of the Code contains, among other provisions, a list of powers and obligations which the instrument may contain without affecting its negotiability.

⁸ NEB. REV. STAT. § 62-103 (Reissue 1958).

⁹ U.C.C. § 3-105(1) (g).

¹⁰ U.C.C. § 3-105(1) (h).

¹¹ U.C.C. § 3-105(1).

¹² U.C.C. § 3-105(2) (a).

PAYABLE ON DEMAND OR AT A DEFINITE TIME.

In connection with the requirement that the instrument be payable on demand or at a definite time, the Commercial Code reverses the rule of the N.I.L. that an instrument payable on or at a fixed period after the occurrence of a specified event which is certain to happen though the time of happening be uncertain may be negotiable.¹³ Thus an instrument payable "one day after my death" will no longer be negotiable in Nebraska.¹⁴ The greatest difficulty that the courts had in connection with the requirement that an instrument be payable at a definite time was with instruments which contained acceleration clauses.¹⁵ The Code clarifies this area by providing in subsection 3-109(1) (c) that an instrument is payable at a definite time if it is payable at "a definite time subject to any acceleration," thus making it clear that acceleration has nothing to do with the concept of negotiability.¹⁶ The Commercial Code treats the question of instruments which provide for extensions of the time of payment in a similar fashion. The instrument may provide for payment at a definite time "subject to extension at the option of the holder, or to extension to a further definite time at the option of the maker or acceptor or automatically upon or after a specified act or event."¹⁷

WORDS OF NEGOTIABILITY.

The requirement that the instrument contain words of negotiability, i.e., be payable to order or bearer, is amplified and clarified

¹³ U.C.C. § 3-109(2). Under NEB. REV. STAT. 62-104(3) such an instrument was payable at a determinable future time.

¹⁴ Although the question of negotiability was not in issue, *Keeler v. Estate of Hiles*, 103 Neb. 465, 172 N.W. 363 (1919) stated that an instrument so payable was negotiable under the Nebraska Uniform Negotiable Instruments Law.

¹⁵ See BRITTON, *BILLS AND NOTES* §§ 26-30 (2d ed. 1961).

¹⁶ While an instrument which is payable on a fixed date or sooner at the option of the holder if he deems himself insecure is not nonnegotiable because of uncertainty as to time, § 1-208 of the Code requires, with regard to such clauses, that the holder shall have the power to accelerate "only if he in good faith believes that the prospect of payment or performance is impaired."

While as noted, an instrument payable "one day after my death" is not negotiable under the Code, it has been pointed out that the same purpose can be accomplished in a negotiable instrument by use of an acceleration clause. An instrument made payable at a sufficiently distant definite future time but accelerated by the death of an individual would appear to be payable at a definite time under the Commercial Code. HAWKLAND, *COMMERCIAL PAPER* §2(d) (1959).

¹⁷ U.C.C. § 3-109 (1) (d).

by sections 3-110 and 3-111 of the Commercial Code. Instruments payable to the order of estates, trusts, funds, partnerships or unincorporated associations are order instruments under the Commercial Code,¹⁸ thus avoiding any problem of whether an instrument so payable is order or bearer paper. Under the N.I.L. there was a conflict of authority as to whether an instrument which contained the words "payable upon the return of this instrument properly indorsed" was payable to order.¹⁹ The Code settles the question by providing that an instrument not otherwise payable to order is not made so by the presence of such language.²⁰

In addition to these formal requisites of negotiability, the Commercial Code sets forth in section 3-112 a list of terms and omissions which do not affect the negotiability of an instrument which is otherwise negotiable. Among the more important of the provisions which may be included in a negotiable instrument are:

- a statement that collateral has been given for the instrument or in case of default on the instrument the collateral may be sold;²¹
- a promise or power to maintain or protect collateral or to give additional collateral;²²
- a term in a draft providing that the payee by indorsing it or cashing it acknowledges full satisfaction of the obligation of the drawer.²³

Section 3-121 of the Commercial Code also effects a change in the law as set forth in the Nebraska Uniform Negotiable Instruments Law. Under the N.I.L. an instrument made payable at a bank was "equivalent to an order to the bank to pay the same for the account of the principal debtor thereon."²⁴ Under the Commercial Code a note or acceptance so payable "is not of itself an order or authorization to the bank to pay it,"²⁵ and an instrument "payable through a bank" does not "of itself authorize the bank to pay the instrument."²⁶

¹⁸ U.C.C. §§ 3-110(1) (e), (f), (g); 3-111.

¹⁹ See BRITTON, *BILLS AND NOTES* § 24 (2d. ed. 1961).

²⁰ U.C.C. § 3-110(2).

²¹ U.C.C. § 3-112(1) (b).

²² U.C.C. § 3-112(1) (c).

²³ U.C.C. § 3-112(1) (f).

²⁴ NEB. REV. STAT. § 62-187 (Reissue 1958).

²⁵ U.C.C. § 3-121. This section was offered in alternative form with the alternative form providing "A note or acceptance which states that it is payable at a bank is the equivalent of a draft drawn on the bank payable when it falls due out of any funds of the maker or acceptor in current account or otherwise available for such payment." Many jurisdictions have adopted this form of § 3-121 just as many had amended their version of the N.I.L.

²⁶ U.C.C. § 3-120.

TRANSFER AND NEGOTIATION.

Part 2 of Article 3 of the Code covers the area of transfer and negotiation. Transfer is a broad term covering all cases where one party passes his rights in the instrument to another, while negotiation "... is the transfer of an instrument in such form that the transferee becomes a holder."²⁷ As under the N.I.L., bearer instruments are negotiated by delivery alone, while instruments payable to order are negotiated by delivery with any necessary indorsements.²⁸

Several situations involving the question of whether an instrument was payable to bearer or to order, and thus whether an indorsement was necessary in order to negotiate the instrument which arose under the N.I.L. have been dealt with and settled by the Commercial Code. Under section 40 of the N.I.L.²⁹ and instrument payable to bearer was always negotiable by delivery alone even though it bore a later special indorsement i.e., "pay to the order of John Jones." The Code reverses this rule by providing that the indorsement of the special indorsee is necessary for further negotiations of the instrument³⁰ and this also renders moot the question of whether section 40 of the N.I.L. applied only to an instrument which was originally payable to bearer.

Two other situations with which the courts have had difficulty under the N.I.L. were those involving imposters and cases where an employee of the drawer, who was to furnish names of proper payees to the official with authority to draw checks, padded the list intending to later withdraw and negotiate the additional checks himself.

In the imposter cases—where the drawer or maker was induced by the imposter to issue an instrument to the imposter under his assumed name—the problem was whether the imposter's indorsement was effective. Under prior law the result often turned upon whether the impersonation took place in a face to face situation or use of the mails.³¹ Under the Code the indorsement by any person in the name of the named payee in an imposter situation is effective without regard to the method by which the impersonation was accomplished.³² In the situation where an employee or agent of the

²⁷ U.C.C. § 3-202(1).

²⁸ U.C.C. § 3-202(1).

²⁹ NEB. REV. STAT. § 62-140 (Reissue 1958).

³⁰ U.C.C. § 3-204(2).

³¹ See BRITTON, *BILLS AND NOTES* § 151 (2d ed. 1961).

³² U.C.C. § 3-405 (1) (a).

drawer or maker furnishes the drawer or maker with the name of a payee intending that the payee shall have no interest in the instrument, the Code again provides that an indorsement by any person in the name of the named payee is effective,³³ thus avoiding the necessity that existed under the N.I.L. of determining whether such instruments were in fact payable to fictitious payees and thus payable to bearer.

The treatment of indorsements under the Code is, with several exceptions substantially the same as under the N.I.L. The indorsement may be special³⁴ or in blank³⁵ and it may be qualified³⁶ or restrictive.³⁷ The conditional indorsement is under the Code a form of restrictive indorsement.³⁸ While a restrictive indorsement prevented further negotiation under the N.I.L.,³⁹ the Code reverses this rule and permits restrictive indorsees and subsequent owners to be holders in due course under certain conditions.⁴⁰

LIABILITY OF PARTIES.

The Code presents a systematic and much more complete coverage of the questions of the liabilities of parties to negotiable instruments than was set forth in the N.I.L. Many of the Code provisions in this area are, to be sure, declaratory of existing case law, but they represent a first attempt at codification.

Section 3-413 sets forth the liability of the maker, drawer, and acceptor with no substantial change from that provided in the N.I.L.:

- (1) The maker or acceptor engages that he will pay the instrument according to its tenor at the time of his engagement or

³³ U.C.C. § 3-405(1) (b).

³⁴ U.C.C. § 3-204(1).

³⁵ U.C.C. § 3-204(1).

³⁶ U.C.C. § 3-414(1).

³⁷ U.C.C. § 3-205.

³⁸ U.C.C. § 3-205(a).

³⁹ NEB. REV. STAT. §§ 62-136, 62-137, 62-147 (Reissue 1958).

⁴⁰ U.C.C. § 3-206(1). Subsections 3-206(2), (3) and (4) set forth rules to govern the position of the restrictive indorsee and subsequent takers of the restrictively indorsed instrument. They generally require the first taker to apply any value consistently with the indorsement and, to the extent this is done and the taker otherwise meets the requirements of due course holding, he is a holder in due course. Any bank within the collecting process, except the depository bank or the first taker, is not affected by the restrictive indorsement. Later holders for value of an instrument indorsed for the benefit of the indorser or another person are not affected by such restrictive indorsements unless they have knowledge that the negotiation was in breach of duty.

as completed pursuant to Section 3-115 on incomplete instruments.

- (2) The drawer engages that upon dishonor of the draft and any necessary notice of dishonor or protest he will pay the amount of the draft to the holder or to any indorser who takes it up. The drawer may disclaim this liability by drawing without recourse.
- (3) By making, drawing or accepting the party admits as against all subsequent parties including the drawee the existence of the payee and his then capacity to indorse.

The Code, however, does change the law with respect to when a drawer becomes an acceptor. Under the N.I.L. the acceptance or certification did not have to appear on the instrument⁴¹ and where the drawee destroyed or refused to return a bill presented for acceptance the drawee was deemed to have accepted the instrument.⁴² Under the Code the acceptance or certification must be written on the draft or check⁴³ while a drawee who refuses to return an instrument or who makes collateral promises or representations concerning the instrument will not be an acceptor of the instrument, he may still incur liability in tort or contract for these activities under subsections 3-419(1) (a) and (b) and 3-409(2) of the Code.

Thus a drawee who refuses to return an instrument presented for acceptance or payment has converted the instrument⁴⁴ and is liable for the face amount of the instrument.⁴⁵

The indorser's contract is set forth in subsection 3-414(1) of the Code, which provides:

Unless the indorsement otherwise specifies (as by such words as "without recourse") every indorser engages that upon dishonor and any necessary notice of dishonor and protest he will pay the instrument according to its tenor at the time of his indorsement to the holder or to any subsequent indorser who takes it up, even though the indorser who takes it up was not obligated to do so.

Under the Code, as under the N.I.L., the liability of drawers and indorsers is secondary in the sense that presentment, dishonor, notice of dishonor and (in a few cases) protest are ordinarily conditions precedent to actions against them.⁴⁶ Part 5 of Article 3 of the Code collects and states the rules as to the necessity, time for, and method of performing these conditions precedent and when the

⁴¹ NEB. REV. STAT. §§ 62-1,134, 62-1, 135 (Reissue 1958).

⁴² NEB. REV. STAT. § 1,137 (Reissue 1958).

⁴³ U.C.C. §§ 3-410(1), 3-411(1).

⁴⁴ U.C.C. § 3-419(1) (a) and (b).

⁴⁵ U.C.C. § 3-419(2).

⁴⁶ U.C.C. §§ 3-413(2), 3-414(1), 3-501.

performance of these conditions have been excused or waived. In connection with the requirements of presentment, notice of dishonor and protest it should be noted that section 3-501(3) of the Code has virtually eliminated the necessity for protest by providing that it is necessary to charge drawees and indorsers of any draft which appears on its face to be drawn or payable outside of the states and territories of the United States and the District of Columbia.

One of the problems which has plagued courts under the N.I.L. involved the time within which a demand instrument must be presented for payment. Under the N.I.L. the instrument had to be presented "within a reasonable time after its issue, except that in the case of a bill of exchange, presentment for payment will be sufficient if made within a reasonable time after the last negotiation thereof."⁴⁷ The Code still uses "reasonable time" to determine the time within which presentment for payment is necessary with respect to liability of secondary parties, but the time is measured from the time the particular party became liable on the instrument,⁴⁸ and the Code sets forth certain presumptions as to what constitutes a reasonable time in the case of an uncertified check. Subsection 3-503(2) provides in part:

In the case of an uncertified check which is drawn and payable within the United States and which is not a draft drawn by a bank the following are presumed to be reasonable periods within which to present for payment or to initiate bank collection:

- a) with respect to the liability of the drawer, thirty days after date or issue whichever is later; and
- b) with respect to the liability of an indorser, seven days after his indorsement.

LIABILITY OF GUARANTOR.

In addition to setting forth the contracts of the maker, drawer, acceptor and indorser, the Code provides certain rules in section 3-416 concerning the liability of a party who adds words of guaranty to his signature. One who guaranties payment engages "that if the instrument is not paid when due he will pay it according to its tenor without resort by the holder to any other party."⁴⁹ One who guaranties collection also engages to pay the instrument, but only after "the holder has reduced his claim against the maker or acceptor to judgment and execution has been returned unsatisfied, or after the maker or acceptor has become insolvent or it is otherwise apparent

⁴⁷ NEB. REV. STAT. § 62-171 (Reissue 1958).

⁴⁸ U.C.C. § 3-503(1) (e).

⁴⁹ U.C.C. § 3-416(1).

that it is useless to proceed against him."⁵⁰ The user of words of guaranty waives presentment, notice of dishonor and protest.⁵¹

LIABILITY OF THOSE WHO SIGN IN A REPRESENTATIVE CAPACITY.

If the signature of one who claims to be an agent appears on an instrument, the liability of the agent on the instrument depends upon the manner in which the representative capacity is indicated. If the instrument "neither names the person represented nor shows that the signature was in a representative capacity," the agent is personally obligated.⁵² The agent is also personally obligated except as "otherwise established between the immediate parties" if the instrument names the person represented but does not show that the representative signed in a representative capacity or if the instrument shows that the representative signed in a representative capacity but does not name the person represented.⁵³

WARRANTIES ON TRANSFER OF A NEGOTIABLE INSTRUMENT.

In addition to any liability which he might incur as an indorser of an instrument, one who transfers a negotiable instrument for consideration or obtains payment or acceptance of the instrument makes certain warranties under which he may incur liability.

Subsections 3-417(2) and (3) set forth the warranties made by a person who transfers an instrument to subsequent holders.

- (2) Any person who transfers an instrument and receives consideration warrants to his transferee and if the transfer is by indorsement to any subsequent holder who takes the instrument in good faith that
 - a) he has a good title to the instrument or is authorized to obtain payment or acceptance on behalf of one who has a good title and the transfer is otherwise rightful; and
 - b) all signatures are genuine or authorized; and
 - c) the instrument has not been materially altered; and
 - d) no defense of any party is good against him; and
 - e) he has no knowledge of any insolvency proceeding instituted with respect to the maker or acceptor or the drawer of an unaccepted instrument.
- (3) By transferring "without recourse" the transferor limits the obligation stated in subsection (2) (d) to a warranty that he has no knowledge of such a defense.

⁵⁰ U.C.C. § 3-416(2).

⁵¹ U.C.C. § 3-416(5).

⁵² U.C.C. § 3-403(2) (a).

⁵³ U.C.C. § 3-403(2) (b). The Commercial Code thus would allow the use of parol evidence to establish the non-liability of the agent between the immediate parties in a case governed by § 3-403(2) (b).

A significant change from prior law involved in this section is that the warranties are made only by a transferor who receives consideration, thus apparently imposing no warranty liability upon the accommodation indorser. It is also to be noted that the warranties made by one who transfers by an indorsement extend to all subsequent holders who take the instrument in good faith even though the indorsement is qualified—i.e. “without recourse”.

FINALITY OF PAYMENT AND ACCEPTANCE
AND WARRANTIES ON PRESENTMENT.

In the famous case of *Price v. Neal*,⁵⁴ it was held that a drawee who paid two drafts which bore the forged signature of the drawer could not recover the money from the good faith holder for value who received the payment. The Commercial Code adopts the doctrine of finality of payment of *Price v. Neal*, and extends it to similar situations. Section 3-418 of the Commercial Code provides:

Except for recovery of bank payments as provided in the Article on Bank Deposits and Collections (Article 4) and except for liability for breach of warranty on presentment under the preceding section, payment or acceptance of any instrument in final in favor of a holder in due course, or a person who has in good faith changed his position in reliance on the payment.

The warranties on presentment referred to in this section are set forth in section 3-417 (1) of the Commercial Code. With respect to the signature of the maker or drawer section 3-417 (1) (b) of the Code provides that the party who obtains payment or acceptance and any prior transferor warrants to one who in good faith pays or accepts that:

- b) he has no knowledge that the signature of the maker or drawer is unauthorized, except that this warranty is not given by a holder in due course acting in good faith
 - i) to a maker with respect to the maker's own signature; or
 - ii) to a drawer with respect to the drawer's own signature, whether or not the drawer is also the drawee; or
 - iii) to an acceptor of a draft if the holder in due course took the draft after the acceptance or obtained the acceptance without knowledge that the drawer's signature was unauthorized. . . .

Under these provisions the only warranty made is one of no knowledge that the signature is unauthorized and even this warranty is not made by a holder in due course acting in good faith in the situations set forth in section 3-417 (1) (b) (i), (ii) and (iii).

⁵⁴ 3 Burr. 1355, 97 Eng. Rep. 871 (1762).

Section 3-417(1) (c) covers the warranties against material alterations of the instrument and provides:

- c) the instrument has not been materially altered, except that this warranty is not given by a holder in due course acting in good faith
 - i) to the maker of a note; or
 - ii) to the drawer of a draft whether or not the drawer is also the drawee; or
 - iii) to the acceptor of a draft with respect to an alteration made prior to the acceptance if the holder in due course took the draft after the acceptance, even though the acceptance provided "payable as originally drawn" or equivalent terms; or
 - iv) to the acceptor of a draft with respect to an alteration made after the acceptance.

Subsections 3-417(1) (c) (iii) and (ii) settle certain problems which have arisen with regard to alterations and accepted instruments. Under these provisions, an acceptor does not receive a warranty that the instrument has not been materially altered from a holder in due course acting in good faith with respect to an alteration made after the acceptance nor does he receive a warranty with respect to an alteration made prior to acceptance if the holder in due course took the draft after the acceptance even though the acceptance provides "payable as originally drawn" or the like. Thus if a check is drawn for \$10 and, prior to certification, it is raised to \$100 and then, after certification, is negotiated to a holder in due course the bank may not charge back against the holder in due course to whom it pays \$100. Similarly if a \$10 check is certified and then raised to \$100 and negotiated to a holder in due course, the bank may not charge back against the holder in due course to whom it pays \$100.

As mentioned earlier, the provision of the Commercial Code respecting finality of payment and acceptance⁵⁵ is not limited to cases of material alteration or the forged signature of a drawer or maker. As indicated in comment 2 to the official text of section 3-418, payment made in the case where the drawers account was overdrawn or otherwise in error as to the state of the drawers account would be final.

The payor or acceptor does receive a warranty protecting him against forged indorsements.⁵⁶ While the drawee may not properly charge its depositor's account for a payment made on a forged indorsement, and has recourse against its transferors on their war-

⁵⁵ U.C.C. § 3-418.

⁵⁶ U.C.C. § 3-417 (1) (a).

ranty, the law under the N.I.L. was in conflict as to whether the holder whose indorsement had been forged had a cause of action against the drawee who paid on the forged indorsement of the holder.⁵⁷ In *Anschutz v. Central National Bank of Columbus*,⁵⁸ the payee of certain checks initiated an action against the drawee. The payee alleged that the checks had fallen into the possession of another while unindorsed and that the indorsement of the payee was a forgery. In holding that the payee did not state a cause of action against the drawee who paid the checks to subsequent indorsees the court stated:⁵⁹

We hold a drawee bank who unwittingly pays a check to a subsequent indorser where the indorsement of the payee was previously forged is not liable in an action by the payee either on contract or for money had and received or for conversion.

In so far as the *Anschutz* case holds that the former holder of the instrument may not maintain an action against the drawee its holding is reversed by the Commercial Code which provides that payment on a forged indorsement is a conversion of the instrument.⁶⁰ In such a case the drawee is liable for the face amount of the instrument.⁶¹ A collecting bank is not, however, liable to the former holder in conversion or otherwise for handling an instrument bearing the forged indorsement of the holder except that the collecting bank may be compelled to turn over any of the proceeds of the instrument which it still possesses.⁶²

HOLDERS, TRANSFEREES AND DEFENSES.

A "holder" is defined in the Code as one "who is in possession . . . of an instrument . . . drawn, issued or indorsed to him or to his order or to bearer or in blank."⁶³ In order for the holder to be a holder in due course under section 3-302 of the Code, he must take the instrument for value,⁶⁴ in good faith⁶⁵ and without notice that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person.⁶⁶

⁵⁷ See BRITTON, *BILLS AND NOTES* § 146 (2d ed. 1961).

⁵⁸ 173 Neb. 60, 112 N.W.2d 545 (1961).

⁵⁹ *Id.* at 70, 112 N.W.2d at 551.

⁶⁰ U.C.C. § 3-419(1) (c).

⁶¹ U.C.C. § 3-419(2).

⁶² U.C.C. § 3-419(3).

⁶³ U.C.C. § 1-201(20).

⁶⁴ U.C.C. § 3-302(1) (a).

⁶⁵ U.C.C. § 3-302(1) (b).

⁶⁶ U.C.C. § 3-302(1) (c).

While these requirements are substantially the same as set forth in section 52 of the N.I.L.,⁶⁷ the Code does contain some modifications and clarifications which should be noted. Subsection 52(1) of the N.I.L. required that the instrument be "complete and regular upon its face." Under the Code this requirement is not set forth in section 3-302 but is found in a modified form in section 3-304 which provides that the purchaser has notice of a claim or defense if the instrument is so incomplete or irregular "as to call into question its validity, terms or ownership or to create an ambiguity as to the party to pay."⁶⁸ In accord with this provision is subsection 3-304(4) (e) which provides that knowledge that an incomplete instrument has been completed does not give the purchaser notice of a claim or defense unless the purchaser has notice of any improper completion.

Section 3-304 states several other rules which elaborate upon and explain the requirements that the holder take the instrument without notice of a claim or defense or that it is overdue. Under these rules knowledge that the instrument is postdated or antedated or that it was issued or negotiated in return for an executory promise or accompanied by a separate agreement does not give the purchaser notice of a claim or defense.⁶⁹ The purchaser does have notice of a claim or defense if he knows that a fiduciary has negotiated the instrument for his own benefit or in payment of or as security for his own debt⁷⁰ but mere knowledge that the person negotiating the instrument is a fiduciary does not give the purchaser notice.⁷¹

The Code does somewhat clarify the question of when a purchaser has notice that an instrument is overdue. In the case of an instrument which contains an acceleration clause, the purchaser must have reason to know that acceleration has been made before he has notice that the instrument is overdue.⁷² In the case of a demand instrument, the purchaser must have notice either that demand had been made, or that he is taking the instrument more than a reasonable length of time after its issue.⁷³ Although the question of what constitutes a "reasonable length of time" is not

⁶⁷ NEB. REV. STAT. § 62-152 (Reissue 1958).

⁶⁸ U.C.C. § 3-304(1) (a).

⁶⁹ U.C.C. § 3-304(4) (a), (b).

⁷⁰ U.C.C. § 3-304(2).

⁷¹ U.C.C. § 3-304(4) (e).

⁷² U.C.C. § 3-304(3) (b).

⁷³ U.C.C. § 3-304(3) (c).

definitely answered by the Commercial Code with regard to demand instruments generally,⁷⁴ the Commercial Code does provide that thirty days is presumed to be a reasonable time for a check drawn and payable within the states and territories of the United States and the District of Columbia.⁷⁵

Some specific instances are set forth in which the holder does not become a holder in due course. The taking of an instrument under legal process or the purchase of the instrument at a judicial sale does not make the purchaser a holder in due course,⁷⁶ nor does the acquisition of the instrument in taking over an estate⁷⁷ or as part of a bulk transaction not in the regular course of business of the transferor.⁷⁸

The Code settles the question of whether a payee may be a holder in due course if he otherwise meets the requirements by simply stating "A payee may be a holder in due course"⁷⁹ while ordinarily a payee will not be able to qualify as a holder in due course because he will ordinarily have been involved in the events of the transaction and the issuance of the instrument that he would have notice of any claims or defenses to the instrument, there are situations where this is not the case. Comment 2 to the official text of the Code gives several cases illustrating when a payee may be a holder in due course of which the following is representative. "D draws a check payable to P but blank as to the amount, and gives it to his agent to be delivered to P. The agent fills in the check with an excessive amount, and P takes it for value, in good faith and without notice."

The requirement that a holder in due course take the instrument for value is elaborated upon in section 3-303 of the Commercial Code. Under these provisions a holder takes the instrument for value:

- a) to the extent that the agreed consideration has been performed or that he acquires a security interest in or a lien on the instrument otherwise than by legal process; or
- b) when he takes the instrument in payment of or as security for an antecedent claim against any person whether or not the claim is due; or

⁷⁴ U.C.C. § 1-204(2) provides: "What is a reasonable time for taking any action depends on the nature, purpose and circumstances of such action."

⁷⁵ U.C.C. § 3-304(3) (c).

⁷⁶ U.C.C. § 3-302(3) (a).

⁷⁷ U.C.C. § 3-302(3) (b).

⁷⁸ U.C.C. § 3-302(3) (c).

⁷⁹ U.C.C. § 3-302(2).

- c) when he gives a negotiable instrument for it or makes an irrevocable commitment to a third person.

The importance of being a holder in due course or having the rights of a holder in due course lies, of course, in the fact that the holder in due course takes the instrument free of certain defenses which would otherwise be available to the obligor. Section 3-305 of the Code states the rights of a holder in due course as follows:

To the extent that a holder is a holder in due course he takes the instrument free from

- 1) all claims to it on the part of any person; and
- 2) all defenses of any party to the instrument with whom the holder has not dealt except
 - a) infancy, to the extent that it is a defense to a simple contract; and
 - b) such other incapacity, or duress, or illegality of the transaction, as renders the obligation of the party a nullity; and
 - c) such misrepresentation as has induced the party to sign the instrument with neither knowledge nor reasonable opportunity to obtain knowledge of its character or its essential terms; and
 - d) discharge in insolvency proceedings; and
 - e) any other discharge of which the holder has notice when he takes the instrument.

While section 3-306 dealing with the rights of one who does not have the rights of a holder in due course states:

Unless he has the rights of a holder in due course any person takes the instrument subject to

- a) all valid claims to it on the part of any person; and
- b) all defenses of any party which would be available in an action on a simple contract; and
- c) the defenses of want or failure of consideration, nonperformance of any condition precedent, nondelivery, or delivery for a special purpose; and
- d) the defense that he or a person through whom he holds the instrument acquired it by theft, or that payment or satisfaction to such holder would be inconsistent with the terms of a restrictive indorsement. The claim of any third person to the instrument is not otherwise available as a defense to any party liable thereon unless the third person himself defends the action for such party.

As can be seen from the provisions quoted, the defenses available against a holder in due course (commonly called "real" defenses) are those which generally go to the existence of a contract. Under the N.I.L. non-delivery of an incomplete instrument is a real defense.⁸⁰ The Commercial Code reverses this rule and allows a holder in due course to enforce the instrument as completed.⁸¹

⁸⁰ NEB. REV. STAT. § 62-115 (Reissue 1958).

⁸¹ U.C.C. §§ 3-115(2), 3-407(3).

The provision of subsection 3-305(2) (e), set forth above, that the holder in due course takes subject to any other discharge of which he has notice when he takes the instrument should be read in conjunction with section 3-601 of the Commercial Code, and the sections therein referred to which govern the discharge from liability of a party on a negotiable instrument.

Several of the Code provisions relating to discharge are worth noting here. According to section 3-603 of the Code, an obligor, with two exceptions, may safely pay the holder of the instrument even though he has knowledge of a claim of another person to the instrument unless the adversely claiming party enjoins payment or adequately secures the obligor.⁸²

The discharge or defense resulting from alteration referred to in section 3-601(f) of the Code is covered in detail in section 3-407. A subsequent holder in due course may enforce the instrument according to its original tenor,⁸³ and of course may proceed against those who transferred the instrument for value after the alteration under the warranties set forth in section 3-417(2) (c) of the Code⁸⁴ or under their contract of indorsement under section 3-414(1) wherein the unqualified indorser engages, upon performance of any necessary conditions precedent, to pay the instrument "according to its tenor at the time of his indorsement." In connection with the question of material alteration the Commercial Code prevents any party from asserting the alteration against a holder in due course, a drawee or other payor if the party "by his negligence substantially contributes" to the material alteration.⁸⁵

⁸² The two exceptions to this rule are found in §§ 3-603(1) (a) and (b) which provide that there is no discharge

a) of a party who in bad faith pays or satisfies a holder who acquired the instrument by theft or who (unless having the rights of a holder in due course) holds through one who so acquired it; or

b) of a party (other than an intermediary bank or a payor bank which is not a depository bank) who pays or satisfies the holder of an instrument which has been restrictively indorsed in a manner not consistent with the terms of such restrictive indorsement.

Under §§ 119 and 88 of the N.I.L. payment with notice of an adverse claim could not safely be made by the obligor. In connection with § 3-603, § 3-306(d) which denies the defense of *jus tertii* except where the third party is a party to the action should be noted.

⁸³ U.C.C. § 3-407(3).

⁸⁴ The transferor's warranties under § 3-417(2) run only to his immediate transferee unless the transfer is by indorsement.

⁸⁵ U.C.C. § 3-406.

Although the courts had protected drawees in the case of a material alteration of an instrument which was negligently executed by the drawer, there was a conflict as to whether a holder in due course was entitled to the same protection. The Commercial Code, as noted, protects the holder in due course.

The Commercial Code also provides that the impairment by the holder of an instrument of the rights of recourse which one party to the instrument has against another may discharge the injured party.⁸⁶ If a holder without an express reservation to rights or the consent of a party who the holder knows has a right of recourse, either releases or agrees not to sue any person against whom the party has a right of recourse or agrees to suspend the right to enforce the instrument against, or otherwise discharges such a person, the party having the right of recourse is discharged to that extent.⁸⁷ A party is also discharged to the extent that a holder "unjustifiably impairs any collateral for the instrument given by or on behalf of the party or any person against whom he has a right of recourse."⁸⁸ Since the Code expressly provides that an accommodation party has a right of recourse against the party accommodated⁸⁹ it is clear that a holder may not discharge an accommodation maker or acceptor unless he secures consent or expressly reserves his rights against such a party.

Since the right of a party to recover in an action on a negotiable instrument may depend upon whether he is a holder in due course, the Code provides certain rules concerning the burden of establishing the holder's position. Signatures are admitted unless specifically denied in the pleadings⁹⁰ and are presumed genuine unless the purported signer-obligor has died or become incompetent before proof is required.⁹¹ If there is no question of the genuineness of signatures then any holder is entitled to recover unless a defense is established.⁹² If a defense exists then the party claiming the rights of a holder in due course has the burden of "establishing that he or some person under whom he claims is in all respects a holder in due course."⁹³

⁸⁶ U.C.C. § 3-606.

⁸⁷ U.C.C. § 3-606(1)(a).

⁸⁸ U.C.C. § 3-606(1)(b).

⁸⁹ U.C.C. § 3-415(5).

⁹⁰ U.C.C. § 3-307(1).

⁹¹ U.C.C. § 3-307(1)(a).

⁹² U.C.C. § 3-307(2).

⁹³ U.C.C. § 3-307(3).

SUCCESSORS TO HOLDERS IN DUE COURSE.

Under the Code as under the N.I.L.⁹⁴ a party, who is not himself a holder in due course of the instrument, may nevertheless have the rights of one who is a holder in due course. Section 3-201 of the Code provides that a transferee has such rights in the instrument as does his transferor. If the transferee has only a security interest in the instrument, as for example, if the transferee is a pledgee of the instrument, the transferee has these rights only to the extent of the interest transferred.⁹⁵ The Code makes an exception to the general rule that a transferee takes the rights of the transferor by providing that a transferee who has been "a party to any fraud or illegality affecting the instrument or who as a prior holder had notice of a defense or claim against it cannot improve his position by taking from a later holder in due course."⁹⁶

For a transferee to be a holder in due course in his own right he must of course meet the requirements of section 3-302 of the Code. Usually a transferee is not a holder because an instrument payable to order has not been indorsed by the transferor. Under the Code a transferee who gives value is entitled to the unqualified indorsement unless the parties have agreed otherwise.⁹⁷ Negotiation to the transferee occurs when the instrument is indorsed, and if the then holder seeks to establish himself as a holder in due course he must, of course, be without notice of a claim or defense at the time of negotiation.

CONCLUSION

Article 3 of the Commercial Code presents a systematic treatment and modernization of the law of commercial paper. Due to the nature of the subject matter, the same mass of detail which was presented by the N.I.L. and the cases decided thereunder will still exist under Article 3. For better or worse, there can be little doubt that the courts, in deciding cases under the Code, will resort to the provisions of the N.I.L. and the cases applying those provisions until a representative body of case law under the Code comes into existence. Since the Code settles many areas of conflict which existed under the N.I.L., its adoption in Nebraska will obviate many potential disputes in areas in which the Supreme Court of Nebraska has not spoken.

⁹⁴ NEB. REV. STAT. §§ 62-149, 62-158 (Reissue 1958).

⁹⁵ U.C.C. § 3-201(2).

⁹⁶ U.C.C. § 3-201(1).

⁹⁷ U.C.C. § 3-201(3).