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Uniform Commercial Code - Commercial Paper

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UNIFORM COMMERCIAL CODE — COMMERCIAL PAPER

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Part I

FORM AND INTERPRETATION

The proposed Commercial Code[1] is now reaching the final stages of redrafting before approval and promulgation. It is the purpose of this paper to discuss Article 3 of the proposed code, which constitutes the negotiable instruments section.[2]

The question arises at the outset, why a new Uniform Commercial Code, and why a complete rewriting of familiar language? The need for uniform legislation governing commercial transactions has been long felt.[3] The question at issue was one of policy, and the drafters reasoned that it would be easier to persuade legislators to enact one statute than to amend and re-enact several. Furthermore, a single statute would enable the draftsmen to integrate and organize their material, and commercial law appears to have been a unit that lent itself readily to such treatment. The rewriting was necessary to avoid perpetuating errors and conflicts of the past; and in addition it gave the draftsmen their opportunity to create a statute that had meaning to laymen as well as to skilled technicians.

While many lawyers will feel that settled law is thus to be unsettled, there is much to be said for the new code. The fear that it will require hours of additional study and dangers of mistaken interpretation commonly to be associated with the reading of a new statute does not appear well founded. Although arbitrary choices between conflicting rules of law had to be made, the drafters attempted to exhaust legal, commercial, and business sources before making an election. To

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[1] All references are to the Uniform Commercial Code, Proposed Final Draft, Spring, 1950, as submitted by the Council of the American Law Institute for discussion at the twenty-seventh annual meeting of the American Law Institute in joint session with the National Commissioners on Uniform State Laws, May 18, 19, and 20, 1950.

[2] The Uniform Negotiable Instruments Law was promulgated in 1896. Five states adopted the statute in 1897, and the last adoption occurred in 1924.

[3] For a recent discussion on uniform laws see Rossman, *Uniformity of Law: An Elusive Goal*, 36 A.B.A.J. 175 (March, 1950); Chnader, *The New Commercial Code: Modernizing Our Uniform Commercial Acts*, 36 A.B.A.J. 179 (March, 1950).

give the courts a new start on uniformity of construction, the Code states expressly in the opening section that it "is remedial and shall be liberally construed and applied to promote its underlying reasons, purposes and policies . . ." [4] On the other hand, one of the reasons for varying rules under existing uniform acts has been the failure of the courts to distinguish between presumptions created by statute and mandatory rules. The present act makes its provisions mandatory except where the rule is qualified by the words "unless otherwise agreed." [5] Finally, each section is followed by annotations, designated "Official Comments," which the drafters intended to serve as a guide in construing the statute.[6] Each comment indicates changes made in existing law, if any, with reference to the statute amended, and a discussion of any change or new material added.

The first striking impression of Article 3 [7] is its compactness. Thus the new code devotes only 79 sections to negotiable instruments, as compared to 198 sections in the N.I.L. The reason for this condensation lies in the careful integration of related sections, widely dispersed in the original statute, and the deletion of obsolete provisions. Yet, surprisingly enough, many of the sections cover new material.

In accordance with sound practice in draftsmanship, Article 3 opens with a short title section [8] and a section on definitions. Users will find the definition section valuable as a descriptive word index leading into the body of the statute. Among other terms, the word "issue" is redefined in this section,[9] and now permits issue of the instrument to a remitter. The N.I.L. contains no section dealing directly with the rights of one who purchases an instrument but is not named as a party. Clearly he is an owner, but whether or not he is a holder entitled to recover on the instrument in his own

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[4] U.C.C. §1-102 (Spring, 1950).

[5] *Id.* §1-107.

[6] "The Official Comments of the National Conference of Commissioners on Uniform State Laws and the American Law Institute may be consulted by the courts to determine the underlying reasons, purposes and policies of this Act and may be used as a guide in its construction and application." U.C.C. §1-102 (2).

[7] To conserve space the present uniform act will be referred to as the "N.I.L." while the proposed code will be referred to as "U.C.C." Where Article 3 of the Uniform Commercial Code is referred to it will be cited simply as "Article 3."

[8] "This Article shall be known and may be cited as Uniform Commercial Code — Commercial Paper." U.C.C. §3-101.

[9] " 'Issue' means the first delivery of an instrument to a holder or remitter." U.C.C. §3-102 (c).

name under §51 of the N.I.L.[10] is in doubt because the present definition of "issue" requires delivery of a complete instrument to one who takes as a holder.[11] In turn, "holder" has been defined as including only the "payee or endorsee" in possession of the instrument.[12] The result is that the case must be treated as one not provided for under the statute and a recovery allowed on common law principles.[13] Another difficulty arising under the present definition of "issue" stems from the requirement that the instrument must be complete when issued. Clearly rights do arise when incomplete instruments are delivered,[14] and Article 3 accordingly eliminates the requirement that a complete instrument be delivered.

The words "order" and "promise" are also defined in this section.[15] These definitions taken together with the omission of §10 of the N.I.L.[16] make it clear that the language used must clearly express an order or promise. Doubts are to be resolved against negotiability unless the language used is a clear equivalent. Thus the comment indicates that "I undertake" is the equivalent of "I promise," and "Pay to Holder" creates an order instrument.[17] The definition of order permits naming of alternative drawees, expressly denied in §128 of the N.I.L.[18] The reason suggested is the convenience of naming drawees in different parts of the country. A presentment to any one of the named drawees is sufficient to bring later sections on presentment and dishonor into application. Successive drawees are not permitted because the holder should be entitled to treat the instrument as dishonored after the first presentment.

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[10] N.D. Rev. Code §45-0501 (1943).

[11] N.I.L. §41-0102 (1943).

[12] *Ibid.*

[13] Britton, Bills and Notes §75 (1943); Brannon, Negotiable Instruments Law 655 *et seq.* (7th ed. 1948); Comment, 28 Yale L. J. 695 (1919); Moore, *The Right of a Remitter of a Bill or Note*, 20 Col. L. Rev. 749 (1920); Beutel, *Rights of Remitter and Other Owners not Within the Tenor of Negotiable Instruments*, 12 Minn. L. Rev. 584 (1928).

[14] See N.I.L. §§14, 16, N. D. Rev. Code §§41-0214, 41-0216 (1943).

[15] "An 'order' is a clearly expressed direction to pay and must be more than a mere authorization or request. It must identify the drawee with reasonable certainty. It may be addressed to a single drawee or to drawees jointly or in the alternative but not in succession." U.C.C. §3-102 (d).

"A 'promise' is a clearly expressed undertaking to pay and must be more than a mere acknowledgment of an obligation." U.C.C. §3-102 (e).

[16] "The instrument need not follow the language of this title, but any terms are sufficient which clearly indicate an intention to conform to the requirements hereof." N.D. Rev. Code §41-0210 (1943).

[17] Comment, U.C.C. §3-104.

[18] N.D. Rev. Code §41-1003 (1943).

SCOPE OF ARTICLE 3

Article 3 expressly excludes money, documents of title, and investment securities.[19] It is limited strictly to commercial paper, but goes a step further than the N.I.L. by including commercial paper conforming to the statute in all respects, although not payable to order or to bearer.[20] Thus a check payable to John Doe is included within the scope of the act, although no one can be a holder in due course. Such an instrument is treated as a mercantile specialty in that it passes by indorsement and delivery. The present act makes it clear that this instrument is covered by its terms in relation to indorsement, consideration, burden of proof and other matters aside from holder in due course. Such an instrument is not a simple contract as would be true of a note containing a clause making it conditional.

FORM OF NEGOTIABLE INSTRUMENTS

The prerequisites of a negotiable instrument as set out in the N.I.L. have given rise to conflicting interpretations as to its scope.[21] One question that has troubled the courts under the N.I.L. arises from an ambiguity in the opening sentence of §1: "An instrument to be negotiable must conform to the following requirements. . ." [22] The implication is that the act covers all instruments, an unfortunate result in that it led courts in some instances to refuse limited negotiability to order instruments dealt in on investment markets,[23] and on the other

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[19] U.C.C. §3-103.

[20] "This Article applies to any instrument whose terms do not preclude transfer and which is otherwise negotiable within this Article but which is not payable to order or to bearer, except that there can be no holder in due course of such an instrument." U.C.C. §3-705.

[21] N.I.L. §65, N.D. Rev. Code §41-0606 (1943), concludes: "The provisions of subdivision three of the section do not apply to persons negotiating public or corporate securities, other than bills and notes."

The implication is that to be negotiable an instrument must comply with the N.I.L. whether or not it is a bill or a note. It is obvious that a limited negotiability making for free transferability is an essential element in instruments dealt in on a commodities market. On the other hand, the question of cutting off defenses of the maker must be determined by policies related to the function of the instrument. For an excellent discussion on this point see Leary, *Some Clarifications in the Law of Commercial Paper Under the Proposed Uniform Commercial Code*, 97 U of Pa.L.Rev. 354, 355 *et seq.* (1949).

[22] N.D. Rev. Code §41-0201 (1943).

[23] In Manhattan Co. v. Morgan, 242 N.Y. 38, 150 N.E. 594 (1926), the N.I.L. was applied to interim certificates; in King Cattle Co. v. Joseph, 158 Minn. 481, 198 N.W. 798 (1924), the statute was applied to corporate bonds; and in Manker v. American Savings Bank and Trust Co., 131 Wash. 430, 230 Pac. 406 (1924), it was applied to municipal bonds. In all three of these cases the rights of a subsequent bona fide purchaser were defeated because the instrument did not meet the requirements of the Act.

hand to uphold instruments in the nature of conditional sales and chattel mortgages although thinly disguised as promissory notes.[24] Article 3 avoids these difficulties by expressly excluding from coverage investment securities and any writing reserving security rights, and makes it clear that the article applies only to commercial paper by specifying the four types of commercial paper covered.[25]

WHEN PROMISE OR ORDER UNCONDITIONAL

Section 3 of the N.I.L. concludes: "But an order or promise to pay out of a particular fund is not unconditional." [26] Article 3 introduces two important exceptions to this general principle.[27] The Code expressly makes negotiable order paper issued by governmental agencies, although payable out of a specific fund. Problems of the same nature have arisen in regard to trust estates and unincorporated associations.[28] Under this section, a promise remains unconditional although it is "limited to payment out of the entire assets of a partnership, unincorporated association, trust or estate by or on behalf of which the instrument is issued." [29] The question of individual liability remains a subject of state law aside from Article 3; the act purports to deal only with the question of negotiability.

This section expressly negatives the effect of constructive and implied conditions arising from recitals relating to the

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[24] For an illustration of a conditional sales contract successfully incorporated in a promissory note without destroying negotiability, see Abingdon Bank & Trust Co. v. Shipplett-Moloney Co., 316 Ill. App. 79, 43 N.E.2d 857 (1942). *Contra*: Fleming v. Sherwood, 24 N.D. 144, 139 N.W. 101 (1912) *semble*.

[25] "A writing which complies with the requirements of this section is

(a) a 'draft' if it is an order;
(b) a 'check' if it is a draft drawn on a bank and payable on demand;
(c) a 'certificate of deposit' if it is an acknowledgment by a bank or other depository of receipt of money engaging to repay it;
(d) a 'note' if it is a promise other than a certificate of deposit.

"A writing which purports to create or reserve security rights does not fall within this Article, even though it also contains a promise to pay money." U.C.C. §3-104 (2) and (3).

[26] N.D. Rev. Code §41-0203 (1943).

[27] "A promise or order otherwise unconditional is not made conditional by the fact that the instrument. . .

(f) is limited to payment out of a particular fund or the proceeds of a particular source, if the instrument is issued by a government or governmental agency or unit; or
(g) is limited to payment out of the entire assets of a partnership, unincorporated association, trust or estate by or on behalf of which the instrument is issued." U.C.C. §3-105.

[28] Note the fact situation in Vorachek v. Anderson, 54 N.D. 891, 211 N.W. 984 (1927). Under the proposed act it now becomes feasible to limit the holder to recovery against the assets of a voluntary association.

[29] See note 27 *supra*.

consideration giving rise to the instrument, and makes more definite the rule that such recitals in no way qualify the duty to pay. Thus a statement "that the promise or order is made or the instrument matures in accordance with or 'as per' such transaction; . . ." is treated as a mere recital of the consideration.[30] A reference to security or reservation of title receives similar treatment.[31] Here a distinction is to be noted between an instrument that creates a security interest and one that merely refers to the fact that it is secured. The first type is expressly excluded from the Code.[32] The purport of the section is that an instrument is negotiable where the holder can ascertain all its essential terms from an examination of its face. If he is compelled to go outside the instrument by its express terms, it is not negotiable.[33]

SUM CERTAIN

Article 3 makes several important changes in §2 of the N.I.L.[34] The original act contained no provisions covering many common practices relating to interest, exchange, and costs of collection on default. Under the proposed section the practices of providing for different rates of interest before and after default, or allowing discounts for payment in advance, or additions if not paid at maturity, are recognized and provided for. The section recognizes varying practices in regard to exchange. Exchange may be either added or subtracted without affecting certainty of the sum payable.[35] Two important extensions of the original section relate to costs of collection, and acceleration and extension clauses. The N.I.L.

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[30] U.C.C. §3-105 (b).

[31] U.C.C. §3-105 (d).

[32] See note 25 *supra*.

[33] The hope of the drafters is that negotiable instruments will become "courier(s) without luggage."

[34] "(1) The sum payable is a sum certain even though it is to be paid
(a) with stated interest or by stated installments; or
(b) with stated different rates of interest before and after default or a specified date; or
(c) with a stated discount or addition if paid before or after the date fixed for payment; or
(d) with exchange or less exchange, whether at a fixed rate or at the current rate; or
(e) with costs of collection or an attorney's fee, or both upon default; or
(f) upon acceleration or after extension.
"(2) Nothing in this section shall validate any term which is otherwise illegal." U.C.C. §3-106.

[35] The test of certainty is simply whether the holder at any maturity date can compute the sum due by reference to information given on the face of the instrument.

limited the addition of costs of collection and an attorney's fee to default at maturity. The present section covers all defaults. Similarly, where the N.I.L. limits acceleration to the case of defaults in installments of principal or interest, the proposed act not only permits all types of acceleration, but also includes extensions.[36]

It is to be noted that no amendment of this section will be necessary to make it conform to North Dakota policy. The act relates only to the effect of such clauses on negotiability of the instrument.[37]

MONEY

Money is not defined in the N.I.L. The only reference to money in that act is found in §6 (5) and that refers to "current money." [38] The problem has several aspects. Is an instrument negotiable when payable in a particular kind of current money not recognized as legal tender? [39] Would such an instrument be negotiable if the medium of exchange were current only in a particular community? [40] Is an instrument payable in foreign money negotiable? [41] Would such an instrument be negotiable if made payable in the United States in foreign money?

The Code gives a definite answer to these questions for the first time. First, it requires that the instrument be payable in a medium recognized as part of the currency at the time the instrument is made.[42] This rejects the view that money is limited to legal tender, or that money includes a medium of

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[36] Discussed *infra*, under "Definite Time."

[37] North Dakota policy is opposed to allowance of an attorney's fee. N.D. Rev. Code §§28-2604, 41-0202 (5) (1943). A loan contract may not provide for a higher rate of interest after default, N.D. Rev. Code §47-1405 (1943). However, interest may be deducted in advance, N.D. Rev. Code §47-1408 (1943), but compounding of interest is prohibited. N.D. Rev. Code §47-1409 (1943).

[38] N.D. Rev. Code §41-0206 (5) (1943).

[39] That an instrument payable in "currency" is negotiable, see Merchants National Bank v. Santa Maria Sugar Co., 162 App. Div. 248, 147 N.Y. Supp. 498 (1914). *Contra*: First State Bank v. Hidalgo Land Co., 268 S.W. 144 (Tex. Com. App. 1925), *reversing*, 257 S.W. 275 (Tex. Civ. App. 1923).

[40] U.C.C. §1-201 (23) provides: " 'Money' means a medium of exchange authorized or adopted by a domestic or foreign government as a part of its currency."

[41] The authorities are reviewed in Incitti v. Ferrante, 12 N.J. Misc. 840, 175 Atl. 908 (1933). The case held that a note payable in "15,400 Italian lires" was negotiable, and if payable in this country was payable in American money at the current rate of exchange.

[42] See note 40 *supra*.

exchange acceptable in a particular community.[43] The test is governmental sanction.

Second, an instrument payable in currency or current funds is payable in money under the test set out above.[44]

Third, the Code recognizes that instruments payable in foreign money are payable in American money at the current rate of exchange unless the parties specifically provide that it shall be payable in foreign money in the United States. The assumption is that the foreign money has governmental sanction where issued.[45]

PAYABLE ON DEMAND

Article 3 omits the concluding sentence of § 7 of the N.I.L.[46] "Where an instrument is issued, accepted, or indorsed when overdue, it is, as regards the person so issuing, accepting, or indorsing it, payable on demand." The language is confusing and misleading. It implies that paper reissued when overdue takes on new life.[47] But under §53 of the N.I.L.[48] one must take within a reasonable length of time after issue to be a holder in due course of demand paper, and "issue" means the first delivery of the instrument.[49] The only purpose of the section was to indicate that the drawer and indorser of overdue paper was entitled to the same presentment and notice as in the case of demand paper.[50] The topic properly belonged in another section, and hence it is treated under the section on presentment.

The section clarifies the question of at what point interest begins to run on a demand instrument where no specific provision for interest is made. The drafters took the view that it should not run until demand is made unless the instrument provides otherwise. The reason suggested is that no default occurs until demand.

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[43] The weight of authority is in accord. However, some states in the early 1800's made instruments payable in certain types of personal property negotiable. Britton, Bills and Notes 119 n.1 (1943).

[44] See note 39 *supra*. This settles a dispute and is in accord with the better view.

[45] See note 40 *supra*.

[46] N.D. Rev. Code §41-0207 (1943).

[47] In Idaho State Bank of Twin Falls v. Hooper Sugar Co., 74 Utah 24, 276 Pac. 659 (1929), a bona fide pledgee of an instrument indorsed after maturity was held to be a holder in due course.

[48] N.D. Rev. Code §41-0503 (1943).

[49] N.I.L. §191, N.D. Rev. Code §41-0102 (1943).

[50] Torgerson v. Ohnstad, 149 Minn. 46, 182 N.W. 724 (1921); Morgan v. Hoffman, 76 Mont. 396, 247 Pac. 326 (1926); Nees v. Hagan, 22 Tenn. App. 78, 118 S.W.2d 566 (1938).

DEFINITE TIME

This section adopts the language "definite time" in lieu of "determinable future time," and reverses the rule of §4 (3) of the N.I.L.[51] If the time of payment can be determined from the face of the instrument it is payable at a definite time, and hence the more exact language was deemed preferable. A note payable one year after the death of the maker, or one year after the war is over will no longer be negotiable. This was a wise change since such paper would not be acceptable in general commerce because of the uncertainty of maturity — hence defenses of the maker are now preserved. The comment points out that an undated note payable 30 days after date would be an incomplete instrument and could be filled up and enforced.

The problems raised by acceleration and extension clauses are directly dealt with in this section. Three types of acceleration clauses may exist. The instrument may be subject to acceleration (1) at the option of the maker,[52] (2) at the option of the holder,[53] or (3) automatically on a specified act or event.[54]

Type one is usually an "on or before" instrument and was negotiable at common law and under the N.I.L. Type two, however, has given rise to conflicts in decision with the weight of authority sustaining negotiability where the operation of the clause depends upon the occurrence of an event bearing a close relation to the problems of collection.[55] On the other hand, a clause giving the holder the option to mature the instrument when he "deems himself insecure" has been held to destroy negotiability.[56] Clearly, both uncertainty in amount and indefiniteness as to time enter into the problem and Article 3 settles the question by permitting all types of acceleration. The justification for this view is that since demand in-

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[51] N.D. Rev. Code §41-0204 (3) (1943).

[52] "It is usually said that, in order to make an instrument negotiable under the law merchant, the time of payment must be certain. But a note payable on or before a certain date is negotiable. The maker of such a note has the right to pay before the date named, but the holder cannot demand payment before that date." Spalding, J., in First National Bank v. Buttery, 17 N.D. 326, 116 N.W. 341 (1908).

[53] Hollinshead v. John Stuart & Co., 8 N.D. 35, 77 N.W. 89 (1898).

[54] Cedar Rapids National Bank v. Snoozy, 55 N.D. 655, 215 N.W. 96 (1927).

[55] See Chafee, *Acceleration Provisions in Time Paper*, 32 Harv. L. Rev. 747 (1919); Britton, Bills and Notes 101 (1943).

[56] First State Bank of Cheyenne v. Barton, 129 Okla. 67, 263 Pac. 142 (1928); Puget Sound State Bank v. Washington Paving Co., 94 Wash. 504, 162 Pac. 870 (1917).

struments are accelerable at the option of either party, uncertainties as to time and amount are no more objectionable where a time instrument is involved. In fact the latter instrument, having an ultimate due date, is least objectionable on this count. To guard against abuse of discretion by the holder the Code provides as follows:

"A term providing that one party may accelerate payment or performance or require collateral or additional collateral not on stated contingencies but 'at will' or 'when he deems himself insecure' or in words of similar import means that he has power to do so only in the good faith belief that the prospect of payment or performance is impaired but the burden of establishing lack of good faith is on the party against whom the power is to be exercised." [57]

Extension clauses bear a close relationship to acceleration. A note may be made payable two years after date, with an option in the maker to pay on or before that date. The same transaction might be handled by making the note payable one year from date, with an option in the maker to extend the time of payment one year. Both should be negotiable. On the other hand, a note which gives an option to the maker to renew at will for an indefinite period would clearly violate the rule as to certainty of time. Hence the section in question provides that an extension to a further definite time at the option of the maker or automatically upon a specified act or event will not make the time of payment indefinite. Where the extension is at the option of the holder a later section provides: "Notwithstanding any term of the instrument, the holder may extend it only with the consent of the maker at the time of extension. Unless otherwise specified consent to extension authorizes a single extension for not longer than the original period." [58]

In brief, the purpose of the section is to clear away uncertainties under the N.I.L. relating to acceleration and extension clauses and eliminate objectionable instruments that do not in fact have free circulation in commerce.

PAYABLE TO ORDER

Section 8 of the N.I.L. concludes: "Where the instrument is payable to order the payee must be named or otherwise indi-

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[57] U.C.C. §1-208.
[58] *Id.* §3-119 (b).

cated therein with reasonable certainty." [59] This language is eliminated as inconsistent with the new section which permits an instrument to be made payable to "an estate, trust, fund, partnership, or unincorporated association." or "an office or officer as such." [60] Clearly, such instruments are not intended to be payable to bearer. The section recognizes that people are not exact in drafting their instruments, and that all that is required is that the payee be capable of identification. Thus an instrument payable to the order of the X Building Fund may be cashed or negotiated by any person authorized to hold the instrument in behalf of the X Building Fund. Nor is it essential that the payee be a legal entity to bring the principle into operation. The same is true where the instrument is payable to an officer or the office itself. Either the incumbent or his successors may negotiate, transfer, or discharge the instrument.[61]

The Code reverses cases such as *Nelson v. Citizens' Bank*,[62] where a certificate of deposit was held payable to order by implication arising from the phrase "on return of this certificate properly indorsed."

The concluding clause covers the case where the instrument is payable both to order and to bearer. The assumption is that the order should control because a specific payee is named. That assumption is overcome, however, where the bearer words are handwritten or typewritten.

An important change results from the elimination of the reference to joint payees in §8 of the N.I.L.[63] The practice of making instruments payable to A and B has nothing to do with survivorship in the absence of express language to that

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[59] N.D. Rev. Code §41-0208 (1943).

[60] U.C.C. §3-110 (e) (f).

[61] "An instrument made payable to a named person with the addition of words describing him

(a) as agent or officer of a specified person is payable to his principal but the agent or officer may act as if he were the holder;

(b) as any other fiduciary for a specified person or purpose is payable to the payee and may be negotiated, discharged or enforced by him;

(c) in any other manner is payable to the payee unconditionally and the additional words are without effect on subsequent parties." U.C.C. §3-118.

[62] 191 App. Div. 19, 180 N.Y.Supp. 747 (1920).

[63] N. D. Rev. Code §41-0208 (4) (1943).

effect. Hence the change in language makes A and B tenants in common.[64] The rule as to indorsement remains the same.[65]

PAYABLE TO BEARER

The important change here is the elimination of §9 (3) and (5) of the N.I.L.[66] Subsection three is dealt with under the subject of imposters,[67] where a new approach to the subject has been adopted. Subsection five is dealt with under the subject of indorsement, where it properly belongs.[68] The import of the section is to make it clear that a bearer instrument is not intended in any case where an identifiable payee is named. On the other hand, a blank instrument is not a bearer instrument, but rather an incomplete one that can be filled up by the holder. The section must be construed in the light of the section immediately preceding it.

TERMS AND OMISSIONS NOT AFFECTING NEGOTIABILITY

The substance of the material in §§5 [69] and 6 [70] of the N.I.L. are set out in this section. Subsection four of section five is omitted because it was not desirable to give the holder an option to require something to be done in lieu of the payment of money. Such provisions might be proper in investment paper but are unusual in commercial paper. Subsection four and five of section six are also omitted. The first deals with the effect of a seal. The Code now provides: "An instrument otherwise negotiable is within this Article even though it is under seal." [71] The purpose is to make clear that sealed instruments are on the same footing as other instruments under Article 3. Subsection five is now covered by the section on Money, discussed *supra*.

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[64] "It may be payable to the order of . . . (d) two or more payees together or in the alternative; . . ."

[65] "An instrument payable to the order of two or more persons

(a) if in the alternative is payable to any one of them and may be negotiated, discharged or enforced by any of them who has possession of it;

(b) if not in the alternative is payable to all of them and may be negotiated, discharged or enforced only by all of them." U.C.C. §3-117.

[66] "The instrument is payable to bearer: (3) When it is payable to the order of a fictitious or nonexisting person, and such fact was known to the person making it so payable; or . . . (5) When the only or last endorsement is an endorsement in blank." N.D. Rev. Code §41-0209 (1943).

[67] U.C.C. §3-405, to be discussed later.

[68] *Id.* §3-204, to be discussed later.

[69] N.D. Rev. Code §41-0205 (1943).

[70] *Id.* §41-0206.

[71] U.C.C. §3-113.

The provisions in the N.I.L. regarding collateral have been broadened. Under this section a clause authorizing the sale of collateral is no longer limited to default at maturity, but covers any default in principal or interest. Tying the section in with the provisions on acceleration, it is now possible to include a clause covering a demand for additional collateral. Apparently the original act by implication would not permit the addition of such a clause. It is included here to conform with banking practice. The common practice of including a term in a draft that the indorser acknowledges full satisfaction by indorsing or cashing is now expressly authorized.

The provisions of this section are to be read in the light of the provisions of the section on form. "Any writing to be a negotiable instrument within this Article must (b) contain an unconditional promise or order to pay a sum certain in money and no other promise, order, obligation or power given by the maker or drawer except as authorized by this Article . . ." [72]

TERMS LIMITING VALIDITY OR TIME OF PRESENTMENT

The material covered in this section is new. The insertion of a clause requiring that an instrument be presented for payment within a set period of time is resorted to in cases where a large number of checks are issued at regular intervals. The purpose of the clause is to induce prompt presentment, thus enabling the drawer to clear his records periodically. Such a clause should not be effective to protect the drawer from liability either on the draft or on the debt. The statute provides that "Such a term in a check is effective only as a direction to stop payment . . ." It will so operate only if conspicuously placed in the instrument. It does not affect negotiability, and the drawer's contract remains unchanged unless he signs "without recourse." [73]

DATE, ANTEDATING, POSTDATING

Article 3 brings together in this section isolated provisions of the N.I.L. which deal with the general topic of dates. Thus §6 (1) of the N.I.L.[74] states that the validity and negotiability of an instrument is not affected by lack of a date. Section 11 [75]

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[72] *Id.* §3-104 (1).
[73] *Id.* §3-114.
[74] N.D. Rev. Code §41-0206 (1) (1943).
[75] *Id.* §41-0211.

makes any date presumptively correct. Section 12 [76] permits both ante and postdating if no illegal or fraudulent purpose is involved. Section 17 (3) [77] states that an undated instrument is to be treated as if it bore the date of issuance.

Since dating does not affect negotiability of an instrument, the reference to fraud or illegality has been eliminated. Fraudulent or illegal dating is not a special kind of fraud and would be a matter of defense.

The section undertakes to fix the time of payment of ante and postdated instruments. If payable at a fixed period after date, the date on the instrument will govern maturity and it thus becomes possible in the case of an antedated instrument that it will be overdue before it is issued. It is of interest to note that the present law would give indorsers of an overdue instrument the right to require presentment and notice of nonpayment.[78] The Code reverses this rule and delay would not discharge secondary parties.[79] The dated demand instrument is payable either on the stated date or the date of issue, whichever is later. The sentence harmonizes with the concluding section on form: "A cause of action against the maker of a note payable on demand accrues upon its issue, or if postdated upon the stated date. . ." [80]

The problem of the undated instrument requires mention here. A demand note bearing no date of issue may or may not be an incomplete instrument. If no space is left to be filled, a date is not necessary either under the N.I.L. or Article 3. An undated instrument payable at a fixed period after date is obviously an incomplete instrument and does not fall under this section.

INCOMPLETE INSTRUMENTS

The substance of §§14 [81] and 15 [82] of the N.I.L. have been telescoped into two sentences in Article 3. Section 13 [83] has been eliminated since omission of a date needs no special treatment. If an instrument is undated, it may nevertheless be a

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[76] *Id.* §41-0212.
[77] *Id.* §41-0217 (3).
[78] "Where an instrument is issued, accepted, or endorsed when overdue, it is, as regards the person so issuing, accepting, or endorsing it, payable on demand." N.I.L. §7, N.D. Rev. Code §41-0207 (1943). See note 47 *supra*.
[79] U.C.C. §3-502, to be discussed later.
[80] *Id.* §3-123.
[81] N.D. Rev. Code §41-0214 (1943).
[82] *Id.* §41-1215.
[83] *Id.* §41-0213.

complete instrument if no space is left for a date and it is payable on demand.

The central idea in the section is that an unauthorized completion of an instrument is a material alteration, and is governed as such. Under the new section this holds true although the incomplete instrument was stolen and filled in. Thus, §15 of the N.I.L., making nondelivery of an incomplete instrument a real defense, has been reversed. The justification for the change lies in the fact that the holder takes the instrument in reliance on the genuine signature, whether the instrument was stolen or delivered. The policy is in line with cases holding that the drawer of a blank check is estopped to set up nondelivery as a defense.[84] As a common law matter, nondelivery of an instrument whether complete or not was treated as a real defense.[85] However, in this country there were decisions that nondelivery of a complete instrument could not be set up against a holder in due course, and this rule was adopted by the N.I.L., but the original common law viewpoint was retained as to nondelivery of an incomplete instrument. It would have been more consistent for the drafters of the N.I.L. to have rejected the common law view as to nondelivery as to both complete and incomplete instruments. As the law now stands, nondelivery of a complete instrument is a personal defense as is unauthorized completion of a delivered instrument. Where there is both nondelivery and unauthorized completion, the result should be the same.

INSTRUMENTS PAYABLE WITH WORDS OF DESCRIPTION

Section 42 of the N.I.L. provides: "Where an instrument is drawn or indorsed to a person as 'Cashier' or other fiscal officer of a bank or corporation, it is deemed prima facie to be payable to the bank or corporation . . . and may be negotiated by either . . ." [86]

This section [87] extends the policy of §42 to cover all payees. The purpose of the drawer is not mere identification of the payee; he intends the instrument to be payable to the principal, and names an officer or agent to enable the latter to cash

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[84] Heimberg v. Lincoln Nat. Bank, 113 N.J.L. 76, 172 Atl. 528 (1934); N.P. Ry. v. Spokane Valley Growers' Union, 132 Wash. 607, 232 Pac. 691 (1925). *Cf.* Linick v. Nutting & Co., 140 App. Div. 265, 125 N.Y.Supp. 93 (1910).

[85] Britton, Bills and Notes 344 (1943).

[86] N.D. Rev. Code §41-0413 (1943).

[87] U.C.C. §3-118.

the check. The act covers descriptions such as: "John Doe, Agent Baseball Association of Grafton," "John Doe, Administrator of estate of Bill Smith," "John Doe, City Treasurer." Of course, if no principal is disclosed, the instrument is payable to the named payee.[88] This extension of the principle of §42 appears to be sound and requires no modification of other sections of the N.I.L. relating to defenses and rights of a holder in due course.

AMBIGUOUS TERMS AND RULES OF CONSTRUCTION

The substance of §17 [89] is carried forward in this section. The omission of subdivisions three [90] and six [91] results from their treatment in other portions of the Code. The section seems self-explanatory, its purpose being to prevent resort to parol evidence to vary the terms of the instrument.[92]

OTHER WRITINGS AFFECTING THE INSTRUMENT

The N.I.L. contains no provisions which deal with the effect of a collateral contract on the rights of a holder who takes the contract by assignment, or has notice of its term when the instrument is transferred to him. Under the terms of the N.I.L. there are two situations in which a term of a

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88 "An instrument made payable to a named person with the addition of words describing him . . . (c) in any other manner is payable to the payee unconditionally and the additional words are without effect on subsequent parties." U.C.C. §3-118.

89 N.D. Rev. Code §41-0217 (1943).

90 "Where the instrument is not dated, it will be considered to be dated as of the time it was issued." N.D. Rev. Code §41-0217 (3) (1943).

91 "Where a signature is so placed upon the instrument that it is not clear in what capacity the person making the same intended to sign, he is to be deemed an indorser; . . ." N.D. Rev. Code §41-0217 (6) (1943).

92 "The following rules apply to every instrument:

(a) Where there is doubt whether the instrument is a draft or a note the holder may treat it as either. A draft drawn on the drawer is effective as a note.

(b) Handwritten terms control typewritten and printed terms, and typewritten control printed.

(c) Words control figures except that if the words are ambiguous figures control.

(d) Unless otherwise specified a provision for interest means interest at the legal rate at the place of payment from the date of the instrument, or if it is undated from the date of issue.

(e) Unless the instrument otherwise specifies two or more persons who sign in the same capacity and as a part of the same transaction are jointly and severally liable even though the instrument contains such words as 'I promise to pay.'

(f) Nothwithstanding any term of the instrument, the holder may extend it only with the consent of the maker at the time of extension. Unless otherwise specified consent to extension authorizes a single extension for not longer than the original period." U.C.C. §3-119.

negotiable instrument may be incorporated in a separate instrument. Section 31 [93] permits indorsement on a separate piece of paper when the back of the instrument is filled up, provided the paper is attached to the instrument. Sections 134 and 135 [94] cover acceptances of existing and future instruments on separate writings. Aside from these two cases, unless the terms of the note are expressly conditioned on a contemporaneous agreement, the weight of authority is that the terms of a note cannot be varied by provisions in contemporaneous contracts for the purpose of destroying negotiability. The principle is illustrated by the mortgage cases which refuse to permit acceleration of a note unless the note itself so provides.[95] On the other hand, it is not at all clear that this view should prevail where the mortgage clause purports to govern the note. The problem is forcibly illustrated by the facts in *National Bank of Watervliet v. Martin*,[96] where a note for $7,500 was issued together with a collateral writing which provided for periodic renewal of the note on payment of $250 installments. The court permitted recovery on the face of the note, despite the fact that the assignee of the contract expressly agreed to be bound by its terms and conditions. It seems more sensible to hold that the transferee was a holder in due course, but took subject to the renewal provisions of which he had notice. To permit the holder to disregard the provisions as to renewal might cause the maker great hardship, and the decision could not be upheld under the U.C.C. This section applies to negotiable instruments the general rule that applies in other branches of contract law that contemporaneous writings are to be read together when they constitute part of a single transaction.[97] It is not intended to mean that clauses in the contemporaneous writings are always read into the note.

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[93] N.D. Rev. Code §41-0402 (1943).

[94] *Id.* §§41-1103, 41-1104.

[95] Baird v. Meyer, 55 N.D. 930, 215 N.W. 542 (1927).

[96] 203 App. Div. 390, 196 N.Y.Supp. 714 (1922), *aff'd*, 235 N.Y. 611, 139 N.E. 755 (1923).

[97] "(1) As between the obligor and his immediate obligee or any transferee the terms of an instrument may be modified or affected by any other written agreement executed as a part of the same transaction, except that

(a) A transferee to whom the other agreement is not assigned acquires no rights under it except as a transferee; and . . .

(c) A holder in due course is not affected by any limitation of his rights arising out of the separate agreement if he had no notice of it when he took the instrument.

"(2) A separate written agreement does not affect the negotiability of an instrument." U.C.C. §3-120.

Such a construction could not be sustained since it would render many instruments nonnegotiable. As indicated above, whether or not an acceleration clause in a mortgage affects the rights of a holder depends upon the intention of the parties as expressed in the mortgage, and whether the holder took with notice.

A special problem will arise where the terms of the instrument and those of the accompanying contract are not consistent. Thus if the mortgage fixes the debt at $4,000 and the note at $3,500, the answer appears to be that the note should govern, since we treat the mortgage as incidental.[98]

While there is a substantial body of authority favoring the view that defenses should be let in where finance houses, operating in connection with sales agencies, take the contract and note as a step in completing the sale;[99] the present statute would appear to compel a contrary result, at least where a separate legal entity is set up to handle financing. As a matter of policy no solution is offered to this problem in Article 3. This section simply establishes the negotiability of an instrument accompanied by security. Since the holder taking without assignment is the owner of the security, whether or not a formal assignment is executed, it is difficult to see why a holder who takes by assignment should be in a worse position.

In conclusion, this section will definitely compel reading the note, draft, or other instrument, together with any collateral contract. The result is not to render the instrument nonnegotiable unless the writing contains a limitation constituting a defense. Thus a provision in the writing to the effect that the note shall be nonnegotiable would prevent any holder who had notice of the provision from enforcing the note. On the other hand, if the collateral writing contains an acceleration or other clause which would not affect the negotiability of the note if included among its provisions, a holder without notice would take free of the clause, but one who took with notice will nonetheless be a holder in due course, subject to the rights created in the obligor by the terms of the writing.

Instruments Payable Through or At a Bank

Many institutions issue payroll, dividend and other checks payable through a particular bank. This section is new, and

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[98] Brynjolfson v. Osthus, 12 N.D. 42, 96 N.W. 261 (1903).

[99] Palmer, *Negotiable Instruments Under the Uniform Commercial Code*, 48 Mich.L.Rev. 255, 269, and n. 49,51 (1950).

makes it clear that such a direction or order does not make the bank a drawee, nor compel it to accept the instrument for collection in the absence of an agreement with the drawer to that effect.[100] This appears to conform with commercial understanding and practice.

On the other hand, where the instrument is payable "at" a bank, the practice in banking and commercial circles is not uniform. Section 87 of the N.I.L. provides:

"Where an instrument is made payable at a bank it is equivalent to an order to the bank to pay the same for the account of the principal debtor thereon."

The omission of this section in the North Dakota Code is suggestive of the conflict in practice throughout the country. The N.I.L. rule was presumably based on a New York practice of treating such an instrument as the equivalent of a check. The rule was followed in neighboring states but appears to have been rejected by the southern and western states. The prevailing view in the west is that such a provision creates a mere agency. The bank notifies the drawer, but is not authorized to charge the account of the drawer without his consent. The section is proposed in alternative forms to fit the practice in each state. To require uniformity in this instance would upset long established practices and might do more harm than good.[101]

ACCRUAL OF CAUSE OF ACTION

This is the concluding section in Part I on Form and Interpretation, and deals with a subject touched on indirectly in the N.I.L. Under §192 of the original act,[102] the person primarily liable was the one required to pay by the terms of the instrument. Sections 60 [103] and 62 [104] made the maker and the

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100 "An instrument which states that it is 'payable through' a bank or the like designates that bank as a collecting bank to make presentment but unless otherwise agreed neither authorizes the bank to pay the instrument nor requires the bank to collect it." U.C.C. §3-121.

101 "Alternative A —

"A note or acceptance which states that it is payable at a bank is the equivalent of a bill 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.

"Alternative B —

"A note or acceptance which states that it is payable at a bank is not of itself an order or authorization to the bank to pay it." U.C.C. §3-122.

102 N.D. Rev. Code §41-0103 (1943).

103 *Id.* §41-0601.

104 *Id.* §41-0603.

acceptor primary parties who engaged to pay the instrument. Under §70,[105] presentment was not necessary to charge primary parties, but was required to charge the drawer and indorsers. Thus a clear line is drawn in the N.I.L. between primary and secondary parties as to the accrual of a cause of action.

Dealing first with the liability of primary parties, in the case of a time instrument the statute of limitations ran from the maturity date. In demand instruments the date of issue was the maturity date, unless the instrument were postdated.[106] The principle is the familiar one applied at common law on a simple contract claim that demand is not a condition precedent to suit. However, certain exceptions grew up in connection with banking transactions. The reason for these exceptions seems to lie in the peculiar relationship created when a bank accepts a deposit or borrows money on its certificate of deposit. A banker ordinarily expects to pay on demand. The establishment of a checking account illustrates the point nicely. The deposit creates a debtor-creditor relationship, but the contract of the bank is to pay only on demand, and hence the statute of limitations runs against the depositor only from the date of demand.[107]

While a certificate of deposit is a promissory note issued by a bank, and the bank is primarily liable as maker, the courts have held the statute ran only from the date of demand, and this is the point of view adopted by Article 3, because it accords with commercial understanding and practice.[108]

The position of the acceptor of a demand instrument is unusual in that the holder is entitled to payment, not acceptance. When does the statute of limitations run against the liability of the acceptor on a demand instrument? In the case of a certified check the cases have held that the statute ran from the date of demand [109] by analogy to the cases on certificates of deposit. No good reason exists why the same rule should not apply to the acceptance of an ordinary demand instrument. By presenting the instrument for acceptance the holder has

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[105] *Id.* §41-0701.

[106] McAdam v. Grand Forks Mercantile Co., 24 N.D. 645, 140 N.W. 725 (1913).

[107] For special legislation apparently setting up a short statute of limitations in favor of the bank, see N.D. Rev. Code §6-0824 (Supp. 1949).

[108] Dean v. Iowa-Des Moines National Bank, 227 Iowa 1239, 290 N.W. 664 (1940).

[109] See note 106 *supra*.

asked for a new contract with the drawee, and one that he is not entitled to as a matter of right. The promise of the acceptor in such a case is to pay on presentment of the instrument, *i.e.*, on demand. Thus the proposed section provides: "A cause of action . . . against the . . . acceptor of an instrument payable on demand does not accrue until demand . . ." [110]

The drawer, on the other hand, is secondarily liable. Under §61 of the N.I.L.,[111] he engages that he will pay the instrument if duly presented for payment and payment is refused, provided the proper steps are taken to notify him of this fact. Prima facie, it would be reasonable to assume that since the drawer is discharged unless proper presentment is made or excused, and demand being a condition precedent to accrual of a cause of action, that the statute of limitations would run from the date of demand. The cases, however, treat the problem raised by the statute of limitations as a distinct problem and hold that while a cause of action accrues on demand, the statute runs from a reasonable time after the date of issue.[112] The present section adopts the logical view that the cause of action accrues upon demand, and apparently the statute of limitations would run against the liability of the drawer from that date. If presentment were delayed and not excused of course the drawer is discharged.

In conclusion, the present section attempts to codify existing case law on accrual of a cause of action. The implication is that since a cause of action accrues at times set in the statute, the statute of limitations would run from the same date.

(To be continued)

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[110] U.C.C. §3-123.
[111] N.D. Rev. Code §41-0602 (1943).
[112] See note 107 *supra*.

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