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## Commercial Paper

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# UNIFORM COMMERCIAL CODE COMMENTARY

## COMMERCIAL PAPER

### THE RIGHTS OF A REMITTER OF A NEGOTIABLE INSTRUMENT

It is common in commercial transactions for the person making payment to do so by personal check.<sup>1</sup> In certain situations; however, one may wish to use the credit of a bank in addition to, or as a substitute for his own, and, in such cases, he may purchase a different kind of negotiable instrument. This instrument may take one of several forms, generally labeled as cashier's check, bank draft,<sup>2</sup> traveler's check,<sup>3</sup> postal money order,<sup>4</sup> and personal money order. The purchaser of one of these instruments is commonly called a remitter,<sup>5</sup> and his rights and duties are not expressly provided for in the Code. In order to define his status, then, it is necessary to examine the operation of the various instruments involved and to consider as well the sources of law which supplement the Code.<sup>6</sup>

The drawer<sup>7</sup> of a personal check is a creditor of the drawee bank, and his check is an order<sup>8</sup> to that bank to pay a sum certain<sup>9</sup> to a designated person or his order. It is essential to note at this point that the check is merely an order, and "does not of itself operate as an assignment of any funds . . ." <sup>10</sup> Moreover, since the check is only an order, the Code explicitly gives

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<sup>1</sup> "Check" is defined in U.C.C. § 3-104(1), (2)(b). All Code citations are to the 1962 Official Text.

<sup>2</sup> Courts do not always make the distinction between cashier's checks and bank drafts, and they often define the former as a check of the bank's cashier on his or on another bank. See, e.g., *Leo Syntax Auto Sales, Inc. v. Peoples Bank & Sav. Co.*, 6 Ohio Misc. 226, 215 N.E.2d 68 (C.P. 1965). See Annot., 107 A.L.R. 1463 (1937). For the purposes of this comment, however, this distinction will be made, and a "bank draft" will refer only to a draft drawn by one bank upon another.

<sup>3</sup> Express companies often issue traveler's checks through a bank which acts as a selling agent for the company. *Hawkland, American Travelers Checks*, 15 Buffalo L. Rev. 501, 503 (1966). This comment will be concerned only with traveler's checks issued by a bank.

<sup>4</sup> The issuing of money orders by the government is the exercise of a governmental function for the public benefit, and such money orders are not subject to commercial law. *Bolognesi v. United States*, 189 Fed. 335, 336 (2d Cir. 1911).

<sup>5</sup> The term remitter used in its business sense applies to any person who sends money credit to another, usually through the medium of a bank or commercial credit house. The remittance may be made by negotiable instrument with the remitter acting as purchaser, payee or indorsee . . . .  
*Beutel, Rights of Remitters and Other Owners Not Within the Tenor of Negotiable Instruments*, 12 Minn. L. Rev. 584, 588 (1928).

<sup>6</sup> For the supplementary sources of law specifically provided for in the Code, see U.C.C. § 1-103.

<sup>7</sup> The drawer's contract is set forth in U.C.C. § 3-413(2).

<sup>8</sup> U.C.C. § 3-104(2)(a)-(b).

<sup>9</sup> U.C.C. § 3-104(1)(b), -106.

<sup>10</sup> U.C.C. § 3-409(1).

the drawer the right to countermand it before it is paid, accepted, or certified by the drawee.<sup>11</sup> Similarly, the drawee is not liable until it accepts or certifies a check,<sup>12</sup> and a stop-order complied with before that time will in no way impair the drawee's credit. As a result of its acceptance,<sup>13</sup> the bank becomes primarily liable on the instrument, and the drawer's liability becomes secondary.

Under the Code, moreover, certification operates as acceptance.<sup>14</sup> Once certified, a check loses its character as a mere order, and the bank becomes liable to the holder.<sup>15</sup> If the bank certifies at the request of the holder, the bank becomes *solely* liable on the instrument, and the drawer is discharged.<sup>16</sup> "The theory for such release is that the holder, by requesting certification instead of payment, enters into a new contract with the bank, and one not within the contemplation of the drawer or a prior indorser."<sup>17</sup> Certification by the holder, therefore, has the same effect as payment, and the drawer has no further interest in the check.

Certification by the *drawer*, on the other hand, does not have entirely this same legal effect, but under the Code the drawer does lose his right to countermand.<sup>18</sup> When the drawer procures the certification, there is no discharge, and he remains liable on the check. Because of this liability, pre-Code law allowed the drawer to stop payment when the check was in the hands of one not a holder in due course<sup>19</sup> and the drawer had a defense.<sup>20</sup> The Code has eliminated this distinction, however, and provides that once certified by either holder or drawer, a check is not subject to a stop-order.<sup>21</sup> The principal reason for the Code rule is that, as "acceptor," the bank has engaged to pay the instrument, and it "is not required to impair [its] . . . credit by refusing payment for the convenience of the drawer."<sup>22</sup> In considering the status of the remitter, then, it will be essential to remember that once an ordinary check has been certified or accepted, the drawer has lost the right to countermand.

When a remitter chooses to make payment by cashier's check, traveler's check, or bank draft, he is not a party to the instrument and, consequently, he is in no way liable on it. For example, a cashier's check is drawn by a bank upon itself to the order of another person. Technically, it is a bill of exchange which is accepted at the moment of its issuance, and the bank, as acceptor,

<sup>11</sup> U.C.C. § 3-303, 4-303.

<sup>12</sup> U.C.C. § 3-410, -411.

<sup>13</sup> U.C.C. § 3-413(1).

<sup>14</sup> U.C.C. § 3-411.

<sup>15</sup> U.C.C. § 3-413. "Holder" is defined in U.C.C. § 1-201(20).

<sup>16</sup> U.C.C. § 3-411(1).

<sup>17</sup> The Law of Certification of Checks, 78 Banking L.J. 369, 377 (1961).

<sup>18</sup> U.C.C. § 4-303(1)(a).

<sup>19</sup> "Holder in due course" is defined in U.C.C. § 3-302. Section 3-305(1) provides: "To the extent that a holder is a holder in due course he takes the instrument free from (1) all the claims to it on the part of any person . . ."

<sup>20</sup> For a discussion of certified checks under both Code and pre-Code law, see 14 Wyo. L.J. 39 (1960).

<sup>21</sup> U.C.C. § 4-303(1)(a).

<sup>22</sup> U.C.C. § 4-403, Comment 5.

contracts to "pay the instrument according to its tenor at the time of [its] . . . engagement . . ." <sup>23</sup> Under section 3-413(1), this contract is exactly the same as the contract of a maker, and since the bank has the obligation of a maker, it is not at all unreasonable that section 3-118(a) provides that such a check is effective as a note. In the same way, it has been held that the payee is entitled to treat a cashier's check as a note, *i.e.*, the primary obligation of the bank, binding on the bank even without presentment and without further acceptance by the bank. <sup>24</sup> Since the remitter is not liable on the instrument, and it is the bank which has the liability of a maker or drawer, the remitter is a stranger to the bank's obligation, and therefore, by definition, the remitter has no right to countermand the payment of a cashier's check.

A traveler's check is different in appearance from a cashier's check, but it is essentially the same kind of commercial paper. The purchaser signs the instrument in the upper left or right hand corner when it is purchased, and the drawer bank promises to pay the amount of the check when it is countersigned by this person. The countersignature gives the instrument its negotiability, and it is at this time that the bank's obligation arises. <sup>25</sup> In both the cashier's check and the traveler's check, then, the drawer and the drawee are the same person, and the liability of the remitter and the issuer is the same in each case.

The bank draft differs from the cashier's check and the traveler's check in that it is drawn by one bank upon another. Unlike the parties to those two instruments, then, the drawer and drawee of a bank draft are separate entities, and the instrument is not in the nature of a promissory note. Technically, therefore, it is possible for the drawer bank to cooperate with the remitter and stop payment on his behalf. In the New York case of *International Firearms Co. v. Kingston Trust Co.*, <sup>26</sup> the court held that since the purchase of the bank draft resulted in an executed sale of credit not subject to rescission or countermand, payment could not be stopped even by mutual agreement of the drawer bank and depositor. Under section 4-403(1) of the Code, however, "a customer" has the right to stop payment on a check, and the definition of "customer" includes "a bank carrying an account with another bank." <sup>27</sup> This section establishes only that the drawer bank *could* stop payment and, as in the case of the certified check, the bank is by no means required to impair its credit for the convenience of a customer. Nor does it appear likely that a bank would be willing to exercise this power even as a favor to the remitter. As drawer, the bank has contracted to pay the holder of the draft <sup>28</sup> and, since it cannot assert any of the remitter's defenses in an action by such holder, <sup>29</sup> an attempt to stop payment would ultimately be futile.

<sup>23</sup> U.C.C. § 3-413(1).

<sup>24</sup> *In re Pascal's Estate*, 3 Misc. 2d 136, 139, 146 N.Y.S.2d 364, 367 (Sup. Ct. 1956).

<sup>25</sup> U.C.C. § 3-104, Comment 4.

<sup>26</sup> 6 N.Y.2d 406, 160 N.E.2d 656, 189 N.Y.S.2d 911 (1959).

<sup>27</sup> U.C.C. § 4-104(1)(e).

<sup>28</sup> U.C.C. § 3-413(2).

<sup>29</sup> U.C.C. § 3-306(d). The bank would be allowed to raise the defenses of theft or that the holder took through a restrictive indorsement.

Under section 3-603, however, there are two situations in which a drawer bank will not be discharged even if it does make payment, and therefore it would probably be willing to stop payment. These cases are those in which the remitter "supplies indemnity deemed adequate by the [bank] . . . or enjoins payment or satisfaction by order of a court of competent jurisdiction in an action in which the [remitter] . . . and the holder are parties."<sup>30</sup> If the bank's refusal to pay results in an action by the holder against the bank, the remitter will have the opportunity to intervene in that action and assert his claim.<sup>31</sup> Section 3-603 requires this procedure so as to protect the obligor as well as the holder of the instrument. It relieves the bank of the responsibility of raising defenses which it might have difficulty proving. In this respect, then, the bank draft differs from the cashier's check in that the drawer bank *can* stop payment if it so chooses and there are at least two cases in which such a choice is likely to be made.

Given the fact that the the remitter has no right to stop payment on a cashier's check, traveler's check, or bank draft, the question remains as to what rights the remitter does possess. In dealing with this question, the courts have considered various theories,<sup>32</sup> but they have generally rejected the theory that the bank is an agent for the remitter,<sup>33</sup> or that a trust relationship is established.<sup>34</sup> Under the most widely adopted theory, the transaction is viewed as a completed sale of the bank's credit to the remitter by which the money paid to the bank becomes the bank's property.<sup>35</sup> Accordingly, the contract to pay runs not to the remitter but to the holder of the instrument.

As owner of the instrument, however, the remitter may choose not to transmit it to the payee and, under general banking practice, he will be able to recover from the obligor.<sup>36</sup> The difficult question arises when the remitter has delivered the instrument to one not a holder in due course. In such a case, his remedies are not provided by the Code but by supplementary principles of law. That such other remedies were contemplated by the draftsmen is indicated by comment 2 to section 3-207 which provides:

The remedy of any such claimant is to recover the paper by replevin or otherwise; to impound it or to enjoin its enforcement, collection or negotiation; or to intervene in any action brought by the holder against the obligor.

It is apparent that one who has chosen to effect payment of a debt by use of a cashier's check, traveler's check, or bank draft is, as a practical matter, left to his defenses on the contract only. Moreover, one making a gift

<sup>30</sup> U.C.C. § 3-603(1).

<sup>31</sup> U.C.C. § 3-306(d).

<sup>32</sup> See 33 Yale L.J. 177 (1923).

<sup>33</sup> E.g., *Safian v. Irving Nat'l Bank*, 202 App. Div. 459, 196 N.Y.S. 141 (1922).

<sup>34</sup> E.g., *Montana-Wyoming Ass'n of Credit Men v. Commercial Nat'l Bank*, 80 Mont. 174, 259 Pac. 1060 (1927).

<sup>35</sup> E.g., *International Firearms Co. v. Kingston Trust Co.*, supra note 26; *Kerr S.S. Co. v. Chartered Bank of India, Australia & China*, 292 N.Y. 253, 54 N.E.2d 813 (1944).

<sup>36</sup> See *Britton, Bills and Notes* 300-01 (1943); *Moore, The Right of the Remitter of a Bill or Note*, 20 Colum. L. Rev. 749 (1920).

by such means would have no remedy at all. Although the remedies open to the remitter are at best inconvenient, the advantages of using these instruments are also apparent. They are available for immediate use in banking circles and are readily accepted in distant markets where a personal check might not be honored. The public relies on these instruments as cash substitutes, and one who uses them is justifiably subject to the disadvantages encountered by one who makes payments in cash. It is clear, then, that the right of countermand is quite properly denied to the remitter of any of these instruments.

A fairly new instrument, generally characterized as a "personal money order,"<sup>37</sup> presents problems which are different from those encountered above. This instrument bears the name and address of the bank and contains the words "personal money order." The form generally provides that the check is not valid over a certain amount and, when issued<sup>38</sup> for a nominal fee, the exact amount is inserted by the bank. A blank is provided for the name of the payee, and further blanks are provided in the lower right hand corner for the name and address of the purchaser. The problem facing the courts is whether to treat this instrument as a cashier's check of the bank or as the personal check of the purchaser. Two New York decisions have reached opposite results.

In *Rose Check Cashing Serv. v. Chemical Bank New York Trust Co.*,<sup>39</sup> the court held that the instrument was in essence a cashier's check and therefore a primary obligation of the bank. The court relied upon the visible differences between the personal money order and the personal check, as well as the differences in the underlying relationships of the parties. The words "personal money order" appeared prominently on the face of the instrument, and, where the maker or the drawer ordinarily signed, there was an additional line for the address of the signer. The court stated that this requirement was ordinarily for an indorser or a co-maker but not for a drawer.<sup>40</sup> The court gave little weight to the fact that there was no cashier's signature on the instrument and held that the printed name of the bank was sufficient.

The court found the underlying relationship between the parties to a personal money order to be different from that of the parties to a personal check. A personal check involves no assignment of funds until the check is accepted or paid, but the court concluded that the purchase of a personal money order was a sale where the "funds to pay the instrument . . . immediately come within the bank's exclusive control and ownership."<sup>41</sup> Following this reasoning, the court decided that the instrument was in the nature of a cashier's check and, therefore, that the bank's liability arose upon sale of the instrument; thus, there could be no right to stop payment.

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<sup>37</sup> See *Rose Check Cashing Serv. v. Chemical Bank New York Trust Co.*, 40 Misc. 2d 995, 996, 244 N.Y.S.2d 474, 475 (N.Y. City Civ. Ct. 1963), aff'd, 43 Misc. 2d 679, 252 N.Y.S.2d 100 (App. T. 1964).

<sup>38</sup> U.C.C. § 3-102(1)(a) defines "issue" as "the first delivery of an instrument to a holder or a remitter."

<sup>39</sup> *Supra* note 37.

<sup>40</sup> *Id.* at 997, 244 N.Y.S.2d at 477.

<sup>41</sup> *Id.* at 998, 244 N.Y.S.2d at 477.

In *Garden Check Cashing Serv., Inc. v. First Nat'l City Bank*,<sup>42</sup> the Appellate Division came to the opposite result and decided that this kind of instrument was more like a personal check, with the purchaser as drawer and the bank as drawee. The court stated that if the instrument were a cashier's check drawn by the bank upon itself, it would be non-negotiable, since it had not been signed by the drawer as required by section 3-104(1)(a).<sup>43</sup> The court decided, therefore, that it was not a cashier's check, and that the bank's liability arose only upon certification or acceptance of the instrument. Since it was thus in the nature of a personal check, the instrument could be countermanded in the same manner.

The basic difference between the decisions of the two courts is the weight given to the fact that the cashier's signature did not appear on the instrument. One court dismissed it as irrelevant and found that the printed signature of the bank was sufficient, while the other court found that the lack of the signature would have made the instrument non-negotiable. The problem is by no means clear, as there are persuasive arguments for either side. Under sections 3-104(2) and 1-201(39), it could be argued that the printed name of the bank is sufficient as its signature. On the other hand, it can be argued that in the past, when a bank has intended to be primarily bound, as in the case of cashier's checks and traveler's checks, it has evidenced its intent by including the cashier's signature. It could therefore be inferred that the absence of the signature on the personal money order is an indication that the banks do not intend to be so bound.<sup>44</sup>

A corollary to the question of the nature of the bank's signature is the question of the nature of the purchaser's signature. Section 3-402 states that "unless the instrument clearly indicates that a signature is made in some other capacity it is an indorsement." The comment points out, however, that by long established practice a signature in the lower right hand corner of an instrument indicates an intent to sign as maker of a note or drawer of a draft. The signature of the purchaser, therefore, could be that of either a drawer or an indorser.

As for the issue of the remitter's right to stop payment, the Code leaves unsettled the question of whether the personal money order should be treated as a cashier's check or as a personal check subject to countermand; perhaps, therefore, considerations of commercial policy should be controlling. To treat the personal money order as a cashier's check would satisfy no discernible commercial need and, in fact, it would disregard the essential characteristics of the personal money order. Commercial demands are adequately served by other well-established instruments such as the cashier's check and the bank draft; a third such commercial tool would be superfluous. Furthermore, as the personal money order is available only in amounts under \$300, it is unsuitable for use in any significant commercial transaction.

On the other hand, the personal money order could be uniquely tailored to the day-to-day needs of the ordinary consumer who, for some reason, does

<sup>42</sup> 25 App. Div. 2d 137, 267 N.Y.S.2d 698 (1966).

<sup>43</sup> Id. at 140, 267 N.Y.S.2d at 701.

<sup>44</sup> See U.C.C. § 1-205(2).

not have the convenience of a personal checking account. For this consumer, the fact that the instrument is available only in small denominations is not a bar to its usefulness, and, if it is treated as a personal check with the corresponding right to countermand, the personal money order will be ideally responsive to his needs.<sup>45</sup> The only real policy objection to this treatment of the personal money order is that the public might have come to rely on it as a cash substitute. If this is the case, however, it would seem that this reliance must as yet be insubstantial, since the personal money order has been developed only recently. On balance, then, it would seem that the public interest would best be served by analogizing the remitter of a personal money order to the drawer of a personal check. It does not appear that there is any compelling statutory or policy basis for doing otherwise.

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<sup>45</sup> For example, consider any individual who is incapable of managing a checking account, or the teenager or pensioner who will use a negotiable instrument only occasionally. It is also important that these instruments are often sold in shopping centers and the like, and are thus very useful to one who cannot conveniently conduct his business in normal banking hours. Obviously these consumers are not adequately served by remedies such as the injunction; for them, the right to countermand is the only practical remedy.