Chapter 4: Article Three: Commercial Paper

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§4.1. Repeals and revisions generally. Section 2 of Chapter 765 of the Massachusetts Acts and Resolves of 1957 repeals all but a few sections of the old Chapter 107, "Money and Negotiable Instruments." Still left standing are Section 1, "Money of Account"; Section 2, "Accounts etc. expressed in other Monies"; Section 3, "Rate of Interest"; Section 4, "Issue of Registered Bonds"; Section 7, "Bonds etc. Redeemable in Numerical Order, etc. Not to be Issued"; Section 8, "Penalties" (for violations of the preceding section); Section 10, "Damages on Other Contracts"; Section 13, "Protest Prima Facie Evidence"; and Section 45-A, "Use of Facsimile Signatures on Checks by Treasurers of Public Bodies." Only these sections survive the repealer clause in the new legislation of 1957; they formed no part of the Uniform Negotiable Instruments Law, which on October 1, 1958, will be replaced by Article 3 of the Uniform Commercial Code.

The Massachusetts uniform enumeration of the sections of the new Code, which conforms with that of Pennsylvania and of the 1957 Official Edition published by the sponsors, will substantially aid the lawyer studying some problem. The facilitation of comparative research thus achieved will increase as other states adopt the Code with the same uniform enumeration. The brief-writer need no longer be irritated and delayed by finding, for example, a holder in due course defined by Section 75 of Chapter 107 of the Massachusetts General Laws, but by Section 91 of the New York Negotiable Instruments Law, and by Section 52 of the Uniform NIL.

Article 3 of the new Code will not work any revolutionary changes in the Massachusetts law of negotiable paper. Chapter 107 of the General Laws has proved reasonably convenient and clear; litigation under it has become comparatively infrequent. There was no need for drastic change; correction of certain anomalies and inconsistencies which had inadvertently been included in the old Uniform NIL, or which had become apparent as customs of doing business had changed with the years, was the only requirement. Such comparatively modest reforms have been accomplished; the new Article is a businesslike and

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§4.3 UNIFORM COMMERCIAL CODE: ART. 3

easily understood statute, which should serve still further to reduce the areas of uncertainty in the law of negotiable instruments, and should render litigation even more infrequent.

An attempt to enumerate here every minor change made by Article 3 would be tedious to the reader and serve little purpose. The Special Supplement to the Annotated Laws of Massachusetts, New Chapter 109 (1958) will better accomplish that end. These notes will describe only what appear to be the more conspicuous amendments which Article 3 introduces.

§4.2. "Investment securities": Negotiability of Massachusetts trust obligations. One change made by Article 3 does perhaps deserve to be called a drastic departure from the old NIL. This is the transfer to a separate Article — Article 8 — of the entire subject of bearer bonds and any similar obligation "of a type commonly dealt in upon securities exchanges or markets or commonly recognized in any area in which it is issued or dealt in as a medium for investment..." 1 The policy considerations affecting such "investment securities" are quite different from those covering ordinary commercial paper — checks, notes, trade acceptances, and so on. The effort to make the Negotiable Instruments Law cover both types has on occasion produced strained constructions 2 which Article 8 will render unnecessary.

A question has sometimes been asked about the negotiability of obligations of a "Massachusetts trust." Under the provision of G.L., c. 107, §25, "an order or promise to pay only out of a particular fund is not unconditional" 3 and an instrument containing such a qualified promise is not negotiable. Section 3-105 (1) (h) of the Code provides that an obligation is not made conditional by the fact that "A promise or order otherwise unconditional... 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." 4 Any obligations of a Massachusetts trust not governed by Article 8 as "investment securities" will under Article 3 clearly not be deprived of negotiability merely because the holder can only have recourse to trust assets.

§4.3. Restrictive endorsements. Under G.L., c. 107, §§59, 60 and 70, 1 a restrictive endorsement deprived the instrument of negotiability. The necessities of bank collection require that checks be handled rapidly in great numbers; intermediary and payor banks have no real opportunity to scrutinize endorsements; under the NIL liability for handling a restrictively endorsed check may thus rest on a bank which has no effective way to protect itself. See, as an example, the 1938

§4.2. 1 UCC §8-102 (1) (a) (ii).

2 See, for example, Enoch v. Brandon, 249 N.Y. 263, 164 N.E. 45 (1928).

3 NIL §5.

4 UCC §3-105(1)(h).

§4.3. 1 NIL §§36, 37, 47.

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opinion of the New York Court of Appeals in *Soma v. Handrulis.* The remedy is not, however, simple elimination of the effect of restrictive endorsements; this would also produce injustices; people are used to writing “For Deposit” or similar directions on the backs of instruments, intending thus to put them beyond successful theft. The Code had to reach a compromise between these extremes, and this was accomplished by a series of changes, appearing in Sections 3-102, 3-205, 3-206, 3-304, 3-419, 3-603, and, in Article 4, Sections 4-203 and 4-205.

The effect of Section 3-206 and the associated sections is to give to the instrument endorsed “for collection,” “for deposit,” “pay any bank,” or the like, complete negotiability in bank-collection channels, except in the hands of the first bank to handle the paper; but to retain liability against the first bank and all others who may fail to pay or apply consistently with the endorsement. The owner of a check who so endorses it thus has at least one financially reliable party — the first bank recipient — to hold liable for misuse of the instrument. Trust endorsements are treated more leniently by Section 3-206 (4) of the Code; a trustee-holder to carry out his functions must be able to realize on trust assets by negotiating to any bona fide purchaser instruments endorsed to him in trust, and thereby to make any such transferee a holder in due course. Section 3-206 (4) accomplishes this.

§4.4. “Once bearer paper, always bearer paper”? Order paper may, of course, be endorsed simply with the payee’s name without additional words (blank endorsement); or it may be endorsed by the the payee to some other named person (special endorsement). Where order paper bears first a blank endorsement, and then a special endorsement, the Massachusetts rule appears to be that the blank endorsement permanently characterizes the instrument, which forever thereafter is bearer paper even if it bears later special endorsements. The Code changes this rule by making the last endorsement of “any instrument” control. Thus under the Code an order instrument may be endorsed first in blank, thus becoming bearer paper by virtue of that endorsement; then to Jones or order, thus becoming order paper; next in blank again, becoming bearer paper anew, in an infinite series.

277 N.Y. 223, 14 N.E.2d 46 (1938).
2 The Uniform Commercial Code spells “endorsement” with an initial “i.” The Uniform Commercial Code spells it “indorsement.” After some hesitation the initial “i” was chosen for these brief commentaries. Whoever writes next year’s *Annual Survey,* when the old order will have changed, may well spell the word with an “i.”

§4.4. 1 *Parker v. Roberts,* 243 Mass. 174, 137 N.E. 295 (1922). This holding has been criticized on the ground that G.L., c. 107, §63, NIL §40, is inconsistent with G.L., c. 107, §31 (5), NIL §9 (5), and G.L. c. 107, §57, NIL §34; hence that G.L., c. 107, §63 should be applied to instruments payable to bearer on their face which should remain bearer paper despite the form of any endorsement, but G.L., c. 107, §§31 (5) and 57 should be applied to instruments originally made payable to order, on which the last endorsement should control. See Britton, Bills and Notes §64 (1945). From this maze one turns with relief to §3-204 of the Code.

2 *UCC §3-204.*
§4.5. Negligence contributing to alteration. From time to time a negotiable instrument (typically a check) is so carelessly drawn that a wrongdoer can easily raise it and obtain payment of it from the drawee, or can sell it to a holder in due course. Under the 1827 English rule of Young v. Grote, the drawee was allowed to charge the negligent drawer's account for the instrument as raised; but the drawer could set up the alteration as a defense against a holder in due course. General Laws, c. 107 had no provision on the point, but decisional law in Massachusetts was the same. Section 3-406 of the Code will change the law as to holders in due course; the negligent drawer or maker will be precluded from setting up the alteration not only against a drawee who pays in good faith and in accordance with reasonable commercial standards, but also against a holder in due course.

§4.6. Warranties to a payor. General Laws, c. 107, §§88 and 89 provide respectively for warranties by one “negotiating” by delivery or qualified endorsement; and for warranties by an unqualified endorser running “to all subsequent holders in due course.” As the obtaining of payment is not “negotiation” and the payor, drawer or maker who pays the instrument does not become a “holder,” the weight of authority has held that one who in good faith obtains payment of an instrument from a drawee or maker gives to the payor no implied warranties. In banking practice this lack has been supplied by such stamped endorsements as “All previous endorsements guaranteed”; the Code (with exceptions to be noted) imposes warranties on all who obtain payment or acceptance of instruments. There are, however, no such warranties where the principle of Price v. Neal applies; it is inappropriate for one acting in good faith to give war-


§4.6. 1 NIL §§65, 66.
3 Here should be pointed out another principle of law which, even in the absence of warranty by one who obtains payment of an instrument, may still render him liable to the payor. If the payor pays in reliance on a mistake of fact — for example in reliance of the genuineness of a chain of endorsements apparently carrying good title to the last holder, whereas one endorsement is forged — the payor may be able to recover his money from the recipient. This was the situation in Carpenter v. Northborough National Bank, 123 Mass. 66 (1877), which upheld such a recovery. But if the party who presented the instrument to the payor was merely a collection agent, so known to be by the payor, the agent's liability ends when he pays over the collected sum to his principal. National Park Bank of New York v. Seaboard Bank, 114 N.Y. 28, 20 N.E. 632 (1889). See Britton, Bills and Notes §§139, 140 (1945).
§4.7. Presentment, notice of dishonor and protest. Section 3-501 of the Code puts in one place a large number of provisions on these subjects, which are scattered through the NIL. There are only minor changes of substance. Protest is made unnecessary except on international drafts. Section 3-502 makes new law covering the situation (now happily almost nonexistent in banking) where a drawer maintains funds on deposit with a drawee, or payor bank, to meet his drafts, but the drawee, or payor bank, becomes insolvent during unreasonable delay in presentment by the payee or other holder. The Code does not thereby effect a discharge of the drawer of a check "to the extent of the loss caused," as was the case under G.L., c. 107, §209.1
Section 3-502 now provides instead that any drawer, or the acceptor or maker of an instrument payable at a bank, under these circumstances obtains a discharge only on giving to the holder a written assignment of his rights against the drawee or payor bank. The "forced novation" so effected is the penalty of the holder for his delay in presentment. And for consistency, Section 3-502 applies the same rule to delay in notice of dishonor to any party other than an endorser; the endorser is discharged as he always has been.

Presentment of demand paper under G.L., c. 107, §§ 94 and 209 2 must be made "within a reasonable time after its issue." Under Section 3-503 (1) (e) of the Code, for purposes of determining the liability of secondary parties, presentment of demand paper is due within a reasonable time after the secondary party becomes liable thereon. Section 3-503 (2) sets up presumed reasonable periods of presentment or initiation of collection of an uncertified check (not drawn by a bank) drawn and payable within the United States "(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 endorser, seven days after his indorsement."

This will give a longer time for presentment

5 In Massachusetts, Price v. Neal is held to be law, not by judicial construction of G.L., c. 107, §85, NIL §82, but as a principle of the common law which was unaffected by the uniform statute. South Boston Trust Co. v. Levin, 249 Mass. 45, 143 N.E. 816 (1924). Negligence by the presenting party has, however, permitted the drawee to recover despite the rule of Price v. Neal. First National Bank of Danvers v. First National Bank of Salem, 151 Mass. 280, 24 N.E. 44 (1890). See Britton, Bills, and Notes ¶136 (1943).
§4.7. 1 NIL ¶186.
2 NIL §§71 modified, 186.
3 UCC §§3-503(2)(a), (b).
§4.8. The "jus tertii" as a defense. A troublesome question is raised when one liable on negotiable paper sets up as a defense the lack of proper title in the holder. The classic Massachusetts case is *Prouty v. Roberts*, which in 1850 disallowed to a maker a defense that the note was got from the payee by fraud. The question was considered by the Supreme Judicial Court in 1955 in *Nichols v. Somerville Savings Bank*. The drawer of a bank draft was sued on the draft by a real estate broker who had obtained the draft by endorsement from the payee. The defendant drawer was allowed to set up as a defense the conditional delivery of the instrument by the payee to the plaintiff-endorsee. The defendant drawer had attempted to interplead the payee, one Ferretti, but the trial court had denied this motion. The Supreme Judicial Court's opinion says of this matter: "It seems unfortunate that the defendant's motion to interplead Ferretti was denied. Favorable action would have given an opportunity to do justice simultaneously among all the parties to the instrument."

Section 3-306 of the Code provides:

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, non-performance of any condition precedent, non-delivery, or delivery for a special purpose (section 3-409); 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.

If a *Nichols* case were to arise with the Code in force, one would suppose that under subparagraph (d) Ferretti, the payee of the bank draft, would be entitled as of right to defend the action for the Somerville Bank, and that if he did so, his rights against Nichols would be a defense as they were held to be in the actual case.

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4 NIL §71 modified.
6 16 Cush. 19 (Mass. 1850).
8 333 Mass. at 490, 132 N.E.2d at 159.
9 UCC §3-506.
Section 3-603 of the Code supports this analysis; the liability of a defendant drawer in the situation of the Nichols case would be discharged under that section by payment to the holder, unless the payee supplied indemnity to the defendant drawer or obtained an injunction in a proceeding to which holder, drawer and payee were parties. Section 3-603 would thus inferentially sustain the defense if the payee did supply indemnity, and it would encourage the joinder of all three parties which the Nichols opinion suggests.

§4.9. Rights of the irregular endorser who pays the holder. In Quimby v. Varnum, the Supreme Judicial Court in 1906 held that an irregular endorser who paid the instrument could not recover on it against the maker. This anomaly is corrected by Section 3-603 (2) of the Code.

§4.10. 1957 Bills and Notes cases. There have been few reported bills and notes cases, in addition to those previously mentioned in this chapter, decided either in the federal courts for Massachusetts or the Supreme Judicial Court during the 1957 Survey year. In United States v. deVallet the opinion applies G.L., c. 107, § 39 (6): "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 endorser," and §86: "A person placing his signature upon an instrument otherwise than as maker, drawer or acceptor is deemed to be an endorser, unless he clearly indicates by appropriate words his intention to be bound in some other capacity."

The District Court, in this suit brought against a bank by the United States to recover insurance the government had paid when an insured note was defaulted, held (as seems obvious) that a purported signature on the lower left of the face (which had been forged) was that of a "party," and thus that under a FHA regulation requiring that signatures of all "parties" must be genuine the government could recover the insurance it had paid. If the signature was not that of a co-maker, the purported signer was "at least an endorser" — though the signature appeared on the face of the note.

The Supreme Judicial Court, in A-Z Servicenter, Inc. v. Segall, held that where a mortgage note, given for the purchase price of $20,000 for realty, stated that $41,400, comprising principal and interest, was to be paid monthly over a period of fifteen years, and that in event of default the holder of the note had an option to declare the entire amount immediately due and payable as liquidated damages and not as a penalty, the acceleration provision of the note constituted a "penalty" and was not enforceable as to future interest.

§4.9. 1 190 Mass. 211, 76 N.E. 671 (1906).


2 NIL §17 (6).

3 Id. §63.

§4.10 UNIFORM COMMERCIAL CODE: ART. 3

The Supreme Judicial Court, in *Blender v. Epstein*, exemplified the usual rule that the parol evidence rule does not bar testimony on behalf of the defendant in an action brought by the party accommodated against the accommodation party, to show the latter's true character, and hence to defeat an action for contribution where the accommodated party has paid the instrument. Section §4-15 (3) and (5) of the Code restates this long-established principle of law.

§ 334 Mass. 693, 128 N.E.2d 270 (1956). The action was brought by the administratrix of the accommodated party; the principle is no different from that in an action by the party himself.