

1966

## Article Three: Commercial Paper

E. McGruder Faris Jr.

---

### Repository Citation

Faris, E. McGruder Jr., "Article Three: Commercial Paper" (1966). *Faculty Publications*. 1061.  
<https://scholarship.law.wm.edu/facpubs/1061>

Copyright c 1966 by the authors. This article is brought to you by the William & Mary Law School Scholarship Repository.  
<https://scholarship.law.wm.edu/facpubs>

# ARTICLE THREE: COMMERCIAL PAPER

E. McGRUDER FARIS, JR.\*

## SUMMARY OF CONTENTS

GENERAL COMMENTS .....	598
I. The General Nature of Article 3 .....	599
II. The Scope of Article 3 .....	600
SUMMARY OF CODE PROVISIONS .....	605
I. Form and Interpretation .....	605
II. Transfer and Negotiation .....	613
III. Rights of a Holder .....	615
IV. Liability of Parties .....	617
V. Presentment, Notice of Dishonor, and Protest .....	621
VI. Discharge .....	624
VII. Miscellaneous .....	625

## GENERAL COMMENTS

“Old wine in new bottles” has been used to describe Article 3 on commercial paper. Perhaps this description is more aptly applied to the commercial paper provisions than to other articles of the Uniform Commercial Code, for the substantive changes in the law of negotiable instruments are not extensive.

Usually, the practicing attorney’s loudest lament about any statutory change in existing law is that he must unlearn much of what he already has mastered. This attitude is based on the assumption that he has a mastery of the subject being tampered with by legislation. In the area of commercial paper, however, it is submitted that most practitioners have probably become somewhat rusty on the refinements of existing law. Such a waning of knowledge is understandable, for so many legal problems associated with negotiable instruments are resolved in out-of-court settlements, by default judgments, or by a simple failure of holders of “bad paper” to seek legal advice. The fact that only about a dozen negotiable instrument cases have reached the Supreme Court of North Carolina since 1952 is some indication of the paucity of complicated litigation on the matter.<sup>1</sup>

---

\* Member of the Virginia Bar and Lecturer in Law at the Marshall-Wythe School of Law of the College of William and Mary; consultant to North Carolina Legislative Council for Articles 3, 4 and 5.

<sup>1</sup> The scarcity of appellate cases could be considered as an indication

Since the typical reader probably is not conversant with the existing law of negotiable instruments, he most likely will view North Carolina's passage of Article 3 not as a threat to his usual way of doing things but as an opportunity to review briefly a few somewhat basic rules relating to negotiable instruments in general. The following commentary is based on this premise.

Though discussion is primarily of basic law, a few comments will be made on more refined problems for the benefit of readers interested in the esoteric. Also, an occasional suggestion will be made for further legislative action that might facilitate collections of negotiable instruments.

### I. THE GENERAL NATURE OF ARTICLE 3

Generally, Article 3 is a revision of the Uniform Negotiable Instruments Law<sup>2</sup> promulgated by the National Conference on Uniform State Laws in 1896 and promptly adopted by North Carolina in 1899. Though the NIL had been adopted in every state by 1925, the desired uniformity of law did not materialize in practice. Many states modified by legislative action various statutory provisions, and some eighty of the NIL's 198 sections have received conflicting constructions by the courts.

Briefly stated, the general purposes of Article 3 are:

(1) to reconcile prior inconsistencies by adopting in statutory form the "best" view of the courts;

(2) to eliminate obsolete provisions of the NIL;

(3) to consolidate the prolix 198 sections of the NIL into seventy-nine revised sections under Article 3;

(4) to narrow the scope of the provisions by eliminating from coverage under the modified rules of the NIL certain instruments that were previously lumped in with commercial paper to form a nebulous hodgepodge of paper called negotiable instruments; and

(5) to leave to the coverage of Article 4 (bank deposits and collections) certain specific rules on commercial paper when such paper is involved in the banking process and the bank—customer relationship.

---

that the law of North Carolina is well settled in matters affecting negotiable instruments. However, the frequency with which other apparently well-settled matters are appealed argues for the minimum litigation conclusion.

<sup>2</sup> Hereinafter referred to as the NIL.

It is appropriate to note that the lawyer's research task will be immeasurably facilitated by Article 3. While the seventy-nine Code sections and comments thereon may not answer all questions, they do give a sound starting point that is far superior to prior statutory law with its multiple views (views often prompted by insignificant peculiarities of the facts which made a particular construction expedient at the time). The law will surely be easier to find, at least until we again develop a body of new conflicting constructions.

In particular, attention is called to the official comments in the 1962 official text of the Code and the North Carolina comments compiled for the Legislative Council. While these comments are not law in themselves, they do set forth changes from prior law, and in some instances the exact meaning of rather concise statutory provisions can be determined only by a careful study of the 1962 official comments.

A cautionary word is added here. This writer must take the responsibility for the North Carolina comments to Articles 3, 4 and 5, and because of the haste necessary in their preparation they should not be taken as either definitive or final.

In reading the official text and the official comments to the Code, the reader is forewarned that punctuation is at a minimum. Clarity at times is achieved by mentally adding an occasional comma or semicolon. Also, some sections can be better understood by reading the concluding sentences first. As one wag at a recent meeting put it, "and it sometimes helps to not only reverse the sentence order, but to read each sentence backwards." Though this is an obvious overstatement, one may gain new insight into many sections by experimenting with some rearrangement of words.

## II. THE SCOPE OF ARTICLE 3

Item (4) of the purposes listed above notes that the scope of Article 3 covering commercial paper is narrower than the existing coverage of the NIL. This narrowing of coverage is of considerable importance, and a bit of history will give the proper perspective for appreciating more fully the "labeling technique" employed in the past and under the Code.

Fundamentally, a negotiable paper is a species of contract having legal attributes quite different from other contracts. For example, the so-called "negotiable instrument" was one that could be assigned

(or negotiated) at a time when the common law frowned on the assignment of contract rights. Further, the transfer of such paper could be accomplished with relative ease, *i.e.*, by mere delivery in the case of bearer paper or an indorsement plus a delivery in the case of order paper. Also, a subsequent good faith purchaser could collect on the contract free of defenses existing between prior parties, this being the subsequent owner's main advantage in being classified as a holder in due course. In addition to the ease-of-transfer and freedom-from-defense attributes of a negotiable instrument, such an instrument occasionally has minor advantages such as ease of procedure in suit, more liberal rules on interest allowance, and longer periods of limitations.

In the following analysis a distinction must be made between a contract that is negotiable in the sense that it can be easily negotiated free of defenses, a technical "negotiable instrument," as that term is used in the NIL, and "a negotiable instrument within this article," as the term is employed in Article 3. Distinctions between these three classes of instruments will be made more apparent in later paragraphs.

Prior to the NIL, the laws of non-money negotiable instruments and the laws of moneyed negotiable instruments were somewhat different, but they did have the basic similarity of ease of transfer and freedom from certain defenses when sued on by a bona fide purchaser.

When the English codified the law of moneyed paper in the Bills of Exchange Act in 1882, they carefully distinguished between moneyed and non-moneyed instruments by providing, "Bills, notes and checks in order to be negotiable . . . must be payable in money." Thus, moneyed paper, (bills, notes and checks), had a special law of "negotiable instruments"; but non-moneyed paper could be negotiable apart from the Bills of Exchange Act.

Later in the century, when the basic rules of the Bills of Exchange Act were adopted by John J. Crawford in his draft of the NIL, section 1<sup>3</sup> awkwardly stated, "*an instrument* to be negotiable . . . (2) must contain an unconditional promise or order to pay a sum certain in money." This "an instrument" phraseology has been descriptively called "Crawford's Blunder," because non-moneyed paper, such as stocks, interim receipts, warehouse receipts,

---

<sup>3</sup> N.C. GEN. STAT. § 25-7 (1953).

and bills of lading that had previously been capable of easy transfer and freedom from defenses did not meet the "in money" test so as to be negotiable under the NIL.

The legislatures set to work passing statutes such as the Uniform Bills of Exchange Act, the Uniform Warehouse Receipts Act, the Uniform Interim Receipts Act, and the Uniform Stock Transfer Act in order to give back to non-moneyed papers the ancient attributes of negotiable paper that the NIL already gave to paper payable in money.

One class of paper that clearly could come under the NIL's "in money" requirement is the corporate bond, and for years the negotiability of such investment paper was tested by the detailed definition of a "negotiable instrument" contained in NIL sections 1 through 10.<sup>4</sup> Often, one or more of the usually elaborate provisions of a corporate bond would cause such bond to fail the tests for negotiability. At times, however, the courts stretched the NIL definition of a negotiable instrument or construed the terms of the bond in such a manner as to permit it to be classified as a "negotiable instrument" so as to bring into play the beneficial provisions of that law.

The bond cases are typical of the "classification technique" so frequently applied by courts and legislatures. For example, instead of asking whether an innocent purchaser for value of a bearer bond should be able to hold the bond free of the claims of a prior owner from whom it has been stolen, the courts tend to become embroiled in the secondary question of whether some one of the provisions inserted by the corporate issuer happened not to meet the test of a "negotiable instrument" laid down by the NIL.

Under the classification technique, if the bond is classified as a "negotiable instrument," the innocent purchaser for value may be a holder in due course (hereinafter called an HDC) free from claims of the original true owner. Conversely, if the bond fails the NIL test, the same equally innocent purchaser for value is not an HDC. Consequently, he is subject to the claim of the prior owner under the bromide that "a thief cannot pass title," or the more picturesque "title, like a stream, can rise no higher than its source." While there is a place for such conclusions, they are not really very

---

<sup>4</sup> N.C. GEN. STAT. §§ 25-7 to -16 (1953).

helpful in deciding who has the better claim to paper that is designed to circulate freely in a Wall Street world.

Fortunately for the investor, corporate bonds are no longer lumped together with bills, notes and checks under Article 3.<sup>5</sup> Instead such investment paper is covered by Code Article 8 on investment securities. Other types of negotiable paper are covered by Article 5 (letters of credit) and Article 7 (warehouse receipts, bills of lading, and other documents of title).

In summary, then, Article 3 is left to cover only drafts, checks, certificates of deposit and notes. These items are described as commercial paper,<sup>6</sup> from which the article derives its title.

Turning again to the "labeling game," we find an interesting new phrase appearing in Code section 3-104(1): "Any writing to be a *negotiable instrument within this article* must . . ."<sup>7</sup> Here in the very first substantive section, we find the "old wine," the familiar, though troublesome, terminology. Even Article 3 with its new name "Commercial Paper"<sup>8</sup> continues to call the paper it governs "a negotiable instrument." However, it limits this to "within this Article." The significance is seen in the official comment: "'within this article' in subsection (1) leaves open the possibility that some writings may be made negotiable by other statutes or by judicial decision. The same is true as to any new type of paper which commercial practice may develop in the future."<sup>9</sup> Consequently, it now appears that in the future the lawyer will be dealing with different kinds of negotiable or quasi-negotiable paper:

(1) Moneyed or commercial paper that meets the definition of "a negotiable instrument within this article," which will be governed by the express terms of Article 3.

(2) Quasi-negotiable paper in the form of documents of title to be governed by Article 7.

(3) Quasi-negotiable paper in the form of investment securities covered by Article 8.

(4) Other court-sanctioned negotiable paper to be governed by some none-too-certain law.

---

<sup>5</sup> G.S. § 25-3-103(1) provides: "This article does not apply to money, documents of title or investment securities."

<sup>6</sup> See G.S. § 25-3-104, comment 1.

<sup>7</sup> Emphasis added.

<sup>8</sup> Interestingly, the term "commercial paper" is only generally defined in G.S. § 25-3-101, comment 1, and it is not defined in the Code proper.

<sup>9</sup> G.S. § 25-3-104(1), comment 1.

For the last type of paper, the courts revert to the rules of the law merchant.<sup>10</sup> However, it is suggested that the courts adopt as a part of the decisional law of North Carolina the views expressed in the Code provisions if they are deciding a question involving an instrument that is for practical purposes the equivalent of "a negotiable instrument within this article."

One such instrument might have been a check that omits the magic words of negotiability—"order" or "bearer." Technically, such a check does not come within the definition of Code section 3-104. However, it is not necessary to speculate whether such a check should be treated by decisional law in approximately the same way as a technically perfect "negotiable instrument within this article." Such check or similar instrument is expressly made subject to all provisions of Article 3, except that there can be no holder in due course of such instrument.<sup>11</sup> For the past year or so counter-checks omitting the words "order" or "bearer" have been in use in North Carolina.<sup>12</sup>

Before moving to an analysis of individual provisions of Article 3, it is important to note the intimate relationship between it and Article 4 (bank collections and deposits).

Whenever commercial paper covered by Article 3 finds its way into the bank deposit and collection process, it is necessary to consider both Articles 3 and 4. To the extent of any conflict between the two, the specific provisions of Article 4 prevail over the more general provisions of Article 3.<sup>13</sup>

The close relationship between Articles 3 and 4, however, does not necessarily mean that every moneyed paper that gets into the hands of a bank will be subject to both articles. For example, Article 4 applies to moneyed paper that may not be a negotiable instrument within the definition of Code section 3-104. Also, some commercial paper covered by Article 3 may be in the hands of a bank other than as a part of the deposit and collection process. In this latter case, only the rules of Article 3 apply.

---

<sup>10</sup> G.S. § 25-1-103 permits the law merchant to be followed unless displaced by some provision of chapter 25 of the General Statutes.

<sup>11</sup> G.S. § 25-3-805.

<sup>12</sup> The presence of such checks may be explained by the fact that one of the companies printing checks for North Carolina users is located in Georgia, which adopted the Code several years ago.

<sup>13</sup> G.S. §§ 25-3-103(2), -4-102(1).



## SUMMARY OF CODE PROVISIONS

A full section-by-section commentary is not possible within the space allotted, and any comprehensive commentary would be, to a large extent, merely repetitive of the Article 3 provisions, the official comments, and the North Carolina comments, all of which fill about 122 tightly packed pages in newly published Volume 1D of *The General Statutes of North Carolina*. For those who wish to pursue a matter not considered here, the pocket supplement to the volume offers a useful index tool not available in the Official Uniform Commercial Code volume published by the Commissioners on Uniform State Laws. Over five pages of the pocket index to Volume 1D is devoted to "commercial paper."

The succeeding commentary follows a straight progression through some of the more significant provisions of Article 3. Only those sections containing significant changes in existing negotiable instrument law are discussed at length, but omission of discussion of a section does not necessarily mean that it contains no modifications to existing law.

## I. FORM AND INTERPRETATION

Section 25-3-102. *Definitions and Index of Definitions*.—This section not only gives definitions and citations to other definitions in the related Articles 3 and 4 but also provides in subsection (4) that the general definitions and principles of construction of Article 1 are applicable to Article 3.

The principle change here relates to the permissibility of using alternative drawees. NIL section 128<sup>14</sup> did not permit an order to be addressed to two or more drawees in the alternative. The Code permits this, thus recognizing current commercial practice whereby corporations issuing dividend checks (and certain other drawers) name a number of drawee banks (often in different parts of the country).<sup>15</sup>

Section 25-3-103. *Limitations on Scope of Article*.—As previously observed, this section limits the application of Article 3 to checks, drafts, promissory notes, and certificates of deposit. Other types of paper are governed by other articles.

<sup>14</sup> N.C. GEN. STAT. § 25-135 (1953).

<sup>15</sup> Also, subsection (1)(a) makes it clear that a remitter can take. G.S. § 25-3-102, comment 1.

Section 25-3-104. *Form of Negotiable Instruments; "Draft"; "Check"; "Certificate of Deposit"; "Note."*—The full text of this fundamental statute should be studied, because only if the instrument in question meets this definition does Article 3 come into play.<sup>16</sup> The definition of a "negotiable instrument within this Article" is set forth in subsection (1) (a). This definition is substantially the same as the definition of a "negotiable instrument" under NIL section 1.<sup>17</sup> A full comprehension of the general definition can be attained only by a further examination of sections 25-3-105 (on "unconditional promise or order"); -3-106 (on "sum certain"); -3-107 (on "in money"); -3-108 (on "on demand"); -3-109 (on "at a definite time"); -3-110 (on "to order"); -3-111 (on "to bearer"); and -3-112 (on additional promises, orders, obligations or powers which can be included without killing negotiability under Article 3).

An examination of the above list together with the definition in subsection (1) (b) of section 25-3-104 reveals that the full tests for determining whether a particular instrument is a negotiable instrument under Article 3 can be determined only by reading sections 25-3-104 through 25-3-112 as a unit. Also, sections 25-3-113 (seal), 25-3-114 (date, antedating, postdating), and 25-3-119 (other writings affecting instrument) deal in part with the problem of whether a particular instrument is a "negotiable instrument within this article."

Of special importance under subsection (1) (b) is the provision that any promise or order in addition to the basic promise or order to pay money will kill negotiability unless the additional promise or order is expressly approved by section 25-3-112 or other sections in Article 3. Thus, as will be noted when section 25-3-112 is commented upon, the Code takes an "exclusive" approach to the question of what additional matters may be included in an instrument without killing its negotiability.

Section 25-3-105. *When Promise or Order Unconditional.*—Two of the salutary changes of this section are:

(a) Subsection (1) (g), which permits instruments of governmental units to be limited to payment from a particular fund or

---

<sup>16</sup> As noted earlier, G.S. § 25-3-805 permits instruments lacking the words "order" or "bearer" to be governed by Article 3, except that there can be no holder in due course.

<sup>17</sup> N.C. GEN. STAT. § 25-7 (1953).

source without losing their status as negotiable instruments. Usually, obligations of governmental units will be classified as investment securities coming under Article 8; however, some limited-source obligations may come under Article 3 as negotiable instruments.

(b) Subsection (1)(h), which states that an instrument is not rendered non-negotiable merely because it is limited to payment from the entire assets of a partnership, unincorporated association, trust or estate by or on behalf of which the instrument is issued. Previously it was doubtful that such instruments were negotiable, because they were limited to payment from a particular fund.

Section 23-3-106. *Sum Certain*.—Perhaps the most significant aspect of this section is its recognition that an instrument may be negotiable even though it provides for the payment of (a) costs of collection and (b) an attorney's fee upon a default in payment. This is really nothing new because General Statutes section 25-8(5), which it replaces, also recognized that such provisions did not kill negotiability. However, the really interesting question is whether such reasonable agreements will be enforced.<sup>18</sup>

It is submitted that, in the absence of a clear statutory prohibition, such contractual terms should be enforceable. In North Carolina, however, prior to the Code there was a prohibition that "a provision incorporated in the instrument to pay counsel fees for collection is not enforceable . . ." <sup>19</sup> However, these prohibitory words will not be a part of North Carolina law after the NIL becomes inoperative on July 1, 1967.

This writer's suggestion to the North Carolina Legislative Council in preparing the study of Article 3 was that a statute similar to General Statutes section 6-21 be passed to permit attorney's fees to be collected as a part of costs in suits on negotiable instruments even though the paper did not contain an express clause permitting such fees to be collected by the holder.<sup>20</sup> If such a statute were passed, most surely many persons would start honoring their bad notes and checks. Word would soon get around that a holder could afford to pay a lawyer to help him collect on paper that, in theory

---

<sup>18</sup> G.S. § 25-3-106(2) takes no position on the matter.

<sup>19</sup> N.C. GEN. STAT. § 25-8 (1953).

<sup>20</sup> Attorney's fees are now allowed in certain cases. See generally N.C. GEN. STAT. §§ 6-21 (1965), 6-21.1 (1963), 28-170.1 (1957), and 50-16 (1955). See also 38 N.C.L. Rev. 16 (1960) on attorney's fees as a part of costs.

at least, is supposed to be a substitute for money. Such unpaid obligations should be collectible at face value.

Although the 1965 General Assembly did not take action to permit the collection of attorney's fees in all suits on negotiable instruments, this inaction does not necessarily affect collection of attorney's fees when they are specifically contracted for. There is some dictum in *Queen City Coach Co. v. Lumberton Coach Co.*<sup>21</sup> implying that attorney's fees may be collected when contracted for. And in the absence of any express statutory prohibition after the repeal of General Statutes section 25-8, there is some reason to believe that a contract for attorney's fees will be honored by the courts.

Section 25-2-109. *Definite Time.*—A troublesome problem under NIL section 4<sup>22</sup> was whether a note payable at a time certain but subject to an acceleration clause was payable at a determinable future time as required by the NIL. Some of the cases involved acceleration clauses permitting a holder to accelerate at his will, and the courts occasionally held that such acceleration clauses made the time uncertain; thus the instrument was non-negotiable.

By this faulty "non-negotiable" reasoning, the courts attempted to protect the maker of the instrument who had contracted for an acceleration clause that was harsh to him. Better reasoned decisions, however, took the view that the note was still negotiable, but that the harsh acceleration clause should not be enforced.

By amendment of NIL section 4 North Carolina permitted an acceleration clause. The amendment added: "But an instrument payable at a determinable future time is negotiable, even though it may mature or be declared due upon a contingency happening before such future time."<sup>23</sup> A similar provision is found in subsection (1)(c) of section 25-3-109.

The amendment to NIL section 4 did not specify the effect of a clause that gave the holder a capricious option to accelerate, and there are no North Carolina cases on this matter.

The capricious option problem now is solved, however, by section 25-1-208, which provides that clauses permitting a holder to

---

<sup>21</sup> 229 N.C. 534, 50 S.E.2d 288 (1948). There the court said attorney's fees will not be allowed "in the absence of express agreement." *Id.* at 536, 50 S.E.2d at 289.

<sup>22</sup> N.C. GEN. STAT. § 25-10 (1953).

<sup>23</sup> *Ibid.*

accelerate "at will," etc., will be enforced only when he acts in "good faith." Thus, under the Code the question of "negotiability" is separated from the independent question of "enforceability."

As explained in the official comment, subsection 25-3-109(2) makes an important change by excluding from the operation of Article 3 those instruments that are payable on the happening of a certain event the time of which is uncertain.<sup>24</sup> For example, an instrument payable at the death of an individual (or at the end of a war, etc.) will not be a "negotiable instrument within this article," for the official comment strongly states that instruments payable at such uncertain times are not fit to be ordinary commercial paper.

Section 25-3-110. *Payable to Order*.—There are no important North Carolina cases on this matter, and no real change is made in existing law.

Section 25-3-111. *Payable to Bearer*.—The only important North Carolina decisions relating to bearer paper concern the "fictitious payee" problem. Further comment is made on this matter in discussion of section 25-3-405.

Section 25-3-112. *Terms and Omissions Not Affecting Negotiability*.—This important section sets forth the "extras" or the so-called "permissive luggage," that may be included in an instrument without killing negotiability. Subsection (2) provides, however, that the section itself does not validate any of these.

It is important to note that the extras expressly permitted by this and other sections are the only extras that can be safely included. If a provision not expressly approved is included, the paper is not a "negotiable instrument within this article," even though fair-minded judges and businessmen might agree that such a clause was a useful addition to commercial paper. In substance, Article 3 takes the "exclusive" view of permissive luggage.

As was observed above, the fact that a paper is not a "negotiable instrument within this article" does not necessarily preclude the paper from being a negotiable instrument by other statutes or by decisions. This possibility must not be overlooked when the instrument in question looks negotiable but does not quite meet the definition of section 25-3-104.

A few states have seen fit to expand the list of permissives in Code section 3-112. For example, California and Virginia have

---

<sup>24</sup> G.S. § 25-3-109, comment 1.

added to subsection (1)(c) language permitting a promise or a power "to furnish financial information or to do or refrain from doing any other act for the protection of the obligations expressed in the instrument not involving the payment of money on account of the indebtedness evidenced by the instrument . . . ." <sup>25</sup> This modification was rejected by the Permanent Editorial Board in 1962 for the reason that "it would not only move substantially away from the 'courier without luggage' principle, but, in addition, could produce substantial confusion and litigation."<sup>26</sup> The difference of opinion on this matter is one of many instances where nonuniform law has already been produced under the Code.

Subsection 25-3-112(1)(d) permitting a confession of judgment clause is of special interest. First, the clause is harmless only if it permits a confession *after* the instrument is overdue. A clause authorizing a confession *before* the instrument is due probably would kill negotiability.

Of related interest is the fact that North Carolina apparently does not authorize an actual confession of judgment by the holder of a note.<sup>27</sup> Even though the holder may not be able to confess judgment against the maker in North Carolina, the clause can be of use if enforcement is sought in a state that does enforce such clauses.

Section 25-3-113. *Seal*.—One problem resolved by this section involves the question whether the donor of a sealed negotiable instrument can plead the defense of "want of consideration" when sued by the donee. There is no North Carolina case exactly on this point, but there is much dicta to the effect that a seal imports a consideration.

The purpose of section 25-3-113 is to make all negotiable instruments alike, seal or no seal, as far as defenses are concerned, and "want and failure of consideration" are defenses against a non-HDC under section 25-3-306(c). Thus, a donor would have a defense against his donee in a suit on a sealed negotiable instrument,

---

<sup>25</sup> CAL. COMM. CODE § 3112(1)(c) (1964); VA. CODE § 8.3-112(1)(c) (1964).

<sup>26</sup> 1 PERMANENT EDITORIAL BOARD, UCC REP. 73 (1963). New York had the same language as California and Virginia in its original version of this section but took it out of the section by amendment in 1963. N.Y. Sess. Laws 1963, ch. 1003, § 5.

<sup>27</sup> See N.C. GEN. STAT. §§ 1-247 to -249 (1953) (confession of judgment).

even though he might not have such defense in a suit on a sealed non-negotiable instrument.

The statute of limitations on a negotiable instrument under seal will continue to be ten years for suits against the principal obligor. Note that the ten-year period of General Statutes section 1-47 applies only to an action against the principal to the sealed instrument.

Section 25-3-115. *Incomplete Instruments*.—This section makes some changes in prior law. One change is a reversal of the rule of NIL section 15,<sup>28</sup> which provided that an incomplete undelivered instrument could not be enforced even by an HDC. Under subsection 25-3-115(2) an HDC can enforce an instrument even though there has been no technical delivery by the maker or drawer.

Basically, the problem of unauthorized completions (whether of delivered or undelivered paper) is covered by section 25-3-407 on material alteration.

Section 25-3-116. *Instruments Payable to Two or More Persons*.—This section in effect says that if the instrument is payable to "A or B", either may negotiate, enforce or discharge it. If the instrument is payable to "A and B", both must indorse in order to negotiate it. However, since one may be authorized to sign for the other, one person may make both signatures. Nevertheless, it seems that even when one party is fully authorized to deal with the instrument, there can be no technical negotiation unless both names actually appear as indorsements.

Section 25-3-119. *Other Writings Affecting Instrument*.—This section permits collateral written agreements to modify the terms of a negotiable instrument. It does not purport to cover what parol evidence may be introduced to modify the instrument. Hopefully, the odd rule of *Brown v. Osteen*<sup>29</sup> may be changed by this section. The *Brown* case held that notes containing no acceleration clause could not be recovered on before their stated maturity even though a contemporaneous mortgage securing the notes clearly stated that "a failure to pay any part of the interest, or any note or any part thereof, when due, shall mature all the indebtedness secured by the mortgage."

As noted in the official comment,<sup>30</sup> if the provision of the collateral agreement relates only to acceleration for time of sale of

---

<sup>28</sup> N.C. GEN. STAT. § 25-21 (1953).

<sup>29</sup> 197 N.C. 305, 148 S.E. 434 (1929).

<sup>30</sup> G.S. § 25-3-119, comment 3.

security and does not state that the basic obligation in the notes is accelerated, then the only acceleration will be of the sale of security. In the *Brown* case, however, the contemporaneous agreement in the mortgage also clearly covered acceleration of the notes, and the agreement could be given effect under this new section.

Section 25-3-121. *Instruments Payable at a Bank*.—This is one of many sections in the Code in which alternatives have been afforded the states without threatening the goal of uniformity. North Carolina chose Alternative B, which adopts the view that the provision that an instrument is payable at a named bank is neither an order nor an authorization to the bank to pay the instrument.

Alternative A takes the position that when a note or an acceptance is payable at a named bank, this is the equivalent of an order on such bank to pay the instrument. Under this "Northeastern" view, the bank should pay its depositor's instrument when the bank is the place of payment.

Virginia has adopted a compromise approach. In Virginia a provision that a note be payable at a bank is not per se an order to the bank to pay it from the maker's deposits, but "the bank may consider it an authorization to pay."<sup>31</sup>

There is some merit to the Virginia approach. For example, if a bank's depositor has made a note payable at the bank, and the bank has been unable to receive instructions on whether the customer wishes to have such note paid from his accounts, the bank is not under a duty to pay. However, it may safely pay the instrument if it believes that the customer would prefer this to a dishonor.

Section 25-3-122. *Accrual of Cause of Action; Interest*.—This is an entirely new section, and in general it poses no special problems. Subsection (3), however, may have some unintended results. At least it warrants the careful consideration of lawyers.

Subsection (3) states: "A cause of action against a drawer of a draft or an indorser of any instrument *accrues upon demand* following dishonor of the instrument. Notice of dishonor is a demand."<sup>32</sup> As is noted in the North Carolina comment on section 25-3-122, there is a possibility that the holder of an instrument is given a power to determine when the period of limitations begins to run against him. Surely, this is not a sound rule.

---

<sup>31</sup> VA. CODE § 8.3-21 (1964).

<sup>32</sup> Emphasis added.



## II. TRANSFER AND NEGOTIATION

Section 25-3-201. *Transfer; Right of Indorsement.*—The section recognizes that a negotiation is not the only way that rights in a negotiable instrument can be transferred. Any transfer vests in the transferee such rights as the transferor had therein. There is a proviso, however, that prohibits a reacquirer from improving his position by taking from a later HDC if the reacquirer was a party to any fraud or illegality affecting the instrument or if as a prior holder he had notice of a defense or claim against the instrument. In substance, a bad faith prior holder cannot give the instrument an “immunity bath” by passing it through a later HDC. Such a reacquirer is said to “stand in his old dirty shoes.” There were some decisions under the NIL that permitted one having knowledge of fraud in the original transaction (but not participating in it) who transferred to an HDC and then reacquired the paper to have the status of an HDC.<sup>33</sup>

Subsection (3) grants to the transferee of unindorsed “order paper” the right to the unqualified indorsement of his transferor, provided value has been given and there is no agreement that the transferee is not entitled such indorsement. Also, until the transferee obtains the indorsement of “order paper,” he is not a holder, and consequently he cannot be an HDC. The time at which his status as an HDC will be tested is the time that the transferee finally obtains the indorsement. For this reason, an originally innocent purchaser prior to maturity may lose his ability to become an HDC if he acquires knowledge of a defense between the date of purchase and the date of the later indorsement.

Section 25-3-202. *Negotiation.*—Because this is a key section, the full text should be studied carefully.

Subsection (4) clarifies a sometimes worrisome matter. When words such as “I assign this note” were added to the signature on the back of a negotiable instrument, it was at times difficult for the courts to interpret their exact meaning. Did they mean that the transfer was a mere assignment, rather than a negotiation? If so, there was no “holder” and no HDC. Did the word “assign” mean that the indorser was limiting his warranties to those of a mere assignor or qualified indorser, rather than extending his war-

---

<sup>33</sup> See G.S. § 25-3-201, comment 3(e).

ranties to those of an unqualified indorser?<sup>34</sup> Under subsection (4) the transfer of title is clear, but additional words may operate to limit the transferor's *liability*.

Section 25-3-204. *Special Indorsement; Blank Indorsement*.—Under NIL section 33<sup>35</sup> there were four general categories of indorsement: (1) special or blank,<sup>36</sup> (2) qualified or unqualified,<sup>37</sup> (3) conditional or unconditional,<sup>38</sup> and (4) restrictive or nonrestrictive.<sup>39</sup>

To describe fully any single indorsement, one term from each of the four categories should be used because each deals with a different legal effect. Under the Code, special and blank indorsements are covered by section 25-3-204. Restrictive and nonrestrictive are covered by the following two sections. Coverage of conditional indorsements is merged into the sections on restrictive indorsements without any major change. Qualified indorsements are now covered under "without recourse" provisions of sections 25-2-414(1) and 25-3-417(3).

Section 25-3-205. *Restrictive Indorsements*.—Perhaps the biggest change here is subsection (c), which states that restrictive indorsements include those that contain words like "for collection," "for deposit," "pay any bank or banker," or other terms signifying a purpose of deposit or collection. Under the NIL there was considerable difference of opinion as to the effect of these words.

Section 25-3-206. *Effect of Restrictive Indorsement*.—This section completely revises the NIL, and the official comments should be examined carefully. Generally, the section lessens the restrictions of a restrictive indorsement.

Subsection (1) reverses the NIL rule that "Pay *A* only" or similar words would prevent a further negotiation. Under the new provisions, an instrument may be further negotiated despite the presence of such words in the indorsement.

Subsection (3) changes NIL section 39 by permitting an in-

<sup>34</sup> *Evans v. Freeman*, 142 N.C. 70, 54 S.E. 847 (1906), held that an indorsement with the added words, "I assign all my right, title and interest," was an unqualified indorsement.

<sup>35</sup> N.C. GEN. STAT. § 25-39 (1953).

<sup>36</sup> N.C. GEN. STAT. § 25-40 (1953).

<sup>37</sup> N.C. GEN. STAT. § 25-44 (1953).

<sup>38</sup> N.C. GEN. STAT. § 25-45 (1953).

<sup>39</sup> N.C. GEN. STAT. § 25-42 (1953).

dorsee under a restrictive indorsement to be an HDC free of the indorser's claim if certain requirements are met.

Section 25-3-207. *Negotiation Effective Although It May Be Rescinded.*—Basically, this section helps to expand the negotiability of instruments. For example, subsection (1) permits a negotiation to be effective even though (a) made by a person without capacity, (b) there was fraud or duress, (c) the negotiation was part of an illegal transaction, or (d) the negotiation was in breach of duty.

Subsection (2) recognizes that the injured party may have some remedy against other parties, but not against an HDC.

Section 25-3-208. *Reacquisition.*—The most important part of this section relates to the discharge of intervening parties after an instrument has been reacquired by a prior owner. The rights of the reacquirer himself were mentioned in the comment on section 25-3-201.

### III. RIGHTS OF A HOLDER

Section 25-3-301. *Rights of a Holder.*—Hopefully, this section will legislatively overrule the opinion of *First Nat'l Bank v. Rochamora*,<sup>40</sup> which said that, because of the real-party-in-interest statute in North Carolina,<sup>41</sup> an agent could not enforce an instrument of which he is the holder. This ruling, which was really not necessary to the determination of the case, has plagued students, professors, and practitioners for many years, and the Code should put it to rest. The latest expression of legislative intent is that any holder, whether he be agent or owner, may enforce payment in his own name. Of course, this does not mean that a mere agent will be free of defenses against the agent's principal.

Section 25-3-302. *Holder in Due Course.*—By a few clarifying additions this section somewhat broadens the tests for HDC status. For example, it is now made clear that a payee can be an HDC if he meets the usual tests. To obtain a full appreciation of the new provisions, this section should be considered in conjunction with section 25-3-303 (taking for value) and section 25-3-304 (notice to purchasers).

A major change eliminates the requirement of NIL section 52 that one must take an instrument "complete and regular on its

---

<sup>40</sup> 193 N.C. 1, 136 S.E. 259 (1927) (criticized in 5 N.C.L. REV. 369 (1927)).

<sup>41</sup> N.C. GEN. STAT. § 1-57 (1953).

face" in order to be an HDC. Under the Code incompleteness and irregularity are considered only as a subdivision of the primary test of "notice." Also, subsection (2) specifically states that a payee may be an HDC.

Section 25-3-303. *Taking for Value*.—One change, academic perhaps, makes it clear that in order for one to be an HDC, he must have himself given value. He cannot "tack" his own good faith to a prior holder's value.

The troublesome problem of when bank credit is value is not covered by this section but is left to the more specific banking provisions of section 25-4-209.

Section 25-3-304. *Notice to Purchaser*.—The official comment on this significant section is extensive and should be considered in any analysis of the subject.

One significant change relates to the previously mentioned "complete and regular" requirement for HDC status. Under subsection (1)(a), incompleteness will give notice of a claim or defense only if the instrument is "so incomplete" as to raise a question about its validity. Though this liberalizing language may produce increased litigation, minor omissions are no longer death to HDC standing.

There appears to be some conflict between subsection (2) covering the consequences of taking from a fiduciary and certain sections of the Uniform Fiduciaries Act.<sup>42</sup>

Section 25-3-305. *Rights of a Holder in Due Course*.—Covered by this section are the rights of both an HDC in his own right and one who is a derivative HDC under section 25-3-201.

An important change is made to the rule of NIL section 15,<sup>43</sup> which did not permit an HDC to recover from one who had signed incomplete and undelivered paper. Now, however, if such paper is stolen and negotiated to an HDC, the HDC can recover. Thus, the liability of one who signs such paper is increased.

Even an HDC is subject to certain so-called "real defenses"; and these are listed in subsection (2).

Section 25-3-306. *Rights of One Not a Holder in Due Course*.

---

<sup>42</sup> N.C. GEN. STAT. §§ 32-5 to -7 (1950). The official comments, however, declare that the Code follows the policy of this act. G.S. § 25-3-305, comment 5.

<sup>43</sup> N.C. GEN. STAT. § 25-21 (1953).

—Basically, the rules are about the same as under the NIL and the North Carolina decisions.

Section 25-3-307. *Burden of Establishing Signatures, Defenses and Due Course.*—Here the rules of procedure are simplified by omitting some of the fictional “presumptions” that were used under the NIL. The official comment<sup>44</sup> notes that one who is not a holder, but who is in possession of the instrument, must prove his right to it and must account for the absence of any indorsement.

#### IV. LIABILITY OF PARTIES

The nineteen sections of this part set forth the liabilities of various parties to the instrument. Sections 25-3-401 through 25-3-406 are on signatures. The provisions of section 25-3-407 on alterations to the instrument are especially important.

Section 25-3-403. *Signature by Authorized Representative.*—Subsection (1) permits a party’s name to be signed by another when authorized. The person whose name is so signed becomes liable on the instrument. Subsection (2)(a) makes an authorized representative personally liable when neither his representative capacity nor the name of his principal appears on the instrument. Also, a representative runs a risk of personal liability under subsection (2)(b) when only one of these appears on the instrument. Thus there is danger in not revealing the name of a principal. This risk is accentuated when it is remembered that the principal whose name is not on the instrument is not “liable on the instrument” under section 25-3-401(1).

Section 25-3-404. *Unauthorized Signatures.*—Under this section an unauthorized signature is generally not operative as the signature of the person whose name appears. However, it is operative as the signature of the person who makes the unauthorized signature. Furthermore, one whose signature has been wrongfully made may ratify such signature or he may be precluded from denying that it is authorized.

Because the question of authorization is a matter not appearing on the face of the instrument, suit on a possibly unauthorized signature should include as defendants both the party who did the signing and the party whose name was signed.

Section 25-3-405. *Imposters; Signature in Name of Payee.*—

---

<sup>44</sup> G.S. § 25-3-307, comment 2.

This section codifies the better decisions relating to "imposters" and "payroll padders." Under the NIL, these problems were solved usually by the fiction of the "fictitious payee doctrine." By this certain instruments payable to the order of persons not intended to have any interest in the instrument were classified as "bearer" paper, which could be negotiated by a delivery alone without the indorsement of the named payee who was not intended to have any interest in the item.

Under the Code, the drawer or maker of a note who has let himself be swindled out of an instrument by an imposter or a defrauding payroll clerk will still bear the loss as against his drawee or an innocent purchaser, but the technique to produce this proper result is different. Under the new technique:

- (1) an instrument issued in the name of a payee not intended to have an interest does not become mere bearer paper;
- (2) a purportedly regular indorsement is required;
- (3) however, any person may indorse in the name of the named payee.

Since the section is limited to the signatures of "payees," there may be some question of its applicability when the imposter has the sucker indorse a paper to him pretending that it is for an indorsee not intended to have any interest in the item. The following section may cover this problem.

Section 25-3-406. *Negligence Contributing to Alteration or Unauthorized Signature.*—The long-recognized effect of negligence is hereby codified. Note that this section differs from the prior one in which negligence is not required in order to charge the defrauded party. Note, also, that the liability here is not in tort but on the instrument by the "precluded" theory. Can a party damaged by the negligence of another also sue in tort? Such may be the only remedy of a bona fide purchaser who does not quite meet the technical definition of an HDC.

Section 25-3-407. *Alteration.*—The official comment to this important section should be studied to appreciate fully its coverage. Basically, it combines in one section the former rules of incomplete instruments<sup>45</sup> and materially altered instruments.<sup>46</sup>

The old rule which did not make liable the signer of an incom-

---

<sup>45</sup> N.C. GEN. STAT. § 25-20 (1953).

<sup>46</sup> N.C. GEN. STAT. § 25-131 (1953).

plete and undelivered instrument<sup>47</sup> has been reversed. The signer of such paper is now liable on the instrument.

Section 25-3-408. *Consideration*.—Like the NIL, Article 3 continues to distinguish consideration and value. *Consideration* is concerned with what the obligor received, and it pertains to whether he has a defense of lack of consideration. By contrast, *value* pertains to what a purchaser has given in order to be a taker for value. Value is the element required for HDC status. No major change is made in North Carolina law.

Section 25-3-409. *Draft Not an Assignment*.—This continues the prior rule that a check or other draft does not per se operate as an assignment of any funds in the hands of the drawee,<sup>48</sup> and the drawee is not liable on the instrument until he accepts it.

Section 25-3-410. *Definition and Operation of Acceptance*.—Probably the most important change is that all acceptances must be on the instrument. Under the prior law<sup>49</sup> an acceptance could be on a separate paper.

Though an acceptance must be on the draft, the section is not intended to eliminate the liability of a drawee in contract, in tort or otherwise arising from a separate writing or from any other obligation or representation.

Subsection (1) eliminates the provisions of NIL section 137<sup>50</sup> on constructive acceptance when the drawee destroys the instrument or refuses to return it within twenty-four hours after receipt. However, under section 25-3-419, the drawee is liable for conversion.

Section 25-3-411. *Certification of a Check*.—Subsection (1) continues the rule of NIL section 188<sup>51</sup> that the obtaining of certification of a check by the *drawer* leaves him liable as a secondary party, while the obtaining of certification by a *holder* discharges the drawer and all prior indorsers.

Section 25-3-412. *Acceptance Varying Draft*.—Drawees do not often accept in a manner that varies the draft, but there are a few changes from prior law not justifying comment here.

Section 25-3-413. *Contract of Maker, Drawer and Acceptor*.—No real change in substance is made, but the section should be

---

<sup>47</sup> N.C. GEN. STAT. § 25-21 (1953).

<sup>48</sup> See 13 N.C.L. REV. 131 (1934) and 31 N.C.L. REV. 190 (1953) as to what constitutes an assignment.

<sup>49</sup> N.C. GEN. STAT. §§ 25-141, -142 (1953).

<sup>50</sup> N.C. GEN. STAT. § 25-144 (1953).

<sup>51</sup> N.C. GEN. STAT. § 25-196 (1953).

read in conjunction with other sections cited in the official comment.

Section 25-3-414. *Contract of Indorser; Order of Liability.*—The contract of an indorser is to pay the instrument if there is a dishonor and if any necessary notice and protest are properly made. This contractual obligation attaches whether or not the indorser is also a transferor. If, as is usual, the indorser is also a transferor, he is subject to the warranty obligations of section 25-3-417 covering “warranties on presentment and transfer.” Thus, this section and section 25-3-417 must be read together to determine the full liability of the typical transferor-indorser.

A transferor-indorser may eliminate his contract to pay by indorsing “without recourse” or by otherwise indicating that he does not agree to pay the instrument. Furthermore, by use of the words “without recourse,” the transferor can also slightly limit his warranties under section 25-3-417(3).

Section 25-3-415. *Contract of Accommodation Party.*—As under existing law, an accommodation party is liable on the instrument even though he receives no consideration and even though he is known to be a mere accommodation party. He is not liable, however, to the party being accommodated, and if he pays the instrument, he is given a right of recourse *on the instrument* against such accommodated party.

Section 25-3-416. *Contract of Guarantor.*—This new section states the usual commercial rule that one who adds words of guaranty to his signature is immediately liable upon default in payment, and the holder need not resort to any other party. Some change may be made from prior North Carolina decisions on the question of whether presentment was necessary to charge a surety or a guarantor.<sup>52</sup>

It is submitted that this section should not supersede the provisions of General Statutes section 26-7 permitting a guarantor to request a creditor to take diligent action against the principal, with the requesting guarantor's being discharged to the extent he is prejudiced if the creditor refuses or fails to take action.<sup>53</sup>

Section 25-3-417. *Warranties on Presentment and Transfer.*—Here certain warranties are thrust upon one who transfers an instrument or presents it for payment. As previously noted in the com-

---

<sup>52</sup> See *Rouse v. Wooten*, 140 N.C. 557, 53 S.E. 430 (1906); *Dry v. Reynolds*, 205 N.C. 571, 172 S.E. 351 (1934).

<sup>53</sup> N.C. GEN. STAT. § 26-9 (1953).



ment on section 25-3-414, the warranties of a transferor can be slightly limited by use of the words "without recourse." By using such words, the transferor eliminates his warranty that there are no defenses against him and merely warrants that he knows of no such defenses.

Closely related to this section is section 25-4-207 governing the warranties of a customer and a collecting bank on the transfer or presentment of claims in the bank collection process.

Section 25-3-418. *Finality of Payment and Acceptance.*—Basically, this restatement of prior rules follows the rule of the leading case of *Price v. Neal*,<sup>54</sup> which decided that when a drawee pays an instrument containing the forged name of the drawer, the drawee cannot recover back the money from the recipient of the funds. As the great exception to the usual rule that money paid by mistake can be recovered, the decision is justified on the grounds that the mistake is primarily that of the drawee, who is in a superior position to know the drawer's signature.

The section clearly states that payment is final only when made to an HDC or a person who has in good faith changed his position in reliance on the payment. This may be a change from prior law.

Section 25-3-419. *Conversion of the Instrument; Innocent Representation.*—A party who refuses to return an instrument is liable as a convertor for the face amount of the instrument. Thus, the liability of a wrongdoing drawee will be the same as if there had been a constructive acceptance under prior law. Constructive acceptance has been eliminated under section 25-3-410. Again, we see about the same results, but technically different reasoning.

## V. PRESENTMENT, NOTICE OF DISHONOR, AND PROTEST

The eleven sections in this part deal with the details of the conditions precedent to the liability of secondary parties (usually drawers and indorsers). Though there has been a considerable streamlining of prior law, there are few fundamental changes. Generally, Part 5 eliminates some of the technicalities of presentment, notice of dishonor and protest, and it simplifies others.

Section 25-3-501. *When Presentment, Notice of Dishonor, and Protest Necessary or Permissible*—Though presentment, notice of dishonor and protest are usually necessary to charge a secondary

---

<sup>54</sup> 3 Burr. 1354, 97 Eng. Rep. 871 (K.B. 1762).

party, they may be excused. This section states when they are necessary, and section 25-3-511 indicates when they are excused.

One of the interesting aspects of this section is that it broadens the class of secondary parties to include some parties not usually thought of as being in this class. Typically, drawers and indorsers are the only secondary parties whose liability is conditional on timely presentment, notice of dishonor and protest. However, because instruments payable at a bank are in many jurisdictions the equivalent of an order to the bank,<sup>55</sup> some parties normally considered as primary parties are shifted to secondary status.

For example, consider the maker of a note or the acceptor of a draft. Normally, these parties have contracted "to pay," not to "pay if someone else does not." Thus, they are usually so-called primary parties. If, however, the note or the accepted draft is payable at a bank, section 25-3-121 comes into play. And under Alternative A, adopted in many states, such an instrument becomes the equivalent of a draft or order to the bank to pay the instrument from funds of the maker or acceptor.<sup>56</sup>

Since, the instrument payable at the bank is the equivalent of a draft, the maker or acceptor now occupies the position of a mere secondary party. Consequently, section 25-3-501 provides that presentment for payment and notice of dishonor are necessary in order to charge "the acceptor of a draft payable at a bank or the maker of a note payable at a bank."

Does this rule apply in North Carolina even though the state has rejected Alternative A and has adopted Alternative B stating that the provision that the instrument is payable at a bank does not amount to an order or an authorization to pay? The answer to this question is found, not in section 25-3-501, but in subsection 25-3-511(2) which provides:

Presentment or notice or protest as the case may be is entirely excused when

(b) such party has himself dishonored the instrument or has countermanded payment or otherwise has no reason to expect or right to require that the instrument be accepted or paid. . . .

Because an instrument payable at a bank is not an order to the bank under the North Carolina version of Code section 3-121, any

<sup>55</sup> See G.S. § 25-3-121, N.C. comment.

<sup>56</sup> See discussion of G.S. § 25-3-121 *supra*.

dishonor will be by the maker or the acceptor, and the above-quoted "entirely excused" clause will apply.

Section 25-3-502. *Unexcused Delay; Discharge.*—Certain secondary parties are discharged by unexcused delay in presentment and notice of dishonor. An indorser is fully discharged, but a drawer, the acceptor of a draft payable at a bank, and the maker of a note payable at a bank are discharged only in special situations as provided by subsection (1)(b). Also, failure to make a necessary protest will discharge a drawer or an indorser.

Section 25-3-503. *Time of Presentment.*—In addition to general time provisions, the section contains two new provisions giving specific times within which presentment of an uncertified check must be made. Subsections (2)(a) and (2)(b) provide that, as against a drawer of an uncertified check, presentment must be made within thirty days after date of issue or stated date, whichever is later; against an indorser, presentment must be made within seven days after his indorsement. Since late presentment grants a full discharge to an indorser under the preceding section, the holder of an uncertified check must make a prompt presentment to hold the indorser.

Section 25-3-504. *How Presentment Made.*—The rules on the methods of presentment are here simplified. If an item is to be collected through the banking process, section 25-4-210 should also be consulted.

Section 25-3-505. *Rights of the Party to Whom Presentment Is Made.*—This expanded and modified version of NIL section 74 should be read in conjunction with section 25-3-804 (lost, destroyed or stolen instruments). Clearly, such instruments cannot be presented in the usual manner, and since one of the presentee's rights is exhibition of the instrument, the owner of a lost or destroyed instrument may be forced to bring action as provided for in section 25-3-804.

Section 25-3-506. *Time Allowed For Acceptance or Payment.*—The person to whom presentment is made for *acceptance* usually has until the close of the next business day after presentment to decide what he will do. When an item is presented for *payment*, payment must be made by the end of the business day on which presentment is made; otherwise there is a dishonor. If presentment is made to a bank, the deferred posting provisions of section 25-4-301 will modify the terms of this section.

Section 25-3-509. *Protest; Noting For Protest.*—The mechanics of protest are simplified. Also, protest is not required except on drafts drawn or payable outside of the United States.<sup>57</sup>

Section 25-3-511. *Waiver and Excused Presentment, Protest or Notice of Dishonor or Delay Therein.*—Here in one section are combined many rambling provisions of the NIL. In reading the section, it is important to distinguish between “excused” and “entirely excused.” In commercial practice, this section will be quite important, and a careful study is suggested. When a client has not made the normal presentment and notice of dishonor, this section may keep him from having inadvertently granted discharges to other parties.

## VI. DISCHARGE

The six sections of this part provides several methods by which the various parties to a negotiable instrument are discharged from liability on the instrument or other than on the instrument.

Section 25-3-601. *Discharge Of Parties.*—Throughout Article 3 are scattered sections dealing with the discharge of a party from liability on the instrument. Subsection (1) of this section contains a convenient index to these other provisions.

Section 25-3-602. *Effect of Discharge Against Holder in Due Course.*—While a holder may be an HDC under section 25-3-304(1)(b) even when he knows of the discharge of some parties, this section in a negative sort of way provides that the HDC cannot hold such parties liable.

Section 25-3-603. *Payment or Satisfaction.*—Subsection (1) changes existing law by eliminating the requirement of NIL section 88<sup>58</sup> that a payor is discharged by payment only if he makes payment at a time when he does not know of adverse claims to the instrument. The payor now is relieved of worrying about other parties' squabbles unless the claimant supplies adequate indemnity to the payor, or the claimant enjoins payment. Thus, the burden of taking action to prevent payment is placed on the adverse claimant.

In two situations, however, a payor will not be discharged when he makes a payment, even though he has not been indemnified or enjoined:

---

<sup>57</sup> Thus the inland-foreign bill of exchange distinction dies. See NIL § 129, N.C. GEN. STAT. § 25-136 (1953).

<sup>58</sup> N.C. GEN. STAT. § 25-95 (1953).

- (a) when he in bad faith pays one who has taken through a thief (unless the taker has the rights of an HDC); or
- (b) when he pays contrary to the terms of a restrictive indorsement.

Subsection (2) permits a stranger to pay an instrument with the consent of the *holder*, and the person who so pays will be given the rights of a transferee when the instrument is surrendered to him: There seems to be no sound reason for not affording the same privilege to one who pays with the consent of the owner, even though the owner may not be a *holder*.

Section 25-3-604. *Tender of Payment*.—Subsection (1) is a new provision partially discharging one who makes full tender. Such a party is discharged of all subsequent liability for interest, costs, and attorney's fees.

Section 25-3-605. *Cancellation and Renunciation*.—This section apparently will continue the rule of *Page Trust Co. v. Lewis*<sup>59</sup> that a verbal renunciation is ineffectual. A renunciation must be in writing.

Section 25-3-606. *Impairment of Recourse or of Collateral*.—By this section a *holder* may discharge secondary parties when without the parties' consent the holder releases his rights against certain persons or property. However, the *holder* may preserve certain rights by an express reservation of these rights. There seems to be no good reason for limiting these rules to *holders*.

## VII. MISCELLANEOUS

Of the five sections in Part 8, all but the first are new provisions not found in the NIL. They restate in code form rules that have developed by decision alone or by legislation other than the NIL.

Section 25-3-801. *Drafts in a Set*.—Drafts in a set are not widely used in domestic commerce, and the matter does not justify summarization here.

Section 25-3-802. *Effect of Instrument on Obligation for which it is Given*.—This important section probably changes some prior North Carolina case law. Under the new rules, if the item given in payment is an item drawn or accepted by a bank, such as a cashier's check or a certified check, the underlying obligor is dis-

---

<sup>59</sup> 200 N.C. 286, 156 S.E. 504 (1931).

charged *pro tanto* on the underlying obligation, and he is not liable on the instrument if the bank fails to honor it.

When any other instrument is given in payment, the underlying obligation is suspended<sup>60</sup> *pro tanto* until the instrument is due. If the instrument is dishonored, action may be maintained either on the instrument or on the underlying obligation. The discharge of an obligor on the instrument also discharges him on the underlying obligation. This probably means a *pro tanto* discharge.

Section 25-3-803. *Notice to Third Party*.—This procedural section permits a party defendant to give notice of a pending suit to any person that may be liable to the joined defendant. A full scale “vouching in” of parties defendant is not authorized. However a limited type of vouching in is approved to give the joined defendant the privilege of pleading *res judicata* on some issues in a later suit against the notified party.

Section 25-3-804. *Lost, Destroyed or Stolen Instrument*.—There may be a good reason for limiting the right of recovery to the *owner*, but there may be some reason to let a mere collection agent recover in order to protect himself and his principal.

Section 25-3-805.—*Instruments Not Payable to Order or Bearer*.—As earlier noted, an instrument that has all of the attributes of a negotiable instrument within this article except that it lacks the words “order” or “bearer” will be subject to all of the rules of Article 3, except there can be no HDC.<sup>61</sup>

### CONCLUSION

Article 3 and its modernization of the NIL have not been a particularly controversial matter. Nearly everyone agrees that it does a reasonably good job of streamlining the law of commercial paper. Most of us will not have to unlearn too much, and research will be considerably simplified.

---

<sup>60</sup> See G.S. § 25-3-802, N.C. comment, for discussion of a possible ambiguity in the new “suspension” rule.

<sup>61</sup> See G.S. § 25-3-805, comment.