

UCC: NEGOTIABLE INSTRUMENTS

House Bill 4723 as introduced
First Analysis (5-25-93)

Sponsor: Rep. Kirk A. Profit
Committee: Business & Finance

THE APPARENT PROBLEM:

According to information provided by the National Conference of Commissioners on Uniform State Laws, payment by check and other paper instruments is governed in every state by Article 3 (Negotiable Instruments) and Article 4 (Bank Deposits and Collections) of the Uniform Commercial Code (UCC), which was enacted in Michigan in 1962. Article 3 apparently is simply a revision of the previous uniform act, the Uniform Negotiable Instruments Law, which was drafted in 1896 and is based primarily on 18th and 19th century British case law. Article 4, according to official UCC comment in the Michigan Compiled Laws Annotated (Volume 22), adopted many of the rules of the American Bankers Association Bank Collection Code, as well as the principles and rules of the Deferred Posting and other statutes, codified some rules established by court decisions, and states certain preexisting but uncodified patterns and procedures. Neither of the articles has been amended substantially since 1962, and many feel that revisions are necessary to eliminate archaic language and concepts, accommodate changing business practices, and address issues and problems that have arisen because the articles reportedly are ambiguous or silent on certain topics.

It has been noted, for example, that when the articles were drafted, only banks offered checking accounts. Currently, banks, savings and loans, credit unions, and other brokerage houses offer accounts upon which checks and other payment orders can be drawn, but only banks and checks are clearly governed under the articles. Also, some claim, Article 3 treats all negotiable instruments in the same manner even though notes and drafts perform different functions and, therefore, merit different treatment. Further, Article 3 requires negotiable instruments to state a "sum certain", thus effectively excluding instruments with variable rates of interest--a relatively new type of instrument--from the category of, and regulation as, negotiable instruments. In addition, some note, changes to the provisions in Article 4 concerning monthly balance

statements and canceled checks are necessary to take into account the current practice by many financial institutions of providing customers with itemized statements in lieu of the canceled checks. For these reasons, it has been recommended that Articles 3 and 4 of the Uniform Commercial Code be updated and clarified according to the suggestions of the National Conference of Commissioners on Uniform State Laws.

THE CONTENT OF THE BILL:

The bill would amend Articles 3 and 4 of the Uniform Commercial Code, which govern commercial paper and bank deposits and collections, to, among other things, redefine "negotiable instrument" to allow for fixed and variable interest rates and specifically include checks; provide contribution rules for multiple parties to a draft or note; add a statute of limitations within which any action would have to be brought; limit the effect of restrictive endorsements on the right to receive payment, and exempt a non-depository payor bank from liability in payment of a restrictive endorsement; provide for warranties for encoding and retention of items for presentation; and allow a bank to provide a customer with only a statement of his or her account, rather than a statement and the items paid (e.g., canceled checks or drafts), and require the customer to report altered or forged items upon receipt of the statement. The bill would take effect September 30, 1993.

Article 3

Negotiable Instruments - General Provisions and Definitions. The bill specifies that Article 3 would apply to negotiable instruments, not to money, payment orders governed by Article 4a, or securities governed by Article 8. Further, if there were a conflict between Article 3 and Articles 4 and 9--

which pertain to bank deposits and secured transactions--Articles 4 and 9 would govern.

In addition, the bill specifies that regulations of the board of governors of the Federal Reserve System and operating circulars of the Federal Reserve Banks would supersede any inconsistent provision of Article 3 to the extent of the inconsistency.

The act currently states that in order for a writing to be a negotiable instrument it must be signed by the maker or drawer, contain an unconditional promise or order to pay a sum certain in money, and be payable to order or bearer on demand or at a definite time. The bill would delete these provisions and would define "negotiable instrument" as an unconditional promise or order to pay a fixed amount of money, with or without interest or other charges described in the promise or order, if all of the following applied:

- * It was payable to the bearer or to order at the time it was issued or first came into possession of a holder;

- * It was payable on demand or at a definite time;

- * It did not state any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money, but the promise or order could contain an undertaking or power to give, maintain, or protect collateral to secure payment, an authorization or power to the holder to confess judgment or realize on or dispose of collateral, or a waiver of the benefit of any law intended for the advantage or protection of an obligor.

An order that met all of these requirements, except for being payable to bearer or to order, and otherwise qualified as a "check" would be a negotiable instrument and a check. "Check" would mean a draft, other than a documentary draft, payable on demand and drawn on a bank or a cashier's check or teller's check. An instrument could be a check even though it was described on its face by another term, such as "money order."

The bill specifies that the person to whom an instrument was initially payable would be determined by the intent of the person, whether or not authorized, signing as, or in the name or behalf of, the issuer of the instrument. A person to whom an instrument was payable could be identified in any way, including by name, identifying number, office or account number. If the signature of the issuer of an instrument were made by a automated means,

such as a check-writing machine, the payee of the instrument would be determined by the intent of the person who supplied the name or identification of the payee, whether or not authorized to do so. The bill would eliminate language that specifies that certain conditions, such as omission of a statement of any consideration, do not affect the negotiability of an instrument.

The act currently specifies that two or more persons who sign as maker, acceptor, or drawer or indorser and as part of the same transaction are jointly and severally liable unless otherwise provided in the instrument. The bill provides further that a party having joint and several liability who pays the instrument would be entitled to receive from any party having the same joint and several liability contribution in accordance with applicable law. In addition, discharge of one party having joint and several liability by a person entitled to enforce the instrument would not affect the right of a party having the same joint and several liability to receive contribution from the party discharged. The bill would establish statutes of limitations for commencing actions to enforce the obligation of a party to pay a note, draft, or certificate of deposit, and other obligations.

Negotiation, Transfer and Endorsement. Under the act, an order instrument requires an endorsement for negotiation. The act provides for restrictive endorsements that restrict the right to negotiate the instrument or obtain payment. The bill would limit the effect of restrictive endorsements on the right to receive by stating that such an endorsement would not affect the right of the endorsee to enforce the instrument. Further, although the bill, like the act, provides for certain restrictive endorsements such as "for deposit" and "for collection" that must be honored except by intermediary banks and non-depository payor banks, the bill specifically would exempt a non-depository bank from liability along with intermediary banks.

Enforcement of Instruments. The bill would require that for a holder to be a holder in due course, an instrument could not bear such apparent evidence of forgery or alteration or be so irregular or incomplete as to call into question its authenticity. Also, the bill would impose standards for obtaining holder-in-due-course rights for a person dealing with the defaulting agent or fiduciary. The bill specifies the circumstances under which a person receiving funds would have notice of a breach of

fiduciary duty and resulting liability, and includes provisions pertaining to the validity of signatures in actions concerning instruments, the point at which instruments payable on demand would become overdue, and the discharge of claims.

Liability of Parties. The act generally provides that a person who by being negligent substantially contributes to a material alteration of an instrument is precluded from asserting the alteration against a person who pays the instrument in good faith. The bill would expand on these provisions by stating that any loss that could occur would be allocated between the person precluded and the person asserting the preclusion according to the extent to which the failure of each to exercise care contributed to the failure. The bill specifies what the obligations and liabilities of a drawer and endorser would be if an unaccepted draft or instrument were dishonored.

The bill would add provisions governing circumstances in which a check was lost or stolen while in the possession of either the remitter or the payee of the check, including provisions governing the loss of a certified check by either the drawer or payee. Generally, the bill would establish rights and responsibilities for the various parties (remitter, drawer or payee on a lost or stolen check or certified check) involved when a check or certified check was lost or stolen.

Dishonor. The bill describes the conditions under which a draft or note could be dishonored and the methods by which notice of dishonor could be given. The obligations of an endorser or drawer could not be enforced unless he or she were given notice of the dishonor or the notice of dishonor were excused. The bill further identifies what would be considered admissible evidence and what would create a presumption of dishonor.

Discharge and Payment. The act provides that the liability of any party is discharged to the extent of his or her payment or satisfaction to the holder even if it is made with knowledge of a claim of another person to the instrument unless prior to the payment the claimant supplied indemnity deemed adequate by the party seeking the discharge or enjoined payment or satisfaction by court order. The act further specifies the conditions under which liability will not be discharged. The bill would delete these provisions and specify the conditions under which the obligations of an endorser or

accommodation party would be discharged and to what extent.

Article 4

Collection of Items: Depositary and Collecting Banks. The act provides for warranties of customers and collecting banks to a payor of an item. The warranties include good title, lack of knowledge of an unauthorized signature, and no material alteration of the instrument. Further, there are warranties from a customer or collecting bank to a subsequent transferee or collecting bank. In addition to warranties of good title, no material alteration of the instrument, and lack of knowledge of an unauthorized signature, the subsequent transferee or collecting bank has the advantage of warranted signatures on the instrument, lack of a defense against payment, and lack of knowledge of insolvency of the maker, acceptor, or drawer of an instrument.

Under the bill, transfer warranties to a subsequent transferee or collecting bank would not be changed substantially. Presentment warranties would apply with no exception for holder in due course status. The bill specifies damages that could be recovered for breach of warranty. The bill also provides for warranties from one who encoded information with respect to an item that the information was correctly encoded, and retention warranties that would pertain to those who presented items pursuant to a truncation agreement and retained the original instrument while transmitting an image of it as presentation for payment.

Relationship Between Payor Bank and Its Customers. The act specifies that a bank may charge against a customer's account an item that is properly payable from the account even though the charge creates an overdraft. The bill states that an item would be properly payable if it were authorized by the customer and were in accordance with any agreement between the customer and the bank. Further, a customer would not be liable for the amount of an overdraft if the customer neither signed the item nor benefitted from the proceeds of the item. The bill also provides that the bank could charge against a customer's account a check that was otherwise properly payable from the account, even though payment was made before the date of the check, unless the customer gave notice to the bank of the postdating describing the check with reasonable certainty.

Under the act, a customer is responsible to report on altered and forged items upon receipt of the items with the customer's statement. The bill would permit a sufficiently detailed statement to be notification of altered or forged items and would require the customer to report such items upon receipt of the statement. The bank, however, would have to retain the items or legible copies for seven years and supply at least the copies at the customer's request.

Repeals. The bill would repeal sections of the act that pertain to instruments payable at or through a bank, accrual of cause of action, reacquisition of instruments, time allowed for acceptance or payment, dishonor, holder's right of recourse, impairment of recourse or collateral, letter of advice of international sight draft, effect of an instrument on an underlying obligation, and lost, stolen or destroyed instruments and instruments not payable to order or bearer.

MCL 440.1201 et al.

FISCAL IMPLICATIONS:

The Financial Institutions Bureau in the Department of Commerce says the bill would not affect state or local budget expenditures. (5-21-93)

ARGUMENTS:

For:

The bill would make those changes that are necessary to modernize and clarify Articles 3 and 4 of the Michigan Uniform Commercial Code in order to accommodate current business practices within the financial institutions industry, and to address problems and issues that have arisen since 1962--when Articles 3 and 4 were first adopted in this state. By keeping the UCC up to date in Michigan, the bill would help reduce litigation and preclude the nonuniform resolution of issues among the states. Similar legislation has already been adopted in 23 other states (in three states legislation is simply awaiting the governor's signature) and is being considered for adoption in six others.

Against:

While adopting the language proposed by the National Conference of Commissioners on Uniform State Laws would modernize the way Michigan regulates negotiable instruments and bring this state into conformity with national standards, some have

argued that it would legitimize a movement among financial institutions toward charging consumers higher fees for checking accounts and other banking "services" while reducing the actual services made available to them under depository agreements.

Response:

According to a spokeswoman with the NCCUSL, changes proposed to Articles 3 and 4 by the NCCUSL and recommended for adoption in all 50 states under the Uniform Commercial Code not only balance the interests of both consumers and financial institutions in an equitable way, but provide consumers more protections than they currently have under the act.

POSITIONS:

The National Conference of Commissioners on Uniform State Laws, of Chicago, Illinois, supports the bill. (5-21-93)

The Michigan Bankers Association supports the bill. (5-24-93)

The Michigan Credit Union League supports the bill. (5-21-93)

The Michigan League of Savings Institutions supports the bill. (5-21-93)

The Financial Institutions Bureau believes that sections of the Michigan Uniform Commercial Code governing negotiable instruments need to be modernized to reflect today's banking practices and activities, but has no position on the bill. (5-21-93)