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Senate Bills 547 and 548 (as introduced 9-25-13)
Sponsor: Senator Darwin L. Booher
Committee: Banking and Financial Institutions

Date Completed: 10-10-13

CONTENT

Senate Bill 547 would amend Article 3 of the Uniform Commercial Code (UCC), which governs negotiable instruments, to do the following:

- Provide that a person could enforce a lost instrument if he or she acquired ownership of the instrument from a person who was entitled to enforce it when loss of possession occurred, if certain conditions were met.
- Provide for a payment on an instrument to be discharged if a person made payment on an instrument to the person identified as the person with the power to enforce the instrument, even if the instrument had been transferred to another person with the power to enforce it, until the person required to pay was given notice of the transfer.
- Amend the rules of suretyship to specify rights of primary and secondary obligors with regard to enforcing instruments and discharging obligations.
- Provide that if an instrument in a consumer transaction did not include a statement that the rights of a holder or transferee were subject to a claim or defense that the issuer could assert against the original payee, the instrument would be regarded as if it included the statement.
- Provide a warranty for the transfer of a remotely created consumer item.
- Change various requirements for or references to "writing" and "written record" to "record".

Senate Bill 548 would amend the Uniform Electronic Transactions Act to revise citations to various sections of the UCC.

Senate Bill 548 is tie-barred to Senate Bill 547.

Senate Bill 547

Enforcing a Lost Instrument

Under Article 3, a person not in possession of an instrument is entitled to enforce it if: 1) he or she was in possession of the instrument and entitled to enforce it when loss of possession occurred; 2) the loss of possession was not the result of a transfer by the person or a lawful seizure; and 3) the person cannot reasonably obtain possession because the instrument was destroyed, lost, or in the wrongful possession of an unknown person or a person that cannot be found or is not amenable to service of process.

Under the bill, the first condition would be the person either was entitled to enforce the instrument when loss of possession occurred, or had directly or indirectly acquired ownership of the instrument from a person who was entitled to enforce it when loss of possession occurred.

The bill also would require all three conditions to be satisfied.

Remotely Created Consumer Item

Article 3 provides that when a person transfers an instrument for consideration, he or she warrants to the transferee, and, if the transfer is by endorsement, to any subsequent transferee, certain rights with regard to the authenticity of and rights under the instrument.

Additionally, if an unaccepted draft is presented to the drawee for payment or acceptance and the drawee pays or accepts the draft, the person obtaining payment or acceptance, at the time of presentment, and a previous transferor of the draft, at the time of transfer, warrant to the drawee certain rights with regard to the authenticity of and rights under the instrument. (A drawee is the person ordered in a draft to make a payment.)

The bill would add a warranty in both of the situations described above. For a remotely created consumer item, the respective party would warrant that the person on whose account the item was drawn had authorized the item to be issued for the amount drawn.

"Remotely created consumer item" would mean an item drawn on a consumer account, which is not created by the payor bank and does not bear a handwritten signature purporting to be the signature of the drawer.

"Consumer account" would mean an account established by an individual primarily for personal, family, or household purposes.

Rules of Suretyship

Article 3 generally discharges the obligations of indorsers and accommodation parties to the extent that the drawer or maker of an instrument was discharged, while retaining any right of recourse for loss that the indorser or accommodation party has against the drawer or maker. Also, indorsers and accommodation parties are discharged from any secondary obligations to the extent of impairment to the collateral.

The bill would replace the existing provisions, and instead refer to principal obligor and secondary obligor within the context of suretyships. "Principal obligor" would mean, with respect to an instrument, the accommodated party or any other party to the instrument against whom a secondary obligor has recourse under Article 3. "Secondary obligor" would mean, with respect to an instrument, any of the following: 1) an indorser or an accommodation party; 2) a drawer that has the obligation described under Section 3414(4) (which involves drafts accepted by a party other than a bank) and 3) any other party to the instrument that has recourse against another party to the instrument under Section 3116(2) (which involves rights of parties with joint and several liability who pay the instrument).

If a person entitled to enforce an instrument released the obligation of a principal obligor, and another party to the instrument were a secondary obligor with respect to the obligation of the principal obligor, the following rules would apply:

- Any obligations of the principal obligor to the secondary obligor with respect to any previous payment by the secondary obligor would not be affected, and the principal obligor would be discharged from duties unless the terms of the release preserved the secondary obligor's recourse.

- Unless the release provided that the person entitled to enforce the instrument retained that right against the secondary obligor, the secondary obligor would be discharged to the same extent as the principal obligor from any unperformed obligation.
- If the secondary obligor were not discharged as described in the second rule, he or she would be discharged to the extent of the value of the consideration for the release, and to the extent that the release would otherwise have caused the secondary obligor a loss.

If a person entitled to enforce an instrument granted a principal obligor an extension of the time at which one or more payments were due on the instrument and another party to the instrument were a secondary obligor, the following rules would apply:

- Obligations of the principal obligor with respect to any previous payment to the secondary obligor would not be affected, and the extension would correspondingly extend the time for performance of any other duties owed to the secondary obligor, unless the terms of the extension preserved the secondary obligor's recourse.
- The secondary obligor would be discharged to the extent that the extension would otherwise have caused the secondary obligor a loss.
- If the secondary obligor were not discharged as described in the second rule, the secondary obligor could perform its obligations to a person entitled to enforce the instrument as if the time for payment had not been extended or, unless the terms of the extension provided that the right to enforce was retained as if there were no extension, treat the time for performance of obligations as having been extended correspondingly.

If a person entitled to enforce an instrument agreed, with or without consideration, to a modification of the obligation of a principal obligor other than a complete or partial release or an extension of the due date and another party to the instrument were a secondary obligor, the following rules would apply:

- Any obligations of the principal obligor to the secondary obligor with respect to any previous payment by the secondary obligor would not be affected, and the modification would correspondingly modify any other duties that the primary obligor owed to the secondary obligor.
- The secondary obligor would be discharged from any unperformed portion of his or her obligation to the extent that the modification would otherwise cause the secondary obligor a loss.
- To the extent that the secondary was not discharged under the second rule, the secondary obligor could satisfy its obligation on the instrument as if the modification had not occurred, or treat its obligation on the instrument as having been modified correspondingly.

If the obligation of a principal obligor were secured by an interest in collateral, another party to the instrument would be a secondary obligor with respect to that obligation, and a person entitled to enforce the instrument impaired the value of the interest in collateral, the obligation of the secondary obligor would be discharged to the extent of the impairment. The value of an interest in collateral would be impaired to the extent the value of the interest was reduced to an amount less than the amount of the recourse of the secondary obligor, or the reduction in value of the interest caused an increase in the amount by which the amount of the recourse exceeded the value of the interest.

Impairing the value of an interest in collateral would include failure to obtain or maintain perfection or recordation of the interest in collateral, release of collateral without substitution of collateral of equal value or equivalent reduction of the underlying obligation, failure to perform a duty to preserve the value of collateral owed, under Article 9 (which governs secured transactions) or other law, to a debtor or other person secondarily liable, and failure to comply with applicable law in disposing of or otherwise enforcing the interest in collateral.

A secondary obligor would not be discharged as described above unless the person entitled to enforce the instrument knew that the secondary obligor was the secondary obligor or had notice that the instrument was signed for accommodation.

A secondary obligor also would not be discharged if he or she consented to the event or conduct that was the basis of the discharge, or the instrument or a separate agreement of the party provided for waiver of discharge under these provisions or by general language indicating that parties waived defenses based on suretyship or impairment of collateral. Unless circumstances indicated otherwise, consent by a principal obligor to an act that would lead to a discharge under these provisions would constitute consent to that act by the secondary obligor if the secondary obligor controlled the principal obligor or dealt with the person entitled to enforce the instrument on behalf of the principal obligor.

A release or extension would preserve a secondary obligor's recourse if its terms provided both of the following:

- That the person entitled to enforce the instrument retained the right to enforce it against the secondary obligor.
- That the recourse of the secondary obligor continued as if the release or extension had not been granted.

A secondary obligor who asserted discharge under these provisions would have the burden of persuasion with respect to the occurrence of any alleged acts that harmed the secondary obligor and caused loss or prejudice. However, if the secondary obligor showed prejudice caused by an impairment of its recourse, and the circumstances of the case indicated that the amount of loss was not reasonably susceptible of calculation or required proof of facts that were not ascertainable, it would be presumed that the act that impaired recourse caused a loss or impairment equal to the liability of the secondary obligor on the instrument. In that event, the burden of persuasion as to any lesser amount of the loss would be on the person entitled to enforce the instrument.

Notice of Transfer; Payment Obligations

Under the bill, if the signature of a party to an instrument included words that guaranteed payment, or the signer signed the instrument as an accommodation party in some other manner that did not unambiguously indicate an intention to guarantee collection rather than payment, the signer would be obliged to pay the amount due to a person entitled to enforce the instrument in the same circumstances as the accommodated party would be obliged, without prior resort to the accommodated party by the person entitled to enforce the instrument.

Article 3 provides that an accommodation party who pays an instrument is entitled to reimbursement from and enforcement of the instrument against the accommodated party. Under the bill, in proper circumstances, an accommodation party could obtain relief that required the accommodated party to perform its obligations.

Article 3 also provides that an instrument is paid to the extent payment is made on behalf of the obligated party to a person entitled to enforce it.

Under the bill, subject to certain claims, a note would be paid to the extent payment was made by or on behalf of a party obliged to pay the note to a person that formerly was entitled to enforce the note only if, at the time of the payment, the party obliged to pay had not received adequate notice that the note was transferred and that payments were to go to the transferee.

Adequate notice would have to be signed by the transferor or transferee, reasonably identify the transferred note, and provide an address for payment. Upon request, a transferee would have to seasonably furnish reasonable proof of the transfer. Unless the transferee complied, a payment to the person that formerly was entitled to enforce the note would be effective for discharge purposes even if the obliged party had received a notice under these provisions.

Subject to certain claims, a transferee, or any party that had acquired rights in the instrument directly or indirectly from a transferee, including any party that had acquired those rights and that had rights as a holder in due course, would be deemed to have notice of any payment that was made under the provisions discussed above after the date that the note was transferred to the transferee but before the obliged party received adequate notice of the transfer.

("Signed" would include, with respect to a record that was not in writing, the attachment to or logical association with the record of an electronic symbol, sound, or process with the present intent to adopt or accept the record.)

Senate Bill 548

The bill would amend the Uniform Electronic Transactions Act to revise citations to various sections of the UCC.

The bill would make changes in the definition of "transferable record" and in a provision under which a person having control of a transferable record is the holder of the record and has the same rights and defenses as a holder of an equivalent record or writing under the UCC.

(A "transferable record" is an electronic record that would be a note under Article 3 of the UCC or a document under Article 4 of the UCC if it were in writing; and whose issuer has expressly agreed is a transferable record.)

MCL 440.3103 et al. (S.B. 547)
450.846 (S.B. 548)

BACKGROUND

The National Conference of Commissioners on Uniform State Laws (the Uniform Law Commission, or ULC) made certain recommendations regarding revising Article 3 of the UCC. These recommendations dealt with several topics, which are described below.

Enforcing a Lost Instrument

The Uniform Law Commission found that to alleviate bad case law respecting bankruptcies, it should be made clear that a person could enforce a lost instrument when he or she acquired ownership from a person entitled to enforce it when the loss of possession occurred.

Remotely Created Consumer Items

Remotely created consumer items are checks that a consumer authorizes to be issued in his or her name over the telephone or through other remote means. This type of check is a relatively new phenomenon that is not addressed within Article 3. General warranties in Articles 3 and 4 apply to checks, but no warranty applies specifically to the authenticity of a remotely created consumer item. The ULC recommended an amendment to Article 3 to

provide that a person who transfers a remotely created consumer item for payment warrants that the check is authorized for the amount which it was drawn.

Rules of Suretyship

According to the ULC, the recommended amendments to suretyship rules would bring Article 3 into conformance with the Restatement of Suretyship. "Secondary obligor" would encompass a broader range than the existing terms. Also, the amendments would bring greater flexibility in reorganizing obligations, except when it would result in the detriment of secondary obligors.

Notice of Transfer; Payment Obligations

Under current law, if a borrower's loan is transferred from one bank to another, and the borrower makes a payment to the first bank, the borrower still could be required to make a payment to the second bank if the second bank is a holder in due course. According to the ULC, this situation would not arise under the recommended amendments.

"Writing", "Written Record", and "Record"

The ULC also recommended modifying several requirements for certain documents to be in writing. According to the ULC, requiring a record, rather than a writing, would bring consistency between the Uniform Electronic Transactions Act and Article 4, and allow electronic records in these circumstances to satisfy statute of frauds requirements.

Legislative Analyst: Glenn Steffens

FISCAL IMPACT

The bills would have no fiscal impact on State or local government.

Fiscal Analyst: Josh Sefton