UCC Update: Revised Articles 3 and 4

Michael D. Sabbath

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I. INTRODUCTION

The National Conference of Commissioners on Uniform State Laws and the American Law Institute, cosponsors of the Uniform Commercial Code ("UCC"), have approved comprehensive changes to Articles 3 and 4. The Revised Articles were initially presented to the various states for approval in early 1991. As of September 1996, forty-four jurisdictions have adopted the Revised Articles, most with few, if any, variations to the official text. Revised Articles 3 and 4 became law in Georgia effective July 1, 1996.

Few debate that Prior Articles 3 and 4, which were drafted more than forty years ago, were in need of revision. Article 3 was the most dated article of the UCC. It was merely a revision of the previous uniform act, the Uniform Negotiable Instruments Law, which was drafted in 1896, and was based primarily on eighteenth and nineteenth century British case law. Some of the concepts and language of Prior Article 3 were quite archaic. It should be noted that Revised Article 3 does not radically depart from previous law. Revised Article 3 carries forward the
basic doctrines of negotiable instruments law embodied in Prior Article 3. Moreover, the organization of the new statute generally follows that of the old statute. But the revision does update Article 3 to modernize language and take into account technological developments and changes in business practice. In addition, the revision resolves conflicting lines of case authority.

Similarly, Prior Article 4 was seriously outdated, having emerged as part of the “1958 Official Text” of the UCC. However, Magnetic Ink Character Recognition (“MICR”)—the encoding of identifying numbers on checks that made automated check processing possible—did not become operable until 1959. Thus, Prior Article 4, drafted in a time of manual processing of checks, was inadequate to deal with the automated processing of checks based on MICR technology. Prior Article 4 was saved to some extent by section 4-103, which allows the parties to vary the terms of that article by agreement, and provides that Federal Reserve regulations and letters, clearinghouse rules, and the like, have the effect of agreements. But the movement from a paper-based payments system to an electronic-based payments system made it apparent that Prior Article 4 needed to be reformed. Revised Article 4 accommodates technical developments in automated check processing and check truncation. Although some changes have been made to accommodate Federal Regulation CC (which relates to mandated funds availability), those provisions most heavily impacted by Regulation CC remain intact and are retained for nonpreempted provisions and for items other than checks. Although the drafting committee initially intended to extensively coordinate Article 4 with Regulation CC, it ultimately abandoned this effort due to the extensive preemption that exists, and also because of the different character of the provisions in Article 4 and Regulation CC. In addition, the Federal Reserve Board has revised, and will continue to revise, Regulation CC administratively. State legislative processes move much more slowly than these administrative processes, making it very difficult to keep Article 4 and Regulation CC closely coordinated.

II. DISCUSSION

No effort will be made here to cover every aspect of the revisions to Articles 3 and 4. Instead, this Article will discuss some of the major new provisions to illustrate improvements made by the revisions.

A. Revised Article 3

1. Scope of Article 3. Revised Article 3 clarifies the types of contracts within Article 3. For example, the confusion over whether traveler's checks are covered has been eliminated. Traveler's checks are governed under Revised Article 3.\(^5\) Although the requirement of a countersignature is a condition to the obligation to pay, it is recognized that traveler's checks are treated in the commercial world as money substitutes and therefore should be governed by Article 3.\(^6\) The revision also expressly recognizes the negotiability of, and clarifies much of the law with respect to, teller's checks, cashier's checks, and checks that may omit "words of negotiability."\(^7\) In an important provision, variable rate instruments are included as negotiable instruments under Revised Article 3.\(^8\) Prior Article 3 required that a negotiable instrument state a "sum certain."\(^9\) The holder must be "able to determine the amount then payable from the instrument itself."\(^10\) Most courts considering the issue under Prior Section 3-106 found that instruments with variable interest rates could not be negotiable instruments because of this "sum certain" requirement.\(^11\) However, instruments providing for variable interest rates pegged to some sort of fluctuating standard rate of interest are much more common now than they were when Article 3 was originally promulgated. The requirement of a sum certain has been completely eliminated in Revised Article 3. Rather than a sum certain, an instrument must show a "fixed amount of money, with or without interest or other charges described in the promise or order."\(^12\) Rates of interest may be stated as "fixed or variable."\(^13\) Thus, the revision clearly recognizes the negotiability of variable rate instruments.

The revision also clarifies the impact of the Federal Trade Commission "holder" rule.\(^14\) This federal regulation requires a conspicuous legend in consumer notes that makes any holder subject to the claims and

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5. U.C.C. §§ 3-104(i), 3-106(c) (1990).
6. Id. § 3-106 cmt. 2.
7. Id. § 3-104.
8. Id. §§ 3-104(a), 3-112.
13. Id. § 3-112(b).
defenses which the issuer could assert against the original payee. Revised Article 3 makes clear that complying with the federal regulation does not render the instrument "conditional" so as to exclude it from Article 3. The revision treats such notes bearing the legend as negotiable instruments for all purposes except that no one may be a holder in due course of such instruments.

Under Prior Article 3, a promise to pay was not made conditional (thereby destroying negotiability) if the promise was limited to payment out of a particular fund or source, so long as the instrument was issued by a government or governmental agency or unit. But a corporation's or individual's promise to pay that was limited to a particular fund was conditional, destroying negotiability. Revised Article 3 rejects this approach, stating that a promise to pay is not made conditional "because payment is limited to resort to a particular fund or source."

Finally, the revision has some special rules governing checks. Under Revised Article 3, there is no way to destroy the negotiability of a check. A check need not be payable to order or to bearer. Further, even if a drawer prints or types the words "not negotiable" or adds a statement that the check is not governed by Article 3, it nevertheless is negotiable. This change is in recognition of automated processing and avoids prejudicing a party who takes the instrument without the ability to notice the exclusionary language. On the other hand, a promissory note containing similar language prevents the writing from being a negotiable instrument for any purpose. Of course, a court could nevertheless apply Article 3 principles to such a writing by analogy.

2. "Good Faith" and "Ordinary Care." The most significant benefit offered to consumers by Revised Articles 3 and 4 may be the new definition of "good faith." Under the prior articles, good faith was defined as "honesty in fact." The new definition, found in Revised Section 3-103(a)(4), requires both honesty in fact and "observance of

15. Id.
17. Id. § 3-106(d).
18. U.C.C. § 3-105(1)(g) (1958).
19. Id. § 3-105(2)(b).
21. Id. § 3-104(a), (c).
22. Id. § 3-104(a).
23. Id. § 3-104 cmt. 2.
24. Id. § 3-104 cmt. 3.
25. Id. §§ 3-103(a)(4), 4-104(c).
reasonable commercial standards of fair dealing." This new definition is consistent with the definitions of good faith applicable to Articles 2, 2A, 4, and 4A.

"Ordinary care" was not defined generally in Prior Articles 3 and 4. The official comments to Prior Article 4 stated that "[n]o attempt is made in this Article to define in toto what constitutes ordinary care or lack thereof." Revised Section 3-103(a)(7) contains a detailed definition of ordinary care. "Ordinary care" means, for a person engaged in business, the "observance of reasonable commercial standards, prevailing in the area in which the person is located, with respect to the business in which the person is engaged." Reasonable commercial standards do not require banks that process instruments for collection or payment by automated means to examine every instrument if the failure to examine does not violate the bank's procedures, and if those procedures do not vary from general banking usage. This revision resolves a conflict between cases holding that the use of automated procedures which did not require the examination of every item constituted a lack of ordinary care as a matter of law, and cases holding that the issue of whether the use of such procedures constituted ordinary care was one of fact. The revision is also consistent with the policy of encouraging the rapid processing of checks and establishing a statutory framework for accommodating a regime of truncation in which payor banks will have to pay checks with no opportunity to see them. It should be noted, however, that the "prevailing standards" test is not intended to shield unreasonable bank procedures. Comment 5 to Revised Section 3-103 states: "Nothing in Section 3-103(a)(7) is intended to prevent a customer from proving that the procedures followed by a bank are unreasonable, arbitrary, or unfair."
3. Holder in Due Course Status. A holder in due course must take an instrument "in good faith." As discussed above, Revised Article 3 has redefined good faith. Therefore, satisfying the good faith element for qualifying as a holder in due course will require observance of reasonable commercial standards in addition to honesty in fact.

Under Prior Article 3, an incomplete or irregular instrument would prevent a purchaser from having the lack of notice of a claim or defense required of a holder in due course. It was unclear whether the claim or defense had to relate to the irregular or incomplete nature of the instrument. Revised Article 3 provides that apparent evidence of forgery, alteration, irregularity, or incompleteness will prevent holder in due course status, without regard to whether the claim or defense is related to the problem evidenced by the face of the instrument.

Revised Article 3 clarifies that a holder who has not paid or performed the full consideration for an instrument has pro rata rights as a holder in due course; such rights equal "the fraction of the amount payable under the instrument equal to the value of the partial performance divided by the value of the promised performance."

Revised Article 3 expands and clarifies the rules for determining when a person who has taken an instrument from a fiduciary has notice of breach of that fiduciary's duty. A "fiduciary" includes "an agent, trustee, partner, corporate officer or director, or other representative owing a fiduciary duty with respect to an instrument." Revised Section 3-307 applies if (1) an instrument is taken from a fiduciary for payment or collection, or for value, (2) the taker has knowledge of the fiduciary status of the fiduciary, and (3) the beneficiary makes a claim against the transferee for the instrument or its proceeds on the ground that her fiduciary breached his duty. In these circumstances, if the taker has notice of a possible breach of fiduciary duty, the taker would not be a holder in due course and would be liable to the beneficiary if there is a misappropriation of the proceeds of the instrument. In the case of an instrument payable to or issued by the fiduciary as such, the taker has notice of the breach of fiduciary duty, and therefore, notice of

35. Id. § 3-302(a)(2).
36. Id. § 3-103(a)(4).
39. Id. § 3-302(d).
40. Id. § 3-307.
41. Id. § 3-307(a)(1).
42. Id. § 3-307(b).
43. See id. § 1-201(20).
the claim of the represented person, if the instrument is (1) taken in payment of, or as security for, a debt known by the taker to be the personal debt of the fiduciary, (2) taken in a transaction known by the taker to be for the personal benefit of the fiduciary, or (3) deposited to an account other than an account of the fiduciary.44

4. Effect of Instrument on Underlying Obligation. The revision expands the provisions governing the effect of an instrument on the obligation for which it is taken. Prior Article 3 provided that an obligation was discharged if a bank was a drawer, maker, or acceptor of the instrument and if, "there is no recourse on the instrument against the underlying obligor."45 For example, the underlying obligation was not discharged if the obligor indorsed a cashier's check. Under Revised Article 3, where a certified check, cashier's check, or teller's check is taken for an obligation, the obligation is always discharged, although this discharge does not affect any liability the obligor may have on the instrument.46

A considerable amount of litigation occurred under prior law concerning whether Prior Section 1-207 changed the law of accord and satisfaction. Most courts held that it did not alter pre-Code common law on accord and satisfaction.47 A person receiving a check offered in full payment of a pre-existing dispute waived the balance of her claim by accepting and cashing the check.48 The revision codifies this rule by stating in Revised Section 1-207(2) that a payee may not cash a check offering an accord and satisfaction with a reservation of rights and then seek to collect the balance of the debt that would have been owed if an accord and satisfaction had not been created.49 In addition, Revised Article 3 protects organizational payees from inadvertently losing their claims because of mechanical processing of full settlement checks.50 Organizational creditors can prevent accord and satisfaction by notifying their debtors that full satisfaction checks must be sent to a designated location and proving that the purported full payment check was not

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44. Id. § 3-307(b)(1), (2), (4).
47. See generally Vitaus M. Gulbis, Annotation, Application of U.C.C. § 1-207 to Avoid Discharge of Disputed Claim Upon Qualified Acceptance of Check Tendered as Payment In Full, 37 A.L.R. 4th 358, 366 (1985).
50. See id. § 3-311(c)(1).
sent. A creditor desiring not to have payments sent to a separate office and unknowingly cashing a full settlement check may prevent an accord and satisfaction by returning the money within ninety days.

5. Signatures. The revision states that the law of agency determines whether represented persons are bound by signatures. Prior Section 3-401(1) stated that "[n]o person is liable on an instrument unless his signature appears thereon." This language was generally interpreted to mean that an undisclosed principal was not liable on an instrument despite the fact that this interpretation was inconsistent with ordinary agency law that binds an undisclosed principal on a simple contract. Under Revised Article 3, an undisclosed principal is liable on the instrument.

Similarly, courts relied on the apparently clear language of Prior Section 3-403(2) to hold corporate agents liable on checks drawn on corporate accounts where the agents had signed without indicating their representative capacity and the checks did not name the corporate principal. The revision provides that, so long as the corporation is identified on the check, an authorized signer is not personally liable, even if the signer's agency status is not indicated.

Finally, under Prior Article 3, an agent was personally liable if the instrument neither named the principal nor showed that the agent signed in a representative capacity. Parol evidence was not admissible to avoid this personal liability. Except as against a holder in due course, Revised Article 3 always allows an agent to prove that his signature was made in a representative capacity, regardless of the form of the instrument.

6. Fictitious Payees, Impostors, and Faithless Employees; Comparative Negligence. While the basic structure of the loss allocation provisions of Prior Articles 3 and 4 is unchanged by the revision, the drawer's responsibility in cases of impostors, fictitious

51. See id.
52. See id. § 3-311(c)(2).
53. See id. § 3-402 cmt. 1.
55. See RESTATEMENT (SECOND) OF AGENCY § 190 (1958).
58. U.C.C. § 3-402(c) (1990).
60. See id. § 3-403 cmt. 3.
payees, faithless employees, and negligence has been clarified and, to some extent, expanded.

Under Prior Section 3-405(1)(a), one who impersonated another person and obtained a check made payable to the impersonated person could forge the check and pass good title. However, if the impersonator pretended to be an agent of a principal, and the victim took the precaution of making the check payable to the principal, the impersonator had no power to indorse the name of the principal. Thus, the indorsement with the name of the payee-principal was a forgery and was ineffective under Prior Article 3. Revised Article 3 gives the impostor the power to negotiate the check even when the check is made out to the impostor's purported principal.

Prior Section 3-405(1) stated, among other things, that an indorsement by any person "in the name of a named payee" was effective. Some courts focusing on this language found that any deviation, no matter how slight, between the indorsement and the name of the payee on the face of the check prevented a bank from asserting Section 3-405. Thus, the loss fell upon the bank. The revision rejects this view, providing instead that an indorsement is made in the name of a payee if it is made in a name substantially similar to that of the payee, or if the instrument, whether or not indorsed, is deposited in an account bearing a substantially similar name.

Revised Section 3-405 expands the per se negligence rule in Prior Section 3-405. Prior Section 3-405(1)(c) provided that an indorsement by any person in the name of a named payee was effective if the agent or employee of the maker or drawer "supplied him with the name of the payee intending the latter to have no such interest." If, at the time the check was supplied to the employer, the employee had no intention of forging the payee's signature and stealing the check, Prior Section 3-405(1)(c) did not apply. In addition, fraudulent indorsements of the employer's name to instruments payable to the employer were not covered by Prior Section 3-405; the employer bore the loss in such cases only if its negligence could be proven under Prior Section 3-406.

The faithless employee doctrine is set out in detail in Revised Section 3-405. It allocates to the employer the risk of loss for fraudulent indorsements by employees entrusted with responsibility with respect to

63. See id. § 3-402 cmt. 2.
64. See U.C.C. § 3-404 cmt. 1 (1990).
67. Id.
instruments, rather than to the bank that takes or pays the instrument. 68 An employee has “responsibility” if she handles instruments in a responsible capacity. 69 In cases of indorsements made in the name of payees of instruments issued by the employer, Revised Section 3-405 applies even if, at the time the check is supplied to the employer, the employee entrusted with responsibility has no intention of forging the payee’s name and indorsing the check. 70 The forged indorsement would be effective. 71 Fraudulent indorsements of the employer’s name to instruments payable to the employer also are covered by Revised Section 3-405; the fraudulent indorsement of the employer’s name by the employee entrusted with responsibility would be effective. 72

Finally, Prior Section 3-405 had no language that required a bank, seeking to avoid liability by relying on the impostor rule or fictitious payee rule, to exercise reasonable care. This absence in Prior Section 3-405 of a requirement that the bank exercise ordinary care led some courts to conclude that the drafters intended that the drawer would be liable without regard to the bank’s negligence. 73 Under Revised Article 3, a comparative negligence standard applies. 74 It should be noted that Prior Section 3-406 also has been revised so that negligence of the financial institution no longer prevents it from asserting the preclusion. 75 Under Revised Section 3-406, comparative negligence is now the rule. 76

7. Transfer and Presentment Warranties. Prior Section 3-417 has been replaced by Revised Section 3-416, which covers transfer warranties, and Revised Section 3-417, which covers presentment warranties. Prompt notice of a breach of a transfer or presentment warranty must be given or the warrantor may be discharged to the extent of loss caused by the delayed notice. 77 Transfer and presentment warranties may not be disclaimed with respect to checks. 78

68. Id. § 3-405.
69. Id. § 3-405(a)(5).
70. See id. § 3-405.
71. Id.
72. Id.
75. See id. § 3-406.
76. Id.
77. See id. §§ 3-416(c), 3-417(e).
78. Id.
Under the revision, a warrantor, in addition to warranting that all signatures are authentic and authorized and that the instrument has not been altered, also warrants that she is entitled to enforce the instrument and that “the instrument is not subject to a defense or claim in recoupment of any party which can be asserted against the warrantor.”79 Although Prior Section 3-417(3) permitted a transferor to limit this warranty by transferring “without recourse,”80 Revised Section 3-416 deletes this provision.

Even if the transferee takes as a holder in due course who takes free of the defense or claim in recoupment, the warranty gives the transferee the option of proceeding against the transferor rather than litigating with the obligor on the instrument the issue of the holder-in-due-course status of the transferee.81

With regard to an unauthorized drawer’s signature, the revision retains the rule of Price v. Neal.82 Unless the party presenting the instrument knows that the drawer’s signature was unauthorized, the drawee takes the risk that the drawer’s signature was unauthorized.83 A drawer may sue on a presentment warranty only when presentment is made to the drawer with respect to a dishonored draft.84 A drawee who seeks recovery for breach of warranties based on an unauthorized indorsement or alteration is subject to the defense that the indorsement is effective, or that the drawer is precluded from raising the forgery or alteration.85

In addition, the revision clarifies that a drawee may have a right of restitution for mistaken payment, but preserves the finality of payment aspect of Price v. Neal as to holders in due course and reliance payees.86

8. Conversion of Instruments. Revised Section 3-420 replaces Prior Section 3-419, and clarifies a number of points. Revised Section 3-420(a) settles a split in authority by providing that neither the drawer of a check, nor a payee who has failed to receive the check, may sue for conversion of that check.87 The revision also addresses the problem of

79. Id. § 3-416(a)(4).
84. See id. § 3-417(d).
85. See id. §§ 3-417(e), 3-404 to -406.
86. See id. § 3-418.
87. Id. § 3-420.
conversion actions in multiple payee cases when payment is made over a missing indorsement.\textsuperscript{88} Prior Section 3-419 was silent on the measure of recovery when a joint payee wrongfully collected without the necessary signature of her joint payee. Revised Section 3-420(b) states that in an action for conversion, "the measure of liability is presumed to be the amount payable on the instrument, but recovery may not exceed the amount of the plaintiff's interest in the instrument.\textsuperscript{89}"

The revision's most significant change relates to conversion actions against depositary banks. Prior Section 3-419(3) provided that when a depositary bank, in good faith and in observance of reasonable commercial standards, dealt with an instrument or its proceeds on behalf of one who was not the true owner, it was "not liable in conversion or otherwise to the true owner beyond the amount of any proceeds remaining in his hands."\textsuperscript{90} Often there were no proceeds left, and the rightful owner would be required to bring her conversion against the payor bank or banks. Yet the depositary bank was ultimately liable in the case of a forged indorsement under warranty theory, and it was often the most convenient defendant, especially in cases involving multiple checks drawn on different banks.\textsuperscript{91} Revised Section 3-420 deletes this "proceeds remaining" clause, and now the depositary bank is fully liable.\textsuperscript{92}

9. **Suretyship Defenses.** Because most instruments contain enforceable waiver provisions, suretyship defenses seldom come into play in commercial transactions. The revision continues to permit waiver to occur "either specifically or by general language indicating that parties waive defenses based on suretyship or impairment of collateral."\textsuperscript{93} Nevertheless, litigation continues to arise in situations where no waiver has occurred. Revised Section 3-605 clarifies most of the issues commonly litigated, such as who has the impairment of collateral defenses (both sureties and makers) and what constitutes impairment of collateral. The defenses available are extended to include material modifications of the obligation, but are generally limited to the extent of actual prejudice.\textsuperscript{94}

\textsuperscript{88} Id.
\textsuperscript{89} Id. § 3-420(b).
\textsuperscript{90} U.C.C. § 3-419(3) (1958).
\textsuperscript{91} U.C.C. § 3-420 cmt. 3 (1990).
\textsuperscript{92} See id. § 3-420.
\textsuperscript{93} Id. § 3-605(i).
\textsuperscript{94} See id. § 3-605.
B. Revised Article 4

1. Scope, Definitions, and General Provisions. Since Articles 3 and 4 were originally drafted, the world of financial institutions has changed dramatically. The term “bank” no longer means simply “commercial bank.” Revised Article 4 expands the definition of bank to include thrifts and credit unions so that their checks are governed by the UCC. Revised Article 4 also clarifies that checks written on credit lines and asset accounts are included. However, debit and credit card slips are explicitly excluded, leaving them to be governed by system agreements and rules.

Revised Article 4 incorporates the Revised Article 3 definition of “good faith.” This includes honesty in fact and the observance of reasonable commercial standards of fair dealing.

Prior Sections 3-120 and 3-121 have been rewritten and consolidated into Revised Section 4-106. The revision specifies that a payable-through item must be presented to the drawee only by or through the designated bank. For collection purposes, a bank often is named on a draft that is drawn on a nonbank drawee. Absent clear indication to the contrary, the revision treats the bank as a collecting bank, and not as a codrawee subject to the payor’s midnight deadline. This overturns contrary case law. It should be noted, however, that Regulation CC treats a payable-through bank as a paying bank for the purposes of “expeditious return” of dishonored items. Therefore, if dishonored payable-through items are not returned expeditiously under Regulation CC rules based on the time of presentment to the payable-through bank, the payable-through bank may be liable for damages under Regulation CC for nonexpeditious return.

Revised Section 4-111 creates a uniform three year statute of limitations for actions to enforce an obligation, duty, or right arising

95. See id. §§ 3-103(c), 4-105(i).
96. See id. § 4-104(a)(1).
97. Id. § 4-104(a)(9).
98. Id. § 4-104(c).
99. See id. § 3-103(a)(4).
100. Id. § 4-106(a)(ii).
101. Id. § 4-106(c).
under Article 4. 104 Prior Article 4 had no express statute of limitations.

2. Accommodating Modern Technology. Changes made to accommodate modern technology and check processing practices best illustrate the need for Revised Article 4. For example, the process of posting was designed as an early cutoff point for payment, or matters such as stop payment, garnishment, and the like. However, the process of posting contemplates human involvement that is no longer consistent with automated processing. Revised Article 4 has eliminated all references to the process of posting. Because completion of the process of posting is eliminated as a cutoff, Revised Section 4-303(a)(5) permits banks to establish a cutoff hour for the four legals as early as one hour after the opening of the banking day after receipt of the check. 105

Prior Section 4-205(1) permitted depositary banks to supply missing indorsements of their customers. 106 Revised Section 4-205(1) now makes the depositary bank a holder if its nonindorsing customer was a holder; the bank need not physically supply its customer's indorsement. 107

Under Prior Articles 3 and 4, postdated checks were not properly payable until the date stated. 108 This rule caused problems because the automated check processing system paid checks upon presentment without regard to the date of the check. The revision addresses this situation by permitting a bank to charge a customer's account for a check paid before its date unless the customer provides the bank with a timely and sufficient notice of postdating. 109

Because Prior Article 4 was drafted at the dawn of automated processing, it provided no rules for misencoding. Depositary banks or their customers now encode checks with magnetic ink, thus enabling payor banks to electronically read the amount of the check, the identity of the payor bank, and the identity of the customer. Problems arise when checks are either underencoded or overencoded. Revised Section 4-209(a) provides that the person who encodes information warrants to

105. Id. § 4-303(a)(5).
Any knowledge, notice, or stop payment order received by, any legal process served upon, or any right of setoff exercised by a payor bank is too late to affect the bank's rights or duties with respect to an item if they are received, served or exercised after the time limit specified in Section 4-303.
108. See U.C.C. §§ 3-114(2), 4-104(1) (1958).
the collection chain that the information is encoded correctly. A good faith recipient of a warranty may recover from the warrantor as damages the loss suffered as a result of the breach, plus expenses and loss of interest.

Midnight deadline litigation clogged the courts under Prior Article 4. Revised Section 4-302(a) retains the rule of Prior Section 4-302(a) that a payor bank is responsible for an item if it keeps the item without settling it beyond midnight of the day of receipt, or it does not pay or return the item or send notice of dishonor until after its midnight deadline—midnight of the banking day following the banking day of receipt. Revised Section 4-302(b) states that liability of the payor bank for not meeting midnight deadlines is subject to defenses based on breach-of-presentment warranties. It also codifies the line of cases that excuse delay beyond the midnight deadline when the person presenting the item was attempting to defraud the bank. For example, a presenter who knows that a drawer's account is insufficient would be barred from claiming a breach of the midnight deadline rule by the payor bank. Revised Section 4-214(a) resolves conflicting lines of authority by providing that a collecting bank that fails to meet its midnight deadline does not necessarily lose its right to chargeback; a collecting bank loses its rights only to the extent of damages for any loss resulting from the delay.

Due to the Expedited Funds Availability Act and Regulation CC, electronic developments, and the desire to reduce costs in the banking industry, check truncation has developed. With truncation, a depositary or other collecting bank retains the physical item while presentment is made electronically. The revision provides for presentment by means of a “presentment notice” pursuant to an “agreement for electronic presentment.” A person who retains an item pursuant to an agreement warrants to banks in the collection chain and the payor that the retention and presentment comply with the agreement.

In addition, the substantial revisions to Prior Section 4-406 facilitate truncation. Revised Section 4-406 authorizes a descriptive bank statement that permits the bank to supply only the item number,
amount, and date of payment. Currently, the Magnetic Ink Character Recognition line cannot supply the name of the payee and item date. It should be noted that the customer must only notify the bank of unauthorized payments that reasonably should have been discovered based on the statement provided to that customer. As technology allows more information to be made available, the self interest of the bank, as well as competitive forces, will likely induce the provision of additional information. The party possessing the items must either retain them or, if the items are destroyed, be able to furnish legible copies of them for a period of seven years after their receipt. The bank that paid the item must be able to provide the item or a copy thereof within a reasonable time after request by the customer. The bank, as previously discussed, does not fail to exercise ordinary care merely because it does not examine every item. If both the bank and the customer fail to exercise ordinary care, a comparative negligence standard prevails. The outside time limit for a customer to report successive forgeries or alterations is increased from the fourteen days in Prior Section 4-406 to thirty days in Revised Section 4-406(d) in recognition of the fact that customer check volume has increased significantly. Finally, Revised Section 4-406(f) retains the notion that regardless of care or lack thereof by either the customer or the bank, a customer is precluded from asserting a claim against the bank unless the customer discovers and reports an unauthorized signature or alteration within one year. Prior Section 4-406(4) provided that a customer must discover and report an unauthorized payee's signature to the drawee bank within three years after the customer receives the item. Revised Article 4 deletes this concept.

One should note that Georgia's Prior Section 4-406 varied from the official text of Prior Section 4-406. Under Georgia's Prior Section 4-406(4), a customer had sixty days (not one year) to report his unauthorized signature or alteration, and one year (not three years) to report an

119. See id. § 4-406.
120. Id. § 4-406(c).
121. Id. § 4-406(b).
122. Id.
123. See id. §§ 3-103(a)(7), 4-104(c).
124. See id. § 4-406(e).
125. Id. § 4-406(d).
126. Id. § 4-406(f).
unauthorized indorsement. As is discussed later, this variation is retained in Georgia's version of Revised Article 4.

3. Additional Substantive Changes. Revised Section 4-403(a) states that a "customer or any person authorized to draw on an account if there is more than one person may stop payment of any item drawn on the customer's account ...." Thus, it makes clear that any person that can draw on an account can stop payment of an item drawn on that account. It also makes explicit that a nonsigning customer is not liable for an overdraft on a joint account unless the person benefits from the proceeds of the item.

Another clarification involves the common law "trader rule," under which a businessperson need not prove actual damages to recover substantial damages for wrongful dishonor. Prior Section 4-402 provided that "when the dishonor occurs through mistake," liability was limited to actual damages proved. This language led some courts to conclude that the trader rule survived in cases involving dishonor for reasons other than mistake. Revised Section 4-402 unequivocally eliminates the trader rule.

Revised Section 4-402(c) also allows a bank to check the account balance of its customer once within its midnight deadline and not be liable if it dishonors on that basis if a subsequent credit arrives. This provision is in line with general banking practice in dealing with checks by automated means and confirms agreements that so provide.

III. CRITICISMS OF REVISED ARTICLES 3 AND 4

There appears to be universal agreement that Prior Articles 3 and 4 were seriously outdated. It also is generally agreed that Revised Articles 3 and 4 are well drafted, and that they serve to clarify the law and accommodate changing business practices. However, several commentators have expressed concern over the approach of Revised Articles 3 and 4 to consumer issues.

For example, under Revised Article 4 a bank may pay a postdated check prior to the stated date unless the customer gives the bank timely

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129. Id. § 11-4-406(4).
130. Id. § 11-4-406(f) (Supp. 1996).
135. See id. § 4-402(c).
notice of the postdating.\textsuperscript{136} Although this seems reasonable given the technology used by most banks, concern exists that Revised Article 4 neither requires banks to inform their customers of the need to notify, nor does it regulate fees that banks may charge their customers for a notice of postdating.\textsuperscript{137} Comment 3 to Revised Section 4-401 recognizes that fees are not regulated, but points out that courts have reviewed fees and the bank's exercise of discretion to set fees "under principles of law such as unconscionability or good faith and fair dealing."\textsuperscript{138} Some commentators are concerned that this may not afford consumers adequate protection from unscrupulous practices.\textsuperscript{139} Although no state specifically requires banks to inform their customers of the notice requirement regarding postdated checks, a few states have chosen to modify the language of Revised Article 4 and regulate fees that banks may charge for a notice of postdating. West Virginia, for example, requires banks to accept a specified number of notices without charge.\textsuperscript{140} Washington denies banks the right to charge their customers any fee for notice of postdating.\textsuperscript{141} However, most states have adopted the revision as written.

Similar concerns have been expressed about Revised Section 4-406. Although Revised Section 4-406(b) requires a bank to provide requested checks or legible copies of checks to its customers, it sets no definite time limit; the bank must act "in a reasonable time."\textsuperscript{142} In addition, the revision is silent concerning the fee that can be charged to the customer for providing these checks or copies. A few states have modified Revised Section 4-406 to require banks to produce a specified number of canceled checks to customers free of charge.\textsuperscript{143} Most states, however, have adopted the revision as written.

\textsuperscript{136} See id. § 4-401(c).


\textsuperscript{138} U.C.C. § 4-401 cmt. 3 (1990).

\textsuperscript{139} See, e.g., Mark E. Budnitz, Consumer Issues in Revised Articles 3 and 4, 47 CONSUMER L. Q. REP. 119 (1993).

\textsuperscript{140} See W. VA. CODE § 46-4-401(c) (1996) (requiring banks to accept nine such notices each year for each account without charge).

\textsuperscript{141} See WASH. REV. CODE ANN. § 62A.4-401(c) (West 1995).

\textsuperscript{142} U.C.C. § 4-406(b) (1990).

\textsuperscript{143} See, e.g., CAL. COM. CODE § 4406(b) (West 1995) (banks must furnish free of charge two items per statement to customers upon request); N.H. REV. STAT. ANN. § 382-A:4-406 (1995) (banks shall provide upon request and without charge 10 items or copies of items per statement); W. VA. CODE § 46-4-406(g) (1996) (customer may request 18 checks per year free of charge).
There also has been some criticism of the introduction of comparative negligence concepts through Revised Section 3-406(b) and 4-406(e). Under Prior Section 3-406, even if a customer's negligence substantially contributed to a material alteration or unauthorized signature, the loss nevertheless shifted to the bank unless it paid the check "in good faith and in accordance with the reasonable commercial standards" of the bank's business. Similarly, under Prior Section 4-406(3), if a customer failed to exercise ordinary care and promptness in examining bank statements and in notifying the bank, the loss still fell on the bank "if the customer established lack of ordinary care on the part of the bank in paying the item(s)."

Under Revised Article 4, the loss does not automatically fall on a bank that fails to exercise ordinary care. Instead, a comparative negligence scheme operates, allocating the loss between the customer and the bank to the extent the failure of each to exercise ordinary care contributed to the loss.

Professor Mark Budnitz is concerned that this scheme may force a consumer into costly litigation in order to show exactly how negligent the bank was as compared to the consumer. He believes that this will discourage settlements. However, the provisions concerning comparative negligence contained in Revised Articles 3 and 4 are consistent with similar provisions found in Regulation CC. Under Regulation CC, if a person, including a bank, fails to exercise ordinary care or act in good faith in indorsing a check, accepting a returned check or notice of nonpayment, or otherwise, the damages that person may have sustained are diminished in proportion to the amount of negligence or bad faith attributable to that person.

Another commentator, Gail Hillebrand, would like Revised Articles 3 and 4 to deal with numerous other issues faced by consumers concerning checking accounts. She points out that consumers need access to affordable checking accounts and check cashing services. Hillebrand suggests that banks be required to cash government checks for nondepositors for a set fee such as one dollar per check, and be required to offer low-cost, limited-use checking accounts to persons at qualifying
low-income levels.\textsuperscript{154} She believes that fees charged on consumer accounts for ancillary procedures should be controlled by statute, and that state lawmakers should consider the desirability of standardized disclosures of the cost of checking accounts.\textsuperscript{155} She believes that such matters could be dealt with as part of the revisions to Articles 3 and 4.\textsuperscript{156}

Professor Fred Miller has defended the Revised Articles 3 and 4 approach of not differentiating the rules between commercial and consumer transactions.\textsuperscript{157} He gives four justifications for his position. First, the debate over consumer provisions may preclude or destroy the necessary consensus on the commercial law. The experience with the failed New Payments Code demonstrates this.\textsuperscript{158}

Second, for the most part, the UCC is not a regulatory statute. Consumer provisions are regulatory in nature, cannot be made subject to variation by agreement, and require sanctions for violation to ensure compliance. Differentiating the rules between commercial and consumer transactions would generate a rigidity that is particularly inappropriate in a statute like the UCC that needs flexibility to accommodate evolving and changing practices, procedures, and technologies.\textsuperscript{159}

Third, consumer law in relation to Articles 3 and 4 has grown outside of the UCC and as an appendage to it in the area of commercial paper. Therefore, state consumer law relating to drafts and notes is not uniform across the country. Some states have more consumer protection statutes than others. A statute to be enacted nationally, like the UCC, which contained extensive consumer provisions (assuming a consensus could be reached on what they should be) could serve well in states with little prior protective legislation. However, it is unlikely that such a statute would be accepted in lieu of established provisions in those states where extensive provisions already have been negotiated.\textsuperscript{160}

Fourth, Articles 3 and 4 must facilitate, not hamper, the nationwide check system in functioning at maximum efficiency for the benefit of all its users, and in minimizing financial institution risk.\textsuperscript{161} Most consumer provisions are inconsistent with this design because they generally promote the individual customer's interest over the interest of

\begin{enumerate}
\item \textsuperscript{154} Id. at 713.
\item \textsuperscript{155} Id. at 717.
\item \textsuperscript{156} Id. at 719.
\item \textsuperscript{157} See Fred Miller, National Conference of Commissioners on Uniform State Laws, The Approach of Revised UCC Articles 3 and 4 to Consumer Issues (1991).
\item \textsuperscript{158} Id. at 1.
\item \textsuperscript{159} Id.
\item \textsuperscript{160} Id.
\item \textsuperscript{161} Id. at 2.
\end{enumerate}
the system and its users as a whole. Such provisions increase costs, which institutions in turn recover by spreading the cost over all the institution’s customers.

Professor Miller insists that he is not repudiating consumer protection provisions. He concludes that “if extensive consumer protection provisions are deemed desirable after careful consideration of a proper balance in a particular jurisdiction, separate provisions should be enacted. This has been the tested historical approach of the UCC.”

IV. GEORGIA VARIATIONS FROM THE OFFICIAL TEXT

A subcommittee of the Corporate and Banking Law Section of the State Bar of Georgia carefully reviewed Revised Articles 3 and 4, and considered the variations that had been enacted in several states. It also considered the concerns expressed by some regarding consumer issues.

The subcommittee recognized that the goal of uniformity should be given considerable weight in deciding whether to vary from the official text of the UCC. Although subcommittee members expressed some concerns about the treatment of certain consumer-related issues, the subcommittee concurred with the Permanent Editorial Board’s view that consumer protection matters generally should be dealt with outside of the UCC. The subcommittee believed that Revised Articles 3 and 4 are generally well-drafted, and do much to clarify and modernize the law governing negotiable instruments and bank collections. It recommended that Revised Articles 3 and 4 (along with conforming amendments to Article 1) should be adopted with just a few variations from the official text. The appropriate governing bodies of the State Bar of Georgia approved the recommendation, and the Revised Articles were presented to and approved by the Georgia General Assembly during the 1996 legislative session. However, Georgia’s version of Revised Articles 3 and 4 does contain variations from the official text.

The official text of Revised Section 4-406(f) states:

Without regard to care or lack of care of either the customer or the bank, a customer who does not within one year after the statement or items are made available to the customer (subsection (a)) discover and report the customer’s unauthorized signature on or any alteration on the item is precluded from asserting against the bank the unauthorized signature or alteration. If there is a preclusion under this subsection, the payor bank may not recover for breach of warranty under Section

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162. Id.
4-208 with respect to the unauthorized signature or alteration to which the preclusion applies.\textsuperscript{163}

Georgia adopted the official text of Revised Section 4-406, except that Georgia's Revised Section 4-406(f) leaves the reporting deadlines at the sixty day and one year time periods that existed under Georgia's Prior Section 4-406.\textsuperscript{164} The sixty day and one year reporting deadlines appear to have worked well in Georgia for many years. These deadlines were retained in an effort to combat fraud—an increasing problem for banks, especially in connection with large commercial accounts. Georgia's Revised Section 4-406(f) now provides:

Without regard to care or lack of care of either the customer or the bank, a customer who does not within 60 days after the statement or items are made available to the customer (subsection (a) of this Code section) discover and report the customer's unauthorized signature on or any alteration on the face of the item or who does not within one year from that time discover and report any unauthorized indorsement or alteration on the back of the item is precluded from asserting against the bank the unauthorized signature, indorsement, or alteration.

If there is a preclusion under this subsection, the payor bank may not recover for breach of warranty under Code Section 11-4-208 with respect to the unauthorized signature or alteration to which the preclusion applies.\textsuperscript{165}

Georgia also has retained two other nonuniform provisions found in Georgia's Prior Sections 3-508(3) and 3-603(3). Georgia's Revised Section 3-503(b) now provides:

Notice of dishonor may be given by any person. Notice of dishonor may be given by any commercially reasonable means, including an oral, written, or electronic communication. Notice of dishonor is sufficient if it reasonably identifies the instrument and indicates that the instrument has been dishonored or has not been paid or accepted. Return of an instrument given to a bank for collection is sufficient notice of dishonor. \textit{Upon request of any party to the instrument, the drawee shall provide a statement to the requesting party giving the specific reason for dishonor, and the drawee shall have no additional liability to the drawer as a result of such statement}.\textsuperscript{166}

\textsuperscript{163} U.C.C. § 4-406(f) (1990).
\textsuperscript{164} O.C.G.A. § 11-4-406(f) (Supp. 1996).
\textsuperscript{165} Id.
\textsuperscript{166} Id. § 11-3-503(b) (italics indicates the nonuniform portion of this subsection retained from Georgia's Prior Section 3-508(3)).
Georgia's Revised Section 3-602 was amended to add subsection (c) which provides:

Notwithstanding any other provision of this article, with respect to a note which is a negotiable instrument within the meaning of this article and which is to be paid off in installment payments or in more than one payment, the maker or drawer is authorized to pay the assignor until the assignee or its authorized agent sends a registered or certified letter to the maker or drawer at the maker's or drawer's last known address notifying the maker or drawer that the amount due or to become due has been assigned and that payment is to be made to the assignee. A notification that does not reasonably identify the rights assigned is ineffective. If requested by the drawer or maker, the assignee must furnish reasonable proof that the assignment has been made and, unless the assignee does so, the maker or drawer may pay the assignor.\(^{167}\)

It was also necessary to amend the official text of Revised Section 3-118, which provides for a statute of limitations on actions to enforce notes and drafts.\(^ {168}\) Under this section, if a note is payable at a definite time, a six year limitations period starts at the due date of the note, subject to prior acceleration.\(^ {169}\) If a note is payable on demand, there are two limitations periods. If a demand for payment is made to the maker, a six year limitations period starts to run when the demand is made.\(^ {170}\) An action to enforce the note is barred if no demand has been made on the note and no payment of interest or principal has been made for a continuous period of ten years.\(^ {171}\) The Official Code of Georgia Annotated ("O.C.G.A.") section 9-3-23 currently provides that: "Actions upon bonds or other instruments under seal shall be brought within 20 years after the right of action has accrued. No instrument shall be considered under seal unless so recited in the body of the instrument."\(^ {172}\) It was believed that the twenty year limitation period for sealed instruments should not be disturbed by the UCC. Revised Section 3-118 was amended to make clear that its limitations periods do not apply to instruments under seal. Subsection (h) was added to Georgia's Revised Section 3-118 which provides: "This Code section does

\(^{167}\) Id. § 11-3-602(c) (italics indicates the nonuniform portion of this subsection retained from Georgia's Prior Section 3-603(3)).

\(^{168}\) U.C.C. § 3-118(a) (1990).

\(^{169}\) Id.

\(^{170}\) Id. § 3-118(b)

\(^{171}\) Id. § 3-118(c).

\(^{172}\) O.C.G.A. § 9-3-23 (1982).
not apply to sealed instruments, which are governed by the provisions
of Code Section 9-3-23."\textsuperscript{173}

O.C.G.A. Section 9-3-24 also was amended. That section previously
provided that:

All actions upon promissory notes, drafts, or other simple contracts in
writing shall be brought within six years after the same become due
and payable. However, this Code section shall not apply to actions for
the breach of contracts for the sale of goods under Article 2 of Title
11.\textsuperscript{174}

This section was amended by deleting the phrase “promissory notes,
drafts, or other.”\textsuperscript{175} Thus, the limitations periods set out in the
Revised Section 3-118 now apply to notes (not under seal) and drafts.
O.C.G.A. section 9-3-24 was amended to provide:

All actions upon simple contracts in writing shall be brought within six
years after the same become due and payable. However, this Code
section shall not apply to actions for the breach of contracts for the sale
of goods under Article 2 of Title 11 or to negotiable instruments under
Article 3 of Title 11.\textsuperscript{176}

In order to provide additional consumer protection and to enhance the
check truncation programs adopted by banks and other financial
institutions, the Georgia Evidence Code\textsuperscript{177} was amended by adding
O.C.G.A. section 24-4-23.1 which provides:

(a) As used in this Code section:

(1) “Bank” means any person engaged in the business of banking and
includes, in addition to a commercial bank, a savings and loan associa-
tion, savings bank, or credit union; and

(2) “Check” means a draft, other than a documentary draft, payable
on demand and drawn on a bank, even though it is described by
another term, such as “share draft” or “negotiable order of withdrawal.”

(b) In any dispute concerning payment by means of a check, a copy of
the check produced in accordance with Code Section 24-5-26, together
with the original bank statement that reflects payment of the check by
the bank on which it was drawn or a copy thereof produced in the same
manner, creates a presumption that the check has been paid.\textsuperscript{178}

\textsuperscript{173} Id. § 11-3-118(h) (Supp. 1996).
\textsuperscript{174} Id. § 9-3-24 (1981).
\textsuperscript{175} Id. § 9-3-24 (Supp. 1996).
\textsuperscript{176} Id.
\textsuperscript{177} Id. §§ 24-1-1 to -154 (1995 & Supp. 1996).
\textsuperscript{178} Id. § 24-4-23.1 (Supp. 1996).