CHAPTER 3

Commercial Code—Negotiable Instruments

Editor’s Note

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The Introduction to this chapter was not reenacted as a part of the amendment by 2008 Act No. 204.

Part 1

General Provisions and Definitions

Editor’s Note

2008 Act No. 204 Section 1 provides in part as follows:

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2008 Act No. 204, Section 4.A provides as follows:

“This act applies to a transaction occurring on or after the effective date [July 1, 2008] of this act. This act does not apply to a transaction or event, or obligation or duty arising out of or associated with a transaction or event, before the effective date of this act.”

2008 Act No. 204 Section 4.B provides as follows:

“A transaction occurring before the effective date [July 1, 2008] of this act and the rights, obligations, and interests flowing from that transaction are governed by any statute or other law amended or repealed by this act as if repeal or amendment had not occurred and may be terminated, completed, consummated, or enforced under that statute or other law.”

**SECTION 36‑3‑101.** Short title.

This chapter may be cited as Uniform Commercial Code—Negotiable Instruments.

HISTORY: 1962 Code Section 10.3‑101; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

SOUTH CAROLINA REPORTER’S COMMENT

None.

RESEARCH REFERENCES

Encyclopedias

S.C. Jur. Cooperative Credit Unions Section 139, South Carolina Uniform Commercial Code.

Forms

Am. Jur. Pl. & Pr. Forms Bills and Notes Section 1 , Introductory Comments.

Am. Jur. Pl. & Pr. Forms Uniform Commercial Code Section 3:1 , Introductory Comments.

LAW REVIEW AND JOURNAL COMMENTARIES

The check is ... on the telephone? 47 S.C. L. Rev. 305 (Winter 1996).

Misconceptions About Article 3 of the Uniform Commercial Code: A Suggested Methodology and Proposed Revisions. 62 S.C. L. Rev. 115 (October 1983).

The Witch’s brew: Nigerian schemes, counterfeit cashier’s checks, and your trust account. Clark H.C. Lacy, 61 S.C. L. Rev. 753 (Summer 2010).

**SECTION 36‑3‑102.** Subject matter.

(a) This chapter applies to negotiable instruments. It does not apply to money, to payment orders governed by Chapter 4A, or to securities governed by Chapter 8.

(b) If there is conflict between this chapter and Chapter 4 or 9, Chapters 4 and 9 govern.

(c) Regulations of the Board of Governors of the Federal Reserve System and operating circulars of the Federal Reserve Banks supersede any inconsistent provision of this chapter to the extent of the inconsistency.

HISTORY: 1962 Code Section 10.3‑102; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. Former Article 3 had no provision affirmatively stating its scope. Former Section 3‑103 was a limitation on scope. In revised Article 3, Section 3‑102 states that Article 3 applies to “negotiable instruments,” defined in Section 3‑104. Section 3‑104(b) also defines the term “instrument” as a synonym for “negotiable instrument” in most places Article 3 uses the shorter term “instrument”. This follows the convention used in former Article 3.

2. The reference in former Section 3‑103(1) to “documents of title” is omitted as superfluous because these documents contain no promise to pay money. The definition of “payment order” in Section 4A‑103(a)(1)(iii) excludes drafts which are governed by Article

3. Section 3‑102(a) makes clear that a payment order governed by Article 4A is not governed by Article 3. Thus, Article 3 and Article 4A are mutually exclusive.

ARTICLE 8 states in Section 8‑103(d) that “A writing that is a security certificate is governed by this ARTICLE and not by ARTICLE 3, even though it also meets the requirements of that ARTICLE.” Section 3‑102(a) conforms to this provision. With respect to some promises or orders to pay money, there may be a question whether the promise or order is an instrument under Section 3‑104(a) or a certificated security under Section 8‑102(a)(4) and (15). Whether a writing is covered by ARTICLE 3 or ARTICLE 8 has important consequences. Among other things, under Section 8‑207, the issuer of a certificated security may treat the registered owner as the owner for all purposes until the presentment for registration of a transfer. The issuer of a negotiable instrument, on the other hand, may discharge its obligation to pay the instrument only by paying a person entitled to enforce under Section 3‑301. There are also important consequences to an indorser. An indorser of a security does not undertake the issuer’s obligation or make any warranty that the issuer will honor the underlying obligation, while an indorser of a negotiable instrument becomes secondarily liable on the underlying obligation.

Ordinarily the distinction between instruments and certificated securities in non‑bearer form should be relatively clear. A certificated security under Article 8 must be in registered form (Section 8‑102(a)(13)) so that it can be registered on the issuer’s records. By contrast, registration plays no part in Article 3. The distinction between an instrument and a certificated security in bearer form may be somewhat more difficult and will generally lie in the economic functions of the two writings. Ordinarily, negotiable instruments under Article 3 will be separate and distinct instruments, while certificated securities under Article 8 will be either one of a class or series or by their terms divisible into a class or series (Section 8‑102(a)(15)(ii)). Thus, a promissory note in bearer form could come under either Article 3 if it were simply an individual note, or under Article 8 if it were one of a series of notes or divisible into a series. An additional distinction is whether the instrument is of the type commonly dealt in on securities exchanges or markets or commonly recognized as a medium for investment (Section 8‑102(a)(15)(iii)). Thus, a check written in bearer form (i.e., a check made payable to “cash”) would not be a certificated security within Article 8 of the Uniform Commercial Code.

Occasionally, a particular writing may fit the definition of both a negotiable instrument under Article 3 and of an investment security under Article 8. In such cases, the instrument is subject exclusively to the requirements of Article 8. Section 8‑103(d) and Section 3‑102(a). 3. Although the terms of Article 3 apply to transactions by Federal Reserve Banks, federal preemption would make ineffective any Article 3 provision that conflicts with federal law. The activities of the Federal Reserve Banks are governed by regulations of the Federal Reserve Board and by operating circulars issued by the Reserve Banks themselves. In some instances, the operating circulars are issued pursuant to a Federal Reserve Board regulation. In other cases, the Reserve Bank issues the operating circular under its own authority under the Federal Reserve Act, subject to review by the Federal Reserve Board. Section 3‑102(c) states that Federal Reserve Board regulations and operating circulars of the Federal Reserve Banks supersede any inconsistent provision of Article 3 to the extent of the inconsistency. Federal Reserve Board regulations, being valid exercises of regulatory authority pursuant to a federal statute, take precedence over state law if there is an inconsistency. Childs v. Federal Reserve Bank of Dallas, 719 F.2d 812 (5th Cir.1983), reh. den. 724 F.2d 127 (5th Cir. 1984). Section 3‑102(c) treats operating circulars as having the same effect whether issued under the Reserve Bank’s own authority or under a Federal Reserve Board regulation. Federal statutes may also preempt Article 3. For example, the Expedited Funds Availability Act, 12 U.S.C. Section 4001 et seq., provides that the Act and the regulations issued pursuant to the Act supersede any inconsistent provisions of the UCC. 12 U.S.C. Section 4007(b).

4. In Clearfield Trust Co. v. United States, 318 U.S. 363 (1943), the Court held that if the United States is a party to an instrument, its rights and duties are governed by federal common law in the absence of a specific federal statute or regulation. In United States v. Kimbell Foods, Inc., 440 U.S. 715 (1979), the Court stated a three‑pronged test to ascertain whether the federal common‑law rule should follow the state rule. In most instances courts under the Kimbell test have shown a willingness to adopt UCC rules in formulating federal common law on the subject. In Kimbell the Court adopted the priorities rules of Article 9.

5. In 1989 the United Nations Commission on International Trade Law completed a Convention on International Bills of Exchange and International Promissory Notes. If the United States becomes a party to this Convention, the Convention will preempt state law with respect to international bills and notes governed by the Convention. Thus, an international bill of exchange or promissory note that meets the definition of instrument in Section 3‑104 will not be governed by Article 3 if it is governed by the Convention. That Convention applies only to bills and notes that indicate on their face that they involve cross‑border transactions. It does not apply at all to checks. Convention Articles 1(3), 2(1), 2(2). Moreover, because it applies only if the bill or note specifically calls for application of the Convention, Convention Article 1, there is little chance that the Convention will apply accidentally to a transaction that the parties intended to be governed by this Article.

SOUTH CAROLINA REPORTER’S COMMENTS

This section replaces former Section 36‑3‑103. Subsection (a) expressly provides that Chapter 3 applies to negotiable instruments, but revises the former section by providing that Chapter 3 does not apply to payment orders under Chapter 4A and deleting the reference to documents of title.

Subsection (c) provides that regulations of the Board of Governors of the Federal Reserve system and operating circulars of the Federal Reserve Banks supersede inconsistent provisions in Chapter 3.

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| Definitional Cross References: |  |
| “Money” | Section 36‑1‑201(24) |
| “Negotiable instrument” | Section 36‑3‑104(a) |
| “Payment order” | Section 36‑4A‑103(a)(1) |
| “Security” | Section 36‑8‑102(a)(15) |

Cross References:

1. The definition of “instrument” applicable under Chapter 9 includes not only negotiable instruments under Chapter 3 but also “a writing that evidences a right to payment of a monetary obligation of a type that in the ordinary course of business with any necessary indorsement or assignment” Section 36‑9‑102(a)(47).

2. Chapter 9 governs the rights of a purchaser of an instrument that does not qualify as a negotiable instrument. See Section 36‑9‑330(d).

**SECTION 36‑3‑103.** Definitions.

(a) In this chapter:

(1) “Acceptor” means a drawee who has accepted a draft.

(2) “Consumer account” means an account established by an individual primarily for personal, family, or household purposes.

(3) “Consumer transaction” means a transaction in which an individual incurs an obligation primarily for personal, family, or household purposes.

(4) “Drawee” means a person ordered in a draft to make payment.

(5) “Drawer” means a person who signs or is identified in a draft as a person ordering payment.

(6) “[Reserved]”.

(7) “Maker” means a person who signs or is identified in a note as a person undertaking to pay.

(8) “Order” means a written instruction to pay money signed by the person giving the instruction. The instruction may be addressed to any person, including the person giving the instruction, or to one or more persons jointly or in the alternative but not in succession. An authorization to pay is not an order unless the person authorized to pay is also instructed to pay.

(9) “Ordinary care” in the case of a person engaged in business means 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. In the case of a bank that takes an instrument for processing for collection or payment by automated means, reasonable commercial standards do not require the bank to examine the instrument if the failure to examine does not violate the bank’s prescribed procedures and the bank’s procedures do not vary unreasonably from general banking usage not disapproved by this chapter or Chapter 4.

(10) “Party” means a party to an instrument.

(11) “Principal obligor,” with respect to an instrument, means the accommodated party or any other party to the instrument against whom a secondary obligor has recourse under this article.

(12) “Promise” means a written undertaking to pay money signed by the person undertaking to pay. An acknowledgment of an obligation by the obligor is not a promise unless the obligor also undertakes to pay the obligation.

(13) “Prove” with respect to a fact means to meet the burden of establishing the fact (Section 36‑1‑201(b)(8)).

(14) “Record” means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.

(15) “Remitter” means a person who purchases an instrument from its issuer if the instrument is payable to an identified person other than the purchaser.

(16) “Remotely‑created consumer item” means 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.

(17) “Secondary obligor,” with respect to an instrument, means (a) an indorser or an accommodation party, (b) a drawer having the obligation described in Section 36‑3‑414(d), or (c) any other party to the instrument that has recourse against another party to the instrument pursuant to Section 36‑3‑116(b).

(b) Other definitions applying to this chapter and the sections in which they appear are:

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| “Acceptance” | Section 36‑3‑409 |
| “Accommodated party” | Section 36‑3‑419 |
| “Accommodation party” | Section 36‑3‑419 |
| “Account” | Section 36‑4‑104 |
| “Alteration” | Section 36‑3‑407 |
| “Anomalous indorsement” | Section 36‑3‑205 |
| “Blank indorsement” | Section 36‑3‑205 |
| “Cashier’s check” | Section 36‑3‑104 |
| “Certificate of deposit” | Section 36‑3‑104 |
| “Certified check” | Section 36‑3‑409 |
| “Check” | Section 36‑3‑104 |
| “Consideration” | Section 36‑3‑303 |
| “Draft” | Section 36‑3‑104 |
| “Holder in due course” | Section 36‑3‑302 |
| “Incomplete instrument” | Section 36‑3‑115 |
| “Indorsement” | Section 36‑3‑204 |
| “Indorser” | Section 36‑3‑204 |
| “Instrument” | Section 36‑3‑104 |
| “Issue” | Section 36‑3‑105 |
| “Issuer” | Section 36‑3‑105 |
| “Negotiable instrument” | Section 36‑3‑104 |
| “Negotiation” | Section 36‑3‑201 |
| “Note” | Section 36‑3‑104 |
| “Payable at a definite time” | Section 36‑3‑108 |
| “Payable on demand” | Section 36‑3‑108 |
| “Payable to bearer” | Section 36‑3‑109 |
| “Payable to order” | Section 36‑3‑109 |
| “Payment” | Section 36‑3‑602 |
| “Person entitled to enforce” | Section 36‑3‑301 |
| “Presentment” | Section 36‑3‑501 |
| “Reacquisition” | Section 36‑3‑207 |
| “Special indorsement” | Section 36‑3‑205 |
| “Teller’s check” | Section 36‑3‑104 |
| “Transfer of instrument” | Section 36‑3‑203 |
| “Traveler’s check” | Section 36‑3‑104 |
| “Value” | Section 36‑3‑303 |

(c) The following definitions in other chapters apply to this chapter:

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| “Banking day” | Section 36‑4‑104 |
| “Clearing house” | Section 36‑4‑104 |
| “Collecting bank” | Section 36‑4‑105 |
| “Depositary bank” | Section 36‑4‑105 |
| “Documentary draft” | Section 36‑4‑104 |
| “Intermediary bank” | Section 36‑4‑105 |
| “Item” | Section 36‑4‑104 |
| “Payor bank” | Section 36‑4‑105 |
| “Suspends payments” | Section 36‑4‑104 |

(d) In addition, Chapter 1 contains general definitions and principles of construction and interpretation applicable throughout this chapter.

HISTORY: 1962 Code Section 10.3‑103; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008; 2014 Act No. 213 (S.343), Section 24, eff October 1, 2014.

OFFICIAL COMMENT

1. Subsection (a) defines some common terms used throughout the Article that were not defined by former Article 3 and adds the definitions of “order” and “promise” found in former Section 3‑102(1)(b) and (c).

2. The definition of “order” includes an instruction given by the signer to itself. The most common example of this kind of order is a cashier’s check: a draft with respect to which the drawer and drawee are the same bank or branches of the same bank. Former Section 3‑118(a) treated a cashier’s check as a note. It stated “a draft drawn on the drawer is effective as a note.” Although it is technically more correct to treat a cashier’s check as a promise by the issuing bank to pay rather than an order to pay, a cashier’s check is in the form of a check and it is normally referred to as a check. Thus, revised Article 3 follows banking practice in referring to a cashier’s check as both a draft and a check rather than a note. Some insurance companies also follow the practice of issuing drafts in which the drawer draws on itself and makes the draft payable at or through a bank. These instruments are also treated as drafts. The obligation of the drawer of a cashier’s check or other draft drawn on the drawer is stated in Section 3‑412.

An order may be addressed to more than one person as drawee either jointly or in the alternative. The authorization of alternative drawees follows former Section 3‑102(1)(b) and recognizes the practice of drawers, such as corporations issuing dividend checks, who for commercial convenience name a number of drawees, usually in different parts of the country. Section 3‑501(b)(1) provides that presentment may be made to any one of multiple drawees. Drawees in succession are not permitted because the holder should not be required to make more than one presentment. Dishonor by any drawee named in the draft entitles the holder to rights of recourse against the drawer or indorsers.

3. The last sentence of subsection (a)(9) is intended to make it clear that an I.O.U. or other written acknowledgment of indebtedness is not a note unless there is also an undertaking to pay the obligation.

4. This Article now uses the broadened definition of good faith in revised Article 1. The definition requires not only honesty in fact but also “observance of reasonable commercial standards of fair dealing.” Although fair dealing is a broad term that must be defined in context, it is clear that it is concerned with the fairness of conduct rather than the care with which an act is performed. Failure to exercise ordinary care in conducting a transaction is an entirely different concept than failure to deal fairly in conducting the transaction. Both fair dealing and ordinary care, which is defined in Section 3‑103(a)(7), are to be judged in the light of reasonable commercial standards, but those standards in each case are directed to different aspects of commercial conduct.

5. Subsection (a)(7) is a definition of ordinary care which is applicable not only to Article 3 but to Article 4 as well. See Section 4‑104(c). The general rule is stated in the first sentence of subsection (a)(7) and it applies both to banks and to persons engaged in businesses other than banking. Ordinary care means observance of reasonable commercial standards of the relevant businesses prevailing in the area in which the person is located. The second sentence of subsection (a)(7) is a particular rule limited to the duty of a bank to examine an instrument taken by a bank for processing for collection or payment by automated means. This particular rule applies primarily to Section 4‑406 and it is discussed in Comment 4 to that section. 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.

6. The definition of consumer account includes a joint account established by more than one individual. See Section 1‑106(1).

SOUTH CAROLINA REPORTER’S COMMENTS

This provision replaces former Section 36‑3‑102. Subsection (a) replaces former Section 36‑2‑102(1) and provides the definitions of 17 terms that appear in Chapter 3. Some of the terms Subsection (a) defines are common terms with accepted definitions, but were not defined under former Chapter 3. These terms include: acceptor, drawee, and drawer. Subsection (a) also revises the definitions of several terms defined in former Section 36‑3‑102(1). Under Subsection (a)(8) and (12) an “order” and a “promise” to pay money must be in writing and these definitions impose the requirement that an instrument must be a writing. Subsection (a)(17) substitutes a definition of “secondary obligor” for the definition of “secondary party” in former Section 36‑3‑102(1)(d).

Subsection (a) does not define the terms “issue” and “instrument” that were defined in former Section 36‑3‑102(1). “Issue” is now defined in Section 36‑3‑105(a) and “instrument” is now defined in Section 36‑3‑104(b).

Subsection (a) also defines several terms that did not appear in former Chapter 3 including “consumer account,” “consumer transaction,” “record,” and “remotely‑created consumer items.”

The most significant changes to prior law that Subsection (a) effects are the revision of the definition of “good faith” in Subsection (a)(6) and the provision of a definition of “ordinary care” in Subsection (a)(9). The definitions of “good faith” and “ordinary care” apply not only under Chapter 3, but also under Chapter 4. See Section 36‑4‑104(c).

Subsection (a)(6) provides a definition of “good faith” applicable under Chapters 3 and 4 that requires not only in fact but also the “observance of reasonable commercial standards of fair dealing.” Although this definition adds an objective factor to the determination of whether a person acted in good faith, it does not convert the obligation to perform in good faith into an obligation to exercise ordinary care. As Official Comment 4 notes, “[f]ailure to exercise ordinary care in conducting a transaction is an entirely different concept than failure to deal fairly in conducting the transaction.” Therefore, the revision to the definition of “good faith” should not change the body of case law holding that proof that a party violated its own procedures in handling an instrument does not establish a lack of good faith. See Midfirst Bank, SSB v. C.W. Haynes & Co., Inc., 893 F. Supp. 1304, 1316 (D.S.C. 1994); Stone Manufacturing Co. v. NCNB of South Carolina, 308 S.C. 287, 291, 417 S.E.2d 628, 630 (S.C. App. 1992).

Subsection (a)(9) defines “ordinary care” for purposes of both Chapters 3 and 4. See Section 36‑4‑104(c). The first sentence of the definition applies to all persons engaged in business and provides that “ordinary care” means the observance of reasonable commercial standards in the area where the person is located and with respect to the business in which the person is engaged. The second sentence of the definition applies only to banks that process instruments taken for collection or payment by automated means. In determining whether such a bank has exercised ordinary care in processing an instrument, Subsection (a)(9) provides that reasonable commercial standards do not require the bank to examine the instrument if the failure to examine does not violate the bank’s prescribed procedures and those procedures do not vary unreasonably from general banking usage. The definition of ordinary care applicable to a bank’s processing instruments by automated means has a significant impact upon check fraud litigation and effects a substantial change in South Carolina Law.

The significance of the definition of a bank’s duty of ordinary care set forth in the second sentence of Subsection (a)(9) is most apparent in check fraud cases in which a drawee/payor bank has paid a check that either bears an unauthorized drawer’s signature or has been altered. When the customer discovers this fraud, the customer will claim that the check was not properly payable and that the bank is obligated to re‑credit the customer’s account. See Section 36‑4‑104(a) and (d)(1). In response to such a claim, the bank may contend that under Section 36‑3‑406(a) or Section 36‑3‑406(d), the customer’s negligence precludes the customer from asserting the unauthorized signature or alteration against the bank. The preclusion under Section 36‑3‑406(a) and 36‑4‑406(d), however, is conditional. Even if the bank establishes a preclusion under Section 36‑3‑406(a) or Section 36‑3‑406(d), if the customer proves that the bank failed to exercise ordinary care in paying the check, the loss will be allocated between the parties based upon principles of comparative fault. See Sections 36‑3‑406(b) and 36‑4‑406(e).

In South Carolina, check fraud litigation involving forged drawers’ signatures, customers have sought to establish that the drawee/payor bank failed to exercise ordinary care in paying the check because the bank did not have an adequate process for examining the checks and comparing the signature on the check with the customer’s signature on a signature authorization card. See Read v. South Carolina National Bank, 286 S.C. 534, 335 S.E.2d 359 (1985); Dennis v. South Carolina National Bank, 299 S.C. 34, 382 S.E.2d 237 (S.C. App. 1988). In Dennis, the drawee/payor bank followed a procedure under which clerks examined all checks for forged drawer’s signature by comparing the signature on the check with a signature authorization card before posting the check to the customer’s account. Nevertheless, the Court held that evidence that the bank did not train the clerks to develop handwriting expertise in order to determine forgeries was sufficient to support a verdict that the bank failed to exercise ordinary care.

The definition of “ordinary care” in Subsection (a)(9) overrules the decision in Dennis v. South Carolina National Bank. Under Subsection (a)(9) “reasonable commercial standards” do not require a drawee/payor bank that processes checks by automated means to examine checks prior to payment. Therefore, a bank that processes by automated means cannot fail to exercise ordinary care because it does not have handwriting professionals verify drawers’ signatures.

Regulation CC 12 C.F.R. Section 229.2(fff) defines “remotely created check” to include remotely created checks drawn on business accounts as well as consumer accounts.

Subsection (b) sets forth a reference to the definitions of terms defined in other provisions of Chapter 3 and Subsection (c) sets forth a reference for the definitions of terms defined in other chapters.

Cross References:

1. To qualify as a holder in due course a party must take the instrument in good faith. Section 36‑3‑302(a)(2)(ii).

2. A person whose failure to exercise ordinary care substantially contributed to an alteration or forged signature on an instrument may be precluded from asserting the alteration or forgery. Section 36‑3‑406(a).

3. If both the customer and the bank failed to exercise ordinary care and the failure of both substantially contribute to the forgery or alteration, the loss is allocated on the basis of comparative fault. Section 36‑3‑406(b).

4. When a customer fails to give the payor bank timely notice of a forgery or alteration and the payor bank failed to exercise ordinary care but acted in good faith, the loss is allocated based upon the principles of comparative fault. Section 36‑4‑406(e).

Editor’s Note

2014 Act No. 213, Section 51, provides as follows:

“SECTION 51. This act becomes effective on October 1, 2014. It applies to transactions entered into and events occurring after that date.”

Effect of Amendment

2014 Act No. 213, Section 24, reserved subsection (a)(6), which formerly defined “good faith”; and in subsection (a)(13), substituted “36‑1‑201(b)(8)” for “36‑1‑201(8)”.

CROSS REFERENCES

Bank deposits and collections, see Section 36‑4‑101 et seq.

Documents of title, see Section 36‑7‑101 et seq.

Investment securities, see Section 36‑8‑101 et seq.

Secured transactions, see Section 36‑9‑101 et seq.

**SECTION 36‑3‑104.** Negotiable instrument.

(a) Except as provided in Subsections (c) and (d), “negotiable instrument” means 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 it:

(1) is payable to bearer or to order at the time it is issued or first comes into possession of a holder;

(2) is payable on demand or at a definite time; and

(3) does 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 may contain (i) an undertaking or power to give, maintain, or protect collateral to secure payment, (ii) an authorization or power to the holder to confess judgment or realize on or dispose of collateral, or (iii) a waiver of the benefit of any law intended for the advantage or protection of an obligor.

(b) “Instrument” means a negotiable instrument.

(c) An order that meets all of the requirements of Subsection (a), except Paragraph (1), and otherwise falls within the definition of “check” in Subsection (f) is a negotiable instrument and a check.

(d) A promise or order other than a check is not an instrument if, at the time it is issued or first comes into possession of a holder, it contains a conspicuous statement, however expressed, to the effect that the promise or order is not negotiable or is not an instrument governed by this Chapter.

(e) An instrument is a “note” if it is a promise and is a “draft” if it is an order. If an instrument falls within the definition of both “note” and “draft,” a person entitled to enforce the instrument may treat it as either.

(f) “Check” means (i) a draft, other than a documentary draft, payable on demand and drawn on a bank or (ii) a cashier’s check or teller’s check. An instrument may be a check even though it is described on its face by another term, such as “money order.”

(g) “Cashier’s check” means a draft with respect to which the drawer and drawee are the same bank or branches of the same bank.

(h) “Teller’s check” means a draft drawn by a bank (i) on another bank, or (ii) payable at or through a bank.

(i) “Traveler’s check” means an instrument that (i) is payable on demand, (ii) is drawn on or payable at or through a bank, (iii) is designated by the term “traveler’s check” or by a substantially similar term, and (iv) requires, as a condition to payment, a countersignature by a person whose specimen signature appears on the instrument.

(j) “Certificate of deposit” means an instrument containing an acknowledgment by a bank that a sum of money has been received by the bank and a promise by the bank to repay the sum of money. A certificate of deposit is a note of the bank.

HISTORY: 1962 Code Section 10.3‑104; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. The definition of “negotiable instrument” defines the scope of Article 3 since Section 3‑102 states: “This Article applies to negotiable instruments.” The definition in Section 3‑104(a) incorporates other definitions in Article 3. An instrument is either a “promise,” defined in Section 3‑103(a)(9), or “order,” defined in Section 3‑103(a)(6). A promise is a written undertaking to pay money signed by the person undertaking to pay. An order is a written instruction to pay money signed by the person giving the instruction. Thus, the term “negotiable instrument” is limited to a signed writing that orders or promises payment of money. “Money” is defined in Section 1‑201(24) and is not limited to United States dollars. It also includes a medium of exchange established by a foreign government or monetary units of account established by an intergovernmental organization or by agreement between two or more nations. Five other requirements are stated in Section 3‑104(a): First, the promise or order must be “unconditional.” The quoted term is explained in Section 3‑106. Second, the amount of money must be “a fixed amount \*\*\* with or without interest or other charges described in the promise or order.” Section 3‑112(b) relates to “interest.” Third, the promise or order must be “payable to bearer or to order.” The quoted phrase is explained in Section 3‑109. An exception to this requirement is stated in subsection (c). Fourth, the promise or order must be payable “on demand or at a definite time.” The quoted phrase is explained in Section 3‑108. Fifth, the promise or order may 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” with three exceptions. The quoted phrase is based on the first sentence of N.I.L. Section 5 which is the precursor of “no other promise, order, obligation or power given by the maker or drawer” appearing in former Section 3‑104(1)(b). The words “instruction” and “undertaking” are used instead of “order” and “promise” that are used in the N.I.L. formulation because the latter words are defined terms that include only orders or promises to pay money. The three exceptions stated in Section 3‑104(a)(3) are based on and are intended to have the same meaning as former Section 3‑112(1)(b), (c), (d), and (e), as well as N.I.L. Section 5(1), (2), and (3). Subsection (b) states that “instrument” means a “negotiable instrument.” This follows former Section 3‑102(1)(e) which treated the two terms as synonymous.

2. Unless subsection (c) applies, the effect of subsection (a)(1) and Section 3‑102(a) is to exclude from Article 3 any promise or order that is not payable to bearer or to order. There is no provision in revised Article 3 that is comparable to former Section 3‑805. The comment to former Section 3‑805 states that the typical example of a writing covered by that section is a check reading “Pay John Doe.” Such a check was governed by former Article 3 but there could not be a holder in due course of the check. Under Section 3‑104(c) such a check is governed by revised Article 3 and there can be a holder in due course of the check. But subsection (c) applies only to checks. The comment to former Section 3‑805 does not state any example other than the check to illustrate that section. Subsection (c) is based on the belief that it is good policy to treat checks, which are payment instruments, as negotiable instruments whether or not they contain the words “to the order of”. These words are almost always pre‑printed on the check form. Occasionally the drawer of a check may strike out these words before issuing the check. In the past some credit unions used check forms that did not contain the quoted words. Such check forms may still be in use but they are no longer common. Absence of the quoted words can easily be overlooked and should not affect the rights of holders who may pay money or give credit for a check without being aware that it is not in the conventional form.

Total exclusion from Article 3 of other promises or orders that are not payable to bearer or to order serves a useful purpose. It provides a simple device to clearly exclude a writing that does not fit the pattern of typical negotiable instruments and which is not intended to be a negotiable instrument. If a writing could be an instrument despite the absence of “to order” or “to bearer” language and a dispute arises with respect to the writing, it might be argued that the writing is a negotiable instrument because the other requirements of subsection (a) are somehow met. Even if the argument is eventually found to be without merit it can be used as a litigation ploy. Words making a promise or order payable to bearer or to order are the most distinguishing feature of a negotiable instrument and such words are frequently referred to as “words of negotiability.” Article 3 is not meant to apply to contracts for the sale of goods or services or the sale or lease of real property or similar writings that may contain a promise to pay money. The use of words of negotiability in such contracts would be an aberration. Absence of the words precludes any argument that such contracts might be negotiable instruments.

An order or promise that is excluded from Article 3 because of the requirements of Section 3‑104(a) may nevertheless be similar to a negotiable instrument in many respects. Although such a writing cannot be made a negotiable instrument within Article 3 by contract or conduct of its parties, nothing in Section 3‑104 or in Section 3‑102 is intended to mean that in a particular case involving such a writing a court could not arrive at a result similar to the result that would follow if the writing were a negotiable instrument. For example, a court might find that the obligor with respect to a promise that does not fall within Section 3‑104(a) is precluded from asserting a defense against a bona fide purchaser. The preclusion could be based on estoppel or ordinary principles of contract. It does not depend upon the law of negotiable instruments. An example is stated in the paragraph following Case # 2 in Comment 4 to Section 3‑302.

Moreover, consistent with the principle stated in Section 1‑102(2)(b), the immediate parties to an order or promise that is not an instrument may provide by agreement that one or more of the provisions of Article 3 determine their rights and obligations under the writing. Upholding the parties” choice is not inconsistent with Article 3. Such an agreement may bind a transferee of the writing if the transferee has notice of it or the agreement arises from usage of trade and the agreement does not violate other law or public policy. An example of such an agreement is a provision that a transferee of the writing has the rights of a holder in due course stated in Article 3 if the transferee took rights under the writing in good faith, for value, and without notice of a claim or defense.

Even without an agreement of the parties to an order or promise that is not an instrument, it may be appropriate, consistent with the principles stated in Section 1‑102(2), for a court to apply one or more provisions of Article 3 to the writing by analogy, taking into account the expectations of the parties and the differences between the writing and an instrument governed by Article 3. Whether such application is appropriate depends upon the facts of each case.

3. Subsection (d) allows exclusion from Article 3 of a writing that would otherwise be an instrument under subsection (a) by a statement to the effect that the writing is not negotiable or is not governed by Article 3. For example, a promissory note can be stamped with the legend NOT NEGOTIABLE. The effect under subsection (d) is not only to negate the possibility of a holder in due course, but to prevent the writing from being a negotiable instrument for any purpose. Subsection (d) does not, however, apply to a check. If a writing is excluded from Article 3 by subsection (d), a court could, nevertheless, apply Article 3 principles to it by analogy as stated in Comment 2.

4. Instruments are divided into two general categories: drafts and notes. A draft is an instrument that is an order. A note is an instrument that is a promise. Section 3‑104(e). The term “bill of exchange” is not used in Article 3. It is generally understood to be a synonym for the term “draft.” Subsections (f) through (j) define particular instruments that fall within the categories of draft and note. The term “draft,” defined in subsection (e), includes a “check” which is defined in subsection (f). “Check” includes a share draft drawn on a credit union payable through a bank because the definition of bank (Section 4‑105) includes credit unions. However, a draft drawn on an insurance company payable through a bank is not a check because it is not drawn on a bank. “Money orders” are sold both by banks and non‑banks. They vary in form and their form determines how they are treated in Article 3. The most common form of money order sold by banks is that of an ordinary check drawn by the purchaser except that the amount is machine impressed. That kind of money order is a check under Article 3 and is subject to a stop order by the purchaser‑drawer as in the case of ordinary checks. The seller bank is the drawee and has no obligation to a holder to pay the money order. If a money order falls within the definition of a teller’s check, the rules applicable to teller’s checks apply. Postal money orders are subject to federal law. “Teller’s check” is separately defined in subsection (h). A teller’s check is always drawn by a bank and is usually drawn on another bank. In some cases a teller’s check is drawn on a nonbank but is made payable at or through a bank. Article 3 treats both types of teller’s check identically, and both are included in the definition of “check.” A cashier’s check, defined in subsection (g), is also included in the definition of “check.” Traveler’s checks are issued both by banks and nonbanks and may be in the form of a note or draft. Subsection (i) states the essential characteristics of a traveler’s check. The requirement that the instrument be “drawn on or payable at or through a bank” may be satisfied without words on the instrument that identify a bank as drawee or paying agent so long as the instrument bears an appropriate routing number that identifies a bank as paying agent.

The definitions in Regulation CC Section 229.2 of the terms “check,” “cashier’s check,” “teller’s check,” and “traveler’s check” are different from the definitions of those terms in Article 3.

Certificates of deposit are treated in former Article 3 as a separate type of instrument. In revised Article 3, Section 3‑104(j) treats them as notes.

5. There are some differences between the requirements of Article 3 and the requirements included in Article 3 of the Convention on International Bills of Exchange and International Promissory Notes. Most obviously, the Convention does not include the limitation on extraneous undertakings set forth in Section 3‑104(a)(3), and does not permit documents payable to bearer that would be permissible under Section 3‑104(a)(1) and Section 3‑109. See Convention Article 3. In most respects, however, the requirements of Section 3‑104 and Article 3 of the Convention are quite similar.

SOUTH CAROLINA REPORTER’S COMMENTS

This provision replaces former Section 36‑3‑104. Subsection (a) defines the term “negotiable instrument” and in effect defines the scope of Chapter 3. In defining negotiable instrument, Subsection (a) incorporates definitions from other provisions of Part 1 of Chapter 3 and from Section 36‑1‑201 as set forth in the Definitional Cross Reference. Subsection (b) defines “instrument” as a negotiable instrument.

Subsections (e) through (i) define the various types of instruments: notes, drafts, checks, cashier’s checks, teller’s checks, traveler’s checks, and certificates of deposit. In Specialty Flooring Co., Inc. v. Palmetto Federal Savings Bank of South Carolina, 302 S.C. 107, 394 S.E.2d 13 (S.C. App. 1990) the court described a check drawn by a bank on that bank’s account at another bank as a “bank check.” Under Subsection (h) such an instrument would be a teller’s check.

Subsection (c) provides that an order which meets all of the requirements for a check under Subsection (f) except that it is not payable to bearer or to order constitutes a negotiable instrument.

Subsection (d) provides that a promise or order other than a check is not a negotiable instrument if, at the time it is issued or comes into the possession of a holder, the writing contains a conspicuous statement that it is not negotiable or is not an instrument subject to Chapter 3.

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| Definitional Cross References: |  |
| “Bank” | Section 36‑1‑201(4) |
| “Conspicuous” | Section 36‑1‑201(10) |
| “Drawee” | Section 36‑3‑103(a)(4) |
| “Drawer” | Section 36‑3‑103(a)(5) |
| “Holder” | Section 36‑1‑201(20) |
| “Issue” | Section 36‑3‑105(a) |
| “Money” | Section 36‑1‑201(24); |
|  | see also Section 36‑3‑107 (foreign money) |
| “Order” | Section 36‑3‑103(a)(8) |
| “Payable at a definite time” | Section 36‑3‑108(b) |
| “Payable at or through bank” | Section 36‑3‑106 |
| “Payable on demand” | Section 36‑3‑108(a) |
| “Payable to bearer” | Section 36‑3‑109(a) |
| “Payable to order” | Section 36‑3‑109(b) |
| “Promise” | Section 36‑3‑103(a)(12) |
| “Unconditional promise or order” | Section 36‑3‑106 |

Cross References:

1. To qualify as a negotiable instrument the order or promise to pay money must be in writing signed by the person giving the order or making the promise. Section 36‑3‑103(a)(8) and (12).

2. To qualify as a negotiable instrument the order or promise to pay must be “unconditional” under Section 36‑3‑106.

3. To qualify as a negotiable instrument the order or promise must be to pay a fixed amount. The fixed amount requirement applies only to principal and a note providing for interest at variable rates computed by reference to information not contained in the note can qualify as a negotiable instrument. Section 36‑3‑112(b) and Official Comment 1.

4. Except as provided in Subsection (c) with respect to checks, to qualify as a negotiable instrument an order or promise must be payable “to bearer or to order” within the meaning of Section 36‑3‑109.

5. To qualify as a negotiable instrument an order or promise must be payable “on demand or at a definite” within the meaning of Section 36‑3‑108.

LIBRARY REFERENCES

Bills and Notes 1, 4 to 12, 15 to 21, 28, 30 to 40, 41 to 47, 54 to 61, 113, 144 to 175.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 2 to 18, 22, 26 to 32, 75, 127 to 138, 143, 148, 155, 159, 197, 261, 263 to 264.

RESEARCH REFERENCES

ALR Library

76 ALR 5th 289 , What Constitutes “Fixed Amount of Money” for Purposes of [Rev] Section 3‑104 of Uniform Commercial Code Providing that Negotiable Instrument Must Contain Unconditional Promise to Pay Fixed Amount of Money.

LAW REVIEW AND JOURNAL COMMENTARIES

Couriers without luggage: Negotiable instruments and digital signatures. 49 S.C. L. Rev. 739 (Summer 1998).

NOTES OF DECISIONS

In general 1

Negotiable instrument 2

Promise to pay 3

1. In general

A promissory note secured by a real estate mortgage is a “negotiable instrument” under the Uniform Commercial Code (UCC), and therefore is an “instrument” under UCC provision stating that authenticity of signatures on instruments are admitted unless specifically denied in the pleadings. Deep Keel, LLC v. Atlantic Private Equity Group, LLC (S.C.App. 2015) 413 S.C. 58, 773 S.E.2d 607. Bills and Notes 167; Bills and Notes 474

ARTICLE 3 of Uniform Commercial Code (UCC), which governs negotiable instruments, governs a note secured by a mortgage on real property. Swindler v. Swindler (S.C.App. 2003) 355 S.C. 245, 584 S.E.2d 438, rehearing denied. Mortgages And Deeds Of Trust 707

An Unconditional Continuing Guarantee did not satisfy the requirements of a “negotiable instrument” and, therefore, the guarantor was not a “party to the instrument” under Section 36‑3‑606 and could not assert an impairment of collateral defense. Sunrise Sav. & Loan Ass’n v. Mariner’s Cay Development Corp. (S.C. 1988) 295 S.C. 208, 367 S.E.2d 696. Bills And Notes 121; Bills And Notes 151; Bills And Notes 453

Where note, executed as separate document along with conditional sales contract, was assigned to bank for valuable consideration and bank sued maker for balance due on note, court held (1) that trial court erred in holding that note and conditional sales contract had merged, thus rendering note nonnegotiable and causing bank not to be holder in due course; (2) that note satisfied requirements of negotiability under UCC Section 3‑104(1); (3) that under UCC Section 3‑119(2), negotiability of note was not affected by separate sales contract; and (4) that since bank had paid value in good faith for note on day it was executed and assignment of note had preceded any notice of claim about merchandise sold, bank was holder in due course under UCC Section 3‑302(1). Northwestern Bank v. Neal (S.C. 1978) 271 S.C. 544, 248 S.E.2d 585.

2. Negotiable instrument

Certification to South Carolina’s highest court of question of whether promissory note was negotiable under South Carolina’s governing version of Uniform Commercial Code (UCC), even though note had variable interest rate, was not warranted in proceedings on mortgage loan servicer’s motion for stay relief and Chapter 7 trustee’s objection to proof of claim based on mortgage and note; necessity of ruling from state’s highest court was questionable, since issue was based on statute no longer in effect, abundance of case law existed on issue from other jurisdictions, as well as recent decision from another judge in same bankruptcy court, and statutory principles and stated purposes of UCC were clear. In re McFadden (Bkrtcy.D.S.C. 2012) 471 B.R. 136. Federal Courts 3107

3. Promise to pay

Even though it had variable interest rate, promissory note underlying mortgage was “negotiable” under governing version of South Carolina’s Uniform Commercial Code (UCC), which required for negotiability that instrument contain “unconditional promise or order to pay a sum certain in money.” In re McFadden (Bkrtcy.D.S.C. 2012) 471 B.R. 136. Bills and Notes 158

**SECTION 36‑3‑105.** Issue of instrument.

(a) “Issue” means the first delivery of an instrument by the maker or drawer, whether to a holder or nonholder, for the purpose of giving rights on the instrument to any person.

(b) An unissued instrument, or an unissued incomplete instrument that is completed, is binding on the maker or drawer, but nonissuance is a defense. An instrument that is conditionally issued or is issued for a special purpose is binding on the maker or drawer, but failure of the condition or special purpose to be fulfilled is a defense.

(c) “Issuer” applies to issued and unissued instruments and means a maker or drawer of an instrument.

HISTORY: 1962 Code Section 10.3‑105; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. Under former Section 3‑102(1)(a) “issue” was defined as the first delivery to a “holder or a remitter” but the term “remitter” was neither defined nor otherwise used. In revised Article 3, Section 3‑105(a) defines “issue” more broadly to include the first delivery to anyone by the drawer or maker for the purpose of giving rights to anyone on the instrument. “Delivery” with respect to instruments is defined in Section 1‑201(14) as meaning “voluntary transfer of possession.”

2. Subsection (b) continues the rule that nonissuance, conditional issuance or issuance for a special purpose is a defense of the maker or drawer of an instrument. Thus, the defense can be asserted against a person other than a holder in due course. The same rule applies to nonissuance of an incomplete instrument later completed.

3. Subsection (c) defines “issuer” to include the signer of an unissued instrument for convenience of reference in the statute.

SOUTH CAROLINA REPORTER’S COMMENT

This provision replaces former Section 36‑3‑102(1)(a). Subsection (a) defines “issue” as the first delivery of an instrument by a maker or drawer for the purpose of giving rights on the instrument. The term “issuer” includes the maker of a note and the drawer of a draft, and under Subsection (c) a maker or drawer is an issuer even if the instrument is not issued. Under Subsection (b), an unissued instrument is binding on the issuer, but nonissuance is a defense that the issuer can assert against a person other than a holder in due course. In addition, under Subsection (b) an instrument issued conditionally or for a special purpose is binding on the maker or drawer, but the maker or drawer can raise the failure of the condition or special purpose as a defense against a party other than a holder in due course.

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| Definitional Cross References: |  |
| “Delivery” | Section 36‑1‑201(14) |
| “Drawer” | Section 36‑3‑103(a)(5) |
| “Holder” | Section 36‑1‑201(20) |
| “Incomplete instrument” | Section 36‑3‑115(a) |
| “Instrument” | Section 36‑3‑104(b) |
| “Maker” | Section 36‑3‑103(a)(7) |

Cross References:

1. Requirements for meeting holder in due course status. Section 36‑3‑302(a).

2. A holder in due course takes free of a defense under Section 36‑3‑105(b). Section 36‑3‑305(a)(2) and (b).

LIBRARY REFERENCES

Bills and Notes 1, 4, 12, 17, 20, 21, 28, 30, 40, 44, 46, 47, 132, 144, 147 to 152, 163 to 166.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 2 to 3, 5 to 12, 15, 17 to 18, 22, 75, 88, 102, 127 to 131, 133, 135 to 136, 138, 143.

**SECTION 36‑3‑106.** Unconditional promise or order.

(a) Except as provided in this section, for the purposes of Section 36‑3‑104(a), a promise or order is unconditional unless it states (i) an express condition to payment, (ii) that the promise or order is subject to or governed by another record, or (iii) that rights or obligations with respect to the promise or order are stated in another record. A reference to another record does not of itself make the promise or order conditional.

(b) A promise or order is not made conditional (i) by a reference to another record for a statement of rights with respect to collateral, prepayment, or acceleration, or (ii) because payment is limited to resort to a particular fund or source.

(c) If a promise or order requires, as a condition to payment, a countersignature by a person whose specimen signature appears on the promise or order, the condition does not make the promise or order conditional for the purposes of Section 36‑3‑104(a). If the person whose specimen signature appears on an instrument fails to countersign the instrument, the failure to countersign is a defense to the obligation of the issuer, but the failure does not prevent a transferee of the instrument from becoming a holder of the instrument.

(d) If a promise or order at the time it is issued or first comes into possession of a holder contains a statement, required by applicable statutory or administrative law, to the effect that the rights of a holder or transferee are subject to claims or defenses that the issuer could assert against the original payee, the promise or order is not thereby made conditional for the purposes of Section 36‑3‑104(a); but if the promise or order is an instrument, there cannot be a holder in due course of the instrument.

HISTORY: 1962 Code Section 10.3‑106; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. This provision replaces former Section 3‑105. Its purpose is to define when a promise or order fulfills the requirement in Section 3‑104(a) that it be an “unconditional” promise or order to pay. Under Section 3‑106(a) a promise or order is deemed to be unconditional unless one of the two tests of the subsection make the promise or order conditional. If the promise or order states an express condition to payment, the promise or order is not an instrument. For example, a promise states, “I promise to pay $ 100,000 to the order of John Doe if he conveys title to Blackacre to me.” The promise is not an instrument because there is an express condition to payment. However, suppose a promise states, “In consideration of John Doe’s promise to convey title to Blackacre I promise to pay $ 100,000 to the order of John Doe.” That promise can be an instrument if Section 3‑104 is otherwise satisfied. Although the recital of the executory promise of Doe to convey Blackacre might be read as an implied condition that the promise be performed, the condition is not an express condition as required by Section 3‑106(a)(i). This result is consistent with former Section 3‑105(1)(a) and (b). Former Section 3‑105(1)(b) is not repeated in Section 3‑106 because it is not necessary. It is an example of an implied condition. Former Section 3‑105(1)(d), (e), and (f) and the first clause of former Section 3‑105(1)(c) are other examples of implied conditions. They are not repeated in Section 3‑106 because they are not necessary. The law is not changed.

Section 3‑106(a)(ii) and (iii) carry forward the substance of former Section 3‑105(2)(a). The only change is the use of “writing” instead of “agreement” and a broadening of the language that can result in conditionality. For example, a promissory note is not an instrument defined by Section 3‑104 if it contains any of the following statements: 1. “This note is subject to a contract of sale dated April 1, 1990 between the payee and maker of this note.”

2. “This note is subject to a loan and security agreement dated April 1, 1990 between the payee and maker of this note.”

3. “Rights and obligations of the parties with respect to this note are stated in an agreement dated April 1, 1990 between the payee and maker of this note. “ It is not relevant whether any condition to payment is or is not stated in the writing to which reference is made. The rationale is that the holder of a negotiable instrument should not be required to examine another document to determine rights with respect to payment. But subsection (b)(i) permits reference to a separate writing for information with respect to collateral, prepayment, or acceleration.

Many notes issued in commercial transactions are secured by collateral, are subject to acceleration in the event of default, or are subject to prepayment. A statement of rights and obligations concerning collateral, prepayment, or acceleration does not prevent the note from being an instrument if the statement is in the note itself. See Section 3‑104(a)(3) and Section 3‑108(b). In some cases it may be convenient not to include a statement concerning collateral, prepayment, or acceleration in the note, but rather to refer to an accompanying loan agreement, security agreement or mortgage for that statement. Subsection (b)(i) allows a reference to the appropriate writing for a statement of these rights. For example, a note would not be made conditional by the following statement: “This note is secured by a security interest in collateral described in a security agreement dated April 1, 1990 between the payee and maker of this note. Rights and obligations with respect to the collateral are [stated in] [governed by] the security agreement.” The bracketed words are alternatives, either of which complies.

Subsection (b)(ii) addresses the issues covered by former Section 3‑105(1)(f), (g), and (h) and Section 3‑105(2)(b). Under Section 3‑106(a) a promise or order is not made conditional because payment is limited to payment from a particular source or fund. This reverses the result of former Section 3‑105(2)(b). There is no cogent reason why the general credit of a legal entity must be pledged to have a negotiable instrument. Market forces determine the marketability of instruments of this kind. If potential buyers don’t want promises or orders that are payable only from a particular source or fund, they won’t take them, but Article 3 should apply.

2. Subsection (c) applies to traveler’s checks or other instruments that may require a countersignature. Although the requirement of a countersignature is a condition to the obligation to pay, traveler’s checks are treated in the commercial world as money substitutes and therefore should be governed by Article 3. The first sentence of subsection (c) allows a traveler’s check to meet the definition of instrument by stating that the countersignature condition does not make it conditional for the purposes of Section 3‑104. The second sentence states the effect of a failure to meet the condition. Suppose a thief steals a traveler’s check and cashes it by skillfully imitating the specimen signature so that the countersignature appears to be authentic. The countersignature is for the purpose of identification of the owner of the instrument. It is not an indorsement. Subsection (c) provides that the failure of the owner to countersign does not prevent a transferee from becoming a holder. Thus, the merchant or bank that cashed the traveler’s check becomes a holder when the traveler’s check is taken. The forged countersignature is a defense to the obligation of the issuer to pay the instrument, and is included in defenses under Section 3‑305(a)(2). These defenses may not be asserted against a holder in due course. Whether a holder has notice of the defense is a factual question. If the countersignature is a very bad forgery, there may be notice. But if the merchant or bank cashed a traveler’s check and the countersignature appeared to be similar to the specimen signature, there might not be notice that the countersignature was forged. Thus, the merchant or bank could be a holder in due course.

3. Subsection (d) concerns the effect of a statement to the effect that the rights of a holder or transferee are subject to claims and defenses that the issuer could assert against the original payee. The subsection applies only if the statement is required by statutory or administrative law. The prime example is the Federal Trade Commission Rule (16 C.F.R. Part 433) preserving consumers’ claims and defenses in consumer credit sales. The intent of the FTC rule is to make it impossible for there to be a holder in due course of a note bearing the FTC legend and undoubtedly that is the result. But, under former Article 3, the legend may also have had the unintended effect of making the note conditional, thus excluding the note from former Article 3 altogether. Subsection (d) is designed to make it possible to preclude the possibility of a holder in due course without excluding the instrument from Article 3. Most of the provisions of Article 3 are not affected by the holder‑in‑due‑course doctrine and there is no reason why Article 3 should not apply to a note bearing the FTC legend if holder‑in‑due‑course rights are not involved. Under subsection (d) the statement does not make the note conditional. If the note otherwise meets the requirements of Section 3‑104(a) it is a negotiable instrument for all purposes except that there cannot be a holder in due course of the note. No particular form of legend or statement is required by subsection (d). The form of a particular legend or statement may be determined by the other statute or administrative law. For example, the FTC legend required in a note taken by the seller in a consumer sale of goods or services is tailored to that particular transaction and therefore uses language that is somewhat different from that stated in subsection (d), but the difference in expression does not affect the essential similarity of the message conveyed. The effect of the FTC legend is to make the rights of a holder or transferee subject to claims or defenses that the issuer could assert against the original payee of the note.

SOUTH CAROLINA REPORTER’S COMMENT

This provision revises former Section 36‑3‑105 and states the standards for determining whether a promise or order is unconditional. The standards under this provision are consistent with the decision in Northwestern Bank v. Neal, 271 S.C. 544, 248 S.E.2d 585 (1978). In that case, Neal had purchased a boiler from Thomas and executed two documents in conjunction with the sale: a promissory note for the purchase price and a conditional sales contract granting Thomas a security interest in boiler to secure the note. Thomas assigned the note and conditional sales contract to Northwestern Bank for value. Neal defaulted on the note and, when the bank sued to enforce the note, Neal asserted that the boiler was defective. Neal contended that he could assert this claim against the bank because the conditional sales contract made Neal’s obligation under the note conditional. As a result, Neal contended that the note was not a negotiable instrument and the bank could not be a holder in due course that took free of Neal’s personal defenses. The court rejected Neal’s argument holding that reference in the note to the conditional sales contract did not render Neal’s obligation under the note conditional. Subsections (a)(ii) and (iii) confirm the holding in Northwestern Bank v. Neal. Under those provisions, a separate writing executed in conjunction with a note will render the maker’s promise under the note conditional only if the note states that it is subject to or governed by the separate writing or that the rights and obligations with respect to the promise are stated in the separate writing.

Under Subsection (d), if a note includes a notice required by statute or administrative regulation that a transferee of the note takes subject to the claims and defenses that the maker had against the payee, the notice does not render the maker’s promise conditional. Nevertheless, the provision also states that no transferee of a note bearing this notice can qualify as a holder in due course. The leading example of a statutory or administrative requirement of notification that transferees take subject to the transferor’s claims and defenses is the Federal Trade Commission Rule in 16 CFR Part 433.

The FTC Rule applies to sales and leases of good and services to consumers and certain purchase‑money loans to consumers. The Rule provides that, with respect to these transactions, it is an unfair trade practice for a seller to take a consumer credit contract that does not contain a conspicuous statement that the assignee of the contract takes subject to the claims and defenses the consumer has against the seller.

The drafters of this provision concluded that the most effective way to implement the consumer protection policy of the FTC Rule was to preclude assignees of notes bearing the FTC notice from claiming holder in due course status, but to otherwise treat the note as an instrument subject to Chapter 3. See Section 36‑3‑106, Official Comment 3.

Section 36‑3‑305(e) addresses the related issue that arises if a creditor fails to include the required FTC notice in a note and transfers the note to a person who would qualify as a holder in due course. Section 36‑3‑305(e) provides that the note has the same effect as if the note included the required notice and that the maker can assert all the claims and defenses against the transferee that maker could have asserted if the notice appeared in the note.

Note that the South Carolina Consumer Protection Code precludes the use of a negotiable instrument other than a check in a consumer credit sale. S.C. Code Ann. Section 37‑2‑403.

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| Definitional Cross References: |  |
| “Holder” | Section 36‑1‑201(20) |
| “Holder in due course” | Section 36‑3‑302(a) |
| “Instrument” | Section 36‑3‑104(b) |
| “Order” | Section 36‑3‑103(a)(8) |
| “Promise” | Section 36‑3‑103(a)(12) |

Cross References:

1. To constitute a negotiable instrument promise or order must be unconditional. Section 36‑3‑104(a).

2. Subsection (c) addresses the effect of failing to obtain a countersignature required as a condition for payment of a traveler’s check. See Section 36‑3‑104(h) for the definition of a traveler’s check.

3. For the effect in a consumer transaction of omitting a required notification that an assignee of an instrument takes subject to the claims and defenses that the issuer had against the original payee, see Section 36‑3‑305(e).

LIBRARY REFERENCES

Bills and Notes 4, 7, 30, 33, 124, 125, 126.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 9 to 11, 75, 79, 84, 100, 238, 313 to 328.

RESEARCH REFERENCES

ALR Library

76 ALR 5th 289 , What Constitutes “Fixed Amount of Money” for Purposes of [Rev] Section 3‑104 of Uniform Commercial Code Providing that Negotiable Instrument Must Contain Unconditional Promise to Pay Fixed Amount of Money.

Notes of Decisions

Bankruptcy proceedings 2

Variable terms 1

1. Variable terms

Even though it had variable interest rate, promissory note underlying mortgage was “negotiable” under governing version of South Carolina’s Uniform Commercial Code (UCC), which required for negotiability that instrument contain “unconditional promise or order to pay a sum certain in money.” In re McFadden (Bkrtcy.D.S.C. 2012) 471 B.R. 136. Bills and Notes 158

2. Bankruptcy proceedings

Certification to South Carolina’s highest court of question of whether promissory note was negotiable under South Carolina’s governing version of Uniform Commercial Code (UCC), even though note had variable interest rate, was not warranted in proceedings on mortgage loan servicer’s motion for stay relief and Chapter 7 trustee’s objection to proof of claim based on mortgage and note; necessity of ruling from state’s highest court was questionable, since issue was based on statute no longer in effect, abundance of case law existed on issue from other jurisdictions, as well as recent decision from another judge in same bankruptcy court, and statutory principles and stated purposes of UCC were clear. In re McFadden (Bkrtcy.D.S.C. 2012) 471 B.R. 136. Federal Courts 3107

**SECTION 36‑3‑107.** Instrument payable in foreign money.

Unless the instrument otherwise provides, an instrument that states the amount payable in foreign money may be paid in the foreign money or in an equivalent amount in dollars calculated by using the current bank‑offered spot rate at the place of payment for the purchase of dollars on the day on which the instrument is paid.

HISTORY: 1962 Code Section 10.3‑107; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

The definition of instrument in Section 3‑104 requires that the promise or order be payable in “money.” That term is defined in Section 1‑201(24) and is not limited to United States dollars. Section 3‑107 states than an instrument payable in foreign money may be paid in dollars if the instrument does not prohibit it. It also states a conversion rate which applies in the absence of a different conversion rate stated in the instrument. The reference in former Section 3‑107(1) to instruments payable in “currency” or “current funds” has been dropped as superfluous.

SOUTH CAROLINA REPORTER’S COMMENT

This provision replaces former Section 36‑3‑107. The provision deletes Subsection (1) of the former statute defining when an instrument is payable in money and relies upon the definition of “money” in Section 36‑1‑201(24). The provision adopts the rules on the payment of instruments payable in foreign money set forth in former Section 36‑3‑107(2).

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| Definitional Cross References: |  |
| “Instrument” | Section 36‑3‑104(b) |
| “Money” | Section 36‑1‑201(24) |

Cross Reference:

1. To qualify as a “negotiable instrument” under Section 36‑3‑104(a) a promise or order must be for the payment of money and under Section 36‑1‑201(24) “money” includes a medium of exchange authorized by a foreign government as its currency.

LIBRARY REFERENCES

Bills and Notes 4, 11, 30, 39, 131, 162.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 9 to 11, 137, 234.

**SECTION 36‑3‑108.** Payable on demand or at definite time.

(a) A promise or order is “payable on demand” if it (i) states that it is payable on demand or at sight, or otherwise indicates that it is payable at the will of the holder, or (ii) does not state any time of payment.

(b) A promise or order is “payable at a definite time” if it is payable on elapse of a definite period of time after sight or acceptance or at a fixed date or dates or at a time or times readily ascertainable at the time the promise or order is issued, subject to rights of (i) prepayment, (ii) acceleration, (iii) extension at the option of the holder, or (iv) extension to a further definite time at the option of the maker or acceptor or automatically upon or after a specified act or event.

(c) If an instrument, payable at a fixed date, is also payable upon demand made before the fixed date, the instrument is payable on demand until the fixed date and, if demand for payment is not made before that date, becomes payable at a definite time on the fixed date.

HISTORY: 1962 Code Section 10.3‑108; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

This section is a restatement of former Section 3‑108 and Section 3‑109. Subsection (b) broadens former Section 3‑109 somewhat by providing that a definite time includes a time readily ascertainable at the time the promise or order is issued. Subsection (b)(iii) and (iv) restates former Section 3‑109(1)(d). It adopts the generally accepted rule that a clause providing for extension at the option of the holder, even without a time limit, does not affect negotiability since the holder is given only a right which the holder would have without the clause. If the extension is to be at the option of the maker or acceptor or is to be automatic, a definite time limit must be stated or the time of payment remains uncertain and the order or promise is not a negotiable instrument. If a definite time limit is stated, the effect upon certainty of time of payment is the same as if the instrument were made payable at the ultimate date with a term providing for acceleration.

SOUTH CAROLINA REPORTER’S COMMENT

Subsection (a) restates the rules of former Section 36‑3‑108 for determining if an instrument is payable on demand.

Subsection (b) revises the rules of former Section 36‑3‑109 for determining if an instrument is payable at a definite time. Subsection (b) changes prior law by providing that an instrument is payable at a definite time if the time of payment “was readily ascertainable at the time the order or promise was given.” Subsection (b) also changes prior law by adding the right of prepayment to the list rights granted to the parties under an instrument that do not preclude the instrument from being payable at a definite time.

Subsection (c) is new and addresses a situation in which an instrument is both payable at a fixed date and also on demand prior to the fixed date. Under Subsection (c) the instrument is payable on demand until the fixed date and, if no demand is made by that date, becomes payable at a definite time.

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| Definitional Cross References: |  |
| “Acceptor” | Section 36‑3‑103(a)(1) |
| “Holder” | Section 36‑1‑201(20) |
| “Instrument” | Section 36‑3‑104(b) |
| “Maker” | Section 36‑3‑103(a)(7) |
| “Order” | Section 36‑3‑103(a)(8) |
| “Promise” | Section 36‑3‑103(a)(12) |

Cross References:

1. To qualify as a negotiable instrument a promise or order must be payable on demand or at a definite time. Section 36‑3‑104(a)(2).

2. The date stated on an instrument determines the time of payment if the instrument is payable at a fixed period after the date, even if the instrument is antedated or postdated. Section 36‑3‑113(a).

3. With the exception of postdated checks that meet the requirements of Section 36‑4‑401(c), an instrument payable on demand is not payable before the date of the date of the instrument. Section 36‑3‑113(a).

4. A payor bank may properly pay a check drawn on a customer’s account even if the payment is made prior to the date of the check unless the customer has given the bank prior notice of the postdating describing the check with reasonable certainty. Section 36‑4‑401(c).

LIBRARY REFERENCES

Bills and Notes 4, 9, 17, 30, 36, 44, 129(3), 155.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 9 to 11, 14, 90, 133 to 134.

**SECTION 36‑3‑109.** Payable to bearer or order.

(a) A promise or order is payable to bearer if it:

(1) states that it is payable to bearer or to the order of bearer or otherwise indicates that the person in possession of the promise or order is entitled to payment;

(2) does not state a payee; or

(3) states that it is payable to or to the order of cash or otherwise indicates that it is not payable to an identified person.

(b) A promise or order that is not payable to bearer is payable to order if it is payable (i) to the order of an identified person or (ii) to an identified person or order. A promise or order that is payable to order is payable to the identified person.

(c) An instrument payable to bearer may become payable to an identified person if it is specially indorsed pursuant to Section 36‑3‑205(a). An instrument payable to an identified person may become payable to bearer if it is indorsed in blank pursuant to Section 3‑205(b).

HISTORY: 1962 Code Section 10.3‑109; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. Under Section 3‑104(a), a promise or order cannot be an instrument unless the instrument is payable to bearer or to order when it is issued or unless Section 3‑104(c) applies. The terms “payable to bearer” and “payable to order” are defined in Section 3‑109. The quoted terms are also relevant in determining how an instrument is negotiated. If the instrument is payable to bearer it can be negotiated by delivery alone. Section 3‑201(b). An instrument that is payable to an identified person cannot be negotiated without the indorsement of the identified person. Section 3‑201(b). An instrument payable to order is payable to an identified person. Section 3‑109(b). Thus, an instrument payable to order requires the indorsement of the person to whose order the instrument is payable.

2. Subsection (a) states when an instrument is payable to bearer. An instrument is payable to bearer if it states that it is payable to bearer, but some instruments use ambiguous terms. For example, check forms usually have the words “to the order of” printed at the beginning of the line to be filled in for the name of the payee. If the drawer writes in the word “bearer” or “cash,” the check reads “to the order of bearer” or “to the order of cash.” In each case the check is payable to bearer. Sometimes the drawer will write the name of the payee “John Doe” but will add the words “or bearer.” In that case the check is payable to bearer. Subsection (a). Under subsection (b), if an instrument is payable to bearer it can’t be payable to order. This is different from former Section 3‑110(3). An instrument that purports to be payable both to order and bearer states contradictory terms. A transferee of the instrument should be able to rely on the bearer term and acquire rights as a holder without obtaining the indorsement of the identified payee. An instrument is also payable to bearer if it does not state a payee. Instruments that do not state a payee are in most cases incomplete instruments. In some cases the drawer of a check may deliver or mail it to the person to be paid without filling in the line for the name of the payee. Under subsection (a) the check is payable to bearer when it is sent or delivered. It is also an incomplete instrument. This case is discussed in Comment 2 to Section 3‑115. Subsection (a)(3) contains the words “otherwise indicates that it is not payable to an identified person.” The quoted words are meant to cover uncommon cases in which an instrument indicates that it is not meant to be payable to a specific person. Such an instrument is treated like a check payable to “cash”. The quoted words are not meant to apply to an instrument stating that it is payable to an identified person such as “ABC Corporation” if ABC Corporation is a nonexistent company. Although the holder of the check cannot be the nonexistent company, the instrument is not payable to bearer. Negotiation of such an instrument is governed by Section 3‑404(b).

SOUTH CAROLINA REPORTER’S COMMENT

Subsection (a) sets forth the rules defining when a promise or order is “payable to bearer” and replaces former Section 36‑3‑111. Subsection (b) sets forth the rules defining when a promise or order is “payable to order” and replaces former Section 36‑3‑110. Subsection (c) restates the rules in former Section 36‑3‑204(1) and (2) that an indorsement in blank transforms an order instrument into a bearer instrument, and that a special indorsement transforms a bearer instrument into an order instrument.

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| Definitional Cross References: |  |
| “Blank indorsement” | Section 36‑3‑205(b) |
| “Indorsement” | Section 36‑3‑204(a) |
| “Instrument” | Section 36‑3‑104(b) |
| “Order” | Section 36‑3‑103(a)(8) |
| “Promise” | Section 36‑3‑103(a)(12) |
| “Special indorsement” | Section 36‑3‑205(a) |

Cross References:

1. With the exception of checks, to qualify as a negotiable instrument a promise or order must be payable to bearer or to order. Section 36‑3‑104(a)(1) and (c).

2. An instrument payable to bearer can be negotiated by transfer of possession without indorsement. Sections 36‑3‑201(b); 36‑3‑205(b).

3. Negotiation of an instrument payable to the order of an identified person requires a transfer of possession and the indorsement of a holder. Sections 36‑3‑201(b); 36‑3‑205(a).

LIBRARY REFERENCES

Bills and Notes 4, 9, 17, 30, 36, 44, 129(1) to 129(2), 130, 155.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 9 to 11, 14, 76, 86 to 89, 91 to 101, 133 to 134.

**SECTION 36‑3‑110.** Identification of person to whom instrument is payable.

(a) The person to whom an instrument is initially payable is 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. The instrument is payable to the person intended by the signer even if that person is identified in the instrument by a name or other identification that is not that of the intended person. If more than one person signs in the name or behalf of the issuer of an instrument and all the signers do not intend the same person as payee, the instrument is payable to any person intended by one or more of the signers.

(b) If the signature of the issuer of an instrument is made by automated means, such as a check‑writing machine, the payee of the instrument is determined by the intent of the person who supplied the name or identification of the payee, whether or not authorized to do so.

(c) A person to whom an instrument is payable may be identified in any way, including by name, identifying number, office, or account number. For the purpose of determining the holder of an instrument, the following rules apply:

(1) If an instrument is payable to an account and the account is identified only by number, the instrument is payable to the person to whom the account is payable. If an instrument is payable to an account identified by number and by the name of a person, the instrument is payable to the named person, whether or not that person is the owner of the account identified by number.

(2) If an instrument is payable to:

(i) a trust, an estate, or a person described as trustee or representative of a trust or estate, the instrument is payable to the trustee, the representative, or a successor of either, whether or not the beneficiary or estate is also named;

(ii) a person described as agent or similar representative of a named or identified person, the instrument is payable to the represented person, the representative, or a successor of the representative;

(iii) a fund or organization that is not a legal entity, the instrument is payable to a representative of the members of the fund or organization; or

(iv) an office or to a person described as holding an office, the instrument is payable to the named person, the incumbent of the office, or a successor to the incumbent.

(d) If an instrument is payable to two or more persons alternatively, it is payable to any of them and may be negotiated, discharged, or enforced by any or all of them in possession of the instrument. If an instrument is payable to two or more persons not alternatively, it is payable to all of them and may be negotiated, discharged, or enforced only by all of them. If an instrument payable to two or more persons is ambiguous as to whether it is payable to the persons alternatively, the instrument is payable to the persons alternatively.

HISTORY: 1962 Code Section 10.3‑110; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. Section 3‑110 states rules for determining the identity of the person to whom an instrument is initially payable if the instrument is payable to an identified person. This issue usually arises in a dispute over the validity of an indorsement in the name of the payee. Subsection (a) states the general rule that the person to whom an instrument is payable is 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.” “Issuer” means the maker or drawer of the instrument. Section 3‑105(c). If X signs a check as drawer of a check on X’s account, the intent of X controls. If X, as President of Corporation, signs a check as President in behalf of Corporation as drawer, the intent of X controls. If X forges Y’s signature as drawer of a check, the intent of X also controls. Under Section 3‑103(a)(3), Y is referred to as the drawer of the check because the signing of Y’s name identifies Y as the drawer. But since Y’s signature was forged Y has no liability as drawer (Section 3‑403(a)) unless some other provision of Article 3 or Article 4 makes Y liable. Since X, even though unauthorized, signed in the name of Y as issuer, the intent of X determines to whom the check is payable.

In the case of a check payable to “John Smith,” since there are many people in the world named “John Smith” it is not possible to identify the payee of the check unless there is some further identification or the intention of the drawer is determined. Name alone is sufficient under subsection (a), but the intention of the drawer determines which John Smith is the person to whom the check is payable. The same issue is presented in cases of misdescriptions of the payee. The drawer intends to pay a person known to the drawer as John Smith. In fact that person’s name is James Smith or John Jones or some other entirely different name. If the check identifies the payee as John Smith, it is nevertheless payable to the person intended by the drawer. That person may indorse the check in either the name John Smith or the person’s correct name or in both names. Section 3‑204(d). The intent of the drawer is also controlling in fictitious payee cases. Section 3‑404(b). The last sentence of subsection (a) refers to rare cases in which the signature of an organization requires more than one signature and the persons signing on behalf of the organization do not all intend the same person as payee. Any person intended by a signer for the organization is the payee and an indorsement by that person is an effective indorsement.

Subsection (b) recognizes the fact that in a large number of cases there is no human signer of an instrument because the instrument, usually a check, is produced by automated means such as a check‑writing machine. In that case, the relevant intent is that of the person who supplied the name of the payee. In most cases that person is an employee of the drawer, but in some cases the person could be an outsider who is committing a fraud by introducing names of payees of checks into the system that produces the checks. A check‑writing machine is likely to be operated by means of a computer in which is stored information as to name and address of the payee and the amount of the check. Access to the computer may allow production of fraudulent checks without knowledge of the organization that is the issuer of the check. Section 3‑404(b) is also concerned with this issue. See Case # 4 in Comment 2 to Section 3‑404.

2. Subsection (c) allows the payee to be identified in any way including the various ways stated. Subsection (c)(1) relates to instruments payable to bank accounts. In some cases the account might be identified by name and number, and the name and number might refer to different persons. For example, a check is payable to “X Corporation Account No. 12345 in Bank of Podunk.” Under the last sentence of subsection (c)(1), this check is payable to X Corporation and can be negotiated by X Corporation even if Account No. 12345 is some other person’s account or the check is not deposited in that account. In other cases the payee is identified by an account number and the name of the owner of the account is not stated. For example, Debtor pays Creditor by issuing a check drawn on Payor Bank. The check is payable to a bank account owned by Creditor but identified only by number. Under the first sentence of subsection (c)(1) the check is payable to Creditor and, under Section 1‑201(20), Creditor becomes the holder when the check is delivered. Under Section 3‑201(b), further negotiation of the check requires the indorsement of Creditor. But under Section 4‑205(a), if the check is taken by a depositary bank for collection, the bank may become a holder without the indorsement. Under Section 3‑102(b), provisions of Article 4 prevail over those of Article 3. The depositary bank warrants that the amount of the check was credited to the payee’s account.

3. Subsection (c)(2) replaces former Section 3‑117 and subsection (1)(e), (f), and (g) of former Section 3‑110. This provision merely determines who can deal with an instrument as a holder. It does not determine ownership of the instrument or its proceeds. Subsection (c)(2)(i) covers trusts and estates. If the instrument is payable to the trust or estate or to the trustee or representative of the trust or estate, the instrument is payable to the trustee or representative or any successor. Under subsection (c)(2)(ii), if the instrument states that it is payable to Doe, President of X Corporation, either Doe or X Corporation can be holder of the instrument. Subsection (c)(2)(iii) concerns informal organizations that are not legal entities such as unincorporated clubs and the like. Any representative of the members of the organization can act as holder. Subsection (c)(2)(iv) applies principally to instruments payable to public offices such as a check payable to County Tax Collector.

4. Subsection (d) replaces former Section 3‑116. An instrument payable to X or Y is governed by the first sentence of subsection (d). An instrument payable to X and Y is governed by the second sentence of subsection (d). If an instrument is payable to X or Y, either is the payee and if either is in possession that person is the holder and the person entitled to enforce the instrument. Section 3‑301. If an instrument is payable to X and Y, neither X nor Y acting alone is the person to whom the instrument is payable. Neither person, acting alone, can be the holder of the instrument. The instrument is “payable to an identified person.” The “identified person” is X and Y acting jointly. Section 3‑109(b) and Section 1‑102(5)(a). Thus, under Section 1‑201(20) X or Y, acting alone, cannot be the holder or the person entitled to enforce or negotiate the instrument because neither, acting alone, is the identified person stated in the instrument.

The third sentence of subsection (d) is directed to cases in which it is not clear whether an instrument is payable to multiple payees alternatively. In the case of ambiguity persons dealing with the instrument should be able to rely on the indorsement of a single payee. For example, an instrument payable to X and/or Y is treated like an instrument payable to X or Y.

SOUTH CAROLINA REPORTER’S COMMENT

This provision includes the rules for identifying the person or persons to whom an instrument is payable set forth in former Sections 36‑3‑110(e), (f) and (g); 36‑3‑116; and 36‑3‑117. Subsection (a) provides that the intent of the person issuing an instrument determines the person to whom the instrument is initially payable, even if the person signing as the drawer of a draft or maker of a note is not authorized to do so. The intent of that person determines the person to whom the instrument is payable.

Subsection (b) provides that if the issuer of an instrument signs the instrument by automated means, the intent of the person who supplied the name of the payee controls to whom the instrument is payable.

Subsection (c)(2)(i) provides the rules on instruments payable to a trust, estate, or trustee formerly codified in Sections 36‑3‑110(1)(e) and 35‑3‑117(b). Subsection (c)(2)(ii) provides the rules on instruments payable to a person described as an agent or representative formerly codified at Section 36‑3‑110(1)(g). Subsection (c)(2)(iv) provides the rules on instruments payable to an office or office holder formerly codified at Section 36‑3‑110(1)(f).

Subsection (d) provides the rules on instruments payable to two or more persons, formerly codified in Sections 36‑3‑110(1)(d), 36‑3‑116, and 36‑3‑118(e). If the instrument is payable to two or more persons alternatively (e.g., Jones or Smith), the instrument can be enforced by any one of those persons. If the instrument is payable to two or more persons jointly (e.g., Jones and Smith), the instrument can be enforced only by all the parties.

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| Definitional Cross References: |  |
| “Account” | Section 36‑4‑104(a)(1) |
| “Instrument” | Section 36‑3‑104(b) |
| “Issuer” | Section 36‑3‑105(c) |
| “Organization” | Section 36‑1‑201(28) |
| “Person” | Section 36‑1‑201(30) |
| “Representative” | Section 36‑1‑201(35) |

Cross References:

1. In fictitious payee cases, Subsections (a) and (b) define the person whose intent determines whether the person identified as the payee has any interest in the instrument. See Section 36‑3‑404(b).

2. If the signature of more than one person is required to constitute the authorized signature of an organization, the signature of the organization is unauthorized if one of the required signatures is missing. Section 36‑4‑403(b).

LIBRARY REFERENCES

Bills and Notes 4, 6, 30, 32, 118 to 123(3), 153.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 10 to 11, 13, 24 to 25, 28, 80 to 83, 128, 249.

**SECTION 36‑3‑111.** Place of payment.

Except as otherwise provided for items in Chapter 4, an instrument is payable at the place of payment stated in the instrument. If no place of payment is stated, an instrument is payable at the address of the drawee or maker stated in the instrument. If no address is stated, the place of payment is the place of business of the drawee or maker. If a drawee or maker has more than one place of business, the place of payment is any place of business of the drawee or maker chosen by the person entitled to enforce the instrument. If the drawee or maker has no place of business, the place of payment is the residence of the drawee or maker.

HISTORY: 1962 Code Section 10.3‑111; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

If an instrument is payable at a bank in the United States, Section 3‑501(b)(1) states that presentment must be made at the place of payment, i.e. the bank. The place of presentment of a check is governed by Regulation CC Section 229.36.

SOUTH CAROLINA REPORTER’S COMMENT

Although the former Chapter 3 did not include a provision expressly defining the place of payment of an instrument in stating the requirements for making presentment, former Section 36‑3‑504(2)(c) imposed rules on the place of payment consistent with Section 36‑3‑111. Note that Regulation CC 12 C.F.R. Part Section 229.36(b) states the rules for presentment of checks.

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| Definitional Cross References: |  |
| “Drawer” | Section 36‑3‑103(a)(5) |
| “Instrument” | Section 36‑3‑104(b) |
| “Maker” | Section 36‑3‑103(a)(7) |
| “Payment” | Section 36‑3‑602(a) |
| “Person” | Section 36‑1‑201(30) |

Cross Reference

1. Item payable at or through a bank. Section 36‑4‑106.

LIBRARY REFERENCES

Bills and Notes 4, 6, 30, 32, 153.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 10 to 11, 13, 128.

**SECTION 36‑3‑112.** Interest.

(a) Unless otherwise provided in the instrument, (i) an instrument is not payable with interest, and (ii) interest on an interest‑bearing instrument is payable from the date of the instrument.

(b) Interest may be stated in an instrument as a fixed or variable amount of money or it may be expressed as a fixed or variable rate or rates. The amount or rate of interest may be stated or described in the instrument in any manner and may require reference to information not contained in the instrument. If an instrument provides for interest, but the amount of interest payable cannot be ascertained from the description, interest is payable at the judgment rate in effect at the place of payment of the instrument and at the time interest first accrues.

HISTORY: 1962 Code Section 10.3‑112; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. Under Section 3‑104(a) the requirement of a “fixed amount” applies only to principal. The amount of interest payable is that described in the instrument. If the description of interest in the instrument does not allow for the amount of interest to be ascertained, interest is payable at the judgment rate. Hence, if an instrument calls for interest, the amount of interest will always be determinable. If a variable rate of interest is prescribed, the amount of interest is ascertainable by reference to the formula or index described or referred to in the instrument. The last sentence of subsection (b) replaces subsection (d) of former Section 3‑118.

2. The purpose of subsection (b) is to clarify the meaning of “interest” in the introductory clause of Section 3‑104(a). It is not intended to validate a provision for interest in an instrument if that provision violates other law.

SOUTH CAROLINA REPORTER’S COMMENT

Subsection (a) and the last sentence of Subsection (b) replace former Section 36‑3‑118(d) addressing the rate and time of accrual of interest when those matters cannot be determined from the instrument.

Under Subsection (b), a note or other promise or order providing for interest at a variable rate determined with reference to information not contained in the instrument does not violate the “fixed amount” requirement for negotiability under Section 36‑3‑104(a). This is a significant change from prior law. Under former Section 36‑3‑104(1)(b) a writing could qualify as a negotiable instrument only if it were an order or promise to pay a “sum certain.” Former Section 36‑3‑106(1) defined the term “sum certain”. Under that definition, a note with a variable interest rate determined by reference to information not contained in the note did not provide for payment of a sum certain and could not qualify as a negotiable instrument. See Official Comment 1 to former Section 36‑3‑106.

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| Definitional Cross References: |  |
| “Instrument” | Section 36‑3‑104(b) |
| “Money” | Section 36‑1‑201(24) |

Cross References:

1. “Fixed amount” requirement for a negotiable instrument. Section 36‑3‑104(a).

2. Judgment rate of interest. Set annually by order of the South Carolina Supreme Court pursuant to S.C. Code Ann. Section 34‑31‑20. Current rate available at www.sccourts.org.

CROSS REFERENCES

Investment securities, see Sections 36‑8‑101 et seq.

Term providing that party may accelerate payment or performance or require collateral or additional collateral, see Section 36‑1‑309.

LIBRARY REFERENCES

Bills and Notes 4, 20, 21, 30, 46, 47, 90, 113, 148.1, 165.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 5, 7, 10 to 11, 41, 127, 129 to 131, 135 to 136, 138, 261, 263 to 264.

RESEARCH REFERENCES

ALR Library

76 ALR 5th 289 , What Constitutes “Fixed Amount of Money” for Purposes of [Rev] Section 3‑104 of Uniform Commercial Code Providing that Negotiable Instrument Must Contain Unconditional Promise to Pay Fixed Amount of Money.

Notes of Decisions

In general 1

1. In general

Even though it had variable interest rate, promissory note underlying mortgage was “negotiable” under governing version of South Carolina’s Uniform Commercial Code (UCC), which required for negotiability that instrument contain “unconditional promise or order to pay a sum certain in money.” In re McFadden (Bkrtcy.D.S.C. 2012) 471 B.R. 136. Bills and Notes 158

**SECTION 36‑3‑113.** Date of instrument.

(a) An instrument may be antedated or postdated. The date stated determines the time of payment if the instrument is payable at a fixed period after date. Except as provided in Section 36‑4‑401(c), an instrument payable on demand is not payable before the date of the instrument.

(b) If an instrument is undated, its date is the date of its issue or, in the case of an unissued instrument, the date it first comes into possession of a holder.

HISTORY: 1962 Code Section 10.3‑113; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

This section replaces former Section 3‑114. Subsections (1) and (3) of former Section 3‑114 are deleted as unnecessary. Section 3‑113(a) is based in part on subsection (2) of former Section 3‑114. The rule that a demand instrument is not payable before the date of the instrument is subject to Section 4‑401(c) which allows the payor bank to pay a postdated check unless the drawer has notified the bank of the postdating pursuant to a procedure prescribed in that subsection. With respect to an undated instrument, the date is the date of issue.

SOUTH CAROLINA REPORTER’S COMMENT

This provision replaces former Section 36‑3‑114. Despite the deletion of former Section 36‑3‑114(1), the negotiability of a promise or order is not affected by the fact that it is undated, antedated, or postdated. Subject to a significant exception, Subsection (b) continues the general rule under former Section 36‑3‑114(2), that when a demand instrument is postdated, the stated date on the instrument determines when it is payable. The exception applies to postdated checks. Under revised Section 36‑4‑401(c) a payor bank can charge a customer’s account prior to the date on a postdated check unless the customer has given the bank adequate notification of the postdating.

Application of revised Section 36‑3‑113 to the facts presented in Fisher v. Carolina Door Products, Inc., 286 S.C. 5, 331 S.E.2d 368 (S.C. App. 1985) would not change the result in that case. In Fisher, the court of appeals held that the fact that a note was antedated did not affect its negotiability.

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| Definitional Cross References: |  |
| “Holder” | Section 36‑1‑201(20) |
| “Issue” | Section 36‑3‑105(a) |
| “Instrument” | Section 36‑3‑104(b) |
| “Payable on demand” | Section 36‑3‑108(a) |
| “Payment” | Section 36‑3‑602(a) |

Cross Reference:

1. Payment of postdated checks. Section 36‑4‑401(c).

LIBRARY REFERENCES

Bills and Notes 16, 43.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Section 16.

NOTES OF DECISIONS

In general 1

1. In general

In action by payee‑holder on note that provided for ten annual and equal payments of principal, plus interest on unpaid balance, commencing on January 1, 1982, on which note maker paid first installment of principal in February 1982, but refused to pay interest for year 1981, court held (1) that under UCC Section 36‑3‑114(1), fact that note was antedated did not affect its negotiability, since in such case time it was payable was determined by its stated date under UCC Section 36‑3‑114(2) and such stated date was presumed to be correct under UCC Sections 36‑3‑114(3) and 36‑1‑201(31); (2) that since note spoke for itself, interest began to run on January 1, l981; and (3) that plaintiff was entitled to interest on interest after January 1, l982. Fisher v. Carolina Door Products, Inc. (S.C.App. 1985) 286 S.C. 5, 331 S.E.2d 368.

**SECTION 36‑3‑114.** Contradictory terms of instrument.

If an instrument contains contradictory terms, typewritten terms prevail over printed terms, handwritten terms prevail over both, and words prevail over numbers.

HISTORY: 1962 Code Section 10.3‑114; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

Section 3‑114 replaces subsections (b) and (c) of former Section 3‑118.

SOUTH CAROLINA REPORTER’S COMMENT

This provision restates former Section 36‑3‑118(b) and (c). Former Section 36‑3‑118(a) provided that when there was doubt about whether an instrument was a draft or a note the holder could treat it as either. A similar rule is now codified in Section 36‑3‑104(e). Former Section 36‑3‑118(a) also provided that a draft drawn on the drawer is effective as a note. That rule is now codified in Section 36‑3‑412.

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| Definitional Cross Reference: |  |
| “Instrument” | Section 36‑3‑104(b) |

LIBRARY REFERENCES

Bills and Notes 4, 8, 30, 34, 148.1.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 10 to 11, 14, 129 to 131.

RESEARCH REFERENCES

Treatises and Practice Aids

11 Causes of Action 143, Cause of Action Against Bank for Payment of Check Over Unauthorized or Missing Endorsement.

Notes of Decisions

Prior law 1

1. Prior law

Promissory note underlying mortgage was properly negotiated by second indorsement in its chain of title under former version of South Carolina’s version of Uniform Commercial Code (UCC), where indorsement was on face of note, indorsement was by representative of then‑current holder of note, and note was delivered to bank as custodian for trustee of trust holding pool of mortgages, even though indorsement was not dated and indorsement contained scrivener’s error in its reference to trust. In re McFadden (Bkrtcy.D.S.C. 2012) 471 B.R. 136. Bills And Notes 182; Bills And Notes 183; Bills And Notes 184; Mortgages And Deeds Of Trust 1472

**SECTION 36‑3‑115.** Incomplete instrument.

(a) “Incomplete instrument” means a signed writing, whether or not issued by the signer, the contents of which show at the time of signing that it is incomplete but that the signer intended it to be completed by the addition of words or numbers.

(b) Subject to Subsection (c), if an incomplete instrument is an instrument under Section 36‑3‑104, it may be enforced according to its terms if it is not completed, or according to its terms as augmented by completion. If an incomplete instrument is not an instrument under Section 36‑3‑104, but, after completion, the requirements of Section 36‑3‑104 are met, the instrument may be enforced according to its terms as augmented by completion.

(c) If words or numbers are added to an incomplete instrument without authority of the signer, there is an alteration of the incomplete instrument under Section 36‑3‑407.

(d) The burden of establishing that words or numbers were added to an incomplete instrument without authority of the signer is on the person asserting the lack of authority.

HISTORY: 1962 Code Section 10.3‑115; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. This section generally carries forward the rules set out in former Section 3‑115. The term “incomplete instrument” applies both to an “instrument,” i.e. a writing meeting all the requirements of Section 3‑104, and to a writing intended to be an instrument that is signed but lacks some element of an instrument. The test in both cases is whether the contents show that it is incomplete and that the signer intended that additional words or numbers be added.

2. If an incomplete instrument meets the requirements of Section 3‑104 and is not completed it may be enforced in accordance with its terms. Suppose, in the following two cases, that a note delivered to the payee is incomplete solely because a space on the pre‑printed note form for the due date is not filled in:

Case # 1. If the incomplete instrument is never completed, the note is payable on demand. Section 3‑108(a)(ii). However, if the payee and the maker agreed to a due date, the maker may have a defense under Section 3‑117 if demand for payment is made before the due date agreed to by the parties.

Case # 2. If the payee completes the note by filling in the due date agreed to by the parties, the note is payable on the due date stated. However, if the due date filled in was not the date agreed to by the parties there is an alteration of the note. Section 3‑407 governs the case.

Suppose Debtor pays Creditor by giving Creditor a check on which the space for the name of the payee is left blank. The check is an instrument but it is incomplete. The check is enforceable in its incomplete form and it is payable to bearer because it does not state a payee. Section 3‑109(a)(2). Thus, Creditor is a holder of the check. Normally in this kind of case Creditor would simply fill in the space with Creditor’s name. When that occurs the check becomes payable to the Creditor.

3. In some cases the incomplete instrument does not meet the requirements of Section 3‑104. An example is a check with the amount not filled in. The check cannot be enforced until the amount is filled in. If the payee fills in an amount authorized by the drawer the check meets the requirements of Section 3‑104 and is enforceable as completed. If the payee fills in an unauthorized amount there is an alteration of the check and Section 3‑407 applies.

4. Section 3‑302(a)(1) also bears on the problem of incomplete instruments. Under that section a person cannot be a holder in due course of the instrument if it is so incomplete as to call into question its validity. Subsection (d) of Section 3‑115 is based on the last clause of subsection (2) of former Section 3‑115.

SOUTH CAROLINA REPORTER’S COMMENT

This provision restates the rules in former Section 36‑3‑115. The leading South Carolina decision on incomplete instruments, American Federal Bank, FSB v. Parker, 301 S.C 509, 392 S.E.2d 798 (S.C. App. 1990), is authoritative precedent under the revised statute. In that case, the maker of a promissory note signed the note, leaving the amount of the note blank. A wrongdoer completed the note in an amount significantly greater than the maker had authorized and transferred the note to a bank that qualified as a holder in due course. The court held that the maker was liable to the bank for the amount of the note as completed.

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| Definitional Cross References: |  |
| “Instrument” | Section 36‑3‑104(b) |
| “Person” | Section 36‑1‑201(30) |
| “Signed” | Section 36‑1‑201(39) |
| “Writing” | Section 36‑1‑201(46) |

Cross References:

1. If an instrument is so incomplete or irregular as to call its authenticity into question, a holder of the instrument cannot qualify as a holder in due course. Section 36‑3‑302(a)(1).

2. The term “alteration” includes an unauthorized addition of words or numbers or other change to an incomplete instrument. Section 36‑3‑407(a).

3. A payor bank or drawee paying an instrument with an unauthorized completion or a person taking such an instrument for value, in good faith, and without notice of the unauthorized completion may enforce the instrument as completed. Section 36‑3‑407(c)(ii).

LIBRARY REFERENCES

Bills and Notes 1, 4, 28, 30, 58, 61, 148.1 to 152.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 2 to 3, 5 to 12, 17 to 18, 22, 27, 29, 75, 129 to 131, 133, 138.

NOTES OF DECISIONS

In general 1

1. In general

A borrower was liable to the lending bank for the entire amount of an $85,000 promissory note, even though he intended to borrow only $35,000, where he signed a blank promissory note and relied upon a third party to co‑sign the note and fill in the amount for $35,000, but the third party entered $85,000 as the amount, presented the note to the bank, and received the funds from the bank. As a holder in due course, the bank was entitled to enforce the note against the borrower as completed since the bank took the note in good faith and without notice of any defense to it by the borrower. American Federal Bank, FSB v. Parker (S.C.App. 1990) 301 S.C. 509, 392 S.E.2d 798.

**SECTION 36‑3‑116.** Joint and several liability; contribution.

(a) Except as otherwise provided in the instrument, two or more persons who have the same liability on an instrument as makers, drawers, acceptors, indorsers who indorse as joint payees, or anomalous indorsers are jointly and severally liable in the capacity in which they sign.

(b) Except as provided in Section 36‑3‑419(f) or by agreement of the affected parties, a party having joint and several liability who pays the instrument is entitled to receive from any party having the same joint and several liability contribution in accordance with applicable law.

HISTORY: 1962 Code Section 10.3‑116; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. Subsection (a) replaces subsection (e) of former Section 3‑118. Subsection (b) states contribution rights of parties with joint and several liability by referring to applicable law. But subsection (b) is subject to Section 3‑419(f). If one of the parties with joint and several liability is an accommodation party and the other is the accommodated party, Section 3‑419(f) applies. Because one of the joint and several obligors may have recourse against the other joint and several obligor under subsection (b), each party that is jointly and severally liable under subsection (a) is a secondary obligor in part and a principal obligor in part, as those terms are defined in Section 3‑103(a). Accordingly, Section 3‑605 determines the effect of a release, an extension of time, or a modification of the obligation of one of the joint and several obligors, as well as the effect of an impairment of collateral provided by one of those obligors.

2. Indorsers normally do not have joint and several liability. Rather, an earlier indorser has liability to a later indorser. But indorsers can have joint and several liability in two cases. If an instrument is payable to two payees jointly, both payees must indorse. The indorsement is a joint indorsement and the indorsers have joint and several liability and subsection (b) applies. The other case is that of two or more anomalous indorsers. The term is defined in Section 3‑205(d). An anomalous indorsement normally indicates that the indorser signed as an accommodation party. If more than one accommodation party indorses a note as an accommodation to the maker, the indorsers have joint and several liability and subsection (b) applies.

SOUTH CAROLINA REPORTER’S COMMENT

Subsection (a) restates the rule of joint and several liability formerly codified in Section 36‑3‑118(e).

Subsection (b) provides that as a general rule, a party with joint and several liability on an instrument who pays the instrument is entitled to receive contribution from any other party having the same joint and several liability. This rule is consistent with the holding in United Carolina Bank v. Caroprop, Ltd., 316 S.C. 1, 446 S.E.2d 415 (1994). The principle exception to this rule is that, under Section 36‑3‑419(e), an accommodated party who pays an instrument is not entitled to contribution from an accommodation party. See Williams v. Sandman, 187 F.3d 379, 382 (4th Cir. 1999) (South Carolina law).

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| Definitional Cross References: |  |
| “Acceptor” | Section 36‑3‑103(a)(1) |
| “Agreement” | Section 36‑1‑201(3) |
| “Anomalous indorsement” | Section 36‑3‑205(d) |
| “Drawer” | Section 36‑3‑103(a)(5) |
| “Indorser” | Section 36‑3‑204(b) |
| “Instrument” | Section 36‑3‑104(b) |
| “Maker” | Section 36‑3‑103(a)(7) |
| “Party” | Section 36‑3‑103(a)(10) |
| “Person entitled to enforce” | Section 36‑3‑301 |
| “Signed” | Section 36‑1‑201(39) |

Cross References:

1. Obligation of maker of note and issuer of cashier’s check. Section 36‑3‑412.

2. Obligation of acceptor of a draft. Section 36‑3‑413.

3. Obligation of drawer of a draft other than a cashier’s check or other draft drawn on the drawer. Section 36‑3‑414.

4. Obligation of indorser. Section 36‑3‑415.

5. Obligations of accommodation parties and accommodated parties. Section 36‑3‑419.

LIBRARY REFERENCES

Bills and Notes 4, 6, 30, 32, 120, 153.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 10 to 11, 13, 81, 83, 128, 249.

**SECTION 36‑3‑117.** Other agreements affecting instrument.

Subject to applicable law regarding exclusion of proof of contemporaneous or previous agreements, the obligation of a party to an instrument to pay the instrument may be modified, supplemented, or nullified by a separate agreement of the obligor and a person entitled to enforce the instrument, if the instrument is issued or the obligation is incurred in reliance on the agreement or as part of the same transaction giving rise to the agreement. To the extent an obligation is modified, supplemented, or nullified by an agreement under this section, the agreement is a defense to the obligation.

HISTORY: 1962 Code Section 10.3‑117; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. The separate agreement might be a security agreement or mortgage or it might be an agreement that contradicts the terms of the instrument. For example, a person may be induced to sign an instrument under an agreement that the signer will not be liable on the instrument unless certain conditions are met. Suppose X requested credit from Creditor who is willing to give the credit only if an acceptable accommodation party will sign the note of X as co‑maker. Y agrees to sign as co‑maker on the condition that Creditor also obtain the signature of Z as co‑maker. Creditor agrees and Y signs as co‑maker with X. Creditor fails to obtain the signature of Z on the note. Under Sections 3‑412 and 3‑419(b), Y is obliged to pay the note, but Section 3‑117 applies. In this case, the agreement modifies the terms of the note by stating a condition to the obligation of Y to pay the note. This case is essentially similar to a case in which a maker of a note is induced to sign the note by fraud of the holder. Although the agreement that Y not be liable on the note unless Z also signs may not have been fraudulently made, a subsequent attempt by Creditor to require Y to pay the note in violation of the agreement is a bad faith act. Section 3‑117, in treating the agreement as a defense, allows Y to assert the agreement against Creditor, but the defense would not be good against a subsequent holder in due course of the note that took it without notice of the agreement. If there cannot be a holder in due course because of Section 3‑106(d), a subsequent holder that took the note in good faith, for value and without knowledge of the agreement would not be able to enforce the liability of Y. This result is consistent with the risk that a holder not in due course takes with respect to fraud in inducing issuance of an instrument.

2. The effect of merger or integration clauses to the effect that a writing is intended to be the complete and exclusive statement of the terms of the agreement or that the agreement is not subject to conditions is left to the supplementary law of the jurisdiction pursuant to Section 1‑103. Thus, in the case discussed in Comment 1, whether Y is permitted to prove the condition to Y’s obligation to pay the note is determined by that law. Moreover, nothing in this section is intended to validate an agreement which is fraudulent or void as against public policy, as in the case of a note given to deceive a bank examiner.

SOUTH CAROLINA REPORTER’S COMMENT

This provision replaces former Section 36‑3‑119. Subject to the parol evidence rule, the obligation of a party to an instrument can be modified or even nullified by a separate agreement if the instrument was issued or the party’s obligation was incurred in reliance upon the agreement or as part of the same transaction that gave rise to the agreement. To the extent that the separate agreement modifies the party’s obligation, the agreement is a defense to the obligation.

In contrast to former Section 36‑3‑119, this provision does not expressly state that the separate agreement does not affect negotiability of the instrument or that the separate agreement does not provide a defense against a holder in due course. This provision does not, however, change these rules. See Official Comment 1. Therefore, the decision in Northwestern Bank v. Neal, 271 S.C. 544, 248 S.E.2d 585 (1978) remains authoritative. See South Carolina Reporter’s Comment to Section 36‑3‑106.

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| Definitional Cross References: |  |
| “Agreement” | Section 36‑1‑201(3) |
| “Instrument” | Section 36‑3‑104(b) |
| “Party” | Section 36‑3‑103(a)(10) |
| “Person” | Section 36‑1‑201(30) |
| “Person entitled to enforce” | Section 36‑3‑301 |

Cross References:

1. Defenses that can be asserted against a person other than a holder in due course. Section 36‑3‑305(a).

2. Defenses that can be asserted against a holder in due course. Section 36‑3‑305(b).

LIBRARY REFERENCES

Bills and Notes 4, 6, 30, 32, 119, 153.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 10 to 11, 13, 80, 82, 128.

RESEARCH REFERENCES

Treatises and Practice Aids

11 Causes of Action 143, Cause of Action Against Bank for Payment of Check Over Unauthorized or Missing Endorsement.

Notes of Decisions

Prior law 1

1. Prior law

Promissory note underlying mortgage was properly negotiated by second indorsement in its chain of title under former version of South Carolina’s version of Uniform Commercial Code (UCC), where indorsement was on face of note, indorsement was by representative of then‑current holder of note, and note was delivered to bank as custodian for trustee of trust holding pool of mortgages, even though indorsement was not dated and indorsement contained scrivener’s error in its reference to trust. In re McFadden (Bkrtcy.D.S.C. 2012) 471 B.R. 136. Bills And Notes 182; Bills And Notes 183; Bills And Notes 184; Mortgages And Deeds Of Trust 1472

**SECTION 36‑3‑118.** Statute of limitations.

(a) Except as provided in Subsection (e), an action to enforce the obligation of a party to pay a note payable at a definite time must be commenced within six years after the due date or dates stated in the note or, if a due date is accelerated, within six years after the accelerated due date.

(b) Except as provided in Subsection (d) or (e), if demand for payment is made to the maker of a note payable on demand, an action to enforce the obligation of a party to pay the note must be commenced within six years after the demand. If no demand for payment is made to the maker, an action to enforce the note is barred if neither principal nor interest on the note has been paid for a continuous period of 10 years.

(c) Except as provided in Subsection (d), an action to enforce the obligation of a party to an unaccepted draft to pay the draft must be commenced within three years after dishonor of the draft or 10 years after the date of the draft, whichever period expires first.

(d) An action to enforce the obligation of the acceptor of a certified check or the issuer of a teller’s check, cashier’s check, or traveler’s check must be commenced within three years after demand for payment is made to the acceptor or issuer, as the case may be.

(e) An action to enforce the obligation of a party to a certificate of deposit to pay the instrument must be commenced within six years after demand for payment is made to the maker, but if the instrument states a due date and the maker is not required to pay before that date, the six‑year period begins when a demand for payment is in effect and the due date has passed.

(f) An action to enforce the obligation of a party to pay an accepted draft, other than a certified check, must be commenced (i) within six years after the due date or dates stated in the draft or acceptance if the obligation of the acceptor is payable at a definite time, or (ii) within six years after the date of the acceptance if the obligation of the acceptor is payable on demand.

(g) Unless governed by other law regarding claims for indemnity or contribution, an action (i) for conversion of an instrument, for money had and received, or like action based on conversion, (ii) for breach of warranty, or (iii) to enforce an obligation, duty, or right arising under this Article and not governed by this section must be commenced within three years after the cause of action accrues.

HISTORY: 1962 Code Section 10.3‑118; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. Section 3‑118 differs from former Section 3‑122, which states when a cause of action accrues on an instrument. Section 3‑118 does not define when a cause of action accrues. Accrual of a cause of action is stated in other sections of Article 3 such as those that state the various obligations of parties to an instrument. The only purpose of Section 3‑118 is to define the time within which an action to enforce an obligation, duty, or right arising under Article 3 must be commenced. Section 3‑118 does not attempt to state all rules with respect to a statute of limitations. For example, the circumstances under which the running of a limitations period may be tolled is left to other law pursuant to Section 1‑103.

2. The first six subsections apply to actions to enforce an obligation of any party to an instrument to pay the instrument. This changes present law in that indorsers who may become liable on an instrument after issue are subject to a period of limitations running from the same date as that of the maker or drawer. Subsections (a) and (b) apply to notes. If the note is payable at a definite time, a six‑year limitations period starts at the due date of the note, subject to prior acceleration. If the note is payable on demand, there are two limitations periods. Although a note payable on demand could theoretically be called a day after it was issued, the normal expectation of the parties is that the note will remain outstanding until there is some reason to call it. If the law provides that the limitations period does not start until demand is made, the cause of action to enforce it may never be barred. On the other hand, if the limitations period starts when demand for payment may be made, i.e. at any time after the note was issued, the payee of a note on which interest or portions of principal are being paid could lose the right to enforce the note even though it was treated as a continuing obligation by the parties. Some demand notes are not enforced because the payee has forgiven the debt. This is particularly true in family and other noncommercial transactions. A demand note found after the death of the payee may be presented for payment many years after it was issued. The maker may be a relative and it may be difficult to determine whether the note represents a real or a forgiven debt. Subsection (b) is designed to bar notes that no longer represent a claim to payment and to require reasonably prompt action to enforce notes on which there is default. If a demand for payment is made to the maker, a six‑year limitations period starts to run when demand is made. The second sentence of subsection (b) bars an action to enforce a demand note if no demand has been made on the note and no payment of interest or principal has been made for a continuous period of 10 years. This covers the case of a note that does not bear interest or a case in which interest due on the note has not been paid. This kind of case is likely to be a family transaction in which a failure to demand payment may indicate that the holder did not intend to enforce the obligation but neglected to destroy the note. A limitations period that bars stale claims in this kind of case is appropriate if the period is relatively long.

3. Subsection (c) applies primarily to personal uncertified checks. Checks are payment instruments rather than credit instruments. The limitations period expires three years after the date of dishonor or 10 years after the date of the check, whichever is earlier. Teller’s checks, cashier’s checks, certified checks, and traveler’s checks are treated differently under subsection (d) because they are commonly treated as cash equivalents. A great delay in presenting a cashier’s check for payment in most cases will occur because the check was mislaid during that period. The person to whom traveler’s checks are issued may hold them indefinitely as a safe form of cash for use in an emergency. There is no compelling reason for barring the claim of the owner of the cashier’s check or traveler’s check. Under subsection (d) the claim is never barred because the three‑year limitations period does not start to run until demand for payment is made. The limitations period in subsection (d) in effect applies only to cases in which there is a dispute about the legitimacy of the claim of the person demanding payment.

4. Subsection (e) covers certificates of deposit. The limitations period of six years doesn’t start to run until the depositor demands payment. Most certificates of deposit are payable on demand even if they state a due date. The effect of a demand for payment before maturity is usually that the bank will pay, but that a penalty will be assessed against the depositor in the form of a reduction in the amount of interest that is paid. Subsection (e) also provides for cases in which the bank has no obligation to pay until the due date. In that case the limitations period doesn’t start to run until there is a demand for payment in effect and the due date has passed.

5. Subsection (f) applies to accepted drafts other than certified checks. When a draft is accepted it is in effect turned into a note of the acceptor. In almost all cases the acceptor will agree to pay at a definite time. Subsection (f) states that in that case the six‑year limitations period starts to run on the due date. In the rare case in which the obligation of the acceptor is payable on demand, the six‑year limitations period starts to run at the date of the acceptance.

6. Subsection (g) covers warranty and conversion cases and other actions to enforce obligations or rights arising under Article 3. A three‑year period is stated and subsection (g) follows general law in stating that the period runs from the time the cause of action accrues. Since the traditional term “cause of action” may have been replaced in some states by “claim for relief” or some equivalent term, the words “cause of action” have been bracketed to indicate that the words may be replaced by an appropriate substitute to conform to local practice.

7. One of the most significant differences between this Article and the Convention on International Bills of Exchange and International Promissory Notes is that the statute of limitation under the Convention generally is only four years, rather than the six years provided by this section. See Convention Article 84.

SOUTH CAROLINA REPORTER’S COMMENT

In contrast to former Section 36‑3‑122, this provision does not determine when a cause of action on an instrument accrues. Rather, the provision states the time within which such actions must be commenced. The statutes of limitation are imposed under Subsections (a)‑(f). These provisions vary according to type of instrument being enforced. Subsection (g) addresses actions for conversion, breach of warranty, and other actions for a breach of a duty under Chapter 3 not specifically addressed in another subsection. In some cases the statutes of limitation under this provision are longer than the three‑year period under S.C. Code Section 15‑3‑530 governing most civil actions.

Subsection (a) applies to notes payable at a definite time and provides that an action to enforce the obligation of a party to pay the note must be brought within six years of the due date of the note. If the note has been accelerated the action must be commenced within six years of the accelerated due date. Under this provision the same statute of limitations applies to all parties to an instrument including both makers and indorsers of notes.

Subsection (b) applies to notes payable on demand and provides that an action to enforce the obligation of party to the note must be commenced within six years after the demand. If no demand has been made and neither principal nor interest has been paid for ten years, Subsection (b) provides that an action to enforce the note is barred.

Subsection (c) applies to unaccepted drafts including checks and provides that an action to enforce the obligation of a party to the draft must be commenced before the earlier of three years following dishonor of the draft or 10 years of the date of the draft.

Subsection (d) applies to certified checks, cashier’s checks, and teller’s checks and provides that an action to enforce the obligation of the acceptor of a certified check or the issuer of cashier’s check or teller’s check must be commenced within three years of a demand for payment.

Subsection (e) applies to negotiable certificates of deposit and provides that an action to enforce the obligation of a party to the certificate generally must be commenced within six years of a demand for payment. But if the certificate of deposit states a due date and the maker is not obligated to pay before that date, the six‑year period runs from the due date. This exception is limited because, if the holder of the certificate can obtain payment prior to the due date by paying a penalty, the maker is obligated to pay prior to the due date.

Subsection (f) applies to accepted drafts other than certified checks and provides that an action to enforce the obligation of a party to the draft must be commenced within six years after the due date if the obligation of the acceptor is to pay at a definite time. If the obligation of the acceptor is to pay on demand, the action must be commenced within six years of the date of acceptance.

Subsection (g) provides a three‑year statute of limitations on actions for conversion of an instrument, breach of warranty, and other actions to enforce an obligation under Chapter 3 not specifically addressed in another subsection.

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| Definitional Cross References: |  |
| “Action” | Section 36‑1‑201(1) |
| “Acceptance” | Section 36‑3‑409(a) |
| “Acceptor” | Section 36‑3‑103(a)(1) |
| “Cashier’s check” | Section 36‑3‑104(g) |
| “Certificate of deposit” | Section 36‑3‑104(j) |
| “Certified check” | Section 36‑3‑409(d) |
| “Draft” | Section 36‑3‑104(e) |
| “Instrument” | Section 36‑3‑104(b) |
| “Issuer” | Section 36‑3‑105(c) |
| “Maker” | Section 36‑3‑103(a)(7) |
| “Note” | Section 36‑3‑104(e) |
| “Party” | Section 36‑3‑103(a)(10) |
| “Payable at a definite time” | Section 36‑3‑108(b) |
| “Payable on demand” | Section 36‑3‑108(a) |
| “Payment” | Section 36‑3‑602(a) |
| “Teller’s check” | Section 36‑3‑104(h) |
| “Traveler’s check” | Section 36‑3‑104(i) |

Cross References:

1. The obligation of the maker of a note and the issuer of a cashier’s check. Section 36‑3‑412.

2. The obligation of the acceptor of a draft. Section 36‑3‑413.

3. The obligation of the drawer of an unaccepted draft other than a cashier’s check or other draft drawn on the drawer. Section 36‑3‑414.

4. The obligation of an indorser. Section 36‑3‑415.

5. Dishonor of instruments. Section 36‑3‑502.

6. Conversion of an instrument. Section 36‑3‑420.

7. Presentment warranties. Section 36‑3‑417.

8. Transfer warranties. Section 36‑3‑416.

LIBRARY REFERENCES

Bills and Notes 116 to 135.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 4, 24 to 25, 28, 76, 79 to 105, 234, 238, 249, 313 to 328.

**SECTION 36‑3‑119.** Notice of right to defend action.

In an action for breach of an obligation for which a third person is answerable over pursuant to this chapter or Chapter 4, the defendant may give the third person notice of the litigation in a record, and the person notified may then give similar notice to any other person who is answerable over. If the notice states (i) that the person notified may come in and defend and (ii) that failure to do so will bind the person notified in an action later brought by the person giving the notice as to any determination of fact common to the two litigations, the person notified is so bound unless after seasonable receipt of the notice the person notified does come in and defend.

HISTORY: 1962 Code Section 10.3‑119; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

This section is a restatement of former Section 3‑803.

SOUTH CAROLINA REPORTER’S COMMENT

This section substantially restates former Section 36‑3‑803. The only significant change from prior law is that under current law, the notice to come in and defend the litigation need not be written to be effective.

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| Definitional Cross References: |  |
| “Action” | Section 36‑1‑201(1) |
| “Notice” | Section 36‑1‑201(25) [see now Section 36‑1‑202] |
| “Person” | Section 36‑1‑201(30) |

Cross Reference:

1. The procedure under this provision applicable to claims made under Articles 3 and 4 is comparable to the vouching in provisions applicable to sales and leases of goods under Chapters 2 and 2A. Sections 36‑2‑607(5) and 36‑2A‑516(4).

LIBRARY REFERENCES

Bills and Notes 21, 47, 136, 165, 166.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 5, 7, 106 to 107, 127, 130, 135 to 136, 138.

NOTES OF DECISIONS

In general 1

1. In general

ARTICLE 3 of Uniform Commercial Code (UCC), which governs negotiable instruments, governs a note secured by a mortgage on real property. Swindler v. Swindler (S.C.App. 2003) 355 S.C. 245, 584 S.E.2d 438, rehearing denied. Mortgages And Deeds Of Trust 707

UCC Section 3‑119(2) rejects decisions which have carried the rule about reading contemporaneous writings together to the point of holding that a clause in a mortgage affecting a note destroys the negotiability of the note. The negotiability of an instrument is always determined solely by what appears on the face of the instrument itself, and if it is negotiable by itself, a purchaser without notice of a separate writing is in no way affected by such writing. If the instrument itself states that it is subject to or governed by any other agreement, it is not negotiable under Article 3; but if it merely refers to a separate agreement or states that it arises out of such an agreement, it is negotiable. Northwestern Bank v. Neal (S.C. 1978) 271 S.C. 544, 248 S.E.2d 585.

Where note, executed as separate document along with conditional sales contract, was assigned to bank for valuable consideration and bank sued maker for balance due on note, court held (1) that trial court erred in holding that note and conditional sales contract had merged, thus rendering note nonnegotiable and causing bank not to be holder in due course; (2) that note satisfied requirements of negotiability under UCC Section 3‑104(1); (3) that under UCC Section 3‑119(2), negotiability of note was not affected by separate sales contract; and (4) that since bank had paid value in good faith for note on day it was executed and assignment of note had preceded any notice of claim about merchandise sold, bank was holder in due course under UCC Section 3‑302(1). Northwestern Bank v. Neal (S.C. 1978) 271 S.C. 544, 248 S.E.2d 585.

**SECTIONS 36‑3‑120 to 36‑3‑122.** Omitted by 2008 Act No. 204, Section 2, eff July 1, 2008.

Editor’s Note

Former Section 36‑3‑120 was entitled “Instruments ‘payable through’ bank” and was derived from 1962 Code Section 10.3‑120; 1966 (54) 2716.

Former Section 36‑3‑121 was entitled “Instruments payable at bank” and was derived from 1962 Code Section 10.3‑121; 1966 (54) 2716.

Former Section 36‑3‑122 was entitled “Accrual of cause of action” and was derived from 1962 Code Section 10.3‑122; 1966 (54) 2716.

Part 2

Negotiation, Transfer, and Indorsement

Editor’s Note

2008 Act No. 204 Section 1 provides in part as follows:

“The South Carolina Reporters’ Comments contained in Chapters 3 and 4 of Title 36, may not be reproduced in whole or in part in any form or for inclusions in any material which is offered for sale without the express written permission of the Clerk of the South Carolina Senate.”

2008 Act No. 204, Section 4.A provides as follows:

“This act applies to a transaction occurring on or after the effective date [July 1, 2008] of this act. This act does not apply to a transaction or event, or obligation or duty arising out of or associated with a transaction or event, before the effective date of this act.”

2008 Act No. 204 Section 4.B provides as follows:

“A transaction occurring before the effective date [July 1, 2008] of this act and the rights, obligations, and interests flowing from that transaction are governed by any statute or other law amended or repealed by this act as if repeal or amendment had not occurred and may be terminated, completed, consummated, or enforced under that statute or other law.”

**SECTION 36‑3‑201.** Negotiation.

(a) “Negotiation” means a transfer of possession, whether voluntary or involuntary, of an instrument by a person other than the issuer to a person who thereby becomes its holder.

(b) Except for negotiation by a remitter, if an instrument is payable to an identified person, negotiation requires transfer of possession of the instrument and its indorsement by the holder. If an instrument is payable to bearer, it may be negotiated by transfer of possession alone.

HISTORY: 1962 Code Section 10.3‑201; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. Subsections (a) and (b) are based in part on subsection (1) of former Section 3‑202. A person can become holder of an instrument when the instrument is issued to that person, or the status of holder can arise as the result of an event that occurs after issuance. “Negotiation” is the term used in Article 3 to describe this post‑issuance event. Normally, negotiation occurs as the result of a voluntary transfer of possession of an instrument by a holder to another person who becomes the holder as a result of the transfer. Negotiation always requires a change in possession of the instrument because nobody can be a holder without possessing the instrument, either directly or through an agent. But in some cases the transfer of possession is involuntary and in some cases the person transferring possession is not a holder. In defining “negotiation” former Section 3‑202(1) used the word “transfer,” an undefined term, and “delivery,” defined in Section 1‑201(14) to mean voluntary change of possession. Instead, subsections (a) and (b) use the term “transfer of possession” and, subsection (a) states that negotiation can occur by an involuntary transfer of possession. For example, if an instrument is payable to bearer and it is stolen by Thief or is found by Finder, Thief or Finder becomes the holder of the instrument when possession is obtained. In this case there is an involuntary transfer of possession that results in negotiation to Thief or Finder.

2. In most cases negotiation occurs by a transfer of possession by a holder or remitter. Remitter transactions usually involve a cashier’s or teller’s check. For example, Buyer buys goods from Seller and pays for them with a cashier’s check of Bank that Buyer buys from Bank. The check is issued by Bank when it is delivered to Buyer, regardless of whether the check is payable to Buyer or to Seller. Section 3‑105(a). If the check is payable to Buyer, negotiation to Seller is done by delivery of the check to Seller after it is indorsed by Buyer. It is more common, however, that the check when issued will be payable to Seller. In that case Buyer is referred to as the “remitter.” Section 3‑103(a)(11). The remitter, although not a party to the check, is the owner of the check until ownership is transferred to Seller by delivery. This transfer is a negotiation because Seller becomes the holder of the check when Seller obtains possession. In some cases Seller may have acted fraudulently in obtaining possession of the check. In those cases Buyer may be entitled to rescind the transfer to Seller because of the fraud and assert a claim of ownership to the check under Section 3‑306 against Seller or a subsequent transferee of the check. Section 3‑202(b) provides for rescission of negotiation, and that provision applies to rescission by a remitter as well as by a holder.

3. Other sections of Article 3 may modify the rule stated in the first sentence of subsection (b). See for example, Sections 3‑404, 3‑405 and 3‑406.

SOUTH CAROLINA REPORTER’S COMMENT

This provision revises the definition of “negotiation” and the requirements for negotiating order and bearer instruments that were set forth in former Section 36‑3‑202(1). Subsection (a) clarifies prior law by providing that, for purposes of negotiation, a transfer of possession may be an involuntary as well as a voluntary delivery. As a result, a thief who steals a bearer instrument is a holder. See Section 36‑3‑202(a). Subsection (b) clarifies prior law relating to the negotiation of an order instrument by a remitter. Under Subsection (b), a remitter can negotiate a cashier’s or teller’s check payable to the order of a person other than the remitter without indorsing the instrument.

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| Definitional Cross References: |  |
| “Holder” | Section 36‑1‑201(20) |
| “Indorsement” | Section 36‑3‑204(a) |
| “Instrument” | Section 36‑3‑104(b) |
| “Issuer” | Section 36‑3‑105(c) |
| “Payable to bearer” | Section 36‑3‑109(a) |
| “Payable to an identified person” | Section 36‑3‑109(b) |
| “Person” | Section 36‑1‑201(30) |
| “Remitter” | Section 36‑3‑103(a)(15) |
| “Transfer of instrument” | Section 36‑3‑203(a) |

Cross References

1. Rescission of negotiation. Section 36‑3‑202(b).

2. Transfer of instrument. Section 36‑3‑203.

3. Person entitled to enforce an instrument. Section 36‑3‑301.

LIBRARY REFERENCES

Bills and Notes 195 to 202, 220 to 222, 363.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 29, 144, 150 to 151, 155, 159, 190, 201.

RESEARCH REFERENCES

Encyclopedias

S.C. Jur. Mortgages Section 168, Construction.

Forms

Am. Jur. Pl. & Pr. Forms Uniform Commercial Code Section 3:66 , Introductory Comments.

NOTES OF DECISIONS

In general 1

1. In general

Bank serving as successor indenture trustee for trust holding pool of mortgages was holder entitled to enforce mortgagor’s promissory note, under former version of South Carolina’s version of Uniform Commercial Code (UCC), where bank assumed all right, title, and interest of resigning trustee pursuant to agreement, under agreement bank became trustee of trust, documents in trust were held by custodian for trust, giving bank constructive possession through custodian, as its agent, from which bank could obtain note at any time simply by requesting it, and instruments were transferred to trust with clear intention to transfer title to trust. In re McFadden (Bkrtcy.D.S.C. 2012) 471 B.R. 136. Bills And Notes 443(1); Mortgages And Deeds Of Trust 1205

There was neither legal transfer of notes under Section 36‑3‑202, nor perfection of security interest in notes under Section 36‑9‑304, where notes had never been assigned from decedent to wife and were thus property of estate of decedent, because assignment of mortgage as distinct from debt it secures is nugatory and confers no rights upon transferee absent some indication that parties also intended to transfer debt; there was no intent, based on record, that decedent intended to assign notes to wife to secure mortgage where record showed that decedent was aware that assignment of mortgage should also be accompanied by assignment of notes; most telling indication of decedent’s intention was fact that he did not give possession of notes to wife. South Carolina Nat. Bank v. Halter (S.C.App. 1987) 293 S.C. 121, 359 S.E.2d 74.

**SECTION 36‑3‑202.** Negotiation subject to rescission.

(a) Negotiation is effective even if obtained (i) from an infant, a corporation exceeding its powers, or a person without capacity, (ii) by fraud, duress, or mistake, or (iii) in breach of duty or as part of an illegal transaction.

(b) To the extent permitted by other law, negotiation may be rescinded or may be subject to other remedies, but those remedies may not be asserted against a subsequent holder in due course or a person paying the instrument in good faith and without knowledge of facts that are a basis for rescission or other remedy.

HISTORY: 1962 Code Section 10.3‑202; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. This section is based on former Section 3‑207. Subsection (2) of former Section 3‑207 prohibited rescission of a negotiation against holders in due course. Subsection (b) of Section 3‑202 extends this protection to payor banks.

2. Subsection (a) applies even though the lack of capacity or the illegality, is of a character which goes to the essence of the transaction and makes it entirely void. It is inherent in the character of negotiable instruments that any person in possession of an instrument which by its terms is payable to that person or to bearer is a holder and may be dealt with by anyone as a holder. The principle finds its most extreme application in the well settled rule that a holder in due course may take the instrument even from a thief and be protected against the claim of the rightful owner. The policy of subsection (a) is that any person to whom an instrument is negotiated is a holder until the instrument has been recovered from that person’s possession. The remedy of a person with a claim to an instrument is to recover the instrument by replevin or otherwise; to impound it or to enjoin its enforcement, collection or negotiation; to recover its proceeds from the holder; or to intervene in any action brought by the holder against the obligor. As provided in Section 3‑305(c), the claim of the claimant is not a defense to the obligor unless the claimant defends the action.

3. There can be no rescission or other remedy against a holder in due course or a person who pays in good faith and without notice, even though the prior negotiation may have been fraudulent or illegal in its essence and entirely void. As against any other party the claimant may have any remedy permitted by law. This section is not intended to specify what that remedy may be, or to prevent any court from imposing conditions or limitations such as prompt action or return of the consideration received. All such questions are left to the law of the particular jurisdiction. Section 3‑202 gives no right that would not otherwise exist. The section is intended to mean that any remedies afforded by other law are cut off only by a holder in due course.

SOUTH CAROLINA REPORTER’S COMMENT

Subsection (a) restates former Section 36‑3‑207(1) and provides that a negotiation is effective even if obtained through illegal conduct. Subsection (b) revises former Section 36‑3‑207(2) and provides protection from rescission not only to a holder in due course but also to a payor bank that pays an instrument in good faith and without knowledge of the facts that form the basis of the rescission claim.

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| Definitional Cross References: |  |
| “Good Faith” | Section 36‑3‑103(a)(6) |
| “Holder in due course” | Section 36‑3‑302(a) |
| “Instrument” | Section 36‑3‑104(b) |
| “Knowledge” | Section 36‑1‑201(25) [see now Section 36‑1‑202] |
| “Negotiation” | Section 36‑3‑201(a) |
| “Person” | Section 36‑1‑201(30) |

Cross References

1. A holder in due course takes free of all claims to an instrument including claims for rescission of negotiation under Section 36‑3‑202(b). Section 36‑3‑306.

LIBRARY REFERENCES

Bills and Notes 176, 184, 187 to 189, 203, 209 to 212, 248, 287 to 295, 330.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 24 to 25, 139 to 140, 143 to 157, 159 to 160, 170, 201.

RESEARCH REFERENCES

Encyclopedias

S.C. Jur. Assignments Section 53, Partial Assignments.

S.C. Jur. Mortgages Section 165, Form.

S.C. Jur. Mortgages Section 167, Validity.

S.C. Jur. Mortgages Section 168, Construction.

Treatises and Practice Aids

11 Causes of Action 143, Cause of Action Against Bank for Payment of Check Over Unauthorized or Missing Endorsement.

LAW REVIEW AND JOURNAL COMMENTARIES

Hiller, The check is ... on the telephone? 47 S.C. L. Rev. 305, Winter 1996.

Notes of Decisions

Prior law 1

1. Prior law

Under former version of South Carolina’s version of Uniform Commercial Code (UCC), indorsement of promissory note underlying mortgage was properly negotiated, where allonge containing indorsement from original lender to mortgage company was attached to note, original lender signed allonge, and note was delivered to mortgage company. In re McFadden (Bkrtcy.D.S.C. 2012) 471 B.R. 136. Bills And Notes 183; Bills And Notes 184; Mortgages And Deeds Of Trust 1408

Promissory note underlying mortgage was properly negotiated by second indorsement in its chain of title under former version of South Carolina’s version of Uniform Commercial Code (UCC), where indorsement was on face of note, indorsement was by representative of then‑current holder of note, and note was delivered to bank as custodian for trustee of trust holding pool of mortgages, even though indorsement was not dated and indorsement contained scrivener’s error in its reference to trust. In re McFadden (Bkrtcy.D.S.C. 2012) 471 B.R. 136. Bills And Notes 182; Bills And Notes 183; Bills And Notes 184; Mortgages And Deeds Of Trust 1472

Final indorsement in chain of title for promissory note underlying mortgage, made by second allonge attached to note evidencing change in indenture trustee for trust holding pool of mortgages into which mortgage loan had been transferred, was unnecessary under former version of South Carolina’s version of Uniform Commercial Code (UCC); at the time of allonge’s execution, loan had already been transferred into trust and remained there despite change in trustee. In re McFadden (Bkrtcy.D.S.C. 2012) 471 B.R. 136. Bills And Notes 183; Mortgages And Deeds Of Trust 1472

**SECTION 36‑3‑203.** Transfer of instrument; rights acquired by transfer.

(a) An instrument is transferred when it is delivered by a person other than its issuer for the purpose of giving to the person receiving delivery the right to enforce the instrument.

(b) Transfer of an instrument, whether or not the transfer is a negotiation, vests in the transferee any right of the transferor to enforce the instrument, including any right as a holder in due course, but the transferee cannot acquire rights of a holder in due course by a transfer, directly or indirectly, from a holder in due course if the transferee engaged in fraud or illegality affecting the instrument.

(c) Unless otherwise agreed, if an instrument is transferred for value and the transferee does not become a holder because of lack of indorsement by the transferor, the transferee has a specifically enforceable right to the unqualified indorsement of the transferor, but negotiation of the instrument does not occur until the indorsement is made.

(d) If a transferor purports to transfer less than the entire instrument, negotiation of the instrument does not occur. The transferee obtains no rights under this chapter and has only the rights of a partial assignee.

HISTORY: 1962 Code Section 10.3‑203; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENTS

1. Section 3‑203 is based on former Section 3‑201 which stated that a transferee received such rights as the transferor had. The former section was confusing because some rights of the transferor are not vested in the transferee unless the transfer is a negotiation. For example, a transferee that did not become the holder could not negotiate the instrument, a right that the transferor had. Former Section 3‑201 did not define “transfer.” Subsection (a) defines transfer by limiting it to cases in which possession of the instrument is delivered for the purpose of giving to the person receiving delivery the right to enforce the instrument.

Although transfer of an instrument might mean in a particular case that title to the instrument passes to the transferee, that result does not follow in all cases. The right to enforce an instrument and ownership of the instrument are two different concepts. A thief who steals a check payable to bearer becomes the holder of the check and a person entitled to enforce it, but does not become the owner of the check. If the thief transfers the check to a purchaser the transferee obtains the right to enforce the check. If the purchaser is not a holder in due course, the owner’s claim to the check may be asserted against the purchaser. Ownership rights in instruments may be determined by principles of the law of property, independent of Article 3, which do not depend upon whether the instrument was transferred under Section 3‑203. Moreover, a person who has an ownership right in an instrument might not be a person entitled to enforce the instrument. For example, suppose X is the owner and holder of an instrument payable to X. X sells the instrument to Y but is unable to deliver immediate possession to Y. Instead, X signs a document conveying all of X’s right, title, and interest in the instrument to Y. Although the document may be effective to give Y a claim to ownership of the instrument, Y is not a person entitled to enforce the instrument until Y obtains possession of the instrument. No transfer of the instrument occurs under Section 3‑203(a) until it is delivered to Y.

An instrument is a reified right to payment. The right is represented by the instrument itself. The right to payment is transferred by delivery of possession of the instrument “by a person other than its issuer for the purpose of giving to the person receiving delivery the right to enforce the instrument.” The quoted phrase excludes issue of an instrument, defined in Section 3‑105, and cases in which a delivery of possession is for some purpose other than transfer of the right to enforce. For example, if a check is presented for payment by delivering the check to the drawee, no transfer of the check to the drawee occurs because there is no intent to give the drawee the right to enforce the check.

2. Subsection (b) states that transfer vests in the transferee any right of the transferor to enforce the instrument “including any right as a holder in due course.” If the transferee is not a holder because the transferor did not indorse, the transferee is nevertheless a person entitled to enforce the instrument under Section 3‑301 if the transferor was a holder at the time of transfer. Although the transferee is not a holder, under subsection (b) the transferee obtained the rights of the transferor as holder. Because the transferee’s rights are derivative of the transferor’s rights, those rights must be proved. Because the transferee is not a holder, there is no presumption under Section 3‑308 that the transferee, by producing the instrument, is entitled to payment. The instrument, by its terms, is not payable to the transferee and the transferee must account for possession of the unindorsed instrument by proving the transaction through which the transferee acquired it. Proof of a transfer to the transferee by a holder is proof that the transferee has acquired the rights of a holder. At that point the transferee is entitled to the presumption under Section 3‑308.

Under subsection (b) a holder in due course that transfers an instrument transfers those rights as a holder in due course to the purchaser. The policy is to assure the holder in due course a free market for the instrument. There is one exception to this rule stated in the concluding clause of subsection (b). A person who is party to fraud or illegality affecting the instrument is not permitted to wash the instrument clean by passing it into the hands of a holder in due course and then repurchasing it.

3. Subsection (c) applies only to a transfer for value. It applies only if the instrument is payable to order or specially indorsed to the transferor. The transferee acquires, in the absence of a contrary agreement, the specifically enforceable right to the indorsement of the transferor. Unless otherwise agreed, it is a right to the general indorsement of the transferor with full liability as indorser, rather than to an indorsement without recourse. The question may arise if the transferee has paid in advance and the indorsement is omitted fraudulently or through oversight. A transferor who is willing to indorse only without recourse or unwilling to indorse at all should make those intentions clear before transfer. The agreement of the transferee to take less than an unqualified indorsement need not be an express one, and the understanding may be implied from conduct, from past practice, or from the circumstances of the transaction. Subsection (c) provides that there is no negotiation of the instrument until the indorsement by the transferor is made. Until that time the transferee does not become a holder, and if earlier notice of a defense or claim is received, the transferee does not qualify as a holder in due course under Section 3‑302.

4. The operation of Section 3‑203 is illustrated by the following cases. In each case Payee, by fraud, induced Maker to issue a note to Payee. The fraud is a defense to the obligation of Maker to pay the note under Section 3‑305(a)(2).

Case # 1. Payee negotiated the note to X who took as a holder in due course. After the instrument became overdue X negotiated the note to Y who had notice of the fraud. Y succeeds to X’s rights as a holder in due course and takes free of Maker’s defense of fraud.

Case # 2. Payee negotiated the note to X who took as a holder in due course. Payee then repurchased the note from X. Payee does not succeed to X’s rights as a holder in due course and is subject to Maker’s defense of fraud.

Case # 3. Payee negotiated the note to X who took as a holder in due course. X sold the note to Purchaser who received possession. The note, however, was indorsed to X and X failed to indorse it. Purchaser is a person entitled to enforce the instrument under Section 3‑301 and succeeds to the rights of X as holder in due course. Purchaser is not a holder, however, and under Section 3‑308 Purchaser will have to prove the transaction with X under which the rights of X as holder in due course were acquired.

Case # 4. Payee sold the note to Purchaser who took for value, in good faith and without notice of the defense of Maker. Purchaser received possession of the note but Payee neglected to indorse it. Purchaser became a person entitled to enforce the instrument but did not become the holder because of the missing indorsement. If Purchaser received notice of the defense of Maker before obtaining the indorsement of Payee, Purchaser cannot become a holder in due course because at the time notice was received the note had not been negotiated to Purchaser. If indorsement by Payee was made after Purchaser received notice, Purchaser had notice of the defense when it became the holder.

5. Subsection (d) restates former Section 3‑202(3). The cause of action on an instrument cannot be split. Any indorsement which purports to convey to any party less than the entire amount of the instrument is not effective for negotiation. This is true of either “Pay A one‑half,” or “Pay A two‑thirds and B one‑third.” Neither A nor B becomes a holder. On the other hand an indorsement reading merely “Pay A and B” is effective, since it transfers the entire cause of action to A and B as tenants in common. An indorsement purporting to convey less than the entire instrument does, however, operate as a partial assignment of the cause of action. Subsection (d) makes no attempt to state the legal effect of such an assignment, which is left to other law. A partial assignee of an instrument has rights only to the extent the applicable law gives rights, either at law or in equity, to a partial assignee.

6. The rules for transferring instruments set out in this section are similar to the rules in Article 13 of the Convention on International Bills of Exchange and International Promissory Notes.

SOUTH CAROLINA REPORTER’S COMMENT

This provision is based upon former Sections 36‑3‑201 and 36‑3‑202(3). Subsection (a) adds a definition determining when an instrument is transferred. Subsection (b) restates and clarifies the provisions in former Section 36‑3‑201(1) defining the rights of a transferee of an instrument. Subsection (c) restates and clarifies the right of a transferee of order paper for value to an unqualified indorsement of the instrument. Subsection (d) restates the rule in former Section 36‑3‑202(3) that transfer of less than the transferor’s entire interest in an instrument cannot qualify as a negotiation.

In South Carolina National Bank v. Halter, 293 S.C. 121, 359 S.E.2d 74 (S. C. App. 1987), the court asserted that a legal interest in promissory notes could be transferred only by negotiation of the notes under former Section 36‑3‑202. Under the current statute, ownership of an instrument can be transferred without negotiation. In South Carolina National Bank v. Halter, the purported assignee of the note never obtained possession of the notes. Under current law, the lack of possession would not only preclude the assignee from taking by negotiation under Section 36‑3‑201(a) but would also preclude the assignee from taking by transfer under Section 36‑3‑203(a). For a person to qualify as a transferee of an instrument, the instrument must be delivered to that person. Section 36‑1‑201(14) defines delivery of an instrument as a “voluntary transfer of possession.” It should be noted, however, that under the current statute a person can be a holder of an instrument but not the owner and a person can be the owner of an instrument but not a holder. See Official Comment 1 to this section.

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| Definitional Cross References: |  |
| “Delivery” | Section 36‑1‑201(14) |
| “Holder” | Section 36‑1‑201(20) |
| “Holder in due course” | Section 36‑3‑302(a) |
| “Indorsement” | Section 36‑3‑204(a) |
| “Instrument” | Section 36‑3‑104(b) |
| “Issuer” | Section 36‑3‑105(c) |
| “Negotiation” | Section 36‑3‑201(a) |
| “Person” | Section 36‑1‑201(30) |
| “Rights” | Section 36‑1‑201(36) |
| “Transferred for value” | Section 36‑3‑303(a) |

Cross Reference:

1. A person who received a transfer of an instrument from a holder is a “person entitled to enforce” the instrument. Section 36‑3‑301(ii).

LIBRARY REFERENCES

Bills and Notes 153, 183.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 128, 147, 149.

RESEARCH REFERENCES

Encyclopedias

125 Am. Jur. Trials 541, Litigation Concerning Mortgage Foreclosures.

NOTES OF DECISIONS

In general 1

Standing 2

1. In general

Mortgage loan servicer, which had received delivery and taken possession of original promissory note for purpose of enforcing it on behalf of holder, had right to enforce note under South Carolina’s version of Uniform Commercial Code (UCC) as nonholder in possession with rights of holder. In re Neals (Bkrtcy.D.S.C. 2011) 459 B.R. 612. Mortgages And Deeds Of Trust 1221

Under South Carolina law, prepetition transfer of Chapter 7 debtor’s promissory note to loan servicer, by endorsement in blank, gave servicer right to payment under note, and therefore servicer, which had possession of note and mortgage at the time it moved for automatic stay relief, was “creditor” for purposes of determining whether it was party in interest with standing to seek stay relief. In re Woodberry (Bkrtcy.D.S.C. 2008) 383 B.R. 373. Bankruptcy 2438; Mortgages And Deeds Of Trust 1414; Mortgages And Deeds Of Trust 1443

A bank which cashed payroll checks fraudulently drawn by an employee of the drawer was entitled, based on the application of “the padded payroll defense” (Section 36‑3‑405[1][c]), to a directed verdict in an action by the drawer, even though it failed to meet its own guidelines of identification and authorization in cashing the checks, since Section 36‑1‑201(19) defines “good faith” as “honesty in fact in the conduct or transaction concerned,” and the bank’s failure to enforce its rules against a known employee was at most mere negligence. Stone Mfg. Co. v. NCNB of South Carolina (S.C.App. 1992) 308 S.C. 287, 417 S.E.2d 628.

2. Standing

Mortgage loan servicer, in addition to right to enforce Chapter 13 debtors’ note, had significant interest in seeking relief from automatic stay, as required for it to be “real party in interest” and thus “party in interest” with standing to seek stay relief, given servicer’s pecuniary interest in collecting past‑due payments under terms of note and mortgage and enforcing terms of note, which it was prevented by stay from doing through initiation of foreclosure proceedings or other means. In re Neals (Bkrtcy.D.S.C. 2011) 459 B.R. 612. Bankruptcy 2438

**SECTION 36‑3‑204.** Indorsement.

(a) “Indorsement” means a signature, other than that of a signer as maker, drawer, or acceptor, that alone or accompanied by other words is made on an instrument for the purpose of (i) negotiating the instrument, (ii) restricting payment of the instrument, or (iii) incurring indorser’s liability on the instrument, but regardless of the intent of the signer, a signature and its accompanying words is an indorsement unless the accompanying words, terms of the instrument, place of the signature, or other circumstances unambiguously indicate that the signature was made for a purpose other than indorsement. For the purpose of determining whether a signature is made on an instrument, a paper affixed to the instrument is a part of the instrument.

(b) “Indorser” means a person who makes an indorsement.

(c) For the purpose of determining whether the transferee of an instrument is a holder, an indorsement that transfers a security interest in the instrument is effective as an unqualified indorsement of the instrument.

(d) If an instrument is payable to a holder under a name that is not the name of the holder, indorsement may be made by the holder in the name stated in the instrument or in the holder’s name or both, but signature in both names may be required by a person paying or taking the instrument for value or collection.

HISTORY: 1962 Code Section 10.3‑204; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. Subsection (a) is a definition of “indorsement,” a term which was not defined in former Article 3. Indorsement is defined in terms of the purpose of the signature. If a blank or special indorsement is made to give rights as a holder to a transferee the indorsement is made for the purpose of negotiating the instrument. Subsection (a)(i). If the holder of a check has an account in the drawee bank and wants to be sure that payment of the check will be made by credit to the holder’s account, the holder can indorse the check by signing the holder’s name with the accompanying words “for deposit only” before presenting the check for payment to the drawee bank. In that case the purpose of the quoted words is to restrict payment of the instrument. Subsection (a)(ii). If X wants to guarantee payment of a note signed by Y as maker, X can do so by signing X’s name to the back of the note as an indorsement. This indorsement is known as an anomalous indorsement (Section 3‑205(d)) and is made for the purpose of incurring indorser’s liability on the note. Subsection (a)(iii). In some cases an indorsement may serve more than one purpose. For example, if the holder of a check deposits it to the holder’s account in a depositary bank for collection and indorses the check by signing the holder’s name with the accompanying words “for deposit only” the purpose of the indorsement is both to negotiate the check to the depositary bank and to restrict payment of the check.

The “but” clause of the first sentence of subsection (a) elaborates on former Section 3‑402. In some cases it may not be clear whether a signature was meant to be that of an indorser, a party to the instrument in some other capacity such as drawer, maker or acceptor, or a person who was not signing as a party. The general rule is that a signature is an indorsement if the instrument does not indicate an unambiguous intent of the signer not to sign as an indorser. Intent may be determined by words accompanying the signature, the place of signature, or other circumstances. For example, suppose a depositary bank gives cash for a check properly indorsed by the payee. The bank requires the payee’s employee to sign the back of the check as evidence that the employee received the cash. If the signature consists only of the initials of the employee it is not reasonable to assume that it was meant to be an indorsement. If there was a full signature but accompanying words indicated that it was meant as a receipt for the cash given for the check, it is not an indorsement. If the signature is not qualified in any way and appears in the place normally used for indorsements, it may be an indorsement even though the signer intended the signature to be a receipt. To take another example, suppose the drawee of a draft signs the draft on the back in the space usually used for indorsements. No words accompany the signature. Since the drawee has no reason to sign a draft unless the intent is to accept the draft, the signature is effective as an acceptance. Custom and usage may be used to determine intent. For example, by long‑established custom and usage, a signature in the lower right hand corner of an instrument indicates an intent to sign as the maker of a note or the drawer of a draft. Any similar clear indication of an intent to sign in some other capacity or for some other purpose may establish that a signature is not an indorsement. For example, if the owner of a traveler’s check countersigns the check in the process of negotiating it, the countersignature is not an indorsement. The countersignature is a condition to the issuer’s obligation to pay and its purpose is to provide a means of verifying the identify of the person negotiating the traveler’s check by allowing comparison of the specimen signature and the countersignature. The countersignature is not necessary for negotiation and the signer does not incur indorser’s liability. See Comment 2 to Section 3‑106.

The last sentence of subsection (a) is based on subsection (2) of former Section 3‑202. An indorsement on an allonge is valid even though there is sufficient space on the instrument for an indorsement.

2. Assume that Payee indorses a note to Creditor as security for a debt. Under subsection (b) of Section 3‑203 Creditor takes Payee’s rights to enforce or transfer the instrument subject to the limitations imposed by Article 9. Subsection (c) of Section 3‑204 makes clear that Payee’s indorsement to Creditor, even though it mentions creation of a security interest, is an unqualified indorsement that gives to Creditor the right to enforce the note as its holder.

3. Subsection (d) is a restatement of former Section 3‑203. Section 3‑110(a) states that an instrument is payable to the person intended by the person signing as or in the name or behalf of the issuer even if that person is identified by a name that is not the true name of the person. In some cases the name used in the instrument is a misspelling of the correct name and in some cases the two names may be entirely different. The payee may indorse in the name used in the instrument, in the payee’s correct name, or in both. In each case the indorsement is effective. But because an indorsement in a name different from that used in the instrument may raise a question about its validity and an indorsement in a name that is not the correct name of the payee may raise a problem of identifying the indorser, the accepted commercial practice is to indorse in both names. Subsection (d) allows a person paying or taking the instrument for value or collection to require indorsement in both names.

SOUTH CAROLINA REPORTER’S COMMENT

Subsection (a) defines the term “indorsement” and is based in part on former Section 36‑3‑202(2). Subsection (b) defines the term “indorser.” Subsection (c) provides that an indorsement that transfers a security interest in an instrument is effective as an unqualified indorsement for the purpose of determining whether the transferee is a holder. Subsection (d) is a restatement of former Section 36‑3‑203 on a wrong or misspelled name of the payee.

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| Definitional Cross References: |  |
| “Acceptor” | Section 36‑3‑103(a)(1) |
| “Drawer” | Section 36‑3‑103(a)(5) |
| “Holder” | Section 36‑1‑201(20) |
| “Instrument” | Section 36‑3‑104(b) |
| “Maker” | Section 36‑3‑103(a)(7) |
| “Negotiation” | Section 36‑3‑201(a) |
| “Payment” | Section 36‑3‑602(a) |
| “Person” | Section 36‑1‑201(30) |
| “Security interest” | Section 36‑1‑201(37) [see now Section 36‑1‑203] |
| “Signed” | Section 36‑1‑201(39) |
| “Value” | Section 36‑3‑303(a) |

Cross References:

1. Special indorsements. Section 36‑3‑205(a).

2. Blank indorsements. Section 36‑3‑205(b).

3. Indorsing an instrument for the purpose of incurring liability on the instrument as an accommodation party. Sections 36‑3‑419 and 36‑3‑205(d).

4. Indorsing an instrument for the purpose of restricting the payment of the instrument. Section 36‑3‑206.

LIBRARY REFERENCES

Bills and Notes 170, 188, 189.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 148, 152 to 153, 159.

RESEARCH REFERENCES

ALR Library

46 ALR 1498 , Sufficiency of Signing or Indorsing Bill or Note by Printing or Stamping.

NOTES OF DECISIONS

In general 3/4

Blank endorsement 1

Signatures on allonges 2

3 4. In general

“No space test,” providing that indorsements must be made in blank space on promissory note if there is space on note, does not apply under South Carolina law. In re McFadden (Bkrtcy.D.S.C. 2012) 471 B.R. 136. Bills and Notes 183

1. Blank endorsement

Under South Carolina law, “allonge to note,” which contained blank endorsement stating “pay to the order of without recourse,” converted mortgagor’s promissory note to bearer instrument, and therefore ownership of note passed with delivery of instrument, and proof of ownership could be made by possession; no written assignment of mortgage was required. In re Woodberry (Bkrtcy.D.S.C. 2008) 383 B.R. 373. Bills And Notes 211; Mortgages And Deeds Of Trust 1406; Mortgages And Deeds Of Trust 1414; Mortgages And Deeds Of Trust 1523

2. Signatures on allonges

Under South Carolina’s version of Uniform Commercial Code (UCC), stapling of allonges to promissory note underlying mortgage was sufficient to “affix” allonges to note, as required for signatures on allonges to be indorsements on note. In re McFadden (Bkrtcy.D.S.C. 2012) 471 B.R. 136. Bills And Notes 183; Mortgages And Deeds Of Trust 1408

Existence of multiple sets of staple holes in promissory note and attached allonges did not establish that allonges were not properly affixed to note, as required for signatures on allonges to be indorsements on note under South Carolina’s version of Uniform Commercial Code (UCC); there was no evidence that allonges were attached in anticipation of litigation, and it was reasonable to expect that staples would be removed from documents containing multiple pages when documents were photocopied or electronically imaged, as occurred with note and allonges. In re McFadden (Bkrtcy.D.S.C. 2012) 471 B.R. 136. Bills and Notes 183

**SECTION 36‑3‑205.** Special indorsement; blank indorsement; anomalous indorsement.

(a) If an indorsement is made by the holder of an instrument, whether payable to an identified person or payable to bearer, and the indorsement identifies a person to whom it makes the instrument payable, it is a “special indorsement.” When specially indorsed, an instrument becomes payable to the identified person and may be negotiated only by the indorsement of that person. The principles stated in Section 36‑3‑110 apply to special indorsements.

(b) If an indorsement is made by the holder of an instrument and it is not a special indorsement, it is a “blank indorsement.” When indorsed in blank, an instrument becomes payable to bearer and may be negotiated by transfer of possession alone until specially indorsed.

(c) The holder may convert a blank indorsement that consists only of a signature into a special indorsement by writing, above the signature of the indorser, words identifying the person to whom the instrument is made payable.

(d) “Anomalous indorsement” means an indorsement made by a person who is not the holder of the instrument. An anomalous indorsement does not affect the manner in which the instrument may be negotiated.

HISTORY: 1962 Code Section 10.3‑205; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. Subsection (a) is based on subsection (1) of former Section 3‑204. It states the test of a special indorsement to be whether the indorsement identifies a person to whom the instrument is payable. Section 3‑110 states rules for identifying the payee of an instrument. Section 3‑205(a) incorporates the principles stated in Section 3‑110 in identifying an indorsee. The language of Section 3‑110 refers to language used by the issuer of the instrument. When that section is used with respect to an indorsement, Section 3‑110 must be read as referring to the language used by the indorser.

2. Subsection (b) is based on subsection (2) of former Section 3‑204. An indorsement made by the holder is either a special or blank indorsement. If the indorsement is made by a holder and is not a special indorsement, it is a blank indorsement. For example, the holder of an instrument, intending to make a special indorsement, writes the words “Pay to the order of” without completing the indorsement by writing the name of the indorsee. The holder’s signature appears under the quoted words. The indorsement is not a special indorsement because it does not identify a person to whom it makes the instrument payable. Since it is not a special indorsement it is a blank indorsement and the instrument is payable to bearer. The result is analogous to that of a check in which the name of the payee is left blank by the drawer. In that case the check is payable to bearer. See the last paragraphs of Comment 2 to Section 3‑115.

A blank indorsement is usually the signature of the indorser on the back of the instrument without other words. Subsection (c) is based on subsection (3) of former Section 3‑204. A “restrictive indorsement” described in Section 3‑206 can be either a blank indorsement or a special indorsement. “Pay to T, in trust for B” is a restrictive indorsement. It is also a special indorsement because it identifies T as the person to whom the instrument is payable. “For deposit only” followed by the signature of the payee of a check is a restrictive indorsement. It is also a blank indorsement because it does not identify the person to whom the instrument is payable.

3. The only effect of an “anomalous indorsement,” defined in subsection (d), is to make the signer liable on the instrument as an indorser. Such an indorsement is normally made by an accommodation party. Section 3‑419.

4. Articles 14 and 16 of the Convention on International Bills of Exchange and International Promissory Notes includes similar rules for blank and special indorsements.

SOUTH CAROLINA REPORTER’S COMMENT

Subsection (a) addressing special indorsements is based upon former Section 36‑3‑204(1). Subsection (b) addressing blank indorsements is based upon former Section 36‑3‑204(2). Subsection (c) addressing the right of a holder to convert a blank indorsement into a special indorsement is based upon former Section 36‑3‑204(3). Subsection (d) adds a definition of an “anomalous indorsement” that is significant in determining whether the indorser is an accommodation party.

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| Definitional Cross References: |  |
| “Holder” | Section 36‑1‑201(20) |
| “Indorsement” | Section 36‑3‑204(a) |
| “Instrument” | Section 36‑3‑104(b) |
| “Negotiation” | Section 36‑3‑201(a) |
| “Payable to bearer” | Section 36‑3‑109(a) |
| “Payable to an identified person” | Section 36‑3‑109(b) |
| “Transfer of instrument” | Section 36‑3‑203(a) |

Cross References:

1. A person whose signature on an instrument is an anomalous indorsement is presumed to be an accommodation party. Section 36‑3‑419(c).

2. When an instrument is specially indorsed, the intent of the indorser determines the person to whom the instrument is payable. Section 36‑3‑110.

LIBRARY REFERENCES

Bills and Notes 171, 190.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 154 to 155.

Notes of Decisions

In general 1

1. In general

Under South Carolina law, promissory note secured by mortgage, which contained initial indorsement in blank executed by original holder, was initially bearer instrument that was negotiable by delivery alone, but once was it was specifically indorsed, it was converted to instrument payable to order of specific indorsee, negotiable only by indorsement of specific indorsee. In re Neals (Bkrtcy.D.S.C. 2011) 459 B.R. 612. Mortgages And Deeds Of Trust 1408

**SECTION 36‑3‑206.** Restrictive endorsements.

(a) An indorsement limiting payment to a particular person or otherwise prohibiting further transfer or negotiation of the instrument is not effective to prevent further transfer or negotiation of the instrument.

(b) An indorsement stating a condition to the right of the indorsee to receive payment does not affect the right of the indorsee to enforce the instrument. A person paying the instrument or taking it for value or collection may disregard the condition, and the rights and liabilities of that person are not affected by whether the condition has been fulfilled.

(c) If an instrument bears an indorsement (i) described in Section 36‑4‑201(b), or (ii) in blank or to a particular bank using the words “for deposit,” “for collection,” or other words indicating a purpose of having the instrument collected by a bank for the indorser or for a particular account, the following rules apply:

(1) A person, other than a bank, who purchases the instrument when so indorsed converts the instrument unless the amount paid for the instrument is received by the indorser or applied consistently with the indorsement.

(2) A depositary bank that purchases the instrument or takes it for collection when so indorsed converts the instrument unless the amount paid by the bank with respect to the instrument is received by the indorser or applied consistently with the indorsement.

(3) A payor bank that is also the depositary bank or that takes the instrument for immediate payment over the counter from a person other than a collecting bank converts the instrument unless the proceeds of the instrument are received by the indorser or applied consistently with the indorsement.

(4) Except as otherwise provided in Paragraph (3), a payor bank or intermediary bank may disregard the indorsement and is not liable if the proceeds of the instrument are not received by the indorser or applied consistently with the indorsement.

(d) Except for an indorsement covered by Subsection (c), if an instrument bears an indorsement using words to the effect that payment is to be made to the indorsee as agent, trustee, or other fiduciary for the benefit of the indorser or another person, the following rules apply:

(1) Unless there is notice of breach of fiduciary duty as provided in Section 36‑3‑307, a person who purchases the instrument from the indorsee or takes the instrument from the indorsee for collection or payment may pay the proceeds of payment or the value given for the instrument to the indorsee without regard to whether the indorsee violates a fiduciary duty to the indorser.

(2) A subsequent transferee of the instrument or person who pays the instrument is neither given notice nor otherwise affected by the restriction in the indorsement unless the transferee or payor knows that the fiduciary dealt with the instrument or its proceeds in breach of fiduciary duty.

(e) The presence on an instrument of an indorsement to which this section applies does not prevent a purchaser of the instrument from becoming a holder in due course of the instrument unless the purchaser is a converter under Subsection (c) or has notice or knowledge of breach of fiduciary duty as stated in Subsection (d).

(f) In an action to enforce the obligation of a party to pay the instrument, the obligor has a defense if payment would violate an indorsement to which this section applies and the payment is not permitted by this section.

HISTORY: 1962 Code Section 10.3‑206; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. This section replaces former Sections 3‑205 and 3‑206 and clarifies the law of restrictive indorsements.

2. Subsection (a) provides that an indorsement that purports to limit further transfer or negotiation is ineffective to prevent further transfer or negotiation. If a payee indorses “Pay A only,” A may negotiate the instrument to subsequent holders who may ignore the restriction on the indorsement. Subsection (b) provides that an indorsement that states a condition to the right of a holder to receive payment is ineffective to condition payment. Thus if a payee indorses “Pay A if A ships goods complying with our contract,” the right of A to enforce the instrument is not affected by the condition. In the case of a note, the obligation of the maker to pay A is not affected by the indorsement. In the case of a check, the drawee can pay A without regard to the condition, and if the check is dishonored the drawer is liable to pay A. If the check was negotiated by the payee to A in return for a promise to perform a contract and the promise was not kept, the payee would have a defense or counterclaim against A if the check were dishonored and A sued the payee as indorser, but the payee would have that defense or counterclaim whether or not the condition to the right of A was expressed in the indorsement. Former Section 3‑206 treated a conditional indorsement like indorsements for deposit or collection. In revised Article 3, Section 3‑206(b) rejects that approach and makes the conditional indorsement ineffective with respect to parties other than the indorser and indorsee. Since the indorsements referred to in subsections (a) and (b) are not effective as restrictive indorsements, they are no longer described as restrictive indorsements.

3. The great majority of restrictive indorsements are those that fall within subsection (c) which continues previous law. The depositary bank or the payor bank, if it takes the check for immediate payment over the counter, must act consistently with the indorsement, but an intermediary bank or payor bank that takes the check from a collecting bank is not affected by the indorsement. Any other person is also bound by the indorsement. For example, suppose a check is payable to X, who indorses in blank but writes above the signature the words “For deposit only.” The check is stolen and is cashed at a grocery store by the thief. The grocery store indorses the check and deposits it in Depositary Bank. The account of the grocery store is credited and the check is forwarded to Payor Bank which pays the check. Under subsection (c), the grocery store and Depositary Bank are converters of the check because X did not receive the amount paid for the check. Payor Bank and any intermediary bank in the collection process are not liable to X. This Article does not displace the law of waiver as it may apply to restrictive indorsements. The circumstances under which a restrictive indorsement may be waived by the person who made it is not determined by this Article.

4. Subsection (d) replaces subsection (4) of former Section 3‑206. Suppose Payee indorses a check “Pay to T in trust for B.” T indorses in blank and delivers it to (a) Holder for value; (b) Depositary Bank for collection; or (c) Payor Bank for payment. In each case these takers can safely pay T so long as they have no notice under Section 3‑307 of any breach of fiduciary duty that T may be committing. For example, under subsection (b) of Section 3‑307 these takers have notice of a breach of trust if the check was taken in any transaction known by the taker to be for T’s personal benefit. Subsequent transferees of the check from Holder or Depositary Bank are not affected by the restriction unless they have knowledge that T dealt with the check in breach of trust.

5. Subsection (f) allows a restrictive indorsement to be used as a defense by a person obliged to pay the instrument if that person would be liable for paying in violation of the indorsement.

SOUTH CAROLINA REPORTER’S COMMENT

Subsection (a) provides that an indorsement limiting payment to a particular person or prohibiting further transfer is not effective to prevent further transfer or negotiation of the instrument. This provision is consistent with former Sections 36‑3‑205(b) and 36‑3‑206(1).

Subsection (b) provides that a conditional indorsement does not affect the right of the indorsee to enforce the instrument and that a person taking the instrument for value or collection may disregard the condition. Subsection (b) changes prior law. Under former Section 36‑3‑205(a), a conditional indorsement was a restrictive indorsement and had the same effect as a “for deposit” indorsement.

Subsection (c) is based upon former Sections 36‑3‑205(c) and (d) and 36‑3‑206(2) and (3) and continues prior law. Subsection (c)(1) expressly provides that a person other than a bank who purchases a restrictively indorsed instrument converts the instrument unless the amount paid is received by the indorser or applied consistently with the indorsement. Subsection (c)(2) provides that a depositary bank converts a restrictively indorsed instrument unless the amount paid by the bank is received by the indorser or applied consistently with the indorsement.

Subsection (d) replaces former Section 36‑3‑206(4) and addresses indorsements that provide that payment is to be made to the indorsee as a fiduciary for the indorser or a third party. Under Subsection (d), unless there is notice of a breach of a fiduciary duty, a person purchasing the instrument from the indorsee may pay the proceeds to the indorsee and is not affected by the restriction in the indorsement.

Subsection (e) is consistent with former Section 36‑3‑206(3) and (4) in providing that a restrictive indorsement does not prevent a purchaser of an instrument from qualifying as a holder in due course, unless the purchaser converts the instrument under Subsection (c) or has notice of breach of a fiduciary duty under Subsection (d).

Subsection (f) provides that in an action to enforce an instrument, the obligor can raise the defense that payment would violate a restrictive indorsement.

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| Definitional Cross References: |  |
| “Account” | Section 36‑4‑104(a)(1) |
| “Bank” | Section 36‑1‑201(4) |
| “Blank indorsement” | Section 36‑3‑205(b) |
| “Collecting bank” | Section 36‑4‑105(5) |
| “Depositary bank” | Section 36‑4‑105(2) |
| “Holder in due course” | Section 36‑3‑302(a) |
| “Indorsement” | Section 36‑3‑204(a) |
| “Indorser” | Section 36‑3‑204(b) |
| “Instrument” | Section 36‑3‑104(b) |
| “Knowledge” | Section 36‑1‑201(25) [see now Section 36‑1‑202] |
| “Negotiation” | Section 36‑3‑201(a) |
| “Notice” | Section 36‑1‑201(25) [see now Section 36‑1‑202] |
| “Party” | Section 36‑3‑103(a)(10) |
| “Payment” | Section 36‑3‑602(a) |
| “Payor bank” | Section 36‑4‑105(3) |
| “Person” | Section 36‑1‑201(30) |
| “Rights” | Section 36‑1‑201(36) |
| “Transfer of instrument” | Section 36‑3‑203(a) |
| “Transfer for value” | Section 36‑3‑303(a) |

Cross References

1. An indorsement “pay any bank” is a restrictive indorsement under Section 36‑3‑206(c). A “pay any bank” indorsement prevents a person other than a bank from being a holder of the instrument until it is returned to the customer initiating collection or specially indorsed by a bank to a person who is not a bank. Section 36‑4‑201(b).

2. Conversion of instruments. Section 36‑3‑420.

3. Notice of breach of a fiduciary duty. Section 36‑3‑307.

4. To qualify as a holder in due course, a holder must take the instrument without notice of a claim to the instrument and without notice that any party has a defense or claim of recoupment. Section 36‑3‑302(a)(2)(v) and (vi).

5. A holder in due course takes free of an obligor’s defenses under the provisions of Article 3 against a person other than the holder. Section 36‑3‑305(a)(2) and (b).

6. Effect of instructions on the collection of item. Section 36‑4‑203.

LIBRARY REFERENCES

Bills and Notes 171, 190, 199.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 154 to 155, 159.

**SECTION 36‑3‑207.** Reacquisition.

Reacquisition of an instrument occurs if it is transferred to a former holder, by negotiation or otherwise. A former holder who reacquires the instrument may cancel indorsements made after the reacquirer first became a holder of the instrument. If the cancellation causes the instrument to be payable to the reacquirer or to bearer, the reacquirer may negotiate the instrument. An indorser whose indorsement is canceled is discharged, and the discharge is effective against any subsequent holder.

HISTORY: 1962 Code Section 10.3‑207; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

Section 3‑207 restates former Section 3‑208. Reacquisition refers to cases in which a former holder reacquires the instrument either by negotiation from the present holder or by a transfer other than negotiation. If the reacquisition is by negotiation, the former holder reacquires the status of holder. Although Section 3‑207 allows the holder to cancel all indorsements made after the holder first acquired holder status, cancellation is not necessary. Status of holder is not affected whether or not cancellation is made. But if the reacquisition is not the result of negotiation the former holder can obtain holder status only by striking the former holder’s indorsement and any subsequent indorsements. The latter case is an exception to the general rule that if an instrument is payable to an identified person, the indorsement of that person is necessary to allow a subsequent transferee to obtain the status of holder. Reacquisition without indorsement by the person to whom the instrument is payable is illustrated by two examples:

Case # 1. X, a former holder, buys the instrument from Y, the present holder. Y delivers the instrument to X but fails to indorse it. Negotiation does not occur because the transfer of possession did not result in X’s becoming holder. Section 3‑201(a). The instrument by its terms is payable to Y, not to X. But X can obtain the status of holder by striking X’s indorsement and all subsequent indorsements. When these indorsements are struck, the instrument by its terms is payable either to X or to bearer, depending upon how X originally became holder. In either case X becomes holder. Section 1‑201(20).

Case # 2. X, the holder of an instrument payable to X, negotiates it to Y by special indorsement. The negotiation is part of an underlying transaction between X and Y. The underlying transaction is rescinded by agreement of X and Y, and Y returns the instrument without Y’s indorsement. The analysis is the same as that in Case # 1. X can obtain holder status by cancelling X’s indorsement to Y.

In Case # 1 and Case # 2, X acquired ownership of the instrument after reacquisition, but X’s title was clouded because the instrument by its terms was not payable to X. Normally, X can remedy the problem by obtaining Y’s indorsement, but in some cases X may not be able to conveniently obtain that indorsement. Section 3‑207 is a rule of convenience which relieves X of the burden of obtaining an indorsement that serves no substantive purpose. The effect of cancellation of any indorsement under Section 3‑207 is to nullify it. Thus, the person whose indorsement is canceled is relieved of indorser’s liability. Since cancellation is notice of discharge, discharge is effective even with respect to the rights of a holder in due course. Sections 3‑601 and 3‑604.

SOUTH CAROLINA REPORTER’S COMMENT

This provision restates former Section 36‑3‑208 on the effect of reacquisition of an instrument by a former holder of the instrument.

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| Definitional Cross References: |  |
| “Holder” | Section 36‑1‑201(20) |
| “Indorsement” | Section 36‑3‑204(a) |
| “Indorser” | Section 36‑3‑204(b) |
| “Instrument” | Section 36‑3‑104(b) |
| “Negotiation” | Section 36‑3‑201(a) |
| “Payable to bearer” | Section 36‑3‑109(a) |
| “Transfer of instrument” | Section 36‑3‑203(a) |

Cross References:

1. Effect of discharge against the rights of a subsequent holder in due course. Section 36‑3‑601(b).

2. Discharge by cancellation or renunciation. Section 36‑3‑604.

LIBRARY REFERENCES

Bills and Notes 143, 169, 183, 195, 219, 363.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 108, 147, 149, 159, 190, 201.

**SECTION 36‑3‑208.** Omitted by 2008 Act No. 204, Section 2, eff July 1, 2008.

Editor’s Note

Former Section 36‑3‑208 was entitled “Reacquisition” and was derived from 1962 Code Section 10.3‑208; 1966 (54) 2716.

Part 3

Enforcement of Instruments

Editor’s Note

2008 Act No. 204 Section 1 provides in part as follows:

“The South Carolina Reporters’ Comments contained in Chapters 3 and 4 of Title 36, may not be reproduced in whole or in part in any form or for inclusions in any material which is offered for sale without the express written permission of the Clerk of the South Carolina Senate.”

2008 Act No. 204, Section 4.A provides as follows:

“This act applies to a transaction occurring on or after the effective date [July 1, 2008] of this act. This act does not apply to a transaction or event, or obligation or duty arising out of or associated with a transaction or event, before the effective date of this act.”

2008 Act No. 204 Section 4.B provides as follows:

“A transaction occurring before the effective date [July 1, 2008] of this act and the rights, obligations, and interests flowing from that transaction are governed by any statute or other law amended or repealed by this act as if repeal or amendment had not occurred and may be terminated, completed, consummated, or enforced under that statute or other law.”

**SECTION 36‑3‑301.** Person entitled to enforce instrument.

“Person entitled to enforce” an instrument means (i) the holder of the instrument, (ii) a nonholder in possession of the instrument who has the rights of a holder, or (iii) a person not in possession of the instrument who is entitled to enforce the instrument pursuant to Section 36‑3‑309 or 36‑3‑418(d). A person may be a person entitled to enforce the instrument even though the person is not the owner of the instrument or is in wrongful possession of the instrument.

HISTORY: 1962 Code Section 10.3‑301; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

This section replaces former Section 3‑301 that stated the rights of a holder. The rights stated in former Section 3‑301 to transfer, negotiate, enforce, or discharge an instrument are stated in other sections of Article 3. In revised Article 3, Section 3‑301 defines “person entitled to enforce” an instrument. The definition recognizes that enforcement is not limited to holders. The quoted phrase includes a person enforcing a lost or stolen instrument. Section 3‑309. It also includes a person in possession of an instrument who is not a holder. A nonholder in possession of an instrument includes a person that acquired rights of a holder by subrogation or under Section 3‑203(a). It also includes both a remitter that has received an instrument from the issuer but has not yet transferred or negotiated the instrument to another person and also any other person who under applicable law is a successor to the holder or otherwise acquires the holder’s rights.

SOUTH CAROLINA REPORTER’S COMMENT

This provision replaces in part former Section 36‑3‑301 that defined the rights of a holder. This section addresses only the right to enforce an instrument, but provides that persons in addition to a holder may have the right to enforce an instrument. Under Item (ii), “a nonholder in possession who has the rights of a holder” is entitled to enforce an instrument. In 2002, the Official Comment to this section was amended to include in this class of persons entitled to enforce an instrument “a remitter that has received an instrument from an issuer but has not yet transferred or negotiated the instrument”. This amendment is inconsistent with Official Comment 1, Section 36‑3‑312 that provides that a remitter is not entitled to enforce a cashier’s or teller’s check.

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| Definitional Cross References: |  |
| “Holder” | Section 36‑1‑201(20) |
| “Instrument” | Section 36‑3‑104(b) |
| “Person” | Section 36‑1‑201(30) |

Cross References

1. Discharge by payment of an instrument to a person entitled to enforce the instrument. Section 36‑3‑602(a).

2. Discharge when a person entitled to enforce an instrument renounces the instrument. Section 36‑3‑604.

3. Rights acquired by transfer of an instrument. Section 36‑3‑203(b).

4. Right of a person not in possession to enforce a lost, destroyed, or stolen instrument. Section 36‑3‑309.

5. When an instrument is paid by mistake and the payor recovers payment, the instrument is deemed dishonored and the person from whom the payment is recovered is a person entitled to enforce the dishonored instrument. Section 36‑3‑418(d).

LIBRARY REFERENCES

Bills and Notes 182, 203, 258, 304, 327, 363.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 29, 139, 142 to 143, 147, 150 to 151, 157, 159 to 160, 169, 190, 201.

RESEARCH REFERENCES

Forms

Am. Jur. Pl. & Pr. Forms Uniform Commercial Code Section 3:92 , Introductory Comments.

LAW REVIEW AND JOURNAL COMMENTARIES

Beane, Rights of Drawers, Banks, and Holders in Bank Checks and Other Cash Equivalents. 19 Tulsa L J 612, Summer, 1984.

**SECTION 36‑3‑302.** Holder in due course.

(a) Subject to Subsection (c) and Section 36‑3‑106(d), “holder in due course” means the holder of an instrument if:

(1) the instrument when issued or negotiated to the holder does not bear such apparent evidence of forgery or alteration or is not otherwise so irregular or incomplete as to call into question its authenticity; and

(2) the holder took the instrument (i) for value, (ii) in good faith, (iii) without notice that the instrument is overdue or has been dishonored or that there is an uncured default with respect to payment of another instrument issued as part of the same series, (iv) without notice that the instrument contains an unauthorized signature or has been altered, (v) without notice of any claim to the instrument described in Section 36‑3‑306, and (vi) without notice that any party has a defense or claim in recoupment described in Section 36‑3‑305(a).

(b) Notice of discharge of a party, other than discharge in an insolvency proceeding, is not notice of a defense under subsection (a), but discharge is effective against a person who became a holder in due course with notice of the discharge. Public filing or recording of a document does not of itself constitute notice of a defense, claim in recoupment, or claim to the instrument.

(c) Except to the extent a transferor or predecessor in interest has rights as a holder in due course, a person does not acquire rights of a holder in due course of an instrument taken (i) by legal process or by purchase in an execution, bankruptcy, or creditor’s sale or similar proceeding, (ii) by purchase as part of a bulk transaction not in ordinary course of business of the transferor, or (iii) as the successor in interest to an estate or other organization.

(d) If, under Section 36‑3‑303(a)(1), the promise of performance that is the consideration for an instrument has been partially performed, the holder may assert rights as a holder in due course of the instrument only to 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.

(e) If (i) the person entitled to enforce an instrument has only a security interest in the instrument and (ii) the person obliged to pay the instrument has a defense, claim in recoupment, or claim to the instrument that may be asserted against the person who granted the security interest, the person entitled to enforce the instrument may assert rights as a holder in due course only to an amount payable under the instrument which, at the time of enforcement of the instrument, does not exceed the amount of the unpaid obligation secured.

(f) To be effective, notice must be received at a time and in a manner that gives a reasonable opportunity to act on it.

(g) This section is subject to any law limiting status as a holder in due course in particular classes of transactions.

HISTORY: 1962 Code Section 10.3‑302; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. Subsection (a)(1) is a return to the N.I.L. rule that the taker of an irregular or incomplete instrument is not a person the law should protect against defenses of the obligor or claims of prior owners. This reflects a policy choice against extending the holder in due course doctrine to an instrument that is so incomplete or irregular “as to call into question its authenticity.” The term “authenticity” is used to make it clear that the irregularity or incompleteness must indicate that the instrument may not be what it purports to be. Persons who purchase or pay such instruments should do so at their own risk. Under subsection (1) of former Section 3‑304, irregularity or incompleteness gave a purchaser notice of a claim or defense. But it was not clear from that provision whether the claim or defense had to be related to the irregularity or incomplete aspect of the instrument. This ambiguity is not present in subsection (a)(1).

2. Subsection (a)(2) restates subsection (1) of former Section 3‑302. Section 3‑305(a) makes a distinction between defenses to the obligation to pay an instrument and claims in recoupment by the maker or drawer that may be asserted to reduce the amount payable on the instrument. Because of this distinction, which was not made in former Article 3, the reference in subsection (a)(2)(vi) is to both a defense and a claim in recoupment. Notice of forgery or alteration is stated separately because forgery and alteration are not technically defenses under subsection (a) of Section 3‑305.

3. Discharge is also separately treated in the first sentence of subsection (b). Except for discharge in an insolvency proceeding, which is specifically stated to be a real defense in Section 3‑305(a)(1), discharge is not expressed in Article 3 as a defense and is not included in Section 3‑305(a)(2). Discharge is effective against anybody except a person having rights of a holder in due course who took the instrument without notice of the discharge. Notice of discharge does not disqualify a person from becoming a holder in due course. For example, a check certified after it is negotiated by the payee may subsequently be negotiated to a holder. If the holder had notice that the certification occurred after negotiation by the payee, the holder necessarily had notice of the discharge of the payee as indorser. Section 3‑415(d). Notice of that discharge does not prevent the holder from becoming a holder in due course, but the discharge is effective against the holder. Section 3‑601(b). Notice of a defense under Section 3‑305(a)(1) of a maker, drawer or acceptor based on a bankruptcy discharge is different. There is no reason to give holder in due course status to a person with notice of that defense. The second sentence of subsection (b) is from former Section 3‑304(5).

4. Professor Britton in his treatise Bills and Notes 309 (1961) stated: “A substantial number of decisions before the [N.I.L.] indicates that at common law there was nothing in the position of the payee as such which made it impossible for him to be a holder in due course.” The courts were divided, however, about whether the payee of an instrument could be a holder in due course under the N.I.L.. Some courts read N.I.L. Section 52(4) to mean that a person could be a holder in due course only if the instrument was “negotiated” to that person. N.I.L. Section 30 stated that “an instrument is negotiated when it is transferred from one person to another in such manner as to constitute the transferee the holder thereof.” Normally, an instrument is “issued” to the payee; it is not transferred to the payee. N.I.L. Section 191 defined “issue” as the “first delivery of the instrument \*\*\* to a person who takes it as a holder.” Thus, some courts concluded that the payee never could be a holder in due course. Other courts concluded that there was no evidence that the N.I.L. was intended to change the common law rule that the payee could be a holder in due course. Professor Britton states on p. 318: “The typical situations which raise the [issue] are those where the defense of a maker is interposed because of fraud by a [maker who is] principal debtor \*\*\* against a surety co‑maker, or where the defense of fraud by a purchasing remitter is interposed by the drawer of the instrument against the good faith purchasing payee.”

Former Section 3‑302(2) stated: “A payee may be a holder in due course.” This provision was intended to resolve the split of authority under the N.I.L.. It made clear that there was no intent to change the common‑law rule that allowed a payee to become a holder in due course. See Comment 2 to former Section 3‑302. But there was no need to put subsection (2) in former Section 3‑302 because the split in authority under the N.I.L. was caused by the particular wording of N.I.L. Section 52(4). The troublesome language in that section was not repeated in former Article 3 nor is it repeated in revised Article 3. Former Section 3‑302(2) has been omitted in revised Article 3 because it is surplusage and may be misleading. The payee of an instrument can be a holder in due course, but use of the holder‑in‑due‑course doctrine by the payee of an instrument is not the normal situation.

The primary importance of the concept of holder in due course is with respect to assertion of defenses or claims in recoupment (Section 3‑305) and of claims to the instrument (Section 3‑306). The holder‑in‑due‑course doctrine assumes the following case as typical. Obligor issues a note or check to Obligee. Obligor is the maker of the note or drawer of the check. Obligee is the payee. Obligor has some defense to Obligor’s obligation to pay the instrument. For example, Obligor issued the instrument for goods that Obligee promised to deliver. Obligee never delivered the goods. The failure of Obligee to deliver the goods is a defense. Section 3‑303(b). Although Obligor has a defense against Obligee, if the instrument is negotiated to Holder and the requirements of subsection (a) are met, Holder may enforce the instrument against Obligor free of the defense. Section 3‑305(b). In the typical case the holder in due course is not the payee of the instrument. Rather, the holder in due course is an immediate or remote transferee of the payee. If Obligor in our example is the only obligor on the check or note, the holder‑in‑due‑course doctrine is irrelevant in determining rights between Obligor and Obligee with respect to the instrument.

But in a small percentage of cases it is appropriate to allow the payee of an instrument to assert rights as a holder in due course. The cases are like those referred to in the quotation from Professor Britton referred to above, or other cases in which conduct of some third party is the basis of the defense of the issuer of the instrument. The following are examples:

Case # 1. Buyer pays for goods bought from Seller by giving to Seller a cashier’s check bought from Bank. Bank has a defense to its obligation to pay the check because Buyer bought the check from Bank with a check known to be drawn on an account with insufficient funds to cover the check. If Bank issued the check to Buyer as payee and Buyer indorsed it over to Seller, it is clear that Seller can be a holder in due course taking free of the defense if Seller had no notice of the defense. Seller is a transferee of the check. There is no good reason why Seller’s position should be any different if Bank drew the check to the order of Seller as payee. In that case, when Buyer took delivery of the check from Bank, Buyer became the owner of the check even though Buyer was not the holder. Buyer was a remitter. Section 3‑103(a)(11). At that point nobody was the holder. When Buyer delivered the check to Seller, ownership of the check was transferred to Seller who also became the holder. This is a negotiation. Section 3‑201. The rights of Seller should not be affected by the fact that in one case the negotiation to Seller was by a holder and in the other case the negotiation was by a remitter. Moreover, it should be irrelevant whether Bank delivered the check to Buyer and Buyer delivered it to Seller or whether Bank delivered it directly to Seller. In either case Seller can be a holder in due course that takes free of Bank’s defense.

Case # 2. X fraudulently induces Y to join X in a spurious venture to purchase a business. The purchase is to be financed by a bank loan for part of the price. Bank lends money to X and Y by deposit in a joint account of X and Y who sign a note payable to Bank for the amount of the loan. X then withdraws the money from the joint account and absconds. Bank acted in good faith and without notice of the fraud of X against Y. Bank is payee of the note executed by Y, but its right to enforce the note against Y should not be affected by the fact that Y was induced to execute the note by the fraud of X. Bank can be a holder in due course that takes free of the defense of Y. Case # 2 is similar to Case # 1. In each case the payee of the instrument has given value to the person committing the fraud in exchange for the obligation of the person against whom the fraud was committed. In each case the payee was not party to the fraud and had no notice of it.

Suppose in Case # 2 that the note does not meet the requirements of Section 3‑104(a) and thus is not a negotiable instrument covered by Article 3. In that case, Bank cannot be a holder in due course but the result should be the same. Bank’s rights are determined by general principles of contract law. Restatement Second, Contracts Section 164(2) governs the case. If Y is induced to enter into a contract with Bank by a fraudulent misrepresentation by X, the contract is voidable by Y unless Bank “in good faith and without reason to know of the misrepresentation either gives value or relies materially on the transaction.” Comment e to Section 164(2) states:

“This is the same principle that protects an innocent person who purchases goods or commercial paper in good faith, without notice and for value from one who obtained them from the original owner by a misrepresentation. See Uniform Commercial Code Section 2‑403(1), 3‑305. In the cases that fall within [Section 164(2)], however, the innocent person deals directly with the recipient of the misrepresentation, which is made by one not a party to the contract.”

The same result follows in Case # 2 if Y had been induced to sign the note as an accommodation party (Section 3‑419). If Y signs as co‑maker of a note for the benefit of X, Y is a surety with respect to the obligation of X to pay the note but is liable as maker of the note to pay Bank. Section 3‑419(b). If Bank is a holder in due course, the fraud of X cannot be asserted against Bank under Section 3‑305(b). But the result is the same without resort to holder‑in‑due‑course doctrine. If the note is not a negotiable instrument governed by Article 3, general rules of suretyship apply. Restatement, Security Section 119 states that the surety (Y) cannot assert a defense against the creditor (Bank) based on the fraud of the principal (X) if the creditor “without knowledge of the fraud \*\*\* extended credit to the principal on the security of the surety’s promise \*\*\*.” The underlying principle of Section 119 is the same as that of Section 164(2) of Restatement Second, Contracts.

Case # 3. Corporation draws a check payable to Bank. The check is given to an officer of Corporation who is instructed to deliver it to Bank in payment of a debt owed by Corporation to Bank. Instead, the officer, intending to defraud Corporation, delivers the check to Bank in payment of the officer’s personal debt, or the check is delivered to Bank for deposit to the officer’s personal account. If Bank obtains payment of the check, Bank has received funds of Corporation which have been used for the personal benefit of the officer. Corporation in this case will assert a claim to the proceeds of the check against Bank. If Bank was a holder in due course of the check it took the check free of Corporation’s claim. Section 3‑306. The issue in this case is whether Bank had notice of the claim when it took the check. If Bank knew that the officer was a fiduciary with respect to the check, the issue is governed by Section 3‑307.

Case # 4. Employer, who owed money to X, signed a blank check and delivered it to Secretary with instructions to complete the check by typing in X’s name and the amount owed to X. Secretary fraudulently completed the check by typing in the name of Y, a creditor to whom Secretary owed money. Secretary then delivered the check to Y in payment of Secretary’s debt. Y obtained payment of the check. This case is similar to Case # 3. Since Secretary was authorized to complete the check, Employer is bound by Secretary’s act in making the check payable to Y. The drawee bank properly paid the check. Y received funds of Employer which were used for the personal benefit of Secretary. Employer asserts a claim to these funds against Y. If Y is a holder in due course, Y takes free of the claim. Whether Y is a holder in due course depends upon whether Y had notice of Employer’s claim.

5. Subsection (c) is based on former Section 3‑302(3). Like former Section 3‑302(3), subsection (c) is intended to state existing case law. It covers a few situations in which the purchaser takes an instrument under unusual circumstances. The purchaser is treated as a successor in interest to the prior holder and can acquire no better rights. But if the prior holder was a holder in due course, the purchaser obtains rights of a holder in due course.

Subsection (c) applies to a purchaser in an execution sale or sale in bankruptcy. It applies equally to an attaching creditor or any other person who acquires the instrument by legal process or to a representative, such as an executor, administrator, receiver or assignee for the benefit of creditors, who takes the instrument as part of an estate. Subsection (c) applies to bulk purchases lying outside of the ordinary course of business of the seller. For example, it applies to the purchase by one bank of a substantial part of the paper held by another bank which is threatened with insolvency and seeking to liquidate its assets. Subsection (c) would also apply when a new partnership takes over for value all of the assets of an old one after a new member has entered the firm, or to a reorganized or consolidated corporation taking over the assets of a predecessor.

In the absence of controlling state law to the contrary, subsection (c) applies to a sale by a state bank commissioner of the assets of an insolvent bank. However, subsection (c) may be preempted by federal law if the Federal Deposit Insurance Corporation takes over an insolvent bank. Under the governing federal law, the FDIC and similar financial institution insurers are given holder in due course status and that status is also acquired by their assignees under the shelter doctrine.

6. Subsections (d) and (e) clarify two matters not specifically addressed by former Article 3:

Case # 5. Payee negotiates a $ 1,000 note to Holder who agrees to pay $900 for it. After paying $ 500, Holder learns that Payee defrauded Maker in the transaction giving rise to the note. Under subsection (d) Holder may assert rights as a holder in due course to the extent of $ 555.55 ($ 500 / $ 900 = .555 × $ 1,000 = $ 555.55). This formula rewards Holder with a ratable portion of the bargained for profit.

Case # 6. Payee negotiates a note of Maker for $ 1,000 to Holder as security for payment of Payee’s debt to Holder of $ 600. Maker has a defense which is good against Payee but of which Holder has no notice. Subsection (e) applies. Holder may assert rights as a holder in due course only to the extent of $ 600. Payee does not get the benefit of the holder‑in‑due‑course status of Holder. With respect to $ 400 of the note, Maker may assert any rights that Maker has against Payee. A different result follows if the payee of a note negotiated it to a person who took it as a holder in due course and that person pledged the note as security for a debt. Because the defense cannot be asserted against the pledgor, the pledgee can assert rights as a holder in due course for the full amount of the note for the benefit of both the pledgor and the pledgee.

7. There is a large body of state statutory and case law restricting the use of the holder in due course doctrine in consumer transactions as well as some business transactions that raise similar issues. Subsection (g) subordinates Article 3 to that law and any other similar law that may evolve in the future. Section 3‑106(d) also relates to statutory or administrative law intended to restrict use of the holder‑in‑due‑course doctrine. See Comment 3 to Section 3‑106.

8. The status of holder in due course resembles the status of protected holder under Article 29 of the Convention on International Bills of Exchange and International Promissory Notes. The requirements for being a protected holder under Article 29 generally track those of Section 3‑302.

SOUTH CAROLINA REPORTER’S COMMENT

Subsection (a) defines “holder in due course”. Subsection (a)(1) is based upon former Section 36‑3‑304(a)(2). Under the former statute, a purchaser has notice of a claim or defense if the instrument is so incomplete, bears such visible evidence of forgery or alteration, or is otherwise so irregular as to call its validity into question. Subsection (a)(1) incorporates this requirement into the definition of a “holder in due course”.

Subsection (a)(2) is based upon former Section 36‑3‑302(1) and retains the requirement that to qualify as a holder in due course, a holder must take an instrument for value, in good faith, and without notice that the instrument is overdue or has been dishonored. The good faith requirement under Subsection (a)(2)(ii), however, may be more demanding than the good faith requirement under former Section 36‑3‑103(1)(b), because good faith now requires not only “honesty in fact”, but also “the observance of reasonable commercial standards of fair dealing”. Section 36‑3‑103(a)(6). Subsection (a)(2) is also more specific than former Section 36‑3‑302(1)(c) in addressing the claims and defenses, notice of which precludes a holder from qualifying as a holder in due course.

The first sentence of Subsection (b) addressing the effect of discharge, is consistent with former Section 36‑3‑305(2)(d) and (e). The second sentence of Subsection (b) addressing the effect of public filing or recording of a document is consistent with former Section 36‑3‑304(5).

Subsection (c) addressing the status of a purchaser of an instrument at a judicial sale or in a bulk transfer is consistent with former Section 36‑3‑302(3). Subsections (d) and (e) clarify issues that former Chapter 3 did not address. Subsection (d) provides that when an instrument was issued in exchange for a promise of performance and that promise has been only partially performed, the ratio of the value of actual performance to the value of the promised performance fixes the extent to which a holder can assert holder in due course status.

Subsection (e) applies when the person entitled to enforce an instrument holds only a security interest in the instrument and the person obligated to pay the instrument has a claim or defense against the debtor who granted the security interest. In such cases the person entitled to enforce the instrument can assert holder in due course status only to the extent of the unpaid secured obligation. Subsection (f) restates former Section 36‑3‑304(6).

Subsection (g) provides that the provisions of Section 36‑3‑302 are subject to any law limiting status as a holder in due course in particular classes of transactions. As a result, the provisions of the South Carolina Consumer Protection Code precluding the use of negotiable instruments other than checks in consumer credit transactions preempt the holder in due course rules of Chapter 3. See S.C. Code Ann. Section 37‑1‑101 et seq.

Although this section does not include the express provision of former Section 36‑3‑302(2) that “a payee may be a holder in due course,” no change in the law is intended. See Section 36‑3‑302, Official Comment 4.

The holdings in the leading South Carolina decisions on holder in due course status remain authoritative under this section. In Davenport v. Unicapital Corp., 267 S.C. 691, 230 S.E.2d 905 (1976), the holder of a note bearing a usurious interest rate did not qualify as a holder in due course. In Specialty Flooring Co., Inc. v. Palmetto Federal Savings Bank, 302 S.C. 107, 394 S.E.2d 13 (S.C. App. 1990), a purchaser of a bank check did not qualify as a holder in due course because it knew that the consideration it gave in exchange for the bank check would fail. In First Federal Savings and Loan Ass’n of South Carolina v. Chrysler Credit Corp., 981 F.2d 127 (4th Cir. 1993), a depositary bank was not a holder in due course when it knew that the payee was in financial difficulty and was using checks drawn by the drawer to cover checks payable to the drawer.

The revision of the definition of “good faith” in Section 36‑3‑103(a)(6) to require “observance of reasonable commercial standards of fair dealing” does not affect the validity of cases holding that proof of negligence does not establish a lack of good faith. See Midfirst Bank, SSB v. C. W. Haynes Co., 893 F. Supp. 1304 (D.S.C. 1994); Stone Manufacturing Co. v. NCNB of South Carolina, 308 S.C. 287, 290‑91, 417 S.E.2d 628, 631 (S.C. App. 1992). Although the revised definition imparts an objective factor into the determination of good faith, “fair dealing” is concerned with the fairness of conduct rather than the standard of care. Failure to exercise ordinary care in a transaction does not establish a failure to observe reasonable commercial standards of fair dealing. See Section 36‑3‑103, Official Comment 4.

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| Definitional Cross References: |  |
| “Consideration” | Section 36‑3‑303(b) |
| “Good Faith” | Section 36‑3‑103(a)(6) |
| “Holder” | Section 36‑1‑201(20) |
| “Instrument” | Section 36‑3‑104(b) |
| “Issue” | Section 36‑3‑105(a) |
| “Negotiation” | Section 36‑3‑201(a) |
| “Notice” | Section 36‑1‑201(25) [see now Section 36‑1‑202] |
| “Party” | Section 36‑3‑103(a)(10) |
| “Payment” | Section 36‑3‑602(a) |
| “Person” | Section 36‑1‑201(30) |
| “Person entitled to enforce” | Section 36‑3‑301 |
| “Promise” | Section 36‑3‑103(a)(12) |
| “Unauthorized signature” | Section 36‑1‑201(43) |
| “Value” | Section 36‑3‑303(a) |

Cross References

1. When an instrument is issued or transferred for value. Section 36‑3‑303(a).

2. When an instrument is overdue. Section 36‑3‑304.

3. Defenses that can be asserted against a holder in due course. Section 6‑3‑305(a)(1) and (b).

4. Defenses and claims in recoupment that cannot be asserted against a holder in due course. Section 36‑3‑305(a)(2) and (3), (b).

5. Holder in due course takes free of claims of ownership of an instrument. Section 36‑3‑306.

6. Notice of breach of fiduciary duty by a fiduciary is notice of a claim of the represented party. Section 36‑3‑307.

7. When bank gives value for purposes of holder in due course status. Sections 36‑4‑210 and 211.

8. Effect of statement on instrument required by statute or regulation that a transferee takes subject to claims and defenses that issuer could assert against the original payee. Section 36‑3‑106(d).

9. Effect of omission of notice required in consumer transactions that transferee takes subject to claims and defenses that issuer could assert against original payee. Section 36‑3‑305(e).

LIBRARY REFERENCES

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WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 142 to 147, 149 to 153, 157, 159, 169 to 170, 172 to 174, 177 to 179, 181, 183 to 187, 201.

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1978 Survey: Contracts: installment sales contracts; holder in due course doctrine. 29 S.C. L. Rev. 74.

NOTES OF DECISIONS

In general 1

Good faith 3

Overdue or dishonored 2

1. In general

Depository bank was not holder in due course under Section 36‑3‑302(1) where evidence demonstrated bank’s lack of good faith in its actual notice and knowledge of facts and circumstances giving rise to defense asserted by drawer of dishonored checks; therefore, depository bank which had notice that drawer of checks might be able to refuse payment to payee, was not a holder in due course, where bank’s knowledge that payee was in financial difficulty was accompanied by several previous incidents of bank’s refusal to honor payee’s checks payable to drawer of the checks at issue; lack of good faith precluding holder in due course status was further demonstrated by bank’s knowledge that payee was automobile dealership which was paying its obligations to drawer financier with financier’s own money when it should have instead been paying financier from prior receipts on vehicle inventory sold. First Federal Sav. and Loan Ass’n of South Carolina v. Chrysler Credit Corp. (C.A.4 (S.C.) 1992) 981 F.2d 127.

A holder in due course is a person who is a holder of a negotiable instrument, who took it for value, in good faith, without notice that it is overdue or has been dishonored or of any defenses against or claim to it on the part of any person. Rosemond v. Campbell (S.C.App. 1986) 288 S.C. 516, 343 S.E.2d 641. Bills And Notes 327

Holder of promissory note was not a holder in due course where the note was given in a direct transaction between him and the property owners who had executed the note for home improvements, holder’s finance company was the named payee on the note, and the note itself contained a conditional promise to pay making it nonnegotiable. Rosemond v. Campbell (S.C.App. 1986) 288 S.C. 516, 343 S.E.2d 641. Bills And Notes 341; Bills And Notes 342

2. Overdue or dishonored

A payee of a bank check was not a holder in due course of the check where the payee requested the instrument from the bank with the knowledge that the drawer of a check deposited in the payee’s account intended to stop payment on its check leaving an inadequate balance in the payee’s account to cover the check issued in consideration of the bank check. Since the payee was not a holder in due course, it took the bank check subject to the defense of failure of consideration as provided by Section 36‑3‑306(c), and therefore the bank was not liable on the instrument. Specialty Flooring Co., Inc. v. Palmetto Federal Sav. Bank of South Carolina (S.C.App. 1990) 302 S.C. 107, 394 S.E.2d 13.

Where holder of promissory note received contract for work on property which showed charge of usurious interest on its face along with note, mortgage and completion certificate before deciding to purchase obligation under note, holder of note had knowledge of fact that transaction was usurious and therefore did not qualify as holder in due course. Davenport v. Unicapital Corp. (S.C. 1976) 267 S.C. 691, 230 S.E.2d 905. Bills And Notes 355

3. Good faith

Good‑faith requirement under Section 36‑3‑302(1), which specifies elements of holder in due course status, extends to notice of a defense under Section 36‑3‑304 in that “good faith” pertains to defenses to payment of a check in question, and such defenses are not limited to defenses inherent against the check itself, but also includes defenses with respect to underlying attendant transactions; thus in action brought by depository bank against drawer of checks on which drawer had stopped payment, bank was not a holder in due course where bank’s lack of good faith was shown on knowledge of facts and circumstances relating to defenses to payment of checks at issue, including defenses with respect to the underlying attendant transaction. First Federal Sav. and Loan Ass’n of South Carolina v. Chrysler Credit Corp. (C.A.4 (S.C.) 1992) 981 F.2d 127.

Financial institution could not be said to have acted in good faith and therefore is not entitled to holder in due course status since financial institution knew that retail automobile dealer was in a precarious financial condition, was check kiting, and was unable to pay its debts as they became due; it is beyond credulity to argue that these facts did not give notice to the financial institution that the parent corporation might be able to refuse payment to the automobile dealer upon the dishonor of such a large amount owed to the parent corporation. First Federal Sav. and Loan Ass’n of South Carolina v. Chrysler Credit Corp. (C.A.4 (S.C.) 1992) 981 F.2d 127.

A borrower was liable to the lending bank for the entire amount of an $85,000 promissory note, even though he intended to borrow only $35,000, where he signed a blank promissory note and relied upon a third party to co‑sign the note and fill in the amount for $35,000, but the third party entered $85,000 as the amount, presented the note to the bank, and received the funds from the bank. As a holder in due course, the bank was entitled to enforce the note against the borrower as completed since the bank took the note in good faith and without notice of any defense to it by the borrower. American Federal Bank, FSB v. Parker (S.C.App. 1990) 301 S.C. 509, 392 S.E.2d 798.

Where note, executed as separate document along with conditional sales contract, was assigned to bank for valuable consideration and bank sued maker for balance due on note, court held (1) that trial court erred in holding that note and conditional sales contract had merged, thus rendering note nonnegotiable and causing bank not to be holder in due course; (2) that note satisfied requirements of negotiability under UCC Section 3‑104(1); (3) that under UCC Section 3‑119(2), negotiability of note was not affected by separate sales contract; and (4) that since bank had paid value in good faith for note on day it was executed and assignment of note had preceded any notice of claim about merchandise sold, bank was holder in due course under UCC Section 3‑302(1). Northwestern Bank v. Neal (S.C. 1978) 271 S.C. 544, 248 S.E.2d 585.

**SECTION 36‑3‑303.** Value and consideration.

(a) An instrument is issued or transferred for value if:

(1) the instrument is issued or transferred for a promise of performance, to the extent the promise has been performed;

(2) the transferee acquires a security interest or other lien in the instrument other than a lien obtained by judicial proceeding;

(3) the instrument is issued or transferred as payment of, or as security for, an antecedent claim against any person, whether or not the claim is due;

(4) the instrument is issued or transferred in exchange for a negotiable instrument; or

(5) the instrument is issued or transferred in exchange for the incurring of an irrevocable obligation to a third party by the person taking the instrument.

(b) “Consideration” means any consideration sufficient to support a simple contract. The drawer or maker of an instrument has a defense if the instrument is issued without consideration. If an instrument is issued for a promise of performance, the issuer has a defense to the extent performance of the promise is due and the promise has not been performed. If an instrument is issued for value as stated in Subsection (a), the instrument is also issued for consideration.

HISTORY: 1962 Code Section 10.3‑303; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. Subsection (a) is a restatement of former Section 3‑303 and subsection (b) replaces former Section 3‑408. The distinction between value and consideration in Article 3 is a very fine one. Whether an instrument is taken for value is relevant to the issue of whether a holder is a holder in due course. If an instrument is not issued for consideration the issuer has a defense to the obligation to pay the instrument. Consideration is defined in subsection (b) as “any consideration sufficient to support a simple contract.” The definition of value in Section 1‑201(44), which doesn’t apply to Article 3, includes “any consideration sufficient to support a simple contract.” Thus, outside Article 3, anything that is consideration is also value. A different rule applies in Article 3. Subsection (b) of Section 3‑303 states that if an instrument is issued for value it is also issued for consideration.

Case # 1. X owes Y $ 1,000. The debt is not represented by a note. Later X issues a note to Y for the debt. Under subsection (a)(3) X’s note is issued for value. Under subsection (b) the note is also issued for consideration whether or not, under contract law, Y is deemed to have given consideration for the note.

Case # 2. X issues a check to Y in consideration of Y’s promise to perform services in the future. Although the executory promise is consideration for issuance of the check it is value only to the extent the promise is performed. Subsection (a)(1).

Case # 3. X issues a note to Y in consideration of Y’s promise to perform services. If at the due date of the note Y’s performance is not yet due, Y may enforce the note because it was issued for consideration. But if at the due date of the note, Y’s performance is due and has not been performed, X has a defense. Subsection (b).

2. Subsection (a), which defines value, has primary importance in cases in which the issue is whether the holder of an instrument is a holder in due course and particularly to cases in which the issuer of the instrument has a defense to the instrument. Suppose Buyer and Seller signed a contract on April 1 for the sale of goods to be delivered on May 1. Payment of 50% of the price of the goods was due upon signing of the contract. On April 1 Buyer delivered to Seller a check in the amount due under the contract. The check was drawn by X to Buyer as payee and was indorsed to Seller. When the check was presented for payment to the drawee on April 2, it was dishonored because X had stopped payment. At that time Seller had not taken any action to perform the contract with Buyer. If X has a defense on the check, the defense can be asserted against Seller who is not a holder in due course because Seller did not give value for the check. Subsection (a)(1). The policy basis for subsection (a)(1) is that the holder who gives an executory promise of performance will not suffer an out‑of‑pocket loss to the extent the executory promise is unperformed at the time the holder learns of dishonor of the instrument. When Seller took delivery of the check on April 1, Buyer’s obligation to pay 50% of the price on that date was suspended, but when the check was dishonored on April 2 the obligation revived. Section 3‑310(b). If payment for goods is due at or before delivery and the buyer fails to make the payment, the seller is excused from performing the promise to deliver the goods. Section 2‑703. Thus, Seller is protected from an out‑of‑pocket loss even if the check is not enforceable. Holder‑in‑due‑course status is not necessary to protect Seller.

3. Subsection (a)(2) equates value with the obtaining of a security interest or a nonjudicial lien in the instrument. The term “security interest” covers Article 9 cases in which an instrument is taken as collateral as well as bank collection cases in which a bank acquires a security interest under Section 4‑210. The acquisition of a common‑law or statutory banker’s lien is also value under subsection (a)(2). An attaching creditor or other person who acquires a lien by judicial proceedings does not give value for the purposes of subsection (a)(2).

4. Subsection (a)(3) follows former Section 3‑303(b) in providing that the holder takes for value if the instrument is taken in payment of or as security for an antecedent claim, even though there is no extension of time or other concession, and whether or not the claim is due. Subsection (a)(3) applies to any claim against any person; there is no requirement that the claim arise out of contract. In particular the provision is intended to apply to an instrument given in payment of or as security for the debt of a third person, even though no concession is made in return.

5. Subsection (a)(4) and (5) restate former Section 3‑303(c). They state generally recognized exceptions to the rule that an executory promise is not value. A negotiable instrument is value because it carries the possibility of negotiation to a holder in due course, after which the party who gives it is obliged to pay. The same reasoning applies to any irrevocable commitment to a third person, such as a letter of credit issued when an instrument is taken.

6. The term “promise” in paragraph (a)(1) is used in the phrase “promise of performance” and for that reason does not have the specialized meaning given that term in Section 3‑103(a)(12). See Section 1‑201 (“Changes from Former Law”). No inference should be drawn from the decision to use the phrase “promise of performance,” although the phrase does include the word “promise,” which has the specialized definition set forth in Section 3‑103. Indeed, that is true even though “undertaking” is used instead of “promise” in Section 3‑104(a)(3). See Section 3‑104 comment 1 (explaining the use of the term “undertaking” in Section 3‑104 to avoid use of the defined term “promise”).

SOUTH CAROLINA REPORTER’S COMMENT

Subsection (a) restates the rules of former Section 36‑3‑303 for determining when an instrument is issued or transferred for value. Subsection (b), defining consideration, replaces former Section 36‑3‑408.

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| Definitional Cross References: |  |
| “Drawer” | Section 36‑3‑103(a)(5) |
| “Instrument” | Section 36‑3‑104(b) |
| “Issue” | Section 36‑3‑105(a) |
| “Maker” | Section 36‑3‑103(a)(7) |
| “Negotiable instrument” | Section 36‑3‑104(a) |
| “Party” | Section 36‑3‑103(a)(10) |
| “Payment” | Section 36‑3‑602(a) |
| “Person” | Section 36‑1‑201(30) |
| “Security interest” | Section 36‑1‑201(37) [see now Section 36‑1‑203] |
| “Transfer of instrument” | Section 36‑3‑203(a) |

Cross References:

1. Taking for value as a requirement to establishing holder in due course status. Section 36‑3‑302(a)(1).

2. Lack and failure of consideration given in exchange for an instrument are defenses that the issuer can assert against a transferee other than a holder in due course. Section 36‑3‑305(a)(2) and (b).

3. Distinction between a defense of lack or failure of consideration under Sections 36‑3‑303(b) and 36‑3‑305(a)(2) and a claim in recoupment under Section 36‑3‑305(a)(3). See Section 36‑3‑305, Official Comment 4.

4. A person taking a fraudulently altered instrument for value, in good faith and without notice of the alteration can enforce the instrument according to its original terms or, if the fraudulent alteration was the completion of an incomplete instrument, enforce the instrument as completed. Section 36‑3‑407(c).

5. The restitution remedies available to a drawee that pays or accepts a draft under Section 36‑3‑418(a) and (b) cannot be asserted against a person who took the instrument in good faith and for value. Section 36‑3‑418 (c).

6. When a bank gives value for purposes of determining holder in due course status. Sections 36‑4‑210 and 211.

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WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 171, 185 to 187, 201.

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77 ALR 5th 429 , When is Instrument Issued or Transferred for “Value” Under UCC Section 3‑303.

Encyclopedias

S.C. Jur. Mortgages Section 166, Consideration.

NOTES OF DECISIONS

In general 1

1. In general

In payee’s action on a note which recited that the promise was “for value received,” the maker was not precluded by the parol evidence rule from introducing evidence that the note was unsupported by consideration. Iseman v. Hobbs (S.C.App. 1986) 290 S.C. 482, 351 S.E.2d 351.

In action on note by payee‑holder against maker, where (1) note stated that maker’s promise to pay was “for value received,” and (2) maker pleaded lack of consideration as defense to liability, court held (1) that under UCC Section 3‑408, lack of consideration is valid defense against holder who is not holder in due course; (2) that sole issue in case was whether parol evidence was admissible to show lack of consideration for note that contained recital “for value received”; (3) that since Article 3 provides no explicit resolution of such issue, South Carolina common law was admissible under UCC Section 1‑103 to resolve it; (4) that under South Carolina common law, if consideration recited in note is act or forbearance, as distinguished from promise or covenant, parol evidence is admissible to show that such act or forbearance did not take place and that note is therefore gratuitous and unenforceable; and (5) that in present case, since phrase “for value received” was not recital of promise or covenant, but was recital that act (receipt of value) had occurred, contradiction of alleged fact of receipt would in no way alter note’s contractual terms. Iseman v. Hobbs (S.C.App. 1986) 290 S.C. 482, 351 S.E.2d 351.

Endorsers’ notes did not require consideration to be valid where they were given in place of other notes held by bank. Farmers and Merchants Bank v. Fargnoli (S.C. 1979) 274 S.C. 23, 260 S.E.2d 185. Bills And Notes 95

**SECTION 36‑3‑304.** Overdue instrument.

(a) An instrument payable on demand becomes overdue at the earliest of the following times:

(1) on the day after the day demand for payment is duly made;

(2) if the instrument is a check, 90 days after its date; or

(3) if the instrument is not a check, when the instrument has been outstanding for a period of time after its date which is unreasonably long under the circumstances of the particular case in light of the nature of the instrument and usage of the trade.

(b) With respect to an instrument payable at a definite time the following rules apply:

(1) If the principal is payable in installments and a due date has not been accelerated, the instrument becomes overdue upon default under the instrument for nonpayment of an installment, and the instrument remains overdue until the default is cured.

(2) If the principal is not payable in installments and the due date has not been accelerated, the instrument becomes overdue on the day after the due date.

(3) If a due date with respect to principal has been accelerated, the instrument becomes overdue on the day after the accelerated due date.

(c) Unless the due date of principal has been accelerated, an instrument does not become overdue if there is default in payment of interest but no default in payment of principal.

HISTORY: 1962 Code Section 10.3‑304; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. To be a holder in due course, one must take without notice that an instrument is overdue. Section 3‑302(a)(2)(iii). Section 3‑304 replaces subsection (3) of former Section 3‑304. For the sake of clarity it treats demand and time instruments separately. Subsection (a) applies to demand instruments. A check becomes stale after 90 days.

Under former Section 3‑304(3)(c), a holder that took a demand note had notice that it was overdue if it was taken “more than a reasonable length of time after its issue.” In substitution for this test, subsection (a)(3) requires the trier of fact to look at both the circumstances of the particular case and the nature of the instrument and trade usage. Whether a demand note is stale may vary a great deal depending on the facts of the particular case.

2. Subsections (b) and (c) cover time instruments. They follow the distinction made under former Article 3 between defaults in payment of principal and interest. In subsection (b) installment instruments and single payment instruments are treated separately. If an installment is late, the instrument is overdue until the default is cured.

SOUTH CAROLINA REPORTER’S COMMENT

Subsection (a) addresses when an instrument payable on demand is overdue and replaces former Section 36‑3‑304(3)(c). Subsection (a)(2) changes the law by providing that a check does not become overdue until 90 days after its date.

Subsections (b) and (c) address when an instrument payable at a definite time becomes overdue and replace former Section 36‑3‑304(3)(a) and (b).

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| Definitional Cross References: |  |
| “Check” | Section 36‑3‑104(f) |
| “Instrument” | Section 36‑3‑104(b) |
| “Payment” | Section 36‑3‑602(a) |
| “Payable at a definite time” | Section 36‑3‑108(b) |
| “Payable on demand” | Section 36‑3‑108(a) |

Cross Reference:

1. To qualify as a holder in due course of an instrument, the holder must take without notice that the instrument is overdue. Section 36‑3‑302(a)(2)(iii).

LIBRARY REFERENCES

Bills and Notes 331 to 346, 361.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 170, 172 to 184, 187, 191, 201.

LAW REVIEW AND JOURNAL COMMENTARIES

1978 Survey: Contracts: installment sales contracts; holder in due course doctrine. 29 S.C. L. Rev. 74.

**SECTION 36‑3‑305.** Defenses and claims in recoupment.

(a) Except as otherwise provided in this section, the right to enforce the obligation of a party to pay an instrument is subject to the following:

(1) a defense of the obligor based on (i) infancy of the obligor to the extent it is a defense to a simple contract, (ii) duress, lack of legal capacity, or illegality of the transaction which, under other law, nullifies the obligation of the obligor, (iii) fraud that induced the obligor to sign the instrument with neither knowledge nor reasonable opportunity to learn of its character or its essential terms, or (iv) discharge of the obligor in insolvency proceedings;

(2) a defense of the obligor stated in another section of this chapter or a defense of the obligor that would be available if the person entitled to enforce the instrument were enforcing a right to payment under a simple contract; and

(3) a claim in recoupment of the obligor against the original payee of the instrument if the claim arose from the transaction that gave rise to the instrument; but the claim of the obligor may be asserted against a transferee of the instrument only to reduce the amount owing on the instrument at the time the action is brought.

(b) The right of a holder in due course to enforce the obligation of a party to pay the instrument is subject to defenses of the obligor stated in Subsection (a)(1), but is not subject to defenses of the obligor stated in Subsection (a)(2) or claims in recoupment stated in Subsection (a)(3) against a person other than the holder.

(c) Except as stated in Subsection (d), in an action to enforce the obligation of a party to pay the instrument, the obligor may not assert against the person entitled to enforce the instrument a defense, claim in recoupment, or claim to the instrument (Section 36‑3‑306) of another person, but the other person’s claim to the instrument may be asserted by the obligor if the other person is joined in the action and personally asserts the claim against the person entitled to enforce the instrument. An obligor is not obliged to pay the instrument if the person seeking enforcement of the instrument does not have rights of a holder in due course and the obligor proves that the instrument is a lost or stolen instrument.

(d) In an action to enforce the obligation of an accommodation party to pay an instrument, the accommodation party may assert against the person entitled to enforce the instrument any defense or claim in recoupment under Subsection (a) that the accommodated party could assert against the person entitled to enforce the instrument, except the defenses of discharge in insolvency proceedings, infancy, and lack of legal capacity.

(e) In a consumer transaction, if law other than this article requires that an instrument include a statement to the effect that the rights of a holder or transferee are subject to a claim or defense that the issuer could assert against the original payee, and the instrument does not include such a statement:

(1) the instrument has the same effect as if the instrument included such a statement;

(2) the issuer may assert against the holder or transferee all claims and defenses that would have been available if the instrument included such a statement; and

(3) the extent to which claims may be asserted against the holder or transferee is determined as if the instrument included such a statement.

(f) This section is subject to law other than this article that establishes a different rule for consumer transactions.

HISTORY: 1962 Code Section 10.3‑305; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. Subsection (a) states the defenses to the obligation of a party to pay the instrument. Subsection (a)(1) states the “real defenses” that may be asserted against any person entitled to enforce the instrument.

Subsection (a)(1)(i) allows assertion of the defense of infancy against a holder in due course, even though the effect of the defense is to render the instrument voidable but not void. The policy is one of protection of the infant even at the expense of occasional loss to an innocent purchaser. No attempt is made to state when infancy is available as a defense or the conditions under which it may be asserted. In some jurisdictions it is held that an infant cannot rescind the transaction or set up the defense unless the holder is restored to the position held before the instrument was taken which, in the case of a holder in due course, is normally impossible. In other states an infant who has misrepresented age may be estopped to assert infancy. Such questions are left to other law, as an integral part of the policy of each state as to the protection of infants.

Subsection (a)(1)(ii) covers mental incompetence, guardianship, ultra vires acts or lack of corporate capacity to do business, or any other incapacity apart from infancy. Such incapacity is largely statutory. Its existence and effect is left to the law of each state. If under the state law the effect is to render the obligation of the instrument entirely null and void, the defense may be asserted against a holder in due course. If the effect is merely to render the obligation voidable at the election of the obligor, the defense is cut off.

Duress, which is also covered by subsection (a)(ii), is a matter of degree. An instrument signed at the point of a gun is void, even in the hands of a holder in due course. One signed under threat to prosecute the son of the maker for theft may be merely voidable, so that the defense is cut off. Illegality is most frequently a matter of gambling or usury, but may arise in other forms under a variety of statutes. The statutes differ in their provisions and the interpretations given them. They are primarily a matter of local concern and local policy. All such matters are therefore left to the local law. If under that law the effect of the duress or the illegality is to make the obligation entirely null and void, the defense may be asserted against a holder in due course. Otherwise it is cut off.

Subsection (a)(1)(iii) refers to “real” or “essential” fraud, sometimes called fraud in the essence or fraud in the factum, as effective against a holder in due course. The common illustration is that of the maker who is tricked into signing a note in the belief that it is merely a receipt or some other document. The theory of the defense is that the signature on the instrument is ineffective because the signer did not intend to sign such an instrument at all. Under this provision the defense extends to an instrument signed with knowledge that it is a negotiable instrument, but without knowledge of its essential terms. The test of the defense is that of excusable ignorance of the contents of the writing signed. The party must not only have been in ignorance, but must also have had no reasonable opportunity to obtain knowledge. In determining what is a reasonable opportunity all relevant factors are to be taken into account, including the intelligence, education, business experience, and ability to read or understand English of the signer. Also relevant is the nature of the representations that were made, whether the signer had good reason to rely on the representations or to have confidence in the person making them, the presence or absence of any third person who might read or explain the instrument to the signer, or any other possibility of obtaining independent information, and the apparent necessity, or lack of it, for acting without delay. Unless the misrepresentation meets this test, the defense is cut off by a holder in due course.

Subsection (a)(1)(iv) states specifically that the defense of discharge in insolvency proceedings is not cut off when the instrument is purchased by a holder in due course. “Insolvency proceedings” is defined in Section 1‑201(22) and it includes bankruptcy whether or not the debtor is insolvent. Subsection (2)(e) of former Section 3‑305 is omitted. The substance of that provision is stated in Section 3‑601(b).

2. Subsection (a)(2) states other defenses that, pursuant to subsection (b), are cut off by a holder in due course. These defenses comprise those specifically stated in Article 3 and those based on common law contract principles. Article 3 defenses are nonissuance of the instrument, conditional issuance, and issuance for a special purpose (Section 3‑105(b)); failure to countersign a traveler’s check (Section 3‑106(c)); modification of the obligation by a separate agreement (Section 3‑117); payment that violates a restrictive indorsement (Section 3‑206(f)); instruments issued without consideration or for which promised performance has not been given (Section 3‑303(b)), and breach of warranty when a draft is accepted (Section 3‑417(b)). The most prevalent common law defenses are fraud, misrepresentation or mistake in the issuance of the instrument. In most cases the holder in due course will be an immediate or remote transferee of the payee of the instrument. In most cases the holder‑in‑due‑course doctrine is irrelevant if defenses are being asserted against the payee of the instrument, but in a small number of cases the payee of the instrument may be a holder in due course. Those cases are discussed in Comment 4 to Section 3‑302.

Assume Buyer issues a note to Seller in payment of the price of goods that Seller fraudulently promises to deliver but which are never delivered. Seller negotiates the note to Holder who has no notice of the fraud. If Holder is a holder in due course, Holder is not subject to Buyer’s defense of fraud. But in some cases an original party to the instrument is a holder in due course. For example, Buyer fraudulently induces Bank to issue a cashier’s check to the order of Seller. The check is delivered by Bank to Seller, who has no notice of the fraud. Seller can be a holder in due course and can take the check free of Bank’s defense of fraud. This case is discussed as Case # 1 in Comment 4 to Section 3‑302. Former Section 3‑305 stated that a holder in due course takes free of defenses of “any party to the instrument with whom the holder has not dealt.” The meaning of this language was not at all clear and if read literally could have produced the wrong result. In the hypothetical case, it could be argued that Seller “dealt” with Bank because Bank delivered the check to Seller. But it is clear that Seller should take free of Bank’s defense against Buyer regardless of whether Seller took delivery of the check from Buyer or from Bank. The quoted language is not included in Section 3‑305. It is not necessary. If Buyer issues an instrument to Seller and Buyer has a defense against Seller, that defense can obviously be asserted. Buyer and Seller are the only people involved. The holder‑in‑due‑course doctrine has no relevance. The doctrine applies only to cases in which more than two parties are involved. Its essence is that the holder in due course does not have to suffer the consequences of a defense of the obligor on the instrument that arose from an occurrence with a third party.

3. Subsection (a)(3) is concerned with claims in recoupment which can be illustrated by the following example. Buyer issues a note to the order of Seller in exchange for a promise of Seller to deliver specified equipment. If Seller fails to deliver the equipment or delivers equipment that is rightfully rejected, Buyer has a defense to the note because the performance that was the consideration for the note was not rendered. Section 3‑303(b). This defense is included in Section 3‑305(a)(2). That defense can always be asserted against Seller. This result is the same as that reached under former Section 3‑408.

But suppose Seller delivered the promised equipment and it was accepted by Buyer. The equipment, however, was defective. Buyer retained the equipment and incurred expenses with respect to its repair. In this case, Buyer does not have a defense under Section 3‑303(b). Seller delivered the equipment and the equipment was accepted. Under Article 2, Buyer is obliged to pay the price of the equipment which is represented by the note. But Buyer may have a claim against Seller for breach of warranty. If Buyer has a warranty claim, the claim may be asserted against Seller as a counterclaim or as a claim in recoupment to reduce the amount owing on the note. It is not relevant whether Seller is or is not a holder in due course of the note or whether Seller knew or had notice that Buyer had the warranty claim. It is obvious that holder‑in‑due‑course doctrine cannot be used to allow Seller to cut off a warranty claim that Buyer has against Seller. Subsection (b) specifically covers this point by stating that a holder in due course is not subject to a “claim in recoupment \*\*\* against a person other than the holder.”

Suppose Seller negotiates the note to Holder. If Holder had notice of Buyer’s warranty claim at the time the note was negotiated to Holder, Holder is not a holder in due course (Section 3‑302(a)(2)(iv)) and Buyer may assert the claim against Holder (Section 3‑305(a)(3)) but only as a claim in recoupment, i.e. to reduce the amount owed on the note. If the warranty claim is $ 1,000 and the unpaid note is $ 10,000, Buyer owes $ 9,000 to Holder. If the warranty claim is more than the unpaid amount of the note, Buyer owes nothing to Holder, but Buyer cannot recover the unpaid amount of the warranty claim from Holder. If Buyer had already partially paid the note, Buyer is not entitled to recover the amounts paid. The claim can be used only as an offset to amounts owing on the note. If Holder had no notice of Buyer’s claim and otherwise qualifies as a holder in due course, Buyer may not assert the claim against Holder. Section 3‑305(b).

The result under Section 3‑305 is consistent with the result reached under former Article 3, but the rules for reaching the result are stated differently. Under former Article 3 Buyer could assert rights against Holder only if Holder was not a holder in due course, and Holder’s status depended upon whether Holder had notice of a defense by Buyer. Courts have held that Holder had that notice if Holder had notice of Buyer’s warranty claim. The rationale under former Article 3 was “failure of consideration.” This rationale does not distinguish between cases in which the seller fails to perform and those in which the buyer accepts the performance of seller but makes a claim against the seller because the performance is faulty. The term “failure of consideration” is subject to varying interpretations and is not used in Article 3. The use of the term “claim in recoupment” in Section 3‑305(a)(3) is a more precise statement of the nature of Buyer’s right against Holder. The use of the term does not change the law because the treatment of a defense under subsection (a)(2) and a claim in recoupment under subsection (a)(3) is essentially the same.

Under former Article 3, case law was divided on the issue of the extent to which an obligor on a note could assert against a transferee who is not a holder in due course a debt or other claim that the obligor had against the original payee of the instrument. Some courts limited claims to those that arose in the transaction that gave rise to the note. This is the approach taken in Section 3‑305(a)(3). Other courts allowed the obligor on the note to use any debt or other claim, no matter how unrelated to the note, to offset the amount owed on the note. Under current judicial authority and non‑UCC statutory law, there will be many cases in which a transferee of a note arising from a sale transaction will not qualify as a holder in due course. For example, applicable law may require the use of a note to which there cannot be a holder in due course. See Section 3‑106(d) and Comment 3 to Section 3‑106. It is reasonable to provide that the buyer should not be denied the right to assert claims arising out of the sale transaction. Subsection (a)(3) is based on the belief that it is not reasonable to require the transferee to bear the risk that wholly unrelated claims may also be asserted. The determination of whether a claim arose from the transaction that gave rise to the instrument is determined by law other than this Article and thus may vary as local law varies.

4. Subsection (c) concerns claims and defenses of a person other than the obligor on the instrument. It applies principally to cases in which an obligation is paid with the instrument of a third person. For example, Buyer buys goods from Seller and negotiates to Seller a cashier’s check issued by Bank in payment of the price. Shortly after delivering the check to Seller, Buyer learns that Seller had defrauded Buyer in the sale transaction. Seller may enforce the check against Bank even though Seller is not a holder in due course. Bank has no defense to its obligation to pay the check and it may not assert defenses, claims in recoupment, or claims to the instrument of Buyer, except to the extent permitted by the “but” clause of the first sentence of subsection (c). Buyer may have a claim to the instrument under Section 3‑306 based on a right to rescind the negotiation to Seller because of Seller’s fraud. Section 3‑202(b) and Comment 2 to Section 3‑201. Bank cannot assert that claim unless Buyer is joined in the action in which Seller is trying to enforce payment of the check. In that case Bank may pay the amount of the check into court and the court will decide whether that amount belongs to Buyer or Seller. The last sentence of subsection (c) allows the issuer of an instrument such as a cashier’s check to refuse payment in the rare case in which the issuer can prove that the instrument is a lost or stolen instrument and the person seeking enforcement does not have rights of a holder in due course.

5. Subsection (d) applies to instruments signed for accommodation (Section 3‑419) and this subsection equates the obligation of the accommodation party to that of the accommodated party. The accommodation party can assert whatever defense or claim the accommodated party had against the person enforcing the instrument. The only exceptions are discharge in bankruptcy, infancy and lack of capacity. The same rule does not apply to an indorsement by a holder of the instrument in negotiating the instrument. The indorser, as transferor, makes a warranty to the indorsee, as transferee, that no defense or claim in recoupment is good against the indorser. Section 3‑416(a)(4). Thus, if the indorsee sues the indorser because of dishonor of the instrument, the indorser may not assert the defense or claim in recoupment of the maker or drawer against the indorsee.

Section 3‑305(d) must be read in conjunction with Section 3‑605, which provides rules (usually referred to as suretyship defenses) for determining when the obligation of an accommodation party is discharged, in whole or in part, because of some act or omission of a person entitled to enforce the instrument. To the extent a rule stated in Section 3‑605 is inconsistent with Section 3‑305(d), the Section 3‑605 rule governs. For example, Section 3‑605(a) provides rules for determining when and to what extent a discharge of the accommodated party under Section 3‑604 will discharge the accommodation party. As explained in Comment 2 to Section 3‑605, discharge of the accommodated party is normally part of a settlement under which the holder of a note accepts partial payment from an accommodated party who is financially unable to pay the entire amount of the note. If the holder then brings an action against the accommodation party to recover the remaining unpaid amount of the note, the accommodation party cannot use Section 3‑305(d) to nullify Section 3‑605() by asserting the discharge of the accommodated party as a defense. On the other hand, suppose the accommodated party is a buyer of goods who issued the note to the seller who took the note for the buyer’s obligation to pay for the goods. Suppose the buyer has a claim for breach of warranty with respect to the goods against the seller and the warranty claim may be asserted against the holder of the note. The warranty claim is a claim in recoupment. If the holder and the accommodated party reach a settlement under which the holder accepts payment less than the amount of the note in full satisfaction of the note and the warranty claim, the accommodation party could defend an action on the note by the holder by asserting the accord and satisfaction under Section 3‑305(d). There is no conflict with Section 3‑605() because that provision is not intended to apply to settlement of disputed claims.

6. Subsection (e) is added to clarify the treatment of an instrument that omits the notice currently required by the Federal Trade Commission Rule related to certain consumer credit sales and consumer purchase money loans (16 C.F.R. Part 433). This subsection adopts the view that the instrument should be treated as if the language required by the FTC Rule were present. It is based on the language describing that rule in Section 3‑106(d) and the analogous provision in Section 9‑404(d).

7. Subsection (f) is modeled on Sections 9‑403(e) and 9‑404(c). It ensures that Section 3‑305 is interpreted to accommodate relevant consumer‑protection laws. The absence of such a provision from other sections in Article 3 should not justify any inference about the meaning of those sections.

8. Articles 28 and 30 of the Convention on International Bills of Exchange and International Promissory Notes includes a similar dichotomy, with a narrower group of defenses available against a protected holder under Articles 28(1) and 30 than are available under Article 28(2) against a holder that is not a protected holder.

SOUTH CAROLINA REPORTER’S COMMENT

Subsection (a)(1) restates former Section 36‑3‑305(2) and lists the “real defenses” that can be asserted against a holder in due course under Subsection (b).

Subsections (a)(2) and (b) are based, in part, on former Section 36‑3‑306 and provide that defenses arising under Chapter 3 and common law contracts can be asserted against a holder or transferee of an instrument other than a holder in due course.

Under Subsection (a)(3) and (b), claims for recoupment that an issuer has against the original payee of the instrument which arose from the transaction that gave rise to the instrument can be asserted against a party other than a holder in due course. Limiting the claims in recoupment that an obligor can assert to those that arose from the same transaction that gave rise to the instrument is consistent with the holding in First Federal Savings & Loan Ass’n of South Carolina v. Chrysler Credit Corp., 981 F.2d 127 (4th Cir. 1993). In that case, Chrysler Credit stopped payment on checks that a dealer had deposited into its account at First Federal. First Federal sued Chrysler Credit as drawer of the dishonored checks. Chrysler Credit defended on the grounds that the dealer had breached its security agreement. Chrysler Credit, however, did not establish that the dealer had breached the agreement in obtaining the checks at issue. Although the court concluded that First Federal was not a holder in due course, the court held Chrysler Credit liable on the checks. The court held that in an action to enforce the checks, Chrysler Credit could not defend on the basis that the dealer breached its agreement in transactions that did not give rise to the checks.

Subsection (b) does not include the “with whom the holder has not dealt” limitation upon the protection afforded holders in due course, but achieves the same result by limiting the protection of a holder in due course to defenses and claims in recoupment against a person other than the holder.

Subsection (c) restates former Section 36‑3‑306(d) and provides that, as a general rule, a party liable on an instrument cannot assert the defense, claim in recoupment, or claim of ownership of the instrument of another person.

Subsection (d) defines the extent to which an accommodation party can assert the claims and defenses of the accommodated party against a person entitled to enforce an instrument.

Subsection (e) applies to instruments issued in consumer transactions and provides that if a required statement that the rights of any transferee are subject to the claims that the issuer could assert against the original payee is omitted from the instrument, the instrument will have the same effect as if the statement was included. This provision is consistent with the South Carolina Consumer Protection Code Section 37‑2‑404(1).

Under Subsection (f), the provisions of Section 36‑3‑305 are subject to the South Carolina Consumer Protection Code’s rules relating to instruments issued in consumer transactions.

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| Definitional Cross References: |  |
| “Action” | Section 36‑1‑201(1) |
| “Accommodated party” | Section 36‑3‑419(a) |
| “Accommodation party” | Section 36‑3‑419(a) |
| “Holder in due course” | Section 36‑3‑302(a) |
| “Instrument” | Section 36‑3‑104(b) |
| “Knowledge” | Section 36‑1‑201(25) [see now Section 36‑1‑202] |
| “Party” | Section 36‑3‑103(a)(10) |
| “Person entitled to enforce” | Section 36‑3‑301 |
| “Rights” | Section 36‑1‑201(36) |
| “Signed” | Section 36‑1‑201(39) |
| “Term” | Section 36‑1‑201(42) |

Cross References:

1. Defenses arising under Chapter 3 that can be asserted against a person other than a holder in due course seeking to enforce an instrument. See Sections 36‑3‑105(b), 36‑3‑106(c), 36‑3‑117, 36‑3‑206(f), 36‑3‑303(b), and 36‑3‑417(b).

2. A holder in due course takes free of a claim of ownership of an instrument. Section 36‑3‑306.

3. With respect to a consumer credit sale or consumer lease, the creditor may not take a negotiable instrument other than a check dated not more than ten (10) days after its issuance. Section 37‑2‑403.

LIBRARY REFERENCES

Bills and Notes 327, 363.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 142, 159, 169, 190, 201.

NOTES OF DECISIONS

In general 1

1. In general

Defendant, as party liable on negotiable instrument, could not assert as a defense to a suit on the note that the holder illegally acquired its status. Federal Deposit Ins. Corp. v. Moore (D.C.S.C. 1978) 448 F.Supp. 493.

In action by Federal Deposit Insurance Corporation (FDIC), as owner‑holder of note purchased from bank for which FDIC was receiver, to recover on such note from defendant maker, (1) defendant under Code Section 36‑3‑306(d) could not assert FDIC’s allegedly illegal acquisition of note as defense, since only the bank in receivership or such bank’s shareholders had standing to assert such defense, and (2) if defendant satisfied note by payment to FDIC, he would not risk double liability on note in event bank’s sale of note to FDIC should be set aside, but would be discharged from liability under Code Section 36‑3‑603(1). (Applying SC law; also holding that oral agreement to extend time for paying note was unenforceable under non‑UCC statute of frauds) Federal Deposit Ins. Corp. v. Moore (D.C.S.C. 1978) 448 F.Supp. 493.

A payee of a bank check was not a holder in due course of the check where the payee requested the instrument from the bank with the knowledge that the drawer of a check deposited in the payee’s account intended to stop payment on its check leaving an inadequate balance in the payee’s account to cover the check issued in consideration of the bank check. Since the payee was not a holder in due course, it took the bank check subject to the defense of failure of consideration as provided by Section 36‑3‑306(c), and therefore the bank was not liable on the instrument. Specialty Flooring Co., Inc. v. Palmetto Federal Sav. Bank of South Carolina (S.C.App. 1990) 302 S.C. 107, 394 S.E.2d 13.

A lease‑purchase contract was not a negotiable instrument, and therefore was not subject to the provisions of Section 36‑3‑306. Tri‑Continental Leasing Corp. v. Stevens, Stevens & Thomas, P.A. (S.C.App. 1985) 287 S.C. 338, 338 S.E.2d 343.

**SECTION 36‑3‑306.** Claims to instrument.

A person taking an instrument, other than a person having rights of a holder in due course, is subject to a claim of a property or possessory right in the instrument or its proceeds, including a claim to rescind a negotiation and to recover the instrument or its proceeds. A person having rights of a holder in due course takes free of the claim to the instrument.

HISTORY: 1962 Code Section 10.3‑306; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

This section expands on the reference to “claims to” the instrument mentioned in former Sections 3‑305 and 3‑306. Claims covered by the section include not only claims to ownership but also any other claim of a property or possessory right. It includes the claim to a lien or the claim of a person in rightful possession of an instrument who was wrongfully deprived of possession. Also included is a claim based on Section 3‑202(b) for rescission of a negotiation of the instrument by the claimant. Claims to an instrument under Section 3‑306 are different from claims in recoupment referred to in Section 3‑305(a)(3). The rule of this section is similar to the rule of Article 30(2) of the Convention on International Bills of Exchange and International Promissory Notes.

SOUTH CAROLINA REPORTER’S COMMENT

This provision restates the rules in former Sections 36‑3‑305(1) and 36‑3‑306(a) that a person other than a holder in course takes subject to all valid claims to an instrument and that a holder in due course takes free of all claims to the instrument.

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| Definitional Cross References: |  |
| “Holder in due course” | Section 36‑3‑302(a) |
| “Instrument” | Section 36‑3‑104(b) |
| “Negotiation” | Section 36‑3‑201(a) |
| “Person” | Section 36‑1‑201(30) |
| “Rights” | Section 36‑1‑201(36) |

Cross References:

1. Requirements for qualifying as a holder in due course. Section 36‑3‑302(a).

2. Extent to which a holder in due course takes free of defenses and claims in recoupment. Section 36‑3‑305(a) and (b).

3. Distinction between a claim under Section 36‑3‑306 and a claim in recoupment under Section 36‑3‑302(a)(3). See Section 36‑3‑302, Official Comment 4 and Section 36‑3‑306, Official Comments.

LIBRARY REFERENCES

Bills and Notes 302, 308, 315 to 322.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 160 to 161, 166 to 168.

**SECTION 36‑3‑307.** Notice of breach of fiduciary duty.

(a) In this section:

(1) “Fiduciary” means an agent, trustee, partner, corporate officer or director, or other representative owing a fiduciary duty with respect to an instrument.

(2) “Represented person” means the principal, beneficiary, partnership, corporation, or other person to whom the duty stated in Paragraph (1) is owed.

(b) If (i) an instrument is taken from a fiduciary for payment or collection or for value, (ii) the taker has knowledge of the fiduciary status of the fiduciary, and (iii) the represented person makes a claim to the instrument or its proceeds on the basis that the transaction of the fiduciary is a breach of fiduciary duty, the following rules apply:

(1) Notice of breach of fiduciary duty by the fiduciary is notice of the claim of the represented person.

(2) In the case of an instrument payable to the represented person or the fiduciary as such, the taker has notice of the breach of fiduciary duty if the instrument is (i) taken in payment of or as security for a debt known by the taker to be the personal debt of the fiduciary, (ii) taken in a transaction known by the taker to be for the personal benefit of the fiduciary, or (iii) deposited to an account other than an account of the fiduciary, as such, or an account of the represented person.

(3) If an instrument is issued by the represented person or the fiduciary as such, and made payable to the fiduciary personally, the taker does not have notice of the breach of fiduciary duty unless the taker knows of the breach of fiduciary duty.

(4) If an instrument is issued by the represented person or the fiduciary as such, to the taker as payee, the taker has notice of the breach of fiduciary duty if the instrument is (i) taken in payment of or as security for a debt known by the taker to be the personal debt of the fiduciary, (ii) taken in a transaction known by the taker to be for the personal benefit of the fiduciary, or (iii) deposited to an account other than an account of the fiduciary, as such, or an account of the represented person.

HISTORY: 1962 Code Section 10.3‑307; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. This section states rules for determining when a person who has taken an instrument from a fiduciary has notice of a breach of fiduciary duty that occurs as a result of the transaction with the fiduciary. Former Section 3‑304(2) and (4)(e) related to this issue, but those provisions were unclear in their meaning. Section 3‑307 is intended to clarify the law by stating rules that comprehensively cover the issue of when the taker of an instrument has notice of breach of a fiduciary duty and thus notice of a claim to the instrument or its proceeds.

2. Subsection (a) defines the terms “fiduciary” and “represented person” and the introductory paragraph of subsection (b) describes the transaction to which the section applies. The basic scenario is one in which the fiduciary in effect embezzles money of the represented person by applying the proceeds of an instrument that belongs to the represented person to the personal use of the fiduciary. The person dealing with the fiduciary may be a depositary bank that takes the instrument for collection or a bank or other person that pays value for the instrument. The section also covers a transaction in which an instrument is presented for payment to a payor bank that pays the instrument by giving value to the fiduciary. Subsections (b)(2), (3), and (4) state rules for determining when the person dealing with the fiduciary has notice of breach of fiduciary duty. Subsection (b)(1) states that notice of breach of fiduciary duty is notice of the represented person’s claim to the instrument or its proceeds.

Under Section 3‑306, a person taking an instrument is subject to a claim to the instrument or its proceeds, unless the taker has rights of a holder in due course. Under Section 3‑302(a)(2)(v), the taker cannot be a holder in due course if the instrument was taken with notice of a claim under Section 3‑306. Section 3‑307 applies to cases in which a represented person is asserting a claim because a breach of fiduciary duty resulted in a misapplication of the proceeds of an instrument. The claim of the represented person is a claim described in Section 3‑306. Section 3‑307 states rules for determining when a person taking an instrument has notice of the claim which will prevent assertion of rights as a holder in due course. It also states rules for determining when a payor bank pays an instrument with notice of breach of fiduciary duty.

Section 3‑307(b) applies only if the person dealing with the fiduciary “has knowledge of the fiduciary status of the fiduciary.” Notice which does not amount to knowledge is not enough to cause Section 3‑307 to apply. “Knowledge” is defined in Section 1‑201(25). In most cases, the “taker” referred to in Section 3‑307 will be a bank or other organization. Knowledge of an organization is determined by the rules stated in Section 1‑201(27). In many cases, the individual who receives and processes an instrument on behalf of the organization that is the taker of the instrument “for payment or collection or for value” is a clerk who has no knowledge of any fiduciary status of the person from whom the instrument is received. In such cases, Section 3‑307 doesn’t apply because, under Section 1‑201(27), knowledge of the organization is determined by the knowledge of the “individual conducting that transaction,” i.e. the clerk who receives and processes the instrument. Furthermore, paragraphs (2) and (4) each require that the person acting for the organization have knowledge of facts that indicate a breach of fiduciary duty. In the case of an instrument taken for deposit to an account, the knowledge is found in the fact that the deposit is made to an account other than that of the represented person or a fiduciary account for benefit of that person. In other cases the person acting for the organization must know that the instrument is taken in payment or as security for a personal debt of the fiduciary or for the personal benefit of the fiduciary. For example, if the instrument is being used to buy goods or services, the person acting for the organization must know that the goods or services are for the personal benefit of the fiduciary. The requirement that the taker have knowledge rather than notice is meant to limit Section 3‑307 to relatively uncommon cases in which the person who deals with the fiduciary knows all the relevant facts: the fiduciary status and that the proceeds of the instrument are being used for the personal debt or benefit of the fiduciary or are being paid to an account that is not an account of the represented person or of the fiduciary, as such. Mere notice of these facts is not enough to put the taker on notice of the breach of fiduciary duty and does not give rise to any duty of investigation by the taker.

3. Subsection (b)(2) applies to instruments payable to the represented person or the fiduciary as such. For example, a check payable to Corporation is indorsed in the name of Corporation by Doe as its President. Doe gives the check to Bank as partial repayment of a personal loan that Bank had made to Doe. The check was indorsed either in blank or to Bank. Bank collects the check and applies the proceeds to reduce the amount owed on Doe’s loan. If the person acting for Bank in the transaction knows that Doe is a fiduciary and that the check is being used to pay a personal obligation of Doe, subsection (b)(2) applies. If Corporation has a claim to the proceeds of the check because the use of the check by Doe was a breach of fiduciary duty, Bank has notice of the claim and did not take the check as a holder in due course. The same result follows if Doe had indorsed the check to himself before giving it to Bank. Subsection (b)(2) follows Uniform Fiduciaries Act Section 4 in providing that if the instrument is payable to the fiduciary, as such, or to the represented person, the taker has notice of a claim if the instrument is negotiated for the fiduciary’s personal debt. If fiduciary funds are deposited to a personal account of the fiduciary or to an account that is not an account of the represented person or of the fiduciary, as such, there is a split of authority concerning whether the bank is on notice of a breach of fiduciary duty. Subsection (b)(2)(iii) states that the bank is given notice of breach of fiduciary duty because of the deposit. The Uniform Fiduciaries Act Section 9 states that the bank is not on notice unless it has knowledge of facts that makes its receipt of the deposit an act of bad faith.

The rationale of subsection (b)(2) is that it is not normal for an instrument payable to the represented person or the fiduciary, as such, to be used for the personal benefit of the fiduciary. It is likely that such use reflects an unlawful use of the proceeds of the instrument. If the fiduciary is entitled to compensation from the represented person for services rendered or for expenses incurred by the fiduciary the normal mode of payment is by a check drawn on the fiduciary account to the order of the fiduciary.

4. Subsection (b)(3) is based on Uniform Fiduciaries Act Section 6 and applies when the instrument is drawn by the represented person or the fiduciary as such to the fiduciary personally. The term “personally” is used as it is used in the Uniform Fiduciaries Act to mean that the instrument is payable to the payee as an individual and not as a fiduciary. For example, Doe as President of Corporation writes a check on Corporation’s account to the order of Doe personally. The check is then indorsed over to Bank as in Comment 3. In this case there is no notice of breach of fiduciary duty because there is nothing unusual about the transaction. Corporation may have owed Doe money for salary, reimbursement for expenses incurred for the benefit of Corporation, or for any other reason. If Doe is authorized to write checks on behalf of Corporation to pay debts of Corporation, the check is a normal way of paying a debt owed to Doe. Bank may assume that Doe may use the instrument for his personal benefit.

5. Subsection (b)(4) can be illustrated by a hypothetical case. Corporation draws a check payable to an organization. X, an officer or employee of Corporation, delivers the check to a person acting for the organization. The person signing the check on behalf of Corporation is X or another person. If the person acting for the organization in the transaction knows that X is a fiduciary, the organization is on notice of a claim by Corporation if it takes the instrument under the same circumstances stated in subsection (b)(2). If the organization is a bank and the check is taken in repayment of a personal loan of the bank to X, the case is like the case discussed in Comment 3. It is unusual for Corporation, the represented person, to pay a personal debt of Doe by issuing a check to the bank. It is more likely that the use of the check by Doe reflects an unlawful use of the proceeds of the check. The same analysis applies if the check is made payable to an organization in payment of goods or services. If the person acting for the organization knew of the fiduciary status of X and that the goods or services were for X’s personal benefit, the organization is on notice of a claim by Corporation to the proceeds of the check. See the discussion in the last paragraph of Comment 2.

SOUTH CAROLINA REPORTER’S COMMENT

This section provides the rule for determining when a person taking an instrument from a fiduciary has notice of a breach of fiduciary duty. Under Subsection (b)(1), notice of a fiduciary’s breach of a fiduciary duty is notice of claim by the represented person.

Former Section 36‑3‑304(2) and (4)(e) addressed these issues. Under former Section 36‑3‑304(4)(e) a purchaser’s knowledge that the person negotiating the instrument was a fiduciary did not give the purchaser notice of a claim or defense. Under former Section 36‑3‑304(2), a purchaser’s knowledge that fiduciary negotiated the instrument in payment of or as security for his own debt or in any transaction for his own benefit or in breach of duty gave the purchaser notice of a claim precluding the purchaser from qualifying as a holder in due course. The former provisions did not, however, clearly define when a purchaser had notice of a breach of fiduciary duty.

Subsection (b) sets forth situations in which the taker of an instrument will have notice of a breach of fiduciary duty. In all cases, the taker must have actual knowledge of fiduciary’s fiduciary status. Rush v. South Carolina National Bank, 288 S.C. 560, 343 S.E.2d 667 (S.C. App. 1986) remains valid precedent for determining whether a fiduciary relationship exists.

Subsections (b)(2)‑(4) set forth the situations in which the taker of an instrument from a fiduciary has notice of the fiduciary’s breach of a fiduciary duty. In most cases, the taker of the instrument must have actual knowledge that the fiduciary transferred the instrument for his personal benefit. See 36‑3‑307(2)(i) and (ii), (3), and (4)(i) & (ii). These are, however, situations in which a taker can be liable without actual knowledge that the fiduciary has used the instrument for her personal benefit. See Section 36‑3‑307(b)(iii).

Subsection (b)(2) applies to instruments payable to the represented person or to the fiduciary acting in her fiduciary capacity. A typical example of such an instrument is a check payable to a corporation. If an officer of the corporation uses this check to pay a personal debt or as payment in a transaction entered into for the personal benefit of the officer, under Subsection (b)(2)(i) and (ii) the taker of the check has notice of a breach of fiduciary duty only if the taker had actual knowledge of both the officer’s fiduciary status with respect to the corporation and either that the debt paid was personal or that transaction was for the personal benefit of the officer. In contrast, under Subsection (b)(2)(iii) if the officer deposited the check into the officer’s personal bank account, the depositary bank would have notice of a breach of fiduciary duty if it knew that the officer was a fiduciary of the corporation.

Subsection (b)(4) applies to an instrument issued by the represented person or the fiduciary acting in her fiduciary capacity payable to the taker as payee. If the fiduciary uses this instrument to pay or secure a personal debt or the taker receives the check in a transaction for the personal benefit of the fiduciary, under Subsection (b)(4)(i) and (ii) the taker has notice of a breach of fiduciary duty only if the taker had actual knowledge of not only the fiduciary’s fiduciary status, but also that the fiduciary benefited personally from the transfer of the instrument.

Subsection (b)(4)(iii) applies when the instrument drawn by the represented party is deposited into an account other than an account of the represented party or the fiduciary’s trust account. For example, assume that Corporation (the represented person) issues a check drawn on Bank‑1 payable to Bank‑2 where Corporation also has an account. Assume further that Officer of Corporation obtains possession of the instrument and persuades Bank‑2 to deposit the check in Officer’s personal account at Bank‑2. Under Subsection (b)(4)(iii), Bank‑2 has notice of Corporation’s claim of breach of fiduciary duty if it knew the fiduciary status of Officer, even if it did not know that the Officer was using the funds for her personal benefit.

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| Definitional Cross References: |  |
| “Account” | Section 36‑4‑104(a)(1) |
| “Instrument” | Section 36‑3‑104(b) |
| “Issue” | Section 36‑3‑105(a) |
| “Knowledge” | Section 36‑1‑201(25) [see now Section 36‑1‑202] |
| “Notice” | Section 36‑2‑201(25) |
| “Payment” | Section 36‑3‑602(a) |
| “Person” | Section 36‑1‑201(30) |

Cross References:

1. Under Section 36‑3‑307 (b)(1) notice of a breach of a fiduciary duty is notice of a claim to the instrument on behalf of the represented party. Notice of a claim to the instrument precludes a taker from qualifying as a holder in due course. Section 36‑3‑302(a)(2)(v).

2. A taker who does not qualify as a holder in due course takes an instrument subject to claims of ownership. Section 36‑3‑306.

LIBRARY REFERENCES

Bills and Notes 491 to 497(55).

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 284 to 292, 294 to 295, 297, 302.

NOTES OF DECISIONS

In general 1

1. In general

Fraudulent inducement on the part of financial institution is not a defense to the transaction between retail automobile dealer and parent corporation and hence is not a defense to payment of the 5 stop payment checks to a subsequent holder, namely the financial institution. First Federal Sav. and Loan Ass’n of South Carolina v. Chrysler Credit Corp. (C.A.4 (S.C.) 1992) 981 F.2d 127.

Good‑faith requirement under Section 36‑3‑302(1), which specifies elements of holder in due course status, extends to notice of a defense under Section 36‑3‑304 in that “good faith” pertains to defenses to payment of a check in question, and such defenses are not limited to defenses inherent against the check itself, but also includes defenses with respect to underlying attendant transactions; thus in action brought by depository bank against drawer of checks on which drawer had stopped payment, bank was not a holder in due course where bank’s lack of good faith was shown on knowledge of facts and circumstances relating to defenses to payment of checks at issue, including defenses with respect to the underlying attendant transaction. First Federal Sav. and Loan Ass’n of South Carolina v. Chrysler Credit Corp. (C.A.4 (S.C.) 1992) 981 F.2d 127.

Financial institution could not be said to have acted in good faith and therefore is not entitled to holder in due course status since financial institution knew that retail automobile dealer was in a precarious financial condition, was check kiting, and was unable to pay its debts as they became due; it is beyond credulity to argue that these facts did not give notice to the financial institution that the parent corporation might be able to refuse payment to the automobile dealer upon the dishonor of such a large amount owed to the parent corporation. First Federal Sav. and Loan Ass’n of South Carolina v. Chrysler Credit Corp. (C.A.4 (S.C.) 1992) 981 F.2d 127.

A payee of a bank check was not a holder in due course of the check where the payee requested the instrument from the bank with the knowledge that the drawer of a check deposited in the payee’s account intended to stop payment on its check leaving an inadequate balance in the payee’s account to cover the check issued in consideration of the bank check. Since the payee was not a holder in due course, it took the bank check subject to the defense of failure of consideration as provided by Section 36‑3‑306(c), and therefore the bank was not liable on the instrument. Specialty Flooring Co., Inc. v. Palmetto Federal Sav. Bank of South Carolina (S.C.App. 1990) 302 S.C. 107, 394 S.E.2d 13.

Since under Code 1962 Section 8‑5 [Code 1976 Section 34‑31‑50] double recovery for amount of usurious interest actually paid can be collected by separate action or allowed as counterclaim in any action brought to recover principal sum, usurious note was “voidable in whole or in part” as required by Code 1962 Section 10.3‑304(1)(b) [Code 1976 Section 36‑3‑304(1)(b)], and therefore holder who took usurious note with knowledge of maker’s defense of usury could not obtain status of holder in due course. Davenport v. Unicapital Corp. (S.C. 1976) 267 S.C. 691, 230 S.E.2d 905.

**SECTION 36‑3‑308.** Proof of signatures and status as holder in due course.

(a) In an action with respect to an instrument, the authenticity of, and authority to make, each signature on the instrument is admitted unless specifically denied in the pleadings. If the validity of a signature is denied in the pleadings, the burden of establishing validity is on the person claiming validity, but the signature is presumed to be authentic and authorized unless the action is to enforce the liability of the purported signer and the signer is dead or incompetent at the time of trial of the issue of validity of the signature. If an action to enforce the instrument is brought against a person as the undisclosed principal of a person who signed the instrument as a party to the instrument, the plaintiff has the burden of establishing that the defendant is liable on the instrument as a represented person under Section 36‑3‑402(a).

(b) If the validity of signatures is admitted or proved and there is compliance with Subsection (a), a plaintiff producing the instrument is entitled to payment if the plaintiff proves entitlement to enforce the instrument under Section 36‑3‑301, unless the defendant proves a defense or claim in recoupment. If a defense or claim in recoupment is proved, the right to payment of the plaintiff is subject to the defense or claim, except to the extent the plaintiff proves that the plaintiff has rights of a holder in due course which are not subject to the defense or claim.

HISTORY: 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. Section 3‑308 is a modification of former Section 3‑307. The first two sentences of subsection (a) are a restatement of former Section 3‑307(1). The purpose of the requirement of a specific denial in the pleadings is to give the plaintiff notice of the defendant’s claim of forgery or lack of authority as to the particular signature, and to afford the plaintiff an opportunity to investigate and obtain evidence. If local rules of pleading permit, the denial may be on information and belief, or it may be a denial of knowledge or information sufficient to form a belief. It need not be under oath unless the local statutes or rules require verification. In the absence of such specific denial the signature stands admitted, and is not in issue. Nothing in this section is intended, however, to prevent amendment of the pleading in a proper case.

The question of the burden of establishing the signature arises only when it has been put in issue by specific denial. “Burden of establishing” is defined in Section 1‑201. The burden is on the party claiming under the signature, but the signature is presumed to be authentic and authorized except as stated in the second sentence of subsection (a). “Presumed” is defined in Section 1‑201 and means that until some evidence is introduced which would support a finding that the signature is forged or unauthorized, the plaintiff is not required to prove that it is valid. The presumption rests upon the fact that in ordinary experience forged or unauthorized signatures are very uncommon, and normally any evidence is within the control of, or more accessible to, the defendant. The defendant is therefore required to make some sufficient showing of the grounds for the denial before the plaintiff is required to introduce evidence. The defendant’s evidence need not be sufficient to require a directed verdict, but it must be enough to support the denial by permitting a finding in the defendant’s favor. Until introduction of such evidence the presumption requires a finding for the plaintiff. Once such evidence is introduced the burden of establishing the signature by a preponderance of the total evidence is on the plaintiff. The presumption does not arise if the action is to enforce the obligation of a purported signer who has died or become incompetent before the evidence is required, and so is disabled from obtaining or introducing it. “Action” is defined in Section 1‑201 and includes a claim asserted against the estate of a deceased or an incompetent.

The last sentence of subsection (a) is a new provision that is necessary to take into account Section 3‑402(a) that allows an undisclosed principal to be liable on an instrument signed by an authorized representative. In that case the person enforcing the instrument must prove that the undisclosed principal is liable.

2. Subsection (b) restates former Section 3‑307(2) and (3). Once signatures are proved or admitted a holder, by mere production of the instrument, proves “entitlement to enforce the instrument” because under Section 3‑301 a holder is a person entitled to enforce the instrument. Any other person in possession of an instrument may recover only if that person has the rights of a holder. Section 3‑301. That person must prove a transfer giving that person such rights under Section 3‑203(b) or that such rights were obtained by subrogation or succession.

If a plaintiff producing the instrument proves entitlement to enforce the instrument, either as a holder or a person with rights of a holder, the plaintiff is entitled to recovery unless the defendant proves a defense or claim in recoupment. Until proof of a defense or claim in recoupment is made, the issue as to whether the plaintiff has rights of a holder in due course does not arise. In the absence of a defense or claim in recoupment, any person entitled to enforce the instrument is entitled to recover. If a defense or claim in recoupment is proved, the plaintiff may seek to cut off the defense or claim in recoupment by proving that the plaintiff is a holder in due course or that the plaintiff has rights of a holder in due course under Section 3‑203(b) or by subrogation or succession. All elements of Section 3‑302(a) must be proved.

Nothing in this section is intended to say that the plaintiff must necessarily prove rights as a holder in due course. The plaintiff may elect to introduce no further evidence, in which case a verdict may be directed for the plaintiff or the defendant, or the issue of the defense or claim in recoupment may be left to the trier of fact, according to the weight and sufficiency of the defendant’s evidence. The plaintiff may elect to rebut the defense or claim in recoupment by proof to the contrary, in which case a verdict may be directed for either party or the issue may be for the trier of fact. Subsection (b) means only that if the plaintiff claims the rights of a holder in due course against the defense or claim in recoupment, the plaintiff has the burden of proof on that issue.

SOUTH CAROLINA REPORTER’S COMMENT

This provision is a revision of former Section 36‑3‑307. The first sentence of Subsection (a) restates the rule under former Section 36‑3‑307(1) and provides that, unless specifically denied in pleadings, the authenticity of and authority to make signatures on an instrument are admitted. In Conran v. Yager, 263 S.C. 417, 211 S.E.2d 228 (1975) the court asserted that in an action on a note the defendant’s general denial, that did not specifically deny that he had signed the note, constituted an admission entitling the plaintiff to summary judgment. See also National Equip., Ltd. v. David Jones Sales, Trucking Division, Inc., 268 S.C. 551, 235 S.E.2d 125 (1977) (defendant must allege forgery or specifically deny the authenticity of her signature).

The second sentence of Subsection (a) restates the rules under former Section 36‑3‑307(a) and (b). The second sentence provides that except in cases where the purported signer is deceased or incompetent a signature is presumed authentic and authorized, but when the validity of a signature is specifically denied the burden of proving its validity is on the person claiming that the signature is valid. The court recognized this rule in Pee Dee Production Credit Ass’n v. Joye, 284 S.C. 371, 326 S.E.2d 650 (1984). In that case the defendant placed the authenticity of his indorsement on a note in issue. Nevertheless, the trial judge instructed the jury that the defendant’s signature was presumed genuine. The court held that the trial judge erred in giving this instruction. Nevertheless, because the trial judge repeatedly instructed the jury that the plaintiff had the burden of proving the genuineness of the signature, the court held that the error was harmless.

The final sentence of Subsection (a) is new and addresses the burden of proof when an action is brought against an undisclosed principal to enforce an instrument.

Subsection (b) restates the provisions of former Section 36‑3‑307(2) and (3) relating to the burdens of proof on defenses and holder in due course status in cases in which the validity of the signatures is admitted or proved. Application of Subsection (b) to the facts in Conran v. Yager, 263 S. C. 417, 211 S.E.2d 228 (1975) would not change the result. In Conran, the court affirmed a summary judgment for the plaintiff where the plaintiff produced the instrument and the defendant did not specifically deny the authenticity of his signature.

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| Definitional Cross References: |  |
| “Action” | Section 36‑1‑201(1) |
| “Holder in due course” | Section 36‑3‑302(a) |
| “Instrument” | Section 36‑3‑104(b) |
| “Party” | Section 36‑3‑103(a)(10) |
| “Payment” | Section 36‑3‑602(a) |
| “Person entitled to enforce” | Section 36‑3‑301 |
| “Prove” | Section 36‑3‑103(a)(13) |
| “Rights” | Section 36‑1‑201(36) |
| “Unauthorized signature” | Section 36‑1‑201(43) |

Cross Reference:

1. An undisclosed principal who did not sign an instrument is liable on the instrument if the instrument was signed by an authorized representative. Section 36‑3‑402.

RESEARCH REFERENCES

Encyclopedias

S.C. Jur. Evidence Section 76, Commercial Paper and Related Documents.

NOTES OF DECISIONS

In general 1

1. In general

Promissory note, mortgage, loan modification agreements, and assignment of leases, rents, and profits were self‑authenticating, under rule of evidence providing that commercial paper, signatures thereon, and documents related thereto were self‑authenticating, and thus documents were admissible in mortgage foreclosure action; note and loan modification agreements, which modified the note, were “commercial paper,” mortgage and assignment of leases, rents, and profits were “documents relating thereto” because they represented security interests to secure repayment of the note, and mortgagor did not specifically deny, and thus admitted under the Uniform Commercial Code (UCC), the authenticity of mortgagor’s signature on the loan documents. Deep Keel, LLC v. Atlantic Private Equity Group, LLC (S.C.App. 2015) 413 S.C. 58, 773 S.E.2d 607. Evidence 370(11)

A promissory note secured by a real estate mortgage is a “negotiable instrument” under the Uniform Commercial Code (UCC), and therefore is an “instrument” under UCC provision stating that authenticity of signatures on instruments are admitted unless specifically denied in the pleadings. Deep Keel, LLC v. Atlantic Private Equity Group, LLC (S.C.App. 2015) 413 S.C. 58, 773 S.E.2d 607. Bills and Notes 167; Bills and Notes 474

In a deficiency action brought on a promissory note securing a mortgage, it was harmless error for the trial court to instruct the jury that a signature was presumed genuine where the court also repeatedly stated that the burden of proving the genuineness of the signature was on the party claiming under it. Western Carolina Regional Sewer Authority v. Bell (S.C. 1984) 284 S.C. 364, 326 S.E.2d 650.

Rule in Code 1962 Section 10.3‑307 [Code 1976 Section 36‑3‑307] that genuineness of signature must be specifically denied would be applied to action on equipment lease and guarantee. National Equipment, Ltd. v. David Jones Sales, Trucking Division, Inc. (S.C. 1977) 268 S.C. 551, 235 S.E.2d 125.

A general denial, while effective in an action on a simple contract, is unavailing in an action on a note where the note is attached to the complaint. Conran v. Yager (S.C. 1975) 263 S.C. 417, 211 S.E.2d 228. Bills And Notes 474

In action for collection of note given in sale of realty where purchaser conceded the existence of the note and raised no question as to the genuineness of his signature, the vendor’s production of the note, and the purchaser’s concession as to the amount due, entitled the vendor to recover on it pursuant to statute. Conran v. Yager (S.C. 1975) 263 S.C. 417, 211 S.E.2d 228.

Where contract for sale of realty is an integrated agreement excluding additional terms “without the written consent of the parties”, and the existence of such written consent to additional terms is not alleged, oral evidence of consistent additional terms is not admissible. Conran v. Yager (S.C. 1975) 263 S.C. 417, 211 S.E.2d 228.

**SECTION 36‑3‑309.** Enforcement of lost, destroyed, or stolen instrument.

(a) A person not in possession of an instrument is entitled to enforce the instrument if:

(1) the person seeking to enforce the instrument:

(A) was entitled to enforce the instrument when loss of possession occurred; or

(B) has directly or indirectly acquired ownership of the instrument from a person who was entitled to enforce the instrument 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 of the instrument because the instrument was destroyed, its whereabouts cannot be determined, or it is in the wrongful possession of an unknown person or a person that cannot be found or is not amenable to service of process.

(b) A person seeking enforcement of an instrument under Subsection (a) must prove the terms of the instrument and the person’s right to enforce the instrument. If that proof is made, Section 36‑3‑308 applies to the case as if the person seeking enforcement had produced the instrument. The court may not enter judgment in favor of the person seeking enforcement unless it finds that the person required to pay the instrument is adequately protected against loss that might occur by reason of a claim by another person to enforce the instrument. Adequate protection may be provided by any reasonable means.

HISTORY: 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. Section 3‑309 is a modification of former Section 3‑804. The rights stated are those of “a person entitled to enforce the instrument” at the time of loss rather than those of an “owner” as in former Section 3‑804. Under subsection (b), judgment to enforce the instrument cannot be given unless the court finds that the defendant will be adequately protected against a claim to the instrument by a holder that may appear at some later time. The court is given discretion in determining how adequate protection is to be assured. Former Section 3‑804 allowed the court to “require security indemnifying the defendant against loss.” Under Section 3‑309 adequate protection is a flexible concept. For example, there is substantial risk that a holder in due course may make a demand for payment if the instrument was payable to bearer when it was lost or stolen. On the other hand if the instrument was payable to the person who lost the instrument and that person did not indorse the instrument, no other person could be a holder of the instrument. In some cases there is risk of loss only if there is doubt about whether the facts alleged by the person who lost the instrument are true. Thus, the type of adequate protection that is reasonable in the circumstances may depend on the degree of certainty about the facts in the case.

2. Subsection (a) is intended to reject the result in Dennis Joslin Co. v. Robinson Broadcasting Corp., 977 F. Supp. 491 (D.D.C. 1997). A transferee of a lost instrument need prove only that its transferor was entitled to enforce, not that the transferee was in possession at the time the instrument was lost. The protections of subsection (a) should also be available when instruments are lost during transit, because whatever the precise status of ownership at the point of loss, either the sender or the receiver ordinarily would have been entitled to enforce the instrument during the course of transit. The amendments to subsection (a) are not intended to alter in any way the rules that apply to the preservation of checks in connection with truncation or any other expedited method of check collection or processing.

3. A security interest may attach to the right of a person not in possession of an instrument to enforce the instrument. Although the secured party may not be the owner of the instrument, the secured party may nevertheless be entitled to exercise its debtor’s right to enforce the instrument by resorting to its collection rights under the circumstances described in Section 9‑607. This section does not address whether the person required to pay the instrument owes any duty to a secured party that is not itself the owner of the instrument.

SOUTH CAROLINA REPORTER’S COMMENT

Section 36‑3‑309 is a modification of former Section 36‑3‑804. Subsection (a) sets forth the requirements that a person not in possession of an instrument must meet to enforce the instrument. Subsection (b) imposes the burden of proving the terms of the instrument and a person’s right to enforce the instrument upon the person seeking a lost, destroyed, or stolen instrument. Subsection (b) also conditions enforcement of the instrument upon providing adequate protection to the person against whom enforcement is sought for the risk that person may be liable on the instrument to another party.

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| Definitional Cross References: |  |
| “Instrument” | Section 36‑3‑104(b) |
| “Person Entitled to Enforce” | Section 36‑3‑301 |
| “Prove” | Section 36‑3‑103(a)(13) |

Cross References:

1. Person not in possession entitled to enforce an instrument. Section 36‑3‑303(iii).

2. Lost, destroyed or stolen cashier’s checks, teller’s checks or certified checks. Section 36‑3‑312.

**SECTION 36‑3‑310.** Effect on obligation when instrument taken.

(a) Unless otherwise agreed, if a certified check, cashier’s check, or teller’s check is taken for an obligation, the obligation is discharged to the same extent discharge would result if an amount of money equal to the amount of the instrument were taken in payment of the obligation. Discharge of the obligation does not affect any liability that the obligor may have as an indorser of the instrument.

(b) Unless otherwise agreed and except as provided in Subsection (a), if a note or an uncertified check is taken for an obligation, the obligation is suspended to the same extent the obligation would be discharged if an amount of money equal to the amount of the instrument were taken, and the following rules apply:

(1) In the case of an uncertified check, suspension of the obligation continues until dishonor of the check or until it is paid or certified. Payment or certification of the check results in discharge of the obligation to the extent of the amount of the check.

(2) In the case of a note, suspension of the obligation continues until dishonor of the note or until it is paid. Payment of the note results in discharge of the obligation to the extent of the payment.

(3) Except as provided in Paragraph (4), if the check or note is dishonored and the obligee of the obligation for which the instrument was taken is the person entitled to enforce the instrument, the obligee may enforce either the instrument or the obligation. In the case of an instrument of a third person which is negotiated to the obligee by the obligor, discharge of the obligor on the instrument also discharges the obligation.

(4) If the person entitled to enforce the instrument taken for an obligation is a person other than the obligee, the obligee may not enforce the obligation to the extent the obligation is suspended. If the obligee is the person entitled to enforce the instrument but no longer has possession of it because it was lost, stolen, or destroyed, the obligation may not be enforced to the extent of the amount payable on the instrument, and to that extent the obligee’s rights against the obligor are limited to enforcement of the instrument.

(c) If an instrument other than one described in Subsection (a) or (b) is taken for an obligation, the effect is (i) that stated in subsection (a) if the instrument is one on which a bank is liable as maker or acceptor, or (ii) that stated in Subsection (b) in any other case.

HISTORY: 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. Section 3‑310 is a modification of former Section 3‑802. As a practical matter, application of former Section 3‑802 was limited to cases in which a check or a note was given for an obligation. Subsections (a) and (b) of Section 3‑310 are therefore stated in terms of checks and notes in the interests of clarity. Subsection (c) covers the rare cases in which some other instrument is given to pay an obligation.

2. Subsection (a) deals with the case in which a certified check, cashier’s check or teller’s check is given in payment of an obligation. In that case the obligation is discharged unless there is an agreement to the contrary. Subsection (a) drops the exception in former Section 3‑802 for cases in which there is a right of recourse on the instrument against the obligor. Under former Section 3‑802(1)(a) the obligation was not discharged if there was a right of recourse on the instrument against the obligor. Subsection (a) changes this result. The underlying obligation is discharged, but any right of recourse on the instrument is preserved.

3. Subsection (b) concerns cases in which an uncertified check or a note is taken for an obligation. The typical case is that in which a buyer pays for goods or services by giving the seller the buyer’s personal check, or in which the buyer signs a note for the purchase price. Subsection (b) also applies to the uncommon cases in which a check or note of a third person is given in payment of the obligation. Subsection (b) preserves the rule under former Section 3‑802(1)(b) that the buyer’s obligation to pay the price is suspended, but subsection (b) spells out the effect more precisely. If the check or note is dishonored, the seller may sue on either the dishonored instrument or the contract of sale if the seller has possession of the instrument and is the person entitled to enforce it. If the right to enforce the instrument is held by somebody other than the seller, the seller can’t enforce the right to payment of the price under the sales contract because that right is represented by the instrument which is enforceable by somebody else. Thus, if the seller sold the note or the check to a holder and has not reacquired it after dishonor, the only right that survives is the right to enforce the instrument. What that means is that even though the suspension of the obligation may end upon dishonor under paragraph (b)(1), the obligation is not revived in the circumstances described in paragraph (b)(4).

The last sentence of subsection (b)(3) applies to cases in which an instrument of another person is indorsed over to the obligee in payment of the obligation. For example, Buyer delivers an uncertified personal check of X payable to the order of Buyer to Seller in payment of the price of goods. Buyer indorses the check over to Seller. Buyer is liable on the check as indorser. If Seller neglects to present the check for payment or to deposit it for collection within 30 days of the indorsement, Buyer’s liability as indorser is discharged. Section 3‑415(e). Under the last sentence of Section 3‑310(b)(3) Buyer is also discharged on the obligation to pay for the goods.

4. There was uncertainty concerning the applicability of former Section 3‑802 to the case in which the check given for the obligation was stolen from the payee, the payee’s signature was forged, and the forger obtained payment. The last sentence of subsection (b)(4) addresses this issue. If the payor bank pays a holder, the drawer is discharged on the underlying obligation because the check was paid. Subsection (b)(1). If the payor bank pays a person not entitled to enforce the instrument, as in the hypothetical case, the suspension of the underlying obligation continues because the check has not been paid. Section 3‑602(a). The payee’s cause of action is against the depositary bank or payor bank in conversion under Section 3‑420 or against the drawer under Section 3‑309. In the latter case, the drawer’s obligation under Section 3‑414(b) is triggered by dishonor which occurs because the check is unpaid. Presentment for payment to the drawee is excused under Section 3‑504(a)(i) and, under Section 3‑502(e), dishonor occurs without presentment if the check is not paid. The payee cannot merely ignore the instrument and sue the drawer on the underlying contract. This would impose on the drawer the risk that the check when stolen was indorsed in blank or to bearer.

A similar analysis applies with respect to lost instruments that have not been paid. If a creditor takes a check of the debtor in payment of an obligation, the obligation is suspended under the introductory paragraph of subsection (b). If the creditor then loses the check, what are the creditor’s rights? The creditor can request the debtor to issue a new check and in many cases, the debtor will issue a replacement check after stopping payment on the lost check. In that case both the debtor and creditor are protected. But the debtor is not obliged to issue a new check. If the debtor refuses to issue a replacement check, the last sentence of subsection (b)(4) applies. The creditor may not enforce the obligation of debtor for which the check was taken. The creditor may assert only rights on the check. The creditor can proceed under Section 3‑309 to enforce the obligation of the debtor, as drawer, to pay the check.

5. Subsection (c) deals with rare cases in which other instruments are taken for obligations. If a bank is the obligor on the instrument, subsection (a) applies and the obligation is discharged. In any other case subsection (b) applies.

SOUTH CAROLINA REPORTER’S COMMENT

Subsection (a) is based upon former Section 36‑3‑802(1)(a) and provides the general rule that if a certified check, cashier’s check, or teller’s check is taken for an obligation the obligation is discharged to the extent of the amount of the check. Subsection (a), however, deletes the provision in the former statute that limited an obligor’s discharge to situations where there was no recourse on the instrument against the obligor.

Subsection (b) is based upon former Section 36‑3‑802(1)(b) and applies when a note or uncertified check is taken for an obligation. The subsection states the rules on the effect upon the issuer’s obligation of taking such an instrument. Subsection (b) provides that if a note or uncertified check is taken in payment for an underlying obligation, the underlying obligation is suspended. In the case of an uncertified check, Subsection (b)(1) provides that the underlying obligation remains suspended until the check is dishonored, paid, or certified and that payment or certification of the check will discharge the drawer’s liability upon the underlying obligation. See also Sections 36‑3‑602(c) and 36‑3‑414(c). Upon dishonor of the check, Subsection (b)(3) provides that the payee can bring an action against the drawer for both the drawer’s liability on the check under Section 36‑3‑414(b) and the drawer’s liability on the underlying obligation.

Subsection (b)(2) provides that if a note is taken for an obligation, the obligation remains suspended until the note is paid or dishonored and that payment of the note discharges the maker’s liability on the underlying obligation. See also Section 36‑3‑602(c) (payment discharges maker’s obligation on the note). Under Subsection (b)(3), upon dishonor of the note the payee can enforce both the maker’s liability on the note and on the underlying obligation. See Section 36‑3‑412 (obligation of issuer of note).

Subsection (b)(4) addresses two issues. First, if the obligee has transferred the note or uncertified check to a third party who is entitled to enforce the instrument against the obligor, the obligee cannot enforce the underlying obligation until the note or uncertified check is dishonored. Second, if obligee has not transferred the note or uncertified check, but the instrument has been lost, stolen, or destroyed, the second sentence of Subsection (b)(4) provides that the obligee cannot enforce the underlying obligation and that the obligee’s remedies are limited to enforcing the instrument. See Section 36‑3‑309. Former Section 36‑3‑802(1)(b) did not expressly address lost or stolen checks. Subsection (b)(4) does address this issue.

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| Definitional Cross References: |  |
| “Acceptor” | Section 36‑3‑103(a)(1) |
| “Bank” | Section 36‑1‑201(4) |
| “Cashier’s Check” | Section 36‑3‑104(g) |
| “Certified Check” | Section 36‑3‑409(d) |
| “Check” | Section 36‑3‑104(f) |
| “Indorser” | Section 36‑3‑204(b) |
| “Instrument” | Section 36‑3‑104(b) |
| “Maker” | Section 36‑3‑103(a)(7) |
| “Money” | Section 36‑1‑201(24) |
| “Negotiable Instrument” | Section 36‑3‑104(a) |
| “Note” | Section 36‑3‑104(e) |
| “Payment” | Section 36‑3‑602(a) |
| “Person Entitled to Enforce” | Section 36‑3‑301 |
| “Rights” | Section 36‑1‑201(36) |
| “Teller’s Check” | Section 36‑3‑104(b) |

Cross References:

1. Discharge of obligation of party to pay an instrument. Section 36‑3‑601.

2. Payment of instrument as discharge of the obligation of a party to pay the instrument. Section 36‑3‑602(c).

3. Obligation of issuer of note. Section 36‑3‑412.

4. Obligation of drawer of unaccepted draft. Section 36‑3‑414(b).

5. Discharge of drawer upon certification of a check. Sections 36‑3‑414(c) and 36‑3‑409(d).

6. Enforcement of lost, destroyed or stolen instrument. Section 36‑3‑309.

7. Discharge of obligation of party to an instrument by cancellation or renunciation. Section 36‑3‑604.

8. Discharge of secondary obligors. Section 36‑3‑605.

NOTES OF DECISIONS

In general 1

1. In general

To establish personal jurisdiction over an out‑of‑state defendant under the “doing business” provision, the contacts between the defendant and the state must be fairly extensive before the burden of defending a suit there may be imposed upon it without offending traditional notions of fair play and substantial justice. Wolf v. Richmond County Hosp. Authority (C.A.4 (S.C.) 1984) 745 F.2d 904, certiorari denied 106 S.Ct. 83, 474 U.S. 826, 88 L.Ed.2d 68. Constitutional Law 3965(3)

**SECTION 36‑3‑311.** Accord and satisfaction by use of instrument.

(a) If a person against whom a claim is asserted proves that (i) that person in good faith tendered an instrument to the claimant as full satisfaction of the claim, (ii) the amount of the claim was unliquidated or subject to a bona fide dispute, and (iii) the claimant obtained payment of the instrument, the following subsections apply.

(b) Unless Subsection (c) applies, the claim is discharged if the person against whom the claim is asserted proves that the instrument or an accompanying written communication contained a conspicuous statement to the effect that the instrument was tendered as full satisfaction of the claim.

(c) Subject to Subsection (d), a claim is not discharged under Subsection (b) if either of the following applies:

(1) The claimant, if an organization, proves that (i) within a reasonable time before the tender, the claimant sent a conspicuous statement to the person against whom the claim is asserted that communications concerning disputed debts, including an instrument tendered as full satisfaction of a debt, are to be sent to a designated person, office, or place, and (ii) the instrument or accompanying communication was not received by that designated person, office, or place.

(2) The claimant, whether or not an organization, proves that within 90 days after payment of the instrument, the claimant tendered repayment of the amount of the instrument to the person against whom the claim is asserted. This paragraph does not apply if the claimant is an organization that sent a statement complying with Paragraph (1)(i).

(d) A claim is discharged if the person against whom the claim is asserted proves that within a reasonable time before collection of the instrument was initiated, the claimant, or an agent of the claimant having direct responsibility with respect to the disputed obligation, knew that the instrument was tendered in full satisfaction of the claim.

HISTORY: 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. This section deals with an informal method of dispute resolution carried out by use of a negotiable instrument. In the typical case there is a dispute concerning the amount that is owed on a claim.

Case # 1. The claim is for the price of goods or services sold to a consumer who asserts that he or she is not obliged to pay the full price for which the consumer was billed because of a defect or breach of warranty with respect to the goods or services.

Case # 2. A claim is made on an insurance policy. The insurance company alleges that it is not liable under the policy for the amount of the claim.

In either case the person against whom the claim is asserted may attempt an accord and satisfaction of the disputed claim by tendering a check to the claimant for some amount less than the full amount claimed by the claimant. A statement will be included on the check or in a communication accompanying the check to the effect that the check is offered as full payment or full satisfaction of the claim. Frequently, there is also a statement to the effect that obtaining payment of the check is an agreement by the claimant to a settlement of the dispute for the amount tendered. Before enactment of revised Article 3, the case law was in conflict over the question of whether obtaining payment of the check had the effect of an agreement to the settlement proposed by the debtor. This issue was governed by a common law rule, but some courts hold that the common law was modified by former Section 1‑207 which they interpreted as applying to full settlement checks.

2. Comment d. to Restatement of Contracts, Section 281 discusses the full satisfaction check and the applicable common law rule. In a case like Case # 1, the buyer can propose a settlement of the disputed bill by a clear notation on the check indicating that the check is tendered as full satisfaction of the bill. Under the common law rule the seller, by obtaining payment of the check accepts the offer of compromise by the buyer. The result is the same if the seller adds a notation to the check indicating that the check is accepted under protest or in only partial satisfaction of the claim. Under the common law rule the seller can refuse the check or can accept it subject to the condition stated by the buyer, but the seller can’t accept the check and refuse to be bound by the condition. The rule applies only to an unliquidated claim or a claim disputed in good faith by the buyer. The dispute in the courts was whether Section 1‑207 changed the common law rule. The Restatement states that section “need not be read as changing this well‑established rule.”

3. As part of the revision of Article 3, Section 1‑207 has been amended to add subsection (2) stating that Section 1‑207 “does not apply to an accord and satisfaction.” Because of that amendment and revised Article 3, Section 3‑311 governs full satisfaction checks. Section 3‑311 follows the common law rule with some minor variations to reflect modern business conditions. In cases covered by Section 3‑311 there will often be an individual on one side of the dispute and a business organization on the other. This section is not designed to favor either the individual or the business organization. In Case # 1 the person seeking the accord and satisfaction is an individual. In Case # 2 the person seeking the accord and satisfaction is an insurance company. Section 3‑311 is based on a belief that the common law rule produces a fair result and that informal dispute resolution by full satisfaction checks should be encouraged.

4. Subsection (a) states three requirements for application of Section 3‑311. “Good faith” in subsection (a)(i) is defined in Section 3‑103(a)(4) as not only honesty in fact, but the observance of reasonable commercial standards of fair dealing. The meaning of “fair dealing” will depend upon the facts in the particular case. For example, suppose an insurer tenders a check in settlement of a claim for personal injury in an accident clearly covered by the insurance policy. The claimant is necessitous and the amount of the check is very small in relationship to the extent of the injury and the amount recoverable under the policy. If the trier of fact determines that the insurer was taking unfair advantage of the claimant, an accord and satisfaction would not result from payment of the check because of the absence of good faith by the insurer in making the tender. Another example of lack of good faith is found in the practice of some business debtors in routinely printing full satisfaction language on their check stocks so that all or a large part of the debts of the debtor are paid by checks bearing the full satisfaction language, whether or not there is any dispute with the creditor. Under such a practice the claimant cannot be sure whether a tender in full satisfaction is or is not being made. Use of a check on which full satisfaction language was affixed routinely pursuant to such a business practice may prevent an accord and satisfaction on the ground that the check was not tendered in good faith under subsection (a)(i).

Section 3‑311 does not apply to cases in which the debt is a liquidated amount and not subject to a bona fide dispute. Subsection (a)(ii). Other law applies to cases in which a debtor is seeking discharge of such a debt by paying less than the amount owed. For the purpose of subsection (a)(iii) obtaining acceptance of a check is considered to be obtaining payment of the check.

The person seeking the accord and satisfaction must prove that the requirements of subsection (a) are met. If that person also proves that the statement required by subsection (b) was given, the claim is discharged unless subsection (c) applies. Normally the statement required by subsection (b) is written on the check. Thus, the canceled check can be used to prove the statement as well as the fact that the claimant obtained payment of the check. Subsection (b) requires a “conspicuous” statement that the instrument was tendered in full satisfaction of the claim. “Conspicuous” is defined in Section 1‑201(10). The statement is conspicuous if “it is so written that a reasonable person against whom it is to operate ought to have noticed it.” If the claimant can reasonably be expected to examine the check, almost any statement on the check should be noticed and is therefore conspicuous. In cases in which the claimant is an individual the claimant will receive the check and will normally indorse it. Since the statement concerning tender in full satisfaction normally will appear above the space provided for the claimant’s indorsement of the check, the claimant “ought to have noticed” the statement.

5. Subsection (c)(1) is a limitation on subsection (b) in cases in which the claimant is an organization. It is designed to protect the claimant against inadvertent accord and satisfaction. If the claimant is an organization payment of the check might be obtained without notice to the personnel of the organization concerned with the disputed claim. Some business organizations have claims against very large numbers of customers. Examples are department stores, public utilities and the like. These claims are normally paid by checks sent by customers to a designated office at which clerks employed by the claimant or a bank acting for the claimant process the checks and record the amounts paid. If the processing office is not designed to deal with communications extraneous to recording the amount of the check and the account number of the customer, payment of a full satisfaction check can easily be obtained without knowledge by the claimant of the existence of the full satisfaction statement. This is particularly true if the statement is written on the reverse side of the check in the area in which indorsements are usually written. Normally, the clerks of the claimant have no reason to look at the reverse side of checks. Indorsement by the claimant normally is done by mechanical means or there may be no indorsement at all. Section 4‑205(a). Subsection (c)(1) allows the claimant to protect itself by advising customers by a conspicuous statement that communications regarding disputed debts must be sent to a particular person, office, or place. The statement must be given to the customer within a reasonable time before the tender is made. This requirement is designed to assure that the customer has reasonable notice that the full satisfaction check must be sent to a particular place. The reasonable time requirement could be satisfied by a notice on the billing statement sent to the customer. If the full satisfaction check is sent to the designated destination and the check is paid, the claim is discharged. If the claimant proves that the check was not received at the designated destination the claim is not discharged unless subsection (d) applies.

6. Subsection (c)(2) is also designed to prevent inadvertent accord and satisfaction. It can be used by a claimant other than an organization or by a claimant as an alternative to subsection (c)(1). Some organizations may be reluctant to use subsection (c)(1) because it may result in confusion of customers that causes checks to be routinely sent to the special designated person, office, or place. Thus, much of the benefit of rapid processing of checks may be lost. An organization that chooses not to send a notice complying with subsection (c)(1)(i) may prevent an inadvertent accord and satisfaction by complying with subsection (c)(2). If the claimant discovers that it has obtained payment of a full satisfaction check, it may prevent an accord and satisfaction if, within 90 days of the payment of the check, the claimant tenders repayment of the amount of the check to the person against whom the claim is asserted.

7. Subsection (c) is subject to subsection (d). If a person against whom a claim is asserted proves that the claimant obtained payment of a check known to have been tendered in full satisfaction of the claim by “the claimant or an agent of the claimant having direct responsibility with respect to the disputed obligation,” the claim is discharged even if (i) the check was not sent to the person, office, or place required by a notice complying with subsection (c)(1), or (ii) the claimant tendered repayment of the amount of the check in compliance with subsection (c)(2).

A claimant knows that a check was tendered in full satisfaction of a claim when the claimant “has actual knowledge” of that fact. Section 1‑201(25). Under Section 1‑201(27), if the claimant is an organization, it has knowledge that a check was tendered in full satisfaction of the claim when that fact is brought to the attention of the individual conducting that transaction, and in any event when it would have been brought to his attention if the organization had exercised due diligence. An organization exercises due diligence if it maintains reasonable routines for communicating significant information to the person conducting the transaction and there is reasonable compliance with the routines. Due diligence does not require an individual acting for the organization to communicate information unless such communication is part of his regular duties or unless he has reason to know of the transaction and that the transaction would be materially affected by the information.

With respect to an attempted accord and satisfaction the “individual conducting that transaction” is an employee or other agent of the organization having direct responsibility with respect to the dispute. For example, if the check and communication are received by a collection agency acting for the claimant to collect the disputed claim, obtaining payment of the check will result in an accord and satisfaction even if the claimant gave notice, pursuant to subsection (c)(1), that full satisfaction checks be sent to some other office. Similarly, if a customer asserting a claim for breach of warranty with respect to defective goods purchased in a retail outlet of a large chain store delivers the full satisfaction check to the manager of the retail outlet at which the goods were purchased, obtaining payment of the check will also result in an accord and satisfaction. On the other hand, if the check is mailed to the chief executive officer of the chain store subsection (d) would probably not be satisfied. The chief executive officer of a large corporation may have general responsibility for operations of the company, but does not normally have direct responsibility for resolving a small disputed bill to a customer. A check for a relatively small amount mailed to a high executive officer of a large organization is not likely to receive the executive’s personal attention. Rather, the check would normally be routinely sent to the appropriate office for deposit and credit to the customer’s account. If the check does receive the personal attention of the high executive officer and the officer is aware of the full‑satisfaction language, collection of the check will result in an accord and satisfaction because subsection (d) applies. In this case the officer has assumed direct responsibility with respect to the disputed transaction.

If a full satisfaction check is sent to a lock box or other office processing checks sent to the claimant, it is irrelevant whether the clerk processing the check did or did not see the statement that the check was tendered as full satisfaction of the claim. Knowledge of the clerk is not imputed to the organization because the clerk has no responsibility with respect to an accord and satisfaction. Moreover, there is no failure of “due diligence” under Section 1‑201(27) if the claimant does not require its clerks to look for full satisfaction statements on checks or accompanying communications. Nor is there any duty of the claimant to assign that duty to its clerks. Section 3‑311(c) is intended to allow a claimant to avoid an inadvertent accord and satisfaction by complying with either subsection (c)(1) or (2) without burdening the check‑processing operation with extraneous and wasteful additional duties.

8. In some cases the disputed claim may have been assigned to a finance company or bank as part of a financing arrangement with respect to accounts receivable. If the account debtor was notified of the assignment, the claimant is the assignee of the account receivable and the “agent of the claimant” in subsection (d) refers to an agent of the assignee.

SOUTH CAROLINA REPORTER’S COMMENT

This provision is new and modifies the common law of accord and satisfaction. The provision attempts to provide a balanced approach to the use of a check submitted in full satisfaction of a disputed or unliquidate debt in an era in which payees may not physically examine checks received or comprehend the significance of cashing such a check.

Under common law of South Carolina, accord and satisfaction occurs when there is (1) an agreement to accept in discharge of an obligation something different from that which the creditor is claiming or is entitled to receive (accord) and (2) payment of the consideration expressed in the new agreement. Mercury Marine Division of Brunswick Corp. v. Costas, 288 S.C. 383, 342 S.E. 2d 632 (S.C. App. 1986). Acceptance of a check for less than the amount due does not indicate assent to the lesser sum in satisfaction of the full sum due, unless acceptance of the lesser sum is intended by both parties as an accord and satisfaction. Florence City‑County Airport Comm’n v. Air Terminal Parking Co., 283 S.C. 337, 322 S.E.2d 471 (S.C. App. 1984). Accepting a check marked “final payment” does not, without more, release a debtor from his obligation to fully repay his creditor. Id. The debtor must intend and make unmistakably clear that the payment tendered fully satisfies the creditor’s demand, and the creditor must accept payment with the intention that it shall operate as a satisfaction. Tremont Constr. Co., Inc. v. Dunlap, 310 S.C. 180, 425 S.E.2d 792 (S.C. App. 1992).

Subsections (a) and (b) are not inconsistent with the common law. Under Subsection (a) a person against whom a claim is asserted can establish a defense of accord and satisfaction through use of a negotiable instrument only if: (1) the person asserting the defense in good faith tendered the instrument in full satisfaction of the claim, (2) the amount of the claim was unliquidated or subject to a bona fide dispute, and (3) the claimant obtained payment of the instrument. Subsection (b) conditions discharge of the claim upon the person claiming the discharge proving that the instrument or a written communication accompanying the instrument contained a conspicuous statement that the instrument was tendered in full satisfaction of the claim.

Subsection (c) changes the common law by providing two exceptions to the rule that an accord and satisfaction that meets the requirements of Subsections (a) and (b) discharges a claim. Subsection (c)(1) reflects the current automated check collection process under which a commercial payee would not see even a conspicuous “full satisfaction” statement on the back of a check. Under Subsection (c)(1) if an organization sends its customers conspicuous statements providing that all communications concerning disputed debts including checks tendered in full satisfaction must be sent to a designated office, the organization is not bound unless the check submitted in full satisfaction is received by that office. Under Subsection (c)(2) a claimant, whether or not it is an organization, can avoid the effect of an accord and satisfaction by repaying the amount tendered within 90 days after the payment. Repayment under Subsection (c)(2), however, is not available to an organization that sent a statement under Subsection (c)(1).

Subsection (d) provides that the exceptions to discharge under Subsection (c) do not apply if the person asserting the discharge who complied with the requirements of subsections (a) and (b) proves that the claimant had actual knowledge that the instrument was submitted in full satisfaction of the claim.

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| Definitional Cross References: |  |
| “Conspicuous” | Section 36‑1‑201(10) |
| “Good Faith” | Section 36‑3‑103(a)(6) |
| “Instrument” | Section 36‑3‑104(b) |
| “Payment” | Section 36‑3‑602(a) |
| “Prove” | Section 36‑3‑103(a)(13) |

Cross References:

1. Payment of an instrument discharges the obligation of a party to pay the instrument. Section 36‑3‑602(c).

2. Payment of an uncertified check or note discharges the obligation for which the instrument was issued. Section 36‑3‑310(b).

**SECTION 36‑3‑312.** Lost, destroyed, or stolen cashier’s check, teller’s check, or certified check.

(a) In this section:

(1) “Check” means a cashier’s check, teller’s check, or certified check.

(2) “Claimant” means a person who claims the right to receive the amount of a cashier’s check, teller’s check, or certified check that was lost, destroyed, or stolen.

(3) “Declaration of loss” means a statement, made in a record under penalty of perjury, to the effect that (i) the declarer lost possession of a check, (ii) the declarer is the drawer or payee of the check, in the case of a certified check, or the remitter or payee of the check, in the case of a cashier’s check or teller’s check, (iii) the loss of possession was not the result of a transfer by the declarer or a lawful seizure, and (iv) the declarer cannot reasonably obtain possession of the check because the check was destroyed, its whereabouts cannot be determined, or it is in the wrongful possession of an unknown person or a person that cannot be found or is not amenable to service of process.

(4) “Obligated bank” means the issuer of a cashier’s check or teller’s check or the acceptor of a certified check.

(b) A claimant may assert a claim to the amount of a check by a communication to the obligated bank describing the check with reasonable certainty and requesting payment of the amount of the check, if (i) the claimant is the drawer or payee of a certified check or the remitter or payee of a cashier’s check or teller’s check, (ii) the communication contains or is accompanied by a declaration of loss of the claimant with respect to the check, (iii) the communication is received at a time and in a manner affording the bank a reasonable time to act on it before the check is paid, and (iv) the claimant provides reasonable identification if requested by the obligated bank. Delivery of a declaration of loss is a warranty of the truth of the statements made in the declaration. If a claim is asserted in compliance with this subsection, the following rules apply:

(1) The claim becomes enforceable at the later of (i) the time the claim is asserted, or (ii) the 90th day following the date of the check, in the case of a cashier’s check or teller’s check, or the 90th day following the date of the acceptance, in the case of a certified check.

(2) Until the claim becomes enforceable, it has no legal effect and the obligated bank may pay the check or, in the case of a teller’s check, may permit the drawee to pay the check. Payment to a person entitled to enforce the check discharges all liability of the obligated bank with respect to the check.

(3) If the claim becomes enforceable before the check is presented for payment, the obligated bank is not obliged to pay the check.

(4) When the claim becomes enforceable, the obligated bank becomes obliged to pay the amount of the check to the claimant if payment of the check has not been made to a person entitled to enforce the check. Subject to Section 36‑4‑302(a)(1), payment to the claimant discharges all liability of the obligated bank with respect to the check.

(c) If the obligated bank pays the amount of a check to a claimant under Subsection (b)(4) and the check is presented for payment by a person having rights of a holder in due course, the claimant is obliged to (i) refund the payment to the obligated bank if the check is paid, or (ii) pay the amount of the check to the person having rights of a holder in due course if the check is dishonored.

(d) If a claimant has the right to assert a claim under Subsection (b) and is also a person entitled to enforce a cashier’s check, teller’s check, or certified check which is lost, destroyed, or stolen, the claimant may assert rights with respect to the check either under this section or Section 36‑3‑309.

HISTORY: 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. This section applies to cases in which a cashier’s check, teller’s check, or certified check is lost, destroyed, or stolen. In one typical case a customer of a bank closes his or her account and takes a cashier’s check or teller’s check of the bank as payment of the amount of the account. The customer may be moving to a new area and the check is to be used to open a bank account in that area. In such a case the check will normally be payable to the customer. In another typical case a cashier’s check or teller’s check is bought from a bank for the purpose of paying some obligation of the buyer of the check. In such a case the check may be made payable to the customer and then negotiated to the creditor by indorsement. But often, the payee of the check is the creditor. In the latter case the customer is a remitter. The section covers loss of the check by either the remitter or the payee. The section also covers loss of a certified check by either the drawer or payee.

Under Section 3‑309 a person seeking to enforce a lost, destroyed, or stolen cashier’s check or teller’s check may be required by the court to give adequate protection to the issuing bank against loss that might occur by reason of the claim by another person to enforce the check. This might require the posting of an expensive bond for the amount of the check. Moreover, Section 3‑309 applies only to a person entitled to enforce the check. It does not apply to a remitter of a cashier’s check or teller’s check or to the drawer of a certified check. Section 3‑312 applies to both. The purpose of Section 3‑312 is to offer a person who loses such a check a means of getting refund of the amount of the check within a reasonable period of time without the expense of posting a bond and with full protection of the obligated bank.

2. A claim to the amount of a lost, destroyed, or stolen cashier’s check, teller’s check, or certified check may be made under subsection (b) if the following requirements of that subsection are met. First, a claim may be asserted only by the drawer or payee of a certified check or the remitter or payee of a cashier’s check or teller’s check. An indorsee of a check is not covered because the indorsee is not an original party to the check or a remitter. Limitation to an original party or remitter gives the obligated bank the ability to determine, at the time it becomes obligated on the check, the identity of the person or persons who can assert a claim with respect to the check. The bank is not faced with having to determine the rights of some person who was not a party to the check at that time or with whom the bank had not dealt. If a cashier’s check is issued to the order of the person who purchased it from the bank and that person indorses it over to a third person who loses the check, the third person may assert rights to enforce the check under Section 3‑309 but has no rights under Section 3‑312.

Second, the claim must be asserted by a communication to the obligated bank describing the check with reasonable certainty and requesting payment of the amount of the check. “Obligated bank” is defined in subsection (a)(4). Third, the communication must be received in time to allow the obligated bank to act on the claim before the check is paid, and the claimant must provide reasonable identification if requested. Subsections (b)(iii) and (iv). Fourth, the communication must contain or be accompanied by a declaration of loss described in subsection (b). This declaration is an affidavit or other writing made under penalty of perjury alleging the loss, destruction, or theft of the check and stating that the declarer is a person entitled to assert a claim, i.e. the drawer or payee of a certified check or the remitter or payee of a cashier’s check or teller’s check.

A claimant who delivers a declaration of loss makes a warranty of the truth of the statements made in the declaration. The warranty is made to the obligated bank and anybody who has a right to enforce the check. If the declaration of loss falsely alleges loss of a cashier’s check that did not in fact occur, a holder of the check who was unable to obtain payment because subsection (b)(3) and (4) caused the obligated bank to dishonor the check would have a cause of action against the declarer for breach of warranty.

The obligated bank may not impose additional requirements on the claimant to assert a claim under subsection (b). For example, the obligated bank may not require the posting of a bond or other form of security. Section 3‑312(b) states the procedure for asserting claims covered by the section. Thus, procedures that may be stated in other law for stating claims to property do not apply and are displaced within the meaning of Section 1‑103.

3. A claim asserted under subsection (b) does not have any legal effect, however, until the date it becomes enforceable, which cannot be earlier than 90 days after the date of a cashier’s check or teller’s check or 90 days after the date of acceptance of a certified check. Thus, if a lost check is presented for payment within the 90‑day period, the bank may pay a person entitled to enforce the check without regard to the claim and is discharged of all liability with respect to the check. This ensures the continued utility of cashier’s checks, teller’s checks, and certified checks as cash equivalents. Virtually all such checks are presented for payment within 90 days.

If the claim becomes enforceable and payment has not been made to a person entitled to enforce the check, the bank becomes obligated to pay the amount of the check to the claimant. Subsection (b)(4). When the bank becomes obligated to pay the amount of the check to the claimant, the bank is relieved of its obligation to pay the check. Subsection (b)(3). Thus, any person entitled to enforce the check, including even a holder in due course, loses the right to enforce the check after a claim under subsection (b) becomes enforceable.

If the obligated bank pays the claimant under subsection (b)(4), the bank is discharged of all liability with respect to the check. The only exception is the unlikely case in which the obligated bank subsequently incurs liability under Section 4‑302(a)(1) with respect to the check. For example, Obligated Bank is the issuer of a cashier’s check and, after a claim becomes enforceable, it pays the claimant under subsection (b)(4). Later the check is presented to Obligated Bank for payment over the counter. Under subsection (b)(3), Obligated Bank is not obliged to pay the check and may dishonor the check by returning it to the person who presented it for payment. But the normal rules of check collection are not affected by Section 3‑312. If Obligated Bank retains the check beyond midnight of the day of presentment without settling for it, it becomes accountable for the amount of the check under Section 4‑302(a)(1) even though it had no obligation to pay the check.

An obligated bank that pays the amount of a check to a claimant under subsection (b)(4) is discharged of all liability on the check so long as the assertion of the claim meets the requirements of subsection (b) discussed in Comment 2. This is important in cases of fraudulent declarations of loss. For example, if the claimant falsely alleges a loss that in fact did not occur, the bank, subject to Section 1‑203, may rely on the declaration of loss. On the other hand, a claim may be asserted only by a person described in subsection (b)(i). Thus, the bank is discharged under subsection (a)(4) only if it pays such a person. Although it is highly unlikely, it is possible that more than one person could assert a claim under subsection (b) to the amount of a check. Such a case could occur if one of the claimants makes a false declaration of loss. The obligated bank is not required to determine whether a claimant who complies with subsection (b) is acting wrongfully. The bank may utilize procedures outside this Article, such as interpleader, under which the conflicting claims may be adjudicated.

Although it is unlikely that a lost check would be presented for payment after the claimant was paid by the bank under subsection (b)(4), it is possible for it to happen. Suppose the declaration of loss by the claimant fraudulently alleged a loss that in fact did not occur. If the claimant negotiated the check, presentment for payment would occur shortly after negotiation in almost all cases. Thus, a fraudulent declaration of loss is not likely to occur unless the check is negotiated after the 90‑day period has already expired or shortly before expiration. In such a case the holder of the check, who may not have noticed the date of the check, is not entitled to payment from the obligated bank if the check is presented for payment after the claim becomes enforceable. Subsection (b)(3). The remedy of the holder who is denied payment in that case is an action against the claimant under subsection (c) if the holder is a holder in due course, or for breach of warranty under subsection (b). The holder would also have common law remedies against the claimant under the law of restitution or fraud.

4. The following cases illustrate the operation of Section 3‑312:

Case # 1. Obligated Bank (OB) certified a check drawn by its customer, Drawer (D), payable to Payee (P). Two days after the check was certified, D lost the check and then asserted a claim pursuant to subsection (b). The check had not been presented for payment when D’s claim became enforceable 90 days after the check was certified. Under subsection (b)(4), at the time D’s claim became enforceable OB became obliged to pay D the amount of the check. If the check is later presented for payment, OB may refuse to pay the check and has no obligation to anyone to pay the check. Any obligation owed by D to P, for which the check was intended as payment, is unaffected because the check was never delivered to P.

Case # 2. Obligated Bank (OB) issued a teller’s check to Remitter (R) payable to Payee (P). R delivered the check to P in payment of an obligation. P lost the check and then asserted a claim pursuant to subsection (b). To carry out P’s order, OB issued an order pursuant to Section 4‑403(a) to the drawee of the teller’s check to stop payment of the check effective on the 90th day after the date of the teller’s check. The check was not presented for payment. On the 90th day after the date of the teller’s check P’s claim becomes enforceable and OB becomes obliged to pay P the amount of the check. As in Case # 1, OB has no further liability with respect to the check to anyone. When R delivered the check to P, R’s underlying obligation to P was discharged under Section 3‑310. Thus, R suffered no loss. Since P received the amount of the check, P also suffered no loss except with respect to the delay in receiving the amount of the check.

Case # 3. Obligated Bank (OB) issued a cashier’s check to its customer, Payee (P). Two days after issue, the check was stolen from P who then asserted a claim pursuant to subsection (b). Ten days after issue, the check was deposited by X in an account in Depositary Bank (DB). X had found the check and forged the indorsement of P. DB promptly presented the check to OB and obtained payment on behalf of X. On the 90th day after the date of the check P’s claim becomes enforceable and P is entitled to receive the amount of the check from OB. Subsection (b)(4). Although the check was presented for payment before P’s claim becomes enforceable, OB is not discharged. Because of the forged indorsement X was not a holder and neither was DB. Thus, neither is a person entitled to enforce the check (Section 3‑301) and OB is not discharged under Section 3‑602(a). Thus, under subsection (b)(4), because OB did not pay a person entitled to enforce the check, OB must pay P. OB’s remedy is against DB for breach of warranty under Section 4‑208(a)(1). As an alternative to the remedy under Section 3‑312, P could recover from DB for conversion under Section 3‑420(a).

Case # 4. Obligated Bank (OB) issued a cashier’s check to its customer, Payee (P). P made an unrestricted blank indorsement of the check and mailed the check to P’s bank for deposit to P’s account. The check was never received by P’s bank. When P discovered the loss, P asserted a claim pursuant to subsection (b). X found the check and deposited it in X’s account in Depositary Bank (DB) after indorsing the check. DB presented the check for payment before the end of the 90‑day period after its date. OB paid the check. Because of the unrestricted blank indorsement by P, X became a holder of the check. DB also became a holder. Since the check was paid before P’s claim became enforceable and payment was made to a person entitled to enforce the check, OB is discharged of all liability with respect to the check. Subsection (b)(2). Thus, P is not entitled to payment from OB. Subsection (b)(4) doesn’t apply.

Case # 5. Obligated Bank (OB) issued a cashier’s check to its customer, Payee (P). P made an unrestricted blank indorsement of the check and mailed the check to P’s bank for deposit to P’s account. The check was never received by P’s bank. When P discovered the loss, P asserted a claim pursuant to subsection (b). At the end of the 90‑day period after the date of the check, OB paid the amount of the check to P under subsection (b)(4). X then found the check and deposited it to X’s account in Depositary Bank (DB). DB presented the check to OB for payment. OB is not obliged to pay the check. Subsection (b)(4). If OB dishonors the check, DB’s remedy is to charge back X’s account. Section 4‑214(a). Although P, as an indorser, would normally have liability to DB under Section 3‑415(a) because the check was dishonored, P is released from that liability under Section 3‑415(e) because collection of the check was initiated more than 30 days after the indorsement. DB has a remedy only against X. A depositary bank that takes a cashier’s check that cannot be presented for payment before expiration of the 90‑day period after its date is on notice that the check might not be paid because of the possibility of a claim asserted under subsection (b) which would excuse the issuer of the check from paying the check. Thus, the depositary bank cannot safely release funds with respect to the check until it has assurance that the check has been paid. DB cannot be a holder in due course of the check because it took the check when the check was overdue. Section 3‑304(a)(2). Thus, DB has no action against P under subsection (c).

Case # 6. Obligated Bank (OB) issued a cashier’s check payable to bearer and delivered it to its customer, Remitter (R). R held the check for 90 days and then wrongfully asserted a claim to the amount of the check under subsection (b). The declaration of loss fraudulently stated that the check was lost. R received payment from OB under subsection (b)(4). R then negotiated the check to X for value. X presented the check to OB for payment. Although OB, under subsection (b)(2), was not obliged to pay the check, OB paid X by mistake. OB’s teller did not notice that the check was more than 90 days old and was not aware that OB was not obliged to pay the check. If X took the check in good faith, OB may not recover from X. Section 3‑418(c). OB’s remedy is to recover from R for fraud or for breach of warranty in making a false declaration of loss. Subsection (b).

SOUTH CAROLINA REPORTER’S COMMENT

This section is new and provides a process under which the remitter or payee of cashier’s and teller’s checks and the drawer or payee of a certified check can recover the amount of a lost, stolen, or destroyed check without having to post adequate protection.

The provision seeks to balance the interests of the remitter or payee of the cashier’s, teller’s, or certified check who has given value of the check against expectations of transferees that such check will be paid on presentment even if over the objection of the remitter. See Sections 36‑3‑411, 36‑4‑403 Official Comment 4 (customer purchasing a cashier’s or teller’s check has no right to stop payment). The basic device adopted to balance these conflicting claims requires the remitter or payee that claims that the check was lost, destroyed or stolen to give the bank obligated on the check a declaration of loss and notice that the remitter or payee claims the check. The remitter’s claim becomes effective on the 90th day after the date of the check. If the check has not been paid when the claim becomes effective, the obligated bank is not required to pay the check when presented and is generally obligated to pay the amount of the check to the remitter or payee. See Subsection (b)(3) and (4). In contrast, under Subsection (b)(2), until the claim becomes effective, the remitter or payee’s claim has no legal effect and the obligated bank may pay the check when presented and that payment will discharge all the bank’s liability with respect to the check.

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| Definitional Cross References: |  |
| “Acceptance” | Section 36‑3‑409(a) |
| “Acceptor” | Section 36‑3‑103(a)(1) |
| “Bank” | Section 36‑1‑201(4) |
| “Cashier’s Check” | Section 36‑3‑104(g) |
| “Certified Check” | Section 36‑3‑409(d) |
| “Check” | Section 36‑3‑104(f) |
| “Drawee” | Section 36‑3‑103(a)(4) |
| “Drawer” | Section 36‑3‑103(a)(5) |
| “Holder in Due Course” | Section 36‑3‑302(a) |
| “Issuer” | Section 36‑3‑105(c) |
| “Payment” | Section 36‑3‑602(a) |
| “Person” | Section 36‑1‑201(30) |
| “Person Entitled to Enforce” | Section 36‑3‑301 |
| “Remitter” | Section 36‑3‑103(a)(15) |
| “Rights” | Section 36‑1‑201(36) |

Cross References:

1. A payee of cashier’s and teller’s checks and the drawer and payee of a certified check may be able to enforce a lost, destroyed or stolen check under Section 36‑3‑309.

2. Certification of a check. Section 36‑3‑409.

3. Obligation of an issuer of a cashier’s check. Section 36‑3‑412.

4. Liability of bank for refusing to pay a cashier’s or certified check, or stopping payment or refusing to pay a dishonored teller’s check. Section 36‑3‑411.

Part 4

Liability of Parties

Editor’s Note

2008 Act No. 204 Section 1 provides in part as follows:

“The South Carolina Reporters’ Comments contained in Chapters 3 and 4 of Title 36, may not be reproduced in whole or in part in any form or for inclusions in any material which is offered for sale without the express written permission of the Clerk of the South Carolina Senate.”

2008 Act No. 204, Section 4.A provides as follows:

“This act applies to a transaction occurring on or after the effective date [July 1, 2008] of this act. This act does not apply to a transaction or event, or obligation or duty arising out of or associated with a transaction or event, before the effective date of this act.”

2008 Act No. 204 Section 4.B provides as follows:

“A transaction occurring before the effective date [July 1, 2008] of this act and the rights, obligations, and interests flowing from that transaction are governed by any statute or other law amended or repealed by this act as if repeal or amendment had not occurred and may be terminated, completed, consummated, or enforced under that statute or other law.”

**SECTION 36‑3‑401.** Signature.

(a) A person is not liable on an instrument unless (i) the person signed the instrument, or (ii) the person is represented by an agent or representative who signed the instrument and the signature is binding on the represented person under Section 36‑3‑402.

(b) A signature may be made (i) manually or by means of a device or machine, and (ii) by the use of any name, including a trade or assumed name, or by a word, mark, or symbol executed or adopted by a person with present intention to authenticate a writing.

HISTORY: 1962 Code Section 10.3‑401; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. Obligation on an instrument depends on a signature that is binding on the obligor. The signature may be made by the obligor personally or by an agent authorized to act for the obligor. Signature by agents is covered by Section 3‑402. It is not necessary that the name of the obligor appear on the instrument, so long as there is a signature that binds the obligor. Signature includes an indorsement.

2. A signature may be handwritten, typed, printed or made in any other manner. It need not be subscribed, and may appear in the body of the instrument, as in the case of “I, John Doe, promise to pay \*\*\*” without any other signature. It may be made by mark, or even by thumbprint. It may be made in any name, including any trade name or assumed name, however false and fictitious, which is adopted for the purpose. Parol evidence is admissible to identify the signer, and when the signer is identified the signature is effective. Indorsement in a name other than that of the indorser is governed by Section 3‑204(d).

This section is not intended to affect any other law requiring a signature by mark to be witnessed, or any signature to be otherwise authenticated, or requiring any form of proof.

SOUTH CAROLINA REPORTER’S COMMENT

Subsection (a)(i) restates former Section 36‑3‑401(1). Subsection (a)(ii) is new and provides that a principal represented by an agent who signed an instrument can be liable on the instrument even if the principal’s name does not appear on the instrument. Subsection (b) is a restatement and revision of former Section 36‑3‑402. Subsection (b)(i) expressly recognizes that a signature may be made by a device or machine.

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| Definitional Cross References: |  |
| “Instrument” | Section 36‑3‑104(b) |
| “Person” | Section 36‑1‑201(30) |
| “Representative” | Section 36‑1‑201(35) |
| “Signed” | Section 36‑1‑201(39) |
| “Writing” | Section 36‑1‑201(46) |

Cross References:

1. Signature by representative. Section 36‑3‑402.

2. Unauthorized signature. Section 36‑3‑405.

LIBRARY REFERENCES

Bills and Notes 54, 59.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 26 to 30.

RESEARCH REFERENCES

Forms

Am. Jur. Pl. & Pr. Forms Uniform Commercial Code Section 3:143 , Introductory Comments.

LAW REVIEW AND JOURNAL COMMENTARIES

Commercial Transactions—Uniform Commercial Code—Signature by Authorized Representative—Failure to Indicate Representative Capacity. 20 S.C. L. Rev. 446.

Couriers without luggage: Negotiable instruments and digital signatures. 49 S.C. L. Rev. 739 (Summer 1998).

Electronic commerce on the internet and the statute of frauds. 49 S.C. L. Rev. 787 (Summer 1998).

NOTES OF DECISIONS

In general 1

1. In general

Whether a signature on a note providing that “makers, endorsers or guarantors waive demand, presentment, protest, notice of nonpayment, and all defenses on the ground of extension of time for payment” was in an accommodation maker or accommodation endorser capacity was of no legal consequence, as the liability of an endorser was secondary only with respect to these rights which were waived. Bankers Trust of South Carolina v. Culbertson (S.C. 1977) 268 S.C. 564, 235 S.E.2d 130.

Signature in the lower right hand corner of a note, instead of on the back where spaces were specifically provided for endorsers, shows that signer was a maker and not an accommodation endorser. Bankers Trust of South Carolina v. Culbertson (S.C. 1977) 268 S.C. 564, 235 S.E.2d 130.

**SECTION 36‑3‑402.** Signature by representative.

(a) If a person acting, or purporting to act, as a representative signs an instrument by signing either the name of the represented person or the name of the signer, the represented person is bound by the signature to the same extent the represented person would be bound if the signature were on a simple contract. If the represented person is bound, the signature of the representative is the “authorized signature of the represented person” and the represented person is liable on the instrument, whether or not identified in the instrument.

(b) If a representative signs the name of the representative to an instrument and the signature is an authorized signature of the represented person, the following rules apply:

(1) If the form of the signature shows unambiguously that the signature is made on behalf of the represented person who is identified in the instrument, the representative is not liable on the instrument.

(2) Subject to Subsection (c), if (i) the form of the signature does not show unambiguously that the signature is made in a representative capacity or (ii) the represented person is not identified in the instrument, the representative is liable on the instrument to a holder in due course that took the instrument without notice that the representative was not intended to be liable on the instrument. With respect to any other person, the representative is liable on the instrument unless the representative proves that the original parties did not intend the representative to be liable on the instrument.

(c) If a representative signs the name of the representative as drawer of a check without indication of the representative status and the check is payable from an account of the represented person who is identified on the check, the signer is not liable on the check if the signature is an authorized signature of the represented person.

HISTORY: 1962 Code Section 10.3‑402; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. Subsection (a) states when the represented person is bound on an instrument if the instrument is signed by a representative. If under the law of agency the represented person would be bound by the act of the representative in signing either the name of the represented person or that of the representative, the signature is the authorized signature of the represented person. Former Section 3‑401(1) stated that “no person is liable on an instrument unless his signature appears thereon.” This was interpreted as meaning that an undisclosed principal is not liable on an instrument. This interpretation provided an exception to ordinary agency law that binds an undisclosed principal on a simple contract.

It is questionable whether this exception was justified by the language of former Article 3 and there is no apparent policy justification for it. The exception is rejected by subsection (a) which returns to ordinary rules of agency. If P, the principal, authorized A, the agent, to borrow money on P’s behalf and A signed A’s name to a note without disclosing that the signature was on behalf of P, A is liable on the instrument. But if the person entitled to enforce the note can also prove that P authorized A to sign on P’s behalf, why shouldn’t P also be liable on the instrument? To recognize the liability of P takes nothing away from the utility of negotiable instruments. Furthermore, imposing liability on P has the merit of making it impossible to have an instrument on which nobody is liable even though it was authorized by P. That result could occur under former Section 3‑401(1) if an authorized agent signed “as agent” but the note did not identify the principal. If the dispute was between the agent and the payee of the note, the agent could escape liability on the note by proving that the agent and the payee did not intend that the agent be liable on the note when the note was issued. Former Section 3‑403(2)(b). Under the prevailing interpretation of former Section 3‑401(1), the principal was not liable on the note under former 3‑401(1) because the principal’s name did not appear on the note. Thus, nobody was liable on the note even though all parties knew that the note was signed by the agent on behalf of the principal. Under Section 3‑402(a) the principal would be liable on the note.

2. Subsection (b) concerns the question of when an agent who signs an instrument on behalf of a principal is bound on the instrument. The approach followed by former Section 3‑403 was to specify the form of signature that imposed or avoided liability. This approach was unsatisfactory. There are many ways in which there can be ambiguity about a signature. It is better to state a general rule. Subsection (b)(1) states that if the form of the signature unambiguously shows that it is made on behalf of an identified represented person (for example, “P, by A, Treasurer”) the agent is not liable. This is a workable standard for a court to apply. Subsection (b)(2) partly changes former Section 3‑403(2). Subsection (b)(2) relates to cases in which the agent signs on behalf of a principal but the form of the signature does not fall within subsection (b)(1). The following cases are illustrative. In each case John Doe is the authorized agent of Richard Roe and John Doe signs a note on behalf of Richard Roe. In each case the intention of the original parties to the instrument is that Roe is to be liable on the instrument but Doe is not to be liable.

Case # 1. Doe signs “John Doe” without indicating in the note that Doe is signing as agent. The note does not identify Richard Roe as the represented person.

Case # 2. Doe signs “John Doe, Agent” but the note does not identify Richard Roe as the represented person.

Case # 3. The name “Richard Roe” is written on the note and immediately below that name Doe signs “John Doe” without indicating that Doe signed as agent.

In each case Doe is liable on the instrument to a holder in due course without notice that Doe was not intended to be liable. In none of the cases does Doe’s signature unambiguously show that Doe was signing as agent for an identified principal. A holder in due course should be able to resolve any ambiguity against Doe.

But the situation is different if a holder in due course is not involved. In each case Roe is liable on the note. Subsection (a). If the original parties to the note did not intend that Doe also be liable, imposing liability on Doe is a windfall to the person enforcing the note. Under subsection (b)(2) Doe is prima facie liable because his signature appears on the note and the form of the signature does not unambiguously refute personal liability. But Doe can escape liability by proving that the original parties did not intend that he be liable on the note. This is a change from former Section 3‑403(2)(a).

A number of cases under former Article 3 involved situations in which an agent signed the agent’s name to a note, without qualification and without naming the person represented, intending to bind the principal but not the agent. The agent attempted to prove that the other party had the same intention. Some of these cases involved mistake, and in some there was evidence that the agent may have been deceived into signing in that manner. In some of the cases the court refused to allow proof of the intention of the parties and imposed liability on the agent based on former Section 3‑403(2)(a) even though both parties to the instrument may have intended that the agent not be liable. Subsection (b)(2) changes the result of those cases, and is consistent with Section 3‑117 which allows oral or written agreements to modify or nullify apparent obligations on the instrument.

Former Section 3‑403 spoke of the represented person being “named” in the instrument. Section 3‑402 speaks of the represented person being “identified” in the instrument. This change in terminology is intended to reject decisions under former Section 3‑403(2) requiring that the instrument state the legal name of the represented person.

3. Subsection (c) is directed at the check cases. It states that if the check identifies the represented person the agent who signs on the signature line does not have to indicate agency status. Virtually all checks used today are in personalized form which identify the person on whose account the check is drawn. In this case, nobody is deceived into thinking that the person signing the check is meant to be liable. This subsection is meant to overrule cases decided under former Article 3 such as Griffin v. Ellinger, 538 S.W.2d 97 (Texas 1976).

SOUTH CAROLINA REPORTER’S COMMENT

This provision substantially revises the rules stated in former Section 36‑3‑403, addressing the effect of an agent’s signature on an instrument. Subsection (a) provides that a representative signing an instrument in the name of a represented person or the representative’s name can bind the represented person on the instrument to the same extent the represented person would be bound by the signature on a simple contract. Under Subsection (a), an undisclosed principal can be liable on an instrument signed by an agent.

Subsection (b) addresses an agent’s liability on an instrument in situations in which the agent with authority to bind the principal signs the agent’s name. Under Subsection (a), the principal is liable on the instrument. Subsection (b) determines whether the agent is also liable. Under Subsection (b)(1), if the form of the agent’s signature shows unambiguously that it is made on behalf of the principal who is identified in the instrument, the agent is not liable on the instrument. Subsection (b)(2) governs situations in which the form of the agent’s signature is ambiguous or the principal is not identified, and provides sharply different rules depending upon whether the person seeking enforcement is a holder in due course. The agent is liable on the instrument to a holder in due course, but against any other person the agent can avoid liability by proving that the original parties to the instrument did not intend the agent to be liable.

Subsection (c) provides an exception to Subsection (b) when the instrument is a check. If the agent signs the check without disclosing his representative capacity, but the check is payable from the account of a principal identified on the check, the agent is not liable.

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| Definitional Cross References: |  |
| “Check” | Section 36‑3‑104(f) |
| “Contract” | Section 36‑1‑201(11) |
| “Drawer” | Section 36‑3‑103(a)(5) |
| “Holder in Due Course” | Section 36‑3‑302(a) |
| “Instrument” | Section 36‑3‑104(b) |
| “Notice” | Section 36‑1‑201(25) [see now Section 36‑1‑202] |
| “Party” | Section 36‑3‑103(a)(10) |
| “Person” | Section 36‑1‑201(30) |
| “Representative” | Section 36‑1‑201(35) |
| “Signed” | Section 36‑1‑201(39) |
| “Unauthorized Signature” | Section 36‑1‑201(43) |

Cross References:

1. Principal liable on instrument signed by agent. Section 36‑3‑401(a)(ii).

2. Unauthorized signatures. Section 36‑3‑403.

3. A person whose failure to exercise ordinary care substantially contributes to a forged signature on an instrument is precluded from asserting the forgery against a person who in good faith pays the instrument or takes it for value. Section 36‑3‑406.

4. A customer’s failure to exercise reasonable promptness in reviewing the statement of account and reporting forged checks to the payor bank may preclude the customer from asserting that his signature was unauthorized. Section 36‑4‑406.

5. Obligation of the issuer of a note or cashier’s check. Section 36‑3‑412.

6. Obligation of an acceptor. Section 36‑3‑413.

7. Obligation of a drawer. Section 36‑4‑313.

8. Obligation of an indorser. Section 36‑3‑415.

LIBRARY REFERENCES

Bills and Notes 54, 123(1, 2).

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 26 to 28, 30.

RESEARCH REFERENCES

Encyclopedias

150 Am. Jur. Proof of Facts 3d 93, Proof of Personal Liability of Corporate Officer on Promissory Note.

LAW REVIEW AND JOURNAL COMMENTARIES

Commercial Transactions—Uniform Commercial Code—Signature by Authorized Representative—Failure to Indicate Representative Capacity. 20 S.C. L. Rev. 446.

**SECTION 36‑3‑403.** Unauthorized signature.

(a) Unless otherwise provided in this chapter or Chapter 4, an unauthorized signature is ineffective except as the signature of the unauthorized signer in favor of a person who in good faith pays the instrument or takes it for value. An unauthorized signature may be ratified for all purposes of this chapter.

(b) If the signature of more than one person is required to constitute the authorized signature of an organization, the signature of the organization is unauthorized if one of the required signatures is lacking.

(c) The civil or criminal liability of a person who makes an unauthorized signature is not affected by any provision of this chapter which makes the unauthorized signature effective for the purposes of this chapter.

HISTORY: 1962 Code Section 10.3‑403; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. “Unauthorized” signature is defined in Section 1‑201(43) as one that includes a forgery as well as a signature made by one exceeding actual or apparent authority. Former Section 3‑404(1) stated that an unauthorized signature was inoperative as the signature of the person whose name was signed unless that person “is precluded from denying it.” Under former Section 3‑406 if negligence by the person whose name was signed contributed to an unauthorized signature, that person “is precluded from asserting the \*\*\* lack of authority.” Both of these sections were applied to cases in which a forged signature appeared on an instrument and the person asserting rights on the instrument alleged that the negligence of the purported signer contributed to the forgery. Since the standards for liability between the two sections differ, the overlap between the sections caused confusion. Section 3‑403(a) deals with the problem by removing the preclusion language that appeared in former Section 3‑404.

2. The except clause of the first sentence of subsection (a) states the generally accepted rule that the unauthorized signature, while it is wholly inoperative as that of the person whose name is signed, is effective to impose liability upon the signer or to transfer any rights that the signer may have in the instrument. The signer’s liability is not in damages for breach of warranty of authority, but is full liability on the instrument in the capacity in which the signer signed. It is, however, limited to parties who take or pay the instrument in good faith; and one who knows that the signature is unauthorized cannot recover from the signer on the instrument.

3. The last sentence of subsection (a) allows an unauthorized signature to be ratified. Ratification is a retroactive adoption of the unauthorized signature by the person whose name is signed and may be found from conduct as well as from express statements. For example, it may be found from the retention of benefits received in the transaction with knowledge of the unauthorized signature. Although the forger is not an agent, ratification is governed by the rules and principles applicable to ratification of unauthorized acts of an agent.

Ratification is effective for all purposes of this Article. The unauthorized signature becomes valid so far as its effect as a signature is concerned. Although the ratification may relieve the signer of liability on the instrument, it does not of itself relieve the signer of liability to the person whose name is signed. It does not in any way affect the criminal law. No policy of the criminal law prevents a person whose name is forged to assume liability to others on the instrument by ratifying the forgery, but the ratification cannot affect the rights of the state. While the ratification may be taken into account with other relevant facts in determining punishment, it does not relieve the signer of criminal liability.

4. Subsection (b) clarifies the meaning of “unauthorized” in cases in which an instrument contains less than all of the signatures that are required as authority to pay a check. Judicial authority was split on the issue whether the one‑year notice period under former Section 4‑406(4) (now Section 4‑406(f)) barred a customer’s suit against a payor bank that paid a check containing less than all of the signatures required by the customer to authorize payment of the check. Some cases took the view that if a customer required that a check contain the signatures of both A and B to authorize payment and only A signed, there was no unauthorized signature within the meaning of that term in former Section 4‑406(4) because A’s signature was neither unauthorized nor forged. The other cases correctly pointed out that it was the customer’s signature at issue and not that of A; hence, the customer’s signature was unauthorized if all signatures required to authorize payment of the check were not on the check. Subsection (b) follows the latter line of cases. The same analysis applies if A forged the signature of B. Because the forgery is not effective as a signature of B, the required signature of B is lacking.

Subsection (b) refers to “the authorized signature of an organization.” The definition of “organization” in Section 1‑201(28) is very broad. It covers not only commercial entities but also “two or more persons having a joint or common interest.” Hence subsection (b) would apply when a husband and wife are both required to sign an instrument.

SOUTH CAROLINA REPORTER’S COMMENT

The first sentence of Subsection (a) addressing the ineffectiveness of an unauthorized signature is based upon former Section 36‑3‑404(1). The “unless” clause in Subsection (a) refers to “otherwise provided in this chapter” rather than adopting the “ratified or precluded from denying” language of the former statute. This change was made to reflect that Section 36‑3‑403 provides no independent basis precluding a person from asserting that that the person’s signature was unauthorized. The second sentence of Subsection (a) addressing ratification of an unauthorized signature is based upon the first sentence of former Section 36‑3‑402(2).

Subsection (b) is new and clarifies prior law by providing that if the authorized signature of an organization requires the signature of more than one person, the signature of the organization is unauthorized if one of the required signatures is missing.

Subsection (c) is based on the second sentence of former Section 36‑3‑404(2). Under subsection (c), nothing in Chapter 3 that renders an unauthorized signature effective affects the civil and criminal liability of the person making the unauthorized signature.

South Carolina case law on the ratification of an unauthorized indorsement remains authoritative. In Bankers Trust of South Carolina v. South Carolina National Bank, 284 S.C. 238, 325 S.E.2d 81 (S.C. App. 1985), South Carolina National Bank (SCN) had presented a cashier’s check drawn by Bankers Trust to Bankers Trust that bore the unauthorized indorsement of the payee. Bankers Trust paid the check, but when the fraud was discovered, made a breach of warranty claim against SCN that SCN paid. Subsequently, SCN obtained the indorsement of the payee and brought an equitable action against Bankers Trust for recovery of the amount it paid on the breach of warranty claim. Reasoning that the payee had ratified the unauthorized indorsement which formed the basis of the Bankers Trust warranty claim, the court granted the relief sought by SCN.

In Hayes v. Peoples Federal Savings & Loan Ass’n, 289 S.C. 63, 344 S.E.2d 624 (S.C. App. 1986) a husband forged his wife’s indorsement on checks drawn by the Savings & Loan as withdrawals from her savings account and used the funds for his own purposes. The wife subsequently signed a statement that she did not contest her husband’s right to indorse the checks and obtain the money, releasing the depositary banks that cashed the checks. When the wife sued the Savings & Loan, the Court of Appeals held in favor of the Savings & Loan. An alternative basis for the holding was that the wife was estopped from asserting a claim against the Savings & Loan because she admitted her husband’s authority to indorse the checks in releasing the depositary banks. The wife’s statements appear sufficient to qualify as a ratification under the second sentence of Subsection (a).

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| Definitional Cross References: |  |
| “Good Faith” | Section 36‑3‑103(a)(6) |
| “Instrument” | Section 36‑3‑104(b) |
| “Organization” | Section 36‑1‑201(28) |
| “Person” | Section 36‑1‑201(30) |
| “Unauthorized Signature” | Section 36‑1‑201(43) |
| “Value” | Section 36‑3‑303(a) |

Cross References:

1. Indorsements by anyone in the name of the named payee are effective in imposter and fictitious payee cases. Section 36‑3‑404.

2. Employer’s responsibility for fraudulent indorsement by certain employees. Section 36‑3‑405.

3. A person’s failure to exercise reasonable care that substantially contributes to an unauthorized signature precludes an assertion that the signature is a forgery against a person who in good faith pays the instrument or takes it for value. Section 36‑3‑406.

4. A drawer of a check may be precluded from claiming that the signature on the check is unauthorized, if the drawer fails to exercise reasonable promptness in examining that statement of account and reporting the unauthorized signature. Section 36‑4‑406.

LIBRARY REFERENCES

Bills and Notes 54, 59, 123(1, 2).

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 26 to 30.

RESEARCH REFERENCES

Encyclopedias

S.C. Jur. Intellectual Property Section 68, Personal Liability.

LAW REVIEW AND JOURNAL COMMENTARIES

Commercial Transactions—Uniform Commercial Code—Signature by Authorized Representative—Failure to Indicate Representative Capacity. 20 S.C. L. Rev. 446.

NOTES OF DECISIONS

In general 1

1. In general

According to South Carolina UCC Code Section 36‑3‑404, an unauthorized signature may be ratified by the person whose name was signed; accordingly, in a declaratory judgment action by a trust company against a collecting bank for breach of presentment warranties arising from a cashier’s check, the collecting bank could not represent the check where the collecting bank, after investigation, had secured endorsement of the check. Bankers Trust of South Carolina v. South Carolina Nat. Bank of Charleston (S.C.App. 1985) 284 S.C. 238, 325 S.E.2d 81.

**SECTION 36‑3‑404.** Imposters; fictitious payees.

(a) If an impostor, by use of the mails or otherwise, induces the issuer of an instrument to issue the instrument to the impostor, or to a person acting in concert with the impostor, by impersonating the payee of the instrument or a person authorized to act for the payee, an indorsement of the instrument by any person in the name of the payee is effective as the indorsement of the payee in favor of a person who, in good faith, pays the instrument or takes it for value or for collection.

(b) If (i) a person whose intent determines to whom an instrument is payable (Section 36‑3‑110(a) or (b)) does not intend the person identified as payee to have any interest in the instrument, or (ii) the person identified as payee of an instrument is a fictitious person, the following rules apply until the instrument is negotiated by special indorsement:

(1) Any person in possession of the instrument is its holder.

(2) An indorsement by any person in the name of the payee stated in the instrument is effective as the indorsement of the payee in favor of a person who, in good faith, pays the instrument or takes it for value or for collection.

(c) Under Subsection (a) or (b), an indorsement is made in the name of a payee if (i) it is made in a name substantially similar to that of the payee or (ii) the instrument, whether or not indorsed, is deposited in a depositary bank to an account in a name substantially similar to that of the payee.

(d) With respect to an instrument to which Subsection (a) or (b) applies, if a person paying the instrument or taking it for value or for collection fails to exercise ordinary care in paying or taking the instrument and that failure substantially contributes to loss resulting from payment of the instrument, the person bearing the loss may recover from the person failing to exercise ordinary care to the extent the failure to exercise ordinary care contributed to the loss.

HISTORY: 1962 Code Section 10.3‑404; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. Under former Article 3, the impostor cases were governed by former Section 3‑405(1)(a) and the fictitious payee cases were governed by Section 3‑405(1)(b). Section 3‑404 replaces former Section 3‑405(1)(a) and (b) and modifies the previous law in some respects. Former Section 3‑405 was read by some courts to require that the indorsement be in the exact name of the named payee. Revised Article 3 rejects this result. Section 3‑404(c) requires only that the indorsement be made in a name “substantially similar” to that of the payee. Subsection (c) also recognizes the fact that checks may be deposited without indorsement. Section 4‑205(a).

Subsection (a) changes the former law in a case in which the impostor is impersonating an agent. Under former Section 3‑405(1)(a), if Impostor impersonated Smith and induced the drawer to draw a check to the order of Smith, Impostor could negotiate the check. If Impostor impersonated Smith, the president of Smith Corporation, and the check was payable to the order of Smith Corporation, the section did not apply. See the last paragraph of Comment 2 to former Section 3‑405. In revised Article 3, Section 3‑404(a) gives Impostor the power to negotiate the check in both cases.

2. Subsection (b) is based in part on former Section 3‑405(1)(b) and in part on N.I.L. Section 9(3). It covers cases in which an instrument is payable to a fictitious or nonexisting person and to cases in which the payee is a real person but the drawer or maker does not intend the payee to have any interest in the instrument. Subsection (b) applies to any instrument, but its primary importance is with respect to checks of corporations and other organizations. It also applies to forged check cases. The following cases illustrate subsection (b):

Case # 1. Treasurer is authorized to draw checks in behalf of Corporation. Treasurer fraudulently draws a check of Corporation payable to Supplier Co., a non‑existent company. Subsection (b) applies because Supplier Co. is a fictitious person and because Treasurer did not intend Supplier Co. to have any interest in the check. Under subsection (b)(1) Treasurer, as the person in possession of the check, becomes the holder of the check. Treasurer indorses the check in the name “Supplier Co.” and deposits it in Depositary Bank. Under subsection (b)(2) and (c)(i), the indorsement is effective to make Depositary Bank the holder and therefore a person entitled to enforce the instrument. Section 3‑301.

Case # 2. Same facts as Case # 1 except that Supplier Co. is an actual company that does business with Corporation. If Treasurer intended to steal the check when the check was drawn, the result in Case # 2 is the same as the result in Case # 1. Subsection (b) applies because Treasurer did not intend Supplier Co. to have any interest in the check. It does not make any difference whether Supplier Co. was or was not a creditor of Corporation when the check was drawn. If Treasurer did not decide to steal the check until after the check was drawn, the case is covered by Section 3‑405 rather than Section 3‑404(b), but the result is the same. See Case # 6 in Comment 3 to Section 3‑405.

Case # 3. Checks of Corporation must be signed by two officers. President and Treasurer both sign a check of Corporation payable to Supplier Co., a company that does business with Corporation from time to time but to which Corporation does not owe any money. Treasurer knows that no money is owed to Supplier Co. and does not intend that Supplier Co. have any interest in the check. President believes that money is owed to Supplier Co. Treasurer obtains possession of the check after it is signed. Subsection (b) applies because Treasurer is “a person whose intent determines to whom an instrument is payable” and Treasurer does not intend Supplier Co. to have any interest in the check. Treasurer becomes the holder of the check and may negotiate it by indorsing it in the name “Supplier Co.”

Case # 4. Checks of Corporation are signed by a check‑writing machine. Names of payees of checks produced by the machine are determined by information entered into the computer that operates the machine. Thief, a person who is not an employee or other agent of Corporation, obtains access to the computer and causes the check‑writing machine to produce a check payable to Supplier Co., a non‑existent company. Subsection (b)(ii) applies. Thief then obtains possession of the check. At that point Thief becomes the holder of the check because Thief is the person in possession of the instrument. Subsection (b)(1). Under Section 3‑301 Thief, as holder, is the “person entitled to enforce the instrument” even though Thief does not have title to the check and is in wrongful possession of it. Thief indorses the check in the name “Supplier Co.” and deposits it in an account in Depositary Bank which Thief opened in the name “Supplier Co.” Depositary Bank takes the check in good faith and credits the “Supplier Co.” account. Under subsection (b)(2) and (c)(i), the indorsement is effective. Depositary Bank becomes the holder and the person entitled to enforce the check. The check is presented to the drawee bank for payment and payment is made. Thief then withdraws the credit to the account. Although the check was issued without authority given by Corporation, the drawee bank is entitled to pay the check and charge Corporation’s account if there was an agreement with Corporation allowing the bank to debit Corporation’s account for payment of checks produced by the check‑writing machine whether or not authorized. The indorsement is also effective if Supplier Co. is a real person. In that case subsection (b)(i) applies. Under Section 3‑110(b) Thief is the person whose intent determines to whom the check is payable, and Thief did not intend Supplier Co. to have any interest in the check. When the drawee bank pays the check, there is no breach of warranty under Section 3‑417(a)(1) or 4‑208(a)(1) because Depositary Bank was a person entitled to enforce the check when it was forwarded for payment.

Case # 5. Thief, who is not an employee or agent of Corporation, steals check forms of Corporation. John Doe is president of Corporation and is authorized to sign checks on behalf of Corporation as drawer. Thief draws a check in the name of Corporation as drawer by forging the signature of Doe. Thief makes the check payable to the order of Supplier Co. with the intention of stealing it. Whether Supplier Co. is a fictitious person or a real person, Thief becomes the holder of the check and the person entitled to enforce it. The analysis is the same as that in Case # 4. Thief deposits the check in an account in Depositary Bank which Thief opened in the name “Supplier Co.” Thief either indorses the check in a name other than “Supplier Co.” or does not indorse the check at all. Under Section 4‑205(a) a depositary bank may become holder of a check deposited to the account of a customer if the customer was a holder, whether or not the customer indorses. Subsection (c)(ii) treats deposit to an account in a name substantially similar to that of the payee as the equivalent of indorsement in the name of the payee. Thus, the deposit is an effective indorsement of the check. Depositary Bank becomes the holder of the check and the person entitled to enforce the check. If the check is paid by the drawee bank, there is no breach of warranty under Section 3‑417(a)(1) or 4‑208(a)(1) because Depositary Bank was a person entitled to enforce the check when it was forwarded for payment and, unless Depositary Bank knew about the forgery of Doe’s signature, there is no breach of warranty under Section 3‑417(a)(3) or 4‑208(a)(3). Because the check was a forged check the drawee bank is not entitled to charge Corporation’s account unless Section 3‑406 or Section 4‑406 applies.

3. In cases governed by subsection (a) the dispute will normally be between the drawer of the check that was obtained by the impostor and the drawee bank that paid it. The drawer is precluded from obtaining recredit of the drawer’s account by arguing that the check was paid on a forged indorsement so long as the drawee bank acted in good faith in paying the check. Cases governed by subsection (b) are illustrated by Cases # 1 through # 5 in Comment 2. In Cases # 1, # 2, and # 3 there is no forgery of the check, thus the drawer of the check takes the loss if there is no lack of good faith by the banks involved. Cases # 4 and # 5 are forged check cases. Depositary Bank is entitled to retain the proceeds of the check if it didn’t know about the forgery. Under Section 3‑418 the drawee bank is not entitled to recover from Depositary Bank on the basis of payment by mistake because Depositary Bank took the check in good faith and gave value for the check when the credit given for the check was withdrawn. And there is no breach of warranty under Section 3‑417(a)(1) or (3) or 4‑208(a)(1) or (3). Unless Section 3‑406 applies the loss is taken by the drawee bank if a forged check is paid, and that is the result in Case # 5. In Case # 4 the loss is taken by Corporation, the drawer, because an agreement between Corporation and the drawee bank allowed the bank to debit Corporation’s account despite the unauthorized use of the check‑writing machine.

If a check payable to an impostor, fictitious payee, or payee not intended to have an interest in the check is paid, the effect of subsections (a) and (b) is to place the loss on the drawer of the check rather than on the drawee or the depositary bank that took the check for collection. Cases governed by subsection (a) always involve fraud, and fraud is almost always involved in cases governed by subsection (b). The drawer is in the best position to avoid the fraud and thus should take the loss. This is true in Case # 1, Case # 2, and Case # 3. But in some cases the person taking the check might have detected the fraud and thus have prevented the loss by the exercise of ordinary care. In those cases, if that person failed to exercise ordinary care, it is reasonable that that person bear loss to the extent the failure contributed to the loss. Subsection (d) is intended to reach that result. It allows the person who suffers loss as a result of payment of the check to recover from the person who failed to exercise ordinary care. In Case # 1, Case # 2, and Case # 3, the person suffering the loss is Corporation, the drawer of the check. In each case the most likely defendant is the depositary bank that took the check and failed to exercise ordinary care. In those cases, the drawer has a cause of action against the offending bank to recover a portion of the loss. The amount of loss to be allocated to each party is left to the trier of fact. Ordinary care is defined in Section 3‑103(a)(7). An example of the type of conduct by a depositary bank that could give rise to recovery under subsection (d) is discussed in Comment 4 to Section 3‑405. That comment addresses the last sentence of Section 3‑405(b) which is similar to Section 3‑404(d).

In Case # 1, Case # 2, and Case # 3, there was no forgery of the drawer’s signature. But cases involving checks payable to a fictitious payee or a payee not intended to have an interest in the check are often forged check cases as well. Examples are Case # 4 and Case # 5. Normally, the loss in forged check cases is on the drawee bank that paid the check. Case # 5 is an example. In Case # 4 the risk with respect to the forgery is shifted to the drawer because of the agreement between the drawer and the drawee bank. The doctrine that prevents a drawee bank from recovering payment with respect to a forged check if the payment was made to a person who took the check for value and in good faith is incorporated into Section 3‑418 and Sections 3‑417(a)(3) and 4‑208(a)(3). This doctrine is based on the assumption that the depositary bank normally has no way of detecting the forgery because the drawer is not that bank’s customer. On the other hand, the drawee bank, at least in some cases, may be able to detect the forgery by comparing the signature on the check with the specimen signature that the drawee has on file. But in some forged check cases the depositary bank is in a position to detect the fraud. Those cases typically involve a check payable to a fictitious payee or a payee not intended to have an interest in the check. Subsection (d) applies to those cases. If the depositary bank failed to exercise ordinary care and the failure substantially contributed to the loss, the drawer in Case # 4 or the drawee bank in Case # 5 has a cause of action against the depositary bank under subsection (d). Comment 4 to Section 3‑405 can be used as a guide to the type of conduct that could give rise to recovery under Section 3‑404(d).

SOUTH CAROLINA REPORTER’S COMMENT

Subsection (a) addressing imposter cases is based upon former Section 36‑3‑405(a)(1). Subsection (b) addressing fictitious payee cases is based upon former Section 36‑3‑405(1)(b). Subsection (a) does not include provisions of former section 36‑3‑405(1)(c) addressing “padded payroll” cases. Those cases are now addressed in a separate provision, Section 36‑3‑405. Subsection (a) makes one change in the law applicable to imposters. In contrast to prior law, Subsection (a) applies when the imposter impersonates someone authorized to act for the payee.

If an instrument is within the scope of either Subsection (a) or (b), an indorsement by any person in the name of the payee is effective. Subsection (c) clarifies the meaning of an “indorsement by any person in the name of the payee.” Under Subsection (c)(i), an indorsement is made in the name of the payee if it is made in a name substantially similar to the payee’s name. Moreover, under Subsection (c)(ii), an indorsement is made in the name of the payee if the instrument, with or without indorsement, is deposited in a depositary bank to an account in a name substantially similar to the name of the payee.

Subsection (d) is new and changes prior law. If an indorsement is effective under Subsection (a) or (b), the person bearing the loss is typically the drawer of a check. Under prior law, the drawer had no claim against a person who failed to exercise ordinary care in taking the check. See Stone Manufacturing Co. v. NCNB of South Carolina, 308 S.C. 287, 417 S.E. 2d 628 (S.C. App. 1992). (Padded payroll case decided under former Section 36‑3‑405). Subsection (d) provides that the party bearing the loss in an imposter or fictitious payee case can recover from a person who negligently paid the instrument or took the instrument for value or collection. Under Subsection (d), the party bearing the loss must prove that the person paying or taking the instrument failed to exercise ordinary care and that the failure substantially contributed to the loss resulting from payment of the instrument. If these facts are proved, the person bearing the loss can recover to the extent that the failure to exercise ordinary care contributed to the loss.

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| Definitional Cross References: |  |
| “Account” | Section 36‑4‑104(a)(1) |
| “Depositary Bank” | Section 36‑4‑105(2) |
| “Good Faith” | Section 36‑3‑103(a)(6) |
| “Holder” | Section 36‑1‑201(20) |
| “Indorsement” | Section 36‑3‑204(a) |
| “Instrument” | Section 36‑3‑104(b) |
| “Issuer” | Section 36‑3‑105(c) |
| “Ordinary Care” | Section 36‑3‑103(a)(9) |
| “Payment” | Section 36‑3‑602(a) |
| “Person” | Section 36‑1‑201(30) |
| “Value” | Section 36‑3‑303(a) |

Cross References:

1. Unauthorized signature. Section 36‑3‑403.

2. Employer’s responsibility for fraudulent indorsements by employee with responsibility with respect to instruments. Section 36‑3‑405.

LIBRARY REFERENCES

Bills and Notes 54, 59, 61, 182, 206, 239, 279, 377, 381.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 26 to 30, 144, 147, 150 to 151, 157, 191, 201.

NOTES OF DECISIONS

In general 1

1. In general

The negligence of a bank in cashing fraudulently drawn payroll checks was immaterial to the application of “the padded payroll defense” (Section 36‑3‑405[1][c]) since (1) the drafters of the statute made no reference to a bank’s negligence as an exception to its application, and (2) Official Comment 4 clearly indicated that the loss caused by an unfaithful employee should fall on the employer as a risk of business. Stone Mfg. Co. v. NCNB of South Carolina (S.C.App. 1992) 308 S.C. 287, 417 S.E.2d 628.

A bank which cashed payroll checks fraudulently drawn by an employee of the drawer was entitled, based on the application of “the padded payroll defense” (Section 36‑3‑405[1][c]), to a directed verdict in an action by the drawer, even though it failed to meet its own guidelines of identification and authorization in cashing the checks, since Section 36‑1‑201(19) defines “good faith” as “honesty in fact in the conduct or transaction concerned,” and the bank’s failure to enforce its rules against a known employee was at most mere negligence. Stone Mfg. Co. v. NCNB of South Carolina (S.C.App. 1992) 308 S.C. 287, 417 S.E.2d 628.

**SECTION 36‑3‑405.** Employer’s responsibility for fraudulent indorsement by employee.

(a) In this section:

(1) “Employee” includes an independent contractor and employee of an independent contractor retained by the employer.

(2) “Fraudulent indorsement” means (i) in the case of an instrument payable to the employer, a forged indorsement purporting to be that of the employer, or (ii) in the case of an instrument with respect to which the employer is the issuer, a forged indorsement purporting to be that of the person identified as payee.

(3) “Responsibility” with respect to instruments means authority (i) to sign or indorse instruments on behalf of the employer, (ii) to process instruments received by the employer for bookkeeping purposes, for deposit to an account, or for other disposition, (iii) to prepare or process instruments for issue in the name of the employer, (iv) to supply information determining the names or addresses of payees of instruments to be issued in the name of the employer, (v) to control the disposition of instruments to be issued in the name of the employer, or (vi) to act otherwise with respect to instruments in a responsible capacity. “Responsibility” does not include authority that merely allows an employee to have access to instruments or blank or incomplete instrument forms that are being stored or transported or are part of incoming or outgoing mail, or similar access.

(b) For the purpose of determining the rights and liabilities of a person who, in good faith, pays an instrument or takes it for value or for collection, if an employer entrusted an employee with responsibility with respect to the instrument and the employee or a person acting in concert with the employee makes a fraudulent indorsement of the instrument, the indorsement is effective as the indorsement of the person to whom the instrument is payable if it is made in the name of that person. If the person paying the instrument or taking it for value or for collection fails to exercise ordinary care in paying or taking the instrument and that failure substantially contributes to loss resulting from the fraud, the person bearing the loss may recover from the person failing to exercise ordinary care to the extent the failure to exercise ordinary care contributed to the loss.

(c) Under Subsection (b), an indorsement is made in the name of the person to whom an instrument is payable if (i) it is made in a name substantially similar to the name of that person or (ii) the instrument, whether or not indorsed, is deposited in a depositary bank to an account in a name substantially similar to the name of that person.

HISTORY: 1962 Code Section 10.3‑405; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. Section 3‑405 is addressed to fraudulent indorsements made by an employee with respect to instruments with respect to which the employer has given responsibility to the employee. It covers two categories of fraudulent indorsements: indorsements made in the name of the employer to instruments payable to the employer and indorsements made in the name of payees of instruments issued by the employer. This section applies to instruments generally but normally the instrument will be a check. Section 3‑405 adopts the principle that the risk of loss for fraudulent indorsements by employees who are entrusted with responsibility with respect to checks should fall on the employer rather than the bank that takes the check or pays it, if the bank was not negligent in the transaction. Section 3‑405 is based on the belief that the employer is in a far better position to avoid the loss by care in choosing employees, in supervising them, and in adopting other measures to prevent forged indorsements on instruments payable to the employer or fraud in the issuance of instruments in the name of the employer. If the bank failed to exercise ordinary care, subsection (b) allows the employer to shift loss to the bank to the extent the bank’s failure to exercise ordinary care contributed to the loss. “Ordinary care” is defined in Section 3‑103(a)(7). The provision applies regardless of whether the employer is negligent.

The first category of cases governed by Section 3‑405 are those involving indorsements made in the name of payees of instruments issued by the employer. In this category, Section 3‑405 includes cases that were covered by former Section 3‑405(1)(c). The scope of Section 3‑405 in revised Article 3 is, however, somewhat wider. It covers some cases not covered by former Section 3‑405(1)(c) in which the entrusted employee makes a forged indorsement to a check drawn by the employer. An example is Case # 6 in Comment 3. Moreover, a larger group of employees is included in revised Section 3‑405. The key provision is the definition of “responsibility” in subsection (a)(1) which identifies the kind of responsibility delegated to an employee which will cause the employer to take responsibility for the fraudulent acts of that employee. An employer can insure this risk by employee fidelity bonds.

The second category of cases governed by Section 3—05—fraudulent indorsements of the name of the employer to instruments payable to the employer—were covered in former Article 3 by Section 3‑406. Under former Section 3‑406, the employer took the loss only if negligence of the employer could be proved. Under revised Article 3, Section 3‑406 need not be used with respect to forgeries of the employer’s indorsement. Section 3‑405 imposes the loss on the employer without proof of negligence.

2. With respect to cases governed by former Section 3‑405(1)(c), Section 3‑405 is more favorable to employers in one respect. The bank was entitled to the preclusion provided by former Section 3‑405(1)(c) if it took the check in good faith. The fact that the bank acted negligently did not shift the loss to the bank so long as the bank acted in good faith. Under revised Section 3‑405 the loss may be recovered from the bank to the extent the failure of the bank to exercise ordinary care contributed to the loss.

3. Section 3‑404(b) and Section 3‑405 both apply to cases of employee fraud. Section 3‑404(b) is not limited to cases of employee fraud, but most of the cases to which it applies will be cases of employee fraud. The following cases illustrate the application of Section 3‑405. In each case it is assumed that the bank that took the check acted in good faith and was not negligent.

Case # 1. Janitor, an employee of Employer, steals a check for a very large amount payable to Employer after finding it on a desk in one of Employer’s offices. Janitor forges Employer’s indorsement on the check and obtains payment. Since Janitor was not entrusted with “responsibility” with respect to the check, Section 3‑405 does not apply. Section 3‑406 might apply to this case. The issue would be whether Employer was negligent in safeguarding the check. If not, Employer could assert that the indorsement was forged and bring an action for conversion against the depositary or payor bank under Section 3‑420.

Case # 2. X is Treasurer of Corporation and is authorized to write checks on behalf of Corporation by signing X’s name as Treasurer. X draws a check in the name of Corporation and signs X’s name as Treasurer. The check is made payable to X. X then indorses the check and obtains payment. Assume that Corporation did not owe any money to X and did not authorize X to write the check. Although the writing of the check was not authorized, Corporation is bound as drawer of the check because X had authority to sign checks on behalf of Corporation. This result follows from agency law and Section 3‑402(a). Section 3‑405 does not apply in this case because there is no forged indorsement. X was payee of the check so the indorsement is valid. Section 3‑110(a).

Case # 3. The duties of Employee, a bookkeeper, include posting the amounts of checks payable to Employer to the accounts of the drawers of the checks. Employee steals a check payable to Employer which was entrusted to Employee and forges Employer’s indorsement. The check is deposited by Employee to an account in Depositary Bank which Employee opened in the same name as Employer, and the check is honored by the drawee bank. The indorsement is effective as Employer’s indorsement because Employee’s duties include processing checks for bookkeeping purposes. Thus, Employee is entrusted with “responsibility” with respect to the check. Neither Depositary Bank nor the drawee bank is liable to Employer for conversion of the check. The same result follows if Employee deposited the check in the account in Depositary Bank without indorsement. Section 4‑205(a). Under subsection (c) deposit in a depositary bank in an account in a name substantially similar to that of Employer is the equivalent of an indorsement in the name of Employer.

Case # 4. Employee’s duties include stamping Employer’s unrestricted blank indorsement on checks received by Employer and depositing them in Employer’s bank account. After stamping Employer’s unrestricted blank indorsement on a check, Employee steals the check and deposits it in Employee’s personal bank account. Section 3‑405 doesn’t apply because there is no forged indorsement. Employee is authorized by Employer to indorse Employer’s checks. The fraud by Employee is not the indorsement but rather the theft of the indorsed check. Whether Employer has a cause of action against the bank in which the check was deposited is determined by whether the bank had notice of the breach of fiduciary duty by Employee. The issue is determined under Section 3‑307.

Case # 5. The computer that controls Employer’s check‑writing machine was programmed to cause a check to be issued to Supplier Co. to which money was owed by Employer. The address of Supplier Co. was included in the information in the computer. Employee is an accounts payable clerk whose duties include entering information into the computer. Employee fraudulently changed the address of Supplier Co. in the computer data bank to an address of Employee. The check was subsequently produced by the check‑writing machine and mailed to the address that Employee had entered into the computer. Employee obtained possession of the check, indorsed it in the name of Supplier Co., and deposited it to an account in Depositary Bank which Employee opened in the name “Supplier Co.” The check was honored by the drawee bank. The indorsement is effective under Section 3‑405(b) because Employee’s duties allowed Employee to supply information determining the address of the payee of the check. An employee that is entrusted with duties that enable the employee to determine the address to which a check is to be sent controls the disposition of the check and facilitates forgery of the indorsement. The employer is held responsible. The drawee may debit the account of Employer for the amount of the check. There is no breach of warranty by Depositary Bank under Section 3‑417(a)(1) or 4‑208(a)(1).

Case # 6. Treasurer is authorized to draw checks in behalf of Corporation. Treasurer draws a check of Corporation payable to Supplier Co., a company that sold goods to Corporation. The check was issued to pay the price of these goods. At the time the check was signed Treasurer had no intention of stealing the check. Later, Treasurer stole the check, indorsed it in the name “Supplier Co.” and obtained payment by depositing it to an account in Depositary Bank which Treasurer opened in the name “Supplier Co.”. The indorsement is effective under Section 3‑405(b). Section 3‑404(b) does not apply to this case.

Case # 7. Checks of Corporation are signed by Treasurer in behalf of Corporation as drawer. Clerk’s duties include the preparation of checks for issue by Corporation. Clerk prepares a check payable to the order of Supplier Co. for Treasurer’s signature. Clerk fraudulently informs Treasurer that the check is needed to pay a debt owed to Supplier Co., a company that does business with Corporation. No money is owed to Supplier Co. and Clerk intends to steal the check. Treasurer signs it and returns it to Clerk for mailing. Clerk does not indorse the check but deposits it to an account in Depositary Bank which Clerk opened in the name “Supplier Co.”. The check is honored by the drawee bank. Section 3‑404(b)(i) does not apply to this case because Clerk, under Section 3‑110(a), is not the person whose intent determines to whom the check is payable. But Section 3‑405 does apply and it treats the deposit by Clerk as an effective indorsement by Clerk because Clerk was entrusted with responsibility with respect to the check. If Supplier Co. is a fictitious person Section 3‑404(b)(ii) applies. But the result is the same. Clerk’s deposit is treated as an effective indorsement of the check whether Supplier Co. is a fictitious or a real person or whether money was or was not owing to Supplier Co. The drawee bank may debit the account of Corporation for the amount of the check and there is no breach of warranty by Depositary Bank under Section 3‑417(1)(a).

4. The last sentence of subsection (b) is similar to subsection (d) of Section 3‑404 which is discussed in Comment 3 to Section 3‑404. In Case # 5, Case # 6, or Case # 7 the depositary bank may have failed to exercise ordinary care when it allowed the employee to open an account in the name “Supplier Co.,” to deposit checks payable to “Supplier Co.” in that account, or to withdraw funds from that account that were proceeds of checks payable to Supplier Co. Failure to exercise ordinary care is to be determined in the context of all the facts relating to the bank’s conduct with respect to the bank’s collection of the check. If the trier of fact finds that there was such a failure and that the failure substantially contributed to loss, it could find the depositary bank liable to the extent the failure contributed to the loss. The last sentence of subsection (b) can be illustrated by an example. Suppose in Case # 5 that the check is not payable to an obscure “Supplier Co.” but rather to a well‑known national corporation. In addition, the check is for a very large amount of money. Before depositing the check, Employee opens an account in Depositary Bank in the name of the corporation and states to the person conducting the transaction for the bank that Employee is manager of a new office being opened by the corporation. Depositary Bank opens the account without requiring Employee to produce any resolutions of the corporation’s board of directors or other evidence of authorization of Employee to act for the corporation. A few days later, the check is deposited, the account is credited, and the check is presented for payment. After Depositary Bank receives payment, it allows Employee to withdraw the credit by a wire transfer to an account in a bank in a foreign country. The trier of fact could find that Depositary Bank did not exercise ordinary care and that the failure to exercise ordinary care contributed to the loss suffered by Employer. The trier of fact could allow recovery by Employer from Depositary Bank for all or part of the loss suffered by Employer.

SOUTH CAROLINA REPORTER’S COMMENT

This provision addresses two forms of check fraud practiced by employees that an employer has entrusted with “responsibility” with respect to checks as defined in Subsection (a)(3). The first form of check fraud occurs when an entrusted employee steals a check payable to his employer, forges the employer’s indorsement, and cashes the check or deposits it in an account that the employee controls. Under prior law the employer as owner of the check could maintain conversion actions against both the drawee‑payor bank and the depositary bank. See Equitable Life Assurance Society of the United States v. Okey, 812 F.2d 906 (4th Cir. 1987) (South Carolina law); Flavor‑Inn, Inc. v. National Bank of South Carolina, 309 S.C. 508, 424 S.E.2d 534 (S.C. App. 1992).

The drawee‑payor bank’s best defense in such cases was to establish that the employer was negligent and that the negligence substantially contributed to the unauthorized indorsements. If the drawee‑payor bank succeeded in establishing this negligence defense under former Section 36‑3‑406 the employer would be precluded from claiming that the indorsement was unauthorized. See, e.g., Thompson Maple Products, Inc. of Corry v. Citizens National Bank, 211 Pa.Super. 42, 234 A.2d 32 (Sup. Ct. of Pa. 1967). A depositary bank that was sued for conversion had a defense under former Section 36‑3‑419(3) limiting its liability to the proceeds of the fraudulently indorsed check remaining in the employee’s account. The depositary bank was not entitled to the limitation if it failed to act in accordance with reasonable commercial standards in taking the check.

Under the present statute, a court will address this common form of check fraud by first determining whether the employee who forged the employer’s check had responsibility with respect to the check under Subsection (a)(3). If the employer did entrust the employee with responsibility with respect to the check, then the employee’s indorsement in the name of the employer is effective and neither the drawee‑payor bank nor depositary bank is liable for conversion.

The employer, however, is not without remedies. If the employer can establish that the bank paying the fraudulently indorsed check or taking it for value or collection failed to exercise ordinary care and that failure substantially contributed to the loss resulting from the fraud, the employer can recover from the bank failing to exercise ordinary care to the extent that the failure contributed to the loss.

The second type of employee check fraud addressed in this section is the “padded payroll” situation in which an employee fraudulently induces her employer to issue a check to a real or fictitious person, steals the check, indorses the check in the name of the named payee, and either cashes the check or deposits it in an account the employee controls. Under former Section 36‑3‑405(1)(c) the indorsement by the employee in the name of the payee was effective. As a result, the employer had no claim against the drawee‑payor bank for improper payment of an item bearing a forged indorsement. Moreover, even if the depositary bank was negligent in taking the check, the employer had no claim against the depositary bank. Stone Manufacturing Co. v. NCNB of South Carolina, 308 S.C. 287, 417 S.E.2d 628 (S. C. App. 1992).

Under the current provision, if the person procuring the fraudulent padded payroll check is an employee with responsibility with respect to the check under Subsection (a)(3) and either that employee or a person acting in concert with him indorses the check in the name of the named payee, Subsection (b) provides that the indorsement is as effective as the payee’s indorsement.

Subsection (c) clarifies prior law, noting that an indorsement in a name substantially similar to the payee’s is effective. Further, if the check is deposited into an account at a depositary bank in a name substantially similar to that of the payee, the check is deemed to be effectively indorsed.

The last sentence of Subsection (b) effects a substantial change from prior law, by affording an employer who bears the loss on a padded payroll check a claim against a depositary bank that failed to exercise ordinary care in taking the check. In doing so, Subsection (b) overrules Stone Manufacturing Co. v. NCNB of South Carolina, 308 S.C. 287, 417 S.E.2d 628 (S. C. App. 1992). Under Subsection (b), if the employer can establish that the depositary bank failed to exercise ordinary care and that the failure substantially contributed to the loss, the employer can recover from the depositary bank to the extent that the bank’s failure to exercise ordinary care contributed to the loss.

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| Definitional Cross References: |  |
| “Account” | Section 36‑4‑104(a)(1) |
| “Depositary Bank” | Section 36‑4‑105(2) |
| “Good Faith” | Section 36‑3‑103(a)(6) |
| “Holder” | Section 36‑1‑201(20) |
| “Indorsement” | Section 36‑3‑204(a) |
| “Instrument” | Section 36‑3‑104(b) |
| “Issuer” | Section 36‑3‑105(c) |
| “Payment” | Section 36‑3‑602(a) |
| “Person” | Section 36‑1‑201(30) |
| “Value” | Section 36‑3‑303(a) |

Cross References:

1. As a general rule, a person is not liable upon an instrument unless that person or an authorized representative of that person has signed the instrument. Section 36‑3‑401(a).

2. As a general rule, an unauthorized indorsement is ineffective. Section 36‑3‑403(a).

3. In imposter and fictitious payee situations, an indorsement by any person in the name of the payee is effective. Section 36‑3‑404.

4. A person whose failure to exercise ordinary care substantially contributes to a forged indorsement may be precluded from asserting the forgery. Section 36‑3‑406.

LIBRARY REFERENCES

Bills and Notes 201, 239, 279, 377, 381.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 29 to 30, 150 to 151, 191, 201.

RESEARCH REFERENCES

ALR Library

45 ALR 5th 389 , Construction and Effect of “Padded Payroll” Rule of UCC Section 3‑405.

Encyclopedias

S.C. Jur. Banks and Banking Section 113.1, Documentary Drafts and UCC Liability.

**SECTION 36‑3‑406.** Negligence contributing to forged signature or alteration of instrument.

(a) A person whose failure to exercise ordinary care substantially contributes to an alteration of an instrument or to the making of a forged signature on an instrument is precluded from asserting the alteration or the forgery against a person who, in good faith, pays the instrument or takes it for value or for collection.

(b) Under Subsection (a), if the person asserting the preclusion fails to exercise ordinary care in paying or taking the instrument and that failure substantially contributes to loss, the loss is allocated between the person precluded and the person asserting the preclusion according to the extent to which the failure of each to exercise ordinary care contributed to the loss.

(c) Under Subsection (a), the burden of proving failure to exercise ordinary care is on the person asserting the preclusion. Under Subsection (b), the burden of proving failure to exercise ordinary care is on the person precluded.

HISTORY: 1962 Code Section 10.3‑406; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. Section 3‑406(a) is based on former Section 3‑406. With respect to alteration, Section 3‑406 adopts the doctrine of Young v. Grote, 4 Bing. 253 (1827), which held that a drawer who so negligently draws an instrument as to facilitate its material alteration is liable to a drawee who pays the altered instrument in good faith. Under Section 3‑406 the doctrine is expanded to apply not only to drafts but to all instruments. It includes in the protected class any “person who, in good faith, pays the instrument or takes it for value or for collection.” Section 3‑406 rejects decisions holding that the maker of a note owes no duty of care to the holder because at the time the instrument is issued there is no contract between them. By issuing the instrument and “setting it afloat upon a sea of strangers” the maker or drawer voluntarily enters into a relation with later holders which justifies imposition of a duty of care. In this respect an instrument so negligently drawn as to facilitate alteration does not differ in principle from an instrument containing blanks which may be filled. Under Section 3‑407 a person paying an altered instrument or taking it for value, in good faith and without notice of the alteration may enforce rights with respect to the instrument according to its original terms. If negligence of the obligor substantially contributes to an alteration, this section gives the holder or the payor the alternative right to treat the altered instrument as though it had been issued in the altered form.

No attempt is made to define particular conduct that will constitute “failure to exercise ordinary care [that] substantially contributes to an alteration.” Rather, “ordinary care” is defined in Section 3‑103(a)(7) in general terms. The question is left to the court or the jury for decision in the light of the circumstances in the particular case including reasonable commercial standards that may apply.

Section 3‑406 does not make the negligent party liable in tort for damages resulting from the alteration. If the negligent party is estopped from asserting the alteration the person taking the instrument is fully protected because the taker can treat the instrument as having been issued in the altered form.

2. Section 3‑406 applies equally to a failure to exercise ordinary care that substantially contributes to the making of a forged signature on an instrument. Section 3‑406 refers to “forged signature” rather than “unauthorized signature” that appeared in former Section 3‑406 because it more accurately describes the scope of the provision. Unauthorized signature is a broader concept that includes not only forgery but also the signature of an agent which does not bind the principal under the law of agency. The agency cases are resolved independently under agency law. Section 3‑406 is not necessary in those cases.

The “substantially contributes” test of former Section 3‑406 is continued in this section in preference to a “direct and proximate cause” test. The “substantially contributes” test is meant to be less stringent than a “direct and proximate cause” test. Under the less stringent test the preclusion should be easier to establish. Conduct “substantially contributes” to a material alteration or forged signature if it is a contributing cause of the alteration or signature and a substantial factor in bringing it about. The analysis of “substantially contributes” in former Section 3‑406 by the court in Thompson Maple Products v. Citizens National Bank of Corry, 234 A.2d 32 (Pa.Super.Ct.1967), states what is intended by the use of the same words in revised Section 3‑406(b). Since Section 3‑404(d) and Section 3‑405(b) also use the words “substantially contributes” the analysis of these words also applies to those provisions.

3. The following cases illustrate the kind of conduct that can be the basis of a preclusion under Section 3‑406(a):

Case # 1. Employer signs checks drawn on Employer’s account by use of a rubber stamp of Employer’s signature. Employer keeps the rubber stamp along with Employer’s personalized blank check forms in an unlocked desk drawer. An unauthorized person fraudulently uses the check forms to write checks on Employer’s account. The checks are signed by use of the rubber stamp. If Employer demands that Employer’s account in the drawee bank be recredited because the forged check was not properly payable, the drawee bank may defend by asserting that Employer is precluded from asserting the forgery. The trier of fact could find that Employer failed to exercise ordinary care to safeguard the rubber stamp and the check forms and that the failure substantially contributed to the forgery of Employer’s signature by the unauthorized use of the rubber stamp.

Case # 2. An insurance company draws a check to the order of Sarah Smith in payment of a claim of a policyholder, Sarah Smith, who lives in Alabama. The insurance company also has a policyholder with the same name who lives in Illinois. By mistake, the insurance company mails the check to the Illinois Sarah Smith who indorses the check and obtains payment. Because the payee of the check is the Alabama Sarah Smith, the indorsement by the Illinois Sarah Smith is a forged indorsement. Section 3‑110(a). The trier of fact could find that the insurance company failed to exercise ordinary care when it mailed the check to the wrong person and that the failure substantially contributed to the making of the forged indorsement. In that event the insurance company could be precluded from asserting the forged indorsement against the drawee bank that honored the check.

Case # 3. A company writes a check for $ 10. The figure “10” and the word “ten” are typewritten in the appropriate spaces on the check form. A large blank space is left after the figure and the word. The payee of the check, using a typewriter with a typeface similar to that used on the check, writes the word “thousand” after the word “ten” and a comma and three zeros after the figure “10”. The drawee bank in good faith pays $ 10,000 when the check is presented for payment and debits the account of the drawer in that amount. The trier of fact could find that the drawer failed to exercise ordinary care in writing the check and that the failure substantially contributed to the alteration. In that case the drawer is precluded from asserting the alteration against the drawee if the check was paid in good faith.

4. Subsection (b) differs from former Section 3‑406 in that it adopts a concept of comparative negligence. If the person precluded under subsection (a) proves that the person asserting the preclusion failed to exercise ordinary care and that failure substantially contributed to the loss, the loss may be allocated between the two parties on a comparative negligence basis. In the case of a forged indorsement the litigation is usually between the payee of the check and the depositary bank that took the check for collection. An example is a case like Case # 1 of Comment 3 to Section 3‑405. If the trier of fact finds that Employer failed to exercise ordinary care in safeguarding the check and that the failure substantially contributed to the making of the forged indorsement, subsection (a) of Section 3‑406 applies. If Employer brings an action for conversion against the depositary bank that took the checks from the forger, the depositary bank could assert the preclusion under subsection (a). But suppose the forger opened an account in the depositary bank in a name identical to that of Employer, the payee of the check, and then deposited the check in the account. Subsection (b) may apply. There may be an issue whether the depositary bank should have been alerted to possible fraud when a new account was opened for a corporation shortly before a very large check payable to a payee with the same name is deposited. Circumstances surrounding the opening of the account may have suggested that the corporation to which the check was payable may not be the same as the corporation for which the account was opened. If the trier of fact finds that collecting the check under these circumstances was a failure to exercise ordinary care, it could allocate the loss between the depositary bank and Employer, the payee.

SOUTH CAROLINA REPORTER’S COMMENT

Subsection (a) is based upon former Section 36‑3‑406. Under Subsection (a), a person whose failure to exercise ordinary care substantially contributes to a forgery or alteration is precluded from asserting the forgery or alteration against a person who in good faith pays the instrument or takes it for value or collection. The adoption of this provision does not affect the authority of Read v. South Carolina National Bank, 286 S.C. 534, 335 S.E.2d 359 (1985) which is the leading decision on the effect of a drawer’s negligence upon the drawer’s claim that his signature was unauthorized. In Read, an employer hired a bookkeeper who had been convicted of issuing bad checks without investigating her background, authorized the drawee‑payor bank to pay checks bearing a facsimile stamp of the drawer’s signature, turned the facsimile stamp over to the bookkeeper, allowed the bookkeeper to reconcile the bank statement, and did not review the bank statement or the bookkeeper’s reconciliation. The court held that under former Section 36‑3‑406, the employer’s negligence substantially contributed to the forged drawer’s signature and the employer was precluded from asserting that the signatures were unauthorized. Had Read been decided under the current statute, the drawer would have been precluded from asserting a forgery because the drawer failed to exercise ordinary care and that failure substantially contributed to the forgeries.

Subsection (b) is based upon the final phrase in former Section 36‑3‑406. Under the former provision, a drawer whose negligence substantially contributed to a forgery or alteration was afforded a counter defense. If the drawer could establish that a drawee or other payor did not act in accordance with reasonable commercial standards, the drawer could assert the forgery despite its negligence. The current statute changes the former law on this point in two ways. First, Subsection (b) adopts a comparative fault standard under which the loss is allocated between the drawer and drawee to the extent that the negligence of each caused the loss. Second, and more significantly, the second sentence of Section 36‑3‑103(a)(9) provides a definition of ordinary care applicable to banks that process instruments for payment or collection by automated means. This new definition substantially restricts a drawer’s defense under Subsection (b) and appears to overrule the leading South Carolina decision on a drawee‑payor bank’s duty to review checks presented for payment.

In Dennis v. South Carolina National Bank, 299 S.C. 34, 382 S.E.2d 237 (S. C. App. 1988), an employee forged her employer’s signature on multiple checks which she cashed at a branch of the payor bank. The employee removed the forged checks from the bank statement before giving the statement and cancelled checks to her employer. The employer brought an action against the payor bank to recover the amounts that his account was debited when the bank paid the forged checks. The bank asserted that the drawer’s negligence precluded him from asserting the forgeries. The drawer responded that the bank could not assert the preclusion because the bank had not acted in accordance with reasonable commercial standards. Despite evidence that the bank’s review of the signatures on the checks was at least as thorough as other commercial banks, the court asserted that the bank’s failure to train their file clerks to detect forgeries violated reasonable commercial standards applicable to the bank. As a result, that bank was barred from asserting its preclusion defense under former Section 36‑3‑406.

Under the current statute, a drawer seeking to avoid a preclusion defense by establishing that the payor bank failed to exercise ordinary care will have a more difficult time than the drawer in Dennis. As a general rule, Section 36‑3‑103(a)(9) defines “ordinary care” as the “observance of reasonable commercial standards.” The second sentence of the provision, however, specifically addresses the reasonable commercial standards a bank must observe if the bank processes instruments for collection or payment by “automated means.” Since virtually all commercial banks process checks by automated means, the second sentence is critical in disputes comparable to that in Dennis. Under the second sentence of Section 36‑3‑103(a)(9), if a bank processes checks by automated means, “reasonable commercial standards do not require the bank to examine the instrument if the failure to examine does not violate the bank’s prescribed procedures and the bank’s procedures do not vary unreasonably from general banking usage”.

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| Definitional Cross References: |  |
| “Alteration” | Section 36‑3‑407(a) |
| “Good Faith” | Section 36‑3‑103(a)(6) |
| “Instrument” | Section 36‑3‑104(b) |
| “Ordinary Care” | Section 36‑3‑103(a)(9) |
| “Person” | Section 36‑1‑201(30) |
| “Value” | Section 36‑3‑303(a) |

Cross References:

1. Unauthorized signatures. Section 36‑3‑403.

2. Unauthorized indorsements in name of payee effective in imposter and fictitious payee situations. Section 36‑3‑404.

3. Forged indorsement by employee with responsibility effective. Section 36‑3‑405.

4. Alterations. Section 36‑3‑407.

5. A customer’s failure to review statement of account and report unauthorized signatures of the customer or alterations in a timely manner may preclude the customer from asserting the unauthorized signatures and alterations. Section 36‑4‑406.

LIBRARY REFERENCES

Bills and Notes 377, 378, 381, 452(4).

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 30, 33, 67, 167, 191, 194, 197, 201.

NOTES OF DECISIONS

In general 1

1. In general

The negligence of a bank in cashing fraudulently drawn payroll checks was immaterial to the application of “the padded payroll defense” (Section 36‑3‑405[1][c]) since (1) the drafters of the statute made no reference to a bank’s negligence as an exception to its application, and (2) Official Comment 4 clearly indicated that the loss caused by an unfaithful employee should fall on the employer as a risk of business. Stone Mfg. Co. v. NCNB of South Carolina (S.C.App. 1992) 308 S.C. 287, 417 S.E.2d 628.

There was sufficient evidence to support a finding that a bank did not pay forged checks in good faith and in accordance with reasonable commercial standards of the bank and the banking business in general, and therefore the customer’s negligence did not substantially contribute to the forgeries, where the clerks failed to notice 2 forged checks payable to the forger which were presented to the bank on the same day on 39 separate occasions, 3 forged checks payable to the forger on the same day on 9 separate occasions, 4 forged checks payable to the forger on the same day on 4 separate occasions, and 5 forged checks payable to the forger on the same day on 2 occasions. Dennis v. South Carolina Nat. Bank (S.C.App. 1988) 299 S.C. 34, 382 S.E.2d 237, certiorari dismissed 302 S.C. 51, 393 S.E.2d 382.

In an action by a customer against a bank for the bank’s alleged negligence in honoring forged checks, the bank clearly met its burden of proof on the issue of the customer’s negligence substantially contributing to the making of the unauthorized signatures, under Section 36‑3‑406, where the customer failed to maintain proper control over his signature stamp, allowed the same person who had possession of the checkbook to reconcile the bank statements with no supervision or verification, and failed to examine his bank statements. Read v. South Carolina Nat. Bank (S.C. 1985) 286 S.C. 534, 335 S.E.2d 359.

**SECTION 36‑3‑407.** Alteration.

(a) “Alteration” means (i) an unauthorized change in an instrument that purports to modify in any respect the obligation of a party, or (ii) an unauthorized addition of words or numbers or other change to an incomplete instrument relating to the obligation of a party.

(b) Except as provided in Subsection (c), an alteration fraudulently made discharges a party whose obligation is affected by the alteration unless that party assents or is precluded from asserting the alteration. No other alteration discharges a party, and the instrument may be enforced according to its original terms.

(c) A payor bank or drawee paying a fraudulently altered instrument or a person taking it for value, in good faith and without notice of the alteration, may enforce rights with respect to the instrument (i) according to its original terms, or (ii) in the case of an incomplete instrument altered by unauthorized completion, according to its terms as completed.

HISTORY: 1962 Code Section 10.3‑407; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. This provision restates former Section 3‑407. Former Section 3‑407 defined a “material” alteration as any alteration that changes the contract of the parties in any respect. Revised Section 3‑407 refers to such a change as an alteration. As under subsection (2) of former Section 3‑407, discharge because of alteration occurs only in the case of an alteration fraudulently made. There is no discharge if a blank is filled in the honest belief that it is authorized or if a change is made with a benevolent motive such as a desire to give the obligor the benefit of a lower interest rate. Changes favorable to the obligor are unlikely to be made with any fraudulent intent, but if such an intent is found the alteration may operate as a discharge.

Discharge is a personal defense of the party whose obligation is modified and anyone whose obligation is not affected is not discharged. But if an alteration discharges a party there is also discharge of any party having a right of recourse against the discharged party because the obligation of the party with the right of recourse is affected by the alteration. Assent to the alteration given before or after it is made will prevent the party from asserting the discharge. The phrase “or is precluded from asserting the alteration” in subsection (b) recognizes the possibility of an estoppel or other ground barring the defense which does not rest on assent.

2. Under subsection (c) a person paying a fraudulently altered instrument or taking it for value, in good faith and without notice of the alteration, is not affected by a discharge under subsection (b). The person paying or taking the instrument may assert rights with respect to the instrument according to its original terms or, in the case of an incomplete instrument that is altered by unauthorized completion, according to its terms as completed. If blanks are filled or an incomplete instrument is otherwise completed, subsection (c) places the loss upon the party who left the instrument incomplete by permitting enforcement in its completed form. This result is intended even though the instrument was stolen from the issuer and completed after the theft.

SOUTH CAROLINA REPORTER’S COMMENT

This provision restates former Section 36‑3‑407. Subsection (a) defines alteration to include both an unauthorized change to an instrument and the unauthorized completion of an incomplete instrument. Subsection (b) provides the general rule that an alteration fraudulently made discharges a party whose obligation is affected by the discharge. Subsection (c) provides two exceptions to the rule. First, a payor bank or drawee paying a fraudulently altered instrument or taking it for value without notice of the alteration may enforce the instrument according to its original terms. The second exception applies when an incomplete instrument is completed in an unauthorized manner, and provides that a payor bank or drawee that pays the instrument or a person taking it for value without notice of the unauthorized completion can enforce the instrument as completed. The second exception is consistent with the decision in American Federal Bank, FSB v. Parker, 301 S.C. 509, 392 S.E.2d 798 (S.C. App. 1990) in which a maker of a note signed the writing but left the amount blank. The maker authorized a business associate to complete the note in the amount of $35,000. The business associate completed the note in the amount of $85,000 and transferred the note to a holder in due course. The court held that the holder in due course could enforce the note against the maker to the extent of $85,000.

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| Definitional Cross References: |  |
| “Drawee” | Section 36‑3‑103(a)(4) |
| “Good Faith” | Section 36‑3‑103(a)(6) |
| “Incomplete Instrument” | Section 36‑3‑115(a) |
| “Instrument” | Section 36‑3‑104(b) |
| “Notice” | Section 36‑1‑201(25) [see now Section 36‑1‑202] |
| “Payor Bank” | Section 36‑4‑105(3) |
| “Person” | Section 36‑1‑201(30) |
| “Value” | Section 36‑3‑303(a) |

Cross References:

1. Preclusion from asserting that an instrument has been altered. Sections 36‑3‑406, 36‑4‑406.

2. Presentment warranty that a draft has not been altered. Sections 36‑3‑417(a)(2), 36‑4‑208(a)(2).

3. Transfer warranty that an instrument has not been altered. Sections 36‑3‑416(a)(3), 36‑4‑207(a)(3).

LIBRARY REFERENCES

Alteration of Instruments 1.1.

Bills and Notes 378.

WESTLAW Topic Nos. 25, 56.

C.J.S. Alteration of Instruments Sections 2 to 4.

C.J.S. Bills and Notes; Letters of Credit Sections 33, 197, 201.

NOTES OF DECISIONS

In general 1

1. In general

A borrower was liable to the lending bank for the entire amount of an $85,000 promissory note, even though he intended to borrow only $35,000, where he signed a blank promissory note and relied upon a third party to co‑sign the note and fill in the amount for $35,000, but the third party entered $85,000 as the amount, presented the note to the bank, and received the funds from the bank. As a holder in due course, the bank was entitled to enforce the note against the borrower as completed since the bank took the note in good faith and without notice of any defense to it by the borrower. American Federal Bank, FSB v. Parker (S.C.App. 1990) 301 S.C. 509, 392 S.E.2d 798.

**SECTION 36‑3‑408.** Drawee not liable on unaccepted draft.

A check or other draft does not of itself operate as an assignment of funds in the hands of the drawee available for its payment, and the drawee is not liable on the instrument until the drawee accepts it.

HISTORY: 1962 Code Section 10.3‑408; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. This section is a restatement of former Section 3‑409(1). Subsection (2) of former Section 3‑409 is deleted as misleading and superfluous. Comment 3 says of subsection (2): “It is intended to make it clear that this section does not in any way affect any liability which may arise apart from the instrument.” In reality subsection (2) did not make anything clear and was a source of confusion. If all it meant was that a bank that has not certified a check may engage in other conduct that might make it liable to a holder, it stated the obvious and was superfluous. Section 1‑103 is adequate to cover those cases.

2. Liability with respect to drafts may arise under other law. For example, Section 4‑302 imposes liability on a payor bank for late return of an item.

SOUTH CAROLINA REPORTER’S COMMENT

This provision restates former Section 36‑3‑409(1).

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| Definitional Cross References: |  |
| “Check” | Section 36‑3‑104(f) |
| “Draft” | Section 36‑3‑104(e) |
| “Drawee” | Section 36‑3‑103(a)(4) |
| “Instrument” | Section 36‑3‑104(b) |
| “Payment” | Section 36‑3‑602(a) |

Cross References:

1. Acceptance of a draft and certification of a check. Section 36‑3‑409.

2. Liability for refusal to pay a certified check. Section 36‑3‑411.

3. Lost, stolen or destroyed certified checks. Section 36‑3‑312.

4. Obligation of an acceptor of a draft. Section 36‑3‑413.

LIBRARY REFERENCES

Banks and Banking 370, 452(3), 97 to 5698, 352.1 to 56360.

Bills and Notes 90 to 94(3).

WESTLAW Topic Nos. 52, 56.

C.J.S. Banks and Banking Sections 50 to 51, 67 to 73, 78, 80 to 85.

C.J.S. Bills and Notes; Letters of Credit Sections 41 to 60, 64.

**SECTION 36‑3‑409.** Acceptance of draft; certified check.

(a) “Acceptance” means the drawee’s signed agreement to pay a draft as presented. It must be written on the draft and may consist of the drawee’s signature alone. Acceptance may be made at any time and becomes effective when notification pursuant to instructions is given or the accepted draft is delivered for the purpose of giving rights on the acceptance to any person.

(b) A draft may be accepted although it has not been signed by the drawer, is otherwise incomplete, is overdue, or has been dishonored.

(c) If a draft is payable at a fixed period after sight and the acceptor fails to date the acceptance, the holder may complete the acceptance by supplying a date in good faith.

(d) “Certified check” means a check accepted by the bank on which it is drawn. Acceptance may be made as stated in Subsection (a) or by a writing on the check which indicates that the check is certified. The drawee of a check has no obligation to certify the check, and refusal to certify is not dishonor of the check.

HISTORY: 1962 Code Section 10.3‑409; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. The first three subsections of Section 3‑409 are a restatement of former Section 3‑410. Subsection (d) adds a definition of certified check which is a type of accepted draft.

2. Subsection (a) states the generally recognized rule that the mere signature of the drawee on the instrument is a sufficient acceptance. Customarily the signature is written vertically across the face of the instrument, but since the drawee has no reason to sign for any other purpose a signature in any other place, even on the back of the instrument, is sufficient. It need not be accompanied by such words as “Accepted,” “Certified,” or “Good.” It must not, however, bear any words indicating an intent to refuse to honor the draft. The last sentence of subsection (a) states the generally recognized rule that an acceptance written on the draft takes effect when the drawee notifies the holder or gives notice according to instructions.

3. The purpose of subsection (c) is to provide a definite date of payment if none appears on the instrument. An undated acceptance of a draft payable “thirty days after sight” is incomplete. Unless the acceptor writes in a different date the holder is authorized to complete the acceptance according to the terms of the draft by supplying a date of acceptance. Any date supplied by the holder is effective if made in good faith.

4. The last sentence of subsection (d) states the generally recognized rule that in the absence of agreement a bank is under no obligation to certify a check. A check is a demand instrument calling for payment rather than acceptance. The bank may be liable for breach of any agreement with the drawer, the holder, or any other person by which it undertakes to certify. Its liability is not on the instrument, since the drawee is not so liable until acceptance. Section 3‑408. Any liability is for breach of the separate agreement.

SOUTH CAROLINA REPORTER’S COMMENT

Subsection (a) defines the term “acceptance” and is based upon former Section 36‑3‑410(1). Subsection (b) is a restatement of former Section 36‑3‑410(2) and provides that a draft may be accepted, although it has not been signed by the drawer, is otherwise incomplete, is overdue, or is dishonored. Subsection (c) is a restatement of former Section 36‑3‑410(5) and addresses the issue of an undated acceptance. Subsection (d) is based upon former Section 36‑3‑411 and defines “certified check.”

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| Definitional Cross References: |  |
| “Acceptor” | Section 36‑3‑103(a)(1) |
| “Agreement” | Section 36‑1‑201(3) |
| “Bank” | Section 36‑1‑201(4) |
| “Check” | Section 36‑3‑104(f) |
| “Draft” | Section 36‑3‑104(e) |
| “Drawee” | Section 36‑3‑103(a)(4) |
| “Drawer” | Section 36‑3‑103(a)(5) |
| “Holder” | Section 36‑1‑201(20) |
| “Notice” | Section 36‑1‑201(25) [see now Section 36‑1‑202] |
| “Person” | Section 36‑1‑201(30) |
| “Signer” | Section 36‑1‑201(39) |
| “Writing” | Section 36‑1‑201(46) |

Cross References:

1. Taking a certified check for an obligation discharges the obligation. Section 36‑3‑310(a).

2. Lost, destroyed or stolen certified check. Section 36‑3‑312.

3. Acceptance varying the terms of a draft. Section 36‑3‑410.

4. Liability for refusal to pay a certified check. Section 36‑3‑411.

5. Obligation of acceptor. Section 36‑3‑413.

LIBRARY REFERENCES

Bills and Notes 15, 74, 310.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 6, 9, 18, 39, 139, 159.

**SECTION 36‑3‑410.** Acceptance varying draft.

(a) If the terms of a drawee’s acceptance vary from the terms of the draft as presented, the holder may refuse the acceptance and treat the draft as dishonored. In that case, the drawee may cancel the acceptance.

(b) The terms of a draft are not varied by an acceptance to pay at a particular bank or place in the United States, unless the acceptance states that the draft is to be paid only at that bank or place.

(c) If the holder assents to an acceptance varying the terms of a draft, the obligation of each drawer and indorser that does not expressly assent to the acceptance is discharged.

HISTORY: 1962 Code Section 10.3‑410; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. This section is a restatement of former Section 3‑412. It applies to conditional acceptances, acceptances for part of the amount, acceptances to pay at a different time from that required by the draft, or to the acceptance of less than all of the drawees. It applies to any other engagement changing the essential terms of the draft. If the drawee makes a varied acceptance the holder may either reject it or assent to it. The holder may reject by insisting on acceptance of the draft as presented. Refusal by the drawee to accept the draft as presented is dishonor. In that event the drawee is not bound by the varied acceptance and is entitled to have it canceled.

If the holder assents to the varied acceptance, the drawee’s obligation as acceptor is according to the terms of the varied acceptance. Under subsection (c) the effect of the holder’s assent is to discharge any drawer or indorser who does not also assent. The assent of the drawer or indorser must be affirmatively expressed. Mere failure to object within a reasonable time is not assent which will prevent the discharge.

2. Under subsection (b) an acceptance does not vary from the terms of the draft if it provides for payment at any particular bank or place in the United States unless the acceptance states that the draft is to be paid only at such bank or place. Section 3‑501(b)(1) states that if an instrument is payable at a bank in the United States presentment must be made at the place of payment (Section 3‑111) which in this case is at the designated bank.

SOUTH CAROLINA REPORTER’S COMMENT

This provision is a restatement of former Section 36‑3‑412 and addresses situations in which a drawee’s acceptance varies the terms of the draft. Those situations arise when the holder of a draft presents the draft to the drawee for acceptance and the drawee is unwilling to accept the draft unless the terms of the draft are changed. In such cases, the drawee may make an acceptance varying the essential terms of the draft such as the amount of the draft or time for payment. When the holder receives the varied acceptance, the holder must make a decision. Pursuant to Subsection (a) the holder can refuse the varied acceptance and treat the draft as dishonored. In the alternative, the holder can assent to the varied acceptance in which case the terms of the varied acceptance define the drawee’s obligations as an acceptor. If the holder assents to varied acceptance, Subsection (c) provides that the obligations of the drawer and indorsers are discharged unless they expressly assent to the varied acceptance.

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| Definitional Cross References: |  |
| “Acceptance” | Section 36‑3‑409(a) |
| “Bank” | Section 36‑1‑201(4) |
| “Draft” | Section 36‑3‑104(e) |
| “Drawee” | Section 36‑3‑103(a)(4) |
| “Drawer” | Section 36‑3‑103(a)(5) |
| “Holder” | Section 36‑1‑201(20) |
| “Indorser” | Section 36‑3‑204(b) |

Cross Reference:

1. Obligation of acceptor of a draft. Section 36‑3‑413.

LIBRARY REFERENCES

Bills and Notes 66 to 89.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 4, 19, 21, 24, 37 to 40.

**SECTION 36‑3‑411.** Refusal to pay cashier’s check, teller’s check, and certified check.

(a) In this section, “obligated bank” means the acceptor of a certified check or the issuer of a cashier’s check or teller’s check bought from the issuer.

(b) If the obligated bank wrongfully (i) refuses to pay a cashier’s check or certified check, (ii) stops payment of a teller’s check, or (iii) refuses to pay a dishonored teller’s check, the person asserting the right to enforce the check is entitled to compensation for expenses and loss of interest resulting from the nonpayment and may recover consequential damages if the obligated bank refuses to pay after receiving notice of particular circumstances giving rise to the damages.

(c) Expenses or consequential damages under Subsection (b) are not recoverable if the refusal of the obligated bank to pay occurs because (i) the bank suspends payments, (ii) the obligated bank asserts a claim or defense of the bank that it has reasonable grounds to believe is available against the person entitled to enforce the instrument, (iii) the obligated bank has a reasonable doubt whether the person demanding payment is the person entitled to enforce the instrument, or (iv) payment is prohibited by law.

HISTORY: 1962 Code Section 10.3‑411; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. In some cases a creditor may require that the debt be paid by an obligation of a bank. The debtor may comply by obtaining certification of the debtor’s check, but more frequently the debtor buys from a bank a cashier’s check or teller’s check payable to the creditor. The check is taken by the creditor as a cash equivalent on the assumption that the bank will pay the check. Sometimes, the debtor wants to retract payment by inducing the obligated bank not to pay. The typical case involves a dispute between the parties to the transaction in which the check is given in payment. In the case of a certified check or cashier’s check, the bank can safely pay the holder of the check despite notice that there may be an adverse claim to the check (Section 3‑602). It is also clear that the bank that sells a teller’s check has no duty to order the bank on which it is drawn not to pay it. A debtor using any of these types of checks has no right to stop payment. Nevertheless, some banks will refuse payment as an accommodation to a customer. Section 3‑411 is designed to discourage this practice.

2. The term “obligated bank” refers to the issuer of the cashier’s check or teller’s check and the acceptor of the certified check. If the obligated bank wrongfully refuses to pay, it is liable to pay for expenses and loss of interest resulting from the refusal to pay. There is no express provision for attorney’s fees, but attorney’s fees are not meant to be necessarily excluded. They could be granted because they fit within the language “expenses \*\*\* resulting from the nonpayment.” In addition the bank may be liable to pay consequential damages if it has notice of the particular circumstances giving rise to the damages.

3. Subsection (c) provides that expenses or consequential damages are not recoverable if the refusal to pay is because of the reasons stated. The purpose is to limit that recovery to cases in which the bank refuses to pay even though its obligation to pay is clear and it is able to pay. Subsection (b) applies only if the refusal to honor the check is wrongful. If the bank is not obliged to pay there is no recovery. The bank may assert any claim or defense that it has, but normally the bank would not have a claim or defense. In the usual case it is a remitter that is asserting a claim to the check on the basis of a rescission of negotiation to the payee under Section 3‑202. See Comment 2 to Section 3‑201. The bank can assert that claim if there is compliance with Section 3‑305(c), but the bank is not protected from damages under subsection (b) if the claim of the remitter is not upheld. In that case, the bank is insulated from damages only if payment is enjoined under Section 3‑602(b)(1). Subsection (c)(iii) refers to cases in which the bank may have a reasonable doubt about the identity of the person demanding payment. For example, a cashier’s check is payable to “Supplier Co.” The person in possession of the check presents it for payment over the counter and claims to be an officer of Supplier Co. The bank may refuse payment until it has been given adequate proof that the presentment in fact is being made for Supplier Co., the person entitled to enforce the check.

SOUTH CAROLINA REPORTER’S COMMENT

This provision is new and is intended to discourage banks that have certified a check or issued a cashier’s check or a teller’s check from dishonoring or stopping payment on these items at the request of the remitter who purchased the item. Under Section 36‑4‑403(a), a customer can stop payment only on checks drawn on the customer’s account. A remitter who purchases a certified check, cashier’s check, or teller’s check is not a customer with respect to the account on which those checks are drawn. As a result, the remitter has no right to stop payment on certified checks, cashier’s checks, or teller’s checks. Nevertheless, a bank that certified a check or issued a cashier’s check or a teller’s check may wish to accommodate the remitter by refusing to pay a certified or cashier’s check or by stopping payment on a teller’s check.

Subsection (b) provides that if a bank wrongfully refuses to pay a cashier’s check or certified check or stops payment on a teller’s check, or refuses to pay a dishonored teller’s check, a person asserting the right to enforce the check is entitled to compensation for expenses and lost interest and may be entitled to consequential damages if the bank refuses to pay after receiving notice of the circumstances giving rise to the consequential damages.

Subsection (c)(ii) protects a bank from liability for expenses and consequential damages under Subsection (b) in cases where the bank asserts a claim or defense “of the bank” that the bank has reasonable grounds to believe is available against the person entitled to enforce the instrument. This provision is critical in determining the impact of Section 36‑3‑411 upon South Carolina case law.

In Specialty Flooring Company, Inc. v. Palmetto Federal Savings Bank of South Carolina, 302 S.C. 107, 394 S.E.2d 13 (S.C. App. 1990), the court held that the Savings Bank which had issued a teller’s check (referred to as a bank check in the opinion) drawn on the Savings Bank’s account at Citibank rightfully stopped payment on the teller’s check. Critically, the Savings Bank stopped payment not at the request of the remitter, but because the consideration that the Savings Bank received for the teller’s check had failed. In stopping payment on the teller’s check, the Savings Bank was exercising its right as a customer of Citibank. Ultimately, the Savings Bank was not liable on the teller’s check as a drawer because the party seeking to enforce the check was not a holder in due course. As a result, the Savings Bank could assert the failure of consideration defense against the party seeking enforcement.

Section 36‑3‑411 does not overrule Specialty Flooring because Subsection (b) applies only when a bank wrongfully stops payment on a teller’s check or wrongfully refuses to pay a dishonored teller’s check. In Specialty Flooring, neither the stop‑payment order nor the refusal to pay were wrongful.

Subsection (c)(ii) may apply in a situation where a bank rightfully stopped payment on a teller’s check because the consideration it received for the teller’s check failed, but the teller’s checks had been negotiated to a holder in due course prior to presentment. The bank’s subsequent refusal to pay the dishonored check to the holder in due course would be wrongful, and the bank would be liable for the amount of the teller’s check plus interest. Nevertheless, the bank may be able to avoid liability for expenses and consequential damages. Under Subsection (c)(ii), the bank had a failure of consideration defense. The critical issue is whether the bank had a reasonable belief that it could assert its defense against a holder in due course seeking enforcement of the teller’s check.

The court in Specialty Flooring drew a sharp distinction between teller’s check and cashier’s checks. The court held that a bank could stop payment on a teller’s check, but asserted that a bank that issues a cashier’s check is not entitled to stop payment or countermand the check. Specialty Flooring, 302 S.C. at 109‑10, 394 S.E.2d at 15. To the extent that Specialty Flooring holds that a bank that issues a cashier’s check or certifies a check cannot rightfully refuse to pay based upon the bank’s defense as opposed to the remitter’s, the decision is inconsistent with Subsection (c).

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| Definitional Cross References: |  |
| “Acceptor” | Section 36‑3‑103(a)(1) |
| “Bank” | Section 36‑1‑201(4) |
| “Cashier’s Check” | Section 36‑3‑104(g) |
| “Certified Check” | Section 36‑3‑409(d) |
| “Check” | Section 36‑3‑104(f) |
| “Instrument” | Section 36‑3‑104(b) |
| “Issuer” | Section 36‑3‑105(c) |
| “Notice” | Section 36‑1‑201(25) [see now Section 36‑1‑202] |
| “Payment” | Section 36‑3‑602(a) |
| “Person” | Section 36‑1‑201(30) |
| “Person Entitled to Enforce” | Section 36‑3‑301 |
| “Teller’s Check” | Section 36‑3‑104(h) |

Cross References:

1. Obligation on cashier’s check. Section 36‑3‑412.

2. Obligation of acceptor. Section 36‑3‑413.

3. Customer’s right to stop payment. Section 36‑4‑403.

LIBRARY REFERENCES

Banks and Banking 145.

Bills and Notes 68.

WESTLAW Topic Nos. 52, 56.

C.J.S. Banks and Banking Sections 364 to 368.

C.J.S. Bills and Notes; Letters of Credit Section 37.

**SECTION 36‑3‑412.** Obligation of issuer of note or cashier’s check.

The issuer of a note or cashier’s check or other draft drawn on the drawer is obliged to pay the instrument (i) according to its terms at the time it was issued or, if not issued, at the time it first came into possession of a holder, or (ii) if the issuer signed an incomplete instrument, according to its terms when completed, to the extent stated in Sections 36‑3‑115 and 36‑3‑407. The obligation is owed to a person entitled to enforce the instrument or to an indorser who paid the instrument under Section 36‑3‑415.

HISTORY: 1962 Code Section 10.3‑412; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. The obligations of the maker, acceptor, drawer, and indorser are stated in four separate sections. Section 3‑412 states the obligation of the maker of a note and is consistent with former Section 3‑413(1). Section 3‑412 also applies to the issuer of a cashier’s check or other draft drawn on the drawer. Under former Section 3‑118(a), since a cashier’s check or other draft drawn on the drawer was “effective as a note,” the drawer was liable under former Section 3‑413(1) as a maker. Under Sections 3‑103(a)(6) and 3‑104(f) a cashier’s check or other draft drawn on the drawer is treated as a draft to reflect common commercial usage, but the liability of the drawer is stated by Section 3‑412 as being the same as that of the maker of a note rather than that of the drawer of a draft. Thus, Section 3‑412 does not in substance change former law.

2. Under Section 3‑105(b) nonissuance of either a complete or incomplete instrument is a defense by a maker or drawer against a person that is not a holder in due course.

3. The obligation of the maker may be modified in the case of alteration if, under Section 3‑406, the maker is precluded from asserting the alteration.

4. The rule of this section is similar to the rule of Article 39 of the Convention on International Bills of Exchange and International Promissory Notes.

SOUTH CAROLINA REPORTER’S COMMENT

This section is based upon former Section 36‑3‑413(1) and states the obligation of a maker of a note and the drawer of a cashier’s check or other draft drawn on the drawer to pay the note, cashier’s check, or draft. The former provision addressed the obligations of both a maker and acceptor. The obligation of an acceptor is now codified at Section 36‑3‑413. In addition to covering the obligation of the maker of a note, Section 36‑3‑412 also defines the obligation of the issuer of a cashier’s check or other draft drawn on a drawer. This does not change prior law, because under former Section 36‑3‑118(a) a draft drawn on a drawer is effective as a note.

The basic obligation of the maker of a note or drawer of a cashier’s check or other draft drawn on the drawer is to pay the amount of the instrument at the time it was issued. The duty runs to persons entitled to enforce the instrument and prior to an indorser who paid the instrument.

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| Definitional Cross References: |  |
| “Cashier’s Check” | Section 36‑3‑104(g) |
| “Draft” | Section 36‑3‑104(e) |
| “Drawer” | Section 36‑3‑103(a)(5) |
| “Holder” | Section 36‑1‑201(20) |
| “Indorser” | Section 36‑3‑204(b) |
| “Instrument” | Section 36‑3‑104(b) |
| “Issue” | Section 36‑3‑105(a) |
| “Issuer” | Section 36‑3‑105(c) |
| “Note” | Section 36‑3‑104(e) |
| “Person Entitled to Enforce” | Section 36‑3‑301 |
| “Signed” | Section 36‑1‑201(39) |

Cross References:

1. Obligation of issuer who signed in incomplete instrument. Sections 36‑3‑115 and 36‑3‑407(c)(ii).

2. Obligation of an indorser to pay instrument. Section 36‑3‑415.

LIBRARY REFERENCES

Bills and Notes 83, 256, 301.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 38, 242 to 248.

NOTES OF DECISIONS

In general 1

1. In general

A payee of a bank check was not a holder in due course of the check where the payee requested the instrument from the bank with the knowledge that the drawer of a check deposited in the payee’s account intended to stop payment on its check leaving an inadequate balance in the payee’s account to cover the check issued in consideration of the bank check. Since the payee was not a holder in due course, it took the bank check subject to the defense of failure of consideration as provided by Section 36‑3‑306(c), and therefore the bank was not liable on the instrument. Specialty Flooring Co., Inc. v. Palmetto Federal Sav. Bank of South Carolina (S.C.App. 1990) 302 S.C. 107, 394 S.E.2d 13.

A borrower was liable to the lending bank for the entire amount of an $85,000 promissory note, even though he intended to borrow only $35,000, where he signed a blank promissory note and relied upon a third party to co‑sign the note and fill in the amount for $35,000, but the third party entered $85,000 as the amount, presented the note to the bank, and received the funds from the bank. As a holder in due course, the bank was entitled to enforce the note against the borrower as completed since the bank took the note in good faith and without notice of any defense to it by the borrower. American Federal Bank, FSB v. Parker (S.C.App. 1990) 301 S.C. 509, 392 S.E.2d 798.

The drawer of a check, as the party ultimately liable to pay the instrument, has no recourse against the payee, any subsequent endorser who takes up the instrument, or the holder. First American Bank of Virginia v. Litchfield Co. of South Carolina, Inc. (S.C.App. 1987) 291 S.C. 240, 353 S.E.2d 143. Bills And Notes 23

Section 46‑3‑606 applies only where the party claiming discharge has a right of recourse against a person who has libeled on the instrument or has given collateral for it, and “recourse,” as applied to checks, means the right of a holder or an endorser, upon dishonor, to require the drawer or any prior endorser to pay the instrument according to its tenor at the time it was drawn or endorsed by that person. First American Bank of Virginia v. Litchfield Co. of South Carolina, Inc. (S.C.App. 1987) 291 S.C. 240, 353 S.E.2d 143. Bills And Notes 437

The drawer of a check engages that upon dishonor he will pay the amount of the draft to a holder in due course. First American Bank of Virginia v. Litchfield Co. of South Carolina, Inc. (S.C.App. 1987) 291 S.C. 240, 353 S.E.2d 143. Bills And Notes 23

While the drawer of a check has the right to stop payment, he or she remains liable on the instrument to a holder in due course. First American Bank of Virginia v. Litchfield Co. of South Carolina, Inc. (S.C.App. 1987) 291 S.C. 240, 353 S.E.2d 143. Bills And Notes 23

**SECTION 36‑3‑413.** Obligation of acceptor.

(a) The acceptor of a draft is obliged to pay the draft (i) according to its terms at the time it was accepted, even though the acceptance states that the draft is payable “as originally drawn” or equivalent terms, (ii) if the acceptance varies the terms of the draft, according to the terms of the draft as varied, or (iii) if the acceptance is of a draft that is an incomplete instrument, according to its terms when completed, to the extent stated in Sections 36‑3‑115 and 36‑3‑407. The obligation is owed to a person entitled to enforce the draft or to the drawer or an indorser who paid the draft under Section 36‑3‑414 or 36‑3‑415.

(b) If the certification of a check or other acceptance of a draft states the amount certified or accepted, the obligation of the acceptor is that amount. If (i) the certification or acceptance does not state an amount, (ii) the amount of the instrument is subsequently raised, and (iii) the instrument is then negotiated to a holder in due course, the obligation of the acceptor is the amount of the instrument at the time it was taken by the holder in due course.

HISTORY: 1962 Code Section 10.3‑413; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

Subsection (a) is consistent with former Section 3‑413(1). Subsection (b) has primary importance with respect to certified checks. It protects the holder in due course of a certified check that was altered after certification and before negotiation to the holder in due course. A bank can avoid liability for the altered amount by stating on the check the amount the bank agrees to pay. The subsection applies to other accepted drafts as well. The rule of this section is similar to the rule of Articles 41 of the Convention on International Bills of Exchange and International Promissory Notes. Articles 42 and 43 of the Convention include more detailed rules that in many respects do not have parallels in this Article.

SOUTH CAROLINA REPORTER’S COMMENT

Subsection (a) is based upon former section 36‑3‑413(1) and defines the obligation of an acceptor of a draft to pay the draft. Under Subsection (a) the acceptor obligation is generally to pay the draft according to its terms when the acceptor accepted the draft. Subsection (a), however, does provide exception when the acceptance varies the terms of the draft and when the draft was incomplete at the time of acceptance. Subsection (b) is new and provides that if the acceptance of a draft states the amount accepted, the obligation of the acceptor is limited to that amount. If the acceptance does not state an amount, the amount of the draft is subsequently increased, and the draft is negotiated to a holder in due course then the acceptor’s obligation is the amount of the draft when it was taken by the holder.

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| Definitional Cross References: |  |
| “Acceptance” | Section 36‑3‑409(a) |
| “Acceptor” | Section 36‑3‑103(a)(1) |
| “Check” | Section 36‑3‑104(f) |
| “Draft” | Section 36‑3‑104(e) |
| “Drawer” | Section 36‑3‑103(a)(5) |
| “Holder in Due Course” | Section 36‑3‑302(a) |
| “Indorser” | Section 36‑3‑204(b) |
| “Instrument” | Section 36‑3‑104(b) |
| “Negotiation” | Section 36‑3‑201(a) |
| “Person Entitled to Enforce” | Section 36‑3‑301 |

Cross References:

1. Acceptance of a draft. Section 36‑3‑409(a) and (b).

2. Certification of a check. Section 36‑3‑409(c).

LIBRARY REFERENCES

Bills and Notes 23, 26, 48.1 to 52, 53, 74 to 81.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 9, 18, 20 to 21, 23 to 25, 39 to 40, 81, 167, 203 to 204, 231, 244 to 248, 263, 309.

**SECTION 36‑3‑414.** Obligation of drawer.

(a) This section does not apply to cashier’s checks or other drafts drawn on the drawer.

(b) If an unaccepted draft is dishonored, the drawer is obliged to pay the draft (i) according to its terms at the time it was issued or, if not issued, at the time it first came into possession of a holder, or (ii) if the drawer signed an incomplete instrument, according to its terms when completed, to the extent stated in Sections 36‑3‑115 and 36‑3‑407. The obligation is owed to a person entitled to enforce the draft or to an indorser who paid the draft under Section 36‑3‑415.

(c) If a draft is accepted by a bank, the drawer is discharged, regardless of when or by whom acceptance was obtained.

(d) If a draft is accepted and the acceptor is not a bank, the obligation of the drawer to pay the draft if the draft is dishonored by the acceptor is the same as the obligation of an indorser under Section 36‑3‑415(a) and (c).

(e) If a draft states that it is drawn “without recourse” or otherwise disclaims liability of the drawer to pay the draft, the drawer is not liable under subsection (b) to pay the draft if the draft is not a check. A disclaimer of the liability stated in subsection (b) is not effective if the draft is a check.

(f) If (i) a check is not presented for payment or given to a depositary bank for collection within 30 days after its date, (ii) the drawee suspends payments after expiration of the 30‑day period without paying the check, and (iii) because of the suspension of payments, the drawer is deprived of funds maintained with the drawee to cover payment of the check, the drawer to the extent deprived of funds may discharge its obligation to pay the check by assigning to the person entitled to enforce the check the rights of the drawer against the drawee with respect to the funds.

HISTORY: 1962 Code Section 10.3‑414; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. Subsection (a) excludes cashier’s checks because the obligation of the issuer of a cashier’s check is stated in Section 3‑412.

2. Subsection (b) states the obligation of the drawer on an unaccepted draft. It replaces former Section 3‑413(2). The requirement under former Article 3 of notice of dishonor or protest has been eliminated. Under revised Article 3, notice of dishonor is necessary only with respect to indorser’s liability. The liability of the drawer of an unaccepted draft is treated as a primary liability. Under former Section 3‑102(1)(d) the term “secondary party” was used to refer to a drawer or indorser. The quoted term is not used in revised Article 3. The effect of a draft drawn without recourse is stated in subsection (e).

3. Under subsection (c) the drawer is discharged of liability on a draft accepted by a bank regardless of when acceptance was obtained. This changes former Section 3‑411(1) which provided that the drawer is discharged only if the holder obtains acceptance. Holders that have a bank obligation do not normally rely on the drawer to guarantee the bank’s solvency. A holder can obtain protection against the insolvency of a bank acceptor by a specific guaranty of payment by the drawer or by obtaining an indorsement by the drawer. Section 3‑205(d).

4. Subsection (d) states the liability of the drawer if a draft is accepted by a drawee other than a bank and the acceptor dishonors. The drawer of an unaccepted draft is the only party liable on the instrument. The drawee has no liability on the draft. Section 3‑408. When the draft is accepted, the obligations change. The drawee, as acceptor, becomes primarily liable and the drawer’s liability is that of a person secondarily liable as a guarantor of payment. The drawer’s liability is identical to that of an indorser, and subsection (d) states the drawer’s liability that way. The drawer is liable to pay the person entitled to enforce the draft or any indorser that pays pursuant to Section 3‑415. The drawer in this case is discharged if notice of dishonor is required by Section 3‑503 and is not given in compliance with that section. A drawer that pays has a right of recourse against the acceptor. Section 3‑413(a).

5. Subsection (e) does not permit the drawer of a check to avoid liability under subsection (b) by drawing the check without recourse. There is no legitimate purpose served by issuing a check on which nobody is liable. Drawing without recourse is effective to disclaim liability of the drawer if the draft is not a check. Suppose, in a documentary sale, Seller draws a draft on Buyer for the price of goods shipped to Buyer. The draft is payable upon delivery to the drawee of an order bill of lading covering the goods. Seller delivers the draft with the bill of lading to Finance Company that is named as payee of the draft. If Seller draws without recourse Finance Company takes the risk that Buyer will dishonor. If Buyer dishonors, Finance Company has no recourse against Seller but it can obtain reimbursement by selling the goods which it controls through the bill of lading.

6. Subsection (f) is derived from former Section 3‑502(1)(b). It is designed to protect the drawer of a check against loss resulting from suspension of payments by the drawee bank when the holder of the check delays collection of the check. For example, X writes a check payable to Y for $ 1,000. The check is covered by funds in X’s account in the drawee bank. Y delays initiation of collection of the check for more than 30 days after the date of the check. The drawee bank suspends payments after the 30‑day period and before the check is presented for payment. If the $ 1,000 of funds in X’s account have not been withdrawn, X has a claim for those funds against the drawee bank and, if subsection (e) were not in effect, X would be liable to Y on the check because the check was dishonored. Section 3‑502(e). If the suspension of payments by the drawee bank will result in payment to X of less than the full amount of the $ 1,000 in the account or if there is a significant delay in payment to X, X will suffer a loss which would not have been suffered if Y had promptly initiated collection of the check. In most cases, X will not suffer any loss because of the existence of federal bank deposit insurance that covers accounts up to $ 100,000. Thus, subsection (e) has relatively little importance. There might be some cases, however, in which the account is not fully insured because it exceeds $ 100,000 or because the account doesn’t qualify for deposit insurance. Subsection (f) retains the phrase “deprived of funds maintained with the drawee” appearing in former Section 3‑502(1)(b). The quoted phrase applies if the suspension of payments by the drawee prevents the drawer from receiving the benefit of funds which would have paid the check if the holder had been timely in initiating collection. Thus, any significant delay in obtaining full payment of the funds is a deprivation of funds. The drawer can discharge drawer’s liability by assigning rights against the drawee with respect to the funds to the holder.

7. The obligation of the drawer under this section is similar to the obligation of the drawer under Article 38 of the Convention on International Bills of Exchange and International Promissory Notes.

SOUTH CAROLINA REPORTER’S COMMENT

This provision is based upon former Section 36‑3‑413(2), which defined the obligation of the drawer of a draft. Subsection (a) provides that the section does not apply to cashier’s checks or other drafts drawn on the drawer. Section 36‑3‑412 defined the obligation of drawers of cashier’s checks and other drafts drawn on the drawer.

Subsection (b) provides that the drawer of an unaccepted draft is obligated to pay the draft if it is dishonored. The subsection changes prior law by eliminating the notice of dishonor as a condition upon a drawer’s liability.

Subsection (c) replaces former Section 36‑3‑411(1) and addresses the effect of a bank accepting a draft upon the obligation of the drawer. Although Subsection (c) continues the basic rule under former law that acceptance by a bank discharges a drawer, the provision does modify prior law. Under prior law, the certification of a check discharged the drawer only if a holder procured the certification. Under Subsection (c), the drawer of a draft is discharged when a bank accepts the draft regardless of who obtained the acceptance.

Subsection (d) addresses drafts that are accepted by an acceptor other than a bank. If the acceptor dishonors the draft, the obligation of the drawer to pay the draft is the same as an indorser.

Subsection (e) revises the last sentence of former Section 36‑3‑413(2). With respect to drafts other than checks, a drawer can disclaim the obligation to pay the draft upon dishonor by signing “without recourse.” An attempted disclaimer of a drawer’s liability upon a check, however, is ineffective.

Subsection (f) is based upon former Section 36‑3‑502(1)(b) and provides that a drawer may be discharged by the late presentment of a check only when the drawee suspends payment more than thirty days after the date of the check and the suspension deprives the drawer of funds maintained by the drawee. Subsection (f) is consistent with First American Bank of Virginia v. Litchfield Co. of South Carolina, 291 S.C. 240, 353 S.E.2d 143 (S.C. App. 1987) in which the court held a failure to give notice of dishonor discharges the drawer only to the extent that failure deprived the drawer of funds because the drawee bank became insolvent.

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| Definitional Cross References: |  |
| “Acceptance” | Section 36‑3‑409(a) |
| “Acceptor” | Section 36‑3‑103(a)(1) |
| “Bank” | Section 36‑1‑201(4) |
| “Cashier’s Check” | Section 36‑3‑104(g) |
| “Check” | Section 36‑3‑104(f) |
| “Depositary Bank” | Section 36‑4‑105(2) |
| “Draft” | Section 36‑3‑104(e) |
| “Drawee” | Section 36‑3‑103(a)(4) |
| “Drawer” | Section 36‑3‑103(a)(5) |
| “Holder” | Section 36‑1‑201(20) |
| “Instrument” | Section 36‑3‑104(b) |
| “Payment” | Section 36‑3‑602(a) |
| “Person Entitled to Enforce” | Section 36‑3‑301 |
| “Signed” | Section 36‑1‑201(39) |

Cross References:

1. Obligation of issuer of a cashier’s check or other draft drawn on the drawer. Section 36‑3‑412.

2. Dishonor of an unaccepted draft. Section 36‑3‑502(b).

3. Dishonor of an accepted draft. Section 36‑3‑502(d).

4. Obligation on incomplete instruments. Sections 36‑3‑115 and 36‑3‑407.

5. Obligation of indorser. Section 36‑3‑415.

LIBRARY REFERENCES

Bills and Notes 241 to 246, 253, 256, 280.1 to 295, 298, 301, 302.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 24 to 25, 147, 152 to 156, 160 to 162, 242 to 248.

RESEARCH REFERENCES

Encyclopedias

S.C. Jur. Mortgages Section 168, Construction.

S.C. Jur. Mortgages Section 170, Rights of Assignee as to Assignor.

**SECTION 36‑3‑415.** Obligation of indorser.

(a) Subject to Subsections (b), (c), (d), (e) and to Section 36‑3‑419(d), if an instrument is dishonored, an indorser is obliged to pay the amount due on the instrument (i) according to the terms of the instrument at the time it was indorsed, or (ii) if the indorser indorsed an incomplete instrument, according to its terms when completed, to the extent stated in Sections 36‑3‑115 and 36‑3‑407. The obligation of the indorser is owed to a person entitled to enforce the instrument or to a subsequent indorser who paid the instrument under this section.

(b) If an indorsement states that it is made “without recourse” or otherwise disclaims liability of the indorser, the indorser is not liable under Subsection (a) to pay the instrument.

(c) If notice of dishonor of an instrument is required by Section 36‑3‑503 and notice of dishonor complying with that section is not given to an indorser, the liability of the indorser under Subsection (a) is discharged.

(d) If a draft is accepted by a bank after an indorsement is made, the liability of the indorser under Subsection (a) is discharged.

(e) If an indorser of a check is liable under Subsection (a) and the check is not presented for payment, or given to a depositary bank for collection, within 30 days after the day the indorsement was made, the liability of the indorser under Subsection (a) is discharged.

HISTORY: 1962 Code Section 10.3‑415; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. Subsections (a) and (b) restate the substance of former Section 3‑414(1). Subsection (2) of former Section 3‑414 has been dropped because it is superfluous. Although notice of dishonor is not mentioned in subsection (a), it must be given in some cases to charge an indorser. It is covered in subsection (c). Regulation CC Section 229.35(b) provides that a bank handling a check for collection or return is liable to a bank that subsequently handles the check to the extent the latter bank does not receive payment for the check. This liability applies whether or not the bank incurring the liability indorsed the check.

2. Section 3‑503 states when notice of dishonor is required and how it must be given. If required notice of dishonor is not given in compliance with Section 3‑503, subsection (c) of Section 3‑415 states that the effect is to discharge the indorser’s obligation.

3. Subsection (d) is similar in effect to Section 3‑414(c) if the draft is accepted by a bank after the indorsement is made. See Comment 3 to Section 3‑414. If a draft is accepted by a bank before the indorsement is made, the indorser incurs the obligation stated in subsection (a).

4. Subsection (e) modifies former Sections 3‑503(2)(b) and 3‑502(1)(a) by stating a 30‑day rather than a seven‑day period, and stating it as an absolute rather than a presumptive period.

5. As stated in subsection (a), the obligation of an indorser to pay the amount due on the instrument is generally owed not only to a person entitled to enforce the instrument but also to a subsequent indorser who paid the instrument. But if the prior indorser and the subsequent indorser are both anomalous indorsers, this rule does not apply. In that case, Section 3‑116 applies. Under Section 3‑116(a), the anomalous indorsers are jointly and severally liable and if either pays the instrument the indorser who pays has a right of contribution against the other. Section 3‑116(b). The right to contribution in Section 3‑116(b) is subject to “agreement of the affected parties.” Suppose the subsequent indorser can prove an agreement with the prior indorser under which the prior indorser agreed to treat the subsequent indorser as a guarantor of the obligation of the prior indorser. Rights of the two indorsers between themselves would be governed by the agreement. Under suretyship law, the subsequent indorser under such an agreement is referred to as a sub‑surety. Under the agreement, if the subsequent indorser pays the instrument there is a right to reimbursement from the prior indorser; if the prior indorser pays the instrument, there is no right of recourse against the subsequent indorser. See PEB Commentary No. 11, dated February 10, 1994.

6. The rule of this section is similar to the rule of Article 44 of the Convention on International Bills of Exchange and International Promissory Notes.

SOUTH CAROLINA REPORTER’S COMMENT

Subsection (a) restates former Section 36‑3‑414(1) and provides the general rule that if an instrument is dishonored, an indorser is obligated to pay the amount due on the instrument at the time of the indorsement. In contrast to former Section 36‑3‑414(1), Subsection (a) does not condition an indorser’s obligation upon notice of dishonor and protest. Nevertheless, Section 36‑3‑503(a) provides that the obligation of an indorser under Section 36‑3‑415(a) cannot be enforced unless the indorser has received notice of dishonor or such notice is excused under Section 36‑3‑504(a). Moreover, Subsection (c) provides that if notice of dishonor is required under Section 36‑3‑503 and is not given, the obligation of the indorser is discharged.

An exception to an indorser’s obligation under Subsection (a) arises if the indorsement is unambiguous and made for collection pursuant to Section 36‑3‑419(d). Moreover, if two or more indorsers make anomalous indorsements as accommodation parties, Official Comment 5 provides that the general rule under Subsection (a) that an indorser is liable to a subsequent indorser who pays the instrument is inapplicable. In such case, the rule of contribution under Section 36‑3‑116 controls.

Subsection (b) restates the rule under former Section 36‑3‑414(1) that an indorser can disclaim liability under Subsection (a) by indorsing “without recourse.”

Subsection (d) provides that if a draft is accepted by a bank after it has been indorsed, the indorser is discharged.

Subsection (e) modifies former Sections 36‑3‑503(2)(b) and 36‑3‑501(1)(a) addressing the effect of late presentment of a check upon the obligation of an indorser. Under Subsection (e), an indorser is discharged if the check is neither presented for payment nor given to a depositary bank for collection within 30 days of the indorsement.

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| Definitional Cross References: |  |
| “Acceptance” | Section 36‑3‑409(a) |
| “Bank” | Section 36‑1‑201(4) |
| “Depositary Bank” | Section 36‑4‑105(2) |
| “Draft” | Section 36‑3‑104(e) |
| “Indorsement” | Section 36‑3‑204(a) |
| “Indorser” | Section 36‑3‑204(b) |
| “Instrument” | Section 36‑3‑104(b) |
| “Notice” | Section 36‑1‑201(25) [see now Section 36‑1‑202] |
| “Person Entitled to Enforce” | Section 36‑3‑301 |

Cross References:

1. Obligation of accommodation indorsers. Section 36‑3‑419.

2. Obligation on incomplete instruments. Sections 36‑3‑115 and 36‑3‑407.

3. Notice of dishonor. Sections 36‑3‑503 and 36‑3‑504.

4. Certification of checks. Section 36‑3‑409(d).

LIBRARY REFERENCES

Bills and Notes 49, 52, 237, 238, 256, 371.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 24 to 25, 63, 199, 201, 231, 242 to 248.

NOTES OF DECISIONS

In general 1

1. In general

Section 46‑3‑606 applies only where the party claiming discharge has a right of recourse against a person who has libeled on the instrument or has given collateral for it, and “recourse,” as applied to checks, means the right of a holder or an endorser, upon dishonor, to require the drawer or any prior endorser to pay the instrument according to its tenor at the time it was drawn or endorsed by that person. First American Bank of Virginia v. Litchfield Co. of South Carolina, Inc. (S.C.App. 1987) 291 S.C. 240, 353 S.E.2d 143. Bills And Notes 437

The drawer of a check, as the party ultimately liable to pay the instrument, has no recourse against the payee, any subsequent endorser who takes up the instrument, or the holder. First American Bank of Virginia v. Litchfield Co. of South Carolina, Inc. (S.C.App. 1987) 291 S.C. 240, 353 S.E.2d 143. Bills And Notes 23

In an action by a lender to recover a debt owed by a corporation, the trial court correctly found that endorsers were liable on the note, under Section 36‑3‑414, since their attorney was their agent and the actions of the attorney at the closing of the transaction were imputable to the four endorsers. Costas v. First Federal Sav. and Loan Ass’n (S.C. 1984) 283 S.C. 94, 321 S.E.2d 51.

Whether a signature on a note providing that “makers, endorsers and guarantors waive demand, presentment, protest, notice of nonpayment, and all defenses on the ground of extension of time for payment” was in an accommodation maker or accommodation endorser capacity was of no legal consequence, as the liability of an endorser was secondary only with respect to these rights which were waived. Bankers Trust of South Carolina v. Culbertson (S.C. 1977) 268 S.C. 564, 235 S.E.2d 130.

Signature in the lower right hand corner of a note, instead of on the back where spaces were specifically provided for endorsers, shows that signer was a maker and not an accommodation endorser. Bankers Trust of South Carolina v. Culbertson (S.C. 1977) 268 S.C. 564, 235 S.E.2d 130.

**SECTION 36‑3‑416.** Transfer warranties.

(a) A person who transfers an instrument for consideration warrants to the transferee and, if the transfer is by indorsement, to any subsequent transferee that:

(1) the warrantor is a person entitled to enforce the instrument;

(2) all signatures on the instrument are authentic and authorized;

(3) the instrument has not been altered;

(4) the instrument is not subject to a defense or claim in recoupment of any party which can be asserted against the warrantor;

(5) the warrantor has no knowledge of any insolvency proceeding commenced with respect to the maker or acceptor or, in the case of an unaccepted draft, the drawer; and

(6) with respect to a remotely‑created consumer item, that the person on whose account the item is drawn authorized the issuance of the item in the amount for which the item is drawn.

(b) A person to whom the warranties under Subsection (a) are made and who took the instrument in good faith may recover from the warrantor as damages for breach of warranty an amount equal to the loss suffered as a result of the breach, but not more than the amount of the instrument plus expenses and loss of interest incurred as a result of the breach.

(c) The warranties stated in Subsection (a) cannot be disclaimed with respect to checks. Unless notice of a claim for breach of warranty is given to the warrantor within 30 days after the claimant has reason to know of the breach and the identity of the warrantor, the liability of the warrantor under subsection (b) is discharged to the extent of any loss caused by the delay in giving notice of the claim.

(d) A cause of action for breach of warranty under this section accrues when the claimant has reason to know of the breach.

HISTORY: 1962 Code Section 10.3‑416; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. Subsection (a) is taken from subsection (2) of former Section 3‑417. Subsections (3) and (4) of former Section 3‑417 are deleted. Warranties under subsection (a) in favor of the immediate transferee apply to all persons who transfer an instrument for consideration whether or not the transfer is accompanied by indorsement. Any consideration sufficient to support a simple contract will support those warranties. If there is an indorsement the warranty runs with the instrument and the remote holder may sue the indorser‑warrantor directly and thus avoid a multiplicity of suits.

2. Since the purpose of transfer (Section 3‑203(a)) is to give the transferee the right to enforce the instrument, subsection (a)(1) is a warranty that the transferor is a person entitled to enforce the instrument (Section 3‑301). Under Section 3‑203(b) transfer gives the transferee any right of the transferor to enforce the instrument. Subsection (a)(1) is in effect a warranty that there are no unauthorized or missing indorsements that prevent the transferor from making the transferee a person entitled to enforce the instrument.

3. The rationale of subsection (a)(4) is that the transferee does not undertake to buy an instrument that is not enforceable in whole or in part, unless there is a contrary agreement. 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. Subsection (3) of former Section 3‑417 which limits this warranty is deleted. The rationale is that while the purpose of a “no recourse” indorsement is to avoid a guaranty of payment, the indorsement does not clearly indicate an intent to disclaim warranties.

4. Under subsection (a)(5) the transferor does not warrant against difficulties of collection, impairment of the credit of the obligor or even insolvency. The transferee is expected to determine such questions before taking the obligation. If insolvency proceedings as defined in Section 1‑201(22) have been instituted against the party who is expected to pay and the transferor knows it, the concealment of that fact amounts to a fraud upon the transferee, and the warranty against knowledge of such proceedings is provided accordingly.

5. Transfer warranties may be disclaimed with respect to any instrument except a check. Between the immediate parties disclaimer may be made by agreement. In the case of an indorser, disclaimer of transferor’s liability, to be effective, must appear in the indorsement with words such as “without warranties” or some other specific reference to warranties. But in the case of a check, subsection (c) of Section 3‑416 provides that transfer warranties cannot be disclaimed at all. In the check collection process the banking system relies on these warranties.

6. Subsection (b) states the measure of damages for breach of warranty. There is no express provision for attorney’s fees, but attorney’s fees are not meant to be necessarily excluded. They could be granted because they fit within the phrase “expenses \*\*\* incurred as a result of the breach.” The intention is to leave to other state law the issue as to when attorney’s fees are recoverable.

7. Since the traditional term “cause of action” may have been replaced in some states by “claim for relief” or some equivalent term, the words “cause of action” in subsection (d) have been bracketed to indicate that the words may be replaced by an appropriate substitute to conform to local practice.

8. Subsection (a)(6) is based on a number of nonuniform amendments designed to address concerns about certain kinds of check fraud. The provision implements a limited rejection of Price v. Neal, 97 Eng. Rep. 871 (K.B. 1762), so that in certain circumstances (those involving remotely‑created consumer items) the payor bank can use a warranty claim to absolve itself of responsibility for honoring an unauthorized item. The provision rests on the premise that monitoring by depositary banks can control this type of fraud more effectively than any practices readily available to payor banks. The provision expressly includes both the case in which the consumer does not authorize the item at all and also the case in which the consumer authorizes the item but in an amount different from the amount in which the item is drawn. Similar provisions appear in Sections 3‑417, 4‑207, and 4‑208.

The provision supplements applicable federal law, which requires telemarketers who submit instruments for payment to obtain the customer’s “express verifiable authorization,” which may be either in writing or tape recorded and must be made available upon request to the customer’s bank. Federal Trade Commission’s Telemarketing Sales Rule, 16 C.F.R. Section 310.3(a)(3), implementing the Telemarketing and Consumer Fraud and Abuse Prevention Act, 15 U.S.C. Section 6101‑6108. Some states also have consumer‑protection laws governing authorization of instruments in telemarketing transactions. See, e.g., 9 Vt. Stat. Ann. Section 2464.

9. Article 45 of the Convention on International Bills of Exchange and International Promissory Notes includes warranties that are similar (except for the warranty in subsection (a)(6)).

SOUTH CAROLINA REPORTER’S COMMENT

Subsection (a) listing the transfer warranties is based upon former Section 36‑3‑417(2). Subsection (a)(1)‑(5) provides that a person who transfers an instrument for consideration gives the same transfer warranties that arose under former Section 36‑3‑417(a)‑(e). Subsection (a)(1) changes the wording of former Section 36‑3‑417(2)(a) substituting a warranty that the transferor “is a person entitled to enforce the instrument” for the warranty that the transferor “has a good title to the instrument” the new wording, however, does not change the substance of the provision. It remains, “in effect a warranty that there are no unauthorized or missing indorsements” Section 36‑3‑416, Official Comment 2. Subsection (a)(6) adds a new transfer warranty applicable to the transfers of remotely‑created consumer items. Under this provision, a person who transfers a remotely‑created consumer item for consideration warrants to the transferee that the person on whose account the item is drawn authorized the issuance of the item in the amount for which the item in drawn. Regulation CC, 12 C.F. R. section 229.34(d) provides transfer and presentment warranties given by a bank that transfers or presents a remotely created check which differ from the warranties under Chapters 3 and 4.

Subsection (b) states the measure of damages for breach of a transfer warranty. The second sentence of Subsection (c) provides that if a claimant fails to give a warrantor notice of a claim for breach of warranty within 30 days after the claimant has reason to know of the breach and identity of the warrantor, the warrantor is discharged to the extent of any loss caused by the delay in giving notice. Subsection (d) provides that a cause of action for breach of a transfer warranty accrues when the claimant has reason to know of the breach.

The first sentence of Subsection (c) provides that the transfer warranties cannot be disclaimed with respect to a check. With respect to instruments other than checks, the transfer warranties can be disclaimed. In the case of an indorser, the disclaimer must make specific reference to warranties. The current provision deletes former Section 36‑3‑417(3) under which an indorsement “without recourse” limited the transfer warranty that there were no defenses good against the transferor to a warranty had no knowledge of such a defense. Under the current statute a “without recourse” indorsement is not effective to disclaim or limit the transfer warranties.

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| Definitional Cross References: |  |
| “Acceptor” | Section 36‑3‑103(a)(1) |
| “Alteration” | Section 36‑3‑407(a) |
| “Consideration” | Section 36‑3‑303(b) |
| “Check” | Section 36‑3‑104(f) |
| “Draft” | Section 36‑3‑104(e) |
| “Drawer” | Section 36‑3‑103(a)(5) |
| “Good Faith” | Section 36‑3‑103(a)(6) |
| “Indorsement” | Section 36‑3‑204(a) |
| “Instrument” | Section 36‑3‑104(b) |
| “Knowledge” | Section 36‑1‑201(25) [see now Section 36‑1‑202] |
| “Maker” | Section 36‑3‑103(a)(7) |
| “Notice” | Section 36‑1‑201(25) [see now Section 36‑1‑202] |
| “Party” | Section 36‑3‑103(a)(10) |
| “Person” | Section 36‑1‑201(30) |
| “Person Entitled to Enforce” | Section 36‑3‑3 |
| “Remotely‑Created Consumer Item” | Section 36‑3‑103(a)(16) |
| “Transfer of Instrument” | Section 36‑3‑203(a) |
| “Signature” | Section 36‑1‑201(43) |

Cross References:

1. Transfer of an instrument and the rights acquired by the transferee. Section 36‑3‑203.

2. Persons entitled to enforce an instrument. Section 36‑3‑301.

3. Whether signatures on instrument are authentic and authorized. Sections 36‑3‑401, 36‑3‑402, 36‑3‑403.

4. Alteration of instrument. Section 36‑3‑407.

5. Defenses and claims in recoupment. Section 36‑3‑305(a).

6. Transfer warranties given by a collecting bank or customer under Article 4. Section 36‑4‑207.

LIBRARY REFERENCES

Bills and Notes 48.1, 52, 237, 238, 256, 371.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 23 to 24, 63, 81, 199, 201, 231, 242 to 248.

**SECTION 36‑3‑417.** Presentment warranties.

(a) If an unaccepted draft is presented to the drawee for payment or acceptance and the drawee pays or accepts the draft, (i) the person obtaining payment or acceptance, at the time of presentment, and (ii) a previous transferor of the draft, at the time of transfer, warrant to the drawee making payment or accepting the draft in good faith that:

(1) the warrantor is, or was, at the time the warrantor transferred the draft, a person entitled to enforce the draft or authorized to obtain payment or acceptance of the draft on behalf of a person entitled to enforce the draft;

(2) the draft has not been altered;

(3) the warrantor has no knowledge that the signature of the drawer of the draft is unauthorized; and

(4) with respect to any remotely‑created consumer item, that the person on whose account the item is drawn authorized the issuance of the item in the amount for which the item is drawn.

(b) A drawee making payment may recover from any warrantor damages for breach of warranty equal to the amount paid by the drawee less the amount the drawee received or is entitled to receive from the drawer because of the payment. In addition, the drawee is entitled to compensation for expenses and loss of interest resulting from the breach. The right of the drawee to recover damages under this subsection is not affected by any failure of the drawee to exercise ordinary care in making payment. If the drawee accepts the draft, breach of warranty is a defense to the obligation of the acceptor. If the acceptor makes payment with respect to the draft, the acceptor is entitled to recover from any warrantor for breach of warranty the amounts stated in this subsection.

(c) If a drawee asserts a claim for breach of warranty under Subsection (a) based on an unauthorized indorsement of the draft or an alteration of the draft, the warrantor may defend by proving that the indorsement is effective under Section 36‑3‑404 or 36‑3‑405 or the drawer is precluded under Section 36‑3‑406 or 36‑4‑406 from asserting against the drawee the unauthorized indorsement or alteration.

(d) If (i) a dishonored draft is presented for payment to the drawer or an indorser or (ii) any other instrument is presented for payment to a party obliged to pay the instrument, and (iii) payment is received, the following rules apply:

(1) The person obtaining payment and a prior transferor of the instrument warrant to the person making payment in good faith that the warrantor is, or was, at the time the warrantor transferred the instrument, a person entitled to enforce the instrument or authorized to obtain payment on behalf of a person entitled to enforce the instrument.

(2) The person making payment may recover from any warrantor for breach of warranty an amount equal to the amount paid plus expenses and loss of interest resulting from the breach.

(e) The warranties stated in Subsections (a) and (d) cannot be disclaimed with respect to checks. Unless notice of a claim for breach of warranty is given to the warrantor within 30 days after the claimant has reason to know of the breach and the identity of the warrantor, the liability of the warrantor under Subsection (b) or (d) is discharged to the extent of any loss caused by the delay in giving notice of the claim.

(f) A cause of action for breach of warranty under this section accrues when the claimant has reason to know of the breach.

HISTORY: 1962 Code Section 10.3‑417; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. This section replaces subsection (1) of former Section 3‑417. The former provision was difficult to understand because it purported to state in one subsection all warranties given to any person paying any instrument. The result was a provision replete with exceptions that could not be readily understood except after close scrutiny of the language. In revised Section 3‑417, presentment warranties made to drawees of uncertified checks and other unaccepted drafts are stated in subsection (a). All other presentment warranties are stated in subsection (d).

2. Subsection (a) states three warranties. Subsection (a)(1) in effect is a warranty that there are no unauthorized or missing indorsements. “Person entitled to enforce” is defined in Section 3‑301. Subsection (a)(2) is a warranty that there is no alteration. Subsection (a)(3) is a warranty of no knowledge that there is a forged drawer’s signature. Subsection (a) states that the warranties are made to the drawee and subsections (b) and (c) identify the drawee as the person entitled to recover for breach of warranty. There is no warranty made to the drawer under subsection (a) when presentment is made to the drawee. Warranty to the drawer is governed by subsection (d) and that applies only when presentment for payment is made to the drawer with respect to a dishonored draft. In Sun ‘N Sand, Inc. v. United California Bank, 582 P.2d 920 (Cal.1978), the court held that under former Section 3‑417(1) a warranty was made to the drawer of a check when the check was presented to the drawee for payment. The result in that case is rejected.

3. Subsection (a)(1) retains the rule that the drawee does not admit the authenticity of indorsements and subsection (a)(3) retains the rule of Price v. Neal, 3 Burr. 1354 (1762), that the drawee takes the risk that the drawer’s signature is unauthorized unless the person presenting the draft has knowledge that the drawer’s signature is unauthorized. Under subsection (a)(3) the warranty of no knowledge that the drawer’s signature is unauthorized is also given by prior transferors of the draft.

4. Subsection (d) applies to presentment for payment in all cases not covered by subsection (a). It applies to presentment of notes and accepted drafts to any party obliged to pay the instrument, including an indorser, and to presentment of dishonored drafts if made to the drawer or an indorser. In cases covered by subsection (d), there is only one warranty and it is the same as that stated in subsection (a)(1). There are no warranties comparable to subsections (a)(2) and (a)(3) because they are appropriate only in the case of presentment to the drawee of an unaccepted draft. With respect to presentment of an accepted draft to the acceptor, there is no warranty with respect to alteration or knowledge that the signature of the drawer is unauthorized. Those warranties were made to the drawee when the draft was presented for acceptance (Section 3‑417(a)(2) and (3)) and breach of that warranty is a defense to the obligation of the drawee as acceptor to pay the draft. If the drawee pays the accepted draft the drawee may recover the payment from any warrantor who was in breach of warranty when the draft was accepted. Section 3‑417(b). Thus, there is no necessity for these warranties to be repeated when the accepted draft is presented for payment. Former Section 3‑417(1)(b)(iii) and (c)(iii) are not included in revised Section 3‑417 because they are unnecessary. Former Section 3‑417(1)(c)(iv) is not included because it is also unnecessary. The acceptor should know what the terms of the draft were at the time acceptance was made.

If presentment is made to the drawer or maker, there is no necessity for a warranty concerning the signature of that person or with respect to alteration. If presentment is made to an indorser, the indorser had itself warranted authenticity of signatures and that the instrument was not altered. Section 3‑416(a)(2) and (3).

5. The measure of damages for breach of warranty under subsection (a) is stated in subsection (b). There is no express provision for attorney’s fees, but attorney’s fees are not meant to be necessarily excluded. They could be granted because they fit within the language “expenses \*\*\* resulting from the breach.” Subsection (b) provides that the right of the drawee to recover for breach of warranty is not affected by a failure of the drawee to exercise ordinary care in paying the draft. This provision follows the result reached under former Article 3 in Hartford Accident & Indemnity Co. v. First Pennsylvania Bank, 859 F.2d 295 (3d Cir.1988).

6. Subsection (c) applies to checks and other unaccepted drafts. It gives to the warrantor the benefit of rights that the drawee has against the drawer under Section 3‑404, 3‑405, 3‑406, or 4‑406. If the drawer’s conduct contributed to a loss from forgery or alteration, the drawee should not be allowed to shift the loss from the drawer to the warrantor.

7. The first sentence of subsection (e) recognizes that checks are normally paid by automated means and that payor banks rely on warranties in making payment. Thus, it is not appropriate to allow disclaimer or warranties appearing on checks that normally will not be examined by the payor bank. The second sentence requires a breach of warranty claim to be asserted within 30 days after the drawee learns of the breach and the identity of the warrantor.

8. Since the traditional term “cause of action” may have been replaced in some states by “claim for relief” or some equivalent term, the words “cause of action” in subsection (f) have been bracketed to indicate that the words may be replaced by an appropriate substitute to conform to local practice.

9. For discussion of subsection (a)(4), see Comment 8 to Section 3‑416.

SOUTH CAROLINA REPORTER’S COMMENT

This section replaces former Section 36‑3‑417(1). Subsection (a) provides that four warranties are given to the drawee of a check or other unaccepted draft that is presented for payment or acceptance. The first three of these warranties, set forth in Subsection (a)(1), (2) and (3) are revisions of the presentment warranties under former Section 36‑3‑417(a), (b), and (c). Subsection (a)(4) is new and provides a warranty to the drawee of a remotely‑created consumer item that the person on whose account the item is drawn authorized the issuance of the item in the amount for which it is drawn. Regulation CC, 12 C.F.R. Section 229.34(d) provides that a bank that transfers or presents a remotely created check gives transfer and presentment warranties that differ from these under Chapters 3 and 4.

Subsection (c) provides that when a drawee of a check or other unaccepted draft asserts a claim for breach of a presentment warranty based upon an unauthorized indorsement or alteration, the warrantor can defend by proving that the indorsement is effective under Section 36‑3‑404 (imposter or fictitious payees) or Section 36‑3‑405 (fraudulent indorsement by employee) or that the drawer is precluded from asserting the unauthorized indorsement or alteration under Section 36‑3‑406 or Section 36‑4‑406.

Subsection (d) applies to dishonored drafts presented to a drawer or indorser for payment and to instruments other than unaccepted drafts presented to an obligated party for payment. In these cases, the only presentment warranty given is the warrantor was a person entitled to enforce the instrument which effectively means that there are no missing or unauthorized indorsements.

Subsection (b) provides the measure of damages that a drawee can recover for breach of a presentment warranty. Under this provision, the right of the drawee to recover damages is not affected by the drawee’s failure to exercise ordinary care in paying the draft. The second sentence of Subsection (e) limits a drawee’s claim for damages in cases where the drawee fails to give the warrantor notice of the breach within 30 days after the drawee has reason to know of the breach and the identity of the warrantor. Under that provision the warrantor’s liability is discharged to the extent of any loss resulting from the delay in giving notice. Subsection (f) provides that a cause of action for breach of a presentment warranty accrues when the claimant has reason to know of the breach.

The first sentence of Subsection (e) provides that the presentment warranties cannot be disclaimed in the case of a check.

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| Definitional Cross References: |  |
| “Acceptance” | Section 36‑3‑409(a) |
| “Acceptor” | Section 36‑3‑103(a)(1) |
| “Alteration” | Section 36‑3‑407(a) |
| “Check” | Section 36‑3‑104(f) |
| “Draft” | Section 36‑3‑104(e) |
| “Drawee” | Section 36‑3‑103(a)(4) |
| “Drawer” | Section 36‑3‑103(a)(5) |
| “Good Faith” | Section 36‑3‑103(a)(6) |
| “Indorsement” | Section 36‑3‑204(a) |
| “Indorser” | Section 36‑3‑204(b) |
| “Instrument” | Section 36‑3‑104(b) |
| “Knowledge” | Section 36‑1‑201(25) [see now Section 36‑1‑202] |
| “Ordinary Care” | Section 36‑3‑103(a)(9) |
| “Party” | Section 36‑3‑103(a)(10) |
| “Payment” | Section 36‑3‑602(a) |
| “Person” | Section 36‑1‑201(30) |
| “Person Entitled to Enforce” | Section 36‑3‑301 |
| “Remotely‑Created Consumer Item” | Section 36‑3‑103(a)(16) |
| “Transfer of Instrument” | Section 36‑3‑203(a) |
| “Unauthorized Signature” | Section 36‑1‑201(43) |

Cross References:

1. Whether a person is entitled to enforce an instrument. Section 36‑3‑301.

2. Alteration of an instrument. Section 36‑3‑407.

3. Remotely‑created consumer items. Section 36‑3‑416, Official Comment 6.

4. When an indorsement by any person in the name of the payee is effective in imposter and fictitious payee cases. Section 36‑3‑404.

5. When a fraudulent indorsement of a check in the name of the payee by an employee with responsibility with respect to a check is effective. Section 36‑3‑405.

6. When a person’s failure to exercise ordinary care precludes a person from asserting the alteration of an instrument or the forgery of an indorsement. Section 36‑3‑406.

7. When a customer’s failure to review a statement of account and notify the payor bank of an alteration precludes the customer from asserting the alteration. Section 36‑4‑406(c)—(f).

8. Presentment warranties under Chapter 4. Section 36‑4‑208.

LIBRARY REFERENCES

Bills and Notes 296, 326, 440.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 162 to 165, 249.

**SECTION 36‑3‑418.** Payment for acceptance by mistake.

(a) Except as provided in Subsection (c), if the drawee of a draft pays or accepts the draft and the drawee acted on the mistaken belief that (i) payment of the draft had not been stopped pursuant to Section 36‑4‑403 or (ii) the signature of the drawer of the draft was authorized, the drawee may recover the amount of the draft from the person to whom or for whose benefit payment was made or, in the case of acceptance, may revoke the acceptance. Rights of the drawee under this subsection are not affected by failure of the drawee to exercise ordinary care in paying or accepting the draft.

(b) Except as provided in Subsection (c), if an instrument has been paid or accepted by mistake and the case is not covered by subsection (a), the person paying or accepting may, to the extent permitted by the law governing mistake and restitution, (i) recover the payment from the person to whom or for whose benefit payment was made or (ii) in the case of acceptance, may revoke the acceptance.

(c) The remedies provided by Subsection (a) or (b) may not be asserted against a person who took the instrument in good faith and for value or who in good faith changed position in reliance on the payment or acceptance. This subsection does not limit remedies provided by Section 36‑3‑417 or 36‑4‑407.

(d) Notwithstanding Section 36‑4‑215, if an instrument is paid or accepted by mistake and the payor or acceptor recovers payment or revokes acceptance under Subsection (a) or (b), the instrument is deemed not to have been paid or accepted and is treated as dishonored, and the person from whom payment is recovered has rights as a person entitled to enforce the dishonored instrument.

HISTORY: 1962 Code Section 10.3‑418; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. This section covers payment or acceptance by mistake and replaces former Section 3‑418. Under former Article 3, the remedy of a drawee that paid or accepted a draft by mistake was based on the law of mistake and restitution, but that remedy was not specifically stated. It was provided by Section 1‑103. Former Section 3‑418 was simply a limitation on the unstated remedy under the law of mistake and restitution. Under revised Article 3, Section 3‑418 specifically states the right of restitution in subsections (a) and (b). Subsection (a) allows restitution in the two most common cases in which the problem is presented: payment or acceptance of forged checks and checks on which the drawer has stopped payment. If the drawee acted under a mistaken belief that the check was not forged or had not been stopped, the drawee is entitled to recover the funds paid or to revoke the acceptance whether or not the drawee acted negligently. But in each case, by virtue of subsection (c), the drawee loses the remedy if the person receiving payment or acceptance was a person who took the check in good faith and for value or who in good faith changed position in reliance on the payment or acceptance. Subsections (a) and (c) are consistent with former Section 3‑418 and the rule of Price v. Neal. The result in the two cases covered by subsection (a) is that the drawee in most cases will not have a remedy against the person paid because there is usually a person who took the check in good faith and for value or who in good faith changed position in reliance on the payment or acceptance.

2. If a check has been paid by mistake and the payee receiving payment did not give value for the check or did not change position in reliance on the payment, the drawee bank is entitled to recover the amount of the check under subsection (a) regardless of how the check was paid. The drawee bank normally pays a check by a credit to an account of the collecting bank that presents the check for payment. The payee of the check normally receives the payment by a credit to the payee’s account in the depositary bank. But in some cases the payee of the check may have received payment directly from the drawee bank by presenting the check for payment over the counter. In those cases the payee is entitled to receive cash, but the payee may prefer another form of payment such as a cashier’s check or teller’s check issued by the drawee bank. Suppose Seller contracted to sell goods to Buyer. The contract provided for immediate payment by Buyer and delivery of the goods 20 days after payment. Buyer paid by mailing a check for $ 10,000 drawn on Bank payable to Seller. The next day Buyer gave a stop payment order to Bank with respect to the check Buyer had mailed to Seller. A few days later Seller presented Buyer’s check to Bank for payment over the counter and requested a cashier’s check as payment. Bank issued and delivered a cashier’s check for $ 10,000 payable to Seller. The teller failed to discover Buyer’s stop order. The next day Bank discovered the mistake and immediately advised Seller of the facts. Seller refused to return the cashier’s check and did not deliver any goods to Buyer.

Under Section 4‑215, Buyer’s check was paid by Bank at the time it delivered its cashier’s check to Seller. See Comment 3 to Section 4‑215. Bank is obliged to pay the cashier’s check and has no defense to that obligation. The cashier’s check was issued for consideration because it was issued in payment of Buyer’s check. Although Bank has no defense on its cashier’s check it may have a right to recover $ 10,000, the amount of Buyer’s check, from Seller under Section 3‑418(a). Bank paid Buyer’s check by mistake. Seller did not give value for Buyer’s check because the promise to deliver goods to Buyer was never performed. Section 3‑303(a)(1). And, on these facts, Seller did not change position in reliance on the payment of Buyer’s check. Thus, the first sentence of Section 3‑418(c) does not apply and Seller is obliged to return $ 10,000 to Bank. Bank is obliged to pay the cashier’s check but it has a counterclaim against Seller based on its rights under Section 3‑418(a). This claim can be asserted against Seller, but it cannot be asserted against some other person with rights of a holder in due course of the cashier’s check. A person without rights of a holder in due course of the cashier’s check would take subject to Bank’s claim against Seller because it is a claim in recoupment. Section 3‑305(a)(3).

If Bank recovers from Seller under Section 3‑418(a), the payment of Buyer’s check is treated as unpaid and dishonored. Section 3‑418(d). One consequence is that Seller may enforce Buyer’s obligation as drawer to pay the check. Section 3‑414. Another consequence is that Seller’s rights against Buyer on the contract of sale are also preserved. Under Section 3‑310(b) Buyer’s obligation to pay for the goods was suspended when Seller took Buyer’s check and remains suspended until the check is either dishonored or paid. Under Section 3‑310(b)(1) the obligation is discharged when the check is paid. Since Section 3‑418(d) treats Buyer’s check as unpaid and dishonored, Buyer’s obligation is not discharged and suspension of the obligation terminates. Under Section 3‑310(b)(3), Seller may enforce either the contract of sale or the check subject to defenses and claims of Buyer. If Seller had released the goods to Buyer before learning about the stop order, Bank would have no recovery against Seller under Section 3‑418(a) because Seller in that case gave value for Buyer’s check. Section 3‑418(c). In this case Bank’s sole remedy is under Section 4‑407 by subrogation.

3. Subsection (b) covers cases of payment or acceptance by mistake that are not covered by subsection (a). It directs courts to deal with those cases under the law governing mistake and restitution. Perhaps the most important class of cases that falls under subsection (b), because it is not covered by subsection (a), is that of payment by the drawee bank of a check with respect to which the bank has no duty to the drawer to pay either because the drawer has no account with the bank or because available funds in the drawer’s account are not sufficient to cover the amount of the check. With respect to such a case, under Restatement of Restitution Section 29, if the bank paid because of a mistaken belief that there were available funds in the drawer’s account sufficient to cover the amount of the check, the bank is entitled to restitution. But Section 29 is subject to Restatement of Restitution Section 33 which denies restitution if the holder of the check receiving payment paid value in good faith for the check and had no reason to know that the check was paid by mistake when payment was received.

The result in some cases is clear. For example, suppose Father gives Daughter a check for $ 10,000 as a birthday gift. The check is drawn on Bank in which both Father and Daughter have accounts. Daughter deposits the check in her account in Bank. An employee of Bank, acting under the belief that there were available funds in Father’s account to cover the check, caused Daughter’s account to be credited for $10,000. In fact, Father’s account was overdrawn and Father did not have overdraft privileges. Since Daughter received the check gratuitously there is clear unjust enrichment if she is allowed to keep the $10,000 and Bank is unable to obtain reimbursement from Father. Thus, Bank should be permitted to reverse the credit to Daughter’s account. But this case is not typical. In most cases the remedy of restitution will not be available because the person receiving payment of the check will have given value for it in good faith.

In some cases, however, it may not be clear whether a drawee bank should have a right of restitution. For example, a check‑kiting scheme may involve a large number of checks drawn on a number of different banks in which the drawer’s credit balances are based on uncollected funds represented by fraudulently drawn checks. No attempt is made in Section 3‑418 to state rules for determining the conflicting claims of the various banks that may be victimized by such a scheme. Rather, such cases are better resolved on the basis of general principles of law and the particular facts presented in the litigation.

4. The right of the drawee to recover a payment or to revoke an acceptance under Section 3‑418 is not affected by the rules under Article 4 that determine when an item is paid. Even though a payor bank may have paid an item under Section 4‑215, it may have a right to recover the payment under Section 3‑418. National Savings & Trust Co. v. Park Corp., 722 F.2d 1303 (6th Cir. 1983), cert. denied, 466 U.S. 939 (1984), correctly states the law on the issue under former Article 3. Revised Article 3 does not change the previous law.

SOUTH CAROLINA REPORTER’S COMMENT

This section replaces former Section 36‑3‑418 and expressly provides that a drawee that pays or accepts a draft by mistake has limited rights to restitution. Subsection (a) grants the drawee a right to restitution when the drawee pays or accepts a draft on the mistaken belief that payment of the draft had not been stopped or that the signature of the drawer was authorized.

Subsection (b) addresses cases in which the drawee paid or accepted a draft on a mistaken belief other than those covered by Subsection (a). Under Subsection (b) the drawee can recover the payment or revoke the acceptance to the extent permitted by law governing mistake and restitution.

Subsection (c) is consistent with former Section 36‑3‑418 in providing that the rights to restitution based upon the mistaken payment or acceptance of a draft cannot be asserted against a person who took an instrument in good faith and for value or in good faith changed position in reliance on the payment or acceptance. Subsection (c), however, also provides that it does not limit the remedies for breach of presentment warranties or a payor bank’s right to subrogation under Section 36‑4‑407.

Subsection (d) provides that if an instrument is paid or accepted by mistake and the payor or acceptor recovers payment or revokes acceptance, the instrument is treated as dishonored.

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| Definitional Cross References: |  |
| “Acceptance” | Section 36‑3‑409(a) |
| “Acceptor” | Section 36‑3‑103(a)(1) |
| “Draft” | Section 36‑3‑104(e) |
| “Drawee” | Section 36‑3‑103(a)(4) |
| “Drawer” | Section 36‑3‑103(a)(5) |
| “Good Faith” | Section 36‑3‑103(a)(6) |
| “Instrument” | Section 36‑3‑104(b) |
| “Ordinary Care” | Section 36‑3‑103(a)(9) |
| “Payment” | Section 36‑3‑602(a) |
| “Person” | Section 36‑1‑201(30) |
| “Person Entitled to Enforce” | Section 36‑3‑301 |
| “Value” | Section 36‑3‑303(a) |

Cross References:

1. Customer’s right to stop payment on a draft drawn on the customer’s account at a bank. Section 36‑4‑403.

2. Payor bank’s subrogation rights when the bank improperly pays an item subject to a stop‑payment order. Section 36‑4‑407.

3. Unauthorized signature on an item. Section 36‑3‑403.

4. Presentment warranties relating to a drawer’s unauthorized signature. Sections 36‑3‑417(a)(4), 36‑4‑208(a)(3).

5. Final payment of an item by a payor bank. Section 36‑4‑215.

LIBRARY REFERENCES

Bills and Notes 72, 425, 434.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 40, 231 to 232, 239 to 240, 244 to 248.

**SECTION 36‑3‑419.** Instrument signed for accommodation.

(a) If an instrument is issued for value given for the benefit of a party to the instrument (“accommodated party”) and another party to the instrument (“accommodation party”) signs the instrument for the purpose of incurring liability on the instrument without being a direct beneficiary of the value given for the instrument, the instrument is signed by the accommodation party “for accommodation”.

(b) An accommodation party may sign the instrument as maker, drawer, acceptor, or indorser and, subject to Subsection (d), is obliged to pay the instrument in the capacity in which the accommodation party signs. The obligation of an accommodation party may be enforced notwithstanding any statute of frauds and whether or not the accommodation party receives consideration for the accommodation.

(c) A person signing an instrument is presumed to be an accommodation party and there is notice that the instrument is signed for accommodation if the signature is an anomalous indorsement or is accompanied by words indicating that the signer is acting as surety or guarantor with respect to the obligation of another party to the instrument. Except as provided in Section 36‑3‑605, the obligation of an accommodation party to pay the instrument is not affected by the fact that the person enforcing the obligation had notice when the instrument was taken by that person that the accommodation party signed the instrument for accommodation.

(d) If the signature of a party to an instrument is accompanied by words indicating unambiguously that the party is guaranteeing collection rather than payment of the obligation of another party to the instrument, the signer is obliged to pay the amount due on the instrument to a person entitled to enforce the instrument only if (i) execution of judgment against the other party has been returned unsatisfied, (ii) the other party is insolvent or in an insolvency proceeding, (iii) the other party cannot be served with process, or (iv) it is otherwise apparent that payment cannot be obtained from the other party.

(e) If the signature of a party to an instrument is accompanied by words indicating that the party guarantees payment or the signer signs the instrument as an accommodation party in some other manner that does not unambiguously indicate an intention to guarantee collection rather than payment, the signer is obliged to pay the amount due on the instrument 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.

(f) An accommodation party who pays the instrument is entitled to reimbursement from the accommodated party and is entitled to enforce the instrument against the accommodated party. In proper circumstances, an accommodation party may obtain relief that requires the accommodated party to perform its obligations on the instrument. An accommodated party that pays the instrument has no right of recourse against, and is not entitled to contribution from, an accommodation party.

HISTORY: 1962 Code Section 10.3‑419; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. Section 3‑419 replaces former Section 3‑415 and 3‑416. An accommodation party is a person who signs an instrument to benefit the accommodated party either by signing at the time value is obtained by the accommodated party or later, and who is not a direct beneficiary of the value obtained. An accommodation party will usually be a co‑maker or anomalous indorser. Subsection (a) distinguishes between direct and indirect benefit. For example, if X cosigns a note of Corporation that is given for a loan to Corporation, X is an accommodation party if no part of the loan was paid to X or for X’s direct benefit. This is true even though X may receive indirect benefit from the loan because X is employed by Corporation or is a stockholder of Corporation, or even if X is the sole stockholder so long as Corporation and X are recognized as separate entities.

2. It does not matter whether an accommodation party signs gratuitously either at the time the instrument is issued or after the instrument is in the possession of a holder. Subsection (b) of Section 3‑419 takes the view stated in Comment 3 to former Section 3‑415 that there need be no consideration running to the accommodation party: “The obligation of the accommodation party is supported by any consideration for which the instrument is taken before it is due. Subsection (2) is intended to change occasional decisions holding that there is no sufficient consideration where an accommodation party signs a note after it is in the hands of a holder who has given value. The [accommodation] party is liable to the holder in such a case even though there is no extension of time or other concession.”

3. As stated in Comment 1, whether a person is an accommodation party is a question of fact. But it is almost always the case that a co‑maker who signs with words of guaranty after the signature is an accommodation party. The same is true of an anomalous indorser. In either case a person taking the instrument is put on notice of the accommodation status of the co‑maker or indorser. This is relevant to Section 3‑605(e). But, under subsection (c), signing with words of guaranty or as an anomalous indorser also creates a presumption that the signer is an accommodation party. A party challenging accommodation party status would have to rebut this presumption by producing evidence that the signer was in fact a direct beneficiary of the value given for the instrument.

An accommodation party is always a surety. A surety who is not a party to the instrument, however, is not an accommodation party. For example, if M issues a note payable to the order of P, and S signs a separate contract in which S agrees to pay P the amount of the instrument if it is dishonored, S is a surety but is not an accommodation party. In such a case, S’s rights and duties are determined under the general law of suretyship. In unusual cases two parties to an instrument may have a surety relationship that is not governed by Article 3 because the requirements of Section 3‑419(a) are not met. In those cases the general law of suretyship applies to the relationship. See PEB Commentary No. 11, dated February 10, 1994.

4. Subsection (b) states that an accommodation party is liable on the instrument in the capacity in which the party signed the instrument. In most cases that capacity will be either that of a maker or indorser of a note. But subsection (d) provides a limitation on subsection (b). If the signature of the accommodation party is accompanied by words indicating unambiguously that the party is guaranteeing collection rather than payment of the instrument, liability is limited to that stated in subsection (d), which is based on former Section 3‑416(2).

Former Article 3 was confusing because the obligation of a guarantor was covered both in Section 3‑415 and in Section 3‑416. The latter section suggested that a signature accompanied by words of guaranty created an obligation distinct from that of an accommodation party. Revised Article 3 eliminates that confusion by stating in Section 3‑419 the obligation of a person who uses words of guaranty. Portions of former Section 3‑416 are preserved. Former Section 3‑416(2) is reflected in Section 3‑419(d) and former Section 3‑416(4) is reflected in Section 3‑419(c). Words added to an anomalous indorsement indicating that payment of the instrument is guaranteed by the indorser do not change the liability of the indorser as stated in Section 3‑415. This is a change from former Section 3‑416(5). See PEB Commentary No. 11, supra.

5. Subsection (f) like former Section 3‑415(5), provides that an accommodation party that pays the instrument is entitled to enforce the instrument against the accommodated party. Since the accommodation party that pays the instrument is entitled to enforce the instrument against the accommodated party, the accommodation party also obtains rights to any security interest or other collateral that secures payment of the instrument. Subsection (f) also provides that an accommodation party that pays the instrument is entitled to reimbursement from the accommodated party. See PEB Commentary No. 11, supra.

6. In occasional cases, the accommodation party might pay the instrument even though the accommodated party had a defense to its obligation that was available to the accommodation party under Section 3‑305(d). In such cases, the accommodation party’s right to reimbursement may conflict with the accommodated party’s right to raise its defense. For example, suppose the accommodation party pays the instrument without being aware of the defense. In that case the accommodation party should be entitled to reimbursement. Suppose the accommodation party paid the instrument with knowledge of the defense. In that case, to the extent of the defense, reimbursement ordinarily would not be justified, but under some circumstances reimbursement may be justified depending upon the facts of the case. The resolution of this conflict is left to the general law of suretyship. Section 1‑103. See PEB Commentary No. 11, supra.

7. Section 3‑419, along with Section 3‑116(a) and (b), Section 3‑305(d) and Section 3‑605, provides rules governing the rights of accommodation parties. In addition, except to the extent that it is displaced by provisions of this Article, the general law of suretyship also applies to the rights of accommodation parties. Section 1‑103. See PEB Commentary No. 11, supra.

SOUTH CAROLINA REPORTER’S COMMENT

This provision replaces former Sections 36‑3‑415 and 36‑3‑416. Subsection (a) defines the terms “accommodated party” and “accommodation party.” Under Subsection (c), a person signing an instrument is presumed to be an accommodation party and there is notice of the signer’s accommodation status if the signature is an anomalous indorsement or is accompanied by words indicating that the signer is acting as a surety or guarantor.

Subsection (b) provides that an accommodation party may sign an instrument as maker, drawer, acceptor or indorser and is liable to a person entitled to enforce in the capacity in which the accommodation party signed.

Subsections (d) and (e) address the liability of accommodation parties and are consistent with former Section 36‑3‑416(1)‑(3). If an accommodation party’s signature is accompanied by words unambiguously guaranteeing collection rather than payment of an instrument, Subsection (d) provides that the accommodation party is not liable on the instrument until the person seeking enforcement has effectively exhausted his remedies against the accommodated party. In other cases, Subsection (e) provides that a person entitled to enforce the instrument has the same rights against the accommodation party as that person has against the accommodated party. The rule is consistent with the decision in Bankers Trust of South Carolina v. Culbertson, 268 S.C. 564, 235 S.E.2d 130 (1977).

Subsection (f) is consistent with former Section 36‑3‑415(5) and provides that, if an accommodation party pays an instrument, the accommodation party is entitled to reimbursement from the accommodated party; but that, if an accommodated party pays the instrument, the accommodated party has no rights against the accommodation party.

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| Definitional Cross References: |  |
| “Acceptor” | Section 36‑3‑103(a)(1) |
| “Anomalous Indorsement” | Section 36‑3‑205(d) |
| “Consideration” | Section 36‑3‑303(b) |
| “Drawer” | Section 36‑3‑103(a)(5) |
| “Indorser” | Section 36‑3‑204(b) |
| “Instrument” | Section 36‑3‑104(b) |
| “Issue” | Section 36‑3‑105(a) |
| “Maker” | Section 36‑3‑103(a)(7) |
| “Notice” | Section 36‑1‑201(25) [see now Section 36‑1‑202] |
| “Party” | Section 36‑3‑103(a)(10) |
| “Payment” | Section 36‑3‑602(a) |
| “Person” | Section 36‑1‑201(30) |
| “Person Entitled to Enforce” | Section 36‑3‑301 |
| “Signed” | Section 36‑1‑201(39) |
| “Value” | Section 36‑3‑303(a) |

Cross References:

1. Joint and several liability of person who has the same liability upon an instrument and the right of contribution when one person with joint and several liability pays the instrument. Section 36‑3‑116.

2. Right of accommodation part to raise the accommodated party’s defenses and claims of recoupment in an action to enforce an instrument. Section 36‑3‑305(d).

3. Discharge of the liability of an accommodation party by releasing the accommodated party, extending the accommodated party’s time for payment, or impairing the value of collateral securing the obligation. Section 36‑3‑605.

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Banks and Banking 148(2).

Bills and Notes 52.

Trover and Conversion 19, 50.

WESTLAW Topic Nos. 52, 56, 389.

C.J.S. Banks and Banking Sections 418 to 423, 435 to 438.

C.J.S. Bills and Notes; Letters of Credit Sections 231, 244 to 248.

C.J.S. Trover and Conversion Sections 80, 194.

RESEARCH REFERENCES

Encyclopedias

S.C. Jur. Banks and Banking Section 113.1, Documentary Drafts and UCC Liability.

Treatises and Practice Aids

11 Causes of Action 143, Cause of Action Against Bank for Payment of Check Over Unauthorized or Missing Endorsement.

NOTES OF DECISIONS

In general 1

Consideration 2

Mutual assent 3

1. In general

Cause of action for commonlaw negligence claim against bank based on bank’s acceptance for deposit of checks made payable to plaintiff, upon unauthorized endorsement of plaintiff’s agent, has been displaced by U.C.C. conversion claim. Equitable Life Assur. Soc. of U.S. v. Okey (C.A.4 (S.C.) 1987) 812 F.2d 906.

A payor bank was not liable, based on conversion, for the amounts of documentary drafts presented to it, even though the drafts were accompanied by transmittal invoices containing the phrase “Do Not Hold After Maturity” and marked “Due: sight” and the bank failed to either pay or return the drafts on the day of presentment, where the collector bank waited until its computer system automatically generated a tracer after 15 days, thus showing that it did not consider its transmittal letter a demand for payment at the time of delivery. South Carolina Nat. Bank v. First Union Nat. Bank (S.C. 1993) 310 S.C. 428, 427 S.E.2d 169, rehearing denied.

Trial judge erred in denying motion to amend complaint to add prejudgment interest because Section 36‑3‑419(1)(c) is codification of common‑law conversion, and under Section 36‑1‑103, common‑law supplements provisions of UCC. Measure of damages for money which has been converted is amount converted with legal interest from date of conversion, and there is no difference between conversion of money by bank and conversion of money by individual. Robbins v. First Federal Sav. Bank (S.C.App. 1987) 294 S.C. 219, 363 S.E.2d 418.

Guarantors of secured debt were entitled to have proceeds from mortgage foreclosure applied to reduce debt, but not to reduce contractual limit of liability under guarantee agreements, such that guarantors were liable for unpaid balance due after application of mortgage foreclosure proceeds to debt. Southern Bank & Trust Co. v. Harley (S.C.App. 1987) 292 S.C. 340, 356 S.E.2d 410, affirmed as modified 295 S.C. 423, 368 S.E.2d 908. Guaranty 60

In action brought by copayee based on endorsement of check by and payment to other copayee, failure of first copayee to assert in affidavit demand for either payment or return of check, in compliance with Section 36‑3‑419, combined with reply affidavits of defendant bank, preclude grant of summary judgment to first copayee. Roll Form Products, Inc. v. Citizens and Southern Nat. Bank of South Carolina (S.C.App. 1986) 287 S.C. 629, 340 S.E.2d 562.

Exclusion of evidence on estoppel in form of testimony by bank employee tending to show guarantor was misled into believing guaranty note would terminate at end of six months, even if error, was harmless where talk which proceeded execution of agreement merged into written instrument by which guarantor assumed same liability as if primarily liable. Bankers Trust of South Carolina v. Collins (S.C. 1977) 270 S.C. 26, 239 S.E.2d 889.

Whether a signature on a note providing that “makers, endorsers and guarantors waive demand, presentment, protest, notice of nonpayment, and all defenses on the ground of extension of time for payment” was in an accommodation maker or accommodation endorser capacity was of no legal consequence, as the liability of an endorser was secondary only with respect to these rights which were waived. Bankers Trust of South Carolina v. Culbertson (S.C. 1977) 268 S.C. 564, 235 S.E.2d 130.

Signature in the lower right hand corner of a note, instead of on the back where spaces were specifically provided for endorsers, shows that signer was a maker and not an accommodation endorser. Bankers Trust of South Carolina v. Culbertson (S.C. 1977) 268 S.C. 564, 235 S.E.2d 130.

Accommodation status of signer of note does not affect liability of signer to payee. Bankers Trust of South Carolina v. Culbertson (S.C. 1977) 268 S.C. 564, 235 S.E.2d 130.

In action by payee against accommodation party, there is no difference in liability if accommodation party is called a co‑maker. Bankers Trust of South Carolina v. Culbertson (S.C. 1977) 268 S.C. 564, 235 S.E.2d 130.

Criteria contained in 1962 Code Section 10.3‑105 [1976 Code Section 36‑3‑105] are by analogy applicable to construction of guaranty agreement which contained unambiguous language providing that it was guaranty of payment and not of collection, but which referred to loan documents for information only; there was no intent to incorporate the documents by reference and thereby to condition guaranty agreement upon said documents. Tri‑South Mortg. Investors v. Fountain (S.C. 1976) 266 S.C. 141, 221 S.E.2d 861. Guaranty 77(3)

Applied in Conwed Corp. v. First‑Citizens Bank & Trust Co. (S.C. 1974) 262 S.C. 48, 202 S.E.2d 22.

2. Consideration

Evidence supported finding that note was executed simultaneous to guaranty, such that consideration of note functioned as consideration for guaranty; loan officer testified he prepared the new line of credit and guaranty documents together, delivered them to borrower for requisite signatures, that line of credit would not have been renewed prior to bank’s receipt of signed guaranties, and that executed loan renewal documents, including signed personal guaranty, were returned to bank and entered into bank’s computer system on same date, and guarantor offered no evidence to the contrary at trial. Branch Banking and Trust Co. of South Carolina v. Carolina Crank & Core, Inc. (S.C.App. 2005) 362 S.C. 647, 608 S.E.2d 896. Guaranty 25(3)

Guaranty was supported by sufficient legal consideration, where, in exchange for receiving guaranty, bank agreed to extend the line of credit for an additional eight months past the original maturity date, thus forbearing on its pre‑existing right to enforce other remedies, including collection under the original note against company that employed guarantor and in which he owned stock. Branch Banking and Trust Co. of South Carolina v. Carolina Crank & Core, Inc. (S.C.App. 2005) 362 S.C. 647, 608 S.E.2d 896. Guaranty 16(4)

3. Mutual assent

If the guaranty is signed by the guarantor at the request of the other party, or if the latter’s agreement is contemporaneous with the guaranty, the mutual assent is proved, and the delivery of the guaranty to him or for his use completes the contract. Branch Banking and Trust Co. of South Carolina v. Carolina Crank & Core, Inc. (S.C.App. 2005) 362 S.C. 647, 608 S.E.2d 896. Guaranty 6; Guaranty 12

**SECTION 36‑3‑420.** Conversion of instrument.

(a) The law applicable to conversion of personal property applies to instruments. An instrument is also converted if it is taken by transfer, other than a negotiation, from a person not entitled to enforce the instrument or a bank makes or obtains payment with respect to the instrument for a person not entitled to enforce the instrument or receive payment. An action for conversion of an instrument may not be brought by (i) the issuer or acceptor of the instrument or (ii) a payee or indorsee who did not receive delivery of the instrument either directly or through delivery to an agent or a co‑payee.

(b) In an action under Subsection (a), 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.

(c) A representative, other than a depositary bank, who has in good faith dealt with an instrument or its proceeds on behalf of one who was not the person entitled to enforce the instrument is not liable in conversion to that person beyond the amount of any proceeds that it has not paid out.

HISTORY: 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. Section 3‑420 is a modification of former Section 3‑419. The first sentence of Section 3‑420(a) states a general rule that the law of conversion applicable to personal property also applies to instruments. Paragraphs (a) and (b) of former Section 3‑419(1) are deleted as inappropriate in cases of noncash items that may be delivered for acceptance or payment in collection letters that contain varying instructions as to what to do in the event of nonpayment on the day of delivery. It is better to allow such cases to be governed by the general law of conversion that would address the issue of when, under the circumstances prevailing, the presenter’s right to possession has been denied. The second sentence of Section 3‑420(a) states that an instrument is converted if it is taken by transfer other than a negotiation from a person not entitled to enforce the instrument or taken for collection or payment from a person not entitled to enforce the instrument or receive payment. This covers cases in which a depositary or payor bank takes an instrument bearing a forged indorsement. It also covers cases in which an instrument is payable to two persons and the two persons are not alternative payees, e.g. a check payable to John and Jane Doe. Under Section 3‑110(d) the check can be negotiated or enforced only by both persons acting jointly. Thus, neither payee acting without the consent of the other, is a person entitled to enforce the instrument. If John indorses the check and Jane does not, the indorsement is not effective to allow negotiation of the check. If Depositary Bank takes the check for deposit to John’s account, Depositary Bank is liable to Jane for conversion of the check if she did not consent to the transaction. John, acting alone, is not the person entitled to enforce the check because John is not the holder of the check. Section 3‑110(d) and Comment 4 to Section 3‑110. Depositary Bank does not get any greater rights under Section 4‑205(1). If it acted for John as its customer, it did not become holder of the check under that provision because John, its customer, was not a holder.

Under former Article 3, the cases were divided on the issue of whether the drawer of a check with a forged indorsement can assert rights against a depositary bank that took the check. The last sentence of Section 3‑420(a) resolves the conflict by following the rule stated in Stone & Webster Engineering Corp. v. First National Bank & Trust Co., 184 N.E.2d 358 (Mass. 1962). There is no reason why a drawer should have an action in conversion. The check represents an obligation of the drawer rather than property of the drawer. The drawer has an adequate remedy against the payor bank for recredit of the drawer’s account for unauthorized payment of the check.

There was also a split of authority under former Article 3 on the issue of whether a payee who never received the instrument is a proper plaintiff in a conversion action. The typical case was one in which a check was stolen from the drawer or in which the check was mailed to an address different from that of the payee and was stolen after it arrived at that address. The thief forged the indorsement of the payee and obtained payment by depositing the check to an account in a depositary bank. The issue was whether the payee could bring an action in conversion against the depositary bank or the drawee bank. In revised Article 3, under the last sentence of Section 3‑420(a), the payee has no conversion action because the check was never delivered to the payee. Until delivery, the payee does not have any interest in the check. The payee never became the holder of the check nor a person entitled to enforce the check. Section 3‑301. Nor is the payee injured by the fraud. Normally the drawer of a check intends to pay an obligation owed to the payee. But if the check is never delivered to the payee, the obligation owed to the payee is not affected. If the check falls into the hands of a thief who obtains payment after forging the signature of the payee as an indorsement, the obligation owed to the payee continues to exist after the thief receives payment. Since the payee’s right to enforce the underlying obligation is unaffected by the fraud of the thief, there is no reason to give any additional remedy to the payee. The drawer of the check has no conversion remedy, but the drawee is not entitled to charge the drawer’s account when the drawee wrongfully honored the check. The remedy of the drawee is against the depositary bank for breach of warranty under Section 3‑417(a)(1) or 4‑208(a)(1). The loss will fall on the person who gave value to the thief for the check.

The situation is different if the check is delivered to the payee. If the check is taken for an obligation owed to the payee, the last sentence of Section 3‑310(b)(4) provides that the obligation may not be enforced to the extent of the amount of the check. The payee’s rights are restricted to enforcement of the payee’s rights in the instrument. In this event the payee is injured by the theft and has a cause of action for conversion.

The payee receives delivery when the check comes into the payee’s possession, as for example when it is put into the payee’s mailbox. Delivery to an agent is delivery to the payee. If a check is payable to more than one payee, delivery to one of the payees is deemed to be delivery to all of the payees. Occasionally, the person asserting a conversion cause of action is an indorsee rather than the original payee. If the check is stolen before the check can be delivered to the indorsee and the indorsee’s indorsement is forged, the analysis is similar. For example, a check is payable to the order of A. A indorses it to B and puts it into an envelope addressed to B. The envelope is never delivered to B. Rather, Thief steals the envelope, forges B’s indorsement to the check and obtains payment. Because the check was never delivered to B, the indorsee, B has no cause of action for conversion, but A does have such an action. A is the owner of the check. B never obtained rights in the check. If A intended to negotiate the check to B in payment of an obligation, that obligation was not affected by the conduct of Thief. B can enforce that obligation. Thief stole A’s property not B’s.

2. Subsection (2) of former Section 3‑419 is amended because it is not clear why the former law distinguished between the liability of the drawee and that of other converters. Why should there be a conclusive presumption that the liability is face amount if a drawee refuses to pay or return an instrument or makes payment on a forged indorsement, while the liability of a maker who does the same thing is only presumed to be the face amount? Moreover, it was not clear under former Section 3‑419(2) what face amount meant. If a note for $ 10,000 is payable in a year at 10% interest, it is common to refer to $ 10,000 as the face amount, but if the note is converted the loss to the owner also includes the loss of interest. In revised Article 3, Section 3‑420(b), by referring to “amount payable on the instrument,” allows the full amount due under the instrument to be recovered.

The “but” clause in subsection (b) addresses the problem of conversion actions in multiple payee checks. Section 3‑110(d) states that an instrument cannot be enforced unless all payees join in the action. But an action for conversion might be brought by a payee having no interest or a limited interest in the proceeds of the check. This clause prevents such a plaintiff from receiving a windfall. An example is a check payable to a building contractor and a supplier of building material. The check is not payable to the payees alternatively. Section 3‑110(d). The check is delivered to the contractor by the owner of the building. Suppose the contractor forges supplier’s signature as an indorsement of the check and receives the entire proceeds of the check. The supplier should not, without qualification, be able to recover the entire amount of the check from the bank that converted the check. Depending upon the contract between the contractor and the supplier, the amount of the check may be due entirely to the contractor, in which case there should be no recovery, entirely to the supplier, in which case recovery should be for the entire amount, or part may be due to one and the rest to the other, in which case recovery should be limited to the amount due to the supplier.

3. Subsection (3) of former Section 3‑419 drew criticism from the courts, that saw no reason why a depositary bank should have the defense stated in the subsection. See Knesz v. Central Jersey Bank & Trust Co., 477 A.2d 806 (N.J. 1984). The depositary bank is ultimately liable in the case of a forged indorsement check because of its warranty to the payor bank under Section 4‑208(a)(1) and it is usually the most convenient defendant in cases involving multiple checks drawn on different banks. There is no basis for requiring the owner of the check to bring multiple actions against the various payor banks and to require those banks to assert warranty rights against the depositary bank. In revised Article 3, the defense provided by Section 3‑420(c) is limited to collecting banks other than the depositary bank. If suit is brought against both the payor bank and the depositary bank, the owner, of course, is entitled to but one recovery.

SOUTH CAROLINA REPORTER’S COMMENT

This provision is a modification of former Section 36‑3‑419. Subsection (a) abandons the approach of former Section 36‑3‑419(1) that defined when an instrument was converted. Subsection (a) provides generally that the law applicable to conversion of personal property applies to instruments. Subsection (a), however, does provide an instrument is converted when it is taken by transfer other than negotiation by a person not entitled to enforce the instrument or when a bank pays an instrument to a person not entitled to enforce the instrument. This is consistent with former Section 36‑3‑419(1)(c) under which the drawee was liable for paying an instrument bearing a forged indorsement. Although South Carolina courts allowed payees to maintain conversion actions against depositary banks, see Peoples Life Ins. Co. v. Community Bank, 278 S.C. 70, 292 S.E.2d 188 (1982), the former statute did not expressly grant that right. Under Subsection (a), both a drawee‑payor bank and a depositary bank can be statutorily liable for conversion of a check bearing a forged indorsement.

Subsection (a) also clarifies the resolution of two controversial issues that arose under the prior statute. First, under Subsection (a)(i) the issuer or acceptor of an instrument may not maintain an action for conversion. In practical terms, this means that the drawer of a check cannot recover from a depositary bank for conversion. Second, under Subsection (a)(ii) a payee or indorsee that did not obtain possession of an instrument cannot maintain an action for conversion.

Subsection (b) is consistent with the second sentence of former Section 36‑3‑419(2) and provides that the measure of liability for conversion is presumed to be the amount payable on the instrument. The subsection does not affect the holding in Robbins v. First Federal Savings Bank, 294 S.C. 219, 363 S.E.2d 418 (S.C. App. 1987) that a plaintiff can recover prejudgment interest in an action for conversion of a check.

Subsection (c) revises former Section 36‑3‑419(3) by depriving depositary banks that convert instruments of the limitation of liability to the amount of proceeds of the converted instrument that have not been paid out.

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| Definitional Cross References: |  |
| “Acceptor” | Section 36‑3‑103(a)(1) |
| “Bank” | Section 36‑1‑201(4) |
| “Delivery” | Section 36‑1‑201(14) |
| “Depositary Bank” | Section 36‑4‑105(2) |
| “Good Faith” | Section 36‑3‑103(a)(6) |
| “Instrument” | Section 36‑3‑104(b) |
| “Issuer” | Section 36‑3‑105(c) |
| “Negotiation” | Section 36‑3‑201(a) |
| “Payment” | Section 36‑3‑602(a) |
| “Person Entitled to Enforce” | Section 36‑3‑301 |
| “Representative” | Section 36‑1‑201(35) |

Cross References:

1. Liability for breach of a presentment warranty resulting from a forged indorsement. Sections 36‑3‑417(a)(1) and 36‑4‑208(a)(1).

2. Liability for breach of a transfer warranty resulting from a forged indorsement. Sections 36‑3‑416(a)(1) & (2) and 36‑4‑207(a)(1) & (2).

3. When an indorsement by any person in the name of the named payee is effective in imposter and fictitious payee cases. Section 36‑3‑404.

4. When a fraudulent indorsement in the name of the named payee by employee with responsibility with respect to a check is effective. Section 36‑3‑405.

5. When the negligence of a person whose indorsement is forged precludes the person from asserting the forgery. Section 36‑3‑406.

NOTES OF DECISIONS

In general 1

1. In general

Cause of action for commonlaw negligence claim against bank based on bank’s acceptance for deposit of checks made payable to plaintiff, upon unauthorized endorsement of plaintiff’s agent, has been displaced by U.C.C. conversion claim. Equitable Life Assur. Soc. of U.S. v. Okey (C.A.4 (S.C.) 1987) 812 F.2d 906.

A payor bank was not liable, based on conversion, for the amounts of documentary drafts presented to it, even though the drafts were accompanied by transmittal invoices containing the phrase “Do Not Hold After Maturity” and marked “Due: sight” and the bank failed to either pay or return the drafts on the day of presentment, where the collector bank waited until its computer system automatically generated a tracer after 15 days, thus showing that it did not consider its transmittal letter a demand for payment at the time of delivery. South Carolina Nat. Bank v. First Union Nat. Bank (S.C. 1993) 310 S.C. 428, 427 S.E.2d 169, rehearing denied.

Trial judge erred in denying motion to amend complaint to add prejudgment interest because Section 36‑3‑419(1)(c) is codification of common‑law conversion, and under Section 36‑1‑103, common‑law supplements provisions of UCC. Measure of damages for money which has been converted is amount converted with legal interest from date of conversion, and there is no difference between conversion of money by bank and conversion of money by individual. Robbins v. First Federal Sav. Bank (S.C.App. 1987) 294 S.C. 219, 363 S.E.2d 418.

In action brought by copayee based on endorsement of check by and payment to other copayee, failure of first copayee to assert in affidavit demand for either payment or return of check, in compliance with Section 36‑3‑419, combined with reply affidavits of defendant bank, preclude grant of summary judgment to first copayee. Roll Form Products, Inc. v. Citizens and Southern Nat. Bank of South Carolina (S.C.App. 1986) 287 S.C. 629, 340 S.E.2d 562.

Applied in Conwed Corp. v. First‑Citizens Bank & Trust Co. (S.C. 1974) 262 S.C. 48, 202 S.E.2d 22.

Part 5

Dishonor

Editor’s Note

2008 Act No. 204 Section 1 provides in part as follows:

“The South Carolina Reporters’ Comments contained in Chapters 3 and 4 of Title 36, may not be reproduced in whole or in part in any form or for inclusions in any material which is offered for sale without the express written permission of the Clerk of the South Carolina Senate.”

2008 Act No. 204, Section 4.A provides as follows:

“This act applies to a transaction occurring on or after the effective date [July 1, 2008] of this act. This act does not apply to a transaction or event, or obligation or duty arising out of or associated with a transaction or event, before the effective date of this act.”

2008 Act No. 204 Section 4.B provides as follows:

“A transaction occurring before the effective date [July 1, 2008] of this act and the rights, obligations, and interests flowing from that transaction are governed by any statute or other law amended or repealed by this act as if repeal or amendment had not occurred and may be terminated, completed, consummated, or enforced under that statute or other law.”

**SECTION 36‑3‑501.** Presentment.

(a) “Presentment” means a demand made by or on behalf of a person entitled to enforce an instrument (i) to pay the instrument made to the drawee or a party obliged to pay the instrument or, in the case of a note or accepted draft payable at a bank, to the bank, or (ii) to accept a draft made to the drawee.

(b) The following rules are subject to Chapter 4, agreement of the parties, and clearing‑house rules and the like:

(1) Presentment may be made at the place of payment of the instrument and must be made at the place of payment if the instrument is payable at a bank in the United States; may be made by any commercially reasonable means, including an oral, written, or electronic communication; is effective when the demand for payment or acceptance is received by the person to whom presentment is made; and is effective if made to any one of two or more makers, acceptors, drawees, or other payors.

(2) Upon demand of the person to whom presentment is made, the person making presentment must (i) exhibit the instrument, (ii) give reasonable identification and, if presentment is made on behalf of another person, reasonable evidence of authority to do so, and (iii) sign a receipt on the instrument for any payment made or surrender the instrument if full payment is made.

(3) Without dishonoring the instrument, the party to whom presentment is made may (i) return the instrument for lack of a necessary indorsement, or (ii) refuse payment or acceptance for failure of the presentment to comply with the terms of the instrument, an agreement of the parties, or other applicable law or rule.

(4) The party to whom presentment is made may treat presentment as occurring on the next business day after the day of presentment if the party to whom presentment is made has established a cutoff hour not earlier than 2 p.m. for the receipt and processing of instruments presented for payment or acceptance and presentment is made after the cutoff hour.

HISTORY: 1962 Code Section 10.3‑501; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

Subsection (a) defines presentment. Subsection (b)(1) states the place and manner of presentment. Electronic presentment is authorized. The communication of the demand for payment or acceptance is effective when received. Subsection (b)(2) restates former Section 3‑505. Subsection (b)(2)(i) allows the person to whom presentment is made to require exhibition of the instrument, unless the parties have agreed otherwise as in an electronic presentment agreement. Former Section 3‑507(3) is the antecedent of subsection (b)(3)(i). Since a payor must decide whether to pay or accept on the day of presentment, subsection (b)(4) allows the payor to set a cutoff hour for receipt of instruments presented.

SOUTH CAROLINA REPORTER’S COMMENT

Subsection (a) defining presentment is based upon former Section 36‑3‑504(1). Subsection (b)(1) providing the rules governing the place and manner of presentment is a revision of former Section 36‑3‑504(2) and (3). The rules in Subsection (b), however, are subject to Chapter 4. As a result, the requirement that an instrument payable at a bank in the United States must be made at the place of payment is subject to Section 36‑4‑204(c) that permits a payor bank to specify a place of presentment. Subsection (b)(1) expressly validates electronic presentment.

Subsection (b)(2) addresses the rights of a person to whom presentment is made and is a restatement of former Section 36‑3‑505(1). The rules set forth in Subsection (b), however, are subject to agreements of the parties. As a result, the requirement that upon demand a party presenting an instrument must exhibit the instrument does not apply in cases in which the parties have agreed to electronic presentment.

Subsection (b)(3)(i), permitting a person to whom presentment is made to return the instrument for lack of a necessary indorsement without dishonoring the instrument, is based upon former Section 36‑3‑507(3). Subsection (b)(3)(ii) permits a person to whom an instrument has been presented for payment or acceptance to refuse payment or acceptance for failure of the presentment to comply with applicable requirements without dishonoring the instrument, and is based upon former Section 36‑3‑505(2).

Subsection (b)(4) allows a person to whom presentment is made after an established cutoff hour not earlier than 2:00 p.m. to treat the presentment as occurring on the next business day.

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| Definitional Cross References: |  |
| “Acceptance” | Section 36‑3‑409(a) |
| “Acceptor” | Section 36‑3‑103(a)(1) |
| “Agreement” | Section 36‑1‑201(3) |
| “Bank” | Section 36‑1‑201(4) |
| “Clearing House” | Section 36‑4‑104(a)(4) |
| “Draft” | Section 36‑3‑104(e) |
| “Drawee” | Section 36‑3‑103(a)(4) |
| “Drawer” | Section 36‑3‑103(a)(5) |
| “Indorsement” | Section 36‑3‑204(a) |
| “Instrument” | Section 36‑3‑104(b) |
| “Maker” | Section 36‑3‑103(a)(7) |
| “Note” | Section 36‑3‑104(e) |
| “Party” | Section 36‑3‑103(a)(10) |
| “Payment” | Section 36‑3‑602(a) |
| “Person” | Section 36‑1‑201(30) |
| “Person Entitled to Enforce” | Section 36‑3‑301 |

Cross References

1. The obligation of a drawer of a check is to pay the check if it is dishonored. Section 36‑3‑414(b). A check is dishonored if it is not paid upon presentment. Section 36‑3‑502(b). Therefore, proper presentment of a check is a prerequisite to the drawer’s liability.

2. The obligation of an indorser of an instrument is to pay the amount due on the instrument if it is dishonored. Section 36‑3‑415(a). Presentment is necessary to establish dishonor. Section 36‑3‑502. Therefore, proper presentment is a prerequisite to the indorser’s liability. An indorser’s liability is further conditioned upon notice of dishonor. Section 36‑3‑503.

3. Providing a place for presentment of an item by agreement. Section 36‑4‑204(c).

4. Agreements for electronic presentation. Section 36‑4‑110.

5. A bank right to fix a cutoff hour at 2:00 p.m. or later for handling items. Section 36‑4‑108.

LIBRARY REFERENCES

Bills and Notes 385, 388.1, 389, 394, 422(1).

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 97 to 98, 202, 204, 212 to 215, 219 to 228, 230, 257.

RESEARCH REFERENCES

Forms

Am. Jur. Pl. & Pr. Forms Uniform Commercial Code Section 3:272 , Introductory Comments.

NOTES OF DECISIONS

In general 1

1. In general

Failure to give notice of dishonor of a check discharges the drawer only to the extent he is deprived of funds maintained with the drawee bank to cover the check because the drawee bank became insolvent during the delay. First American Bank of Virginia v. Litchfield Co. of South Carolina, Inc. (S.C.App. 1987) 291 S.C. 240, 353 S.E.2d 143. Bills And Notes 398

**SECTION 36‑3‑502.** Dishonor.

(a) Dishonor of a note is governed by the following rules:

(1) If the note is payable on demand, the note is dishonored if presentment is duly made to the maker and the note is not paid on the day of presentment.

(2) If the note is not payable on demand and is payable at or through a bank or the terms of the note require presentment, the note is dishonored if presentment is duly made and the note is not paid on the day it becomes payable or the day of presentment, whichever is later.

(3) If the note is not payable on demand and Paragraph (2) does not apply, the note is dishonored if it is not paid on the day it becomes payable.

(b) Dishonor of an unaccepted draft other than a documentary draft is governed by the following rules:

(1) If a check is duly presented for payment to the payor bank otherwise than for immediate payment over the counter, the check is dishonored if the payor bank makes timely return of the check or sends timely notice of dishonor or nonpayment under Section 36‑4‑301 or 36‑4‑302, or becomes accountable for the amount of the check under Section 36‑4‑302.

(2) If a draft is payable on demand and Paragraph (1) does not apply, the draft is dishonored if presentment for payment is duly made to the drawee and the draft is not paid on the day of presentment.

(3) If a draft is payable on a date stated in the draft, the draft is dishonored if (i) presentment for payment is duly made to the drawee and payment is not made on the day the draft becomes payable or the day of presentment, whichever is later, or (ii) presentment for acceptance is duly made before the day the draft becomes payable and the draft is not accepted on the day of presentment.

(4) If a draft is payable on elapse of a period of time after sight or acceptance, the draft is dishonored if presentment for acceptance is duly made and the draft is not accepted on the day of presentment.

(c) Dishonor of an unaccepted documentary draft occurs according to the rules stated in Subsection (b)(2), (3), and (4), except that payment or acceptance may be delayed without dishonor until no later than the close of the third business day of the drawee following the day on which payment or acceptance is required by those paragraphs.

(d) Dishonor of an accepted draft is governed by the following rules:

(1) If the draft is payable on demand, the draft is dishonored if presentment for payment is duly made to the acceptor and the draft is not paid on the day of presentment.

(2) If the draft is not payable on demand, the draft is dishonored if presentment for payment is duly made to the acceptor and payment is not made on the day it becomes payable or the day of presentment, whichever is later.

(e) In any case in which presentment is otherwise required for dishonor under this section and presentment is excused under Section 36‑3‑504, dishonor occurs without presentment if the instrument is not duly accepted or paid.

(f) If a draft is dishonored because timely acceptance of the draft was not made and the person entitled to demand acceptance consents to a late acceptance, from the time of acceptance the draft is treated as never having been dishonored.

HISTORY: 1962 Code Section 10.3‑502; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. Section 3‑415 provides that an indorser is obliged to pay an instrument if the instrument is dishonored and is discharged if the indorser is entitled to notice of dishonor and notice is not given. Under Section 3‑414, the drawer is obliged to pay an unaccepted draft if it is dishonored. The drawer, however, is not entitled to notice of dishonor except to the extent required in a case governed by Section 3‑414(d). Part 5 tells when an instrument is dishonored (Section 3‑502) and what it means to give notice of dishonor (Section 3‑503). Often dishonor does not occur until presentment (Section 3‑501), and frequently presentment and notice of dishonor are excused (Section 3‑504).

2. In the great majority of cases presentment and notice of dishonor are waived with respect to notes. In most cases a formal demand for payment to the maker of the note is not contemplated. Rather, the maker is expected to send payment to the holder of the note on the date or dates on which payment is due. If payment is not made when due, the holder usually makes a demand for payment, but in the normal case in which presentment is waived, demand is irrelevant and the holder can proceed against indorsers when payment is not received. Under former Article 3, in the small minority of cases in which presentment and dishonor were not waived with respect to notes, the indorser was discharged from liability (former Section 3‑502(1)(a)) unless the holder made presentment to the maker on the exact day the note was due (former Section 3‑503(1)(c)) and gave notice of dishonor to the indorser before midnight of the third business day after dishonor (former Section 3‑508(2)). These provisions are omitted from Revised Article 3 as inconsistent with practice which seldom involves face‑to‑face dealings.

3. Subsection (a) applies to notes. Subsection (a)(1) applies to notes payable on demand. Dishonor requires presentment, and dishonor occurs if payment is not made on the day of presentment. There is no change from previous Article 3. Subsection (a)(2) applies to notes payable at a definite time if the note is payable at or through a bank or, by its terms, presentment is required. Dishonor requires presentment, and dishonor occurs if payment is not made on the due date or the day of presentment if presentment is made after the due date. Subsection (a)(3) applies to all other notes. If the note is not paid on its due date it is dishonored. This allows holders to collect notes in ways that make sense commercially without having to be concerned about a formal presentment on a given day.

4. Subsection (b) applies to unaccepted drafts other than documentary drafts. Subsection (b)(1) applies to checks. Except for checks presented for immediate payment over the counter, which are covered by subsection (b)(2), dishonor occurs according to rules stated in Article 4. Those rules contemplate four separate situations that warrant discussion. The first two situations arise in the normal course of affairs, in which the drawee bank makes settlement for the amount of the check to the presenting bank. In the first situation, the drawee bank under Section 4‑301 recovers this settlement if it returns the check by its midnight deadline (Section 4‑104). In that case the check is not paid and dishonor occurs under Section 3‑502(b)(1). The second situation arises if the drawee bank has made such a settlement and does not return the check or give notice of dishonor or nonpayment within the midnight deadline. In that case, the settlement becomes final payment of the check under Section 4‑215. Because the drawee bank already has paid such an item, it cannot be “accountable” for the item under the terms of Section 4‑302(a)(1). Thus, no dishonor occurs regardless of whether the drawee bank retains the check indefinitely or for some reason returns the check after its midnight deadline.

The third and fourth situations arise less commonly, in cases in which the drawee bank does not settle for the check when it is received. Under Section 4‑302 if the drawee bank is not also the depositary bank and retains the check without settling for it beyond midnight of the day it is presented for payment, the bank at that point becomes “accountable” for the amount of the check, i.e., it is obliged to pay the amount of the check. If the drawee bank is also the depositary bank, the bank becomes accountable for the amount of the check if the bank does not pay the check or return it or send notice of dishonor by its midnight deadline. Hence, if the drawee bank is also the depositary bank and does not either settle for the check when it is received (a settlement that would ripen into final payment if the drawee bank failed to take action to recover the settlement by its midnight deadline) or return the check or an appropriate notice by its midnight deadline, the drawee bank will become accountable for the amount of the check under Section 4‑302. Thus, in all cases in which the drawee bank becomes accountable under Section 4‑302, the check has not been paid (either by a settlement that became unrecoverable or otherwise) and thus, under Section 3‑502(b)(1), the check is dishonored.

The fact that a bank that is accountable for the amount of the check under Section 4‑302 is obliged to pay the check does not mean that the check has been paid. Indeed, because each of the paragraphs of Section 4‑302(b) is limited by its terms to situations in which a bank has not paid the item, a drawee bank will be accountable under Section 4‑302 only in situations in which it has not previously paid the check. Section 3‑502(b)(1) reflects the view that a person presenting a check is entitled to payment, not just the ability to hold the drawee accountable under Section 4‑302. If that payment is not made in a timely manner, the check is dishonored.

Regulation CC Section 229.36(d) provides that settlement between banks for the forward collection of checks is final. The relationship of that section to Articles 3 and 4 is discussed in the Commentary to that section. Amendments approved by the Permanent Editorial Board for Uniform Commercial Code November 2, 2002.

Subsection (b)(2) applies to demand drafts other than those governed by subsection (b)(1). It covers checks presented for immediate payment over the counter and demand drafts other than checks. Dishonor occurs if presentment for payment is made and payment is not made on the day of presentment.

Subsection (b)(3) and (4) applies to time drafts. An unaccepted time draft differs from a time note. The maker of a note knows that the note has been issued, but the drawee of a draft may not know that a draft has been drawn on it. Thus, with respect to drafts, presentment for payment or acceptance is required. Subsection (b)(3) applies to drafts payable on a date stated in the draft. Dishonor occurs if presentment for payment is made and payment is not made on the day the draft becomes payable or the day of presentment if presentment is made after the due date. The holder of an unaccepted draft payable on a stated date has the option of presenting the draft for acceptance before the day the draft becomes payable to establish whether the drawee is willing to assume liability by accepting. Under subsection (b)(3)(ii) dishonor occurs when the draft is presented and not accepted. Subsection (b)(4) applies to unaccepted drafts payable on elapse of a period of time after sight or acceptance. If the draft is payable 30 days after sight, the draft must be presented for acceptance to start the running of the 30‑day period. Dishonor occurs if it is not accepted. The rules in subsection (b)(3) and (4) follow former Section 3‑501(1)(a).

5. Subsection (c) gives drawees an extended period to pay documentary drafts because of the time that may be needed to examine the documents. The period prescribed is that given by Section 5‑112 in cases in which a letter of credit is involved.

6. Subsection (d) governs accepted drafts. If the acceptor’s obligation is to pay on demand the rule, stated in subsection (d)(1), is the same as for that of a demand note stated in subsection (a)(1). If the acceptor’s obligation is to pay at a definite time the rule, stated in subsection (d)(2), is the same as that of a time note payable at a bank stated in subsection (b)(2).

7. Subsection (e) is a limitation on subsection (a)(1) and (2), subsection (b), subsection (c), and subsection (d). Each of those provisions states dishonor as occurring after presentment. If presentment is excused under Section 3‑504, dishonor occurs under those provisions without presentment if the instrument is not duly accepted or paid.

8. Under subsection (b)(3)(ii) and (4) if a draft is presented for acceptance and the draft is not accepted on the day of presentment, there is dishonor. But after dishonor, the holder may consent to late acceptance. In that case, under subsection (f), the late acceptance cures the dishonor. The draft is treated as never having been dishonored. If the draft is subsequently presented for payment and payment is refused dishonor occurs at that time.

SOUTH CAROLINA REPORTER’S COMMENT

Subsection (a)(1) governs the dishonor of a note payable on demand and is consistent with former Section 36‑3‑507(1). Subsection (a)(2) governs the dishonor of a note that is not payable on demand and is payable at or through a bank. Subsection (a)(3) governs the dishonor of other notes not payable on demand.

Subsection (b) applies to unaccepted drafts other than documentary drafts. Subsection (b)(1) governs checks other than checks presented for immediate payment over the counter and applies the rules of Chapter 4 to determine when a check is dishonored. Subsection (b)(2) applies to checks presented for immediate payment over the counter and to other drafts payable on demand. Subsection (b)(3) and (4) governs drafts payable on a date stated in the draft and drafts payable on elapse of a period after sight or acceptance.

Subsection (c) governs the dishonor of an unaccepted documentary draft and provides payment or acceptance may be delayed without dishonor for up to three business days in order to provide adequate time to examine the documents. The period of three business days is based upon former Section 36‑5‑112(1)(a). A bank presented with a documentary draft under a letter of credit could, without dishonoring the draft, defer honor until the close of the third banking day following the bank’s receipt of the documents. Effective July 2, 2001, Chapter 5 governing letters of credit was revised and former Section 36‑5‑112(1)(a) was repealed. Under current law, the issuer of a letter of credit has “a reasonable time after presentation, but not beyond the end of the seventh business day of issuer after the day of its receipt of the documents” to honor the draft. Section 36‑5‑108(b)(1). A bank relying upon the seven business day period under Chapter 5 to examine documents prior to paying or accepting a documentary draft may inadvertently dishonor the draft under Section 36‑3‑502(c).

Subsection (d) governs the dishonor of accepted drafts. Subsection (e) provides that in cases in which presentment is required for dishonor but has been excused under Section 36‑3‑504, dishonor occurs without presentment if the instrument is not duly accepted or paid.

Subsection (f) provides for curing a dishonor based upon lack of timely acceptance when the holder consents to a late acceptance.

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| Definitional Cross References: |  |
| “Acceptance” | Section 36‑3‑409(a) |
| “Bank” | Section 36‑1‑201(4) |
| “Check” | Section 36‑3‑104(f) |
| “Documentary Draft” | Section 36‑4‑104(a)(6) |
| “Draft” | Section 36‑3‑104(e) |
| “Drawee” | Section 36‑3‑103(a)(4) |
| “Maker” | Section 36‑3‑103(a)(7) |
| “Note” | Section 36‑3‑104(e) |
| “Notice” | Section 36‑1‑201(25) [see now Section 36‑1‑202] |
| “Payable on Demand” | Section 36‑3‑108(a) |
| “Payment” | Section 36‑3‑602(a) |
| “Payor Bank” | Section 36‑4‑105(3) |
| “Person” | Section 36‑1‑201(30) |
| “Presentment” | Section 36‑3‑501(a) |

Cross References:

1. When a promise or order is payable on demand. Section 36‑3‑108(a) and (c).

2. Acceptance of a draft and certification of a check. Section 36‑3‑409.

3. Under Chapter 4 a check is dishonored by a payor bank when the check is returned or, if the check is unavailable for return, notice of dishonor is sent. Section 36‑4‑301(c).

4. A payor bank’s obligations for the return of checks is governed by Regulation CC. 12 C.F.R. Section 229.30.

5. A payor bank that is not also the depositary bank is accountable for a check if it retains the check beyond midnight on the banking day the check is received without making settlement. A payor bank that is also the depositary bank is accountable for a check if it fails to return the check or send notice of dishonor by the bank’s midnight deadline. Section 36‑4‑302(a)(1).

6. If a payor bank settles for a check on the banking day of receipt and returns the check after its midnight deadline, the payor bank has made final payment. Section 36‑4‑215(a)(3). As a result, the payor bank is not accountable for the check. See Official Comment 4 to Section 36‑3‑502.

7. Obligations of a payor bank that has issued a letter of credit to pay or accept a documentary draft presented under the letter of credit. Section 36‑5‑108.

8. When presentment and notice of dishonor are excused. Section 36‑3‑504.

LIBRARY REFERENCES

Bills and Notes 390, 400, 404(1) to 404(2), 416 to 418.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 202, 204, 208, 210.

**SECTION 36‑3‑503.** Notice of dishonor.

(a) The obligation of an indorser stated in Section 36‑3‑415(a) and the obligation of a drawer stated in Section 36‑3‑414(d) may not be enforced unless (i) the indorser or drawer is given notice of dishonor of the instrument complying with this section or (ii) notice of dishonor is excused under Section 36‑3‑504(b).

(b) Notice of dishonor may be given by any person; may be given by any commercially reasonable means, including an oral, written, or electronic communication; and 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.

(c) Subject to Section 36‑3‑504(c), with respect to an instrument taken for collection by a collecting bank, notice of dishonor must be given (i) by the bank before midnight of the next banking day following the banking day on which the bank receives notice of dishonor of the instrument, or (ii) by any other person within 30 days following the day on which the person receives notice of dishonor. With respect to any other instrument, notice of dishonor must be given within 30 days following the day on which dishonor occurs.

HISTORY: 1962 Code Section 10.3‑503; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. Subsection (a) is consistent with former Section 3‑501(2)(a), but notice of dishonor is no longer relevant to the liability of a drawer except for the case of a draft accepted by an acceptor other than a bank. Comments 2 and 4 to Section 3‑414. There is no reason why drawers should be discharged on instruments they draw until payment or acceptance. They are entitled to have the instrument presented to the drawee and dishonored (Section 3‑414(b)) before they are liable to pay, but no notice of dishonor need be made to them as a condition of liability. Subsection (b), which states how notice of dishonor is given, is based on former Section 3‑508(3).

2. Subsection (c) replaces former Section 3‑508(2). It differs from that section in that it provides a 30‑day period for a person other than a collecting bank to give notice of dishonor rather than the three‑day period allowed in former Article 3. Delay in giving notice of dishonor may be excused under Section 3‑504(c).

SOUTH CAROLINA REPORTER’S COMMENT

Subsection (a) provides that the obligations of an indorser and a drawer of a draft that has been accepted by an acceptor other than a bank may not be enforced unless the indorser or drawer is either given timely notice of dishonor or notice of dishonor is excused. As applied to indorsers, Subsection (a) is consistent with former Section 36‑3‑501(2)(a). Subsection (a), however, changes prior law with respect to drawers. Under former Sections 36‑3‑501(2)(b) and 36‑3‑502(1)(b), the failure to give timely notice of dishonor could preclude enforcement against the drawer if the drawee become insolvent during the delay. See First American Bank of Virginia v. Litchfield Co. of South Carolina, 291 S.C. 240, 244, 353 S.E.2d 143, 146 (S.C. App. 1987). Under current law, notice of dishonor is a condition of enforcement against the drawer only when the draft has been accepted and the acceptor is not a bank. See Section 36‑3‑414(d).

Subsection (b) provides the permissible methods for giving notice of dishonor and is based upon former Section 36‑3‑508(1) and (3).

Subsection (c) sets the time limits for giving notice of dishonor and replaces former Section 36‑3‑508(2). With respect to an instrument taken for collection by a collecting bank, Subsection (c)(i) provides that the collecting bank must give notice of dishonor before midnight on the next banking day following the banking day on which the collecting bank received notice of dishonor. As applied to collecting banks, Subsection (c) is consistent with former Section 36‑3‑508(2). In other cases, Subsection (c) changes the timing rules for notice of dishonor. Under former Section 36‑3‑508(2), persons other than a bank were required to give notice of dishonor before midnight on the third business day after the person either dishonored or received notice of dishonor of the instrument. Subsection (c) provides that with respect to an item taken for collection a person other than a collecting bank must give notice of dishonor within 30 days of receiving notice of dishonor. With respect to other instruments, Subsection (c) requires that notice of dishonor must be given within 30 days after the dishonor.

With respect to checks, Regulation CC governs banks’ obligations with respect to the return of dishonored checks. Under 12 C.F.R. Section 229.33, a payor bank that has decided not to pay a check in the amount of $2,500 or more must send a timely notice of nonpayment to the depositary bank.

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| Definitional Cross References: |  |
| “Acceptance” | Section 36‑3‑409(a) |
| “Bank” | Section 36‑1‑201(4) |
| “Banking Day” | Section 36‑4‑104(a)(3) |
| “Collecting Bank” | Section 36‑4‑105(5) |
| “Drawer” | Section 36‑3‑103(a)(5) |
| “Indorser” | Section 36‑3‑204(b) |
| “Instrument” | Section 36‑3‑104(b) |
| “Notice” | Section 36‑1‑201(25) [see now Section 36‑1‑202] |
| “Person” | Section 36‑1‑201(30) |
| “Written” | Section 36‑1‑201(45) |

Cross References:

1. An indorser’s obligation to pay the amount of an instrument when the instrument is dishonored. Section 36‑3‑415.

2. A drawer’s obligation to pay a draft that has been accepted by an acceptor other than a bank when the draft is dishonored by the acceptor. Section 36‑3‑414(a).

3. The presentment of instruments. Section 36‑3‑501.

4. The dishonor of instruments. Section 36‑3‑502.

5. Excuse of notice of dishonor. Section 36‑3‑504.

LIBRARY REFERENCES

Bills and Notes 390, 391, 394, 400, 404(1) to 407.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 97 to 98, 202, 204 to 209, 212, 257.

NOTES OF DECISIONS

In general 1

1. In general

Failure to give notice of dishonor of a check discharges the drawer only to the extent he is deprived of funds maintained with the drawee bank to cover the check because the drawee bank became insolvent during the delay. First American Bank of Virginia v. Litchfield Co. of South Carolina, Inc. (S.C.App. 1987) 291 S.C. 240, 353 S.E.2d 143. Bills And Notes 398

**SECTION 36‑3‑504.** Excused presentment and notice of dishonor.

(a) Presentment for payment or acceptance of an instrument is excused if (i) the person entitled to present the instrument cannot with reasonable diligence make presentment, (ii) the maker or acceptor has repudiated an obligation to pay the instrument or is dead or in insolvency proceedings, (iii) by the terms of the instrument presentment is not necessary to enforce the obligation of indorsers or the drawer, (iv) the drawer or indorser whose obligation is being enforced has waived presentment or otherwise has no reason to expect or right to require that the instrument be paid or accepted, or (v) the drawer instructed the drawee not to pay or accept the draft or the drawee was not obligated to the drawer to pay the draft.

(b) Notice of dishonor is excused if (i) by the terms of the instrument notice of dishonor is not necessary to enforce the obligation of a party to pay the instrument, or (ii) the party whose obligation is being enforced waived notice of dishonor. A waiver of presentment is also a waiver of notice of dishonor.

(c) Delay in giving notice of dishonor is excused if the delay was caused by circumstances beyond the control of the person giving the notice and the person giving the notice exercised reasonable diligence after the cause of the delay ceased to operate.

HISTORY: 1962 Code Section 10.3‑504; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

Section 3‑504 is largely a restatement of former Section 3‑511. Subsection (4) of former Section 3‑511 is replaced by Section 3‑502(f).

SOUTH CAROLINA REPORTER’S COMMENT

The provision in large part restates the rules of former Section 36‑3‑511 on the excuse of presentment and notice of dishonor as conditions upon the enforcement of an instrument. Subsection (a) addresses the excuse of presentment and Subsections (b) and (c) address notice of dishonor.

Subsection (a)(iv) provides that presentment is excused if drawer or indorser whose obligation is being enforced “has no reason to expect or right to require the instrument be paid or accepted.” The identical language appeared in former Section 36‑3‑511(2)(b) and was applied by the court in Federal Deposit Ins. Corp. v. Kirkland, 272 S.C. 310, 251 S.E.2d 750 (1979). In Kirkland, an indorser sued on a note asserted that his obligation was discharged because the bank enforcing the note failed to make presentment of the note and to give the indorser notice of default. The Court held that presentment and notice of default were excused under former Section 36‑3‑511(2)(b) because the indorser knew that the note had not been paid and that the maker would not pay the note. The Court reasoned that the indorser had full knowledge of the information that a notice of dishonor would have provided.

Subsection (a)(v) excuses presentment if the “drawer instructed the drawee not to pay or accept the draft”. To the same effect, former Section 36‑3‑511(2)(b) excused presentment and notice of dishonor when a party “has countermanded payment.” In First American Bank of Virginia v. Litchfield Co. of South Carolina, 291 S.C. 240, 244, 353 S.E.2d 143, 146 (S.C. App. 1987), the court applied the former statute in holding that when a drawer that orders a payor bank to stop payment on a check, the drawer is not entitled to notice of dishonor. See Section 36‑3‑414. Presentment, however, remains a condition. Subsection (a)(v) and the decision in First American Bank would excuse presentment when a drawer orders payment stopped on a check.

Subsection (b) provides that notice of dishonor is excused if the terms of the instrument provide that notice of dishonor is not necessary to enforce the obligation of a party or the person whose obligation is being enforced waives notice of dishonor. Subsection (b) is based upon former Section 36‑3‑511(2)(a) and (6).

Subsection (c) addresses when delay in giving notice of dishonor is excused and restates the rules in former Section 36‑3‑511(1).

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| Definitional Cross References: |  |
| “Acceptance” | Section 36‑3‑409(a) |
| “Acceptor” | Section 36‑3‑103(a)(1) |
| “Draft” | Section 36‑3‑104(e) |
| “Drawee” | Section 36‑3‑103(a)(4) |
| “Drawer” | Section 36‑3‑103(a)(5) |
| “Indorser” | Section 36‑3‑204(b) |
| “Instrument” | Section 36‑3‑104(b) |
| “Maker” | Section 36‑3‑103(a)(7) |
| “Notice” | Section 36‑1‑201(25) [see now Section 36‑1‑202] |
| “Party” | Section 36‑3‑103(a)(10) |
| “Payment” | Section 36‑3‑602(a) |
| “Person” | Section 36‑1‑201(30) |
| “Presentment” | Section 36‑3‑501(a) |

Cross References:

1. The obligation of the maker of a note or drawer of a cashier’s check. Section 36‑3‑412.

2. The obligation of the acceptor of a draft. Section 36‑3‑413.

3. The obligation of the drawer of a draft. Section 36‑3‑414.

4. The obligation of an indorser. Section 36‑3‑415.

5. Presentment of instruments. Section 36‑3‑501.

6. Rules governing the dishonor of instruments. Section 36‑3‑502.

7. Notice of dishonor. Section 36‑3‑503.

LIBRARY REFERENCES

Bills and Notes 388.1 to 391, 401 to 405.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 202, 204 to 209.

NOTES OF DECISIONS

In general 1

1. In general

Since notice of dishonor is excused when the party to be charged has himself countermanded payment, so, where the drawer of a check ordered payment stopped, it was not entitled to notice of dishonor. First American Bank of Virginia v. Litchfield Co. of South Carolina, Inc. (S.C.App. 1987) 291 S.C. 240, 353 S.E.2d 143.

Contention by drawer of a check that Section 36‑3‑511(2)(b) should apply only to notes, cashier’s checks, or other instruments that would be presented directly to the maker, was rejected. First American Bank of Virginia v. Litchfield Co. of South Carolina, Inc. (S.C.App. 1987) 291 S.C. 240, 353 S.E.2d 143.

Section 36‑3‑511(2)(b) refers to notice of dishonor of an “instrument,” which means a negotiable instrument, and a check is unquestionably a negotiable instrument. First American Bank of Virginia v. Litchfield Co. of South Carolina, Inc. (S.C.App. 1987) 291 S.C. 240, 353 S.E.2d 143. Bills And Notes 394

The maker of an outstanding negotiable instrument is presumed to know the instrument is subject to transfer to a holder in due course. First American Bank of Virginia v. Litchfield Co. of South Carolina, Inc. (S.C.App. 1987) 291 S.C. 240, 353 S.E.2d 143. Evidence 65

The drawer of a check is often without actual knowledge that his check has been negotiated, but that ignorance in no way diminishes the rights of a holder in due course. First American Bank of Virginia v. Litchfield Co. of South Carolina, Inc. (S.C.App. 1987) 291 S.C. 240, 353 S.E.2d 143. Bills And Notes 363

Whether a signature on a note providing that “makers, endorsers and guarantors waived demand, presentment, protest, notice of nonpayment, and all defenses on the ground of extension of time for payment” was in an accommodation maker or accommodation endorser capacity was of no legal consequence, as the liability of an endorser is secondary only with respect to these rights which were waived. Bankers Trust of South Carolina v. Culbertson (S.C. 1977) 268 S.C. 564, 235 S.E.2d 130.

Signature in the lower right hand corner of a note, instead of on the back where spaces were specifically provided for endorsers, shows that signer was a maker and not an accommodation endorser. Bankers Trust of South Carolina v. Culbertson (S.C. 1977) 268 S.C. 564, 235 S.E.2d 130.

**SECTION 36‑3‑505.** Evidence of dishonor.

(a) The following are admissible as evidence and create a presumption of dishonor and of any notice of dishonor stated:

(1) a document regular in form as provided in Subsection (b) which purports to be a protest;

(2) a purported stamp or writing of the drawee, payor bank, or presenting bank on or accompanying the instrument stating that acceptance or payment has been refused unless reasons for the refusal are stated and the reasons are not consistent with dishonor;

(3) a book or record of the drawee, payor bank, or collecting bank, kept in the usual course of business which shows dishonor, even if there is no evidence of who made the entry.

(b) A protest is a certificate of dishonor made by a United States consul or vice consul, or a notary public or other person authorized to administer oaths by the law of the place where dishonor occurs. It may be made upon information satisfactory to that person. The protest must identify the instrument and certify either that presentment has been made or, if not made, the reason why it was not made, and that the instrument has been dishonored by nonacceptance or nonpayment. The protest may also certify that notice of dishonor has been given to some or all parties.

HISTORY: 1962 Code Section 10.3‑505; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

Protest is no longer mandatory and must be requested by the holder. Even if requested, protest is not a condition to the liability of indorsers or drawers. Protest is a service provided by the banking system to establish that dishonor has occurred. Like other services provided by the banking system, it will be available if market incentives, inter‑bank agreements, or governmental regulations require it, but liabilities of parties no longer rest on it. Protest may be a requirement for liability on international drafts governed by foreign law which this Article cannot affect.

SOUTH CAROLINA REPORTER’S COMMENT

Subsection (a) is a restatement of former Section 36‑3‑510. Subsection (b) provides the requirement of a protest and is based upon former Section 36‑3‑509. Under former Section 36‑3‑501(3), protest of dishonor was necessary to charge the drawer and indorsers of a draft which on its face appeared to be drawn or payable outside the United States. Protest is not a condition for liability under the current statute.

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| Definitional Cross References: |  |
| “Acceptance” | Section 36‑3‑409(a) |
| “Bank” | Section 36‑1‑201(4) |
| “Collecting Bank” | Section 36‑4‑105(5) |
| “Drawee” | Section 36‑3‑103(a)(4) |
| “Instrument” | Section 36‑3‑104(b) |
| “Notice” | Section 36‑1‑201(25) [see now Section 36‑1‑202] |
| “Party” | Section 36‑3‑103(a)(10) |
| “Payment” | Section 36‑3‑602(a) |
| “Payor Bank” | Section 36‑4‑105(3) |
| “Person” | Section 36‑1‑201(30) |
| “Presenting Bank” | Section 36‑4‑105(6) |
| “Presentment” | Section 36‑3‑501(a) |
| “Writing” | Section 36‑1‑201(46) |

Cross References:

None

LIBRARY REFERENCES

Bills and Notes 388.1, 391, 399.1 to 407, 408.1.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 202, 204 to 209, 211.

**SECTIONS 36‑3‑506 to 36‑3‑511.** Omitted by 2008 Act No. 204, Section 2, eff July 1, 2008.

Editor’s Note

Former Section 36‑3‑506 was entitled “Time allowed for acceptance or payment” and was derived from 1962 Code Section 10.3‑506; 1966 (54) 2716.

Former Section 36‑3‑507 was entitled “Dishonor; holder’s right of recourse; term allowing representment” and was derived from 1962 Code Section 10.3‑507; 1966 (54) 2716.

Former Section 36‑3‑508 was entitled “Notice of dishonor” and was derived from 1962 Code Section 10.3‑508; 1966 (54) 2716.

Former Section 36‑3‑509 was entitled “Protest; noting for protest” and was derived from 1962 Code Section 10.3‑509; 1966 (54) 2716.

Former Section 36‑3‑510 was entitled “Evidence of dishonor and notice of dishonor” and was derived from 1962 Code Section 10.3‑510; 1966 (54) 2716.

Former Section 36‑3‑511 was entitled “Waived or excused presentment, protest or notice of dishonor or delay therein” and was derived from 1962 Code Section 10.3‑511; 1966 (54) 2716.

Part 6

Discharge and Payment

Editor’s Note

2008 Act No. 204 Section 1 provides in part as follows:

“The South Carolina Reporters’ Comments contained in Chapters 3 and 4 of Title 36, may not be reproduced in whole or in part in any form or for inclusions in any material which is offered for sale without the express written permission of the Clerk of the South Carolina Senate.”

2008 Act No. 204, Section 4.A provides as follows:

“This act applies to a transaction occurring on or after the effective date [July 1, 2008] of this act. This act does not apply to a transaction or event, or obligation or duty arising out of or associated with a transaction or event, before the effective date of this act.”

2008 Act No. 204 Section 4.B provides as follows:

“A transaction occurring before the effective date [july 1, 2008] of this act and the rights, obligations, and interests flowing from that transaction are governed by any statute or other law amended or repealed by this act as if repeal or amendment had not occurred and may be terminated, completed, consummated, or enforced under that statute or other law.”

**SECTION 36‑3‑601.** Discharge and effect of discharge.

(a) The obligation of a party to pay the instrument is discharged as stated in this chapter or by an act or agreement with the party which would discharge an obligation to pay money under a simple contract.

(b) Discharge of the obligation of a party is not effective against a person acquiring rights of a holder in due course of the instrument without notice of the discharge.

HISTORY: 1962 Code Section 10.3‑601; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

Subsection (a) replaces subsections (1) and (2) of former Section 3‑601. Subsection (b) restates former Section 3‑602. Notice of discharge is not treated as notice of a defense that prevents holder in due course status. Section 3‑302(b). Discharge is effective against a holder in due course only if the holder had notice of the discharge when holder in due course status was acquired. For example, if an instrument bearing a canceled indorsement is taken by a holder, the holder has notice that the indorser has been discharged. Thus, the discharge is effective against the holder even if the holder is a holder in due course.

SOUTH CAROLINA REPORTER’S COMMENT

Subsection (a) replaces former Section 36‑3‑601(1) and (2). Former Section 36‑3‑601(1) listed the sections of former Chapter 3 governing the discharge of parties from liability on an instrument. Subsection (a) simply provides that the obligation of a party to pay an instrument is discharged as stated in Chapter 3. Former Section 36‑3‑601(2) provided that a party is discharged from liability on an instrument by any act or agreement that would discharge the party’s obligation under a simple contract to pay money. Subsection (a) restates this basis for discharge. Subsection (b) restates former Section 36‑3‑602 and provides that the discharge of the obligation of a party to an instrument is not effective against a holder in due course of the instrument without notice of the discharge.

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| Definitional Cross References: |  |
| “Agreement” | Section 36‑1‑201(3) |
| “Contract” | Section 36‑1‑201(11) |
| “Holder in Due Course” | Section 36‑3‑302(a) |
| “Instrument” | Section 36‑3‑104(b) |
| “Money” | Section 36‑1‑201(24) |
| “Notice” | Section 36‑1‑201(25) [see now Section 36‑1‑202] |
| “Party” | Section 36‑3‑103(a)(10) |
| “Person” | Section 36‑1‑201(30) |

Cross References:

1. Discharge of a party’s obligation to pay an instrument by payment to a person entitled to enforce the instrument. Section 36‑3‑602.

2. Discharge of a party’s obligation to pay an instrument by tender of payment to a person entitled to enforce the instrument. Section 36‑3‑603.

3. Discharge of a party’s obligation to pay an instrument by surrender, destruction, mutilation, or cancellation of the instrument, striking of the party’s signature, or by renouncing rights to the instrument in a signed record. Section 36‑3‑604.

4. Discharge of an indorser’s obligation when a former holder reacquires the instrument and cancels the indorsement. Section 36‑3‑207.

5. Discharge of a party’s obligation to pay an instrument when that obligation is affected by a fraudulent alteration. Section 36‑3‑407.

6. Discharge of a drawer’s obligation on a draft when the draft is accepted by a bank. Section 36‑3‑414(c).

7. Discharge of a drawer’s obligation on a check resulting from a failure to present the check for payment or give it to a depositary bank for collection within 30 days of the date of check and when the drawee suspends payments after the expiration of the 30‑day period. Section 36‑3‑414(f).

8. Discharge of indorser’s obligation to pay an instrument resulting from a failure to give notice of dishonor. Section 36‑3‑415(c).

9. Discharge of indorser’s obligation to pay a check resulting from a failure to present the check or give the check to a depositary bank for collection within 30 days after the indorsement. Section 36‑3‑415(e).

10. Discharge of secondary obligors resulting from release of the obligation of a principal obligor, granting the principle obligor an extension of time to make payment, modification of the obligation of the principle obligor, or impairment of collateral. Section 36‑3‑605.

LIBRARY REFERENCES

Bills and Notes 256, 425, 437 to 440.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 231 to 232, 240 to 249.

RESEARCH REFERENCES

Forms

Am. Jur. Pl. & Pr. Forms Uniform Commercial Code Section 3:329 , Introductory Comments.

NOTES OF DECISIONS

In general 1

1. In general

Under South Carolina law, agreement entered by individual partners in relation to bank’s issuance of letter of credit to partnership was guaranty agreement, not individual undertaking of primary liability on letter of credit by individual partners, notwithstanding language in agreement that it was guaranty of payment and not of collection and that liability undertaken would be primary and not secondary obligation and liability; thus, payment of outstanding balance by single partner, after default, did not free other partners from liability, and that partner could foreclose on collateral pledged by nonpaying partner. Williams v. Sandman (C.A.4 (S.C.) 1999) 187 F.3d 379. Guaranty 4

Under South Carolina law, neither letter of credit payment and security agreement, nor letter of credit, nor partners’ collateral assignments of partnership interests were negotiable instruments, for purpose of statute freeing all parties from liability when one of the makers of an instrument pays the instrument and takes an assignment thereof. Williams v. Sandman (C.A.4 (S.C.) 1999) 187 F.3d 379. Bills And Notes 151

Payment of a note by a maker, or an appointed receiver of the maker, operates to extinguish the note, discharging the liability of any co‑makers on the note. Jeffcoat v. Morris (S.C.App. 1989) 300 S.C. 526, 389 S.E.2d 159. Bills And Notes 440

After a trust company, which was both the drawer and drawee of a cashier’s check paid and cancelled the check, the check had no more vitality as a negotiable interest since payment discharged all parties to the check. Bankers Trust of South Carolina v. South Carolina Nat. Bank of Charleston (S.C.App. 1985) 284 S.C. 238, 325 S.E.2d 81.

**SECTION 36‑3‑602.** Payment.

(a) Subject to Subsection (e), an instrument is paid to the extent payment is made by or on behalf of a party obliged to pay the instrument, and to a person entitled to enforce the instrument.

(b) Subject to Subsection (e), a note is paid to the extent payment is 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 has not received adequate notification that the note has been transferred and that payment is to be made to the transferee. A notification is adequate only if it is signed by the transferor or the transferee; reasonably identifies the transferred note; and provides an address at which payments subsequently are to be made. Upon request, a transferee shall seasonably furnish reasonable proof that the note has been transferred. Unless the transferee complies with the request, a payment to the person that formerly was entitled to enforce the note is effective for purposes of Subsection (c) even if the party obliged to pay the note has received a notification under this paragraph.

(c) Subject to Subsection (e), to the extent of a payment under Subsections (a) and (b), the obligation of the party obliged to pay the instrument is discharged even though payment is made with knowledge of a claim to the instrument under Section 36‑3‑306 by another person.

(d) Subject to Subsection (e), a transferee, or any party that has acquired rights in the instrument directly or indirectly from a transferee, including any such party that has rights as a holder in due course, is deemed to have notice of any payment that is made under Subsection (b) after the date that the note is transferred to the transferee but before the party obliged to pay the note receives adequate notification of the transfer.

(e) The obligation of a party to pay the instrument is not discharged under Subsections (a) through (d) if:

(1) a claim to the instrument under Section 36‑3‑306 is enforceable against the party receiving payment and (i) payment is made with knowledge by the payor that payment is prohibited by injunction or similar process of a court of competent jurisdiction, or (ii) in the case of an instrument other than a cashier’s check, teller’s check, or certified check, the party making payment accepted, from the person having a claim to the instrument, indemnity against loss resulting from refusal to pay the person entitled to enforce the instrument; or

(2) the person making payment knows that the instrument is a stolen instrument and pays a person it knows is in wrongful possession of the instrument.

(f) As used in this section, “signed,” with respect to a record that is not a writing, includes 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.

HISTORY: 1962 Code Section 10.3‑602; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. This section replaces former Section 3‑603(1). The phrase “claim to the instrument” in subsection (a) means, by reference to Section 3‑306, a claim of ownership or possession and not a claim in recoupment. Subsection (e)(1)(ii) is added to conform to Section 3‑411. Section 3‑411 is intended to discourage an obligated bank from refusing payment of a cashier’s check, certified check or dishonored teller’s check at the request of a claimant to the check who provided the bank with indemnity against loss. See Comment 1 to Section 3‑411. An obligated bank that refuses payment under those circumstances not only remains liable on the check but may also be liable to the holder of the check for consequential damages. Section 3‑602(e)(1)(ii) and Section 3‑411, read together, change the rule of former Section 3‑603(1) with respect to the obligation of the obligated bank on the check. Payment to the holder of a cashier’s check, teller’s check, or certified check discharges the obligation of the obligated bank on the check to both the holder and the claimant even though indemnity has been given by the person asserting the claim. If the obligated bank pays the check in violation of an agreement with the claimant in connection with the indemnity agreement, any liability that the bank may have for violation of the agreement is not governed by Article 3, but is left to other law. This section continues the rule that the obligor is not discharged on the instrument if payment is made in violation of an injunction against payment. See Section 3‑411(c)(iv).

2. Subsection (a) covers payments made in a traditional manner, to the person entitled to enforce the instrument. Subsection (b), which provides an alternative method of payment, deals with the situation in which a person entitled to enforce the instrument transfers the instrument without giving notice to parties obligated to pay the instrument. If that happens and one of those parties subsequently makes a payment to the transferor, the payment is effective even though it is not made to the person entitled to enforce the instrument. Unlike the earlier version of Section 3‑602, this rule is consistent with Section 9‑406(a), Restatement of Mortgages Section 5.5, and Restatement of Contracts Section 338(1).

3. In determining the party to whom a payment is made for purposes of this section, courts should look to traditional rules of agency. Thus, if the original payee of a note transfers ownership of the note to a third party but continues to service the obligation, the law of agency might treat payments made to the original payee as payments made to the third party.

SOUTH CAROLINA REPORTER’S COMMENT

This section replaces former Section 36‑3‑603. Subsection (a) provides that an instrument is paid to the extent that payment is made by or on behalf of a person obligated to pay the instrument to a person entitled to enforce the instrument. Subsection (c) provides that payment under Subsection (a) discharges the obligation of the party to pay the instrument.

Subsection (b) is new and addresses situations in which a note is transferred, the party obligated on the note has not received adequate notification of the transfer, and the party obligated on the note makes payments to the transferor after the transfer. Under Subsection (b), the payments to the transferor are deemed payments on the note that discharge the obligation of the party making the payments under Subsection (c). Subsection (b) providers rules for determining whether a notification of transfer is sufficient. Subsection (d) provides that a transferee of a note, including a holder in due course, is deemed to have notice of the payments to the transferor within the scope of Subsection (b) and the discharge of the maker under Subsection (c). As a result, the maker can assert the discharge against a holder in due course under Section 36‑3‑302(b).

Subsection (c) provides two exceptions to the rule that payments made under Subsection (a) or (b) will discharge the obligation of a party to the instrument. Under Subsection (e)(1), a payment will not effect a discharge if a third party has a claim of ownership that is enforceable against the party receiving payment, and the payment is made with knowledge that a court has enjoined the payment or the party making the payment has received indemnity from the claim holder. Under Subsection (e)(2), a payment will not discharge the obligation of the party making payment if that party knows that the instrument was stolen and that the party receiving the payment is in wrongful possession.

The effect of payment by one party to a note upon the obligation of other parties to the note has generated several appellate opinions interpreting the former statute. See Williams v. Sandman, 187 F.3d 379 (4th Cir. 1999) (South Carolina law); United Carolina Bank v. Caroprop, Ltd., 311 S.C. 376, 429 S.E.2d 197 (S.C. App. 1993); Jeffcoat v. Morris, 300 S.C. 526, 389 S.E.2d 159 (S.C. App. 1989). The rules distilled from these cases are: (1) if the party paying the note is an accommodation party, that party has a right of reimbursement against the maker; (2) if the party making payment is a co‑maker of the note and not an accommodation party, the payment will discharge the obligation of all co‑makers of the note; but (3) the co‑maker who paid the note has a right to contribution from the other discharged co‑makers. The current statute confirms these results. See Sections 36‑3‑116(b) and 36‑3‑419(5).

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| Definitional Cross References: |  |
| “Cashier’s Check” | Section 36‑3‑104(g) |
| “Certified Check” | Section 36‑3‑409(d) |
| “Instrument” | Section 36‑3‑104(b) |
| “Knowledge” | Section 36‑1‑201(25) [see now Section 36‑1‑202] |
| “Party” | Section 36‑3‑103(a)(10) |
| “Person Entitled to Enforce” | Section 36‑3‑301 |
| “Teller’s Check” | Section 36‑3‑104(h) |

Cross References:

1. Obligation of a maker of a note. Section 36‑3‑412.

2. Obligation of a drawer. Section 36‑3‑414.

3. Obligation of an indorser. Section 36‑3‑415.

4. Right of a party who pays an instrument to recover contribution from other parties who had the same joint and several liability on the instrument. Section 36‑3‑116(b).

5. Right of an accommodation party to reimbursement from an accommodated party. Section 36‑3‑419(f).

LIBRARY REFERENCES

Bills and Notes 383, 440.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 198, 201, 249.

NOTES OF DECISIONS

In general 1

1. In general

Payment by party liable on a negotiable instrument to the holder of the note would discharge such party and not subject him to double liability in the event the sale to the holder was set aside. Federal Deposit Ins. Corp. v. Moore (D.C.S.C. 1978) 448 F.Supp. 493.

In action by Federal Deposit Insurance Corporation (FDIC), as owner‑holder of note purchased from bank for which FDIC was receiver, to recover on such note from defendant maker, (1) defendant under Code Section 36‑3‑306(d) could not assert FDIC’s allegedly illegal acquisition of note as defense, since only the bank in receivership or such bank’s shareholders had standing to assert such defense, and (2) if defendant satisfied note by payment to FDIC, he would not risk double liability on note in event bank’s sale of note to FDIC should be set aside, but would be discharged from liability under Code Section 36‑3‑603(1). (Applying SC law; also holding that oral agreement to extend time for paying note was unenforceable under non‑UCC statute of frauds), Federal Deposit Ins. Corp. v. Moore (D.C.S.C. 1978) 448 F.Supp. 493.

Payment of a note by a maker, or an appointed receiver of the maker, operates to extinguish the note, discharging the liability of any co‑makers on the note. Jeffcoat v. Morris (S.C.App. 1989) 300 S.C. 526, 389 S.E.2d 159. Bills And Notes 440

**SECTION 36‑3‑603.** Tender of payment.

(a) If tender of payment of an obligation to pay an instrument is made to a person entitled to enforce the instrument, the effect of tender is governed by principles of law applicable to tender of payment under a simple contract.

(b) If tender of payment of an obligation to pay an instrument is made to a person entitled to enforce the instrument and the tender is refused, there is discharge, to the extent of the amount of the tender, of the obligation of an indorser or accommodation party having a right of recourse with respect to the obligation to which the tender relates.

(c) If tender of payment of an amount due on an instrument is made to a person entitled to enforce the instrument, the obligation of the obligor to pay interest after the due date on the amount tendered is discharged. If presentment is required with respect to an instrument and the obligor is able and ready to pay on the due date at every place of payment stated in the instrument, the obligor is deemed to have made tender of payment on the due date to the person entitled to enforce the instrument.

HISTORY: 1962 Code Section 10.3‑603; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

Section 3‑603 replaces former Section 3‑604. Subsection (a) generally incorporates the law of tender of payment applicable to simple contracts. Subsections (b) and (c) state particular rules. Subsection (b) replaces former Section 3‑604(2). Under subsection (b) refusal of a tender of payment discharges any indorser or accommodation party having a right of recourse against the party making the tender. Subsection (c) replaces former Section 3‑604(1) and (3).

SOUTH CAROLINA REPORTER’S COMMENT

This provision replaces former Section 36‑3‑604 and addresses the effect of a tender of payment to a person entitled to enforce an instrument. Subsection (a) provides that the effect of tender of payment is governed by the law applicable to tender of payment under a simple contract. As a result, in contrast to payment, a tender of payment normally does not discharge a party’s liability to pay an instrument. See Fred H. Miller & Alvin C. Harell, The Law of Modern Payment Systems 236‑37 (West Group 2003). Therefore, a party’s obligation on an instrument is not discharged even if that party makes a valid tender of payment which is refused by a person entitle to enforce the instrument. Under Subsection (b), however, a tender of payment that is refused will discharge the obligations of the indorsers and accommodation parties who have a right of recourse. Moreover, under Subsection (c) an obligor’s tender of payment will discharge the obligor’s obligation to pay interest after the due date on the amount tendered.

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| Definitional Cross References: |  |
| “Accommodation party” | Section 36‑3‑419(a) |
| “Indorser” | Section 36‑3‑204(b) |
| “Instrument” | Section 36‑3‑104(b) |
| “Payment” | Section 36‑3‑602(a) |
| “Person Entitled to Enforce” | Section 36‑3‑301 |
| “Presentment” | Section 36‑3‑501(a) |

Cross References:

1. Discharge and the effect of discharge. Section 36‑3‑601.

2. Discharge by payment to a person entitled to enforce an instrument. Section 36‑3‑602(c).

3. Discharge of secondary obligors. Section 36‑3‑605.

LIBRARY REFERENCES

Bills and Notes 429, 435, 440.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 100, 232, 234 to 236, 238, 249.

**SECTION 36‑3‑604.** Discharge by cancellation or renunciation.

(a) A person entitled to enforce an instrument, with or without consideration, may discharge the obligation of a party to pay the instrument (i) by an intentional voluntary act, such as surrender of the instrument to the party, destruction, mutilation, or cancellation of the instrument, cancellation or striking out of the party’s signature, or the addition of words to the instrument indicating discharge, or (ii) by agreeing not to sue or otherwise renouncing rights against the party by a signed record.

(b) Cancellation or striking out of an indorsement pursuant to Subsection (a) does not affect the status and rights of a party derived from the indorsement.

(c) In this section, “signed,” with respect to a record that is not a writing, includes 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.

HISTORY: 1962 Code Section 10.3‑604; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

Section 3‑604 replaces former Section 3‑605.

SOUTH CAROLINA REPORTER’S COMMENT

This provision replaces former Section 36‑3‑605 and sets forth the actions of a person entitled to enforce an instrument which will discharge the obligation of a party to an instrument.

Subsection (a)(i) provides that an intentional voluntary act of a person entitled to enforce an instrument “such as surrender of an instrument to a party” will discharge that party’s obligation. This rule is consistent with Swindler v. Swindler, 355 S.C. 245, 584 S.E.2d 438 (S.C. App. 2003) in which the court held that a maker’s possession of a promissory note payable to the order of her deceased mother gave rise to a rebuttable presumption of the maker’s discharge. The presumption could have been rebutted by evidence that the maker obtained possession of the note unintentionally, under mistake, or without authority. In Swindler, however, the party challenging the discharge failed to present evidence to rebut the presumption.

Subsection (a)(i) also provides that a person entitled to enforce an instrument can discharge the obligation of a party by destruction, mutilation, or cancellation of the instrument, striking out a party’s signature, or adding words to the instrument indicating the discharge of a party. Subsection (a)(ii) provides that a person entitled to enforce an instrument can discharge the obligation of a party by agreeing not to sue or renouncing the person’s rights against the party in a signed record. If the record is in an electronic medium rather than writing, Subsection (c) defines signed as including an electronic symbol or sound intended to authenticate the record.

Subsection (b) addresses the effect of the cancellation of an indorsement. Although the cancellation discharges the obligation of the indorser, it does not affect the status of a party who took the instrument after the indorsement but prior to its cancellation.

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| Definitional Cross References: |  |
| “Consideration” | Section 36‑3‑303(b) |
| “Indorsement” | Section 36‑3‑204(a) |
| “Instrument” | Section 36‑3‑104(b) |
| “Party” | Section 36‑3‑103(a)(10) |
| “Person Entitled to Enforce” | Section 36‑3‑301 |
| “Record” | Section 36‑3‑103(a)(14) |

Cross Reference:

1. Discharge and the effect of discharge. Section 36‑3‑601.

LIBRARY REFERENCES

Bills and Notes 256, 301, 425, 429, 437, 438.

WESTLAW Topic No. 56.

C.J.S. Bills and Notes; Letters of Credit Sections 100, 231 to 232, 234 to 236, 238, 240 to 248.

**SECTION 36‑3‑605.** Discharge of secondary obligors.

(a) If a person entitled to enforce an instrument releases the obligation of a principal obligor in whole or in part, and another party to the instrument is a secondary obligor with respect to the obligation of that principal obligor, the following rules apply:

(1) Any obligations of the principal obligor to the secondary obligor with respect to any previous payment by the secondary obligor are not affected. Unless the terms of the release preserve the secondary obligor’s recourse, the principal obligor is discharged, to the extent of the release, from any other duties to the secondary obligor under this chapter.

(2) Unless the terms of the release provide that the person entitled to enforce the instrument retains the right to enforce the instrument against the secondary obligor, the secondary obligor is discharged to the same extent as the principal obligor from any unperformed portion of its obligation on the instrument. If the instrument is a check and the obligation of the secondary obligor is based on an indorsement of the check, the secondary obligor is discharged without regard to the language or circumstances of the discharge or other release.

(3) If the secondary obligor is not discharged under Paragraph (2), the secondary obligor is discharged to the extent of the value of the consideration for the release, and to the extent that the release would otherwise cause the secondary obligor a loss.

(b) If a person entitled to enforce an instrument grants a principal obligor an extension of the time at which one or more payments are due on the instrument and another party to the instrument is a secondary obligor with respect to the obligation of that principal obligor, the following rules apply:

(1) Any obligations of the principal obligor to the secondary obligor with respect to any previous payment by the secondary obligor are not affected. Unless the terms of the extension preserve the secondary obligor’s recourse, the extension correspondingly extends the time for performance of any other duties owed to the secondary obligor by the principal obligor under this chapter.

(2) The secondary obligor is discharged to the extent that the extension would otherwise cause the secondary obligor a loss.

(3) To the extent that the secondary obligor is not discharged under Paragraph (2), the secondary obligor may 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 provide that the person entitled to enforce the instrument retains the right to enforce the instrument against the secondary obligor as if the time for payment had not been extended, treat the time for performance of its obligations as having been extended correspondingly.

(c) If a person entitled to enforce an instrument agrees, 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 is a secondary obligor with respect to the obligation of that principal obligor, the following rules apply:

(1) Any obligations of the principal obligor to the secondary obligor with respect to any previous payment by the secondary obligor are not affected. The modification correspondingly modifies any other duties owed to the secondary obligor by the principal obligor under this chapter.

(2) The secondary obligor is discharged from any unperformed portion of its obligation to the extent that the modification would otherwise cause the secondary obligor a loss.

(3) To the extent that the secondary obligor is not discharged under Paragraph (2), the secondary obligor may 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.

(d) If the obligation of a principal obligor is secured by an interest in collateral, another party to the instrument is a secondary obligor with respect to that obligation, and a person entitled to enforce the instrument impairs the value of the interest in collateral, the obligation of the secondary obligor is discharged to the extent of the impairment. The value of an interest in collateral is impaired to the extent the value of the interest is reduced to an amount less than the amount of the recourse of the secondary obligor, or the reduction in value of the interest causes an increase in the amount by which the amount of the recourse exceeds the value of the interest. For purposes of this subsection, impairing the value of an interest in collateral includes 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 Chapter 9 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.

(e) A secondary obligor is not discharged under Subsection (a)(3), (b), (c), or (d) unless the person entitled to enforce the instrument knows that the person is a secondary obligor or has notice under Section 36‑3‑419(c) that the instrument was signed for accommodation.

(f) A secondary obligor is not discharged under this section if the secondary obligor consents to the event or conduct that is the basis of the discharge, or the instrument or a separate agreement of the party provides for waiver of discharge under this section specifically or by general language indicating that parties waive defenses based on suretyship or impairment of collateral. Unless the circumstances indicate otherwise, consent by the principal obligor to an act that would lead to a discharge under this section constitutes consent to that act by the secondary obligor if the secondary obligor controls the principal obligor or deals with the person entitled to enforce the instrument on behalf of the principal obligor.

(g) A release or extension preserves a secondary obligor’s recourse if the terms of the release or extension provide that:

(1) the person entitled to enforce the instrument retains the right to enforce the instrument against the secondary obligor; and

(2) the recourse of the secondary obligor continues as if the release or extension had not been granted.

(h) Except as otherwise provided in Subsection (i), a secondary obligor asserting discharge under this section has the burden of persuasion both with respect to the occurrence of the acts alleged to harm the secondary obligor and loss or prejudice caused by those acts.

(i) If the secondary obligor demonstrates prejudice caused by an impairment of its recourse, and the circumstances of the case indicate that the amount of loss is not reasonably susceptible of calculation or requires proof of facts that are not ascertainable, it is presumed that the act impairing 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 is on the person entitled to enforce the instrument.

HISTORY: 1962 Code Section 10.3‑605; 1966 (54) 2716; 2008 Act No. 204, Section 2, eff July 1, 2008.

OFFICIAL COMMENT

1. This section contains rules that are applicable when a secondary obligor (as defined in Section 3‑103(a)(17)) is a party to an instrument. These rules essentially parallel modern interpretations of the law of suretyship and guaranty that apply when a secondary obligor is not a party to an instrument. See generally Restatement of the Law, Third, Suretyship and Guaranty (1996). Of course, the rules in this section do not resolve all possible issues concerning the rights and duties of the parties. In the event that a situation is presented that is not resolved by this section (or the other related sections of this Article), the resolution may be provided by the general law of suretyship because, pursuant to Section 1‑103, that law is applicable unless displaced by provisions of this Act.

2. Like the law of suretyship and guaranty, Section 3‑605 provides secondary obligors with defenses that are not available to other parties to instruments. The general operation of Section 3‑605, and its relationship to the law of suretyship and guaranty, can be illustrated by an example. Bank agrees to lend $ 10,000 to Borrower, but only if Backer also is liable for repayment of the loan. The parties could consummate that transaction in three different ways. First, if Borrower and Backer incurred those obligations with contracts not governed by this Article (such as a note that is not an instrument for purposes of this Article), the general law of suretyship and guaranty would be applicable. Under modern nomenclature, Bank is the “obligee,” Borrower is the “principal obligor,” and Backer is the “secondary obligor.” See Restatement of Suretyship and Guaranty Section 1. Then assume that Bank and Borrower agree to a modification of their rights and obligations after the note is signed. For example, they might agree that Borrower may repay the loan at some date after the due date, or that Borrower may discharge its repayment obligation by paying Bank $3,000 rather than $10,000. Alternatively, suppose that Bank releases collateral that Borrower has given to secure the loan. Under the law of suretyship and guaranty, the secondary obligor may be discharged under certain circumstances if these modifications of the obligations between Bank (the obligee) and Borrower (the principal obligor) are made without the consent of Backer (the secondary obligor). The rights that the secondary obligor has to a discharge of its liability in such cases commonly are referred to as suretyship defenses. The extent of the discharge depends upon the particular circumstances. See Restatement of Suretyship and Guaranty Section 37, 39‑44.

A second possibility is that the parties might decide to evidence the loan by a negotiable instrument. In that scenario, Borrower signs a note under which Borrower is obliged to pay $10,000 to the order of Bank on a due date stated in the note. Backer becomes liable for the repayment obligation by signing the note as a co‑maker or indorser. In either case the note is signed for accommodation, Backer is an accommodation party, and Borrower is the accommodated party. See Section 3‑419 (describing the obligations of accommodation parties). For purposes of Section 3‑605, Backer is also a “secondary obligor” and Borrower is a “principal obligor,” as those terms are defined in Section 3‑103. Because Backer is a party to the instrument, its rights to a discharge based on any modification of obligations between Bank and Borrower are governed by Section 3‑605 rather than by the general law of suretyship and guaranty. Within Section 3‑605, subsection (a) describes the consequences of a release of Borrower, subsection (b) describes the consequences of an extension of time, and subsection (c) describes the consequences of other modifications.

The third possibility is that Borrower would use an instrument governed by this Article to evidence its repayment obligation, but Backer’s obligation would be created in some way other than by becoming party to that instrument. In that case, Backer’s rights are determined by suretyship and guaranty law rather than by this Article. See Comment 3 to Section 3‑419.

A person also can acquire secondary liability without having been a secondary obligor at the time that the principal obligation was created. For example, a transferee of real or personal property that assumes the obligation of the transferor as maker of a note secured by the property becomes by operation of law a principal obligor, with the transferor becoming a secondary obligor. Restatement of Suretyship and Guaranty Section 2(e); Restatement of Mortgages Section 5.1. Article 3 does not determine the effect of the release of the transferee in that case because the assuming transferee is not a “party” to the instrument as defined in Section 3‑103(a)(10). Section 3‑605(a) does not apply then because the holder has not discharged the obligation of a “principal obligor,” a term defined in Section 3‑103(a)(11). Thus, the resolution of that question is governed by the law of suretyship. See Restatement of Suretyship and Guaranty Section 39.

3. Section 3‑605 is not, however, limited to the conventional situation of the accommodation party discussed in Comment 2. It also applies in four other situations. First, it applies to indorsers of notes who are not accommodation parties. Unless an indorser signs without recourse, the indorser’s liability under Section 3‑415(a) is functionally similar to that of a guarantor of payment. For example, if Bank in the second hypothetical discussed in Comment 2 indorsed the note and transferred it to Second Bank, Bank is liable to Second Bank in the event of dishonor of the note by Borrower. Section 3‑415(a). Because of that secondary liability as indorser, Bank qualifies as a “secondary obligor” under Section 3‑103(a)(17) and has the same rights under Section 3‑605 as an accommodation party.

Second, a similar analysis applies to the drawer of a draft that is accepted by a party that is not a bank. Under Section 3‑414(d), that drawer has liability on the same terms as an indorser under Section 3‑415(a). Thus, the drawer in that case is a “secondary obligor” under Section 3‑103(a)(17) and has rights under Section 3‑605 to that extent.

Third, a similar principle justifies application of Section 3‑605 to persons who indorse a check. Assume that Drawer draws a check to the order of Payee. Payee then indorses the check and transfers it to Transferee. If Transferee presents the check and it is dishonored, Transferee may recover from Drawer under Section 3‑414 or Payee under Section 3‑415. Because of that secondary liability as an indorser, Payee is a secondary obligor under Section 3‑103(a)(17). Drawer is a “principal obligor” under Section 3‑103(a)(11). As noted in Comment 4, below, however, Section 3‑605(a)(3) will discharge indorsers of checks in some cases in which other secondary obligors will not be discharged by this section.

Fourth, this section also deals with the rights of co‑makers of instruments, even when those co‑makers do not qualify as accommodation parties. The co‑makers’ rights of contribution under Section 3‑116 make each co‑maker a secondary obligor to the extent of that right of contribution.

4. Subsection (a) is based on Restatement of Suretyship and Guaranty Section 39. It addresses the effects of a release of the principal obligor by the person entitled to enforce the instrument. Paragraph (a)(1) governs the effect of that release on the principal obligor’s duties to the secondary obligor; paragraphs (a)(2) and (a)(3) govern the effect of that release on the secondary obligor’s duties to the person entitled to enforce the instrument.

With respect to the duties of the principal obligor, the release of course cannot affect obligations of the principal obligor with respect to payments that the secondary obligor already has made. But with respect to future payments by the secondary obligor, paragraph (a)(1) (based on Restatement of Suretyship and Guaranty Section 39(a)) provides that the principal obligor is discharged, to the extent of the release, from any other duties to the secondary obligor. That rule is appropriate because otherwise the discharge granted to the principal obligor would be illusory: it would have obtained a release from a person entitled to enforce that instrument, but it would be directly liable for the same sum to the secondary obligor if the secondary obligor later complied with its secondary obligation to pay the instrument. This discharge does not occur, though, if the terms of the release effect a “preservation of recourse” as described in subsection (g). See Comment 10, below.

The discharge under paragraph (a)(1) of the principal obligor’s duties to the secondary obligor is broad, applying to all duties under this article. This includes not only the principal obligor’s liability as a party to an instrument (as a maker, drawer or indorser under Sections 3‑412 through 3‑415) but also obligations under Sections 3‑116 and 3‑419.

Paragraph (a)(2) is based closely on Restatement of Suretyship and Guaranty Section 39(b). It articulates a default rule that the release of a principal obligor also discharges the secondary obligor, to the extent of the release granted to the principal obligor, from any unperformed portion of its obligation on the instrument. The discharge of the secondary obligor under paragraph (a)(2) is phrased more narrowly than the discharge of the principal obligor is phrased under paragraph (a)(1) because, unlike principal obligors, the only obligations of secondary obligors in Article 3 are “on the instrument” as makers or indorsers.

The parties can opt out of that rule by including a contrary statement in the terms of the release. The provision does not contemplate that any “magic words” are necessary. Thus, discharge of the secondary obligor under paragraph (a)(2) is avoided not only if the terms of the release track the statutory language (e.g., the person entitled to enforce the instrument “retains the right to enforce the instrument” against the secondary obligor), or if the terms of the release effect a preservation of recourse under subsection (g), but also if the terms of the release include a simple statement that the parties intend to “release the principal obligor but not the secondary obligor” or that the person entitled to enforce the instrument “reserves its rights” against the secondary obligor. At the same time, because paragraph (a)(2) refers to the “terms of the release,” extrinsic circumstances cannot be used to establish that the parties intended the secondary obligor to remain obligated. If a release of the principal obligor includes such a provision, the secondary obligor is, nonetheless, discharged to the extent of the consideration that is paid for the release; that consideration is treated as a payment in partial satisfaction of the instrument.

Notwithstanding language in the release that prevents discharge of the secondary obligor under paragraph (a)(2), paragraph (a)(3) discharges the secondary obligor from its obligation to a person entitled to enforce the instrument to the extent that the release otherwise would cause the secondary obligor a loss. The rationale for that provision is that a release of the principal obligor changes the economic risk for which the secondary obligor contracted. This risk may be increased in two ways. First, by releasing the principal obligor, the person entitled to enforce the instrument has eliminated the likelihood of future payments by the principal obligor that would lessen the obligation of the secondary obligor. Second, unless the release effects a preservation of the secondary obligor’s recourse, the release eliminates the secondary obligor’s claims against the principal obligor with respect to any future payment by the secondary obligor. The discharge provided by this paragraph prevents that increased risk from causing the secondary obligor a loss. Moreover, permitting releases to be negotiated between the principal obligor and the person entitled to enforce the instrument without regard to the consequences to the secondary obligor would create an undue risk of opportunistic behavior by the obligee and principal obligor. That concern is lessened, and the discharge is not provided by paragraph (a)(3), if the secondary obligor has consented to the release or is deemed to have consented to it under subsection (f) (which presumes consent by a secondary obligor to actions taken by a principal obligor if the secondary obligor controls the principal obligor or deals with the person entitled to enforce the instrument on behalf of the principal obligor). See Comment 9, below.

Subsection (a) (and Restatement Section 39(b), the concepts of which it follows quite closely) is designed to facilitate negotiated workouts between a creditor and a principal obligor, so long as they are not at the expense of a secondary obligor who has not consented to the arrangement (either specifically or by waiving its rights to discharge under this section). Thus, for example, the provision facilitates an arrangement in which the principal obligor pays some portion of a guaranteed obligation, the person entitled to enforce the instrument grants a release to the principal obligor in exchange for that payment, and the person entitled to enforce the instrument pursues the secondary obligor for the remainder of the obligation. Under paragraph (a)(2), the person entitled to enforce the instrument may pursue the secondary obligor despite the release of the principal obligor so long as the terms of the release provide for this result. Under paragraph (a)(3), though, the secondary obligor will be protected against any loss it might suffer by reason of that release (if the secondary obligor has not waived discharge under subsection (f)). It should be noted that the obligee may be able to minimize the risk of such loss (and, thus, of the secondary obligor’s discharge) by giving the secondary obligor prompt notice of the release even though such notice is not required.

The foregoing principles are illustrated by the following cases:

Case 1. D borrows $1000 from C. The repayment obligation is evidenced by a note issued by D, payable to the order of C. S is an accommodation indorser of the note. As the due date of the note approaches, it becomes obvious that D cannot pay the full amount of the note and may soon be facing bankruptcy. C, in order to collect as much as possible from D and lessen the need to seek recovery from S, agrees to release D from its obligation under the note in exchange for $100 in cash. The agreement to release D is silent as to the effect of the release on S. Pursuant to Section 3‑605(a)(2), the release of D discharges S from its obligations to C on the note.

Case 2. Same facts as Case 1, except that the terms of the release provide that C retains its rights to enforce the instrument against S. D is discharged from its obligations to S pursuant to Section 3‑605(a)(1), but S is not discharged from its obligations to C pursuant to Section 3‑605(a)(2). However, if S could have recovered from D any sum it paid to C (had D not been discharged from its obligation to S), S has been harmed by the release and is discharged pursuant to Section 3‑605(a)(3) to the extent of that harm.

Case 3. Same facts as Case 1, except that the terms of the release provide that C retains its rights to enforce the instrument against S and that S retains its recourse against D. Under subsection (g), the release effects a preservation of recourse. Thus, S is not discharged from its obligations to C pursuant to Section 3‑605(a)(2) and D is not discharged from its obligations to S pursuant to Section 3‑605(a)(1). Because S’s claims against D are preserved, S will not suffer the kind of loss described in Case 2. If no other loss is suffered by S as a result of the release, S is not discharged pursuant to this section.

Case 4. Same facts as Case 3, except that D had made arrangements to work at a second job in order to earn the money to fulfill its obligations on the note. When C released D, however, D canceled the plans for the second job. While S still retains its recourse against D, S may be discharged from its obligation under the instrument to the extent that D’s decision to forgo the second job causes S a loss because forgoing the job renders D unable to fulfill its obligations to S under Section 3‑419.

Subsection (a) reflects a change from former Section 3‑605(b), which provided categorically that the release of a principal obligor by the person entitled to enforce the instrument did not discharge a secondary obligor’s obligation on the instrument and assumed that the release also did not discharge the principal obligor’s obligations to the secondary obligor under Section 3‑419. The rule under subsection (a) is much closer to the policy of the Restatement of Suretyship and Guaranty than was former Section 3‑605(b). The change, however, is likely to affect only a narrow category of cases. First, as discussed above, Section 3‑605 applies only to transactions in which the payment obligation is represented by a negotiable instrument, and, within that set of transactions, only to those transactions in which the secondary obligation is incurred by indorsement or cosigning, not to transactions that involve a separate document of guaranty. See Comment 2, above. Second, as provided in subsection (f), secondary obligors cannot obtain a discharge under subsection (a) in any transaction in which they have consented to the challenged conduct. Thus, subsection (a) will not apply to any transaction that includes a provision waiving suretyship defenses (a provision that is almost universally included in commercial loan documentation) or to any transaction in which the creditor obtains the consent of the secondary obligor at the time of the release.

The principal way in which subsection (a) goes beyond the policy of Restatement Section 39 is with respect to the liability of indorsers of checks. Specifically, the last sentence of paragraph (a)(2) provides that a release of a principal obligor grants a complete discharge to the indorser of a check, without requiring the indorser to prove harm. In that particular context, it seems likely that continuing responsibility for the indorser often would be so inconsistent with the expectations of the parties as to create a windfall for the creditor and an unfair surprise for the indorser. Thus, the statute implements a simple rule that grants a complete discharge. The creditor, of course, can avoid that rule by contracting with the secondary obligor for a different result at the time that the creditor grants the release to the principal obligor.

5. Subsection (b) is based on Restatement of Suretyship and Guaranty Section 40 and relates to extensions of the due date of the instrument. An extension of time to pay a note is often beneficial to the secondary obligor because the additional time may enable the principal obligor to obtain the funds to pay the instrument. In some cases, however, the extension may cause loss to the secondary obligor, particularly if deterioration of the financial condition of the principal obligor reduces the amount that the secondary obligor is able to recover on its right of recourse when default occurs. For example, suppose that the instrument is an installment note and the principal debtor is temporarily short of funds to pay a monthly installment. The payee agrees to extend the due date of the installment for a month or two to allow the debtor to pay when funds are available. Paragraph (b)(2) provides that an extension of time results in a discharge of the secondary obligor, but only to the extent that the secondary obligor proves that the extension caused loss. See subsection (h) (discussing the burden of proof under Section 3‑605). Thus, if the extension is for a long period, the secondary obligor might be able to prove that during the period of extension the principal obligor became insolvent, reducing the value of the right of recourse of the secondary obligor. In such a case, paragraph (b)(2) discharges the secondary obligor to the extent of that harm. Although not required to notify the secondary obligor of the extension, the payee can minimize the risk of loss by the secondary obligor by giving the secondary obligor prompt notice of the extension; prompt notice can enhance the likelihood that the secondary obligor’s right of recourse can remain valuable, and thus can limit the likelihood that the secondary obligor will suffer a loss because of the extension. See Restatement of Suretyship and Guaranty Section 38 comment b.

If the secondary obligor is not discharged under paragraph (b)(2) (either because it would not suffer a loss by reason of the extension or because it has waived its right to discharge pursuant to subsection (f)), it is important to understand the effect of the extension on the rights and obligations of the secondary obligor. Consider the following cases:

Case 5. A borrows money from Lender and issues a note payable to the order of Lender that is due on April 1, 2002. B signs the note for accommodation at the request of Lender. B signed the note either as co‑maker or as an anomalous indorser. In either case Lender subsequently makes an agreement with A extending the due date of A’s obligation to pay the note to July 1, 2002. In either case B did not agree to the extension, and the extension did not address Lender’s rights against B. Under paragraph (b)(1), A’s obligations to B under this article are also extended to July 1, 2002. Under paragraph (b)(3), if B is not discharged, B may treat its obligations to Lender as also extended, or may pay the instrument on the original due date.

Case 6. Same facts as Case 5, except that the extension agreement includes a statement that the Lender retains its right to enforce the note against B on its original terms. Under paragraph (b)(3), B is liable on the original due date, but under paragraph (b)(1), A’s obligations to B under Section 3‑419 are not due until July 1, 2002.

Case 7. Same facts as Case 5, except that the extension agreement includes a statement that the Lender retains its right to enforce the note against B on its original terms and B retains its recourse against A as though no extension had been granted. Under paragraph (b)(3), B is liable on the original due date. Under paragraph (b)(1), A’s obligations to B under Section 3‑419 are not extended.

Under section 3‑605(b), the results in Case 5 and Case 7 are identical to the results that follow from the law of suretyship and guaranty. See Restatement of Suretyship and Guaranty Section 40. The situation in Case 6 is not specifically addressed in the Restatement, but the resolution in this Section is consistent with the concepts of suretyship and guaranty law as reflected in the Restatement. If the secondary obligor is called upon to pay on the due date, it may be difficult to quantify the extent to which the extension has impaired the right of recourse of the secondary obligor at that time. Still, the secondary obligor does have a right to make a claim against the obligee at that time. As a practical matter a suit making such a claim should establish the facts relevant to the extent of the impairment. See Restatement of Suretyship and Guaranty Section 37(4).

As a practical matter, an extension of the due date will normally occur only when the principal obligor is unable to pay on the due date. The interest of the secondary obligor normally is to acquiesce in the willingness of the person entitled to enforce the instrument to wait for payment from the principal obligor rather than to pay right away and rely on an action against the principal obligor that may have little or no value. But in unusual cases the secondary obligor may prefer to pay the holder on the original due date so as to avoid continuing accrual of interest. In such cases, the secondary obligor may do so. See paragraph (b)(3). If the terms of the extension provide that the person entitled to enforce the instrument retains its right to enforce the instrument against the secondary obligor on the original due date, though, those terms are effective and the secondary obligor may not delay payment until the extended due date. Unless the extension agreement effects a preservation of recourse, however, the secondary obligor may not proceed against the principal obligor under Section 3‑419 until the extended due date. See paragraph (b)(1). To the extent that delay causes loss to the secondary obligor it is discharged under paragraph (b)(2).

Even in those cases in which a secondary obligor does not have a duty to pay the instrument on the original due date, it always has the right to pay the instrument on that date, and perhaps minimize its loss by doing so. The secondary obligor is not precluded, however, from asserting its rights to discharge under Section 3‑605(b)(2) if it does not exercise that option. The critical issue is whether the extension caused the secondary obligor a loss by increasing the difference between its cost of performing its obligation on the instrument and the amount recoverable from the principal obligor under this Article. The decision by the secondary obligor not to exercise its option to pay on the original due date may, under the circumstances, be a factor to be considered in the determination of that issue, especially if the secondary obligor has been given prompt notice of the extension (as discussed above).

6. Subsection (c) is based on Restatement of Suretyship and Guaranty Section 41. It is a residual provision, which applies to modifications of the obligation of the principal obligor that are not covered by subsections (a) and (b). Under subsection (c)(1), a modification of the obligation of the principal obligor on the instrument (other than a release covered by subsection (a) or an extension of the due date covered by subsection (b)), will correspondingly modify the duties of the principal obligor to the secondary obligor. Under subsection (c)(2), such a modification also will result in discharge of the secondary obligor to the extent the modification causes loss to the secondary obligor. To the extent that the secondary obligor is not discharged and the obligation changes the amount of money payable on the instrument, or the timing of such payment, subsection (c)(3) provides the secondary obligor with a choice: it may satisfy its obligation on the instrument as if the modification had not occurred, or it may treat its obligation to pay the instrument as having been modified in a manner corresponding to the modification of the principal obligor’s obligation.

The following cases illustrate the application of subsection (c):

Case 8. Corporation borrows money from Lender and issues a note payable to Lender. X signs the note as an accommodation party for Corporation. The note refers to a loan agreement under which the note was issued, which states various events of default that allow Lender to accelerate the due date of the note. Among the events of default are breach of covenants not to incur debt beyond specified limits and not to engage in any line of business substantially different from that currently carried on by Corporation. Without consent of X, Lender agrees to modify the covenants to allow Corporation to enter into a new line of business that X considers to be risky, and to incur debt beyond the limits specified in the loan agreement to finance the new venture. This modification discharges X to the extent that the modification otherwise would cause X a loss.

Case 9. Corporation borrows money from Lender and issues a note payable to Lender in the amount of $100,000. X signs the note as an accommodation party for Corporation. The note calls for 60 equal monthly payments of interest and principal. Before the first payment is made, Corporation and Lender agree to modify the note by changing the repayment schedule to require four annual payments of interest only, followed by a fifth payment of interest and the entire $100,000 principal balance. To the extent that the modification does not discharge X, X has the option of fulfilling its obligation on the note in accordance with the original terms or the modified terms.

7. Subsection (d) is based on Restatement of Suretyship and Guaranty Section 42 and deals with the discharge of secondary obligors by impairment of collateral. The last sentence of subsection (d) states four common examples of what is meant by impairment. Because it uses the term “includes,” the provision allows a court to find impairment in other cases as well. There is extensive case law on impairment of collateral. The secondary obligor is discharged to the extent that the secondary obligor proves that impairment was caused by a person entitled to enforce the instrument. For example, assume that the payee of a secured note fails to perfect the security interest. The collateral is owned by the principal obligor who subsequently files in bankruptcy. As a result of the failure to perfect, the security interest is not enforceable in bankruptcy. If the payee were to obtain payment from the secondary obligor, the secondary obligor would be subrogated to the payee’s security interest in the collateral under Section 3‑419 and general principles of suretyship law. See Restatement of Suretyship and Guaranty Section 28(1)(c). In this situation, though, the value of the security interest is impaired completely because the security interest is unenforceable. Thus, the secondary obligor is discharged from its obligation on the note to the extent of that impairment. If the value of the collateral impaired is as much or more than the amount of the note, and if there will be no recovery on the note as an unsecured claim, there is a complete discharge. Subsection (d) applies whether the collateral is personalty or realty, whenever the obligation in question is in the form of a negotiable instrument.

8. Subsection (e) is based on the former Section 3‑605(h). The requirement of knowledge in the first clause is consistent with Section 9‑628. The requirement of notice in the second clause is consistent with Section 3‑419(c).

9. The importance of the suretyship defenses provided in Section 3‑605 is greatly diminished by the fact that the right to discharge can be waived as provided in subsection (f). The waiver can be effectuated by a provision in the instrument or in a separate agreement. It is standard practice to include such a waiver of suretyship defenses in notes prepared by financial institutions or other commercial creditors. Thus, Section 3‑605 will result in the discharge of an accommodation party on a note only in the occasional case in which the note does not include such a waiver clause and the person entitled to enforce the note nevertheless takes actions that would give rise to a discharge under this section without obtaining the consent of the secondary obligor.

Because subsection (f) by its terms applies only to a discharge “under this section”, subsection (f) does not operate to waive a defense created by other law (such as the law governing enforcement of security interests under Article 9) that cannot be waived under that law. See, e.g., Section 9‑602.

The last sentence of subsection (f) creates an inference of consent on the part of the secondary obligor whenever the secondary obligor controls the principal obligor or deals with the creditor on behalf of the principal obligor. That sentence is based on Restatement of Suretyship and Guaranty Section 48(2).

10. Subsection (g) explains the criteria for determining whether the terms of a release or extension preserve the secondary obligor’s recourse, a concept of importance in the application of subsections (a) and (b). First, the terms of the release or extension must provide that the person entitled to enforce the instrument retains the right to enforce the instrument against the secondary obligor. Second, the terms of the release or extension must provide that the recourse of the secondary obligor against the principal obligor continues as though the release or extension had not been granted. Those requirements are drawn from Restatement of Suretyship and Guaranty Section 38.

11. Subsections (h) and (i) articulate rules for the burden of persuasion under Section 3‑605. Those rules are based on Restatement of Suretyship and Guaranty Section 49.

SOUTH CAROLINA REPORTER’S COMMENT

This provision replaces former Section 36‑3‑606 and states the rules for determining the extent to which conduct of a person entitled to enforce an instrument discharges the obligation of a secondary obligor on the instrument. Under the definition of “secondary obligor” in Section 36‑3‑103(a)(17), the provision applies to an accommodation party, an indorser, a drawer of a draft accepted by a nonbank, and a co‑maker of a note with a right of contribution under Section 36‑3‑116. The conduct of a party entitled to enforce an instrument that may discharge the obligation of a secondary obligor includes releasing the principal obligor, granting an extension for payment to the principal obligor, otherwise modifying the obligation of the principal obligor, and, if the obligation of the principal obligor is secured, impairing the value of the collateral. The rules for discharge are set forth in Subsections (a)‑(d) and are illustrated in Official Comments 4‑7.

The application of this provision to discharge the obligation of a secondary obligor is subject to three significant limitations. First, the provision applies only if the secondary obligor’s obligation arises on an instrument. The provision does not apply to the obligation of a guarantor under a separate agreement guaranteeing a maker’s obligation on a note. In this regard, the provision is consistent with prior South Carolina case law. See Citizens and Southern National Bank of South Carolina v. Lanford, 313 S.C. 540, 443 S.E.2d 549 (1994); Sunrise Savings & Loan Ass’n v. Mariner’s Cay Development Corp., 295 S.C. 208, 367 S.E.2d 696 (1988). Second, under Subsection (f) a secondary obligor is not discharged under this provision if the secondary obligor on the instrument or in a separate agreement waives either discharge under this provision or waives the suretyship defenses and impairment of collateral. Third, under Subsection (e) a secondary obligor is not discharged unless the person entitled to enforce the instrument knows the person against whom enforcement is sought is a secondary obligor or that the instrument was signed for accommodation.

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| Definitional Cross References: |  |
| “Accommodation party” | Section 36‑3‑419(a) |
| “Drawer” | Section 36‑3‑103(a)(5) |
| “Indorser” | Section 36‑3‑204(b) |
| “Instrument” | Section 36‑3‑104(b) |
| “Notice” | Section 36‑1‑201(25) [see now Section 36‑1‑202] |
| “Party” | Section 36‑3‑103(a)(10) |
| “Person Entitled to Enforce” | Section 36‑3‑301 |
| “Principal obligor” | Section 36‑3‑103(a)(11) |
| “Prove” | Section 36‑3‑103(a)(13) |
| “Secondary obligor” | Section 36‑3‑103(a)(17) |
| “Value” | Section 36‑3‑303(a) |

Cross References:

1. The obligation of the drawer of a draft accepted by a non‑bank acceptor. Section 36‑3‑414(d).

2. The obligation of an indorser. Section 36‑3‑415.

3. The obligation of an accommodation party. Section 36‑3‑419.

4. The right of a party with joint and several liability who pays the instrument to contribution. Section 36‑3‑116.

LIBRARY REFERENCES

Bills and Notes 256, 301, 437, 438, 440.

Cancellation of Instruments 2.

WESTLAW Topic Nos. 56, 69.

C.J.S. Bills and Notes; Letters of Credit Sections 231, 240 to 249.

C.J.S. Cancellation of Instruments; Rescission Sections 8 to 9, 16 to 20, 26, 40 to 41, 43.

NOTES OF DECISIONS

In general 1

Summary judgment 2

1. In general

Obligor under promissory note secured by real estate mortgage established unrebutted presumption that obligee intended to discharge obligor from her obligations; obligor testified that obligee had delivered note to obligor prior to obligee’s death, obligor testified that she was never informed her possession of note was by mistake or that she had note without authority, and there was no evidence to indicate that obligee made a mistake or did not intend for obligor to be discharged. Swindler v. Swindler (S.C.App. 2003) 355 S.C. 245, 584 S.E.2d 438, rehearing denied. Mortgages And Deeds Of Trust 1178

A guarantor was not a party to note and thus could not avail himself of defenses based on impairment of collateral under Section 36‑3‑606. Citizens and Southern Nat. Bank of South Carolina v. Lanford (S.C. 1994) 313 S.C. 540, 443 S.E.2d 549, rehearing denied.

**SECTION 36‑3‑606 provides no protection to a corporation in an action to foreclose a mortgage given as additional security for a purchase money debt where the deed of trust note was executed by a corporate principal in his individual capacity; since the corporation was not a party to the deed, it could not invoke Section 36‑3‑606.** D.R. Allen & Son, Inc. v. Harwal, Inc. (S.C.App. 1992) 307 S.C. 315, 414 S.E.2d 805.

In order for an agreement under Section 36‑3‑606 to have legal consequences, the agreement must be a binding one, supported by consideration. Seven Lakes Inv. Group, Inc. v. Crowe (S.C. 1989) 297 S.C. 534, 377 S.E.2d 576.

An Unconditional Continuing Guarantee did not satisfy the requirements of a “negotiable instrument” and, therefore, the guarantor was not a “party to the instrument” under Section 36‑3‑606 and could not assert an impairment of collateral defense. Sunrise Sav. & Loan Ass’n v. Mariner’s Cay Development Corp. (S.C. 1988) 295 S.C. 208, 367 S.E.2d 696. Bills And Notes 121; Bills And Notes 151; Bills And Notes 453

Section 36‑3‑606 applies only where the party claiming discharge has a right of recourse against a person who has libeled on the instrument or has given collateral for it, and “recourse,” as applied to checks, means the right of a holder or an endorser, upon dishonor, to require the drawer or any prior endorser to pay the instrument according to its tenor at the time it was drawn or endorsed by that person. First American Bank of Virginia v. Litchfield Co. of South Carolina, Inc. (S.C.App. 1987) 291 S.C. 240, 353 S.E.2d 143. Bills And Notes 437

The drawer of a check, as the party ultimately liable to pay the instrument, has no recourse against the payee, any subsequent endorser who takes up the instrument, or the holder. First American Bank of Virginia v. Litchfield Co. of South Carolina, Inc. (S.C.App. 1987) 291 S.C. 240, 353 S.E.2d 143. Bills And Notes 23

In an action by a lender to recover a debt owed by a corporation, the evidence showed that a lease never became collateral for the loan and therefore, under Section 36‑3‑606, the lender could not have impaired collateral that did not exist. Costas v. First Federal Sav. and Loan Ass’n (S.C. 1984) 283 S.C. 94, 321 S.E.2d 51.

Where promissory note was unintentionally marked paid by creditor’s employees and sent to debtors, debtors were not discharged from liability under UCC Section 3‑605(1)(b), since surrender of instrument was not accomplished by creditor’s intent to discharge. Peoples Bank of South Carolina, Inc. v. Robinson (S.C. 1978) 272 S.C. 155, 249 S.E.2d 784.

2. Summary judgment

Genuine issue of material fact existed as to whether guaranties on loans for residential property development released guarantor from liability when borrow was no longer liable to lender, precluding summary judgment on lender’s breach of contract action against guarantor. CoastalStates Bank v. Hanover Homes of South Carolina, LLC (S.C.App. 2014) 408 S.C. 510, 759 S.E.2d 152. Judgment 181(22)

**SECTION 36‑3‑606.** Omitted by 2008 Act 204, Section 2, eff July 1, 2008.

Editor’s Note

Former Section 36‑3‑606 was entitled “Impairment of recourse or of collateral” and was derived from 1962 Code Section 10.3‑606; 1966 (54) 2716.

Part 7

Advice of International Sight Draft [Omitted]

Editor’s Note

2008 Act No. 204, Section 4.A provides as follows:

“This act applies to a transaction occurring on or after the effective date [July 1, 2008] of this act. This act does not apply to a transaction or event, or obligation or duty arising out of or associated with a transaction or event, before the effective date of this act.”

2008 Act No. 204 Section 4.B provides as follows:

“A transaction occurring before the effective date [July 1, 2008] of this act and the rights, obligations, and interests flowing from that transaction are governed by any statute or other law amended or repealed by this act as if repeal or amendment had not occurred and may be terminated, completed, consummated, or enforced under that statute or other law.”

**SECTION 36‑3‑701.** Omitted by 2008 Act No. 204, Section 2, eff July 1, 2008.

Editor’s Note

Former Section 36‑3‑701 was entitled “Letter of advice of international sight draft” and was derived from 1962 Code Section 10.3‑701; 1966 (54) 2716.

Part 8

Miscellaneous [Omitted]

Editor’s Note

2008 Act No. 204, Section 4.A provides as follows:

“This act applies to a transaction occurring on or after the effective date [July 1, 2008] of this act. This act does not apply to a transaction or event, or obligation or duty arising out of or associated with a transaction or event, before the effective date of this act.”

2008 Act No. 204 Section 4.B provides as follows:

“A transaction occurring before the effective date [July 1, 2008] of this act and the rights, obligations, and interests flowing from that transaction are governed by any statute or other law amended or repealed by this act as if repeal or amendment had not occurred and may be terminated, completed, consummated, or enforced under that statute or other law.”

**SECTIONS 36‑3‑801 to 36‑3‑805.** Omitted by 2008 Act No. 204, Section 2, eff July 1, 2008.

Editor’s Note

Former Section 36‑3‑801 was entitled “Drafts in a set” and was derived from 1962 Code Section 10.3‑801; 1966 (54) 2716.

Former Section 36‑3‑802 was entitled “Effect of instrument on obligation for which it is given” and was derived from 1962 Code Section 10.3‑802; 1966 (54) 2716.

Former Section 36‑3‑803 was entitled “Notice to third party” and was derived from 1962 Code Section 10.3‑803; 1966 (54) 2716.

Former Section 36‑3‑804 was entitled “Lost, destroyed or stolen instruments” and was derived from 1962 Code Section 10.3‑804; 1966 (54) 2716.

Former Section 36‑3‑805 was entitled “Instruments not payable to order or to bearer” and was derived from 1962 Code Section 10.3‑805; 1966 (54) 2716.