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1991 REVISIONS TO ARTICLES 3 AND 4 OF THE UNIFORM COMMERCIAL CODE

David M. S. Shaiken and Timothy S. Fisher



On June 24, 1991, Governor Weicker signed Public Act 91-304, enacting sweeping changes to Articles 3 and 4 of the Uniform Commercial Code ("UCC").¹ The revisions are largely technical, intended to modernize the statute, cure discrepancies in the existing language, and resolve conflicts among jurisdictions.

The revisions are too all-encompassing to address in their entirety in an article of this scope. The authors, therefore, will focus on topics of key significance. Two important issues in debtor-creditor relations are the new provision for accord and satisfaction by means of a check; and the rules establishing when the exercise of a setoff by a bank is effective, and when a garnisheeing creditor defeats the holder of a check. The revisions also made a series of important changes in the law of check fraud.

Accord and Satisfaction

The 1991 amendments to the Uniform Commercial Code clarified the

status of the doctrine of accord and satisfaction, and established rules governing the effect of tender of partial payment of a claim by check.² Accord and satisfaction occur if the drawer tenders a check in good faith in payment of a claim, the amount of the claim is unliquidated and subject to bona fide dispute, the check is paid, and the instrument or accompanying writing contains a conspicuous statement that the check is tendered in full satisfaction of the claim.³ There are two ways a payee may protect itself from an accord and satisfaction. First, a payee may avoid accord and satisfaction by tendering repayment of the amount of the check within ninety days of payment of the check. Alternatively, a payee that is an organization (i.e., one who is not an individual)⁴ may give debtors prior conspicuous notice requiring that all communications regarding a disputed debt, including tender of partial payment in full satisfaction of a disputed debt, be

sent to a designated person, office or place. If the partial payment is not sent in accordance with the notice, the drawer's claim will not be discharged.

Exercise of Setoff by Bank Garnisheeing Creditors and Holders of Checks

When a payor bank exercises its right of setoff against an account, priority issues often arise between the holder of a check drawn on the account and the bank. Alternatively, when a creditor garnishees an account, priority issues may arise between the garnisheeing creditor and the holder of a check drawn on the account.⁵ In order to defeat the competing claim of a holder, a setoff or garnishment must occur before the earlier of the following so-called milestones:

1. the time the bank accepts or certifies the check;
2. the time the bank pays the check in cash;
3. the time the bank settles the check without having the right to revoke the settlement under statute, clearing-house rule, or agreement;
4. the time the bank becomes responsible for the check under UCC Sec. 4-302 dealing with a payor bank's responsibility for late return of items; or
5. a cut-off hour or, if no cut-off hour is fixed, the close of the next banking day after the banking day on which the bank received the check.⁶

These rules have changed prior law in two key ways. It no longer matters whether the bank has reserved the right to revoke settlement. If the setoff or garnishment occurs before expiration of the bank's right to revoke settlement, and none of the other milestones has occurred, the holder's rights are defeated. In addition, the bank's internal posting procedure is no longer relevant. The UCC now looks to a statutory formula based upon the cut-off hour and date of receipt of the check.

(Please see next page)

Check Fraud

The revisions to Articles 3 and 4 in the area of check fraud preserve the existing balance between banks and customers, making few changes in substantive laws. Many technical changes in the statute have been made, however, to modernize the language and to cure drafting errors and conflicts among jurisdictions under the original text.

The most basic rules of check fraud are preserved: first, the drawee bank (the bank on which a check is drawn) is generally answerable for fraud involving drawer's signature on the face of the checks.⁷ Second, the depository bank (the first bank to take the check for collection), in contrast, is generally answerable for fraud relating to the payee's endorsement on the rear of the check.⁸ Third, negligence or delay by an injured party will raise defenses to its claims against banks.⁹

While this part of check-fraud law under Articles 3 and 4 has been well established, the actual experience in litigation under the Code has been mixed. This was due largely to problems in the statutory language, of several different origins. Articles 3 and 4 were drafted separately, leading to inconsistent terminology and occasionally inconsistent results. The original statute also left several gaps in the factual situations it addressed. It reflected the state of the banking industry in the 1950's, and did not accommodate some major changes in check collection and bank operations over the decades since then.

Finally, revisions were necessary to cure anomalies in some courts' interpretations of the original Code. Since Articles 3 and 4 were drafted in the 1950's, chiefly by bank attorneys with little consumer input, they seemed, on their face, to favor banks in situations where judges and juries concluded a different result ought to obtain. As a result, many courts issued opinions that read somewhat surprising exceptions into the code. The revisions have addressed these parts of the case law in mixed fashion: some of the court-created exceptions have been codified,¹⁰ some rejected explicitly,¹¹ and some left to the courts of each jurisdiction to resolve.¹²

The following is an abbreviated list of some of the major areas of change between the old law of check fraud and the new statute after the revisions:

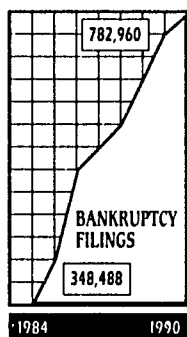
Prior Law	Revisions
1. Contributory negligence. Led to "all or nothing" results. 3-406, 4-406.	Comparative negligence 3-404, 3-405, 3-406, 4-406
2. Statutes of limitation could be avoided by different causes of action.	Universal 3-year limitation period. 3-118(g). (But date of accrual will vary.)
3. Warranties under Articles 3 and 4 were inconsistent (e.g. attorneys' fees, laches provisions)	Warranties are now consistent. 3-416 and 3-417 are parallel to 4-207 and 4-208.
4. Negligence: expressed 3 different ways in different sections. 3-406, 3-419, 4-406.	One standard: "Ordinary Care" 3-406, 3-103(a)(7).
5. Does ordinary care require that banks examine every signature?	More modern rule. 3-103(a)(7).
6. Is good faith by a bank purely subjective?	No: "fair dealing" required by 3-103(a)(4) (similar to merchants' duty under Article 2, 2-103(1)(b)).
7. Can a drawer sue on warranties?	No. Claim is only against its own bank. 4-401.
8. Can a drawer sue in conversion?	No. 3-402(a)(i).
9. Can a payee who never took possession sue in conversion?	No. 3-402(a)(ii).
10. Split of authority on causation needed for contributory negligence defense. 3-406.	Clarified. 3-406, Comment 2.
11. Dual payees: joint or alternative?	Presume alternative if ambiguous. 3-110(d).
12. Impostor and "fictitious payee" rules narrow and outmoded. 3-405.	Broader defense for all employee embezzlements. But comparative negligence added. 3-404, 3-405.
13. Double forgeries were treated as forged drawer's signatures and the drawee bank is ultimately liable (case law only).	Rule confirmed in comments, but with apportionment between banks due to comparative negligence. 3-404, Comment 2, Case 5.
14. Can a bank ever refuse to honor a cashier's check?	Only when payment is prohibited by law, there is reasonable doubt as to the identity of the presenter, the bank asserts a reasonable defense against the presenter, or the bank suspends payments. 3-411(c).
15. Are banks liable for consequential damages for refusing to honor a cashier's check?	Yes; after the presenter warns the bank about the potential consequential damages. 3-411(b).
16. Fraud by the presenter excuses the bank's missing the midnight deadline (case law only).	Rule codified. 4-302(b).

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Fears

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for the defendant in that case. Bailey noted that those unresolved feelings, clear to spectators, were detrimental to an effective prosecution.

I found the discussion at the Litigation Section meeting especially interesting in view of an experience I had while president of the New Haven County Bar Association in 1983-1984. During that year, our executive committee planned a program for our members on stress management. We chose a psychologist with extensive experience in presenting these programs, as well as impressive academic credentials. About 20 members of our executive committee met with this psychologist, and were so impressed that we considered reserving the program for our committee. However, we opened the meeting to the entire county, and when we publicized the event, we received telephone inquiries from all over the state. We invited all interested lawyers to attend, without charge. We had so many advance reservations that we reserved the jury assembly room at the New Haven County Courthouse. Most interestingly, when the evening arrived, only a handful of lawyers came to the program. We were surprised, but the consensus of those who were there was that most lawyers are not willing to acknowledge feelings of insecurity, fear and stress, and certainly will not express these feelings in the company of other lawyers.

Gerry Spence publicly acknowledged his feelings of fear and insecurity. He is also a recognized and successful advocate who has not lost a jury case in 21 years. Can only such a person publicly discuss his fears and the stress that results from battle in the courtroom? Psychologists tell us that stress comes from unresolved and unrecognized conflicts. If we are aware of such issues, we can reduce stress.

These issues represent areas for our concern and attention. Perhaps, through discussion and planning, we can make it easier for attorneys to recognize and deal with stress. If we can do this, life in court might be easier and our representation of our clients even more effective. ■

Susan W. Wolfson

UCC

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It has been the uniform hope of the drafters and commentators on the revisions that they will reduce litigation in this field. The clarifications in the statute should enable parties to better predict their exposure and thereby settle check fraud claims without recourse to the courts. ■

¹ All citations in this article are to the new sections of the UCC, as revised, which will be codified in Title 42a of the General Statutes.

² These changes were accomplished by adding UCC Section 3-311 and amending Section 1-207. See Public Act 91-304 Secs. 37, 111. For a discussion of the law of accord and satisfaction in Connecticut prior to the amendments, see R. Sattin, R. Mule, D. Flynn, J. Newton and D. Shaiken, *A Review of Selected Articles of the Connecticut Uniform Commercial Code*, 64 Conn. B. J. 51 173, 174-75 (Special Issue May 1990).

³ UCC Sec. 3-311.

⁴ UCC Sec. 1-201(28).

⁵ See J. White and R. Summers, 1 *Uniform Commercial Code* 918-30 (3d. ed. 1988) for an excellent discussion of this issue. Garnishment and setoff are two of the so-called four legals. The others are knowledge or notice of the customer's death, incompetency or bankruptcy; and a stop payment order by the customer. *Id.*

⁶ UCC Sec. 4-303. The cut-off hour is calculated under Sec. 4-303 as follows: With respect to checks, a cut-off hour no earlier than one hour after the opening of the next banking day after the banking day on which the bank received the check and no later than the close of that next banking day or, if no cut-off hour is fixed, the close of the next banking day after the banking day on which the bank received the check.

⁷ A forged drawer's signature makes the check not "properly payable" and therefore cannot be charged to the customer's account under UCC §4-401 (C.G.S. 41a-4-401). Yet the drawee bank cannot generally make a breach of warranty claim regarding the check against "upstream" collecting banks. §§3-416, 3-417, 4-207, and 4-208. Therefore, the drawee bank's recourse against any other bank is barred by the Finality of Payment Rule. §3-418.

⁸ The depository bank is directly liable to a payee for conversion, §3-420, or to the drawee bank for breach of warranties, §§3-416, 3-417, 4-207, and 4-208.

⁹ E.g. §§3-404, 3-405, 3-406, 4-406.

¹⁰ The "innocent depository bank" defense of old §3-419(3) has been eliminated, for example.

¹¹ E.g. Drawers cannot sue depository banks directly on the warranties. §3-417(a), Comment 2.

¹² Recovery of attorneys' fees in warranty claims is left "to other state law." §3-416(b), Comment 6.

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Judges' Skills

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The second phase of the program will involve a series of monthly workshops through which the judges will eventually complete twenty civil pre-trial cases (four per seminar). They will evaluate the various factors, discuss how each would handle the case in negotiations and recommend a settlement. Then, we will discuss with the judges the actual outcome of the case and whether they should have approached it differently.

In addition to providing practical experience for the judges, we will be able to identify those judges who are having difficulty applying the knowledge gained in the instructional sessions as well as those who have special talents at negotiating settlements.

The final phase of the program will be a one-year mentor program that will provide each judge with a supervising, experienced judge to confer with on various aspects of the negotiating process and especially individual problems the judge may be confronting.

A possible measure of the potential success of the program is the fact that 47 trial judges applied for the 20 available slots. Applicants included experienced trial judges as well as newly appointed judges who are still experiencing their initial doubts and fears. In addition to the series of programs that commenced in November and a second one that is scheduled to start in May, plans are under way for a similar program for attorneys on how to present cases for settlement. This program is tentatively scheduled for early 1992 and will be sponsored by one of the legal organizations in the state.

The Judicial Settlement Skills Training Program marks a new departure for Connecticut's judiciary. It will establish between the bench and the bar a cooperative effort, mutual respect and a common agenda to encourage civil case settlements earlier in the process for the good of the litigants and the judicial system alike. Most important, it will improve the perception among the legal and judicial professions that pre-trial settlements can and will be successful. ■

Justice Santantello is a Senior Associate Justice of the Connecticut Supreme Court.