A Bird's-Eye View of Changes in the Ohio Law of Commercial Paper and Banking Practice

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In some respects, the newly adopted Uniform Commercial Code represents evolution, by reason of its revision and up-dating of existing statutory law. This holds true for Chapter 1303 of the Ohio Revised Code (article 3 of the Uniform Commercial Code), since this chapter supplants the old Uniform Negotiable Instruments Law. In other respects, the new Code has the aspect of revolution, since it presents a wholly new codification in a field never before given uniform statutory treatment. Chapter 1304 of the Ohio Revised Code (article 4 of the Uniform Commercial Code), which deals with bank deposits and collections, is an example of this.

This article will attempt to point out the most significant changes in both of these fields from the standpoint of the practitioner, leaving the more academic questions to be treated by others.

The order of consideration will be generally the same as the numerical order of the chapters and sections of the Ohio Revised Code, except where a close relation of separated sections dictates otherwise. However, since most commercial paper flows through banks, at times there will be cross-references between these two chapters due to the mutual impingement of their subject matter.

COMMERCIAL PAPER

Definitions and Formal Requisites

Among the definitions in article 3, the only significant change from existing law is that which provides that an "order" may be addressed "to one or more such persons jointly or in the alternative." No such provision permitting alternative drafts existed under the Uniform Negotiable Instruments Law.

1. The Uniform Commercial Code will be referred to throughout the text by the article numbers.
2. OHIO REV. CODE § 1303.01(A) (2), UCC § 3-102(1) (b).
tiable Instruments Law, nor was there any specific prohibition upon such form of draft. The practical result of this is to give statutory approval to the practice of some large corporations whereby dividend checks are drawn upon banks in various parts of the country in the alternative, thus aiding early bank clearance. Similarly, corporate employers having plants at widely separated locations may now conveniently use the same paycheck form for all employees by naming banks in all plant locations as alternative drawees.

**Unconditional Promise**

As under the Uniform Negotiable Instruments Law, the Code identifies commercial paper by its adherence to certain specified form and approved language. The first required element of negotiability under Article 3 is that the paper "contain an unconditional promise or order." Here, the Uniform Commercial Code has introduced several interesting new exceptions to the old rule of the Uniform Negotiable Instruments Law. Formerly, a promise or order was deemed conditional only if it was to be paid out of a particular fund and was not drawn on the general credit of the maker or drawer. This "particular fund" limitation of the Uniform Negotiable Instruments Law caused unfortunate results in some cases, and two of these are corrected by the new Code in section 3-105.

For instance, in many cases certain municipal, school, and other public obligations may legally be paid only from the proceeds of specific levies or assessments and may not become general charges upon the government issuing them. Under the "particular fund" doctrine of the Uniform Negotiable Instruments Law, such notes, warrants, bonds, and similar public obligations have usually been held to be non-negotiable. Also, under the same rule, partnerships and other unincorporated business associations have in the past been unable to limit the obligation on their paper solely to the assets of the business entity, excluding liability of the individual partners or members, without destroying negotiability. This, of course, put them at a practical disadvantage in comparison with corporations, yet the basis for the distinction was too nebulous to be sensible.

Now, however, under subsections (g) and (h) of section 3-105, the Code makes certain specific exceptions to the "particular fund" doctrine by permitting negotiability to attach to orders limited to payment

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5. Ohio Rev. Code § 1303.03(A) (2), UCC § 3-104(1) (b).
7. Note recognition of this rule and avoidance of its effect in Carron v. Little, 40 Ohio St. 597 (1884).
"out of a particular fund or the proceeds of a particular source" where the paper is issued by a governmental entity, and "out of the entire assets of a partnership, unincorporated association, trust or estate" where such entity is the issuing party.

**Sum Certain**

The next requirement of negotiable paper under the Code is that the order or promise be for the payment of "a sum certain." It had long been assumed, though without specific statutory approval under the Uniform Negotiable Instruments Law, that an increase in interest rates after default (or other specified event), or a discount for early payment, or an addition or penalty for late payment would not be violative of the provisions of the Uniform Negotiable Instruments Law so as to destroy negotiability. Now, however, legislative sanction is specifically given to such common provisions by section 3-106 subsections (1) (b), (1) (c), and (1) (d).

Thus, language such as the following now has statutory approval and may be used without fear of loss of negotiability:

... interest to be payable at the rate of 5 percent per annum on all monthly balances, until January 2, 1964, and thereafter at the rate of 6 percent per annum. If not paid in full eight years from the date hereof, undersigned agrees to pay a premium of $25.00 for each $1,000 or part thereof then remaining unpaid, to be added to principal and to bear interest from such date; but in the event this note shall be fully paid within five years from date, then the undersigned shall receive a discount of principal in the amount of $15.00 for each $1,000.00 or part thereof remaining due at the time of final payment.

Naturally, few notes would contain all of these provisions, but apparently none of them, nor any clauses of similar import, would affect negotiability under the new law.

One word of warning, however, should be given under another subdivision of this section. Section 3-106(1) (e) states that no provision for recovering "costs of collection or an attorney's fee or both" will affect the statement of a "sum certain." It would not be unreasonable for many lawyers to jump to the conclusion that, contrary to the long-held but lamented rule in Ohio, this provision now approves the collection of attorney's fees from the debtor as one of the permissible costs of collection. They would be well advised to consider the language of subsection (2) of section 3-106, for this states that "nothing in this section shall validate any term which is otherwise illegal." Although perhaps

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8. OHIO REV. CODE § 1303.03 (A) (2), UCC § 3-104(1) (b).
9. OHIO REV. CODE § 1303.05 (A) (2), (A) (3), and (A) (4).
10. OHIO REV. CODE § 1303.05 (A) (5).
11. OHIO REV. CODE § 1303.05 (B).
most obviously directed at provisions designed to collect usurious interest after default, it would seem clear that in Ohio this provision also keeps in effect the rule of Miller v. Kyle,\(^\text{12}\) holding that although a clause allowing collection of attorney’s fees as a cost of collection will not affect negotiability, it will nevertheless not be enforced, being contrary to public policy. Many Ohio lawyers have no doubt taken the rule of the Miller case to stand for the proposition that it is also against public policy for lawyers to eat, but nevertheless it apparently is still the law.

**Definite Time**

As in the Uniform Negotiable Instruments Law, an instrument is only negotiable if "payable at a definite time,"\(^\text{13}\) or on demand. However, the new Code has made some substantial changes in the meaning of "definite time," both by deletion and by addition.

The first instance of addition to the old rules is a provision for payment "at a definite time subject to any acceleration."\(^\text{14}\) (Emphasis added.) Under this provision, a promise to pay “ninety days from date, or at such time as the holder may deem his security to be insecure” is payable at a definite time. This may appear to be no more than a promise to pay on demand, but no later than ninety days from date. If this were so, it would still give the necessary certainty of time for payment, since it contains a stated time limit as a term note, as well as having the basic characteristic of a demand note. However, the fact is that such a clause does not give a totally uncontrolled right of acceleration to a holder. Section 1-208\(^\text{15}\) requires of a holder a good faith belief that his prospect of payment is in fact impaired, although it places the burden of proving lack of good faith upon the one against whom the right is exercised.

The other three added provisions, found in the same section, permit:

1. a definite time “subject to extension at the option of the holder,”
2. a definite time subject “to extension to a further definite time at the option of the maker or acceptor,” and
3. a definite time subject to further extension “automatically upon or after a specified act or event.”

The first of these only gives to a holder the unlimited power of extension he would always have had, but since only he can exercise such power, the time for payment remains sufficiently certain. However, as to the latter two changes, where the power of extension is in a maker or acceptor, or is automatic, the time for extension must be limited to a definite time, so as to afford certainty to the holder.

\(^{12}\) 85 Ohio St. 186, 97 N.E. 372 (1911).

\(^{13}\) Ohio Rev. Code § 1303.08, UCC § 3-109.

\(^{14}\) Ohio Rev. Code § 1303.08(A)(3), UCC § 3-109(1)(c).

\(^{15}\) Ohio Rev. Code § 1301.14.
Thus, if the power of extension is in a holder, the instrument may promise to pay "120 days after date, or at such later date as the holder may specify before maturity" without affecting negotiability. A similar clause, however, specifying "maker," instead of "holder," would be objectionable; but the following would assure negotiability: "120 days after date, or thirty days thereafter if, before maturity, the maker shall give notice thereof." Likewise, a note payable "six months from date, or in event of my father's death before maturity, then nine months after such event," will qualify as having a date certain. Such an instrument is definite as to time by reason of having a maximum date for payment, to wit: one day less than fifteen months.

This latter rule leads naturally to consideration of the deletion change. Formerly, payment was considered certain if required to occur at a fixed time after an event certain to occur, even though the time of occurrence might be uncertain. Thus, "payable six months after my father's death" was formerly permissible. Now, such language would destroy negotiability. It has been suggested, however, that substantially the same result may be obtained by taking advantage of the "any acceleration" clause, stating a definite time far in the future, with acceleration to occur upon happening of an event certain to occur at an indeterminate date, as: "payable 90 years from date, but to be accelerated by my father's death so as to become due six months after his death."

Silly as such post-obituary provisions may appear, there is sometimes a real desire by a borrower to use such language so as to provide for payment after receipt of an inheritance. Hence, a word of caution should be given due to the deliberate deletion of the language of section 4(3) of the Uniform Negotiable Instruments Law and the official comment indicating an intention to reverse the old rule. It should be recognized that although the exact language of the new rule does not expressly outlaw circumvention in the manner suggested by Hawkland and Anderson, a court might well read the intent and spirit of the change as prohibiting such obvious subterfuge.

Words of Negotiability

As in the Uniform Negotiable Instruments Law, the Code requires words of negotiability, such as "order," "bearer," "cash," and variations of these. The former law, however, permitted the use of what were generally called "words of similar import," by reason of a statement in section 10 of that law approving any terms "which clearly indicate an in-

tention to conform to the requirements hereof.” This loophole had permitted many courts to interpret varying language importing negotiability as broadly, or as narrowly, as the judges deemed proper, causing great disparity and confusion from one jurisdiction to another.

The Code omits such an approval of other words importing negotiability. In fact, section 3-10418 clearly says that in order for any instrument to be negotiable under article 3, it “must . . . be payable to order or to bearer.” This must be seasoned with two grains of salt, however, namely, section 3-110(1)19 and the official comment to the Code. The former states than an instrument “is payable to order when by its terms it is payable to the order or assigns of any person,” as well as if “conspicuously designated on its face as ‘exchange or the like,’” thus approving the variant words, “assigns” and “exchange.” (Emphasis added.) Moreover, the official comment to section 3-104 clearly states an intention to include terms “clearly the equivalent of another.”20

At this point, attention should be drawn to the word “conspicuously” appearing in section 3-110(1). For an understanding of this, reference must be had to section 1-201(10)?1 A term is there defined as being “conspicuous” if printed or written in capitals, in larger or contrasting type, or in a different color from the other printing or writing. Hence, mere use of the word “exchange” or the like will not suffice; the word used must also be conspicuous.

Section 3-110 also adopts a rule which amounts to a specific reversal of an Ohio case regarding certificates of deposit. The new law states that an instrument not otherwise payable to order “is not made so payable by such words as ‘payable upon return of this instrument properly indorsed.’”22 An Ohio court of appeals had at one time held that a bank’s certificate of deposit bearing such words was a proper negotiable instrument, the words meaning, as the court said, “payable to the depositor, or to her order.”23

Requiring Acts Other Than Payment

Just as there had always been some doubt under the Uniform Negotiable Instruments Law as to whether a note or bill might include provisions for premiums for late payment, discounts for early payment, and changes of interest rates,24 there had also been doubt as to whether the

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20. UCC § 3-104, comment 5.
22. Ohio Rev. Code § 1303.09 (B), UCC § 3-110 (2).
24. See note 9 supra and accompanying text.
lender could legally provide for requiring additional collateral and automatic acceleration upon failure to give such added security. Now, however, such doubts as were caused by the Uniform Negotiable Instruments Law prohibition against requiring the doing of any act besides the payment of money have been eliminated by section 3-112.\(^{25}\) This section specifically permits "a promise or power to maintain or protect collateral or to give additional collateral." As has been seen above, section 3-109\(^{26}\) permits acceleration for any reason. Hence, language like the following:

In the event the Bank shall deem said collateral insufficient and give notice thereof, I agree to assign further collateral to the Bank's satisfaction within 48 hours, and, failing to do so, this note shall become forthwith due and payable,

is now clearly permissible. However, two caveats should be observed. First, the term "subject to any acceleration," as used in section 3-109, should not be taken at full face value; and second, the power to require additional collateral given in section 3-112 should not be considered absolute. As previously mentioned, section 1-208\(^{27}\) provides that such powers to accelerate and to require additional security must in all events be exercised in good faith, but the burden of proving lack of good faith lies with the one against whom the power is exercised.

**Transfer and Negotiation**

Reference has already been made to the new statutory approval given to the word "assigns" as a word of negotiability.\(^{28}\) The same holds good for the use of "assign" in the indorsement and transfer of an instrument, as well as to words of "condition, waiver, guaranty, limitation or disclaimer of liability."\(^{29}\) Section 3-202 provides that the use of such words in an indorsement will not affect its character as an indorsement. This constitutes a direct reversal of a principal Ohio case\(^{30}\) in which the transfer of notes was accompanied by such words as "we assign" and "severally guarantee payment." In this case, the court of appeals held the language to constitute a mere assignment with a guaranty of payment. Now, these words become words of indorsement and, by reference to section 3-416,\(^{31}\) actually add the liability of a guarantor to that of an indorser.

25. **Ohio Rev. Code** § 1303.11.
26. See note 14 **supra** and accompanying text.
28. See note 19 **supra** and accompanying text.
Also in the field of transfer, another important addition has been made. Section 3-207 provides for effective transfer to a holder in due course by either an embezzler or a fiduciary exceeding his authority or breaching his duty.

**Holder in Due Course**

An interesting change in concept appears in the definition of a holder in due course. Under the Uniform Negotiable Instruments Law, one could only be a holder in due course if he took the paper before it was overdue, and this rule was followed in Ohio case law. Now, however, the rule has been changed by section 3-302, which only requires that a holder shall have received the instrument without notice that it is overdue, or has been dishonored, or of any defense or claim against it. Under the new rule, a purchaser like the one in the Harvard Mortgage case, who had taken after default but without notice, would become a holder in due course.

The same section of the Code also clears up a question which has long plagued the courts, to wit: whether a payee may become a holder in due course. The Uniform Negotiable Instruments Law used the word "negotiated" in describing the attributes of a holder, and from this the courts had often come to the conclusion that a payee could only become a holder, if at all, under circumstances where he had purchased the paper from an intervening holder. Now, the rule is made clear that a payee may be a holder in due course from the outset if he meets the requirements of section 3-302, i.e., purchase for value, good faith, and lack of notice of default, dishonor, or defense.

Another provision of section 3-302 is that a transferee of an instrument does not become a holder in due course by purchasing it at a judicial sale, or bulk sale, or from an estate. At first blush, this appears to conform to the rule announced in Stowe v. Branigan to the effect that, as to one whose title is derived by operation of law, "the doctrine of due course is immaterial." However, the real question is whether one who takes an instrument under these circumstances from another who is in fact a holder in due course can succeed to such status, even though the mode of transfer itself cannot confer such status. Reference to section 3-201 will indicate that the Code confers on a transferee such rights as the transferor had in the instrument. Viewed in this manner, the Code appears to supersede the rule of the Stowe case, and hereafter a transferee

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35. 7 Ohio L. Abs. 7 (Ct. App. 1928).
will possess the rights of a holder in due course if his transferor had such status, despite his acquisition through a judicial sale, or bulk sale, or from an estate.

A commonly encountered question is what sort of notice will destroy the status of a holder in due course. One type of notice often called into question deals with incompleteness and irregularity of the instrument. Under the Uniform Negotiable Instruments Law a holder must have taken an instrument which is “complete and regular” on its face. The Code, however, reverses this approach in section 3-304, stating that a purchaser only has notice of a claim or a defense if the instrument is so incomplete, irregular, or the like, “as to call into question its validity, terms or ownership or to create an ambiguity as to the party to pay.”

Thus, a check written in early January of a new year, in which the figures denoting the date have been altered by lining out the numerals for the previous year (as: +6-) and writing above it the numerals for the new year (as: 1962) would not seem to give notice of an irregularity, since nearly everyone has difficulty writing the date of a new year for the first several weeks. However, the same sort of a change on the face of a check in the month of August could be said to give notice of an irregularity. Under the Uniform Negotiable Instruments Law, though, both checks would be technically irregular and subject to defenses for this reason.

Other matters relative to notice which will or will not destroy the status of a holder in due course are set forth in section 3-304. One of these, fixing a thirty-day rule as to the staleness of checks, is particularly noteworthy, but will be discussed hereafter under the heading of Banking Practice, since a complete understanding of its effect requires reference to certain sections in article 4. It should be noted, however, that section 3-304 also provides, inter alia, that one may be a holder in due course despite knowledge of a default in interest, of a post-dating or ante-dating of the instrument, of a default on another instrument not of the same series, or of a completion of an incomplete instrument so long as there is no notice of an improper completion. Most of these are new law in Ohio and should be given close scrutiny for this reason.

Pleading and Proof Problems

The careful practitioner is always concerned with problems of pleading and proof. The Code assists in this respect by spelling out the most significant matters relating to commercial paper rather clearly in section

3-307. For instance, unless specifically denied in the pleadings, each signature is deemed to be admitted, thus requiring care that any possible doubts as to the validity of or authority for a signature be immediately put on record in the answer or other appropriate pleading, lest such defense be forever lost. If the effectiveness or validity of a signature has been put in issue, the burden of proof then rests with the one claiming under it. However, this burden may be easily satisfied for the purposes of a prima facie case, since there is a presumption of genuineness and authorization except where the claim is against the estate of a decedent or incompetent who became such before the proof was required. In this way, though the burden of proof still rests with the claimant, the burden of going forward almost always is shifted to the defender by the mere introduction of the instrument into evidence. This seems to be a sort of legal game of ”now you see it, now you don’t.” However, since the policy of the Code is to promote the free flow of commercial paper, such requirements relating to pleading, evidence, and burden of proof are designed to give the maximum reasonable protection to the holder of such paper without destroying the rights of a defendant to prove an actual fraud or invalidity. Viewed in this light, the rules seem sensible and workable.

**Signature Problems**

Some of the principal changes in the law of commercial paper have been made in the areas relating to liability of the parties. One of these areas pertains to the manner of signing the instrument. Under the Uniform Negotiable Instruments Law, an agent became personally liable unless, in signing the bill or note, he disclosed both his representative capacity and his principal. Thus, if a note were signed: “Arresto Corporation, by James Finn, President,” there was no problem. Unfortunately, however, all businessmen are not so careful in observing legal niceties. As a result, many problems of liability have arisen where instruments were signed: “Arresto Corporation, by James Finn,” or just “James Finn, President,” despite the fact that at the time of execution, all parties concerned were well aware of the true nature of the agency and of the identity of the principal. The Code, in section 3-403, disposes of some of these problems by permitting the signer, in a suit between the original parties, to prove the true nature of his agency signature if either his representative capacity or the identity of the principal are revealed in the form of signature. Of course, if the signature merely reads: “James Finn,” both the Uniform Negotiable Instruments Law and the Code make the agent liable. To do otherwise would do violence to the well

established parol evidence rule against varying the effect of written instruments. The Code's relaxation of the earlier rule does not do this, but merely permits the introduction of a parol explanation of an obvious ambiguity, and this only between the original parties who had reason to know the true facts.

A signature problem which the Code has clarified is that presented by an unauthorized signature resulting from the negligence of the maker or drawer. This situation may arise either as an indorsement or as a signature used to issue the instrument. Previous statutory law in Ohio did not cover this situation, but under the case law a maker was held liable when he negligently misdirected a letter containing a check which thereby fell into the hands of a man with a similar name who fraudulently negotiated it. The Ohio court in this case held the drawer liable to the bank, despite its having paid on a forged indorsement. In section 3-406, the Code adopts the rule of the Weisberger case in such form as to broaden the scope of its coverage materially.

Under the new statutory rule, for instance, an employer using either a signature stamp or an automatic signing device may clearly be held liable for the results of carelessly making it available to employees who thereafter use it for fraudulent purposes.

Corollary to this, and constituting a variation from existing Ohio law, is the rule stated in section 3-404(1) whereby a purported signer (either maker, drawer, drawee, or indorser) may ratify his forged signature. Formerly, a number of Ohio courts had held a forgery to be totally void and not subject to ratification, this line of authorities commencing even before the adoption of the Uniform Negotiable Instruments Law provision which was interpreted to support this view. This rather extreme rule, however, had been somewhat softened in Ohio by the qualification that the purported signer might be estopped to assert the defense of forgery in the event that his actions or statements, or his failure to speak under circumstances inviting reliance, had contributed to the payment of the instrument upon the forged signature.

40. S. Weisberger Co. v. Barberton Sav. Bank Co., 84 Ohio St. 21, 95 N.E. 379 (1911).
41. OHIO REV. CODE § 1303.42.
42. OHIO REV. CODE § 1303.40(B).
44. See former Ohio Revised Code section 1301.25, 95 Ohio Laws 174 (1902), which, like present Ohio Revised Code section 1303.40(B), declared forgeries to be "wholly inoperative," but which did not specifically sustain the conclusion of the cases mentioned in footnote 43 that a forgery cannot be ratified. The new language following the words "wholly inoperative" states that "unless he ratifies it or is precluded from denying it," thus approving both the existing Ohio qualification and the heretofore rejected principle of ratification of a forgery.
Two other signature problems are given much more sensible treatment under the Code than previously, namely, the cases of instruments made payable to impostors and instruments made payable to fictitious payees. Under the former Ohio cases, banks had often been held liable for paying on forgeries under circumstances where the maker or drawer was primarily at fault, either directly through being duped by an impostor, or vicariously by employing a dishonest payroll clerk, claim agent, or similar person.

In the former instance, the courts, both in Ohio and elsewhere, had evolved some rather esoteric theories to determine matters of liability, all of which usually resulted in the bank’s becoming liable despite the original fault of the drawer of the check. These rules involved looking into the mind of the drawer of the check to determine whether he really intended the eventual recipient of funds to be the named payee, or whether he had another person in mind. Naturally, when a loss occurred, no drawer would admit that he ever intended an impostor or fictitious payee to receive payment. This rule of intention of the drawer was first developed in Ohio prior to the Uniform Negotiable Instruments Law and had been consistently followed since its adoption. This use of a sort of legal psycho-analysis is largely eliminated by the Code through section 3-405 (1) (a) which approaches the impostor situation by making an indorsement in the name of the named payee effective if the instrument was issued to the impostor or his confederate in the name of the payee. This would reverse the results in the Dodge and Armstrong cases without a doubt and also probably the result in the Hockett case. It is also noteworthy that section 3-405 refers to both mail and face-to-face frauds, since many previous decisions had drawn a rather tenuous distinction between them.

The other signature problem cleared up by section 3-405 relates to instruments drawn payable to a fictitious payee whose fictitious character was known to the individual directly responsible for preparing or ordering the instrument. The most common cases of this type usually involve embezzlement schemes by payroll clerks who “pad” the payroll or by

46. Former Ohio Revised Code section 1301.11(C), 95 Ohio Laws 171 (1902) made an instrument payable to bearer when “payable to the order of a fictitious or non-existing person, and such fact was known to the person making it so payable.” The latter part of this clause, requiring knowledge of the maker, permitted such decisions as Hartford Acc. & Indem. Co. v. First Nat’l Bank, 61 Ohio App. 217, 22 N.E.2d 517 (1938), and J. C. Hockett Co. v. Simmonds, 84 Ohio App. 467, 87 N.E.2d 739 (1949), in both of which the court held the bank liable under circumstances where either the drawer’s agent acted fraudulently or the drawer himself was careless.
47. OHIO REV. CODE § 1303.41(A) (1).
48. See note 45 supra.
49. See note 46 supra.
claims adjusters who supply false claim data to the insurance company. Very often, these cases resulted in trying to determine whether the employee's knowledge of the fictitious nature of the payee should be imputed to the employer. Different rules were said to apply to situations where a dishonest employee himself wrote the check or draft and where he procured its execution by his employer. Under either circumstance, the rules were confusing and unrealistic.

The Uniform Negotiable Instruments Law treated paper drawn payable to a fictitious payee as "bearer" paper. However, the Code approaches these problems by initially treating such paper as "order" paper and by then proceeding to provide that any indorsement in the name of a named payee shall be effective either if the person signing (such as the payroll clerk or claim agent) intended the payee to have no interest in the instrument or if an agent or employee of the maker has supplied the name to the maker with such intention. This approach is more direct and certain than the Uniform Negotiable Instruments Law approach, placing the ultimate liability on the employer, rather than on the bank, which can seldom protect itself adequately against clever embezzlement schemes of customers' employees.

**Acceptance and Payment**

The Uniform Negotiable Instruments Law rule on acceptance of checks and drafts has been changed by section 3-410. Under previous law, three types of acceptance were valid: (1) that written on the face of the instrument, (2) that written on a separate instrument, and (3) that occurring through failure to return the draft within twenty-four hours of receipt. The Code eliminates the latter two and recognizes only a written acceptance on the face of the instrument. However, section 4-302 does provide some modification on this as to bank drafts and checks held without protest beyond the permitted period.

Moreover, the Code imposes liability for conversion on a drawee either if he refuses to return the check or draft on demand or if he pays it on a forged indorsement. This latter, pertaining to payment on a forged indorsement is a reversal of the rule established in *Elyria Savings...*
& Banking Co. v. Walker Bin Company\textsuperscript{55} in which a recovery for conversion against a drawee bank was denied. It should be noted, however, that this rule applies only to forged indorsements, since payment on a forged signature of a maker is treated differently, as will be seen.

It was inevitable that the new Code should give attention to the long-established rule of Price v. Neal\textsuperscript{56} to the effect that, when the drawee of a bill or check pays a holder in due course, the drawee cannot recover his money upon discovery that the drawer's signature was forged. Although the usual explanation of the reason for the rule is that the drawee (usually a bank) should be presumed to know the drawer's signature, it has often been put on the more realistic ground of the desirability of ending commercial transactions at some point, final payment being deemed as good a place as any. For some unaccountable reason, this rule was never fully included in the Uniform Negotiable Instruments Law, although the net effect of one of its provisions on acceptance is substantially the same.\textsuperscript{57} Nevertheless, Ohio courts had accepted the rule of Price v. Neal as law and had even gone so far as to hold that the Uniform Negotiable Instruments Law in fact adopted it.\textsuperscript{58} Now, by section 3-418,\textsuperscript{59} the rule is clearly a part of Ohio law, not only as to payment on forged signatures but also for other purposes (such as payment on an overdraft), and its benefits are extended not only to a holder in due course but also to one who has changed his position in reliance on the payment.

Two exceptions to the rule must be noted, however, which limit its otherwise broad effect: (1) section 4-301\textsuperscript{60} which gives banks certain rights of revocation before their midnight deadline, and (2) section 3-417\textsuperscript{61} which creates a set of warranties which are given by a holder at the time of presentment for payment. These warranties provided in the latter section are substantially that (1) the presenter has good title or is authorized to receive payment for one who has; (2) the presenter has no knowledge that the drawer's signature is unauthorized; and (3) the instrument has not been materially altered. Subject to these exceptions, then, a drawee bank is precluded from revoking its acceptance or payment of an overdraft, forgery, or otherwise improper check or draft.

\textsuperscript{55} 92 Ohio St. 406, 111 N.E. 147 (1915).
\textsuperscript{56} 3 Burr. 1354, 96 Eng. Rep. 221 (K.B. 1762).
\textsuperscript{57} See former Ohio Revised Code section 1301.64, 95 Ohio Laws 178 (1902), which states that acceptance admits the genuineness of the drawer's signature and constitutes an agreement to pay according to the tenor of the acceptance.
\textsuperscript{58} First Nat'l Bank v. First Nat'l Bank, 58 Ohio St. 207, 50 N.E. 723 (1898); Ellis v. Ohio Life Ins. & T. Co., 4 Ohio St. 628 (1855); Commerce-Guardian Bank v. Toledo Trust Co., 60 Ohio App. 337, 21 N.E.2d 173 (1938).
\textsuperscript{59} OHIO REV. CODE § 1303.54.
\textsuperscript{60} OHIO REV. CODE § 1304.21.
\textsuperscript{61} OHIO REV. CODE § 1303.53.
Presentment

Turning to presentment, the Code has simplified and clarified the rules in a number of ways. As to demand instruments, such as bank checks, the Code specifies that they must be presented within a reasonable time, and section 3-503 spells out such "reasonable time" for uncertified checks as being thirty days with respect to the maker's liability and seven days with respect to an indorser's. Although this will be further treated in the discussion of banking practice under article 4, let it suffice to say that this makes it necessary that a check be presented within thirty days after its date or issue, whichever is later, in order to assure the drawer's full liability, and within seven days of its first negotiation in order to assure liability of all indorsers.

However, although failure to make timely presentment will discharge the liability of indorsers under section 3-502, it only works a discharge of a drawer or acceptor to the extent of the actual loss which may have been occasioned by insolvency of a drawee bank during the period of delay.

As a sidelight to these statutory time limits for presentment of checks and drafts, it is interesting to note that section 3-508 allows a bank a different, and shorter, time for giving notice of dishonor than that allowed to other parties. The bank must give notice before its midnight deadline, that is, midnight of the day following dishonor or receipt of the instrument or of notice of its dishonor, whichever is later. Other parties, however, are given until midnight of the third business day following such dishonor or receipt of notice of dishonor. This amounts to a substantial change in the former statutory law, and should be studied carefully for its effects in numerous situations. It would seem that the rationale of this distinction is probably a recognition of the fact that the public in general should be held to a less strict rule than banks, whose personnel would be deemed to constitute the "professionals" among those handling commercial paper.

Discharge

The last few sections of major importance in article 3 deal with the subject of discharge. Section 3-601 lists twelve separate methods of discharging parties to an instrument, yet nowhere in this section is there

64. Ohio Rev. Code § 1303.65.
65. Ohio Rev. Code § 1304.01 (A) (8), UCC § 4-104 (1) (h).
66. See the following sections of the former law in order to appraise the effect of this rule: Ohio Rev. Code §§ 1303.17-19, 1303.22, 95 Ohio Laws 184 (1902).
reference to a means of discharge of the instrument itself, as provided under the Uniform Negotiable Instruments Law. To the contrary, the Code treats discharge as a personal matter, depending on the respective circumstances as to each party. Thus, in order to accomplish discharge of the instrument itself, it is now necessary to secure conditions which work the separate discharge of each party to the instrument. This may, however, be simultaneously accomplished by reacquisition of the instrument by any party who has no right of action or recourse on the instrument, or by discharge of such party.

Section 3-603 elimates the Uniform Negotiable Instruments Law concept of "payment in due course" and substitutes for it a provision permitting any party to secure his own discharge from liability to the extent that he pays or satisfies the current holder, even though such payment is made with knowledge of another party's claim to the instrument. However, in the event that, prior to payment, such claimant supplies indemnity sufficient to the one making payment, or enjoin payment in an action against the holder, no discharge may be secured through such payment. In the absence of indemnification or injunction, the one seeking discharge is at liberty to choose whether to pay the holder or await suit by the holder or claimant before making his tender.

Finally, under the provisions of section 3-606, a holder works a discharge of a party to the extent that, without that party's consent, he releases or agrees not to sue, or suspends the right of enforcement against any person against whom such party had a right of recourse. Similarly, such party will have a pro tanto discharge if, without notice, the holder unjustifiably impairs collateral given by or on behalf of him or any person against whom he has a right of recourse. However, by express reservation of rights against a party having a right of recourse, the holder can preserve his rights against such party as well as the party's rights against others.

Some additional matters relating to commercial paper will be treated or referred to in the ensuing discussion of banking practice, since the interrelation of these two articles makes total separation of their subject-matter an impossibility.

**Banking Practice**

The principal purpose of this portion of the article is to discuss a number of the provisions of article 4 of the Uniform Commercial Code which affect commercial paper, as well as several other provisions which the author considers to be of particular interest to Ohio lawyers. Where-

as the discussion of “Commercial Paper” was substantial, though somewhat less than complete, the coverage of article 4, which is officially designated “Bank Deposits and Collections,” will be considerably more limited.

It should be noted at the outset that, unlike the preceding two articles of the Code covering sales and commercial paper, article 4 does not supplant any extensive codification of banking law or any uniform law formerly in effect in Ohio. There were less than a dozen sections of the Ohio Revised Code which were affected by the new law, and their coverage was extremely limited in effect. Hence, most of article 4 constitutes new statutory law in this state, even though a large part of it was already followed in practice as a result of court decisions, Federal Reserve regulations and their accompanying law, banking customs and practice, and other rules of procedure, both written and unwritten.

**General Principles**

Two points with respect to interpretation should be briefly referred to. First, section 4-102(1) provides that wherever any conflict may appear between provisions of articles 3 and 4, article 4 shall govern, and wherever conflicts may occur between articles 4 and 8, article 8 shall govern. Obviously, since banks act as makers, payees, and drawees of many negotiable instruments of all types, whether notes, checks, drafts, certificates of deposit, or otherwise, it is only natural that occasions should arise where banking practice may run contrary to general commercial practice as codified in article 3. Applying the accepted rule that the particular should govern the general in statutory construction, the drafting committee gives precedence to article 4 where commercial papers affect bank deposits or collections. By the same token, but with opposite result, precedence is given to the particular treatment of article 8 as to investment securities being collected by banks over the general treatment of bank collections contained in article 3.

The other point related to interpretation concerns itself with conflict of laws in two respects. Section 1-105 states the general rule of conflicts of laws under the Code to the effect that where states other than Ohio, or foreign nations, are involved in a transaction, the parties may agree on the applicable law, but failing to do so, the Code (in this case the provisions of article 4) shall govern transactions “bearing an appropriate relation to this state.” Further, section 4-102(2) states that the liability of a bank on matters relating to presentment, payment, or
collection shall be determined "by the law of the place where the bank is located."

Obviously, numerous problems of varying liability might arise with respect to Ohio checks presented to out-of-state banks and vice versa, as well as out-of-state checks bound for out-of-state payee banks, but clearing through Ohio banks. Fortunately, many of these problems are about to be solved through the recent adoption of the Code in Michigan and Illinois, which, together with Pennsylvania and Kentucky, which already have the Code in effect, give substantial Code coverage to most of Ohio's near neighbors where a large volume of this state's interstate trading takes place. Further successful efforts to secure adoption of the Code in other states should be expected and should greatly reduce the importance of these provisions.

Branch Banks and Cut-off Hours

Section 4-106 provides a novel rule to the effect that a branch or separate office of a bank shall be considered a separate bank for the purpose of computing time and determining the place for action to be taken or notice or orders to be given under the requirements of article 4. It should be noted that Ohio courts have held that deposits made in a branch are equivalent to deposits made at the main office and that a bank with branches may be considered indivisible for certain purposes and separate for other purposes. Thus, the full effect of section 4-106 on such decisions is not entirely clear, since it is not expressly contrary to their basic rules, but may be in conflict in particular instances. In any event, they must be kept in mind as possible limitations on its breadth of effect.

It seems certain that this rule, although consistent with section 1(A) of the American Bankers Association Code, will occasionally produce unusual and seemingly illogical results. For instance, it offers the possibility of one branch charging an item to the account of the drawer while another branch may treat the item as dishonored. Likewise, while payment may have been stopped on a check drawn on one branch, it is conceivable that section 4-106 would permit another branch to claim the status of a holder in due course if it accepted the check without notice of the stop order.

73. OHIO REV. CODE § 1304.04.
76. See discussion in 2 ANDERSON, UNIFORM COMMERCIAL CODE 25, comment 3 (1961).
Section 4-107 permits a bank to fix its own cut-off hour (but not earlier than 2:00 p.m.) for the handling of money and items, so as to allow time for accomplishing normal daily bookkeeping work, so that all items or deposits received after that hour may be treated as having been received at the opening of business on the following day. This is only a liberalization of existing statutory law which permits items received after business hours to be so treated, as well as an earlier court decision approving a fixed hour for clearing books, even though the bank may reopen for further business on the same day.

The "Stale" Check Question

Now let us advert for a moment to the matter postponed under article 3, to wit, "staleness" of checks. Section 3-304 provides that a purchaser of paper has notice that the instrument is overdue if he has reason to know that he is taking a demand instrument after a reasonable time since its issue. Up to this point, the rule is familiar, but then the Code adds that a reasonable time for a check drawn and payable within the United States and its territories is presumed to be thirty days. If not fully understood, this provision could cause many sleepless nights for bankers, since many banks of moderate size will clear from 100 to 250 such presumptively stale checks in a single day.

The first question then is: When does the 30-day period terminate, when a check is first cashed, or when it is finally presented for payment? The answer to this seems to be the provision of section 3-503(2) of the Code, which states that, as to the liability of a drawer, the check must be presented for payment or its bank collection initiated thirty days after date or issue, whichever is later.

The second question to be considered is: What is the status of a bank receiving such check from its customer, i.e., is it or is it not a purchaser? Section 4-201 makes such a bank, in the absence of a clearly expressed contrary intent, merely an agent or sub-agent for collection, thus indicating that a bank only becomes a purchaser by actually cashing a check or taking it as payment, but not by receiving it on deposit. Hence, the

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78. OHIO REV. CODE § 1304.05.
79. OHIO REV. CODE § 1105.13(A).
81. OHIO REV. CODE § 1303.33.
82. OHIO REV. CODE § 1303.58.
83. As to the indorser's liability, a reasonable time is presumed to be seven days after his indorsement. This requires that one receiving a check by indorsement commence bank collection or present it for payment promptly after receipt, even though the payee may have a longer period to initiate collection.
84. OHIO REV. CODE § 1304.07.
area in which special care must be exercised is limited to transactions where a check is unequivocally received in payment or is cashed, without any reservations as to its ultimate collection.

However, two additional qualifications should be noted. First, section 3-502, as already noted, limits the discharge of a drawer’s liability occasioned by late presentment by only so much as his actual loss resulting from an intervening failure of the drawee bank. Second, section 4-404 implies implicitly authorizes a bank to honor a customer’s check up to six months after its date under all circumstances, and even thereafter if done in good faith.

**Losses by Correspondent Banks**

Section 4-202(c) presents a change in the existing Ohio rule regarding the liability of a collecting bank for the insolvency, neglect, misconduct, and the like, of its correspondent banks handling an item in process of collection. Ohio had formerly followed the so-called “New York rule” that the correspondent bank is the agent of the collecting or depositary bank, but not of the depositor, thus making the collecting bank primarily liable to its customer. The Code now adopts the “Massachusetts rule” instead, to the effect that a bank is not liable for the negligence of its correspondents (at least so long as they are selected with reasonable care).

**Checks of Decedents and Incompetents**

One final noteworthy item to Ohio practitioners and bankers is the provisions of section 4-405, which substitute a far more sensible rule than in the past with respect to outstanding checks of a deceased or incompetent drawer. Under former case law, Ohio banks could not safely cash outstanding checks of a decedent on the theory that death revoked the agency to pay. The new rule permits payment of such checks by the bank on which they are drawn until such time as the bank knows of death or an adjudication of incompetency and has had reasonable opportunity to act on this knowledge. In addition, even with knowledge of death (but not incompetency), the bank may continue to pay such

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86. Ohio Rev. Code § 1304.27.
87. Ohio Rev. Code § 1304.08.
89. Ohio Rev. Code § 1304.28.
checks for a period of ten days after death unless ordered to stop payment by a person claiming an interest in the account.

The remaining provisions of article 4 contain either statements of law not considered unusual or noteworthy or rules relating to bank procedures, warranties, and similar matters of a more specialized nature. These should be studied carefully by bank counsel and banking personnel, but are of only passing interest to most lawyers.