Negotiable Instruments: The Bank Customer's Ability to Prevent Payment on Various Forms of Checks

*George Wallach**

The commercial world contains many types of checks and drafts that may be used in lieu of cash in various kinds of transactions. This includes, but is by no means limited to, the popular personal check, money orders (both bank money orders and personal money orders), cashier's checks, certified checks and traveler's checks. There are, however, just two basic types of checks in common use. The first is a check that could be called a personal check, because the bank on which the instrument is drawn has no liability on the instrument.[1] The bank has not signed or accepted this type of instrument, and in the absence of a signature or an acceptance, no person is liable on the instrument.[2] At the other extreme is the bank check, a check on which a bank is liable as either a drawer or acceptor. This class of instruments includes cashier's checks and certified checks.[3]

The ability to prevent payment on personal checks is clear, for as the next section of this Article will demonstrate, a bank customer has an absolute right to stop payment on personal checks at any time prior to the actual payment of that instrument by the bank on which it is drawn. However, the bank customer's ability to prevent payment on bank checks is another matter. Neither the Uniform Commercial Code nor the judicial opinions construing the Code are as clear about the ability of a bank customer to prevent payment on bank checks. For this reason, and because comparisons between the

---

*Associate Professor of Law University of Missouri—Columbia School of Law. Member of the New York bar. B.S., City College of the City University of New York, 1964; J.D., State University of New York at Buffalo School of Law, 1967.

[1]Personal checks include ordinary checks drawn by a bank customer and personal money orders, which are the equivalent of one check checking accounts. Hong Kong Importers, Inc. v. American Express Co., 301 So. 2d 707 (La. Ct. of App. 1974); Note, *Personal Money Orders and Teller's Checks: Mavericks Under the UCC*, 67 COLUM. L. REV. 524, 527-28 (1967).

[2]U.C.C. §§ 3-401(1), 3-410.

[3]Cashier's checks and certified checks are the most common types of bank checks. Bank money orders are treated identically to these instruments because a bank has assumed primary liability on the instrument. United States v. Second Nat'l Bank, 502 F.2d 535 (5th Cir. 1974); Fulton Nat'l Bank v. Delco Corp., 128 Ga. App. 16, 195 S.E.2d 455 (1973); Bank of Niles v. American State Bank, 14 Ill. App. 3d 729, 303 N.E.2d 186 (1973); Bailey, *Bank Personal Money Orders as Banking Obligations*, 81 BANKING L.J. 669 (1964); Comment, 67 NW. U.L. REV. 915, 916 (1973). Traveler's checks issued by banks are also bank obligations, and once countersigned, are negotiable instruments. Ashford v. Thom. Cook & Son, 52 Haw. 113, 471 P.2d 530 (1970); Hawkland, *American Travelers Checks*, 15 BUFFALO L. REV. 501 (1965).

ability to prevent payment on personal checks and bank checks becomes important to the discussion, the ability to prevent payment on a personal check is a natural starting point.

I. PERSONAL CHECKS

The Uniform Commercial Code section that is critical to an understanding of the ability to successfully prevent payment on a personal check is section 3-413(2). The author of the check, called a drawer, promises that he will pay the amount of the instrument to any holder thereof subject only to two conditions precedent: Dishonor of the draft, and any necessary notice of dishonor or protest.[4]

A drawer of a personal check has a statutory right to stop payment of his check at any time prior to its payment by the bank on which it is drawn.[5] Payment for this purpose is defined in U.C.C. section 4-303 and includes payment in cash as well as completion of posting.[6] If the drawer of the instrument has ordered his bank to stop payment under circumstances that allow the bank a reasonable time to act upon that stop order, and the bank fails to honor the stop order, the bank may not be able to charge its customer's account for the amount of the item.[7]

---

[4]The drawer's liability does not arise until after the instrument has been dishonored by the drawee bank. U.C.C. § 3-413(2). Dishonor occurs when the check is presented for payment by the holder, and payment is refused for any reason. U.C.C. § 3-507(1)(a). Notice of dishonor is the act of giving actual notice of this dishonor to the drawer. Such notice may be either oral or written. U.C.C. § 3-508(3). Protest is a formalized form of notice of dishonor. U.C.C. § 3.509. It is only required on drafts or checks drawn or payable outside the United States. U.C.C. § 3-509, Comment 1.

[5]U.C.C. § 4-403(1). The stop order must arrive at the bank in time to give the bank an opportunity to act on it before actually paying the instrument. Thus, it is not sufficient for the stop order to arrive moments before payment occurs. The bank is entitled to a reasonable lead time before the stop order is treated as having been timely. U.C.C. § 4-303(1). *See* Horner, *The Stop Payment Order*, 2 BAYLOR L. REV. 275 (1950); Moore, Sussman & Brand, *Legal and Institutional Methods Applied to Orders to Stop Payment of Checks*, 42 YALE L.J. 817 (1943); Morrison & Sneed, *Bank Collections: The Stop-Payment Transaction—A Comparative Study*, 32 TEX. L. REV. 259 (1954); Note, *Stopping Payment of Checks*, 79 BANKING L.J. 185 (1962); Note, *Stop Payment and the Uniform Commercial Code*, 28 IND. L.J. 95 (1952).

[6]U.C.C. § 303 lists five different forms of payment: Acceptance or certification of the item, payment in cash, settlement without right to revoke, completion of posting, and becoming accountable. *See also* U.C.C. § 4-213(1).

[7]The burden of establishing the fact and amount of loss from any failure of the bank to act on the stop order is on the customer. The bank's potential liability to its customer for failing to heed his instructions is greatly alleviated by the bank's right to subrogate to the position of any holder in due course of the instrument under U.C.C. § 4-407(a).

Where the customer's stop order is motivated by anything other than a "real defense" to payment, a holder in due course can enforce the instrument against the

However, the right to stop payment does not destroy the obligation of the drawer to honor his contractual obligation under section 3-413 of the U.C.C.[8] In effect, the stop order does no more than create a breach of the contractual liability that the drawer has assumed under section 3-413. The drawer has promised that he will pay the instrument to any holder, subject only to any necessary notice of dishonor or protest. If the bank has dishonored the instrument in compliance with its customer's direction that payment be stopped, both notice of dishonor and protest are excused.[9] Hence, the conditions precedent to the drawer's contractual liability become inoperative once payment has been stopped.

Ordinarily, the holder of the instrument has no rights against the bank on which the instrument is drawn.[10] The holder's sole recourse is to pursue his rights against the drawer on either the drawer's section 3-413 liability or, in some circumstances, on any underlying obligation the drawer may have to the holder.[11] The only legally recognized objections to honoring a drawer's section 3-413 liability to the holder are those defenses or claims permitted by either sections 3-305 or 3-306.[12] Which of the defenses and claims will

---

drawer even though payment has been stopped. Since the stop order would not have prevented the holder in due course from ultimately collecting the amount of the instrument in full, the bank's failure to act on the stop order is considered harmless to the interests of the customer, and the bank can still charge the amount of the instrument to the customer's account. U.C.C. § 4-403, Comment 8; U.C.C. § 4-407, Comment 1. These rules parallel the pre-Code situation under the Negotiable Instruments Law. Note, *Stop Payment and the Uniform Commercial Code*, 28 IND. L.J. 95, 97-98 (1952).

[8]2 R. ANDERSON, UNIFORM COMMERCIAL CODE § 3-413:12 (2d ed. 1971 & Supp. 1974); H. BAILEY, THE LAW OF THE BANK CHECKS § 13.11 (4th ed. 1969 & Supp. 1975).

[9]U.C.C. § 3-511(2)(b) excuses notice of dishonor and protest to any party who has "countermanded payment" of the instrument.

[10]U.C.C. § 3-409. This is the effect of the rule that a check is not an assignment of the drawer's rights to the funds deposited in his bank but merely a direction from the bank's customer to the bank to pay the instrument.

[11]If the holder of the instrument obtained the instrument from the drawer as part of some personal transaction with the drawer, the check represents conditional payment of the debt or other obligation incurred by the drawer to the holder. U.C.C. § 3-802(1)(b) provides that delivery of a personal check suspends the duty to pay an obligation until the check is presented for payment. If the check is paid, the payment satisfies both the drawer's liability on the instrument and his liability on the "underlying" obligation. If the check is dishonored by the drawee bank, the holder of the check may seek to recover from the drawer of the check on either the drawer's obligation on the instrument or his underlying obligation.

[12]Section 3-305 contains the so-called "real" defenses: Infancy, incapacity, duress, illegality of the transaction, misrepresentation, discharge in insolvency, and any other discharge of which the holder has knowledge. Section 3-306 contains the "personal" defenses: Valid claims by any person, all defenses available in an action on a simple contract, failure of consideration, and similar defenses.

For further discussion *see* note 42 *infra*.

be available for utilization by the drawer depends upon the holder's status. If the holder of the instrument is a holder in due course,[13] only a limited number of objections, primarily those listed in section 3-305 of the Code, may be asserted.[14] If, however, the holder is not a holder in due course, section 3-306 of the Code permits the drawer to raise a broader range of objections to payment of the instrument.[15]

Thus, it is clear that the bank customer may stop payment on his personal check and on other forms of checks that are essentially equivalent to a personal check and thereby put the onus of collection of the instrument on the holder. While the bank customer may ultimately be forced to pay the instrument, he does shift the burden of enforcing the instrument to the holder.[16]

The stop order's effect is only procedural, although the importance of the procedural advantage should not be missed, as the effective stop order gives the drawer an opportunity to raise objections to payment while still in possession of the cash represented by the check.[17] Rather than collecting the amount of the personal check from the bank on which it is drawn, the holder is forced to look for payment elsewhere. If the holder is the person who dealt with the bank customer and, for example, did not provide satisfactory goods or services, this holder will be tempted to negotiate for a reasonable settlement with the drawer. Even if the holder is a holder in due course who could collect on the instrument in spite of the drawer's objection to payment, the holder might choose to return the instru-

---

[13]A holder in due course is a holder who satisfies the requirements of U.C.C. § 3-302(1). In addition to satisfying the three requirements of that subsection, the person in possession of the instrument must also be a holder. A holder is defined by U.C.C. § 1-201(20) as a person in possession of a negotiable instrument issued to him, indorsed to him or his order, or to bearer or in blank.

[14]In some situations, a payee of an instrument will qualify as a holder in due course. U.C.C. § 3-302(2). However, the payee who qualifies as a holder in due course is ordinarily still subject to the drawer's personal defenses, as a non-holder in due course would be. Only holders in due course who have "not dealt" with the drawer take free of the drawer's personal defenses. U.C.C. § 3-305(2). The subject of real and personal defenses is treated in greater detail in the text accompanying note 41 *infra*.

[15]Non-holders in due course take subject to the drawer's personal defenses as well as his real defenses. Such holders also take subject to competing claims of ownership to the instrument asserted by any person, while holders in due course take free of all such claims. *Compare* U.C.C. § 3-306 *with* U.C.C. § 3-305(1). The subject of claims is treated in greater detail in the text accompanying note 40 *infra*.

[16]The holder may sue the drawer to collect on the instrument. If the drawer establishes any type of defense to the payment of the instrument, the holder must then establish that he is a holder in due course who would take free of that type of defense in order to collect the full amount of the instrument. U.C.C. § 3-307(3).

[17]Note, *Blocking Payment on a Certified, Cashier's or Bank Check*, 73 MICH. L. REV. 424 (1974).

ment to the payee with whom the bank customer initially dealt, collect from the payee on his indorser's contract,[18] and leave the payee of the instrument in a position where he must seek to collect from the bank customer who wrote the check, subject to the ability of that bank customer to raise objections to payment.

II. Bank Checks

A corresponding ability to prevent payment on a bank check is not as clearly spelled out in the Code. Judicial opinions, while generally reaching the correct result, are not as well-reasoned as the decisions discussing the rights and liabilities of the parties on a personal check. This is probably due to three interrelated factors: (1) Less litigation has been generated in bank check situations, (2) the Code itself is more ambiguous about the intended rules, and (3) the relationships involved are more numerous and more complex.

A. Certified Check

The two types of bank checks that are most commonly used are the certified check and the cashier's check. The U.C.C deals with certified checks in greater detail than cashier's checks. A certified check is a personal check drawn by the customer of a bank on an account he maintains at the bank on which the bank has stamped a formal certification. The certification acts as an acceptance of the instrument by the bank.[19] Acceptance is defined to be a drawee's (in this case the bank's) signed engagement to honor the check in the form in which it was presented for certification.[20]

Section 3-413 makes an acceptor's liability essentially equivalent to that of a drawer of a personal check. The drawer's obligation on a personal check does not become an absolute obligation until the prerequisite notice of dishonor and protest are satisfied. However, where the drawer has stopped payment, as previously pointed out, these prerequisites are excused.[21] Thus, the nature of a certifying bank's liability is, as a practical matter, equivalent to that of a drawer of a personal check who has stopped payment on the instrument. The U.C.C. goes on to further define the various rights and liabilities of the parties to a certified check,[22] and clearly provides

---

[18]Under U.C.C. § 3-414(1), the indorser promises, upon dishonor, to pay the amount of the instrument to subsequent holders.

[19]U.C.C. § 3-411(1).

[20]U.C.C. § 3-410.

[21]*See* note 9 *supra* and accompanying text.

[22]When the drawer of a personal check has had it certified, the drawer remains liable on the instrument. U.C.C. § 3-411, Comment 1. However, if a holder obtains the certification, the drawer is discharged from his obligation on the instrument. U.C.C. § 3-411(1). Discharge on the instrument discharges the drawer's liability on the underlying obligation. U.C.C. § 3-802.

These rules, which make the drawer's discharge on the instrument dependent upon who procures the certification, are identical to the rules contained in the

that once a check has been certified the drawer of the check loses his ability to stop payment on the instrument.[23]

B. Cashiers' Checks

The Uniform Commercial Code has very little to say about cashiers' checks.[24] A cashier's check is an instrument drawn by a bank upon itself and signed by an authorized agent of the bank, ordinarily the cashier or an officer of the bank.[25] The most common analysis of the liability of the bank on a cashier's check is that the bank has assumed an acceptor's liability on the instrument through the mere act of issuing the instrument.[26] It has also been suggested

---

Negotiable Instruments Law. Roberts & Morris, *The Effect of a Stop Payment Order on a Certified Check*, 5 WYO. L.J. 170, 172-73 (1950).

[23]U.C.C. § 4-303(1)(a). This was not always the rule. Under the Negotiable Instruments Law, the generally accepted view was that payment could not be stopped if the holder had obtained the certification, but it could be stopped if the drawer had obtained the certification. Roberts & Morris, *supra* note 21, at 174-78.

The judicial opinions which established that payment could be stopped on a check certified at the request of the drawer when beyond this simple rule to create a body of law that has continued to plague more recent opinions.

Many of the opinions which recognized this right to stop payment suggested that the ability to stop payment would be lost if the drawer's objection to payment was a mere defense, as opposed to a claim of ownership, and the holder was a holder in due course. *See, e.g.*, Sutter v. Security Trust Co., 95 N.J. Eq. 44, 122 A. 381 (1923), *aff'd*, 96 N.J. Eq. 644, 126 A. 435 (1924); Welch v. Bank of Manhattan Co., 264 App. Div. 906, 35 N.Y.S.2d 894 (1942); Horner, *supra* note 5, at 278-79.

These opinions thus created the impression that the ability to successfully stop payment requires consideration of the nature of the objection to payment and the status of the holder. These questions are ones a bank would have great difficulty resolving prior to deciding whether to honor a customer's request to stop payment. The U.C.C. makes the right to stop payment a absolute one. The nature of the objection to payment and the status of the holder only become relevant when the holder later seeks to collect on the instrument from a party to the instrument. *See* U.C.C. § 4-403, Comment 8.

However, courts occasionally continue to insist on examining the nature of the objection to payment and the status of the holder in determining questions of the right to stop payment on a negotiable instrument. *See, e.g.*, Leo Syntax Auto Sales, Inc. v. Peoples Bank & Sav. Co., 35 Ohio Op. 2d 330, 215 N.E.2d 68 (C.P. Ohio 1965).

[24]The term is not defined in the Uniform Commercial Code and is found in only one section of the Code, § 4-211. Maggs, *The Construction of a Concordance to the Uniform Commercial Code*, 1974 U. ILL. L. F. 7,21.

[25]TPO Inc. v. FDIC, 487 F.2d 131, 135 (3d Cir. 1973); Pennsylvania v. Curtiss Nat'l Bank, 427 F.2d 395, 398 (5th Cir. 1970); State *ex rel.* Chan Siew Lai v. Powell, 536 S.W.2d 14, 16 (Mo. 1976); National Newark & Essex Bank v. Giordano, 111 N.J. Super. 347, 350, 268 A.2d 327, 328 (1970).

[26]Swiss Credit Bank v. Virginia Nat'l Bank, 538 F.2d 587 (4th Cir. 1976); Munson v. American Nat'l Bank & Trust Co., 484 F.2d 620, 623-24 (7th Cir. 1973); Pennslyvania v. Curtiss Nat'l Bank, 427 F.2d 395, 398 (5th Cir. 1970); Banco Ganaderoy Agricola v. Society Nat'l Bank, 418 F. Supp. 520 (N.D. Ohio 1976); Kaufman v. Chase Manhattan Bank, 370 F. Supp. 276 (S.D.N.Y. 1973); Meador v. Ranchmart State Bank, 213 Kan. 372, 517 P.2d 123 (1973); State *ex rel.* Chan Siew Lai v. Powell, 536 S.W.2d 14, 16 (Mo. 1976); Wertz v. Richardson Heights Bank & Trust, 495 S.W.2d 572, 574 (Tex. 1973).

that the instrument has been accepted by the bank as a result of the act of the cashier signing as drawer,[27] or that a cashier's check is equivalent to a note under section 3-118 of the Code.[28] Under this latter analysis, the bank is treated as a maker,[29] and a maker's liability is identical to that of an acceptor.[30]

In certified check situations, it is perfectly clear that the customer of the bank has lost his ability to stop payment once the instrument has been certified. However, while consistency may be desirable, the conclusion that payment may not be stopped on a cashier's check is not as clearly dictated by anything contained within the U.C.C. itself.

Those authorities who analyze the cashier's check situation as one involving an instrument that has been accepted, either through the act of issuance, or a bank officer's act in signing it, or both, suggest that the right to stop payment is lost because of section 4-303 of the Code. This section provides that a stop order arrives too late to bind the bank if it does not arrive within a reasonable time before the bank accepts an instrument.[31] Other authorities suggest that the bank customer who has purchased the cashier's check from his bank is not a "customer" within the meaning of section 4-402 of the Code,[32] the section which establishes the right to stop payment. Whatever the chosen manner of analysis, it is clear that the drawer of the certified check or the purchaser of a cashier's does not have the ability to stop payment on the instrument.[33]

C. Dishonor by the Bank

The mere fact that the drawer of the certified check or purchaser of a cashier's check cannot stop payment is not the end of the

---

[27]National Newark & Essex Bank v. Giordano, 111 N.J. Super. 347, 350, 268 A.2d 327, 329 (1970).

[28]TPO Inc. v. FDIC, 487 F.2d 131, 135-36 (3d Cir. 1973); Banco Ganadero y Agricola v. Society Nat'l Bank, 418 F. Supp. 520, 523-24 (N.D. Ohio 1976).

[29]Although the term "maker" is used with great frequency in the Uniform Commercial Code, it is not defined.

[30]U.C.C. § 3-413(1).

[31]Under U.C.C. § 4-303(1)(a), the stop order is not timely unless it arrives a reasonable time before the bank has accepted or paid the check. Issuance of a cashier's check operates as an acceptance of the cashier's check, and thus, payment cannot be stopped on a cashier's check once it has been issued. Pennsylvania v. Curtiss Nat'l Bank, 427 F.2d 395, 399 (5th Cir. 1970); Banco Ganaderoy Argicola v. Society Nat'l Bank, 418 F. Supp. 520, 526 (N.D. Ohio 1976); National Newark & Essex Bank v. Giordano, 111 N.J. Super. 347, 351, 268 A.2d 327, 329 (1970); Wertz v. Richardson Heights Bank & Trust, 495 S.W.2d 572, 574 (Tex. 1973); U.C.C. § 4-213(1).

[32]National Newark & Essex Bank v. Giordano, 111 N.J. Super. 347, 352, 268 A.2d 327, 329 (1970); Wertz v. Richardson Heights Bank & Trust, 495 S.W.2d 572, 574 (Tex. 1973).

[33]Nor may the issuing bank stop payment on either type of instrument. The bank is not a "customer" with a right to stop payment under U.C.C. § 4-403. The bank can-

inquiry. On either type of instrument, the bank's liability is primary in nature, as that term is used by those who deal with the U.C.C.[34] That is, the bank has an independent and direct obligation to the holder to pay the instrument. This obligation is essentially contractual in nature, or perhaps more accurately it is a voluntarily assumed obligation, the legal implications of which are described in section 3-413 of the Code. The bank can, should it choose to, breach its contractual liability and refuse to pay the instrument, as there is

---

not claim to be its own customer. Kaufman v. Chase Manhattan Bank, 370 F. Supp. 276 (S.D.N.Y. 1973).

Banks do draw checks on other banks at which they maintain accounts. Savings banks maintain checking accounts at commercial banks at least in part so that they will be able to give their customers official looking checks to use. Generally, savings banks do not offer checking accounts to their customers and hence cannot certify checks for customers; nor do savings banks issue cashier's checks. Instead, the savings bank draws a check on an account it maintains at a commercial bank and gives this check to its customer to use in his transaction. This type of check is usually called a teller's check. The bank which issues this check, whether it be a savings or commercial bank, is a customer of the commercial bank on which the check is drawn, and has a right to stop payment under U.C.C. § 4-403.

Several courts have concluded that payment may not be stopped on this type of instrument. *See, e.g.*, Ruskin v. Central Fed. Sav. & Loan Ass'n, 3 U.C.C. REP. 150 (Sup. Ct. N.Y. 1966); Malphrus v. Home Sav. Bank, 44 Misc. 2d 705, 254 N.Y.S.2d 980 (Albany County Ct. 1965).

There is at least one opinion permitting payment to be stopped. Fulton Nat'l Bank v. Delco Corp., 128 Ga. App. 16, 195 S.E.2d 455 (1973). Note, *Personal Money Orders and Teller's Checks: Mavericks Under the UCC*, 67 COLUM. L. REV. 524, 540-43 (1967); *See, Uniform Commercial Code Commentary*, 8 B.C. INDUS. & COM. L. REV. 260, 262-64 (1967).

However, once payment is stopped, the analysis of the ability of the drawing bank's customer to prevent a holder from collecting from the drawing bank on its drawer's contract is identical to that suggested later in the text when a cashier's check or certified check is involved. Benson, *Stop Payment of Cashier's Checks and Bank Drafts Under the Uniform Commercial Code*, 2 OHIO N.L. REV. 445, 459-60 (1975).

[34]Under the U.C.C., parties to a negotiable instrument who may be called upon to pay the instrument have either primary or secondary liability. Primary parties have two basic characteristics: They are the parties a holder will look to for payment first, and their liability is not subject to conditions precedent, other than presentment for payment. Makers of notes and acceptors have primary liability under U.C.C. § 3-413. Secondary parties are not liable until conditions precedent are satisfied. Indorsers are the principal example of secondary parties. Their liability does not arise until after a primary party has dishonored the instrument and the indorser has received notice of dishonor and protest. U.C.C. § 3-414.

Drawers do not fit neatly into either class. Their liability appears to be secondary, since holders look to the drawee first for payment, and the drawer's liability is subject to the same conditions precedent as is an indorser's. U.C.C. § 3-413(2). However, the drawee has no liability on the instrument, and viewing the drawer's liability as secondary would produce a situation where there is no party with primary liability. Nevertheless, the drawer's liability is generally referred to as being "secondary" under U.C.C. § 3-413. Comment, *Adverse Claims Under the Uniform Commercial Code: A Survey and Proposals*, 65 YALE L.J. 807, 818 n.50 (1956).

nothing in the Code which prevents the bank from doing so. Banks can and occasionally will refuse to pay on an instrument either to promote their own self interests[35] or to acommodate a dissatisfied customer who wants to see payment prevented.

The bank, having breached its contractual obligation as maker or acceptor of the instrument, is now certain to be sued by the holder. When the bank has dishonored the instrument to accommodate its customer, rather than to protect its own interests,[36] the bank must seek to utilize its customer's basis for objection to payment to absolve itself from its own contractual liability on the bank check. At common law, this attempt to utilize the bank customer's objections to payment was known as *jus tertii*.[37]

There are two variations of this situation. In the first situation, the bank is attempting to utilize its customer's objection to payment without the customer's presence as a party to the lawsuit brought by the holder of the instrument; in the second, and more common situation, the bank's customer will be a party to the lawsuit and may also have agreed to indemnify the bank for the expenses of

---

[35]Such situations arise when: (1) The bank has been defrauded into issuing or certifying the instrument, TPO Inc. v. FDIC, 487 F.2d 131 (3d Cir. 1973); Rockland Trust Co. v. South Shore Nat'l Bank, 366 Mass. 74, 314 N.E.2d 438 (1974); Mid-Continent Nat'l Bank v. Bank of Independence, 523 S.W.2d 569 (Ct. App. Mo. 1975), (2) There has been a failure of consideration because (a) the bank has issued or certified the instrument in exchange for an instrument on which payment has been stopped, Munson v. American Nat'l Bank & Trust Co., 484 F.2d 620 (7th Cir. 1973); Citizens & S. Nat'l Bank v. Youngblood, 135 Ga. App. 638, 219 S.E.2d 172 (1975); Wertz v. Richardson Heights Bank & Trust, 495 S.W.2d 572 (Tex. 1973), or (b) the bank has issued or certified the instrument in exchange for an instrument that has been dishonored, generally because it was drawn against insufficient funds, Wilmington Trust Co. v. Delaware Auto Sales, 271 A.2d 41 (Del. 1970); Tropicana Pools, Inc. v. First Nat'l Bank, 206 So. 2d 48 (Dist. Ct. App. Fla. 1968), or (3) the bank is owed a debt by the purchaser of the instrument and desires a set-off against the funds represented by the unpaid cashier's or certified check. Swiss Credit Bank v. Virginia Nat'l Bank, 538 F.2d 587 (4th Cir. 1976); Central Bank & Trust Co. v. First N.W. Bank, 332 F. Supp. 1166 (E.D. Mo. 1971).

[36]In these situations, the bank's customer is not even involved in the dispute. The bank may assert the very same claims and defenses that a drawer of a personal check could assert in the same situation, and the list of available claims and defenses depends on whether the holder of the instrument is a holder in due course or not.

If the holder of the instrument is a holder in due course, the bank must have a "real" defense of its own in order to avoid liability as a primary party to the instrument. Central Bank & Trust Co. v. First N.W. Bank, 332 F. Supp. 1166 (E.D. Mo. 1971); Citizens & S. Nat'l Bank v. Youngblood, 135 Ga. App. 638, 219 S.E.2d 172 (1975).

If, however, the holder is not a holder in due course, the bank can assert all of its claims and defenses. TPO Inc. v. FDIC, 487 F.2d 131 (3d Cir. 1973); Pennsylvania v. Curtiss Nat'l Bank, 427 F.2d 395, 399 (5th Cir. 1970); Rockland Trust Co. v. South Shore Nat'l Bank, 366 Mass. 74, 314 N.E.2d 438 (1974); Mid-Continent Nat'l Bank v. Bank of Independence, 523 S.W.2d 569 (Ct. App. Mo. 1975).

[37]*Jus tertii* is defined as "[t]he right of a third party." BLACK'S LAW DICTIONARY 1000 (rev. 4th ed. 1968).

defending the holder's claim. While the bank may be willing to accommodate its customer, it would understandably be reluctant to do so if it would be forced to bear the expense and burden of defending a lawsuit brought by the holder. Hence, banks usually demand and get indemnification agreements from their customers[38] and expect that the customer will assume the burden of defending the lawsuit that is almost certain to be brought by the holder of the instrument.

D. Bank Defenses

The question now becomes what kinds of matters may properly be brought to the court's attention as appropriate grounds for absolving the bank from its contractual obligation upon the instrument. Resolution of this problem depends upon several variables. The important variables are: (1) Whether the objection to payment is a claim or a defense; (2) whether the claim or defense is a first-party or third-party claim or defense; and (3) whether the holder of the bank check is a mere holder, or a holder in due course.

1. Claims and Defenses.—The law of negotiable instruments (as it developed at common law, under the Negotiable Instruments Law, and finally, at least for the time being, under Uniform Commercial Code) has generally drawn significant distinctions between legal claims of ownership, equitable claims of ownership, and defenses to payment.[39]

Legal claims of ownership to a negotiable instrument arise most frequently, if not exclusively, from the theft of the instrument.[40] Equitable claims of ownership arise when the owner of the instrument has voluntarily parted with possession of the instrument under circumstances such that an equitable right to the return of the instrument is recognized. The most commonly recognized situation of this type occurs when the owner has been defrauded into parting with the instrument.[41]

---

[38]Comment, 67 NW. U.L. REV. 915, 928 (1973).

[39]Britton, *Defenses, Claims Of Ownership And Equities—A Comparison Of The Provisions Of The Negotiable Instruments Law With Corresponding Provisions Of Article 3 Of The Proposed Commercial Code*, 7 HASTINGS L.J. 1, 20-26 (1955); Chafee, *Rights in Overdue Paper*, 31 HARV. L. REV. 1104, 1109-19 (1918).

[40]Britton, *supra* note 39, at 25. Theft, and the subsequent forgery of order paper always gives rise to an adverse claim of title on the part of the true owner. Theft of bearer paper also gives rise to adverse title claims enforceable so long as the thief retains the negotiable instrument, but the title claim is lost once a holder in due course obtains the instrument. The concept that permits a thief's defective title in bearer paper to ripen into a good title in the hands of a transferee who qualifies as a holder in due course is one of the most critical features of the law of negotiable instruments. This concept has its genesis in Peacock v. Rhodes, 97 Eng. Rep. 402 (K.B. 1781), and is continued in U.C.C. § 3-305(1)(a). *See* Warren, *Cutting Off Claims of Ownership Under the Uniform Commercial Code*, 30 U. CHI. L. REV. 469, 478-79 (1963).

[41]Comment, 26 ST. JOHN'S L. REV. 135 (1951). Other illustrations of equitable claims of ownership are found in U.C.C. § 3-306, Comment 5:

Defenses to payment, such as breach of warranty and failure of consideration, do not challenge the holder's rightful ownership of the instrument. These defenses are more like counterclaims that challenge the holder's right to collect the full amount of the instrument.[42] This area is complicated by a further division of claims and defenses into first-party claims and defenses, and third-party claims and defenses.

2. First-Party Claims and Defenses, and Third-Party Claims and Defenses.—If the person objecting to payment is raising a claim or defense of his own, a first-party claim or defense is involved. If the claim of title, or defense, belongs to a third party, a third-party claim or defense is involved.

It is sometimes possible to view an objection to payment as fitting within more than one category. However, the simpler cases fit solely within one classification. For example, if a drawer uses a check to pay for goods that do not meet the quality standard of an express or implied warranty, the objection to payment would be a first-party defense of breach of warranty. However, if a drawer delivers a check drawn to the order of a payee, and the check is stolen from the payee, forged by the thief, and presented for payment by a transferee from the thief, the objection to payment is both a first-party defense and a third-party legal claim of title. The drawer has a first-party defense to payment, he is obliged to pay the instrument to any holder, and the person presenting the check is not such a holder.[43] At the same time, the facts also establish that title to the instrument is still in the payee, and the drawee can resist payment by attempting to assert his third-party's (the payee's) claim of ownership.

The provision includes all claims for rescission of a negotiation, whether based in incapacity, fraud, duress, mistake, illegality, breach of trust or duty or any other reason. It includes claims based on conditional delivery or delivery for a special purpose. It includes claims of legal title, lien, constructive trust or other equity against the instrument or its proceeds.

[42]Defenses are divided into two sub-classes: Those that are available against all holders; and those that are available only against mere holders, but not against holders in due course. The Negotiable Instruments Law categorized the former sub-class as "real" defenses and the latter as "personal" defenses. 2 R. ANDERSON, *supra* note 8, § 3-305.3

The Uniform Commercial Code abandons the "real" and "personal" labels although both are still commonly used. The only defenses available under the Code against holders in due course are those listed in U.C.C. § 3-305(2); plus forgery, which is made a "real" defense by U.C.C. § 3-404; and material alteration, which is made a "real" defense by U.C.C. § 3-407.

[43]A holder is a person in possession of a negotiable instrument which, in the case of order paper, must have been indorsed by the original payee. U.C.C. §§ 1-201(20), 3-202 & 3-204.

3. The Status of the Holder.—The holder of the instrument may be either a holder in due course or a mere holder of the instrument. If the holder is a holder in due course, he can enforce the instrument free from all legal and equitable ownership claims of any person to the instrument and free from many first and all third-party defenses. The only defenses a holder in due course is subject to are those known as "real defenses," and then only those real defenses that are first-party defenses.[44]

A mere holder's ability to collect on the instrument is governed by section 3-306 of the Code. This section provides:

> Unless he has the rights of a holder in due course any person takes the instrument subject to
> (a) all valid claims to it on the part of any person; and
> (b) all defenses of any party which would be available in an action on a simple contract; and
> (c) the defenses of want or failure of consideration, non-performance of any condition precedent, non-delivery, or delivery for a special purpose (Section 3-408); and
> (d) the defense that he or a person through whom he holds the instrument acquired it by theft, or that payment or satisfaction to such holder would be inconsistent with the terms of a restrictive indorsement. The claim of any third person to the instrument is not otherwise available as a defense to any party liable thereon unless the third person himself defends the action for such party.

This section is not an easy one to understand. This author believes it establishes the following rules in regard to the bank's ability to raise the *jus tertii* of its customer.

1. Subsection (a).—The bank may assert any claim to title it may have, or a third person could recover the instrument from the holder prior to payment of the instrument;[45] but this subsection does not authorize the bank to raise a third person's legal or equitable claim of ownership as a basis for objecting to its obligation to pay the instrument to the holder. Thus, subsection (a) only allows the bank to raise first-party claims.

---

[44]U.C.C. § 3-305(2) provides what is almost an exclusive list of the "real defenses" available against a holder in due course. The five subparts to subsection (2) rather clearly limit the defenses to first-party rather than third-party defenses. Note, *Personal Money Orders and Teller's Checks: Mavericks Under the UCC*, 67 COLUM. L. REV. 524, 547 (1967).

[45]Warren, *supra* note 40, at 479-80.

2. Subsection (b).—This subsection allows the bank to raise defenses of its own to payment of the instrument but does not authorize the bank to utilize a third person's defenses as a basis for objecting to its obligation to pay the instrument.

3. Subsection (c).—This subsection is designed to insure that certain defenses will always be available as first-party defenses, even if they would not "be available in an action on a simple contract" under subsection (b).[46] However, this subsection does not authorize the bank to utilize a third person's defenses as a basis for its objection to payment of the instrument. Thus, subsections (b) and (c) allow the bank to raise a great number of first-party defenses but do not authorize the bank to raise third-party defenses of any kind.

4. Subsection (d).—This subsection permits the bank to raise two third-party "defenses" to payment: Theft, or violation of a restrictive indorsement. These two objections are really third-party legal claims of title to the instrument and not mere defenses.[47] This subsection then goes on to provide that other third-party claims cannot be raised "unless the third person himself defends the action for such party."[48] Third-party defenses, such as breach of warranty, are not even mentioned.

The U.C.C.'s treatment of third-party equitable claims of ownership and defenses can best be understood from a historical perspective. Legal claims of ownership have traditionally been recognized as valid objections to payment of an instrument, and the law of negotiable instruments has always allowed such claims of ownership to be raised by either the true owner of the instrument or a third party who is liable on the instrument.[49] Hence, a drawer or acceptor could always successfully object to payment because the holder was not the true owner of the instrument, regardless of whether the drawer or acceptor was the true owner, or some third party was the true owner.

The common law of negotiable instruments seemed to prohibit an acceptor or drawer from asserting third-party equitable claims of ownership or third-party defenses as a basis for objecting to his own

---

[46]J. WHITE & R. SUMMERS, UNIFORM COMMERCIAL CODE, § 14-11 (1972).

[47]These "super-claims," which the bank can raise as objections to payment even without the intervention of the bank customer, have been deliberately singled out for such special treatment. The theft "claim" is so treated because of "the policy which refuses to aid a proved thief to recover." U.C.C. § 3-306, Comment 5. The restrictive indorsement "claim" has been made available to the bank to mesh with the Code's special treatment of restrictive indorsements in other contexts. *See* U.C.C. §§ 3-205, 3-206 & 3-603.

[48]U.C.C. § 3-306(d).

[49]W. BRITTON, BILLS AND NOTES § 158 (2d ed. 1961); Britton, *supra* note 39, at 23; Comment, 26 ST. JOHN'S L. REV. 135, 139 (1951).

liability on the instrument.[50] However, some courts operating under the Negotiable Instruments Law began to permit the assertion of third-party equitable claims of ownership, and even third-party defenses.[51] The draftsmen of the U.C.C. sought to return to the more restrictive common law view, which prohibited the utilization of third-party equitable claims or defenses, and section 3-306(d) is the result of this desire. While this section is not as clearly drafted as it could be, the intent was to allow the accepting or certifying bank to raise third-party legal claims of ownership in the context under discussion and to prohibit the bank from raising third-party equitable claims of ownership or third-party defenses, even where the holder of the instrument was not a holder in due course.

The bank customer's equitable claims of ownership can be raised only if the bank customer personally defends the holder's action against the bank.[52] However, third-party defenses are completely unavailable, even if the bank wishes to aid its unhappy customer and refuses to pay the instrument. When the holder sues on the instrument, the bank cannot raise its customer's defenses, and the customer appears to have no right to intervene in the lawsuit to raise his defenses on his own. The holder, even though not a holder in due course, collects the full amount of the instrument.[53]

Thus, even if the bank cooperates with its customer by dishonoring its contractual obligations on the instrument, the bank's ability to utilize the *jus tertii* of its customer is limited to legal claims of ownership. The bank may raise its customer's *equitable* claims of ownership only if the customer intervenes in the lawsuit or is otherwise involved as a party. But the bank may not raise its customer's *mere defenses* to payment, even if the customer seeks to be involved in the litigation. Since defenses to payment are the most common form of objection to payment of an instrument, the bank customer is in large part unable to prevent payment on a bank instrument even when the bank is cooperating.

---

[50]Britton, *supra* note 39, at 23; Comment, 26 ST. JOHN'S L. REV. 135, 139 (1951).

[51]Britton, *supra* note 39, at 24; W. BRITTON, BILLS AND NOTES § 159 (2d ed. 1961); Note, *Blocking Payment on Certified, Cashier's and Bank Checks*, 73 MICH. L. REV. 424, 431 (1973).

[52]*Fulton Nat'l Bank v. Delco Corp.*, 128 Ga. App. 16, 195 S.E.2d 455, 457 (1973).

[53]U.C.C. § 3-306, Comment 5. This comment provides, in part:

> Nothing in this section is intended to prevent the *claimant* from intervening in the holder's action against the obligor or defending the action for the latter, and asserting his *claim* in the course of such intervention or defense. Nothing here stated is intended to prevent any interpleader, deposit in court or other available procedure under which the defendant may bring the *claimant* into court or be discharged without himself litigating the claim as a defense. (Emphasis added.)

This paragraph refers only to claims and claimants, and is further evidence of the Code draftsmen's intent to prevent the utilization of defenses in all situations.

E. Bank Responsibility upon Notice of Adverse Claim

A troublesome problem arises for the bank's customer when the bank is reluctant or unwilling to breach its own contractual obligation on the instrument. The reluctant bank might be pacified by an offer of indemnification, but the bank customer's only method of preventing the unwilling bank from honoring its contractual obligation is by the assertion of an "adverse claim" to the instrument.

Under the common law and the Negotiable Instruments Law, the bank customer could assert an "adverse claim" to the instrument by merely giving notice to the bank of the existence of this outstanding claim.[54] The word "claim" was, however, limited to claims of title of either a legal or equitable nature, and mere defenses did not give rise to a right to assert an adverse claim.[55] A bank which proceeded to pay an instrument after receiving notice of an adverse title claim would remain liable to the claimant, even though payment had been made to the holder.[56] Thus, banks were faced with a risk of double liability if they paid an instrument after receiving notice of an adverse claim. Occasionally, a bank might refuse to pay an instrument after receiving notice of an adverse claim then be held liable to the holder in one action and liable again to the adverse claimant in another action.[57] Double liability was possible even if the bank heeded the notice of adverse claim.

The U.C.C. continues to allow the bank customer to raise adverse claims but has restricted the effect of the bank's failure to heed the notice of this adverse claim.[58] Section 3-603 provides that payment to a holder discharges the liability of any person on an instrument even if made with knowledge of an adverse claim. In only two situations must the bank assert its customer's objection, or else remain liable on the instrument. A bank that in bad faith pays a stolen instrument or pays a restrictively indorsed instrument in a

---

This total inability to utilize a third-party defense, even if the third party is a party to the law suit, is consistent with the traditional common law rule on this question. Note, *Personal Money Orders and Teller's Checks: Mavericks Under the U.C.C.*, 67 COLUM. L. REV. 524, 546 (1967); Uniform Commercial Code Commentary, 4 B.C. INDUS. & COM. L. REV.. 459, 463 (1963).

[54]H. BAILEY *supra* note 8, §§ 10.9 10.10; W. BRITTON, *supra* note 48, § 159; Note, *Automatic Discharge of Negotiable Instruments in the Proposed Commercial Code*, 44 ILL. L. REV. 88 (1949).

[55]Note, *Blocking Payment on a Certified, Cashier's or Bank Check*, 73 MICH. L. REV. 424, 436 (1973).

[56]Comment, *Adverse Claims Under the Uniform Commercial Code: A Survey And Proposals*, 65 YALE L.J. 807, 810-11 (1956).

[57]*Id.* at 811.

[58]H. BAILEY, *supra* note 8, at §§ 10.9, 10.10; *supra* note 39, at 25-26; Comment,*Automatic Discharge of Negotiable Instruments in the Proposed Commercial Code*, 44 ILL. L. REV. 88, 94-95 (1949).

manner not consistent with the restrictive indorsement is not discharged by such payment, even if the third party does not supply indemnity, does not obtain an injunction, or does not participate voluntarily in the defense of any lawsuit that the holder may commence.[59] However, the bank may, in all other cases, proceed to pay the instrument without fear of any liability to its customer.[60]

The bank customer may prevent the bank from receiving the discharge when he has an adverse title claim based on facts other than theft or violation of a restrictive indorsement if he either obtains an injunction or posts indemnity "deemed adequate"[61] by the bank. However, the injunction possibility is of limited practical value to the bank customer. To be effective under section 3-603, the injunction must be obtained in an action to which both the bank and the holder are parties.[62] Aside from the jurisdictional problems raised by this requirement, the injuction must be obtained before the uncooperative bank has paid the instrument, and as a practical matter, this may be an impossible task.[63]

The indemnification possibility appears to be of mere practical significance to the adverse claimant, although the situation is replete with uncertainties regarding the apparently uncontrolled discretion of the bank to determine the adequacy of the offered indemnification.[64] In any event, the requirement that the bank customer's objection to payment be based on an adverse title claim

---

[59]U.C.C. § 3-603(1)(a) & (b). These sections deal only with the bank's discharge on the instrument. The bank might remain liable to the true owner of a stolen instrument. The bank also could be held liable on another theory, such as conversion if it paid a restrictively indorsed instrument in a manner not consistent with the restrictive indorsement. *See* U.C.C. § 3-419.

[60]This represents a significant change from the rule under the Negotiable Instruments Law. Under § 119 of that statute, the paying bank was discharged only if it paid "in due course," which meant without notice of a defect in the holder's title. Under the U.C.C., the discharge is absolute, even if made with notice of such a defect, except in the two situations specifically treated differently by U.C.C. § 3-603 itself. Chenowith v. Bank of Dardanelle, 243 Ark. 310, 419 S.W.2d 792 (1967); Morrison & Sneed, *supra* note 5, at 272-73; Comment, *Automatic Discharge of Negotiable Instruments in the Proposed Commercial Code*, 44 U. ILL. L. REV. 88, 88-89 (1949); Comment, *Adverse Claims Under the Uniform Commercial Code: A Survey and Proposals*, 65 YALE L.J. 807, 810-12 (1956).

[61]U.C.C. § 3-603(1).

[62]The language of U.C.C. § 3-603 clearly requires this: The adverse claimant must enjoin payment" by order of a court of competent jurisdiction in an action in which the adverse claimant and the holder are parties."

[63]The only reported case involving the use of an injunction in an adverse claim situation is Jefferies & Co. v. Arkus-Duntov, 357 F. Supp. 1206 (S.D.N.Y. 1973).

[64]Comment, *Adverse Claims Under the Uniform Commercial Code: A Survey And Proposals*, 65 YALE L.J. 807, 813-14 (1956). The only reported decision involving an attempted indemnification in an adverse claim situation is *National Newark & Essex Bank v. Giordano*, 111 N.J. Super. 347, 268 A.2d 327 (1970).

prevents the bank customer from utilizing this method of preventing payment in the most common kinds of cases. Most dissatisfied bank customers only have a defense to payment, and defenses may not be raised under the doctrine of adverse claim.

This analysis suggests that where a bank is primarily liable on an instrument, it is almost impossible for a bank customer to effectively object to payment even if he can convince the bank to dishonor its obligation, or, in the case of an uncooperative bank, obtain an appropriate injunction or offer indemnity quickly enough to prevent the bank from complying with its contractual obligations under the U.C.C. For even if the initial payment can be prevented, the bank customer is unlikely to be successful in seeing his objections to payment utilized in any subsequent litigation brought by the holder. At the very best, only claims can be raised, and mere defenses to payment are unavailable as a basis for objecting to payment.

III. A Question of Policy

There seems to be little doubt that the draftsmen of the U.C.C. deliberately sought to create the body of law described above.[65] The draftsmen wanted to accomplish at least two things. First, there was a perceived need for forms of negotiable instruments that would function as an almost complete substitute for cash. In order to serve as a satisfactory substitute for cash, these negotiable instruments had to satisfy the two principal concerns of any person who accepted them as a form of payment. Such a person would have to be satisfied that the credit of a substantial business entity stood behind the instrument and that payment by means of such an instrument would produce much of the finality that would be produced by payment in cash. Both of these expectations are satisfied when a bank check is used as the form of payment. In the absence of bank insolvency, or the relatively minor possibilities of successful *jus tertii* or adverse claim assertions, bank checks provide both a certainty of credit and finality of payment. This part of the policy decision is thus rooted in the business and commercial needs of a modern society.[66]

The second principal goal was to eliminate the potential for double liability.[67] This goal has been met through the careful draftsman-

[65]Note, *Blocking Payment on a Certified, Cashier's or Bank Check*, 73 Mich. L. Rev. 424, 431 (1974); Comment, *Adverse Claims Under The Uniform Commercial Code: A Survey And Proposals*, 65 Yale L.J. 807, 812-13 (1956).

[66]National Newark & Essex Bank v. Giordano, 111 N.J. Super. 347, 351-52, 268 A.2d 327, 329 (1970); Strahorn, *The Policy Or Function Of The Law Of Bills And Notes*, 87 U. Pa. L. Rev. 662 (1939).

[67]Comment, *Adverse Claims Under The Uniform Commercial Code: A Survey And Proposals*, 65 Yale L.J. 807, 812 (1956).

ship of section 3-603. In addition, the draftsmen wanted to insulate the bank from possible entanglements in conflicting claims to a right of payment represented by the instrument or in litigation arising out of such conflicting claims, at least in situations where the bank was not willing to assume these risks. Hence, when the bank is not willing to cooperate with its customer and dishonor its obligation, the customer is severely limited in his ability to prevent the bank from paying the instrument and obtaining a total discharge of liability within the rules of section 3-603 of the Code.

Even where the bank is willing to accommodate its customer and dishonor its obligation, section 3-306 of the Code limits those classes of objections that can be used successfully. This gives the bank an excuse for not honoring a customer's request that payment be denied[68] and also serves to protect the holder's expectation that payment by means of a bank check is final.

It would appear that the existing policy choice, which fosters the essential equivalence of bank checks to cash, has the effect of promoting the interests of an alleged wrongdoing holder of the instrument at the expense of the bank customer[69] who is frustrated in his attempt to prevent this person from collecting the full amount of the instrument although the holder may not have fulfilled his part of the transaction. This past decade has seen an increasing concern for the protection of the interests of consumers, and in some situations, consumers are the unhappy users of bank checks.

It is not surprising that there have been both judicial and nonjudicial suggestions that these rules be changed to preserve equitable title claims and defenses when a non-holder in due course is in possession of a bank check. One suggestion is that the rules of sections 3-603 and 3-306 be changed by amending the Code.[70] Another is that the term "claims" be read very broadly under these two sections as they presently exist so as to encompass defenses such as breach of warranty.[71] This would allow the bank customer to successfully raise these defenses.

---

[68]Section 3-306(d) prohibits the utilization of equitable title claims unless the claimant is directly involved. Comment 5 somewhat paternalistically states:

> The contract of the obligor is to pay the holder of the instrument, and the claims of other persons against the holder are generally not his concern. He is not required to set up such a claim as a defense, since he usually will have no satisfactory evidence of his own on the issue; and the provision that he may not do so is intended as much for his protection as for that of the holder.

[69]Comment, *Automatic Discharge of Negotiable Instruments in the Proposed Commercial Code*, 44 ILL. L. REV. 88, 95 (1949).

[70]Note, *Blocking Payment on a Certified, Cashier's or Bank Check*, 73 MICH. L. REV. 424, 441 (1974).

[71]Comment, 67 NW. U.L. REV. 915, 926 (1973). It has also been suggested that the entire concept of negotiability needs to the rethought and that the partial or total

The extent of the judicial interest in protecting a consumer who has used a bank check for payment can be seen in a recent decision, *Dziurak v. Chase Manhattan Bank.*[72] This case, though overruled on appeal, demonstrates the lower courts concern with the plight of the consumer. *Dziurak* involved an individual who was defrauded in a transaction involving the purchase of a part interest in a small business. The court referred to the bank customer, who had used a cashier's check to purchase this interest, as "unsophisticated."[73] The court, while fully recognizing that a traditional analysis would prevent a bank customer from stopping payment on a cashier's check, refused to follow that analysis.[74] Instead, the court ruled that the bank had acted improperly in refusing to honor its customer's request that payment be stopped or that the instrument by dishonored.[75] This decision is clearly outside the mainstream of judicial authority on this question. Nevertheless, it does show the concern for the protection of consumers who may have a defense to payment where the objection does not rise to the level of a claim that can be successfully asserted, or where the consumer has an equitable title claim, as in *Dziurak*, but does not know of or attempt to use the injunction or indemnity options of section 3-603.

The need for a form of negotiable instrument that is an adequate substitute for cash and the desire to protect the hapless consumer who has chosen to use such an instrument seems to have created an irreconcilable conflict. The existing rules function to prevent the successful assertion of consumer defenses to payment that arise before the instrument has been collected, and the complicated rules on *jus tertii* and adverse claim will frequently cause even equitable title claims to be lost.

A direct amendment to the U.C.C. or the adoption of consumer protection legislation could change the current situation and establish the ability of the consumer users of these instruments to simply and successfully raise defenses and equitable title claims. If such legislation were to be adopted, the bank that is being asked to dishonor its contractual liability should be protected by an adequate indemnification provision when the dishonor is for the customer's benefit. This would not only protect the bank from the financial

---

elimination of the concept would be to the benefit of society. Rosenthal, *Negotiability—Who Needs It?* 71 COLUM. L. REV. 375 (1971).

Not all commentators find the existing rules undesirable. *See, e.g., Uniform Commercial Code Commentary*, 8 B.C. INDUS. & COM. L. REV. 260, 264 (1967).

[72]88 Misc. 2d 641, 388 N.Y.S.2d 496 (N.Y. Sup. Ct. 1976), *rev'd* 396 N.Y.S.2d 414 (App. Div. 1977).

[73]*Id.* at 647, 388 N.Y.S.2d at 501.

[74]*Id.* at 643, 388 N.Y.S.2d at 498-99.

[75]*Id.* at 650, 388 N.Y.S.2d at 502-03.

burden of defending the holder's claim for payment but would also help insure that the customer would actively defend the action on behalf of the bank.

There may be a question about the seriousness of the need for such protective legislation. The Uniform Consumer Credit Code[76] and the recently adopted Federal Trade Commission restrictions[77] on the holder in due course concept do not prevent the use of personal checks on which a holder could become a holder in due course with a right to enforce the instrument directly against the consumer free of all title claims and personal defenses.[78] Certainly a holder in due course of a bank instrument would also, at least within existing statutory frameworks, be able to collect on a bank check. It is only when the holder is not a holder in due course that the U.C.C. rules on *jus tertii* and adverse claim provide greater protection from defenses for the holder than either of these consumer protection schemes provide for the holder of a personal check. Where an equitable title claim is involved, the existing scheme does provide equivalent treatment once the cumbersome conditions precedent of intervention under section 3-306(d) or injunction or indemnity under section 3-603 have been satisifed. Thus, proposed legislation would not have to do anything more than insure that a consumer's defenses and equitable claims would be easily available against a non-holder in due course of a bank instrument upon the offer of a defined type of indemnity in order to virtually equalize the treatment of personal and bank checks in this regard.

IV. CONCLUSION

The drawer of a personal check has an absolute right to stop payment on the instrument, a right which can be of great practical significance to the drawer, regardless of whether the instrument is held by a mere holder or a holder in due course. A person who uses a bank check instead of a personal check has given up the power to stop payment, and his ability to prevent payment of the instrument through more indirect means involving *jus tertii* or adverse claim assertions is very limited.

In those cases where a bank check has been used as the form of payment in a business transaction, the existing rules seem to create

---

[76]U.C.C.C. § 2.403 (1970) prohibits the seller from taking a negotiable instrument other than a check in a consumer transaction.

[77]Preservation of Consumers' Claims and Defenses, 16 CFR 433 (1977). The FTC regulations require certain language to be included in consumer notes and consumer credit contracts that subject the holder to most consumer defenses.

[78]The U.C.C.C. specifically allows the use of checks. See U.C.C.C. § 3.307 (1974). The FTC rule is aimed only at credit transactions.

an acceptable balance between the conflicting policy considerations. Legal claims of ownership, at least those involving theft and violation of restrictive indorsements, can be raised by the bank and must be raised if the bank is to obtain a discharge of its liability on the instrument. Equitable claims of ownership can be utilized by the cooperative bank under section 3.306(d) of the U.C.C. if the customer assists in the defense of the holder's action on the instrument, or through the use of an injunction or indemnification offer under section 3.603 if the bank is not willing to cooperate with its customer.

Defenses, while they are the most common basis for objection, rarely involve a sufficient degree of wrongdoing to justify interfering with the need for forms of negotiable instruments that are essentially equivalent to cash.

In those cases where a bank check has been used as the form of payment in a consumer transaction, the greater level of concern for the plight of the consumer may well call for a different set of rules. There appears to be no excuse for not preserving a consumer's defenses when the holder of the bank instrument is not a holder in due course, or for not simplifying the procedures of preserving equitable title claims.