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CHAPTER VI - Negotiable Instruments

Witkin Summary of California Law
 I. DEVELOPMENT OF GOVERNING LAW
 A. Before the Uniform Commercial Code.

4 Witkin Sum. Cal. Law Neg Inst § 1

[§ 1] Before the Uniform Commercial Code.

(1) *Early California Law.* Before the adoption of the Uniform Negotiable Instruments Law the following elements rendered an instrument nonnegotiable:

- (a) A provision for attorneys' fees in case of suit, which made the amount payable uncertain.
- (b) A provision for accelerated maturity, which made the time of payment uncertain.

(c) A provision that the note was secured by a mortgage. Under *C.C.P. 726*, only one action was permitted--foreclosure of the mortgage. The liability on the note arose, therefore, only when there was a deficiency after sale of the property, and hence was merely a contingent liability instead of the necessary absolute liability. (See *Meyer v. Weber* (1901) 133 C. 681, 684, 65 P. 1110.) Even bonds payable to bearer were nonnegotiable. (*Crocker Nat. Bank of San Francisco v. Byrne & McDonnell* (1918) 178 C. 329, 173 P. 752; see 6 *Cal. L. Rev.* 23 [general discussion of former law].)

(2) *Uniform Negotiable Instruments Law.* The "N.I.L." was adopted in California in 1917 as former C.C. 3082 et seq. Thereafter only one of the three foregoing obstacles to negotiability remained: A note secured by a mortgage was still nonnegotiable, because of the provisions of *C.C.P. 726*. In 1915, 2 years before the N.I.L. was adopted, one particular type of note secured by a mortgage, the bearer bond, had been made negotiable by statutory amendment. But the N.I.L. repealed all prior laws on negotiable instruments and thus eliminated the amendment of 1915, leaving bearer bonds nonnegotiable again. This continued from 1917 to 1921, when the provision making bearer bonds negotiable was reenacted. Finally, in 1923, former C.C. 3265 was amended to provide that all notes secured by mortgages would be negotiable if they fulfilled the other requirements of negotiability. (See *Bank of Balboa v. Benneson* (1932) 122 C.A. 121, 123, 9 P.2d 540; *Hayward Lumber & Inv. Co. v. Naslund* (1932) 125 C.A. 34, 38, 13 P.2d 775.)

(3) *Nonnegotiable Instruments and Estoppel.* Even where bonds were nonnegotiable because they were issued under the old law, the transferee might find protection in the doctrine of estoppel. (See *Lynch v. International Banking Corp.* (1924) 68 C.A. 432, 434, 229 P. 968 [elements of estoppel were present].) Estoppel also was applied where stock certificates were indorsed in blank and delivered. (*Powers v. Pacific Diesel Engine Co.* (1929) 206 C. 334, 342, 274 P. 512.) The transfer of stocks and bonds was later covered by the Uniform Stock Transfer Act, now superseded by Division 8 of the Uniform Commercial Code. (See 9 *Summary* (10th), *Corporations*, §132 et seq.)

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 B. Adoption of Uniform Commercial Code.

4 Witkin Sum. Cal. Law Neg Inst § 2

[§ 2] Adoption of Uniform Commercial Code.

The Uniform Commercial Code, adopted in California in 1965, modernized the law relating to commercial transactions. (See 4 *Summary* (10th), *Sales*, §10.) In particular, Division 3, originally entitled "Commercial Paper," was a complete revision and modernization of the Uniform Negotiable Instruments Law. (Official Comment to former U.C.C. 3101.) Division 4, "Bank Deposits and Collections" (see *infra*, §86 et seq.) was intended as "a uniform statement of the principal rules of the bank collection process with ample provision for flexibility to meet the needs of the large volume handled and the changing needs and conditions that are bound to come with the years." (U.C.C. 4101, Official Comment 1.) Division 5, "Letters of Credit" (see *infra*, §136 et seq.) codified for the first time the law of letters of credit and was intended, within its limited scope, "to set an independent theoretical frame for the further development of letters of credit." (U.C.C. 5101, Official Comment.) Division 11, known as Article 4A in the Uniform Commercial Code outside of California, governs fund transfers. (See *infra*, §132 et seq.) (See 7 *Hastings L. J.* 1 [extensive comparison of N.I.L. and Article 3]; 54 *Hastings L. J.* 847 [role of legislation in providing secure payment systems and consumer protections to facilitate electronic commerce]; 17 *San Diego L. Rev.* 287 [Articles 3 and 4 in electronic fund transfer environment]; 23 *A.L.R.3d* 932 [construction and effect of original Article 3]; 18 *A.L.R.3d* 1376 [construction and effect of original Article 4]; 35 *A.L.R.3d* 1404 [construction and effect of original Article 5].)

Negotiable documents of title (bills of lading and warehouse receipts) are governed by Division 7. (See 4 *Summary* (10th), *Sales*, §§138, 139; 13 *Summary* (10th), *Personal Property*, §173 et seq.) Investment securities (stocks and bonds) are governed by Division 8. (See 9 *Summary* (10th), *Corporations*, §132 et seq.) (On credit cards, a subject not covered by the Commercial Code, see *infra*, §144 et seq.)

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Witkin Summary of California Law
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 C. 1990 Revision of Divisions 3 and 4.
 1. Division 3.

4 Witkin Sum. Cal. Law Neg Inst § 3

[§ 3] Division 3.

(1) *U.C.C. Revision.* In 1990 the National Conference of Commissioners on Uniform State Laws and the American Law Institute approved a completely revised Article 3 of the Uniform Commercial Code, entitled "Negotiable Instruments." It replaces former Article 3, entitled "Commercial Paper." The text of the revised article and the extensive official comments are set forth in 2 U.L.A. (Master Ed.), p. 5 et seq. (See 29 *Loyola L.A. L. Rev.* 645 [criticizing revision and suggesting model for future U.C.C. drafting]; 6B Anderson 3d (2003 ed.) §3-101:1R et seq.)

(2) *California Enactment.* In 1992, California's existing provisions were repealed and replaced by the revised article as Division 3 (U.C.C. 3101 et seq.), also entitled "Negotiable Instruments." (Stats. 1992, Chap. 914.) The repeal and replacement are to be construed as an amendment. (U.C.C. 16101.) Unless a change in law has clearly been made, the new provisions are to be regarded as declaratory of the prior provisions' meaning. (U.C.C. 16104.)

Revised Division 3 includes the following chapters:

- (a) Chapter 1, General Provisions and Definitions (U.C.C. 3101 et seq.).
- (b) Chapter 2, Negotiation, Transfer, and Indorsement (U.C.C. 3201 et seq.).
- (c) Chapter 3, Enforcement of Instruments (U.C.C. 3301 et seq.).
- (d) Chapter 4, Liability of Parties (U.C.C. 3401 et seq.).
- (e) Chapter 5, Dishonor (U.C.C. 3501 et seq.).
- (f) Chapter 6, Discharge and Payment (U.C.C. 3601 et seq.).

(3) *Conforming Additions and Amendments.* The chapter adding revised Division 3 made substantial conforming revisions in Division 4 (see *infra*, §4 et seq.) and minor amendments in U.C.C. 1202, 1207, and 2511. It also added two related provisions:

- (a) *B. & P.C. 17538.6* (unlawful business practice to require or request postdated check from consumer). (See 4

Summary (10th), *Sales*, §376.)

(b) *Ev.C. 670* (presumption of payment of check arising from production of copy of check and bank statement).
(See 1 *Cal. Evidence* (4th), *Burden of Proof and Presumptions*, §98.)

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(3) *Conforming Additions and Amendments*. U.C.C. 1202 and 1207 were renumbered U.C.C. 1307 and 1308, respectively, in 2006.



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 2. Division 4.

4 Witkin Sum. Cal. Law Neg Inst § 4

[§ 4] Division 4.

(1) *U.C.C. Revision.* In 1990, the National Conference of Commissioners on Uniform State Laws and the American Law Institute approved amendments to Article 4 of the Uniform Commercial Code, entitled "Bank Deposits and Collections." The amendments conform Article 4 to the revised provisions of Article 3 (see *supra*, §3). The text of the article and the extensive official comments are set forth in 2B (Part I) U.L.A. (Master Ed.), p. 5 et seq.

(2) *Goals of Revision.* The 1990 revision had several important goals, including:

(a) Promoting the efficiency of the check collection process by making the provisions of Article 4 more compatible with the needs of an automated system, thereby increasing the speed and lowering the cost of check collection. (Official Comment 2 to Unif.Com.C. §4-101.)

(b) Removing statutory barriers to programs allowing presentment of checks to payor banks by electronic transmission of information. (Official Comment 2 to Unif.Com.C. §4-101.) (On additional purposes of revision of Articles 3 and 4, see *infra*, §5.)

(3) *Nonregulatory Nature of Revisions.* Article 4 defines rights between parties with respect to bank deposits and collections. It does not regulate the terms of the bank-customer agreement, nor does it prescribe what constraints different jurisdictions may wish to impose on that relationship in the interest of consumer protection. The revisions are intended to create a legal framework that accommodates automation and truncation for the benefit of all bank customers. (Official Comment 3 to Unif.Com.C. §4-101.) (See 29 *Loyola L.A. L. Rev.* 645 [criticizing revision and suggesting model for future U.C.C. drafting]; on bank-customer relationship, see *infra*, §74.)

(4) *California Enactment.* In 1992 the conforming amendments were incorporated into Division 4 (U.C.C. 4101 et seq.), entitled "Bank Deposits and Collections." The repeals, additions, and amendments effected in Division 4 are to be construed as an amendment of the division. (U.C.C. 16101.) Unless a change in law has clearly been made, the new provisions are to be regarded as declaratory of the prior provisions' meaning. (U.C.C. 16104.)

Division 4 may be cited as Uniform Commercial Code--Bank Deposits and Collections. (U.C.C. 4101; see *infra*, §86 et seq.) It includes the following chapters:

4 Witkin Sum. Cal. Law Neg Inst § 4

- (a) Chapter 1, General Provisions and Definitions (U.C.C. 4101 et seq.).
- (b) Chapter 2, Collection of Items: Depository and Collecting Banks (U.C.C. 4201 et seq.).
- (c) Chapter 3, Collection of Items: Payor Banks (U.C.C. 4301 et seq.).
- (d) Chapter 4, Relationship Between Payor Bank and Its Customers (U.C.C. 4401 et seq.).
- (e) Chapter 5, Collection of Documentary Drafts (U.C.C. 4501 et seq.).

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 3. Purpose and Benefits of Revision.

4 Witkin Sum. Cal. Law Neg Inst § 5

[§ 5] Purpose and Benefits of Revision.

The prefatory note to revised Article 3 (see 2 U.L.A. (Master Ed.), p. 8 et seq.) explains the nature and scope of the revision and points out the principal changes.

(1) *Revised Article 3 and Article 4A.* Revised Article 3 on negotiable instruments is a companion undertaking to Article 4A on funds transfers, which was revised in 1989. (See *infra*, §132.) "Both efforts were undertaken for the purpose of accommodating modern technologies and practices in payment systems and with respect to negotiable instruments." (2 U.L.A. (Master Ed.), p. 8.)

(2) *Purpose of Drafting Effort.* The original Articles 3 and 4 and their predecessors were based on a paper payment system. There has been an explosion in the volume of paper to process since Articles 3 and 4 were first promulgated. The original articles did not adequately address the issues of responsibility and liability as they relate to modern technologies and the procedures required by the current volume of checks and by federal laws and regulations. In addition, practices developed that were not easily accommodated within the original Article 3. For example, variable rate notes were unknown when Article 3 first was promulgated; they are common today. Questions about the "cash equivalency" of cashier's checks and money orders have arisen as banks have sought to raise defenses to the payment of these instruments. (2 U.L.A. (Master Ed.), p. 9.)

Article 3 and Article 4 had to be revised to accommodate "changing practices and modern technologies, the needs of a rapidly expanding national and international economy, the requirement for more rapid funds availability, and the need for more clarity and certainty," and to avoid federal preemption of state law. (2 U.L.A. (Master Ed.), p. 9.)

(3) *Uniformity Is Essential.* Traditionally, the legal structures for payments have been regulated by state law through the Uniform Commercial Code. In recent years, however, the federal government has established regulations for credit and debit cards, and for the availability of funds in a way that regulates much of the check collection process. The law governing checks and other negotiable instruments must be uniform and up-to-date, either through state enactments or federal preemption. "Otherwise, checks as a viable payment system in international and national transactions will be severely hampered and the utility of other negotiable instruments impaired." (2 U.L.A. (Master Ed.), p. 10.)

(4) *Benefits to Users.* The following are some examples of the revision's benefits to users of negotiable instruments:

(a) *Good faith:* The definition of good faith has been expanded to include observance of reasonable commercial standards of fair dealing. (2 U.L.A. (Master Ed.), p. 12; see Unif.Com.C. §3-103(a)(4).)

(b) *Fiduciary provisions:* Unif.Com. C. §3-307 protects drawers and persons owed a fiduciary responsibility by imposing stricter standards for obtaining holder in due course rights by a person dealing with the defaulting agent. (2 U.L.A. (Master Ed.), p. 12.)

(c) *Accord and satisfaction:* Payees can avoid unintentional accord and satisfaction by returning the funds or by giving a notice that requires checks to be sent to a particular office where payment proposals can be handled. Meanwhile, the drawer of a full settlement check is protected from the instrument being indorsed with protest and thus losing the money and being liable on the balance of the claim. (2 U.L.A. (Master Ed.), p. 12; see Unif.Com.C. §3-311.)

(d) *Cashier's checks:* Unif.Com.C. §3-411 and related provisions make bank obligations like cashier's checks more acceptable as cash equivalents by discouraging wrongful dishonor. (2 U.L.A. (Master Ed.), p. 12.)

(e) *Indorser liability:* The amount of time to hold a check before the user loses indorser liability has been increased. (2 U.L.A. (Master Ed.), p. 12; see Unif.Com.C. §3-415.)

(f) *Reporting forgeries:* The amount of time a customer has to report forged checks or alterations has been increased to 30 days. A bank truncating checks must retain the item or the capacity to furnish legible copies for 7 years. (2 U.L.A. (Master Ed.), p. 12; see Unif.Com.C. §4-406.)

(g) *Individual agent and corporate liability:* With respect to corporate instruments signed by agents without adequate indication and representation, except as against a holder in due course, a representative may show the parties did not intend individual liability. An agent who signs a corporate check is fully protected, even though the check does not show representative status. (2 U.L.A. (Master Ed.), p. 12; see Unif.Com.C. §3-402.) Also, an organization's signature is considered unauthorized if more than one signature is required and one is missing. (2 U.L.A. (Master Ed.), p. 12; see Unif.Com.C. §3-403(b).)

(h) *Direct suits:* A person whose indorsement is forged may sue the depository bank directly, rather than having to sue each drawee of the checks involved. (2 U.L.A. (Master Ed.), p. 12; see Unif.Com.C. §3-420.)

(5) *Benefits to the Banking Community.* The following are some examples of the revision's benefits to the banking community:

(a) *Certainty:* Unif.Com.C. §3-104 and related provisions clarify what types of contracts are within Article 3 and how they are to be treated, thus promoting certainty of legal rules and reducing litigation costs and risks. Revised Article 3 should eliminate confusion over traveler's checks, money orders, variable rate instruments and checks that omit "words of negotiability." (2 U.L.A. (Master Ed.), p. 12.)

(b) *Ordinary care:* Financial institutions that take checks for processing or for payment by automated means need not manually handle each instrument if not doing so is consistent with the institution's procedures, and the procedures used do not vary unreasonably from general bank usage. (2 U.L.A. (Master Ed.), p. 12; see Unif.Com.C. §§3-103(a)(7), 4-104(c).)

(c) *Statutes of limitations:* Unif.Com.C. §§3-118 and 4-111 include statutory periods of limitations, which will make the periods uniform rather than subject to widely varying state laws. (2 U.L.A. (Master Ed.), p. 13.)

(d) *Employee fraud:* Unif.Com.C. §3-405 expands a per se negligence rule to govern an indorsement forged by an employee whose duties involve handling checks. It also covers the case of a faithless employee who supplies a name

and then forges the indorsement, but it does not require a precise match between the name of the payee and the indorsement. (2 U.L.A. (Master Ed.), p. 13.)

(e) *Bank definition:* Banks include savings and loan associations and credit unions, and checks drawn on those institutions are directly governed by the Code. (2 U.L.A. (Master Ed.), p. 13; see Unif.Com.C. §4-105.) Checks drawn on credit lines are subject to the rules for checks drawn on deposit accounts. (2 U.L.A. (Master Ed.), p. 13; see Unif.Com.C. §4-104.)

(f) *Truncation:* Unif.Com.C. §4-110 authorizes electronic presentation of items and related provisions remove impediments to truncation. Truncation reduces risks from mandated funds availability and improves the check collection process. Unif.Com.C. §4-406, which precludes bank customers from asserting unauthorized signatures or alterations in some circumstances, allows an institution the benefit of its provisions even though the institution does not return the checks due to truncation. If both the customer and the institution fail to use ordinary care, a comparative negligence standard is used rather than placing the full loss on the institution. (2 U.L.A. (Master Ed.), p. 13.)

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 1. Restatement 2d.

4 Witkin Sum. Cal. Law Neg Inst § 6

[§ 6] Restatement 2d.

(1) *In General.* The conflict of laws rules applicable to negotiable instruments are set forth in Chapter 8 of the *Second Restatement of Conflict of Laws*, §214 et seq. (See *54 A.L.R.2d 1053* [enforceability of attorneys' fees provision, valid in state of execution or performance but invalid under forum law]; *60 A.L.R.2d 467* [which locality's usage and custom controls interpretation or performance]; on conflict of laws rules applicable to contracts generally, see 1 *Summary* (10th), *Contracts*, §64 et seq.)

(2) *Obligations of Parties.* The obligations of the maker of a note or the acceptor of a draft are determined by the local law of the state designated in the instrument as the place of payment or, if no place of payment is designated, by the local law of the state where the maker or acceptor delivered the instrument. (*Rest.2d, Conflict of Laws §214*; see *Sullivan v. Shannon (1938) 25 C.A.2d 422, 425, 77 P.2d 498* [law of place of payment governs effect of acceleration clause].) The obligations of an indorser or the drawer of a draft are determined by the local law of the state where the indorser or drawer delivered the instrument. (*Rest.2d, Conflict of Laws §215(1).*)

The place where the instrument was delivered is presumptively the state where the instrument was dated, if such is indicated, and this presumption is conclusive on a holder in due course in the absence of notice to the contrary. (*Rest.2d, Conflict of Laws §§214(2), 215(1).*)

(3) *Validity and Effect of Transfer.* As between the parties to the transfer, the validity and effect of the transfer is determined by the law applicable to chattels in general; i.e., the local law of the state that, with respect to the particular issue, has the most significant relationship to the transfer and the parties. (*Rest.2d, Conflict of Laws §216*, Comment a; see 13 *Summary* (10th), *Personal Property*, §111.) As between persons who were not both parties to the transfer, the local law of the state where the instrument was at the time of transfer governs the validity and effect of the transfer. (*Rest.2d, Conflict of Laws §216(1)*; see *Pintel v. K.N.H. Mohamed & Bros. (1951) 107 C.A.2d 328, 331, 237 P.2d 315.*) The status of any transferee as a holder in due course is also determined by the local law of the state where the instrument was at the time of transfer. (*Rest.2d, Conflict of Laws §216(2).*)

(4) *Presentment, Payment, Protest, and Notice of Dishonor.* If the place of payment is designated in the instrument, the local law of that state determines where presentment may be made. (*Rest.2d, Conflict of Laws §215(2).*) Details of presentment, payment, protest, and notice of dishonor are governed by the law of the state where these activities take

place. (*Rest.2d, Conflict of Laws §217.*)

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2. Commercial Code.

4 Witkin Sum. Cal. Law Neg Inst § 7

[§ 7] Commercial Code.

The Commercial Code's general choice-of-law provisions apply to negotiable instruments: (1) Parties to a transaction are free to choose the applicable law provided the transaction bears a "reasonable" relation to the state or nation whose law is chosen, and (2) absent a choice, California courts will apply the local law of California provided the transaction bears an "appropriate" relation to California. (See U.C.C. 1105(1).)

A special rule deals with bank collection. Liability is determined by the law of the place where the bank, branch, or separate office is located. (U.C.C. 1105(2), 4102(b).) But if the bank, branch, or separate office is located in a Commercial Code jurisdiction, the law governing its liability may be varied by agreement. (U.C.C. 4103(a); see U.C.C. 4102, Official Comment 2(d).)

SUPPLEMENT: [This section is current through the latest supplement]

U.C.C. 1105 was repealed in 2006. Former U.C.C. 1108, a severability provision, was amended and redesignated U.C.C. 1105. The substance of former U.C.C. 1105 is now in U.C.C. 1301, added in 2006.



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Witkin Summary of California Law

II. NEGOTIABLE INSTRUMENTS

A. Scope of Division 3.

4 Witkin Sum. Cal. Law Neg Inst § 8

[§ 8] Scope of Division 3.

(1) *Applicability.* Division 3 applies to negotiable instruments. It does not apply to money, to payment orders governed by Division 11 (U.C.C. 11101 et seq., *infra*, §132 et seq.), or to securities governed by Division 8 (U.C.C. 8101 et seq., 9 *Summary* (10th), *Corporations*, §132 et seq.). (U.C.C. 3102(a); see *11 Am.Jur.2d* (1997 ed.), *Bills and Notes* §13 et seq.; on distinctions between certificated securities and negotiable instruments, see Official Comment 2.) Division 3 does not govern documents of title because they contain no promise to pay money. Divisions 3 and 11 are mutually exclusive; drafts are governed exclusively by Division 3 while payment orders are governed exclusively by Division 11. (Official Comment 2.)

(2) *Conflict Between Divisions.* If there is conflict between Division 3 and Division 4 (U.C.C. 4101 et seq., *infra*, §86 et seq.), or between Division 3 and Division 9 (U.C.C. 9101 et seq., 4 *Summary* (10th), *Secured Transactions in Personal Property*, §21 et seq.), Divisions 4 and 9 govern. (U.C.C. 3102(b).) Federal Reserve System regulations and operating circulars of the Federal Reserve Banks supersede any inconsistent provision of Division 3. (U.C.C. 3102(c).)

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 B. Definitions and Construction of Terms.
 1. In General.

4 Witkin Sum. Cal. Law Neg Inst § 9

[§ 9] In General.

(1) *Parties to Instrument.* "Party" means a party to an instrument. (U.C.C. 3103(a)(8).) A drawer is a person who signs or is identified in a draft as a person ordering payment (U.C.C. 3103(a)(3)), and a drawee is the person ordered in the draft to make payment (U.C.C. 3103(a)(2)). An acceptor is a drawee who has accepted a draft. (U.C.C. 3103(a)(1).) A maker is a person who signs or is identified in a note as a person undertaking to pay. (U.C.C. 3103(a)(5).)

An issuer is an instrument's maker or drawer. The term applies to issued and unissued instruments. (U.C.C. 3105(c); on "issue," see *infra*, this section.) A remitter is someone who purchases an instrument from its issuer if the instrument is payable to an identified person other than the purchaser. (U.C.C. 3103(a)(11).)

A holder is the person in possession of an instrument if the instrument is payable to bearer. If the instrument is payable to an identified person, the possessor must be that identified person to be the holder. (U.C.C. 1201(20); on holder in due course, see *infra*, §27 et seq.)

(2) *Contents of Instrument.* An "order" is a written instruction to pay money signed by the person giving the instruction. The instruction may be addressed to anyone, including the person giving the instruction. (U.C.C. 3103(a)(6); see *Danning v. Bank of America (1984) 151 C.A.3d 961, 977, 199 C.R. 163* [check signed only by corporation's president, without additional required signature, was never effectively signed and hence was not negotiable].) Thus, an order includes a cashier's check. (Official Comment 2.) An instruction may be addressed to several persons jointly or in the alternative, but not in succession. An authorization to pay is not an order unless the person authorized to pay is also instructed to pay. (U.C.C. 3103(a)(6).)

A "promise" is a written undertaking to pay money signed by the person undertaking to pay. An obligor's acknowledgment of an obligation, such as an I.O.U., is not a promise unless the obligor also undertakes to pay the obligation. (U.C.C. 3103(a)(9); Official Comment 3.)

(3) *Issue of Instrument.* "Issue" means the first delivery of an instrument by the maker or drawer, for the purpose of giving rights on the instrument to another person. The delivery may be to either a holder or nonholder. (U.C.C. 3105(a).) An unissued instrument, or an unissued incomplete instrument that is completed, is binding on the maker or drawer, as is an instrument that is conditionally issued or is issued for a special purpose. However, nonissuance and

failure of the condition or special purpose to be fulfilled are defenses. (U.C.C. 3105(b); see *12 Am.Jur.2d (1997 ed.), Bills and Notes §§563, 564.*)

(4) *Other Definitions.* Other definitions applying to Division 3 are set forth in particular sections of Division 3 and in other divisions of the Code. They are listed in U.C.C. 3103(b) and (c). In addition, the general definitions and principles of construction and interpretation in Division 1 are applicable to Division 3. (U.C.C. 3103(d).)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Parties to Instrument.* U.C.C. 1201(20) was renumbered U.C.C. 1201(b)(21) and amended in 2006. U.C.C. 1201(b)(21)(A) defines "holder" as the person in possession of a negotiable instrument that is payable either to bearer or to an identified person who is the person in possession.



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 2. Negotiable Instrument.
 a. General Definition.

4 Witkin Sum. Cal. Law Neg Inst § 10

[§ 10] General Definition.

(1) *Required Characteristics.* A negotiable instrument is an unconditional promise or order to pay a fixed amount of money, with or without interest or other charges described in the promise or order. (U.C.C. 3104(a); see *40 A.L.R.4th 346* [what constitutes "money" within meaning of Uniform Commercial Code]; *76 A.L.R.5th 289* [what constitutes "fixed amount of money"]; Cal. Civil Practice, 4 Business Litigation, §42:3 et seq.; Brady (Bailey) §2.01 et seq.; on unconditional promise, see *infra*, §12; on interest, see *infra*, §15.) Because orders and promises must be in writing (see U.C.C. 3103(a)(6), (a)(9), *supra*, §9), a negotiable instrument is always in writing. (On signature requirement of order and promises, see *supra*, §9.) The terms "instrument" and "negotiable instrument" are interchangeable. (U.C.C. 3104(b).)

The instrument must have all of the following characteristics:

(a) It must be payable to bearer or to order at the time it is issued or first comes into possession of a holder. (U.C.C. 3104(a)(1); see *infra*, §14.) An order that lacks only this characteristic, but otherwise falls within the definition of "check" in U.C.C. 3104(f) (*infra*, §11) is a negotiable instrument and a check. (U.C.C. 3104(c).)

(b) It must be payable on demand or at a definite time. (U.C.C. 3104(a)(2); see *infra*, §13.)

(c) It must not state any other undertaking or instruction by the person promising or ordering payment to do anything besides pay the money. The promise or order may, however, contain (1) an undertaking or power to give, maintain, or protect collateral to secure payment, (2) an authorization or power to the holder to confess judgment or realize on or dispose of collateral, or (3) a waiver of the benefit of any law intended for the advantage or protection of an obligor. (U.C.C. 3104(a)(3); see *44 U.C.L.A. L. Rev. 951* [argument that negotiability is outmoded legal principle in context of modern payment and credit systems]; *75 A.L.R.5th 559* [what constitutes undertaking or instruction to do act in addition to payment of money].)

(2) *"Money" Includes Foreign Money.* The term "money" in U.C.C. 3104 is not limited to United States dollars. Unless it provides otherwise, an instrument that states the amount payable in foreign money may be paid in the foreign money or in an equivalent amount in dollars. The conversion rate, if none is stated in the instrument, is "the current

bank-offered spot rate at the place of payment for the purchase of dollars on the day on which the instrument is paid." (U.C.C. 3107; Official Comment; see *11 Am.Jur.2d (1997 ed.), Bills and Notes §134*; on euro (single currency of European Union) and rules for interpreting contracts expressed in terms of European currencies replaced by euro, see C.C. 1663, 1 *Summary (10th), Contracts, §758.*)

(3) *Excluded Writings*. A promise or order other than a check is not an instrument if, at the time it is issued or first comes into possession of a holder, it states conspicuously that it is not negotiable or is not an instrument governed by Division 3. (U.C.C. 3104(d).)

West's Key Number Digest, Bills and Notes 144

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Required Characteristics*. See Clark, *The Law of Bank Deposits, Collections and Credit Cards (Rev. ed.), Chap. 2.*

(a) *Payable to bearer or to order*: See *McElroy v. Chase Manhattan Mortg. Corp. (2005) 134 C.A.4th 388, 392, 393, 36 C.R.3d 176* ["Bonded Bill of Exchange Order" was not negotiable instrument; it was not made payable to bearer or to order as required by U.C.C. 3104(a)(1), and, although check qualifies as negotiable instrument even if not payable to bearer or order, item here was not drawn on bank and thus was not check under U.C.C. 3104(f); item was worthless piece of paper consisting of incomprehensible words that signified nothing].



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 b. Types of Instruments.

4 Witkin Sum. Cal. Law Neg Inst § 11

[§ 11] Types of Instruments.

(1) *Note or Draft.* An instrument is a note if it contains a promise and a draft if it contains an order. If an instrument falls within the definition of both note and draft, a person entitled to enforce the instrument may treat it as either. (U.C.C. 3104(e).) The term "bill of exchange" is generally understood to be a synonym for "draft." (Official Comment 4.) (See C.E.B., 2 Real Property Sales Transactions 3d, §8.20 [promissory notes secured by deed of trust or mortgage]; *11 Am.Jur.2d (1997 ed.), Bills and Notes §23 et seq.*; for forms, see Cal. Transactions Forms, 4 Business Transactions §25:50 et seq.)

(2) *Check.* A check is (a) a draft, other than a documentary draft, payable on demand and drawn on a bank, (b) a cashier's check or teller's check, or (c) a demand draft (infra, this section). An instrument may be a check even though it is described on its face by another term, such as "money order." (U.C.C. 3104(f); see *Central Bank v. Kaiperm Santa Clara Fed. Credit Union (1987) 191 C.A.3d 186, 198, 236 C.R. 262* [money order lacking signature requirement (see U.C.C. 3103(a), supra, §9) cannot be negotiable instrument; construing former statute]; for definition of "documentary draft," see infra, §89.) A check includes a share draft drawn on a credit union, but not a draft drawn on an insurance company. (Official Comment 4.) (See Brady (Bailey) §1.09 et seq.)

A cashier's check is a draft with respect to which the drawer and drawee are the same bank or branches of the same bank. (U.C.C. 3104(g).) A teller's check is a draft drawn by a bank on another bank, or payable at or through a bank. (U.C.C. 3104(h).)

A traveler's check is an instrument that (a) is payable on demand, (b) is drawn on or payable at or through a bank, (c) is designated by the term "traveler's check" or by a substantially similar term, and (d) requires, as a condition to payment, a countersignature by a person whose specimen signature appears on the instrument. (U.C.C. 3104(i).)

(3) *Certificate of Deposit.* A certificate of deposit is an instrument in which a bank acknowledges that it has received a sum of money and promises to repay it. A certificate of deposit is a note of the bank. (U.C.C. 3104(j).) This is a change from former law, under which a certificate of deposit was a separate type of instrument. (Official Comment 4.) (See *29 U.C.L.A. L. Rev. 330* [nonnegotiable certificates of deposit and Article 9].)

(4) *Demand Draft*. A demand draft is created by a third party under the purported authority of a bank's customer for the purpose of charging the customer's bank account. The customer does not sign the demand draft, but the draft must contain the customer's account number and may contain (a) the customer's printed or typewritten name, (b) a notation that the customer authorized the draft, or (c) the statement "No Signature Required" or words to that effect. A demand draft does not include a check purportedly drawn and signed by a fiduciary, as defined in U.C.C. 3307(a)(1). (U.C.C. 3104(k).)

U.C.C. 3104(k) is intended "to define a new class of payment instrument, drawn on a bank customer's account without an authorized signature, and to shift the risk of loss for processing this instrument to the depositary-collecting bank which is in the best position to prevent its introduction into the check collection system." (See Stats. 1996, Chap. 316, §7 [also listing and illustrating instruments that do, or do not, satisfy statutory definition].)

West's Key Number Digest, Bills and Notes k.148 et seq.

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Note or Draft*. See C.E.B., 2 Real Property Sales Transactions 4th, §9.22 [promissory notes secured by mortgage or deed of trust].



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4 Witkin Sum. Cal. Law Neg Inst § 12

[§ 12] Unconditional Promise or Order.

(1) *General Rule.* For the purposes of U.C.C. 3104(a) (supra, §10), a promise or order is unconditional unless it states (a) an express condition to payment, (b) that the promise or order is subject to or governed by another writing, or (c) that rights or obligations with respect to the promise or order are stated in another writing. (U.C.C. 3106(a); see *Commercial Credit Corp. v. Orange County Machine Works (1950) 34 C.2d 766, 770, 214 P.2d 819* [concurrent execution of note and conditional sales contract did not affect negotiability of note]; *Mann v. Leasko (1960) 179 C.A.2d 692, 696, 4 C.R. 124* [contemporaneous execution and transfer of promissory note and nonnegotiable contract securing performance by lien on real property did not affect negotiability of note]; *Growth Equities Corp. v. Freed (1991) 227 C.A.3d 506, 510, 277 C.R. 848* [promissory notes stating that they were *secured by and subject to* provisions of partnership debt assumption agreement were nonnegotiable]; *88 A.L.R.3d 1100* [what constitutes unconditional promise]; *19 A.L.R.4th 1268* [provision in draft or note directing payment "on acceptance" without indication of whose acceptance is intended]; *58 A.L.R.4th 632* [effect on negotiability of statements expressly limiting negotiability or transferability]; *11 Am.Jur.2d (1997 ed.), Bills and Notes §91 et seq.*)

(2) *Effect of Reference to Other Writing or Payment Source.* A reference to another writing does not alone make the promise or order conditional (U.C.C. 3106(a)), nor does reference to another writing for a statement of rights with respect to collateral, prepayment, or acceleration (U.C.C. 3106(b)(1)). Moreover, the promise or order may limit payment to resort to a particular fund or source. (U.C.C. 3106(b)(2); see Official Comment 1 [U.C.C. 3106(b)(2) reverses result of former U.C.C. 3105(2)(b)].)

(3) *Effect of Countersignature.* A promise or order may, without becoming conditional, require a countersignature by a person whose specimen signature appears on the promise or order as a condition to payment. (U.C.C. 3106(c).) This allows a traveler's check to be a negotiable instrument. (Official Comment 2.) If the person whose specimen signature appears fails to countersign the instrument, the issuer has a defense to its obligation to pay the instrument, but a transferee of the instrument may still qualify as a holder. (U.C.C. 3106(c); on defenses to payment obligation, see U.C.C. 3305(a), *infra*, §31 *et seq.*) Thus, one who cashes a stolen traveler's check with a forged countersignature is a holder and may be a holder in due course. (See Official Comment 2.)

(4) *Effect of Other Laws.* The promise or order may, at the time it is issued or first comes into possession of a

holder, contain a statement, required by applicable statutory or administrative law, to the effect that the rights of a holder or transferee are subject to claims or defenses that the issuer could assert against the original payee. The promise or order does not thereby become conditional, but if it is an instrument, there cannot be a holder in due course of the instrument. (U.C.C. 3106(d); on holder in due course, see *infra*, §27.) Hence, for example, it is impossible to be a holder in due course of a note bearing the Federal Trade Commission legend that preserves consumer claims and defenses in consumer credit sales. (Official Comment 3.)

SUPPLEMENT: [This section is current through the latest supplement]



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4 Witkin Sum. Cal. Law Neg Inst § 13

[§ 13] Payable on Demand or at Definite Time.

(1) *Payable on Demand.* A promise or order is payable on demand if it:

(a) States that it is payable on demand or at sight;

(b) Otherwise indicates that it is payable at the will of the holder; or

(c) Does not state any time of payment. (U.C.C. 3108(a); see *11 Am.Jur.2d (1997 ed.), Bills and Notes §105; 71 A.L.R.5th 443* [when is instrument payable on demand]; on admissibility of parol evidence concerning conditional time of payment, see *Sapin v. Security First Nat. Bank (1966) 243 C.A.2d 201, 205, 52 C.R. 254; Birsner v. Bolles (1971) 20 C.A.3d 635, 637, 97 C.R. 846; 2 Cal. Evidence (4th), Documentary Evidence, §80 et seq.*)

(2) *Payable at Definite Time.* A promise or order is payable at a definite time if it is payable on elapse of a definite period of time after sight or acceptance, at a fixed date or dates, or at a time readily ascertainable at the time the promise or order is issued. It may be subject to rights of (a) prepayment, (b) acceleration, (c) extension at the holder's option, or (d) extension to a further definite time at the option of the maker or acceptor or automatically on or after a specified act or event. (U.C.C. 3108(b); see *11 Am.Jur.2d (1997 ed.), Bills and Notes §106; 71 A.L.R.5th 443* [when is instrument payable at definite time].)

(3) *Payable on Demand and at Fixed Date.* If an instrument, payable at a fixed date, is also payable on demand made before the fixed date, the instrument is payable on demand until the fixed date. If demand for payment is not made before that date, the instrument becomes payable at a definite time on the fixed date. (U.C.C. 3108(c).)

(4) *Effect of Date of Instrument.* An instrument may be antedated or postdated. The stated date determines the time of payment if the instrument is payable at a fixed period after the date. An instrument payable on demand is not payable before the date of the instrument. (U.C.C. 3113(a); see *11 Am.Jur.2d (1997 ed.), Bills and Notes §67*; on exception for postdated checks, see U.C.C. 4401(c), *infra*, §120.) If an instrument is undated, its date is the date of its issue. If the instrument is unissued, its date is the date it first comes into a holder's possession. (U.C.C. 3113(b).)

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4 Witkin Sum. Cal. Law Neg Inst § 14

[§ 14] Payable to Bearer or to Order.

(1) *Payable to Bearer.* Under U.C.C. 3109(a), a promise or order is payable to bearer if it:

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

(b) Does not state a payee; or

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

(2) *Payable to Order.* A promise or order that is not payable to bearer is payable to order if it is payable (a) to the order of an identified person or (b) to an identified person or order. A promise or order that is payable to order is payable to the identified person. (U.C.C. 3109(b); see *77 A.L.R.5th 523* [when is instrument payable to bearer or to order]; *11 Am.Jur.2d (1997 ed.), Bills and Notes §88.*)

(3) *Effect of Indorsement.* An instrument payable to bearer may become payable to an identified person if it is specially indorsed as provided in U.C.C. 3205(a). An instrument payable to an identified person may become payable to bearer if it is indorsed in blank as provided in U.C.C. 3205(b). (U.C.C. 3109(c); on special and blank indorsements, see *infra*, §23.)

SUPPLEMENT: [This section is current through the latest supplement]



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4 Witkin Sum. Cal. Law Neg Inst § 15

[§ 15] Interest.

Unless otherwise provided in the instrument, an instrument is not payable with interest, and interest on an interest-bearing instrument is payable from the date of the instrument. (U.C.C. 3112(a).)

The "fixed amount" required by U.C.C. 3104(a) applies only to principal. (Official Comment 1.) An instrument may provide for interest as a fixed or variable amount of money or as a fixed or variable rate or rates. The instrument may describe the amount or rate of interest in any manner and may require reference to information not contained in the instrument. If an instrument provides for interest, but the amount of interest payable cannot be ascertained from the description, interest is payable at the judgment rate in effect at the place of payment of the instrument and at the time interest first accrues. (U.C.C. 3112(b); on place of payment, see *infra*, §59.)

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SUPPLEMENT: [This section is current through the latest supplement]



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g. Contradictory, Incomplete, and Supplemented Instruments.

4 Witkin Sum. Cal. Law Neg Inst § 16

[§ 16] Contradictory, Incomplete, and Supplemented Instruments.

(1) *Contradictory Terms.* If an instrument contains contradictory terms, typewritten terms prevail over printed terms, handwritten terms prevail over both, and words prevail over numbers. (U.C.C. 3114; see *Rogers v. Harris (1955) 138 C.A.2d 1, 6, 7, 291 P.2d 68* [marginal notation placed on promissory note by maker before signing became part of contract]; *11 Am.Jur.2d (1997 ed.), Bills and Notes §128.*)

(2) *Incomplete Instrument.* An incomplete instrument is a signed writing that shows at the time of signing that it is incomplete but that the signer intended it to be completed by the addition of words or numbers. (U.C.C. 3115(a); see *11 Am.Jur.2d (1997 ed.), Bills and Notes §117 et seq.*) If an incomplete instrument is an instrument under U.C.C. 3104 (supra, §10), it may be enforced according to its terms if it is not completed, or according to its terms as augmented by completion. If an incomplete instrument is not an instrument under U.C.C. 3104, but, after completion, the requirements of that section are met, the instrument may be enforced according to its terms as augmented by completion. (U.C.C. 3115(b).) However, adding words or numbers to an incomplete instrument without the signer's authority is an alteration under U.C.C. 3407. (U.C.C. 3115(c); on alteration, see *infra*, §55.) The burden of establishing that unauthorized words or numbers were added is on the person asserting the lack of authority. (U.C.C. 3115(d).)

(3) *Effect of Separate Agreements.* A party's obligation to pay an instrument may be modified, supplemented, or nullified by a separate agreement of the obligor and a person entitled to enforce the instrument, if the instrument is issued or the obligation is incurred in reliance on the agreement or as part of the same transaction giving rise to the agreement. To the extent that an agreement modifies, supplements, or nullifies an obligation, the agreement is a defense to the obligation. (U.C.C. 3117; see *11 Am.Jur.2d (1997 ed.), Bills and Notes §131; 1 Summary (10th), Contracts, §747.*)

SUPPLEMENT: [This section is current through the latest supplement]



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4 Witkin Sum. Cal. Law Neg Inst § 17

[§ 17] Payee.

(1) *Payee Determined by Intent of Signer.* The intent of the person who signs an instrument as issuer, or in the name or behalf of the issuer, determines to whom the instrument is initially payable. This is true whether or not the signature is authorized. The instrument is payable to the person intended by the signer even if that person is identified in the instrument by a name or other identification that is not that of the intended person. (U.C.C. 3110(a).) Thus, the signer's intent controls even where (a) the signature is a forgery, (b) the name alone is not sufficient to identify the payee, (c) the payee is misidentified, or (d) the payee is fictitious. (Official Comment 1; see *11 Am.Jur.2d (1997 ed.), Bills and Notes §75.*)

If more than one person signs as the issuer and all the signers do not intend the same person as payee, the instrument is payable to any person intended by one or more of the signers. (U.C.C. 3110(a).)

If the issuer's signature is made by automated means, such as a check-writing machine, the payee is determined by the intent of the person who supplied the name or identification of the payee, whether or not authorized to do so. (U.C.C. 3110(b).)

(2) *Identifying Payee.* A person to whom an instrument is payable may be identified in any way, including by name, identifying number, office, or account number. (U.C.C. 3110(c).)

(a) *Instrument payable to a bank account.* The instrument is payable to the person to whom the account is payable, if the account is identified only by number. If the account is identified by number and by a person's name, the instrument is payable to the named person, whether or not that person owns the account identified by number. (U.C.C. 3110(c)(1); for illustrations of ways in which bank accounts are identified, see Official Comment 2.)

(b) *Instrument payable to a trust, an estate, or a person described as trustee or representative of a trust or estate.* The instrument is payable to the trustee, the representative, or a successor of either, whether or not the beneficiary or estate is also named. (U.C.C. 3110(c)(2)(A); see *11 Am.Jur.2d (1997 ed.), Bills and Notes §81.*)

(c) *Instrument payable to a person described as an agent or similar representative of an identified person.* The instrument is payable to the represented person, the representative, or the representative's successor. (U.C.C.

3110(c)(2)(B); see *11 Am.Jur.2d (1997 ed.), Bills and Notes §76.*)

(d) *Instrument payable to a fund or organization that is not a legal entity.* The instrument is payable to a representative of the members of the fund or organization. (U.C.C. 3110(c)(2)(C).)

(e) *Instrument payable to an office or to a person described as holding an office.* The instrument is payable to the named person, the office's incumbent, or the incumbent's successor. (U.C.C. 3110(c)(2)(D); see *11 Am.Jur.2d (1997 ed.), Bills and Notes §80*; on indorsement by levying officer, see *C.C.P. 488.710, 6 Cal. Proc. (4th), Provisional Remedies, §191.*)

The rules in U.C.C. 3110(c)(1) and (c)(2) help determine the holder of an instrument. They do not determine ownership of the instrument or its proceeds. (U.C.C. 3110(c); Official Comment 3.)

(3) *Multiple Payees.* An instrument payable to two or more persons alternatively is payable to any of them. It may be negotiated, discharged, or enforced by any or all of them in possession of the instrument. If an instrument is payable to two or more persons not alternatively, it is payable to all of them and may be negotiated, discharged, or enforced only by all of them. If the instrument is ambiguous as to whether it is payable alternatively, such as an instrument payable to "X and/or Y," it is payable to the persons alternatively. (U.C.C. 3110(d); Official Comment 4; see *47 A.L.R.3d 537* [bank's liability to nonsigning payee for payment of check drawn to joint payees without obtaining indorsement by both]; *11 Am.Jur.2d (1997 ed.), Bills and Notes §79.*)

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Identifying Payee.*

(e) *Instrument payable to an office or to a person described as holding an office.*

Cross-Reference: 6 *Cal. Proc. (5th), Provisional Remedies, §190.*



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4 Witkin Sum. Cal. Law Neg Inst § 18

[§ 18] To Pay Obligation.

(1) *Use of Certified Check, Cashier's Check, or Teller's Check.* Unless otherwise agreed, using a certified check, cashier's check, or teller's check to pay an obligation discharges the obligation to the same extent that using money would. The obligor's liability, if any, as an indorser of the instrument is unchanged. (U.C.C. 3310(a); see *11 Am.Jur.2d (1997 ed.), Bills and Notes §139*; on indorser's liability, see *infra*, §48.) Under former Article 3, the obligation was not discharged if there was a right of recourse on the instrument against the obligor. Under U.C.C. 3310, however, the obligation is discharged, but a right of recourse on the instrument is preserved. (Official Comment 2.)

(2) *Use of Uncertified Check or Note.* Unless otherwise agreed, using a note or an uncertified check to pay an obligation suspends the obligation to the same extent that using money would discharge it. (U.C.C. 3310(b).) In the case of an uncertified check, suspension continues until the check is dishonored, paid, or certified. Payment or certification discharges the obligation to the extent of the amount of the check. (U.C.C. 3310(b)(1).) (See *Canal-Randolph Anaheim v. Wilkoski (1978) 78 C.A.3d 477, 489, 490, 144 C.R. 474* [construing predecessor to U.C.C. 3310(b); check constitutes only conditional payment, and on dishonor action may be maintained on original debt; also underlying obligation is not suspended when drawer has no reason to expect instrument to be accepted or paid (e.g., where drawer has no funds on deposit to cover it)]; *Long v. Cuttle Const. Co. (1998) 60 C.A.4th 834, 837, 838, 70 C.R.2d 698, 8 Cal. Proc. (4th), Enforcement of Judgment, §379* [under U.C.C. 3310, once check is honored, underlying obligation should be considered discharged as of time creditor received check; rule regarding suspension of obligation does not pertain to interim accrual of interest, because if payment were made in money, interest would cease to accrue].) In the case of a note, suspension continues until the note is dishonored or paid. Payment discharges the obligation to the extent of the payment. (U.C.C. 3310(b)(2); see *Jessup Farms v. Baldwin (1983) 33 C.3d 639, 657, 190 C.R. 355, 660 P.2d 813* [construing predecessor to U.C.C. 3310(b)(2)]; *60 Am.Jur.2d (2003 ed.), Payment §37.*)

If the check or note is dishonored and the obligee of the obligation for which the instrument was taken is entitled to enforce the instrument, the obligee may enforce either the instrument or the obligation. In the case of an instrument of a third person that is negotiated to the obligee by the obligor, discharge of the obligor on the instrument also discharges the obligation. (U.C.C. 3310(b)(3).)

If the person entitled to enforce the instrument taken for an obligation is a person other than the obligee, the obligee may not enforce the obligation to the extent the obligation is suspended. If the obligee is the person entitled to enforce

the instrument but no longer has possession of it because it was lost, stolen, or destroyed, the obligation may not be enforced to the extent of the amount payable on the instrument. To that extent, the obligee's rights against the obligor are limited to enforcement of the instrument. (U.C.C. 3310(b)(4).)

U.C.C. 3310(b)(4) applies where the payee's signature is forged and the forger obtains payment. If a payor bank pays a person not entitled to enforce the instrument, the suspension of the underlying obligation continues until the check is paid. The payee's cause of action is against the depository bank or payor bank for conversion under U.C.C. 3420 (infra, §58) or against the drawer under U.C.C. 3309 (infra, §35). The payee cannot merely ignore the instrument and sue the drawer on the underlying contract. Doing so would impose on the drawer the risk that the check when stolen was indorsed in blank or to bearer. (Official Comment 4.)

(3) *Use of Other Instrument.* In the rare cases in which an instrument other than a check or note is taken for an obligation, the effect is that stated in U.C.C. 3310(a) if a bank is liable as maker or acceptor on the instrument. Otherwise, U.C.C. 3310(b) controls. (U.C.C. 3310(c); Official Comment 5.)

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Use of Uncertified Check or Note.* Long case:

Cross-Reference: 8 Cal. Proc. (5th), *Enforcement of Judgment*, §387.



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4 Witkin Sum. Cal. Law Neg Inst § 19

[§ 19] To Resolve Dispute.

(1) *Accord and Satisfaction.* An unliquidated claim or one subject to a bona fide dispute is discharged when the person against whom the claim is asserted tenders an instrument to the claimant and the claimant obtains payment of the instrument. The person against whom the claim is asserted must tender the instrument in good faith as full satisfaction of the claim. (U.C.C. 3311(a), (b); on definition of "good faith," see U.C.C. 3103(a).) In addition, the instrument or an accompanying written communication must state conspicuously that the instrument is tendered as full satisfaction of the claim. (U.C.C. 3311(b).) A statement is conspicuous if it is written so that a reasonable person against whom it is to operate ought to have noticed it. (Official Comment 4.) The person against whom the claim is asserted must prove the above elements of an accord and satisfaction. (U.C.C. 3311(a), (b).)

Thus, U.C.C. 3311 provides an informal method of resolving disputes by use of a negotiable instrument. Typically, a person against whom a claim is asserted attempts an accord and satisfaction by tendering a check for less than the full amount claimed. (Official Comment 1; see *11 Am.Jur.2d (1997 ed.), Bills and Notes §§407, 408.*)

(2) *Exception: Instrument Not Sent to Designated Person.* If the claimant is an organization, it may, within a reasonable time before the tender, send a conspicuous statement to the person against whom the claim is asserted that communications concerning disputed debts, including an instrument tendered as full satisfaction of a debt, are to be sent to a designated person, office, or place. If the instrument or accompanying communication is not received by that designated person, office, or place, the claim is not discharged under U.C.C. 3311(b). (U.C.C. 3311(c)(1).) This protects institutional claimants against inadvertent accord and satisfaction. (Official Comment 5.)

(3) *Exception: Tender of Repayment.* To avoid accord and satisfaction, the claimant may, within 90 days after payment of the instrument, tender repayment of the amount of the instrument to the person against whom the claim is asserted. This is an alternative protection provision available to institutional or individual claimants. (Official Comment 6.) However, it does not apply if the claimant is an organization that sent a statement complying with U.C.C. 3311(c)(1), supra. (U.C.C. 3311(c)(2).)

(4) *Effect of Knowledge That Instrument Was Tendered in Full Satisfaction.* A claim is discharged, even if the claimant complied with U.C.C. 3311(c), if the person against whom the claim is asserted proves that within a reasonable time before collection of the instrument was initiated, the claimant, or an agent of the claimant having direct

responsibility with respect to the disputed obligation, knew that the instrument was tendered in full satisfaction of the claim. (U.C.C. 3311(d).) If a disputed claim has been assigned to a finance company or bank as part of a financing arrangement for accounts receivable and the debtor was notified of the assignment, the claimant is the assignee of the accounts receivable and the agent in U.C.C. 3311(d) refers to the agent of the assignee. (Official Comment 8.)

(5) *Conflict with C.C. 1526.* U.C.C. 3311, which restates with minor variations the common law approach of *Potter v. Pacific Coast Lumber Co. of Calif.* (1951) 37 C.2d 592, 234 P.2d 16, 1 Summary (10th), *Contracts*, §952, conflicts with C.C. 1526, added in 1987. (See 33 *Loyola L.A. L. Rev.* 1 [California's conflicting law on use of accord and satisfaction checks]; 20 *Thomas Jefferson L. Rev.* 97 [California statutory conflict regarding full payment condition checks].) C.C. 1526 permits the creditor to retain the check as partial discharge of the obligation. (See 1 *Summary* (10th), *Contracts*, §952.)

A federal district court, noting the irreconcilable conflict between the two provisions, gave effect to U.C.C. 3311, the later enacted statute. (*Director's Guild of America v. Harmony Pictures* (1998) 32 *F.Supp.2d* 1184.) *Woolridge v. J.F.L. Elec.* (2002) 96 C.A.4th Supp. 52, 117 *C.R.2d* 771, agreed with this approach. In *Woolridge*, plaintiff sued defendant for injuries suffered in an automobile accident. Defendant's insurer issued a \$ 6,545 check payable to plaintiff and bearing the notation "For the total loss of your vehicle and advance car rental." Plaintiff wrote "partial payment" next to his endorsement, but he did not cross out "full and final settlement" language on the face of the check before cashing it. *Held*, the parties had reached an accord and satisfaction.

(a) U.C.C. 3311 applies here, because Article 3 of the California Uniform Commercial Code applies to negotiable instruments, checks are negotiable instruments, and defendant paid with a check. However, C.C. 1526 also applies, because it governs transactions where a debtor tenders a check in full payment of a disputed claim. These statutes conflict because, unlike U.C.C. 3311, C.C. 1526 permits a creditor to "opt out" of an accord and satisfaction while still accepting the check as partial payment. Thus, the two statutes cannot be harmonized. U.C.C. 3311 controls, having been enacted more recently. (96 C.A.4th Supp. 59, 60, citing the text.)

(b) There was substantial evidence of an accord and satisfaction under U.C.C. 3311. A bona fide dispute existed as to the amount defendant owed plaintiff for property damage and loss of use. During telephone discussions with the insurer, plaintiff agreed to a settlement figure. In reliance on that agreement, the insurer mailed plaintiff a check for the settlement amount; thus, the check was tendered in good faith. Plaintiff cashed the check, which contained conspicuous statements indicating it was tendered in full and final satisfaction of the claim. (96 C.A.4th Supp. 60, 61.)

(c) Even if C.C. 1526 had not been superseded, the result here would be the same. That provision clearly requires "striking out" or "otherwise deleting" the full and final payment language in order to opt out of an accord and satisfaction. Plaintiff, who added language, did neither and thus did not satisfy the statutory requirements. (96 C.A.4th Supp. 60, footnote 4.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Accord and Satisfaction.* The definition of "good faith" in U.C.C. 3103(a)(4) was deleted in 2006. The definition of "good faith" in U.C.C. 1201(b)(20) applies to Division 3.



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CHAPTER VI - Negotiable Instruments

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 D. Negotiation, Transfer, and Indorsement.
 1. Negotiation.

4 Witkin Sum. Cal. Law Neg Inst § 20

[§ 20] Negotiation.

(1) *Definition.* Negotiation is the transfer of possession of an instrument by a person other than the issuer to a person who thereby becomes its holder. (U.C.C. 3201(a); see Cal. Civil Practice, 4 Business Litigation, §42:12 et seq.; Brady (Bailey) §7.02; *11 Am.Jur.2d (1997 ed.), Bills and Notes §212* et seq.) Negotiation is usually voluntary, but an involuntary transfer may result in negotiation, such as when a thief or finder acquires an instrument payable to bearer. (Official Comment 1.)

(2) *Methods.* An instrument payable to bearer is negotiated by transfer of possession alone. If an instrument is payable to an identified person, negotiation requires transfer of possession of the instrument and its indorsement by the holder. (U.C.C. 3201(b); on transfer, see *infra*, §21; on indorsement, see *infra*, §22 et seq.) Negotiation by a remitter, such as the owner of a cashier's check, is the exception to this rule. (Official Comment 2.)

(3) *Negotiation Effective Despite Illegalities.* Negotiation is effective even if obtained (a) from an infant, a corporation exceeding its powers, or a person lacking capacity, (b) by fraud, duress, or mistake, or (c) in breach of duty or as part of an illegal transaction. (U.C.C. 3202(a); see *Morgan v. Morgan (1963) 220 C.A.2d 665, 673, 34 C.R. 82* [minor's indorsement]; *11 Am.Jur.2d (1997 ed.), Bills and Notes §215*.) U.C.C. 3202(a) applies even though the lack of capacity or illegality goes to the essence of the transaction and makes it void. The inherent character of negotiable instruments is that a person in possession of an instrument payable to that person or to bearer is a holder and may be dealt with by anyone as a holder. (Official Comment 2.)

(4) *Rescission.* To the extent permitted by other law, negotiation may be rescinded or may be subject to other remedies. Those remedies may not, however, be asserted against a subsequent holder in due course or a person paying the instrument in good faith and without knowledge of facts that are a basis for the rescission or other remedy. (U.C.C. 3202(b); see *12 Am.Jur.2d (1997 ed.), Bills and Notes §618*; on holder in due course, see *infra*, §27 et seq.)

SUPPLEMENT: [This section is current through the latest supplement]



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 2. Transfer.

4 Witkin Sum. Cal. Law Neg Inst § 21

[§ 21] Transfer.

(1) *Importance of Giving Right To Enforce.* A person, other than an instrument's issuer, transfers the instrument by delivering it to someone for the purpose of giving that person the right to enforce it. (U.C.C. 3203(a); see *11 Am.Jur.2d (1997 ed.), Bills and Notes §202 et seq.*) Thus, presentment of a check for payment by delivery to the drawee is not a transfer under U.C.C. 3203. There is no intent to give the drawee enforcement rights. (Official Comment 1.)

The right to enforce an instrument and ownership of the instrument are distinct. For example, a thief who steals a check payable to bearer is entitled to enforce the check, but is not the check's owner. (Official Comment 1.)

Whether or not a transfer is a negotiation, the transferee gains any right of the transferor to enforce the instrument, including any right as a holder in due course. The transferee cannot, however, acquire rights of a holder in due course from a holder in due course if the transferee engaged in fraud or illegality affecting the instrument. (U.C.C. 3203(b); see *Niederer v. Ferreira (1987) 189 C.A.3d 1485, 1501, 234 C.R. 779* [under predecessor to U.C.C. 3203(b), transferee of note was entitled to benefit of general guaranty]; *Finalco v. Roosevelt (1991) 235 C.A.3d 1301, 1305, 3 C.R.2d 865* [assignee who took note as holder in due course retained that status despite subsequent assignment and reacquisition of note with knowledge of claims and defenses]; *11 Am.Jur.2d (1997 ed.), Bills and Notes §242*; on holder in due course, see *infra*, §27 et seq.)

(2) *Transfer Without Indorsement.* Unless otherwise agreed, if an instrument is transferred for value and the transferee does not become a holder because the transferor failed to indorse the instrument, the transferee has a specifically enforceable right to the transferor's unqualified indorsement. Negotiation of the instrument does not occur until the indorsement is made. (U.C.C. 3203(c); see *Security Pac. Nat. Bank v. Chess (1976) 58 C.A.3d 555, 563, 564, 129 C.R. 852* [transferee gets right to indorsement, but negotiation is effective only when indorsement is made]; *11 Am.Jur.2d (1997 ed.), Bills and Notes §243.*)

(3) *Transfer of Less Than Entire Instrument.* If a transferor purports to transfer less than the entire instrument, negotiation does not occur. The transferee obtains no rights under Division 3 and has only the rights of a partial assignee. (U.C.C. 3203(d); see *11 Am.Jur.2d (1997 ed.), Bills and Notes §244.*)

West's Key Number Digest, Bills and Notes k.208 et seq.

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3. Indorsement.

a. In General.

4 *Witkin Sum. Cal. Law Neg Inst § 22*

[§ 22] In General.

(1) *Definitions.* A signature, other than that of a maker, drawer, or acceptor, on an instrument is an indorsement. (U.C.C. 3204(a); see Brady (Bailey) §7.04 et seq.; *11 Am.Jur.2d (1997 ed.), Bills and Notes §218* et seq.) The person who makes the indorsement is the indorser. (U.C.C. 3204(b).) The indorsement may appear alone or accompanied by other words. (U.C.C. 3204(a).)

An indorsement serves the purpose of (a) negotiating the instrument, (b) restricting payment of the instrument, or (c) incurring the indorser's liability on the instrument. (U.C.C. 3204(a).) It may serve more than one purpose. For example, if the holder of a check deposits it in the holder's account in a depository bank for collection and indorses the check by a signature and the words "for deposit only," the purpose of the indorsement is both to negotiate the check and to restrict payment. (Official Comment 1.)

Regardless of the intent of the signer, a signature and its accompanying words are an indorsement unless the accompanying words, terms of the instrument, place of the signature, or other circumstances unambiguously indicate that the signature was made for a purpose other than indorsement. When determining whether a signature is made on an instrument, a paper affixed to the instrument is considered a part of the instrument. (U.C.C. 3204(a); see *Lopez v. Puzina (1966) 239 C.A.2d 708, 714, 49 C.R. 122* [defendants' signatures on separate paper that was not firmly affixed to promissory note did not subject them to liability as indorsers; construing predecessor to U.C.C. 3204(a)].)

(2) *Transfer of Security Interest.* For the purpose of determining whether an instrument's transferee is a holder, an indorsement that transfers a security interest in the instrument operates as an unqualified indorsement. (U.C.C. 3204(c).) Under U.C.C. 3203(b) (*supra*, §21), if a payee indorses a note to a creditor as security for a debt, the creditor takes the payee's rights to enforce or transfer the instrument subject to the limitations of U.C.C. 9101 et seq., 4 *Summary (10th), Secured Transactions in Personal Property*, §21 et seq. However, even though the indorsement mentions creation of a security interest, it is unqualified and the creditor has the right to enforce the note as its holder. (Official Comment 2.)

(3) *Instrument Payable to Holder Under Different Name.* If the name of the payee on an instrument and the actual name of the payee are not the same, indorsement may be made by the payee in the name stated in the instrument or in the payee's name or both. (U.C.C. 3204(d); Official Comment 3.) A person paying or taking the instrument for value or

collection may require signature in both names. (U.C.C. 3204(d).)

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3. Indorsement.

b. Special, Blank, or Anomalous Indorsement.

4 Witkin Sum. Cal. Law Neg Inst § 23

[§ 23] Special, Blank, or Anomalous Indorsement.

(1) *Special Indorsement.* An indorsement made by a holder that identifies a person to whom it makes the instrument payable is a special indorsement. A specially indorsed instrument becomes payable to the identified person and may be negotiated only by that person's indorsement. The principles regarding identification of payees, stated in U.C.C. 3110 (supra, §17), apply to special indorsements. (U.C.C. 3205(a); see *11 Am.Jur.2d (1997 ed.), Bills and Notes* §229; for form, see Cal. Transactions Forms, 4 Business Transactions §25:79.)

(2) *Blank Indorsement.* An indorsement made by a holder that is not a special indorsement is a blank indorsement. An instrument indorsed in blank becomes payable to bearer and may be negotiated by transfer of possession alone until specially indorsed. (U.C.C. 3205(b); see *11 Am.Jur.2d (1997 ed.), Bills and Notes* §227; for form, see Cal. Transactions Forms, 4 Business Transactions §25:78.)

In *Spencer v. Sterling Bank (1998) 63 C.A.4th 1055, 74 C.R.2d 576*, plaintiff executor hired attorney W to probate an estate. Three banks each issued cashier's checks payable to the deceased. W allegedly forged the deceased's signature and indorsed each check by hand "For Deposit Only." W then indorsed the checks again, this time by indorsement stamp, for deposit into her client trust account at defendant bank. Each of the three banks paid defendant the full amount of the cashier's check it had issued. Plaintiff sued defendant for breach of a restrictive indorsement, but the trial judge sustained defendant's demurrer without leave to amend. *Held*, affirmed. Under U.C.C. 3205, the indorsements in the deceased's name "for deposit only," although restrictive indorsements (infra, §24) in that the checks had to be deposited and not otherwise negotiated, were also blank indorsements because they did not specify where or for whose benefit the checks were to be deposited. (*63 C.A.4th 1059, 1060.*) An indorsement of the type here, " 'X, for deposit only' is to a deposit as is a blank payee to a signed check." (*63 C.A.4th 1057.*) Thus, defendant's acceptance for collection of the checks for deposit to W's trust account did not violate a restrictive indorsement. Neither was defendant's acceptance of the checks inconsistent with the indorsement so as to create liability under U.C.C. 3206(c)(2) (infra, §24), because the deceased's indorsements did not use any words indicating a purpose of having the instruments collected by a bank for the indorser or for a particular account. The restriction was in blank, permitting deposit to any account at any bank. (*63 C.A.4th 1060.*)

(3) *Converting Blank Indorsement into Special Indorsement.* The holder may convert a blank indorsement that

consists only of a signature into a special indorsement by identifying above the signature the person to whom the instrument is made payable. (U.C.C. 3205(c); see *11 Am.Jur.2d (1997 ed.)*, *Bills and Notes* §228.)

(4) *Anomalous Indorsement.* An anomalous indorsement is an indorsement made by someone other than the instrument's holder. An anomalous indorsement does not affect the manner in which the instrument may be negotiated. (U.C.C. 3205(d); see *11 Am.Jur.2d (1997 ed.)*, *Bills and Notes* §234.) It makes the signer liable as an indorser. Such an indorsement is normally made by an accommodation party. (Official Comment 3; on indorser liability, see *infra*, §48; on accommodation parties, see *infra*, §51.)

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3. Indorsement.

c. Indorsements Using Limiting or Restrictive Language.

4 *Witkin Sum. Cal. Law Neg Inst § 24*

[§ 24] Indorsements Using Limiting or Restrictive Language.

(1) *Prohibition Against Transfer Ineffective.* An indorsement limiting payment to a particular person or otherwise prohibiting further transfer or negotiation of the instrument does not prevent further transfer or negotiation of the instrument. (U.C.C. 3206(a).)

(2) *Conditional Indorsement Ineffective.* An indorsement conditioning the indorsee's right to receive payment does not affect the indorsee's right to enforce the instrument. A person paying the instrument or taking it for value or collection may disregard the condition, which has no effect on the person's rights and liabilities. (U.C.C. 3206(b).) Former U.C.C. 3206 treated a conditional indorsement like one for deposit or collection (see *infra*, this section), but revised U.C.C. 3206(b) rejects that approach and makes the conditional indorsement ineffective with respect to parties other than the indorser and indorsee. Because the indorsements referred to in U.C.C. 3206(a) and (b) do not effectively restrict payment or transfer, they are no longer referred to as "restrictive indorsements." (Official Comment 2.)

(3) *Conversion of Instrument Indorsed for Collection.* Special rules apply to instruments indorsed "pay any bank," in blank, or to a particular bank using the words "for deposit," "for collection," or other words indicating a purpose of having the instrument collected by a bank for the indorser or for a particular account. (U.C.C. 3206(c); see *11 Am.Jur.2d (1997 ed.), Bills and Notes §230 et seq.*; for form of restrictive indorsement, see *Cal. Transactions Forms, 4 Business Transactions §25:81*; on "pay any bank" indorsement, see U.C.C. 4201(b), *infra*, §95.) The great majority of restrictive indorsements fall within this provision, which continues former law. (Official Comment 3.) The following entities will be liable for conversion of instruments so indorsed unless the amount paid for the instrument is received by the indorser or applied consistently with the indorsement:

(a) A person, other than a bank, who purchases the instrument. (U.C.C. 3206(c)(1).)

(b) A depository bank that purchases the instrument or takes it for collection. (U.C.C. 3206(c)(2).)

(c) A payor bank that is also the depository bank or that takes the instrument for immediate payment over the counter from a person other than a collecting bank. (U.C.C. 3206(c)(3).)

An intermediary bank or a payor bank that takes the instrument from a collecting bank may disregard the indorsement. (U.C.C. 3206(c)(4); Official Comment 3.)

(4) *Breach of Indorsee's Fiduciary Duty.* A person who purchases an instrument from an indorsee or takes the instrument from the indorsee for collection or payment is not bound by an indorsement stating that payment is to be made to the indorsee as agent, trustee, or other fiduciary for the indorser's or another person's benefit. Unless the person has notice of breach of fiduciary duty, the person may pay the proceeds of payment or the value given for the instrument to the indorsee without regard to whether the indorsee violates a fiduciary duty to the indorser. (U.C.C. 3206(d)(1); on notice of breach of fiduciary duty, see U.C.C. 3307, *infra*, §28.) A subsequent transferee or payor is neither given notice nor otherwise affected by the restriction unless the transferee or payor knows that the fiduciary dealt with the instrument or its proceeds in breach of fiduciary duty. (U.C.C. 3206(d)(2).)

(5) *Holder in Due Course of Restrictively Indorsed Instrument.* The purchaser of an instrument containing an indorsement to which U.C.C. 3206 applies may be a holder in due course of the instrument unless the purchaser is a converter or has notice or knowledge of breach of fiduciary duty. (U.C.C. 3206(e).)

(6) *Restrictive Indorsement as Defense.* In an action to enforce payment, the obligor may raise the defense that payment would violate a restrictive indorsement to which U.C.C. 3206 applies and that the payment is not permitted. (U.C.C. 3206(f); Official Comment 5; on defenses generally, see *infra*, §31 *et seq.*)

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4. Reacquisition.

4 Witkin Sum. Cal. Law Neg Inst § 25

[§ 25] Reacquisition.

Reacquisition occurs when an instrument is transferred to a former holder, by negotiation or otherwise. A former holder who reacquires the instrument may cancel indorsements made after the reacquirer first became a holder. If the cancellation causes the instrument to be payable to the reacquirer or to bearer, the reacquirer may negotiate the instrument. An indorser whose indorsement is cancelled is relieved of liability, and this discharge is effective against a subsequent holder. (U.C.C. 3207; Official Comment; see Brady (Bailey) §7.17; *11 Am.Jur.2d (1997 ed.), Bills and Notes §§217, 239; 12 Am.Jur.2d (1997 ed.), Bills and Notes §436.*)

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E. Enforcement of Instruments.
1. Person Entitled To Enforce.

4 Witkin Sum. Cal. Law Neg Inst § 26

[§ 26] Person Entitled To Enforce.

Under U.C.C. 3301, the following persons may enforce an instrument:

- (1) The holder of the instrument. (On definition of holder, see *supra*, §9.)
- (2) A nonholder in possession of the instrument who has the rights of a holder, perhaps through subrogation or transfer under U.C.C. 3203(a) (*supra*, §21).
- (3) A person not in possession of a lost or stolen instrument who is entitled to enforce it. (See U.C.C. 3309, *infra*, §35.)
- (4) A person not in possession of the instrument who is entitled to enforce it under U.C.C. 3418(d) following dishonor. (On U.C.C. 3418(d), see *infra*, §57.)

A person may be entitled to enforce the instrument even though the person does not own the instrument or wrongfully possesses it. (U.C.C. 3301; see *11 Am.Jur.2d (1997 ed.), Bills and Notes §235 et seq.*)

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E. Enforcement of Instruments.

2. Holder in Due Course Doctrine.

a. Obtaining Holder in Due Course Status.

4 *Witkin Sum. Cal. Law Neg Inst* § 27

[§ 27] Obtaining Holder in Due Course Status.

(1) *Required Characteristics.* The holder of an instrument is a holder in due course if the instrument, when issued or negotiated to the holder, does not appear to have been forged or altered or is not otherwise so irregular or incomplete as to call into question its authenticity. (U.C.C. 3302(a)(1); see Brady (Bailey) §8.04 et seq.; *Am.Jur.2d* (1997 ed.), *Bills and Notes* §247 et seq.; on definition of holder, see supra, §9.) U.C.C. 3302(a)(1) is a return to the N.I.L. rule that the taker of an irregular or incomplete instrument is not a person worthy of protection against the obligor's defenses or prior owners' claims. (Official Comment 1.) (See *Bank of Costa Mesa v. Losack* (1977) 74 C.A.3d 287, 293, 141 C.R. 550 [criteria of former version of U.C.C. 3302].)

Moreover, under U.C.C. 3302(a)(2), to be a holder in due course the holder must take the instrument under the following circumstances:

(a) For value (see *infra*, §29);

(b) In good faith (on subjective test of good faith, see *Sun 'N Sand v. United Calif. Bank* (1978) 21 C.3d 671, 689, 148 C.R. 329, 582 P.2d 920; *Security Pac. Nat. Bank v. Chess* (1976) 58 C.A.3d 555, 566, 129 C.R. 852 [good faith found]; 36 A.L.R.4th 212 [what constitutes taking instrument in good faith, and without notice of infirmities or defenses, to support holder-in-due-course status]);

(c) Without notice that the instrument is overdue (see *infra*, §30) or has been dishonored or that there is an uncured default with respect to payment of another instrument issued as part of the same series;

(d) Without notice that the instrument contains an unauthorized signature or has been altered (on presumption of authenticity of signatures, see *infra*, §41);

(e) Without notice of a claim to the instrument described in U.C.C. 3306 (*infra*, §32); and-

(f) Without notice that a party has a defense or claim in recoupment described in U.C.C. 3305(a) (*infra*, §§31, 32).

(2) *Status of Successor in Interest.* Except to the extent a transferor or predecessor in interest has rights as a holder

in due course, a person does not acquire rights of a holder in due course of an instrument taken (a) by legal process or by purchase in an execution, bankruptcy, or creditor's sale or similar proceeding, (b) by purchase as part of a bulk transaction not in the transferor's ordinary course of business, or (c) as the successor in interest to an estate or other organization. (U.C.C. 3302(c).) Thus, for example, a new partnership or a reorganized corporation taking over a predecessor's assets has no better rights than the prior holder. (Official Comment 5.)

(3) *Partial Holder in Due Course Status.* Holder in due course status is limited where the promise of performance that is the consideration for an instrument has been only partially performed (see U.C.C. 3302(d)) or where the instrument's enforcer has only a security interest and the obligor on the instrument has a defense against the person who granted the security interest (see U.C.C. 3302(e)). (For illustrations, see Official Comment 6.)

(4) *Restrictions on Holder in Due Course Status Under Other Laws.* U.C.C. 3302 is subject to laws limiting holder in due course status in consumer transactions and business transactions that raise similar issues. (U.C.C. 3302(g); Official Comment 7.)

(5) *Payee as Holder in Due Course.* Former U.C.C. 3302(2) provided that a payee may be a holder in due course. This provision was eliminated from revised Division 3 as "surplusage." "The payee of an instrument can be a holder in due course, but use of the holder in due course doctrine by the payee of an instrument is not the normal situation." (Official Comment 4.) (See *Gentner & Co. v. Wells Fargo Bank (1999) 76 C.A.4th 1165, 1168, 90 C.R.2d 904*, infra, §57 [payee of cashier's check was holder in due course].)

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SUPPLEMENT: [This section is current through the latest supplement]



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2. Holder in Due Course Doctrine.

b. Notice.

4 Witkin Sum. Cal. Law Neg Inst § 28

[§ 28] Notice.

(1) *When Effective.* To be effective, notice must be received at a time and in a manner that gives a reasonable opportunity to act on it. (U.C.C. 3302(f).) Public filing or recording of a document does not alone constitute notice of a defense, claim in recoupment, or claim to an instrument. (U.C.C. 3302(b).)

(2) *Notice of Discharge.* Notice of discharge of a party, other than discharge in an insolvency proceeding, is not notice of a defense under U.C.C. 3302(a) (*supra*, §27), but discharge is effective against a person who became a holder in due course with notice of the discharge. (U.C.C. 3302(b).)

(3) *Notice of Breach of Fiduciary Duty.* U.C.C. 3307 governs the situation in which someone takes an instrument from a fiduciary for payment or collection or for value, with knowledge of the fiduciary's status, and the person whom the fiduciary represents makes a claim to the instrument or its proceeds on the ground that the fiduciary has breached his or her fiduciary duty. (See *Fireman's Fund Ins. Co. v. Security Pac. Nat. Bank* (1978) 85 C.A.3d 797, 825, 149 C.R. 883 [knowledge that person negotiating instrument is or was fiduciary did not by itself give purchaser notice of claim or defense to instrument; construing predecessor to U.C.C. 3307]; *11 Am.Jur.2d* (1997 ed.), *Bills and Notes* §296; on definitions of fiduciary and represented person, see U.C.C. 3307(a).) Notice of breach of fiduciary duty is notice of the represented person's claim. (U.C.C. 3307(b)(1).)

If the instrument is payable to the represented person or the fiduciary as such, or if it is issued by the represented person or the fiduciary as such and made payable to the taker, the taker has notice of a breach of fiduciary duty under the following circumstances:

(a) The instrument is taken in payment of or as security for a debt that the taker knows is the fiduciary's personal debt. (U.C.C. 3307(b)(2)(A), 3307(b)(4)(A).)

(b) The instrument is taken in a transaction that the taker knows is for the fiduciary's personal benefit. (U.C.C. 3307(b)(2)(B), 3307(b)(4)(B).)

(c) The instrument is deposited to an account other than an account of the fiduciary as such or an account of the

represented person. (U.C.C. 3307(b)(2)(C), 3307(b)(4)(C).)

If the represented person or the fiduciary as such issues an instrument made payable to the fiduciary personally, the taker does not have notice of a breach of fiduciary duty unless the taker knows of the breach. (U.C.C. 3307(b)(3); on definitions of knowledge, see U.C.C. 1201(25) and (27).)

West's Key Number Digest, Bills and Notes k.331 et seq.

SUPPLEMENT: [This section is current through the latest supplement]

(3) *Notice of Breach of Fiduciary Duty.*

Definition of knowledge: U.C.C. 1201(25) and (27) were deleted in 2006. "Knowledge" is now defined in U.C.C. 1202(b), added in 2006.



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c. Value.

4 *Witkin Sum. Cal. Law Neg Inst* § 29

[§ 29] Value.

(1) *Characteristics of Value.* An instrument is issued or transferred for value if it is issued or transferred (a) for a promise of performance, to the extent the promise has been performed (U.C.C. 3303(a)(1)), (b) as payment of, or as security for, an antecedent claim (U.C.C. 3303(a)(3)), or (c) in exchange for a negotiable instrument (U.C.C. 3303(a)(4)). Moreover, if the transferee acquires a security interest or other lien in the instrument, other than a lien obtained by judicial proceeding, the issue or transfer is for value. (U.C.C. 3303(a)(2).) Finally, if the person taking the instrument incurs an irrevocable obligation to a third party, the issue or transfer is for value. (U.C.C. 3303(a)(5).) U.C.C. 3303(a)(4) and (a)(5) are exceptions to the rule that an executory promise is not value. (Official Comment 5.) (See *Sun 'N Sand v. United Calif. Bank* (1978) 21 C.3d 671, 688, 148 C.R. 329, 582 P.2d 920 ["for value" requirement under former version of U.C.C. 3303]; *Tokai Bank of Calif. v. First Pac. Bank* (1986) 186 C.A.3d 1664, 1668, 231 C.R. 503 [bank took cashiers' checks for value when it immediately credited depositor's account and applied total amount to pay checks depositor had written on the account against insufficient funds]; 77 A.L.R.5th 429 [when is instrument issued or transferred for value].)

(2) *Consideration Distinguished.* Consideration and value are distinct for the purposes of Division 3. (Official Comment 1.) Consideration is any consideration sufficient to support a simple contract. An instrument's drawer or maker has a defense if the instrument is issued without consideration. If an instrument is issued for a promise of performance, the issuer has a defense to the extent performance of the promise is due and the promise has not been performed. (U.C.C. 3303(b).) (See *Saks v. Charity Mission Baptist Church* (2001) 90 C.A.4th 1116, 1136, 1137, 110 C.R.2d 45 [defense of failure of consideration was available to church to avoid liability on promissory note payable to plaintiff investor and signed by church's pastor; pastor was improperly using church's name to obtain funds from city, and church never received any money from plaintiff or other benefit].)

Thus, whether an instrument is taken for value helps determine whether a holder is a holder in due course, whereas whether an instrument is issued for consideration is relevant to whether the issuer has a defense to the obligation to pay. (Official Comment 1.) If an instrument is issued for value under U.C.C. 3303(a), the instrument is also issued for consideration. (U.C.C. 3303(b); see *Wilson v. Steele* (1989) 211 C.A.3d 1053, 1065, 259 C.R. 851, 1 Summary (10th), *Contracts*, §492 [discounted payment of \$ 7,000 for \$ 11,064 note was adequate consideration]; 11 *Am.Jur.2d* (1997 ed.), *Bills and Notes* §§145 et seq. [consideration], 269 et seq. [value]; on contract principles of consideration, see 1

Summary (10th), *Contracts*, §202 et seq.)

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d. Overdue Instrument.

4 Witkin Sum. Cal. Law Neg Inst § 30

[§ 30] Overdue Instrument.

(1) *Payable on Demand.* An instrument payable on demand becomes overdue at the earliest of the following times:

(a) On the day after the day demand for payment is duly made. (U.C.C. 3304(a)(1).)

(b) If the instrument is a check, 90 days after its date. (U.C.C. 3304(a)(2).)

(c) If the instrument is not a check, when the instrument has been outstanding for an "unreasonably long" period of time after its date. The circumstances of the particular case, the nature of the instrument, and trade usage determine whether a particular period is "unreasonably long." (U.C.C. 3304(a)(3).) (See *10 A.L.R.3d 1199* [what constitutes reasonable time for taking demand instrument, so as to support the taker's status as holder in due course].)

(2) *Payable at Definite Time.* The following rules govern an instrument payable at a definite time:

(a) If the principal is payable in installments and a due date has not been accelerated, the instrument becomes overdue on default for nonpayment of an installment. The instrument remains overdue until the default is cured. (U.C.C. 3304(b)(1).)

(b) If the principal is not payable in installments and the due date has not been accelerated, the instrument becomes overdue on the day after the due date. (U.C.C. 3304(b)(2).)

(c) If a due date for principal has been accelerated, the instrument becomes overdue on the day after the accelerated due date. (U.C.C. 3304(b)(3).) Unless the due date of principal has been accelerated, an instrument does not become overdue if there is default in payment of interest but no default in payment of principal. (U.C.C. 3304(c); see *Wilson v. Steele (1989) 211 C.A.3d 1053, 1064, 259 C.R. 851, 1 Summary (10th), Contracts, §492* [overdue payments on note calling for monthly payments of "principal and interest ... in installments of [\$ 131.72] or more" did not put purchaser on notice of defense; payments would have gone entirely to cover 15% interest rate]; on overdue instruments generally, see *11 Am.Jur.2d (1997 ed.), Bills and Notes §291*.)

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a. Any Person, Including Holder in Due Course.

4 Witkin Sum. Cal. Law Neg Inst § 31

[§ 31] Any Person, Including Holder in Due Course.

An obligor may assert the following defenses against any person entitled to enforce an instrument, including a holder in due course:

(1) Infancy of the obligor to the extent it is a defense to a simple contract. (U.C.C. 3305(a)(1)(A), 3305(b).)

(2) Duress, lack of legal capacity, or illegality of the transaction which, under other law, nullifies the obligor's obligation. (U.C.C. 3305(a)(1)(B), 3305(b); see *Wilson v. Steele* (1989) 211 C.A.3d 1053, 1062, 259 C.R. 851, 1 Summary (10th), *Contracts*, §492 [note and deed of trust, if related to construction contract by unlicensed contractor, were subject to illegality defense]; 24 A.L.R.2d 1380 [insanity of maker, drawer, or indorser as defense against holder in due course]; 89 A.L.R.5th 577 [duress, incapacity, illegality, or similar defense rendering obligation nullity as affecting enforceability of negotiable instrument against holder in due course]; 1 Summary (10th) *Contracts*, §§309 et seq. [duress], 50 et seq. [incapacity], 419 et seq. [illegality].)

(3) Fraud that induced the obligor to sign the instrument without knowledge or a reasonable opportunity to learn of its character or its essential terms. (U.C.C. 3305(a)(1)(C), 3305(b); see 11 A.L.R.3d 1080 [procuring signature by fraud as forgery]; 78 A.L.R.3d 1020 [fraud in the inducement and fraud in the factum under U.C.C. 3305]; 1 Summary (10th), *Contracts*, §299.)

(4) Discharge of the obligor in insolvency proceedings. (U.C.C. 3305(a)(1)(D), 3305(b).)

The defenses listed in U.C.C. 3305(a)(1) are referred to as "real defenses." (Official Comment 1; see Brady (Bailey) §9.12; 12 Am.Jur.2d (1997 ed.), *Bills and Notes* §548; 39 A.L.R.3d 518 [validity of provision in commercial paper given in connection with sale of consumer goods that waives, as against assignee, defenses good against seller]; on agreements waiving defenses against assignee of account, see 4 Summary (10th) *Secured Transactions in Personal Property*, §160; for statutory limitations on those agreements, see 4 Summary (10th) *Sales*, §§254, 277.)

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(3) *Fraud that induced obligor to sign instrument without knowledge of its character or essential terms:* See 93 Proof of Facts 3d 141 [proof of fraud in making of commercial paper and resulting consequences].



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b. Persons Other Than Holder in Due Course.

4 Witkin Sum. Cal. Law Neg Inst § 32

[§ 32] Persons Other Than Holder in Due Course.

(1) *Simple Contract Defense.* The enforcement rights of a person who is not a holder in due course are subject to a defense of the obligor that would be available if the person were enforcing a right to payment under a simple contract. (U.C.C. 3305(a)(2), (b); see Brady (Bailey) §9.09.)

(2) *Defenses Found Elsewhere in Division 3.* The enforcement rights of a person who is not a holder in due course are subject to defenses stated elsewhere in Division 3. (U.C.C. 3305(a)(2), (b).) These defenses include:

- (a) Nonissuance, conditional issuance, and issuance for a special purpose under U.C.C. 3105(b) (supra, §9);
- (b) Failure to countersign a traveler's check under U.C.C. 3106(c) (supra, §12);
- (c) Modification of an obligation by a separate agreement under U.C.C. 3117 (supra, §16);
- (d) Payment that violates a restrictive indorsement under U.C.C. 3206(f) (supra, §24);
- (e) Instruments issued without consideration or for which promised performance has not been given under U.C.C. 3303(b) (supra, §29);
- (f) Breach of warranty where a draft is accepted under U.C.C. 3417(b) (infra, §50); and
- (g) Misrepresentation or mistake in the issuance of the instrument under common law. (Official Comment 2; see *12 Am.Jur.2d (1997 ed.), Bills and Notes §549.*)

(3) *Claim in Recoupment.* An obligor may assert, against an instrument's enforcer, a claim in recoupment that the obligor has against the instrument's original payee. The claim must have arisen from the transaction that created the instrument. The obligor's claim may be asserted against a transferee of the instrument only to reduce the amount owing on the instrument at the time the action is brought. (U.C.C. 3305(a)(3), (b); see *12 Am.Jur.2d (1997 ed.), Bills and Notes §622 et seq.*) A holder in due course is not subject to the claim, unless the claim is against the holder. (U.C.C. 3305(b).)

Under former Article 3, case law was divided on the extent to which an obligor on a note could assert against a transferee a debt or claim the obligor had against the original payee. U.C.C. 3305(a)(3) limits claims to those that arose in the transaction that gave rise to the note, on the ground that the buyer in a sale transaction should not be denied the right to assert claims arising out of the transaction, but that it is unreasonable to require the transferee to bear the risk of wholly unrelated claims. Whether the claim arose from the transaction giving rise to the instrument is determined by local law. (Official Comment 3.)

(4) *Claims to an Instrument.* A person, other than a holder in due course, who takes an instrument is subject to a claim of a property or possessory right in the instrument or its proceeds, including a claim to rescind a negotiation and to recover the instrument or its proceeds. A holder in due course takes free of these claims. (U.C.C. 3306; see *12 Am.Jur.2d (1997 ed.), Bills and Notes §626.*)

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c. Persons Other Than Obligor.

4 Witkin Sum. Cal. Law Neg Inst § 33

[§ 33] Persons Other Than Obligor.

In an action for payment of an instrument, the obligor may not assert against the person entitled to enforce the instrument a defense, claim in recoupment, or claim to the instrument of another person. The obligor may, however, assert the other person's claim to the instrument if the other person is joined in the action and personally asserts the claim against the person entitled to enforce the instrument. An obligor does not have to pay the instrument to someone other than a holder in due course if the obligor proves that the instrument is lost or stolen. (U.C.C. 3305(c).) U.C.C. 3305(c) applies principally where the obligation is paid with a third person's instrument, such as a cashier's check. (Official Comment 4; see *12 Am.Jur.2d (1997 ed.), Bills and Notes §550.*)

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d. Accommodation Party.

4 Witkin Sum. Cal. Law Neg Inst § 34

[§ 34] Accommodation Party.

In an action to make an accommodation party pay an instrument, the accommodation party may assert any defense or claim in recoupment under U.C.C. 3305(a) (*supra*, §§31, 32) that the accommodated party could assert against the person entitled to enforce the instrument, except the defenses of discharge in insolvency proceedings, infancy, and lack of legal capacity. (U.C.C. 3305(d); see *12 Am.Jur.2d (1997 ed.), Bills and Notes §551.*)

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4. Lost, Destroyed, or Stolen Instrument.

a. Enforcing Instrument.

4 Witkin Sum. Cal. Law Neg Inst § 35

[§ 35] Enforcing Instrument.

(1) *Prerequisites to Enforcement.* A person may enforce a lost, destroyed, or stolen instrument under the following circumstances:

(a) The person was in possession of the instrument and entitled to enforce it when loss of possession occurred (U.C.C. 3309(a)(1));

(b) The loss of possession was not the result of a transfer by the person or a lawful seizure (U.C.C. 3309(a)(2)); and

(c) The person cannot reasonably obtain possession of the instrument because the instrument was destroyed, its whereabouts cannot be determined, or it is in the wrongful possession of an unknown person or a person who cannot be found or is not amenable to service of process (U.C.C. 3309(a)(3)). (See Brady (Bailey) §4.15 et seq.; *11 Am.Jur.2d* (1997 ed.), *Bills and Notes* §§303, 304.)

In *Crystaplex Plastics, Ltd. v. Redevelopment Agency of Barstow* (2000) 77 C.A.4th 990, 92 C.R.2d 197, plaintiff installed a hockey rink as part of a large construction project at a facility owned by defendant. Defendant issued a check in the amount of \$ 31,979 for the hockey rink. The check was made payable jointly to plaintiff and to a subcontractor on the project, who had contracted with plaintiff for the installation. The check was sent to the subcontractor, who cashed it without paying plaintiff. After plaintiff discovered these facts, it sued defendant as drawer of the check. The trial court sustained defendant's demurrer. *Held*, reversed.

(a) According to Official Comment 4 to U.C.C. 3310 (supra, §18), if a payor bank pays a person not entitled to enforce an instrument, the payee has a cause of action against the drawer under U.C.C. 3309. This is precisely the situation here, because the payee who negotiated the check, the subcontractor, was not entitled to enforce the instrument. Under U.C.C. 3110(d) (supra, §17), the joint payees, acting together, were the persons who could enforce the instrument. (77 C.A.4th 995.)

(b) Plaintiff here sufficiently alleged the three elements stated in U.C.C. 3309(a). First, plaintiff alleged possession by contending that it was a joint payee of the check and that the check was delivered to a copayee. Plaintiff did not have

to allege that it was ever in actual possession of the check; constructive possession results from delivery of an instrument to one of several joint payees. (77 C.A.4th 998, 999.) Second, plaintiff alleged that the subcontractor received and negotiated the check without plaintiff's knowledge, consent, or endorsement, which is sufficient to establish that plaintiff did not transfer the check. (77 C.A.4th 999, 1000.) Third, plaintiff claimed that the check was negotiated without the consent of a joint payee, the functional equivalent of alleging that the check was stolen and the endorsement was forged. This satisfies the third requirement of U.C.C. 3309(a) that the person enforcing the check cannot reasonably obtain possession of the check. (77 C.A.4th 1000.)

(2) *Procedure.* A person seeking enforcement under U.C.C. 3309(a) must prove the instrument's terms and the person's right to enforce the instrument. If that proof is made, the rules governing authenticity of signatures apply as if the person seeking enforcement had produced the instrument. (U.C.C. 3309(b); see *11 Am.Jur.2d (1997 ed.), Bills and Notes §305 et seq.*; on rules governing authenticity, see U.C.C. 3308, *infra*, §41.)

The court may not allow enforcement unless the person required to pay the instrument is adequately protected against loss that might occur if another person attempts to enforce the instrument. Adequate protection may be provided by any reasonable means. (U.C.C. 3309(b).)

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b. Asserting Claim for Cashier's, Teller's, or Certified Check.

4 Witkin Sum. Cal. Law Neg Inst § 36

[§ 36] Asserting Claim for Cashier's, Teller's, or Certified Check.

(1) *Procedure.* The drawer or payee of a certified check or the remitter or payee of a cashier's check or teller's check may assert a claim to the amount of a lost, destroyed, or stolen check by describing the check to the obligated bank with reasonable certainty and requesting payment. (U.C.C. 3312(b); see *11 Am.Jur.2d (1997 ed.), Bills and Notes §§308, 309*; on definition of obligated bank, see U.C.C. 3312(a)(4).) The claimant's communication to the bank must include a "declaration of loss," in which the claimant, under penalty of perjury, declares that the loss of possession was not the result of a transfer by the claimant or a lawful seizure, and that the claimant cannot reasonably obtain possession of the check because the check was destroyed, its whereabouts cannot be determined, or it is in the wrongful possession of an unknown person or a person who cannot be found or is not amenable to service of process. (U.C.C. 3312(a), (b).)

The bank must receive the communication with reasonable time to act on it before the check is paid. The claimant must provide the bank with reasonable identification on request. (U.C.C. 3312(a), (b).) By delivering a declaration of loss, the claimant warrants to the bank and to any person entitled to enforce the check that the declaration is true. (U.C.C. 3312(b).)

(2) *Bank's Duties.* A claim under U.C.C. 3312(b) becomes enforceable at the later of:

- (a) The time the claim is asserted;
- (b) The 90th day following the date of the check, in the case of a cashier's check or teller's check; or
- (c) The 90th day following the date of the acceptance, in the case of a certified check. (U.C.C. 3312(b)(1).)

Until the claim becomes enforceable, it has no legal effect and the obligated bank may pay the check or, in the case of a teller's check, may permit the drawee to pay the check. Payment to a person entitled to enforce the check discharges all liability of the obligated bank with respect to the check. (U.C.C. 3312(b)(2).)

If the claim becomes enforceable before the check is presented for payment, the obligated bank need not pay the check. (U.C.C. 3312(b)(3).) When the claim becomes enforceable, the obligated bank must pay the amount of the check to the claimant if the check has not already been paid to a person entitled to enforce it. Subject to U.C.C. 4302(a)(1)

(infra, §116), payment to the claimant discharges all liability of the obligated bank with respect to the check. (U.C.C. 3312(b)(4); see *11 Am.Jur.2d (1997 ed.), Bills and Notes §§310, 311.*)

(3) *Later Presentment by Holder in Due Course.* If the obligated bank pays the amount of a check to a claimant under U.C.C. 3312(b)(4) and, after the claim becomes enforceable, a holder in due course presents the check for payment, the claimant must either (a) refund the payment to the bank if the check is paid, or (b) pay the amount of the check to the holder in due course if the check is dishonored. (U.C.C. 3312(c); see *11 Am.Jur.2d (1997 ed.), Bills and Notes §312.*)

(4) *Choice of Remedy.* If a claimant has the right to assert a claim under U.C.C. 3312(b) and is also a person entitled to enforce a cashier's check, teller's check, or certified check under U.C.C. 3309, the claimant may assert rights under either section. (U.C.C. 3312(d); on U.C.C. 3309, see *supra*, §35.)

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5. Enforcement Actions.

a. Statute of Limitations.

4 Witkin Sum. Cal. Law Neg Inst § 37

[§ 37] Statute of Limitations.

(1) *Action for Payment of Note.* An action to enforce a party's obligation to pay a note payable at a definite time must be commenced within 6 years after the due date or dates stated in the note. If a due date is accelerated, the action must be commenced within 6 years after the accelerated due date. (U.C.C. 3118(a).)

An action to enforce a party's obligation to pay a note payable on demand must be commenced within 6 years after demand for payment is made to the maker. If no demand for payment is made to the maker, an action to enforce the note is barred if neither principal nor interest on the note has been paid for a continuous period of 10 years. (U.C.C. 3118(b).) U.C.C. 3118(b) is designed to bar notes that no longer represent a claim to payment and to require reasonably prompt action to enforce notes on which there is default. (Official Comment 2; see *12 Am.Jur.2d (1997 ed.), Bills and Notes §§634, 635.*)

(2) *Action for Payment of Certificate of Deposit.* An action to enforce a party's obligation pay a certificate of deposit must be commenced within 6 years after demand for payment is made to the maker. If the instrument states a due date before which the maker is not required to pay, the 6-year period begins when a demand for payment is in effect and the due date has passed. (U.C.C. 3118(e).)

(3) *Action for Payment of Check.* An action to enforce a party's obligation to pay an unaccepted draft must be commenced within 3 years after dishonor of the draft or 10 years after the date of the draft, whichever period expires first. (U.C.C. 3118(c).) U.C.C. 3118(c) applies primarily to personal uncertified checks, functioning as payment instruments. (Official Comment 3.)

U.C.C. 3118(d) provides a longer period for those kinds of checks commonly treated as cash equivalents. (Official Comment 3.) An action to enforce the obligation of the acceptor of a certified check or the issuer of a teller's check, cashier's check, or traveler's check must be commenced within 3 years after demand for payment is made to the acceptor or issuer. (U.C.C. 3118(d).) The claim is never barred because the limitations period does not begin to run until the demand is made. The limitations period in U.C.C. 3118(d) in effect applies only to cases in which there is a dispute about the legitimacy of the claim of the person demanding payment. (Official Comment 3.)

(4) *Action for Payment of Accepted Draft.* An action to enforce a party's obligation to pay an accepted draft, other than a certified check, at a definite time must be commenced within 6 years after the due date or dates stated in the draft or acceptance. If the acceptor's obligation is payable on demand, the action must be commenced within 6 years after the acceptance date. (U.C.C. 3118(f).)

(5) *Other Actions.* Unless governed by other law regarding claims for indemnity or contribution, U.C.C. 3118(g) provides that the following types of actions must be commenced within 3 years after the cause of action accrues:

(a) For conversion of an instrument, for money had and received, or a similar action based on conversion;

(b) For breach of warranty; or

(c) To enforce an obligation, duty, or right arising under Division 3 and not otherwise governed by U.C.C. 3118. (See *12 Am.Jur.2d (1997 ed.), Bills and Notes §636*.)

(6) *Accrual and Tolling.* Unlike its predecessor provision in former Article 3, U.C.C. 3118 does not define when a cause of action accrues; it merely defines the time within which an action to enforce an obligation, duty, or right under Division 3 must be commenced. Under U.C.C. 1103, the circumstances under which the running of a limitations period is tolled are left to other law. (Official Comment 1; see *12 Am.Jur.2d (1997 ed.), Bills and Notes §637*.)

(7) *No Retroactive Effect.* Nothing in the provisions regarding the effective date and construction of revised Divisions 3 and 4 (see U.C.C. 16101 et seq.) is intended to apply U.C.C. 3118 to an action commenced before January 1, 1993. (U.C.C. 16103.)

SUPPLEMENT: [This section is current through the latest supplement]

(5) *Other Actions.* In *AmerUS Life Ins. Co. v. Bank of America (2006) 143 C.A.4th 631, 49 C.R.3d 493*, plaintiff insurance company sued defendant bank for conversion. Over a 7-month period starting in late 1995, an independent insurance agent defrauded an elderly widow by selling her forged or fake annuity policies in exchange for three \$ 150,000 checks that were made payable to plaintiff. Instead of remitting the checks to plaintiff, the agent deposited them into his own corporate accounts with defendant. After the widow's death in 2001, her beneficiary filed a claim on the policies with plaintiff, which denied the claims because it had no knowledge of those policies. The beneficiary then sued plaintiff, defendant, and the agent, who could not be located, to recover the losses arising out of the wrongfully paid checks. In 2002, plaintiff filed this cross-complaint against defendant for conversion of the checks, alleging that by paying them into the agent's accounts over his fraudulent indorsements in 1996, defendant had exercised wrongful dominion over plaintiff's property interest as payee of the checks. The trial judge granted summary judgment for defendant. *Held*, affirmed; plaintiff's conversion claim was barred by the 3-year statute of limitations of U.C.C. 3118(g). An instrument is converted when it is paid to an unauthorized person; thus, the 3-year statute of limitations began to run in 1996, when defendant paid the checks into the agent's accounts, and expired more than 3 years before plaintiff filed its cross-claim in December 2002. (*143 C.A.4th 637*.) Plaintiff's argument that its conversion claim accrued only when it suffered damages in 2005, when it entered into a settlement agreement with the beneficiary, was not persuasive. There could have been no conversion unless plaintiff was entitled to possess the checks when defendant negotiated them. Hence, plaintiff's conversion claim necessarily accrued at the time of payment to the agent, because it was the negotiation that divested plaintiff of its possessory right, regardless of any obligations it might have had to a third party such as the beneficiary. (*143 C.A.4th 642*.) In short, plaintiff "cannot contend that it had a possessory interest in the checks as payee at the time of negotiation for purposes of maintaining its conversion claim, while simultaneously asserting that it had no interest in the checks and suffered no damage by their negotiation for purposes of avoiding the statute of limitations." (*143 C.A.4th 641, 642*.)



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E. Enforcement of Instruments.

5. Enforcement Actions.

b. Notice of Right To Defend Action.

4 Witkin Sum. Cal. Law Neg Inst § 38

[§ 38] Notice of Right To Defend Action.

In an action for breach of an obligation for which a third person is answerable over pursuant to Division 3 or Division 4, the defendant may notify the third person in writing of the litigation, and the person notified may then give similar notice to any other person who is answerable over. If the notice states that the person may "come in and defend," and that failure to do so will bind the notified person in an later action brought by the notice giver as to any factual determination common to the two actions, then the notified person is so bound unless after reasonable receipt of the notice the person notified does come in and defend. (U.C.C. 3119; see *12 Am.Jur.2d (1997 ed.), Bills and Notes §§437, 649.*)

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F. Liability of Parties.

1. Significance of Signature.

a. Authorized Signature.

4 Witkin Sum. Cal. Law Neg Inst § 39

[§ 39] Authorized Signature.

(1) *General Rule.* A person is not liable on an instrument unless the person, or the person's agent or representative, signed the instrument. (U.C.C. 3401(a); see *Danning v. Bank of America (1984) 151 C.A.3d 961, 969, 199 C.R. 163* [payor bank was liable to trustee of bankrupt corporation for honoring corporation's check that lacked second of two required signatures].) A signature may be made manually or by using a device or machine. (U.C.C. 3401(b)(1).) The signer may use any name, including a trade or assumed name, a word, mark, or a symbol by which the signer presently intends to authenticate a writing. (U.C.C. 3401(b)(2); see Brady (Bailey) §3.04 et seq.; Cal. Civil Practice, 4 Business Litigation, §42:24 et seq.; *11 Am.Jur.2d (1997 ed.), Bills and Notes §60* et seq.)

A person not liable on the instrument may still be held liable on the underlying debt. (See *First Western Bank & Trust Co. v. Bookasta (1968) 267 C.A.2d 910, 914, 73 C.R. 657* [corporation note signed only by secretary and president; plaintiff payee could not sue B on note, but did state cause of action against B alleging that corporation was his alter ego]; *McClung v. Saito (1970) 4 C.A.3d 143, 151, 84 C.R. 44* [S corporation executed a note on behalf of defendants, a group of joint venturers, who received the proceeds; defendants were liable to plaintiff payee in an action to recover consideration given for note]; *Potts v. First City Bank (1970) 7 C.A.3d 341, 344, 86 C.R. 552.*)

(2) *Signature by Representative.* When someone signs an instrument on someone else's behalf, the represented party ordinarily incurs liability. Liability may, however, attach to the representative under certain circumstances. (For illustrations, see Official Comment 2 to revised U.C.C. 3402.)

(a) *Liability of Represented Person.* A representative may sign an instrument using either the represented person's or the signer's name. The represented person is bound as if the signature were on a simple contract. If the represented person is bound, the representative's signature is the "authorized signature of the represented person" and the represented person is liable on the instrument, regardless of whether the instrument identifies him or her. (U.C.C. 3402(a); see *McCullum v. Steitz (1968) 261 C.A.2d 76, 80, 67 C.R. 703* [managing partner of restaurant who executed note with his own name followed by name and address of restaurant signed as representative, and therefore partnership was liable]; *12 Am.Jur.2d (1997 ed.), Bills and Notes §492.*) Under former Division 3, an undisclosed principal was not liable on an instrument. Under U.C.C. 3402(a), however, it is no longer possible to have an instrument signed by an authorized agent on which neither the agent nor principal is liable. (Official Comment 1; on doctrine of undisclosed

principal, see 3 *Summary* (10th), *Agency and Employment*, §158.)

(b) *Liability of Representative.* If a representative signs his or her own name and the signature is an authorized signature of the represented person, the representative is not liable on the instrument as long as (1) the signature's form shows unambiguously that the signature is made on the represented person's behalf, and (2) the represented person is identified in the instrument. (U.C.C. 3402(b)(1); see *Cohen v. Disner* (1995) 36 C.A.4th 855, 42 C.R.2d 782, *infra*, §47 [incorporation of representative capacity defense of U.C.C. 3402(b)(1) into C.C. 1719].) If these conditions are not met, the representative is liable to a holder in due course who took the instrument without notice that the representative was not intended to be liable. The representative is liable to persons other than a holder in due course unless the representative proves that the original parties did not intend the representative to be liable. (U.C.C. 3402(b)(2); see 12 *Am.Jur.2d* (1997 ed.), *Bills and Notes* §497.)

If a representative signs his or her own name as drawer of a check without indicating representative status, the representative is not liable on the check as long as (1) the check is payable from an account of the represented person, (2) the represented person is identified on the check, and (3) the signature is an authorized signature of the represented person. (U.C.C. 3402(c).) Because virtually all checks used today are in a personalized form that identifies the person on whose account the check is drawn, no one is deceived into thinking that one signing in a representative capacity is meant to be liable. (Official Comment 3.)

In *Home Fed. Savings & Loan Assn. v. Ramos* (1991) 229 C.A.3d 1609, 284 C.R. 1, plaintiff loaned money to a limited partnership in return for a promissory note that was secured by a personal guaranty signed by defendant. Defendant was president of a corporation that was the general partner of the limited partnership. The limited partnership defaulted on the note, and plaintiff sued to enforce the guaranty. Defendant argued that he was not personally liable, because he had added "Pres." after his signature, thus indicating an intent to bind only the general partner. The trial judge granted judgment for plaintiff. *Held*, affirmed. The addition of "Pres." after defendant's signature did not change the personal character of the guaranty. To interpret the document as a guaranty by the general partner was "objectively unreasonable," because the general partner was already liable for the debts of the limited partnership without the guaranty. (229 C.A.3d 1613, 1614.)

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SUPPLEMENT: [This section is current through the latest supplement]



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b. Unauthorized Signature.

4 Witkin Sum. Cal. Law Neg Inst § 40

[§ 40] Unauthorized Signature.

(1) *Effect.* An unauthorized signature includes a forgery as well as a signature made by one exceeding actual or apparent authority. (U.C.C. 1201(42); Official Comment 1 to U.C.C. 3403.) It is ineffective except as the signature of the unauthorized signer in favor of a person who in good faith pays the instrument or takes it for value. (U.C.C. 3403(a); see *42 So. Cal. L. Rev.* 659 [forgeries under former versions of Articles 3 and 4]; *11 Am.Jur.2d (1997 ed.), Bills and Notes* §65; *12 Am.Jur.2d (1997 ed.), Bills and Notes* §§493, 494, 586 et seq.) The unauthorized signer's liability is not in damages for breach of warranty of authority; it is full liability on the instrument in the capacity in which the signer signed. (Official Comment 2; on liability of banks in forgery cases, see *infra*, §§58, 119, 128, 129.)

(2) *Ratification.* An unauthorized signature may be ratified. (U.C.C. 3403(a).) Ratification may result from conduct, such as the retention of benefits received in the transaction with knowledge of the unauthorized signature, as well as from express statements. Ratification neither relieves the signer of liability to the person whose name is signed nor affects any criminal liability for the unauthorized signature. (Official Comment 3; see *Rakestraw v. Rodrigues (1972) 8 C.3d 67, 75, 104 C.R. 57, 500 P.2d 1401* [principal, with knowledge of forgery, accepted benefits and took no steps to rescind for 3 years]; *Common Wealth Ins. Systems v. Kersten (1974) 40 C.A.3d 1014, 1024, 1026, 115 C.R. 653* [evidence sufficiently supported findings of both ratification and estoppel]; *93 A.L.R.3d 967* [what constitutes ratification]; *12 Am.Jur.2d (1997 ed.), Bills and Notes* §495; on negligence as creating estoppel, see *infra*, §56.)

(3) *Signature of Organization.* The signature of an organization is unauthorized if any of the required signatures is lacking. (U.C.C. 3403(b); see *Edward Fineman Co. v. Superior Court (1998) 66 C.A.4th 1110, 78 C.R.2d 478*, *infra*, §130; *12 Am.Jur.2d (1997 ed.), Bills and Notes* §496.) "Organization" is broadly defined in U.C.C. 1201(28) to include two or more persons having a joint or common interest. Thus, U.C.C. 3403(b) applies where a husband and wife are both required to sign an instrument. (Official Comment 4.)

(4) *Additional Liability.* A provision of Division 3 that makes an unauthorized signature effective for the purposes of Division 3 does not affect an unauthorized signer's civil or criminal liability. (U.C.C. 3403(c).)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Effect.* U.C.C. 1201(42) was renumbered U.C.C. 1201(b)(41) in 2006.

(3) *Signature of Organization.* U.C.C. 1201(28) was renumbered U.C.C. 1201(b)(25) and amended in 2006. "Organization" is now defined as "a person other than an individual."



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c. Presumption of Authenticity and Authority.

4 Witkin Sum. Cal. Law Neg Inst § 41

[§ 41] Presumption of Authenticity and Authority.

(1) *Specific Denial Required.* In an action involving an instrument, the authenticity of, and authority to make, each signature on the instrument is admitted unless specifically denied in the pleadings. (U.C.C. 3308(a); see *12 Am.Jur.2d (1997 ed.), Bills and Notes §659.*) The purpose of requiring a specific denial is to give the plaintiff notice of the defendant's claim of forgery or lack of authority, and to afford the plaintiff an opportunity to investigate and obtain evidence. Unless local statutes or rules require otherwise, the denial need not be verified and may be on information and belief. (Official Comment 1.)

(2) *Presumption of Authenticity.* When a signature's validity is denied in the pleadings, the person claiming validity has the burden of establishing validity. The signature is presumed to be authentic and authorized unless the action is to enforce the purported signer's liability and the signer is dead or incompetent at the time the validity issue is tried. (U.C.C. 3308(a); see *12 Am.Jur.2d (1997 ed.), Bills and Notes §659.*) Authenticity is presumed because forged or unauthorized signatures are uncommon, and evidence is normally in the control of, or more accessible to, the defendant. The defendant's evidence need not be sufficient to require a directed verdict, but must be enough to support the denial by permitting a finding in the defendant's favor. (Official Comment 1.)

(3) *Signature of Representative.* If the defendant in an action to enforce an instrument is an undisclosed principal of the person who signed the instrument, the plaintiff has the burden of establishing that the defendant is liable as a represented person under U.C.C. 3402, supra, §39. (U.C.C. 3308(a); see *12 Am.Jur.2d (1997 ed.), Bills and Notes §661.*)

(4) *Proving Holder in Due Course Status.* A plaintiff producing the instrument is entitled to payment after (a) the validity of signatures is admitted or proved, (b) there is compliance with U.C.C. 3308(a), and (c) the plaintiff proves entitlement to enforce the instrument under U.C.C. 3301 (supra, §26). However, if the defendant proves a defense or claim in recoupment, the plaintiff's right to payment is subject to the defense or claim, except to the extent the plaintiff proves that the plaintiff has rights of a holder in due course that are not subject to the defense or claim. (U.C.C. 3308(b); see *11 Am.Jur.2d (1997 ed.), Bills and Notes §241; 12 Am.Jur.2d (1997 ed.), Bills and Notes §660 et seq.;* on defenses that are cut off by holder in due course, see supra, §32.)

Nothing in U.C.C. 3308(b) requires the plaintiff to necessarily prove rights as a holder in due course. The provision means only that a plaintiff claiming the rights of a holder in due course against a defense or right in recoupment has the burden of proof on that issue. (Official Comment 2.)

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a. Drawee/Acceptor.

1. Significance of Acceptance.

4 Witkin Sum. Cal. Law Neg Inst § 42

[§ 42] Significance of Acceptance.

(1) *Prerequisite to Liability.* A check or other draft does not by itself assign funds in the drawee's hands available for its payment. The drawee is not liable on the instrument until the drawee accepts it. (U.C.C. 3408; see *11 Am.Jur.2d (1997 ed.)*, *Bills and Notes* §§140, 382; *12 Am.Jur.2d (1997 ed.)*, *Bills and Notes* §§445, 446; on treating draft as contract for some purposes, see *1 Summary (10th)*, *Contracts*, §107.)

(2) *Method of Acceptance.* Acceptance is the drawee's signed agreement to pay a draft as presented. It must be written on the draft and may consist of the drawee's signature alone. (U.C.C. 3409(a).) Customarily, the signature is written vertically across the instrument's face, but a signature anywhere, including the back of the instrument, is sufficient. It need not be accompanied by words such as "accepted," "certified," or "good." (Official Comment 2; see *11 Am.Jur.2d (1997 ed.)*, *Bills and Notes* §384.)

A certified check, which is a check accepted by the bank on which it is drawn, may be accepted as provided in U.C.C. 3409(a) or by a writing on the check indicating that the check is certified. The check's drawee has no obligation to certify the check, and refusal to certify is not dishonor of the check. (U.C.C. 3409(d); see *Wells Fargo Bank v. Bank of Italy (1931)* 214 C. 156, 159, *4 P.2d 781*; *100 A.L.R.2d 1197* [avoidance of certification obtained by fraud]; *25 A.L.R.3d 1367* [right of bank to cancel check certified by mistake].)

(3) *Incomplete Draft.* A draft may be accepted even though the drawer has not signed it, it is otherwise incomplete, it is overdue, or it has been dishonored. (U.C.C. 3409(b).)

(4) *Timing of Acceptance.* Acceptance may be made at any time. It becomes effective when notification according to instructions is given or when the accepted draft is delivered for the purpose of giving rights on the acceptance to any person. (U.C.C. 3409(a); see *11 Am.Jur.2d (1997 ed.)*, *Bills and Notes* §385.) If a draft is payable at a fixed period after sight and the acceptor fails to date the acceptance, the holder may complete the acceptance by supplying a date in good faith. (U.C.C. 3409(c).) The purpose of U.C.C. 3409(c) is to provide a definite date of payment if none appears on the instrument. (Official Comment 3; see *11 Am.Jur.2d (1997 ed.)*, *Bills and Notes* §386.)

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a. Drawee/Acceptor.

2. Acceptor's Obligation.

4 Witkin Sum. Cal. Law Neg Inst § 43

[§ 43] Acceptor's Obligation.

(1) *Terms of Payment.* The acceptor of a draft must pay a person entitled to enforce the draft or the drawer or an indorser who paid the draft under U.C.C. 3414 (infra, §46) or U.C.C. 3415 (infra, §48). The acceptor must pay the draft according to its terms at the time it was accepted, even if the acceptance states that the draft is payable "as originally drawn" or equivalent terms. If the acceptance varies the draft's terms (see infra, §44), the acceptor must pay the draft according to the terms as varied. If the draft is an incomplete instrument, it is paid according to its terms when completed, to the extent stated in U.C.C. 3115 (supra, §16) and U.C.C. 3407 (infra, §55). (U.C.C. 3413(a); see *11 Am.Jur.2d (1997 ed.), Bills and Notes §382.*)

(2) *Amount Owed.* The acceptor's obligation is the amount stated on the certification of a check or other acceptance of a draft. If (a) the certification or acceptance does not state an amount, (b) the amount of the instrument is subsequently raised, and (c) the instrument is then negotiated to a holder in due course, the acceptor's obligation is the amount at the time the holder in due course took the instrument. (U.C.C. 3413(b).) Thus, U.C.C. 3413(b) protects the holder in due course of a certified check that is altered after certification and before negotiation to the holder in due course. A bank can avoid liability for the altered amount by stating on the check the amount the bank agrees to pay. (Official Comment.)

(3) *Wrongful Act by Obligated Bank.* A debtor using a certified check to pay a debt has no right to stop payment, but some banks will refuse payment as an accommodation to a customer. U.C.C. 3411 is designed to discourage this practice. (Official Comment 1.) If a bank that accepts a certified check wrongfully refuses to pay the check, the person enforcing the check is entitled to compensation for expenses and loss of interest resulting from the nonpayment. The person may also recover consequential damages if the obligated bank refuses to pay after receiving notice of particular circumstances giving rise to the damages. (U.C.C. 3411(b).)

Recovery is limited to cases in which the bank refuses to pay even though its obligation to do so is clear and it is able to pay. (Official Comment 3.) Thus, expenses or consequential damages are not available if the obligated bank refuses to pay for one of the following reasons:

(a) The bank suspends payments. (U.C.C. 3411(c)(1).)

(b) The obligated bank asserts a claim or defense that it reasonably believes is available against the person entitled to enforce the instrument. (U.C.C. 3411(c)(2).)

(c) The obligated bank has a reasonable doubt whether the person demanding payment is the person entitled to enforce the instrument. (U.C.C. 3411(c)(3).)

(d) Payment is prohibited by law. (U.C.C. 3411(c)(4).)

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3. Acceptance Varying Draft.

4 Witkin Sum. Cal. Law Neg Inst § 44

[§ 44] Acceptance Varying Draft.

(1) *Holder's Options.* If the terms of a drawee's acceptance vary from the terms of the draft as presented, the holder may refuse the acceptance and treat the draft as dishonored. In that case, the drawee may cancel the acceptance. (U.C.C. 3410(a).) An acceptance to pay at a particular bank or place in the United States does not vary the draft's terms, unless the acceptance states that the draft is to be paid *only* at that bank or place. (U.C.C. 3410(b); see *11 Am.Jur.2d (1997 ed.), Bills and Notes §387.*)

(2) *Effect on Drawer and Indorser.* If the holder assents to an acceptance varying a draft's terms, the obligation of each drawer and indorser that does not expressly assent to the acceptance is discharged. (U.C.C. 3410(c).) The assent of a drawer or indorser to a varied acceptance must be affirmatively expressed. Mere failure to object within a reasonable time is not assent. (Official Comment 1; see *11 Am.Jur.2d (1997 ed.), Bills and Notes §388.*)

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b. Issuer of Note or Cashier's Check.

4 *Witkin Sum. Cal. Law Neg Inst* § 45

[§ 45] Issuer of Note or Cashier's Check.

(1) *General Rule of Liability.* The issuer of a note or cashier's check or other draft drawn on the drawer must pay a person entitled to enforce the instrument or an indorser who paid the instrument under U.C.C. 3415 (infra, §48). (U.C.C. 3412; see *12 Am.Jur.2d* (1997 ed.), *Bills and Notes* §442.) The issuer must pay the instrument according to its terms as of one of the following times:

(a) The time it was issued. (U.C.C. 3412(a).)

(b) The time it first came into a holder's possession, if it was not issued. (U.C.C. 3412(a).)

(c) When completed, if the issuer signed an incomplete instrument. (U.C.C. 3412(b).) (On completion of incomplete instruments, see U.C.C. 3115, supra, §16; on altered instruments, see U.C.C. 3407, infra, §55.)

(2) *Wrongful Act by Obligated Bank.* A debtor using a cashier's check or a teller's check to pay a debt has no right to stop payment. U.C.C. 3411 discourages banks from refusing payment on these instruments. (Official Comment 1.) If a bank that issues a cashier's check or a teller's check bought from the issuer wrongfully refuses to pay the check, the person enforcing the check is entitled to compensation for expenses and loss of interest resulting from the nonpayment. The person may also recover consequential damages if the obligated bank refuses to pay after receiving notice of particular circumstances giving rise to the damages. (U.C.C. 3411(b).)

Recovery is limited to cases in which the bank refuses to pay even though its obligation to do so is clear and it is able to pay. (Official Comment 3.) Thus, expenses or consequential damages are not available if the obligated bank refuses to pay for one of the following reasons:

(a) The bank suspends payments. (U.C.C. 3411(c)(1).)

(b) The obligated bank asserts a claim or defense that it reasonably believes is available against the person entitled to enforce the instrument. (U.C.C. 3411(c)(2).)

(c) The obligated bank has a reasonable doubt whether the person demanding payment is the person entitled to

enforce the instrument. (U.C.C. 3411(c)(3).)

(d) Payment is prohibited by law. (U.C.C. 3411(c)(4).)

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c. Drawer.

1. In General.

4 Witkin Sum. Cal. Law Neg Inst § 46

[§ 46] In General.

(1) *Governing Law.* U.C.C. 3414 sets forth the obligations of a drawer on an instrument. It does not, however, apply to cashier's checks or other drafts drawn on the drawer. (U.C.C. 3414(a).) Obligations on those instruments are described in U.C.C. 3412, *supra*, §45.

(2) *Unaccepted, Dishonored Draft.* If an unaccepted draft is dishonored, the drawer must pay a person entitled to enforce the draft or an indorser who paid the draft under U.C.C. 3415 (*infra*, §48). (U.C.C. 3414(b); see *12 Am.Jur.2d (1997 ed.), Bills and Notes §451.*) The drawer must pay the instrument according to its terms as of one of the following times:

(a) The time it was issued. (U.C.C. 3414(b)(1).)

(b) The time it first came into a holder's possession, if it was not issued. (U.C.C. 3414(b)(1).)

(c) When completed, if the drawer signed an incomplete instrument. (U.C.C. 3414(b)(2).) (On completion of incomplete instruments, see U.C.C. 3115, *supra*, §16; on altered instruments, see U.C.C. 3407, *infra*, §55.)

(3) *Draft Accepted by Bank.* If a bank accepts a draft, the drawer is discharged, regardless of when or by whom acceptance was obtained. (U.C.C. 3414(c); see *12 Am.Jur.2d (1997 ed.), Bills and Notes §452.*)

(4) *Draft Accepted by Other Than Bank and Dishonored.* If someone other than a bank accepts a draft and then dishonors it, the drawer's obligation to pay is the same as an indorser's under U.C.C. 3415(a) and (c) (see *infra*, §48). (U.C.C. 3414(d); see *12 Am.Jur.2d (1997 ed.), Bills and Notes §453.*) The drawee, as acceptor, becomes primarily liable. The drawer is secondarily liable as a guarantor of payment. A drawer who pays then has a right of recourse against the acceptor under U.C.C. 3413(a) (*supra*, §43). (Official Comment 4.)

(5) *Disclaiming Liability.* If a draft states that it is drawn "without recourse" or otherwise disclaims the drawer's liability, the drawer is not liable under U.C.C. 3414(b) to pay the draft. However, a disclaimer is not effective if the draft is a check. (U.C.C. 3414(e); see *12 Am.Jur.2d (1997 ed.), Bills and Notes §454.*) Issuing a check on which no one

is liable serves no legitimate purpose. (Official Comment 5.)

(6) *Effect of Delayed Collection.* When the following circumstances occur, the drawer of a check is protected from loss caused when the holder of the check delays collection:

- (a) The check is not presented for payment or given to a depository bank for collection within 30 days after its date.
- (b) The drawee suspends payments after expiration of the 30-day period without paying the check.
- (c) Because of the suspension of payments, the drawer is deprived of funds maintained with the drawee to cover payment of the check.

The drawer, to the extent it is deprived of funds, may discharge its obligation to pay the check by assigning its rights against the drawee to the person entitled to enforce the check. (U.C.C. 3414(f); Official Comment 6; see *12 Am.Jur.2d (1997 ed.), Bills and Notes §455.*)

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c. Drawer.

2. Additional Liability to Payee or Payee's Assignee.

4 Witkin Sum. Cal. Law Neg Inst § 47

[§ 47] Additional Liability to Payee or Payee's Assignee.

(1) *Liability for Check Drawn on Insufficient Funds.* A drawer who passes a check on insufficient funds is liable to the payee for the amount of the check and a service charge payable to the payee. The service charge may be as much as \$ 25 for the first check and \$ 35 for each subsequent check to that payee. (C.C. 1719(a)(1).) The drawer may also be liable to the payee for treble damages following a written demand letter. (See C.C. 1719(a)(2); *Mughrabi v. Suzuki (1988) 197 C.A.3d 1212, 1215, 243 C.R. 438* [treble damages provision in C.C. 1719 is mandatory].) A drawer will not, however, be liable for a service charge, costs to mail the written demand, or treble damages, if he or she stops payment in order to resolve a good faith dispute with the payee. (C.C. 1719(a)(3).) Furthermore, the drawer may avoid liability for the service charge if, at any time, the drawer presents the payee with written confirmation by the drawer's financial institution that the check was returned to the payee by the financial institution due to an error by the financial institution. (C.C. 1719(a)(4); for avoidance of service charge where delay in direct deposit of government check caused insufficient funds, see C.C. 1719(a)(5).)

(2) *Cause of Action.* A cause of action under C.C. 1719 may be brought by a holder of the check or an assignee of the payee. A proceeding under C.C. 1719 is a limited civil case. (C.C. 1719(f).) The assignee of the payee or a holder of the check may demand, recover, or enforce the service charge, damages, and costs specified in C.C. 1719 to the same extent as the original payee. (C.C. 1719(i).) The drawer may not be held liable more than once under C.C. 1719 on each check for a service charge, damages, or costs. (C.C. 1719(j).)

(3) *Defenses Available.* C.C. 1719 does not prejudice the rights, claims, remedies, and defenses under Division 3 of a drawer, payee, assignee, or holder, including a holder in due course under U.C.C. 3302. (C.C. 1719(k).) In *Cohen v. Disner (1995) 36 C.A.4th 855, 42 C.R.2d 782*, defendant attorney received checks totaling \$ 100,100 from his clients to be paid to plaintiff creditors as part of a settlement. Defendant deposited the checks into his client trust account. After confirming with his clients' bank that their account had sufficient funds, defendant wrote and delivered a trust account check to plaintiffs' attorney for \$ 100,100, with a note saying, in effect, that the \$ 100,100 was in partial settlement of a named case and that, per agreement, delivery to the attorney constituted delivery to plaintiffs. Also typed on the check was a notation identifying the underlying lawsuit. Without defendant's knowledge, his clients stopped payment on their checks to him. As a result, defendant was left with insufficient funds in the trust account to cover the \$ 100,100 check to

plaintiffs. Plaintiffs filed this action under C.C. 1719, seeking the value of the check, plus the statutory penalty of \$ 500. *Held*, summary judgment for defendant affirmed; C.C. 1719 was subject to the defenses in U.C.C. 3402 (*supra*, §39).

(a) Defendant was not liable under C.C. 1719. He had executed the check in a representative capacity, which was a defense under U.C.C. 3402. Although plaintiffs claimed that C.C. 1719 was a more specific statute that should govern over the more general Uniform Commercial Code, the proper rule is that the newer statute, i.e., C.C. 1719, is subject to existing law, because the Legislature is presumed to be aware of existing law when it enacts a new law. (*36 C.A.4th 859.*)

(b) The express language of C.C. 1719(a) supports this position. The statute imposes liability for "the amount owing upon that check." Thus, by providing that there must be an enforceable obligation, C.C. 1719 incorporates the defenses of the Uniform Commercial Code. The statute recognizes the difference between the words "the amount owing upon a check," which implies that the maker may litigate the enforceability of the maker's obligation to pay, and the words, "the amount written upon the check," which precludes all defenses. (*36 C.A.4th 860*; statutory language was amended in 1995 to refer to "the amount of the check.")

(c) *Mughrab* is distinguishable. That decision held that once the trial judge finds liability under C.C. 1719, he must award treble damages. It did not preclude the trial judge from determining that there is no liability in the first place. (*36 C.A.4th 861.*)

(d) Plaintiffs argued that the representative capacity defense of U.C.C. 3402(b)(2) was not available because defendant failed to meet the conditions of U.C.C. 3402(c), which provides a defense if the check, although signed by the representative, is drawn on an account of the represented person who is identified on the check. "We do not read subdivisions (b)(2) and (c) in that restrictive manner. In our view, any finding of liability under *UCC section 3402*, subdivision (b)(2) is subject to subdivision (c)'s additional exception that the representative is not liable if he signed his name on a personalized check identifying the account of the represented person. Subdivision (c) expands rather than contracts the representative's defenses." (*36 C.A.4th 862.*)

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d. Indorser.

4 *Witkin Sum. Cal. Law Neg Inst* § 48

[§ 48] Indorser.

(1) *Dishonored Instrument.* If an instrument is dishonored, an indorser must pay a person entitled to enforce the instrument or a subsequent indorser who paid the instrument under U.C.C. 3415. (U.C.C. 3415(a); see *18 A.L.R.3d 647* [liability of indorser, other than payee or transferee, of nonnegotiable instrument]; *12 Am.Jur.2d (1997 ed.), Bills and Notes §459* et seq.) The indorser must pay the instrument according to its terms as of one of the following times:

(a) The time it was indorsed. (U.C.C. 3415(a)(1).)

(b) When completed, if the indorser indorsed an incomplete instrument. (U.C.C. 3415(a)(2).) (On completion of incomplete instruments, see U.C.C. 3115, *supra*, §16; on altered instruments, see U.C.C. 3407, *infra*, §55.)

(2) *Exceptions.* An indorser may disclaim liability by indorsing the instrument "without recourse." (U.C.C. 3415(b); see *Gaetani v. Goss-Golden West Sheet Metal Profit Sharing Plan (2000) 84 C.A.4th 1118, 1122, 101 C.R.2d 432* [indorsement that read "For value received, the undersigned hereby assigns and transfers all right, title and interest in and to the within Note" was equivalent to indorsement "without recourse"; former U.C.C. 3414(1), predecessor to U.C.C. 3415(b), continued pre-UCC equivalency rule]; on limited indorsement by accommodation party, see U.C.C. 3419(d), *infra*, §51.) Moreover, an indorser's liability is discharged under the following circumstances:

(a) If the indorser is not given proper notice of dishonor when required by U.C.C. 3503 (*infra*, §63). (U.C.C. 3415(c).)

(b) If a bank accepts a draft after an indorsement is made. (U.C.C. 3415(d).)

(c) If a check is not presented for payment, or given to a depositary bank for collection, within 30 days after the day the indorsement was made. (U.C.C. 3415(e).)

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e. Warrantors.

1. Transferor.

4 Witkin Sum. Cal. Law Neg Inst § 49

[§ 49] Transferor.

(1) *Nature of Transfer Warranties.* A person who transfers an instrument for consideration warrants all of the following:

(a) The warrantor is entitled to enforce the instrument. (U.C.C. 3416(a)(1).) In other words, there are no unauthorized or missing indorsements that prevent the transferor from making the transferee a person entitled to enforce the instrument. (Official Comment 2; see *12 Am.Jur.2d (1997 ed.), Bills and Notes §522.*)

(b) All signatures on the instrument are authentic and authorized. (U.C.C. 3416(a)(2); see *11 Am.Jur.2d (1997 ed.), Banks and Financial Institutions §919; 12 Am.Jur.2d (1997 ed.), Bills and Notes §523.*)

(c) The instrument has not been altered. (U.C.C. 3416(a)(3); see *12 Am.Jur.2d (1997 ed.), Bills and Notes §524.*)

(d) The instrument is not subject to a defense or claim in recoupment against the warrantor. (U.C.C. 3416(a)(4).) This allows a transferee who takes as a holder in due course to proceed against the transferor rather than litigating the issue of holder in due course status with the obligor. (Official Comment 3; see *12 Am.Jur.2d (1997 ed.), Bills and Notes §525.*)

(e) The warrantor has no knowledge of an insolvency proceeding involving the maker or acceptor or, in the case of an unaccepted draft, the drawer. (U.C.C. 3416(a)(5).) The transfer does not warrant against difficulties of collection, impairment of the obligor's credit, or insolvency, but if the transferor knows that insolvency proceedings have been instituted against the party who is expected to pay, concealing that knowledge is a fraud on the transferee. (Official Comment 4; see *12 Am.Jur.2d (1997 ed.), Bills and Notes §526.*)

(f) If the instrument is a demand draft, the person identified as drawer authorized creation of the instrument according to the terms on its face. (U.C.C. 3416(a)(6).) If a transferor does not give this warranty under applicable conflict of law rules, then the warranty is not given to that transferor when that transferor is a transferee. (U.C.C. 3416(e).)

(2) *Enforcing Warranties*. The transfer warranties are given to the transferee and, if the transfer is by indorsement, all subsequent transferees. (U.C.C. 3416(a); see *12 Am.Jur.2d (1997 ed.), Bills and Notes §528*.) A transferee who took the instrument in good faith may recover damages for breach of warranty in an amount equal to the loss suffered as a result of the breach. The transferee cannot recover more than the amount of the instrument plus expenses and loss of interest incurred as a result of the breach. (U.C.C. 3416(b); see *12 Am.Jur.2d (1997 ed.), Bills and Notes §529*.) A cause of action for breach of warranty accrues when the claimant has reason to know of the breach. (U.C.C. 3416(d); see *12 Am.Jur.2d (1997 ed.), Bills and Notes §532*.)

Recovery of attorneys' fees in a breach of warranty action was addressed in *Grasso v. Crow (1997) 57 C.A.4th 847, 67 C.R.2d 367*, a case of first impression. Plaintiffs, successors in interest to the owners of a check cashing business that had cashed defendant's check, sued defendant for breach of contract, breach of transferor's warranty under U.C.C. 3416, breach of indorser's obligations under U.C.C. 3415, and money had and received. Defendant had cashed his check despite having earlier caused payment to be stopped on it. Judgment for plaintiffs awarded them the amount of the check, plus interest, but denied attorneys' fees under U.C.C. 3416(b), which permits recovery of damages for breach of warranty of an amount that includes expenses "incurred as a result of the breach." *Held*, denial of attorneys' fees was proper.

(a) *No specific statutory authorization*. Official Comment 6 to U.C.C. 3416 states that attorneys' fees "are not meant to be necessarily excluded. They could be granted because they fit within the phrase 'expenses incurred as a result of the breach.'" The Comment further states that the intention "is to leave to other state law the issue as to when attorney's fees are recoverable." Thus, the Legislature did not intend to authorize by U.C.C. 3416 itself an award of attorneys' fees. In the absence of specific language in that statute providing for an award of attorneys' fees as an item of expenses, the statute should not be expansively interpreted to permit an award. (*57 C.A.4th 850*.)

(b) *Contractual provision for attorneys' fees*. C.C.P. 1021 (see *7 Cal. Proc. (4th), Judgment, §145*) provides that except as attorneys' fees are specifically provided for by statute, "the measure and mode of compensation of attorneys and counselors at law is left to the agreement, express or implied, of the parties." Here, the parties could have, but did not, contractually agree to payment of attorneys' fees in the event of litigation for breach of warranty. (*57 C.A.4th 850*.)

(3) *Disclaiming Warranties*. The transfer warranties cannot be disclaimed with respect to checks. (U.C.C. 3416(c).) Transfer warranties for instruments other than checks may be disclaimed. Between the immediate parties, disclaimer may be by agreement. An indorser's disclaimer must appear in the indorsement with a specific reference to warranties, such as "without warranties." (Official Comment 5; see *12 Am.Jur.2d (1997 ed.), Bills and Notes §530*.)

(4) *Discharge of Warranty Liability*. The warrantor must receive notice of a claim for breach of warranty within 30 days after the claimant has reason to know of the breach and the warrantor's identity. Otherwise, the warrantor's liability under U.C.C. 3416(b) is discharged to the extent of loss caused by the delay in giving notice. (U.C.C. 3416(c); see *12 Am.Jur.2d (1997 ed.), Bills and Notes §531*.)

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Enforcing Warranties*. *Cross-Reference:* *7 Cal. Proc. (5th), Judgment, §149*.



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e. Warrantors.

2. Presentor.

4 Witkin Sum. Cal. Law Neg Inst § 50

[§ 50] Presentor.

(1) *Presentment Warranties to Drawee.* If an unaccepted draft is presented to the drawee for payment or acceptance and the drawee pays or accepts it in good faith, the drawee receives certain presentment warranties. (U.C.C. 3417(a).) Specifically, the person obtaining payment or acceptance, at the time of presentment, and a previous transferor of the draft, at the time of transfer, warrant the following:

(a) The warrantor is, or was at the time of transfer, entitled to enforce the draft or authorized to obtain payment or acceptance on behalf of a person entitled to enforce it. (U.C.C. 3417(a)(1); see *12 Am.Jur.2d (1997 ed.), Bills and Notes §512.*)

(b) The draft has not been altered. (U.C.C. 3417(a)(2); see *11 Am.Jur.2d (1997 ed.), Banks and Financial Institutions §912; 12 Am.Jur.2d (1997 ed.), Bills and Notes §513.*)

(c) The warrantor has no knowledge that the drawer's signature is unauthorized. (U.C.C. 3417(a)(3); see *12 Am.Jur.2d (1997 ed.), Bills and Notes §514.*)

(d) If the draft is a demand draft, the person identified as drawer authorized creation of the demand draft according to the terms on its face. (U.C.C. 3417(a)(4).) If a transferor does not give this warranty under applicable conflict of law rules, then the warranty is not given to that transferor when that transferor is a transferee. (U.C.C. 3417(h).)

(2) *Presentment Warranties to Drawer, Indorser, or Other Obligor.* A presentment warranty is created when the drawer or an indorser of a dishonored draft pays it on presentment or when a party obliged to pay another instrument pays it on presentment. The person obtaining payment and a prior transferor of the instrument warrant to the person making payment in good faith that the warrantor is, or was at the time of transfer, entitled to enforce the instrument or authorized to obtain payment on behalf of a person entitled to enforce it. (U.C.C. 3417(d)(1).) U.C.C. 3417(d) applies to presentment for payment in all cases not covered by U.C.C. 3417(a), including presentment of notes and accepted drafts to any party obligated to pay, and presentment of dishonored drafts to the drawer or an indorser. In these cases, the warranty provided is the same as that provided by U.C.C. 3417(a)(1). There are no warranties, comparable to U.C.C.

3417(a)(2) or (a)(3), with respect to alteration or knowledge of an unauthorized signature. (Official Comment 4; see *12 Am.Jur.2d (1997 ed.), Bills and Notes §516.*)

(3) *Consequences of Breach of Warranty.* A cause of action for breach of warranty accrues when the claimant has reason to know of the breach. (U.C.C. 3417(f); see *12 Am.Jur.2d (1997 ed.), Bills and Notes §520.*)

(a) *Where warranty is to drawee who pays.* The drawee may recover, as damages for breach of warranty, the amount the drawee paid less the amount the drawee received or is entitled to receive from the drawer because of the payment. In addition, the drawee is entitled to compensation for expenses and loss of interest resulting from the breach. The drawee's right to recover damages is not affected by any failure of the drawee to exercise ordinary care in making payment. (U.C.C. 3417(b).) Damages may include attorneys' fees. (Official Comment 5; see *12 Am.Jur.2d (1997 ed.), Bills and Notes §515.*)

If the drawer's conduct contributed to a loss from forgery or alteration, the drawee may not shift the loss from the drawer to the warrantor. (See U.C.C. 3417(c); Official Comment 6.)

(b) *Where warranty is to drawee who accepts.* If the drawee accepts the draft, breach of warranty is a defense to the acceptor's obligation. If the acceptor pays the draft, the acceptor is entitled to recover the amount the acceptor paid less the amount the acceptor received or is entitled to receive from the drawer because of the payment. In addition, the acceptor is entitled to compensation for expenses and loss of interest resulting from the breach. (U.C.C. 3417(b).)

(c) *Where warranty is to obligor other than drawee.* A person making payment under U.C.C. 3417(d)(1), *supra*, may recover an amount equal to the amount paid plus expenses and loss of interest resulting from the breach. (U.C.C. 3417(d)(2).)

(4) *Disclaimer and Discharge.* The presentment warranties cannot be disclaimed with respect to checks. (U.C.C. 3417(e).) Because payor banks rely on these warranties in paying checks even though checks are normally paid through automatic means, disclaimers would be inappropriate. (Official Comment 7; see *12 Am.Jur.2d (1997 ed.), Bills and Notes §518.*) Furthermore, the warrantor must receive notice of a claim for breach of warranty within 30 days after the claimant has reason to know of the breach and the warrantor's identity. Otherwise, the warrantor's liability is discharged to the extent of any loss caused by the delay in giving notice. (U.C.C. 3417(e); see *12 Am.Jur.2d (1997 ed.), Bills and Notes §519.*)

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f. Accommodation Party.

4 Witkin Sum. Cal. Law Neg Inst § 51

[§ 51] Accommodation Party.

(1) *Nature of Obligation.* An accommodation party signs an instrument for the purpose of incurring liability on it without being a direct beneficiary of the value given for the instrument. (U.C.C. 3419(a); see *90 A.L.R.3d 342* [who is accommodation party]; *10 A.L.R.4th 897* [construction and effect of predecessor to U.C.C. 3419]; *7 Proof of Facts 2d 283* [status as accommodation party]; *11 Am.Jur.2d (1997 ed.), Bills and Notes §§85, 86.*) The accommodation party may sign the instrument as maker, drawer, acceptor, or indorser, and is obliged to pay the instrument in the capacity in which the accommodation party signs. Neither the statute of frauds nor lack of consideration for the accommodation will prevent enforcement of the accommodation party's obligation. (U.C.C. 3419(b); see *Caito v. United Calif. Bank (1978) 20 C.3d 694, 701, 144 C.R. 751, 576 P.2d 466* [accommodation party who signs as maker is bound on instrument to same extent as comaker to those who acted on maker's apparent character as principal]; *11 Am.Jur.2d (1997 ed.), Bills and Notes §162; 12 Am.Jur.2d (1997 ed.), Bills and Notes §§472 et seq., 551.*)

(2) *Presumption of Accommodation Party Status.* A person signing an instrument is presumed to be an accommodation party and there is notice that the instrument is signed for accommodation if the signature is an anomalous indorsement or is accompanied by words indicating that the signer is acting as surety or guarantor for the obligation of another party to the instrument. An accommodation party's obligation to pay is not affected by the fact that the person enforcing the obligation had notice when taking the instrument that the accommodation party signed the instrument for accommodation. (U.C.C. 3419(c); see *Niederer v. Ferreira (1987) 189 C.A.3d 1485, 1500, 234 C.R. 779* [meaning of "payment guaranteed" or equivalent words]; on suretyship defenses to accommodation party's obligation, see U.C.C. 3605, *infra*, §69 et seq.)

A party challenging accommodation party status must rebut the presumption of U.C.C. 3419(c) by producing evidence that the signer was in fact a direct beneficiary of the value given for the instrument. (Official Comment 3.)

(3) *Liability for Collection Only.* If the words accompanying a party's signature indicate unambiguously that the party is guaranteeing collection rather than payment of another party's obligation, the signer must pay the amount due on the instrument only if:

(a) Execution of judgment against the other party has been returned unsatisfied (U.C.C. 3419(d)(1));

- (b) The other party is insolvent or in an insolvency proceeding (U.C.C. 3419(d)(2));
- (c) The other party cannot be served with process (U.C.C. 3419(d)(3)); or
- (d) It is otherwise apparent that payment cannot be obtained from the other party (U.C.C. 3419(d)(4)).

(4) *Right to Reimbursement.* An accommodation party who pays the instrument is entitled to reimbursement from the accommodated party and may enforce the instrument against the accommodated party. An accommodated party who pays the instrument has no right of recourse against, and is not entitled to contribution from, an accommodation party. (U.C.C. 3419(e); see *Collection Control Bureau v. Weiss* (1975) 50 C.A.3d 865, 870, 123 C.R. 625 [guarantor who pays is entitled to enforce instrument against principal debtor (maker)]; *Flojo Int. v. Lassleben* (1992) 4 C.A.4th 713, 721, 722, 6 C.R.2d 99 [following *Collection Control Bureau*; guarantor who paid note was accommodation party entitled to enforce terms governing interest on default and recovery of attorneys' fees]; *Quality Wash Group V, Ltd. v. Hallak* (1996) 50 C.A.4th 1687, 1701, 1702, 58 C.R.2d 592 [purchaser of car wash who assumed primary liability on note as part of purchase price was "accommodated party" under U.C.C. 3419(a); thus, under U.C.C. 3419(e), purchaser, after paying note, had no right of recourse against, and was not entitled to contribution from, sellers who, as guarantors of note, were accommodation parties]; *Great Western Bank v. Kong* (2001) 90 C.A.4th 28, 32, 33, 108 C.R.2d 266 [surety or guarantor who pays debt can maintain action on original obligation against party primarily liable for its payment].)

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3. Joint and Several Liability.

4 *Witkin Sum. Cal. Law Neg Inst* § 52

[§ 52] Joint and Several Liability.

(1) *General Rule.* Except as otherwise provided in the instrument, two or more persons who have the same liability on an instrument as makers, drawers, acceptors, indorsers who indorse as joint payees, or anomalous indorsers are jointly and severally liable in the capacity in which they sign. (U.C.C. 3116(a); see *12 Am.Jur.2d (1997 ed.), Bills and Notes* §439.)

(2) *Right to Contribution.* A party having joint and several liability who pays the instrument is entitled to contribution from another party having the same joint and several liability. The right to contribution is subject to separate agreement between the affected parties. Moreover, if one party is an accommodation party and another is the accommodated party, the parties' rights to reimbursement are governed by U.C.C. 3419(e) (*supra*, §51). (U.C.C. 3116(b); Official Comment 1; see *12 Am.Jur.2d (1997 ed.), Bills and Notes* §440.)

(3) *Effect of Discharge.* If a person who is entitled to enforce an instrument discharges one party, the contribution rights of another party with the same joint and several liability remain. (U.C.C. 3116(c).)

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a. Imposters and Fictitious Payees.

4 Witkin Sum. Cal. Law Neg Inst § 53

[§ 53] Imposters and Fictitious Payees.

(1) *Drawer's Liability*. U.C.C. 3404 places the loss on the drawer of a check paid to an imposter, fictitious payee, or unintended payee, rather than on the drawee or the depository bank that took the check for collection, because the drawer is generally in the best position to avoid fraud. (Official Comment 3.) It applies under the following circumstances:

(a) An impostor induces someone to issue an instrument to him or her, or to an accomplice, by impersonating the instrument's payee or the payee's agent. (U.C.C. 3404(a).)

(b) Someone other than the intended person is identified as payee. (U.C.C. 3404(b).)

(c) The identified payee is fictitious. (U.C.C. 3404(b).)

An indorsement in the payee's name is effective as the indorsement of the payee in favor of a person who, in good faith, pays the instrument or takes it for value or for collection. (U.C.C. 3404(a), (b).) (See *81 A.L.R.2d 1365* [who must bear loss as between drawer or indorser who delivers check to an impostor and one who purchases, cashes, or pays it on impostor's indorsement]; *92 A.L.R.3d 608* [construction and application of Unif.Com.C. 3-405(1)(a) (now Unif.Com.C. 3-404(a)) involving issuance of negotiable instrument induced by impostor]; *11 Am.Jur.2d (1997 ed.), Banks and Financial Institutions §921*; *11 Am.Jur.2d (1997 ed.), Bills and Notes §§82, 222, 223*; *12 Am.Jur.2d (1997 ed.), Bills and Notes §§591, 593*; on identification of intended payee, see U.C.C. 3110(a), (b), *supra*, §17; on what qualifies as indorsement in payee's name, see U.C.C. 3404(c); cf. *Wright v. Bank of California (1969) 276 C.A.2d 485, 490, 81 C.R. 11* [decided under former U.C.C. 3405; drawee bank that took *unindorsed* check payable to fictitious payee in exchange for its own cashier's check was liable for negligence].)

An instrument identifying an unintended or fictitious payee can be any type of instrument, but U.C.C. 3404(b) is primarily important with respect to forged checks and checks of corporations and other organizations. (Official Comment 2; see *92 A.L.R.3d 268* [nominal payee rule of former Unif.Com.C. 3-405(1)(b) (now Unif.Com.C. 3-404)].) It applies until the instrument is negotiated by special indorsement. (U.C.C. 3404(b).) Whoever possesses an instrument identifying an unintended or fictitious payee is its holder. (U.C.C. 3404(b)(1).)

(2) *Necessity of Impersonation.* In *Title Ins. Co. v. Comerica Bank-Calif.* (1994) 27 C.A.4th 800, 32 C.R.2d 735, a lender issued a check, payable to the borrower, to the borrower's son, after the son falsely represented to the lender that he was the borrower's agent. An accomplice of the son then presented the check to defendant bank, which honored it. Plaintiff, the lender's assignee, sued defendant for negligence. Defendant contended that the imposter rule of former U.C.C. 3405(1)(a) (now U.C.C. 3404(a)) barred the suit. The trial judge agreed and sustained defendant's demurrer. *Held*, reversed.

(a) The imposter rule is applicable only when the issuance of the check has been accomplished through impersonation of the payee. (27 C.A.4th 804.) Here, however, the son obtained the check not by impersonating his mother, but by falsely representing that he was her authorized agent. "Although clearly fraudulent, this conduct does not constitute impersonation and thus cannot be considered an inducement to issue the instrument within the meaning of former U.C.C. 3405(1)(a)." (27 C.A.4th 805.)

(b) The fact that the son's accomplice did impersonate the mother when she presented the check to defendant is of no consequence. The imposter rule applies when impersonation induces the issuance of the check, not the payment of it on presentation. (27 C.A.4th 806.)

(c) The result would be the same under U.C.C. 3404(a), the current version of the imposter rule. The new version differs from the old only in its recognition that the imposter may pretend to be either the payee or the payee's agent. Impersonation is still required. Misrepresentation of the perpetrator's agency status does not suffice. (27 C.A.4th 806, 807.)

(3) *Shifting Loss to Negligent Payor.* If the person paying the instrument or taking it for value or for collection fails to exercise ordinary care and that failure contributes to loss from payment, the person bearing the loss may recover from the person failing to exercise ordinary care to the extent the failure to exercise ordinary care contributed to the loss. (U.C.C. 3404(d).) The amount of loss allocated to each party is determined by the trier of fact. (Official Comment 3.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Drawer's Liability.* See Clark, *The Law of Bank Deposits, Collections and Credit Cards* (Rev. ed.), Chap. 9 et seq.



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b. Employer's Liability Following Employee's Fraudulent Indorsement.

4 Witkin Sum. Cal. Law Neg Inst § 54

[§ 54] Employer's Liability Following Employee's Fraudulent Indorsement.

(1) *Employer's Liability.* If an employer entrusts an employee with responsibility over an instrument, and the employee or the employee's accomplice fraudulently indorses the instrument in the intended payee's name, the indorsement is effective as the payee's indorsement in favor of a person who, in good faith, pays the instrument or takes it for value or for collection. (U.C.C. 3405(b); on what constitutes indorsement in payee's name, see U.C.C. 3405(c).) Thus, the risk of loss for an entrusted employee's fraudulent indorsement of a check falls on the employer, rather than on the bank that takes the check or pays it. The employer is in a better position to avoid the loss by using care in choosing and supervising employees. Unlike former Article 3, U.C.C. 3405 places the loss on the employer without proof of negligence. (Official Comment 1; see *22 Pacific L. J. 1263* [allocation of loss for forged checks]; *45 A.L.R.5th 389* [construction and effect of "padded payroll" rule]; *11 Am.Jur.2d (1997 ed.), Banks and Financial Institutions §916*; *12 Am.Jur.2d (1997 ed.), Bills and Notes §§504, 592.*)

(2) *Definition of Employee.* For the purposes of U.C.C. 3405, an employee can be an independent contractor or the employee of an independent contractor retained by the employer. (U.C.C. 3405(a)(1).)

(3) *Types of Fraudulent Indorsements.* In the case of an instrument payable to the employer, a fraudulent indorsement is a forged indorsement purporting to be that of the employer. (U.C.C. 3405(a)(2)(A).) Where the employer is the issuer of an instrument, a forged indorsement purporting to be that of the identified payee is fraudulent. (U.C.C. 3405(a)(2)(B); see *12 Am.Jur.2d (1997 ed.), Bills and Notes §§508, 509.*)

(4) *Positions of Responsibility.* An employer entrusts an employee with responsibility for the purposes of U.C.C. 3405(b) by giving the employee authority to do any of the following:

(a) Sign or indorse instruments on the employer's behalf. (U.C.C. 3405(a)(3)(A).)

(b) Process instruments received by the employer for bookkeeping purposes, for deposit to an account, or for other disposition. (U.C.C. 3405(a)(3)(B).)

(c) Prepare or process instruments for issue in the employer's name. (U.C.C. 3405(a)(3)(C).)

(d) Supply information determining the names or addresses of payees of instruments to be issued in the employer's name. (U.C.C. 3405(a)(3)(D).)

(e) Control the disposition of instruments to be issued in the employer's name. (U.C.C. 3405(a)(3)(E).)

(f) Otherwise act with respect to instruments in a responsible capacity. (U.C.C. 3405(a)(3)(F).)

Merely allowing an employee to have access to instruments or blank or incomplete instrument forms that are being stored or transported or are part of incoming or outgoing mail does not constitute entrusting the employee with "responsibility." (U.C.C. 3405(a)(3); see *12 Am.Jur.2d (1997 ed.), Bills and Notes §§505 et seq.*)

(5) *Shifting Loss to Bank*. If the person paying the instrument or taking it for value or for collection fails to exercise ordinary care and that failure contributes to loss from the fraud, the person bearing the loss may recover from the person failing to exercise ordinary care to the extent the failure to exercise ordinary care contributed to the loss. (U.C.C. 3405(b).) Under former Article 3, the person taking the instrument, usually a bank, avoided liability if it acted in good faith, regardless of negligence. (See *27 U.C.L.A. L. Rev. 147* [effect of bank misconduct on padded payroll preclusion of former version of Unif.Com.C. 3-405].) Under U.C.C. 3405, however, good faith no longer protects the bank from liability for negligence. (Official Comment 2; see *12 Am.Jur.2d (1997 ed.), Bills and Notes §510.*)

In *Lee Newman, M.D. v. Wells Fargo Bank (2001) 87 C.A.4th 73, 104 C.R.2d 310*, the office managers of plaintiff's medical corporation misappropriated a number of checks and drafts by the use of fraudulent indorsements. The fraudulently indorsed checks were delivered to defendant bank for collection. The checks contained irregularities suggestive of fraud, including use of a postal return address mailing stamp instead of a deposit or similar banking stamp, sloppily handwritten entries on business checks, and personal indorsements on large reimbursement checks from insurance companies. Defendant nonetheless permitted the office managers to cash the checks or deposit the funds into their personal accounts. Plaintiff sued on a theory of common law negligence, but the trial court sustained defendant's demurrer and dismissed plaintiff's action. *Held*, reversed. U.C.C. 3405 articulates a loss distribution scheme that applies here and thus displaces an action for common law negligence. (*87 C.A.4th 79, 80.*) However, plaintiff's allegations adequately plead a cause of action under U.C.C. 3405(b), which permits recovery if plaintiff can prove that defendant failed to exercise ordinary care in taking the checks for collection, and that defendant's lack of care contributed to plaintiff's loss. (*87 C.A.4th 84.*)

SUPPLEMENT: [This section is current through the latest supplement]



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c. Liability for Altered Instrument.

4 Witkin Sum. Cal. Law Neg Inst § 55

[§ 55] Liability for Altered Instrument.

(1) *Definition.* An alteration is an unauthorized change in an instrument that purports to modify a party's obligation. It includes an unauthorized addition of words or numbers or other change to an incomplete instrument. (U.C.C. 3407(a); see *4 Am.Jur.2d (1995 ed.), Alteration of Instruments §1* et seq.) Former Division 3 referred to a "material alteration", which it defined as any alteration that changes the parties' contract in any respect. Revised U.C.C. 3407 refers to such a change as simply an alteration. (Official Comment 1.)

(2) *Discharge of Affected Party.* A fraudulently made alteration discharges a party whose obligation is affected by the alteration, unless that party assents or is precluded from asserting the alteration. No other alteration discharges a party, and the instrument may be enforced according to its original terms. (U.C.C. 3407(b); see *88 A.L.R.3d 905* [what constitutes fraudulent alteration]; *11 Am.Jur.2d (1997 ed.), Banks and Financial Institutions §909*; *11 Am.Jur.2d (1997 ed.), Bills and Notes §§120, 396*; *12 Am.Jur.2d (1997 ed.), Bills and Notes §596* et seq.; on preclusion from asserting alteration, see U.C.C. 3406, *infra*, §56.)

(3) *Terms of Enforcement.* A payor bank or drawee paying a fraudulently altered instrument, or a person taking it for value, in good faith, and without notice of the alteration, may enforce rights with respect to the instrument according to its original terms. An incomplete instrument altered by unauthorized completion may be enforced according to its terms as completed. (U.C.C. 3407(c).) Thus, the loss falls on the party who left the instrument incomplete by permitting enforcement in the completed form. This result is intended even when the instrument was stolen and completed after the theft. (Official Comment 2.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Definition.* See *4 Am.Jur.2d (2007 ed.), Alteration of Instruments §1* et seq. (2) *Discharge of Affected Party.* See Clark, *The Law of Bank Deposits, Collections and Credit Cards* (Rev. ed.), Chap. 11.



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d. Preclusion From Asserting Alteration or Forgery.

4 Witkin Sum. Cal. Law Neg Inst § 56

[§ 56] Preclusion From Asserting Alteration or Forgery.

(1) *Negligent Person Precluded.* A person whose failure to exercise ordinary care contributes to an alteration or to a forged signature may not assert the alteration or forgery against someone who, in good faith, pays the instrument or takes it for value or for collection. (U.C.C. 3406(a); see 37 *Santa Clara L. Rev.* 349 [glitch in Article 3 regarding unauthorized and forged indorsements]; 87 *A.L.R.2d* 638 [payee's prior negligence facilitating forging of indorsement as precluding recovery from bank paying check]; 14 *Proof of Facts* 2d 693 [negligence contributing to alteration or unauthorized signature under Unif.Com.C. 3-406]; 4 *Am.Jur.2d* (1995 ed.), *Alteration of Instruments* §§62, 63; 11 *Am.Jur.2d* (1997 ed.), *Banks and Financial Institutions* §§903, 910; 12 *Am.Jur.2d* (1997 ed.), *Bills and Notes* §604 et seq.; for illustrations of conduct that can be basis for preclusion under U.C.C. 3406(a), see Official Comment 3.)

The burden of proving failure to exercise ordinary care is on the person asserting the preclusion. (U.C.C. 3406(c).)

(2) *Effect of Comparative Negligence.* If the person asserting the preclusion fails to exercise ordinary care in paying or taking the instrument and that failure contributes to loss, the loss is allocated between the person precluded and the person asserting the preclusion to the extent to which each one's failure to exercise ordinary care contributed to the loss. (U.C.C. 3406(b).) For this purpose, the burden of proving failure to exercise ordinary care is on the person precluded. (U.C.C. 3406(c).) The comparative negligence concept of U.C.C. 3406(b) was not present in former Article 3. (Official Comment 4.)

(3) *Ordinary Care.* "Ordinary care" in the case of a person engaged in business means observance of reasonable commercial standards, prevailing in the area in which the person is located, with respect to the business in which the person is engaged. When a bank takes an instrument for processing for collection or payment by automated means, reasonable commercial standards do not require the bank to examine the instrument if the failure to examine does not violate the bank's prescribed procedures and the bank's procedures do not vary unreasonably from general banking usage. (U.C.C. 3103(a)(7); see 67 *A.L.R.3d* 144 [what amounts to negligence contributing to alteration or unauthorized signature under Unif.Com.C. 3-406].)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Negligent Person Precluded.* See 4 *Am.Jur.2d* (2007 ed.), *Alteration of Instruments* §50.



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e. Mistaken Payment or Acceptance.

4 Witkin Sum. Cal. Law Neg Inst § 57

[§ 57] Mistaken Payment or Acceptance.

(1) *General Rule of Recovery for Drawee.* A draft's drawee sometimes mistakenly pays or accepts the draft, not realizing that payment of the draft has been stopped under U.C.C. 4403 (infra, §122) or that the drawer's signature has been forged. In these circumstances, the drawee may recover the amount of the draft from the person who received payment or may revoke the acceptance, even when the drawee failed to exercise ordinary care in paying or accepting the draft. (U.C.C. 3418(a); see Official Comment 1; *11 Am.Jur.2d (1997 ed.), Banks and Financial Institutions §905; 11 Am.Jur.2d (1997 ed.), Bills and Notes §410 et seq.; 12 Am.Jur.2d (1997 ed.), Bills and Notes §533.*) The instrument is deemed not to have been paid or accepted and is treated as dishonored, and the person from whom payment is recovered has rights as a person entitled to enforce the dishonored instrument. (U.C.C. 3418(d); see *12 Am.Jur.2d (1997 ed.), Bills and Notes §535.*)

Recovery of payment or revocation of acceptance are also available, to the extent permitted by the law governing mistake and restitution, when the drawee pays or accepts by some other mistake (U.C.C. 3418(b)), such as where the drawer has no account with the drawee or there are insufficient funds in the drawer's account (Official Comment 3).

(2) *Remedies Often Unavailable.* The remedies provided by U.C.C. 3418(a) and 3418(b) may not be asserted against a person who took the instrument in good faith and for value or who in good faith changed position in reliance on the payment or acceptance. (U.C.C. 3418(c); see *12 Am.Jur.2d (1997 ed.), Bills and Notes §534.*) Hence, in most cases, the drawee will not have a remedy against the person paid. (Official Comment 1.) U.C.C. 3418(c) does not limit presentment warranties provided by U.C.C. 3417 (supra, §50) or subrogation rights under U.C.C. 4407 (infra, §125).

In *Gentner & Co. v. Wells Fargo Bank (1999) 76 C.A.4th 1165, 90 C.R.2d 904*, a customer of defendant bank paid plaintiff, who had provided consulting services to the customer, with a \$ 60,000 check drawn on the customer's account. Eleven days later, the customer orally instructed defendant to stop payment on the check. Eleven days after that, plaintiff presented the check to defendant and a teller employed by defendant issued plaintiff, as payee, a cashier's check for \$ 60,000. Defendant later blocked payment of the cashier's check so that when plaintiff deposited it at another bank, it was not honored. Plaintiff sued defendant for wrongful dishonor of the cashier's check. *Held*, judgment for plaintiff affirmed.

(a) U.C.C. 3418(c) applies here. (76 C.A.4th 1177.) Plaintiff had given value for the check from the customer and was acting in good faith when it presented the check to defendant. (76 C.A.4th 1178.) The fact that defendant used a cashier's check, rather than cash, to pay the customer's check makes no difference under U.C.C. 3418. (76 C.A.4th 1177.)

(b) Plaintiff is entitled to holder in due course status with regard to the cashier's check. Under U.C.C. 3418, plaintiff had an irrevocable right to \$ 60,000, which it exchanged for a cashier's check. Thus, plaintiff gave value for the cashier's check as required by U.C.C. 3302(a)(2) (supra, §27) and 3303 (supra, §29). (76 C.A.4th 1178.) The typical situation in which a payee can claim holder in due course status occurs when a bank issues a negotiable instrument to pay for goods or services supplied by the payee to the bank's customer at the request of its customer. (76 C.A.4th 1178, 1179.) That is what happened here, with the additional step of the "buyer" (the customer) issuing a check to the "seller" (plaintiff), which was exchanged for a cashier's check from the "buyer's" bank. The presence of that additional step did not change the nature of the transaction. (76 C.A.4th 1179.)

(c) Although the result here may seem harsh, "it is in line with the Commercial Code's purpose of 'promulgating the integrity, certainty, and finality of commercial transactions.'" (76 C.A.4th 1179.) "When a payee presents a check to the drawee bank, it is entitled to a prompt and accurate answer to the question 'Is this check good?' so that it may plan its financial affairs accordingly. The current state of technology permits bank employees to have the necessary information at their fingertips." (76 C.A.4th 1179.)

SUPPLEMENT: [This section is current through the latest supplement]



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 5. Conversion.

4 *Witkin Sum. Cal. Law Neg Inst* § 58

[§ 58] Conversion.

(1) *Grounds for Liability.* The law applicable to conversion of personal property (see 5 *Summary* (10th), *Torts*, §699 et seq.) applies to instruments. An instrument is also converted if it is taken by transfer, other than a negotiation, from a person not entitled to enforce the instrument or if a bank makes or obtains payment on the instrument for a person not entitled to enforce it or receive payment. (U.C.C. 3420(a); see 11 *Am.Jur.2d* (1997 ed.), *Banks and Financial Institutions* §918; 12 *Am.Jur.2d* (1997 ed.), *Bills and Notes* §536 et seq.) U.C.C. 3420(a) applies where a depository bank takes an instrument with a forged indorsement or takes a check payable to two persons jointly on the indorsement of only one of them. (Official Comment 1.) (See 100 *A.L.R.2d* 670 [right of check owner to recover against one cashing it on forged or unauthorized indorsement and procuring payment by drawee].)

There is no recovery under U.C.C. 3420(a) for conversion of money or securities. (See *Software Design & Application, Ltd. v. Hoefer & Arnett* (1996) 49 *C.A.4th* 472, 485, 56 *C.R.2d* 756, *infra*, §131.)

In *Oswald Machine & Equipment v. Yip* (1992) 10 *C.A.4th* 1238, 13 *C.R.2d* 193, plaintiff's employee was authorized to indorse and deposit checks made out to plaintiff in plaintiff's account. Instead, he opened accounts in defendant banks in similar but fictitious names and deposited the checks there using a fraudulent deposit-indorsement stamp. In this action for conversion under former U.C.C. 3419(1)(c) (now U.C.C. 3420(a)), plaintiff alleged that defendants had paid the checks on a forged indorsement. *Held*, summary judgment for defendants reversed; whether the fraudulent indorsements were authorized was an issue of fact.

(a) For purposes of former U.C.C. 3419(1)(c), "forgery" includes an unauthorized indorsement. If a bank pays an instrument on an unauthorized indorsement, it has exercised dominion and control inconsistent with the rights of the owner, resulting in liability for conversion. (10 *C.A.4th* 1244, citing Comment 3 to former Unif.Com.C. §3-419.)

(b) Here, plaintiff proffered evidence that the employee had no authority to open accounts in similar but fictitious names or use indorsement stamps for those accounts. It supports a reasonable inference that the employee was only authorized to indorse and deposit checks in plaintiff's account and is sufficient to raise a triable issue of fact on the scope of his authority. (10 *C.A.4th* 1246, 1247.)

(2) *Parties for Whom Action Is Not Available.* An action for conversion of an instrument may not be brought by the

instrument's issuer or acceptor. (U.C.C. 3420(a).) Hence, the drawer of a check with a forged indorsement has no action in conversion against the depository bank that took the check. The check represents the drawer's obligation, not the drawer's property, and the drawer has an adequate remedy against the payor bank for recredit of the drawer's account for unauthorized payment. (Official Comment 1; see *104 A.L.R.5th 459* [drawer's right of recovery against depository bank that accepts check with missing indorsement or in violation of restrictive indorsement]; *12 Am.Jur.2d (1997 ed.), Bills and Notes §542.*)

Moreover, a payee or indorsee who did not receive delivery of the instrument either directly or through delivery to an agent or a copayee cannot bring a conversion action. (U.C.C. 3420(a); see *Jones v. Bank of America (1942) 49 C.A.2d 115, 122, 121 P.2d 94.*) The payee has no interest in the instrument until delivery, and does not become a holder or a person entitled to enforce the instrument. (Official Comment 1; see *91 A.L.R.5th 89* [payee's and drawer's right of recovery in conversion for money paid on unauthorized indorsement]; *12 Am.Jur.2d (1997 ed.), Bills and Notes §543.*)

(3) *Measure of Liability.* The measure of liability in an action under U.C.C. 3420(a) is presumed to be the amount payable on the instrument, but recovery may not exceed the amount of the plaintiff's interest in the instrument. (U.C.C. 3420(b); see *85 A.L.R.2d 1349* [measure of damages for conversion or loss of commercial paper]; *12 Am.Jur.2d (1997 ed.), Bills and Notes §544.*) This rule addresses the problem of conversion actions in multiple payee checks by preventing a plaintiff with a limited interest in the proceeds of a check, e.g., a supplier with a limited interest in a check payable to the contractor and the supplier, from receiving a windfall. (Official Comment 2.)

Damages for the time and effort spent uncovering a conversion are not recoverable. (*Stenseth v. Wells Fargo Bank (1995) 41 C.A.4th 457, 48 C.R.2d 192.*) In *Stenseth*, plaintiff physician sued defendant bank for allowing plaintiff's employee to cash checks on plaintiff's forged indorsement. The trial judge excluded evidence of plaintiff's damages that were attributable to his time and effort in uncovering the conversion. *Held*, affirmed; exclusion of this evidence was proper.

(a) C.C. 3336 (see 6 *Summary (10th), Torts, §1722*) provides that damages for conversion of personal property may include "fair compensation for time and money properly expended in pursuit of the property." However, under U.C.C. 1103, the U.C.C. may be supplemented by other statutes only if their relevant principles are not displaced by the particular provisions of the U.C.C. Here, U.C.C. 3420 limits damages to the face amount of the converted instrument. Further, if the U.C.C. articulates a loss distributive scheme, then the U.C.C. provision displaces any other provision of law, including C.C. 3336. (*41 C.A.4th 465, 466.*)

(b) Plaintiff's claim that U.C.C. 3420 is limited to situations where there are multiple payees is without merit. Although U.C.C. 3420(b) contains a clause addressing multiple payee checks, that clause does not alter the subdivision's preceding provision that the measure of liability is presumed to be the amount payable on the instrument. (*41 C.A.4th 466.*)

(4) *Good Faith Defense.* A representative, other than a depository bank, who has in good faith dealt with an instrument or its proceeds on behalf of one who was not the person entitled to enforce the instrument is not liable in conversion to that person beyond the amount of any proceeds that it has not paid out. (U.C.C. 3420(c); see *Cooper v. Union Bank (1973) 9 C.3d 371, 378, 107 C.R. 1, 507 P.2d 609* [former U.C.C. 3419(3) (now U.C.C. 3420(c)) did not immunize collecting banks from conversion liability for payment on forged indorsements]; *25 Hastings L. J. 715 [Cooper]*; *49 A.L.R.4th 888* [bank's "reasonable commercial standards" defense under former Unif.Com.C. 3-419(3)].) Unlike former Article 3, the defense provided by U.C.C. 3420(c) is limited to collecting banks other than depository banks. (Official Comment 3; see *12 Am.Jur.2d (1997 ed.), Bills and Notes §545.*)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Grounds for Liability.* See *Gil v. Bank of America (2006) 138 C.A.4th 1371, 1373, 1377, 1379, 42 C.R.3d 310* [action arising from bank's payment to contractor who was not entitled to enforce instrument; conversion action under U.C.C. 3420, and not common law action for negligence seeking damages beyond amount payable on instrument (see

text, p. 424), was proper remedy against bank that accepted insurance company's check, payable to plaintiffs and lender-lienholder of plaintiffs' home, where lender-lienholder's indorsement was missing].



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 G. Presentment and Dishonor.
 1. Presentment.

4 Witkin Sum. Cal. Law Neg Inst § 59

[§ 59] Presentment.

(1) *Definition.* Presentment occurs when a person entitled to enforce an instrument, or someone acting on the person's behalf, demands payment or acceptance. Presentment is made to the drawee, a party obliged to pay the instrument or, in the case of a note or accepted draft payable at a bank, to the bank. (U.C.C. 3501(a); see *11 Am.Jur.2d (1997 ed.), Bills and Notes §313* et seq.)

(2) *Presentment Made at Place of Payment.* A person may present an instrument at the instrument's "place of payment." Presentment must be made at the place of payment if the instrument is payable at a bank in the United States. (U.C.C. 3501(b)(1); see U.C.C. 4204(c), *infra*, §99; *11 Am.Jur.2d (1997 ed.), Bills and Notes §324* et seq.)

The place of payment may be stated in the instrument. If not, an instrument is payable at the address of the drawee or maker. If no address is stated, the place of payment is the drawee's or maker's place of business, or the drawee's or maker's residence if the drawee or maker has no place of business. If a drawee or maker has more than one place of business, the person entitled to enforce the instrument may chose among them. (U.C.C. 3111; see *11 Am.Jur.2d (1997 ed.), Bills and Notes §§125, 324.*)

(3) *Means of Presentment.* Presentment may be made by any commercially reasonable means, including an oral, written, or electronic communication. It is effective if made to any one of two or more makers, acceptors, drawees, or other payors. (U.C.C. 3501(b)(1); see *11 Am.Jur.2d (1997 ed.), Bills and Notes §337* et seq.)

Presentment is effective when the person to whom presentment is made receives the demand for payment or acceptance. (U.C.C. 3501(b)(1).) The party to whom presentment is made may establish a cutoff hour not earlier than 2 p.m. for the receipt and processing of presented instruments. If presentment is made after the cutoff hour, it may be treated as occurring on the next business day after the day of presentment. (U.C.C. 3501(b)(4); see *11 Am.Jur.2d (1997 ed.), Bills and Notes §337* et seq.)

The person to whom presentment is made may demand that the presenting party do the following:

- (a) Exhibit the instrument;
- (b) Give reasonable identification and, if presentment is made on behalf of another person, reasonable evidence of

authority to do so; and

(c) Sign a receipt on the instrument for any payment made or surrender the instrument if full payment is made. (U.C.C. 3501(b)(2); see *11 Am.Jur.2d (1997 ed.), Bills and Notes §333.*)

(4) *Options of Party to Whom Presentment Is Made.* The party to whom presentment is made may, under proper circumstances, dishonor the instrument. (See *infra*, §60 et seq.) Without dishonoring the instrument, the party may (a) return the instrument for lack of a necessary indorsement or (b) refuse payment or acceptance for failure of the presentment to comply with the terms of the instrument, an agreement of the parties, or other applicable law or rule. (U.C.C. 3501(b)(3); see *11 Am.Jur.2d (1997 ed.), Bills and Notes §333.*)

(5) *Effect of Other Laws.* The rules governing presentment are subject to U.C.C. 4101 et seq. (*infra*, §86 et seq.), agreement of the parties, and clearinghouse rules. (U.C.C. 3501(b).)

(6) *When Excused.* Under U.C.C. 3504(a), presentment is excused under any of the following circumstances:

(a) The person entitled to present the instrument cannot with reasonable diligence make presentment.

(b) The maker or acceptor has repudiated an obligation to pay the instrument or is dead or in insolvency proceedings.

(c) By the terms of the instrument, presentment is not necessary to enforce the obligation of indorsers or the drawer.

(d) The drawer or indorser whose obligation is being enforced has waived presentment or otherwise has no reason to expect or right to require that the instrument be paid or accepted.

(e) The drawer instructed the drawee not to pay or accept the draft or the drawee was not obligated to the drawer to pay the draft. (See *11 Am.Jur.2d (1997 ed.), Bills and Notes §341 et seq.*; for form of waiver of presentment, see Cal. Transactions Forms, 4 Business Transactions §25:87.)

When presentment that is otherwise required for dishonor is excused, dishonor occurs without presentment if the instrument is not duly accepted or paid. (U.C.C. 3502(e).)

West's Key Number Digest, Bills and Notes k.385 et seq.

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G. Presentment and Dishonor.

2. What Constitutes Dishonor.

a. Note.

4 Witkin Sum. Cal. Law Neg Inst § 60

[§ 60] Note.

(1) *Note Payable on Demand.* A note that is payable on demand is dishonored if the note is not paid on the day it is properly presented to the maker. (U.C.C. 3502(a)(1); see *11 Am.Jur.2d (1997 ed.), Bills and Notes §352.*)

(2) *Note Not Payable on Demand.* A note that is not payable on demand is dishonored if it is not paid on the day it becomes payable. (U.C.C. 3502(a)(3).) However, if the note is payable at or through a bank or its terms require presentment, the note is dishonored if presentment is duly made and the note is not paid on the day it becomes payable or the day of presentment, whichever is later. (U.C.C. 3502(a)(2).)

West's Key Number Digest, Bills and Notes k.173

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b. Accepted Draft.

4 Witkin Sum. Cal. Law Neg Inst § 61

[§ 61] Accepted Draft.

(1) *Draft Payable on Demand.* An accepted draft that is payable on demand is dishonored if it is not paid on the day it is properly presented to the acceptor. (U.C.C. 3502(d)(1); see *11 Am.Jur.2d (1997 ed.), Bills and Notes §356.*)

(2) *Draft Not Payable on Demand.* An accepted draft that is not payable on demand is dishonored if it is duly presented to the acceptor for payment and payment is not made on the day it becomes payable or the day of presentment, whichever is later. (U.C.C. 3502(d)(2).)

(3) *Cure of Dishonor by Consent to Late Acceptance.* If a draft is dishonored because it was not timely accepted, the person entitled to demand acceptance may consent to a late acceptance. In that case, from the time of acceptance, the draft is treated as never having been dishonored. (U.C.C. 3502(f).) If the draft is subsequently presented and payment is refused, dishonor occurs at that time. (Official Comment 8; see *11 Am.Jur.2d (1997 ed.), Bills and Notes §359.*)

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c. Unaccepted Draft.

4 Witkin Sum. Cal. Law Neg Inst § 62

[§ 62] Unaccepted Draft.

(1) *Check Presented to Payor.* Under U.C.C. 3502(b)(1), a check that is duly presented for payment to the payor bank, other than for immediate payment over the counter, is dishonored if the payor bank:

(a) Makes timely return of the check;

(b) Sends timely notice of dishonor or nonpayment under U.C.C. 4301 or 4302 (*infra*, §115 et seq.); or

(c) Becomes accountable for the amount of the check under U.C.C. 4302. (See *11 Am.Jur.2d (1997 ed.), Bills and Notes §355.*)

(2) *Draft Payable on Demand.* An unaccepted draft that is payable on demand, other than a check governed by U.C.C. 3502(b)(1), is dishonored if it is not paid on the day it is duly presented to the drawee for payment. (U.C.C. 3502(b)(2); see *11 Am.Jur.2d (1997 ed.), Bills and Notes §353.*)

(3) *Draft Not Payable on Demand.* An unaccepted time draft differs from a time note. The note's maker knows the note has been issued, but the drawee of a draft does not know that a draft has been drawn on it. Therefore, U.C.C. 3502 requires presentment for payment or acceptance of an unaccepted time draft. (Official Comment 4.)

In particular, an unaccepted draft that is payable on a stated date is dishonored if (a) the drawee does not pay it on the day it becomes payable or the day it is duly presented for payment, whichever is later, or (b) it is not accepted when duly presented for acceptance before the stated date. (U.C.C. 3502(b)(3).) An unaccepted draft that is payable after a period of time has elapsed following sight or acceptance is dishonored if it is not accepted on the day it is duly presented for acceptance. (U.C.C. 3502(b)(4).)

(4) *Documentary Draft.* An unaccepted documentary draft is dishonored as provided in U.C.C. 3502(b)(2), (b)(3), and (b)(4). However, the drawee may delay payment or acceptance without dishonor until no later than the close of the drawee's third business day following the day on which payment or acceptance is otherwise required. (U.C.C. 3502(c).) Drawees are given an extended period to pay documentary drafts because they may need time to examine the documents. (Official Comment 5; see *11 Am.Jur.2d (1997 ed.), Bills and Notes §354*; for definition of "documentary

draft," see *infra*, §89.)

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4 Witkin Sum. Cal. Law Neg Inst § 63

[§ 63] Notice of Dishonor.

(1) *Prerequisite to Liability.* An indorser's obligation on an instrument may not be enforced unless the indorser is given proper notice of dishonor or notice of dishonor is excused under U.C.C. 3504(b), *infra*, this section. (U.C.C. 3503(a); on liability of indorser, see U.C.C. 3415(a), *supra*, §48.) The drawer of a draft accepted by someone other than a bank is also entitled to proper notice of dishonor, unless notice is excused. (U.C.C. 3503(a); see *11 Am.Jur.2d (1997 ed.)*, *Bills and Notes* §361 et seq.; on liability of drawer, see U.C.C. 3414(d), *supra*, §46.) With respect to other types of drafts, however, a drawer is merely entitled to have the instrument presented to the drawee and dishonored. Notice of dishonor is not a condition of the drawer's liability. (Official Comment 1.)

(2) *Means of Giving Notice.* Anyone may give notice of dishonor by any commercially reasonable means, including an oral, written, or electronic communication. The notice must reasonably identify the instrument and indicate that the instrument has been dishonored or has not been paid or accepted. Return of an instrument given to a bank for collection is sufficient notice of dishonor. (U.C.C. 3503(b); see *11 Am.Jur.2d (1997 ed.)*, *Bills and Notes* §364 et seq.; for form of notice of dishonor, see Cal. Transactions Forms, 4 Business Transactions §25:86.)

(3) *Time of Notice.* A collecting bank must give notice of dishonor of an instrument taken for collection before midnight of the banking day following the one on which the bank receives notice of the instrument's dishonor. (U.C.C. 3503(c)(1).) Any other person has 30 days following the day on which the person receives notice of dishonor to give notice of dishonor of such an instrument. (U.C.C. 3503(c)(2).)

With respect to any other instrument, notice of dishonor must be given within 30 days following the day on which dishonor occurs. (U.C.C. 3503(c); see *11 Am.Jur.2d (1997 ed.)*, *Bills and Notes* §§366, 367.)

(4) *Excused Notice of Dishonor.* Notice of dishonor is excused if the instrument's terms state that notice is not a prerequisite to enforcing payment. Notice is also excused if the party whose obligation is being enforced waived notice of dishonor. A waiver of presentment is also a waiver of notice of dishonor. (U.C.C. 3504(b); see *11 Am.Jur.2d (1997 ed.)*, *Bills and Notes* §373; for form of waiver of notice of dishonor, see Cal. Transactions Forms, 4 Business Transactions §25:87.)

Delay in giving notice of dishonor is excused if the delay was caused by circumstances beyond the control of the

person giving the notice and that person exercised reasonable diligence after the cause of the delay ended. (U.C.C. 3504(c); see *11 Am.Jur.2d (1997 ed.), Bills and Notes §368.*)

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4 Witkin Sum. Cal. Law Neg Inst § 64

[§ 64] Evidence of Dishonor.

(1) *Protest*. A protest is a certificate of dishonor made by a United States consul or vice consul, a notary public, or another person authorized to administer oaths by the law of the place where dishonor occurs. It may be made on information satisfactory to that person. The protest must identify the instrument and certify either that presentment has been made or, if not made, the reason why it was not made, and that the instrument has been dishonored by nonacceptance or nonpayment. The protest may also certify that notice of dishonor has been given. (U.C.C. 3505(b); see *11 Am.Jur.2d (1997 ed.), Bills and Notes §375 et seq.*) A document that purports to be a protest is admissible as evidence and creates a presumption of dishonor and of a stated notice of dishonor. (U.C.C. 3505(a)(1).)

Protest is not mandatory and must be requested by the holder. Even if requested, it is not a condition to the liability of indorsers or drawers, but a banking service designed to establish that dishonor has occurred. (Official Comment.)

(2) *Other Forms of Evidence*. The following are also admissible as evidence of dishonor:

(a) A purported stamp or writing of the drawee, payor bank, or presenting bank on or accompanying the instrument stating that acceptance or payment has been refused, unless the stamp or writing states reasons for the refusal that are inconsistent with dishonor. (U.C.C. 3505(a)(2).)

(b) A book or record of the drawee, payor bank, or collecting bank, kept in the usual course of business, that shows dishonor, even if there is no evidence of who made the entry. (U.C.C. 3505(a)(3).)

Both of these forms of evidence create a presumption of dishonor and of a stated notice of dishonor. (U.C.C. 3505(a); see *11 Am.Jur.2d (1997 ed.), Bills and Notes §372.*)

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 1. In General.

4 Witkin Sum. Cal. Law Neg Inst § 65

[§ 65] In General.

(1) *Means of Discharge.* A party's obligation to pay an instrument may be discharged in the following ways:

(a) By an act or agreement that would discharge an obligation to pay money under a simple contract. (U.C.C. 3601(a); see *43 A.L.R.3d 246* [renewal note signed by one comaker as discharge of nonsigning comakers]; on discharge of contracts, see *1 Summary* (10th), *Contracts*, §111; on discharge of instruments made payable to two or more payees, see *supra*, §17.)

(b) By payment of the instrument. (See U.C.C. 3602, *infra*, §66.)

(c) By tender of payment. (U.C.C. 3603, *infra*, §67.)

(d) By cancellation or renunciation of the instrument. (U.C.C. 3604, *infra*, §68.)

(e) By extension of the obligation's due date. (U.C.C. 3605(c), *infra*, §70.)

(f) By material modification of the obligation. (U.C.C. 3605(d), *infra*, §71.)

(g) By impairment of the collateral for the instrument. (U.C.C. 3605(e), (f), *infra*, §72.)

(h) By reacquisition. (U.C.C. 3207, *supra*, §25.)

(i) By fraudulent or material alteration. (U.C.C. 3407, *supra*, §55.)

(j) By certification of a check. (U.C.C. 3414(c), *supra*, §46; U.C.C. 3415(d), *supra*, §48.)

(k) By acceptance varying a draft. (U.C.C. 3410(c), *supra*, §44.)

(2) *Effect of Discharge on Holder in Due Course.* Discharge is effective against a holder in due course only if the holder had notice of the discharge when acquiring holder in due course status, for example, when a holder takes an instrument with a cancelled indorsement. (U.C.C. 3601(b); Official Comment; see U.C.C. 3302(b), *supra*, §28; *11 Am.Jur.2d* (1997 ed.), *Bills and Notes* §393.)

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 2. Payment.

4 Witkin Sum. Cal. Law Neg Inst § 66

[§ 66] Payment.

(1) *General Rule.* Payment discharges a party's obligation to pay an instrument to the extent of the payment. This is true even though the payor knows of another person's claim to the instrument under U.C.C. 3306. Payment occurs when a party obliged to pay the instrument, or someone on the party's behalf, pays a person entitled to enforce the instrument. (U.C.C. 3602(a); see Cal. Civil Practice, 4 Business Litigation, §42:40 et seq.; *11 Am.Jur.2d (1997 ed.), Bills and Notes §401* et seq.; on U.C.C. 3306, see supra, §32.)

(2) *Exceptions.* A party's obligation to pay the instrument is not discharged if the payor knowingly pays a person who is in wrongful possession of a stolen instrument. (U.C.C. 3602(b)(2).) Nor is it discharged if someone has an enforceable claim to the instrument under U.C.C. 3306 against the party receiving payment and the payor knows that payment is prohibited by injunction or similar process of a court of competent jurisdiction. (U.C.C. 3602(b)(1)(A); see *11 Am.Jur.2d (1997 ed.), Bills and Notes §404* et seq.)

Moreover, a party's obligation remains if the payor accepted, from the person having a claim under U.C.C. 3306, indemnity against loss resulting from refusal to pay the person entitled to enforce the instrument, except where the instrument is a cashier's check, teller's check, or certified check. (U.C.C. 3602(b)(1)(B).) Hence, payment to the holder of a cashier's check, teller's check, or certified check discharges the obligated bank's obligation to the holder and the claimant, even though the claimant has given indemnity. Any liability the bank may have under the indemnity agreement is governed by local law. (U.C.C. 3411, U.C.C. 3602(b)(1)(A); Official Comment to U.C.C. 3602.)

West's Key Number Digest, Bills and Notes k.428 et seq.

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4 *Witkin Sum. Cal. Law Neg Inst* § 67

[§ 67] Tender of Payment.

(1) *Applicable Law.* The same legal principles that apply to tender of payment under a simple contract apply to tender of payment of an obligation to pay an instrument. (U.C.C. 3603(a).)

(2) *Discharge Following Tender.* If a person entitled to enforce an instrument refuses tender of payment, the obligation of an indorser or accommodation party having a right of recourse is discharged to the extent of the amount of the tender. (U.C.C. 3603(b).) Tender also discharges an obligor's obligation to pay interest after the due date on the amount tendered. To effect tender on the due date of an instrument that requires presentment, the obligor must be able and ready to pay the person entitled to enforce the instrument on the due date at every place of payment stated in the instrument. (U.C.C. 3603(c); on presentment, see *supra*, §59; see also *11 Am.Jur.2d (1997 ed.), Bills and Notes* §§406, 422.)

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 4. Cancellation or Renunciation.

4 Witkin Sum. Cal. Law Neg Inst § 68

[§ 68] Cancellation or Renunciation.

(1) *General Rule.* A person entitled to enforce an instrument, with or without consideration, may discharge a party's obligation to pay the instrument by an intentional voluntary act, such as (a) surrendering the instrument to the party, (b) destroying, mutilating, or cancelling the instrument, (c) cancelling or striking out the party's signature, or (d) adding words to the instrument indicating discharge. (U.C.C. 3604(a)(1).) In addition, the enforcing party may discharge the obligated party by agreeing not to sue or otherwise renouncing rights against the party by a signed writing. (U.C.C. 3604(a)(2); see *96 A.L.R.3d 1144* [renunciation by surrender]; *59 A.L.R.4th 617* [unintentional cancellation of negotiable instrument]; *11 Am.Jur.2d (1997 ed.), Bills and Notes §§394, 395.*)

(2) *Effect on Indorsers.* Cancelling or striking out an indorsement under U.C.C. 3604(a) does not affect the status and rights of a party derived from the indorsement. (U.C.C. 3604(b).) Furthermore, discharge under U.C.C. 3604 of a party's obligation to pay an instrument does not discharge the obligation of an indorser or accommodation party having a right of recourse against the discharged party. (U.C.C. 3605(b).) This allows a creditor to settle with the principal debtor without the risk of losing rights against sureties. (Official Comment 3 to U.C.C. 3605; on discharge of indorsers and accommodation party, see *infra*, §69 et seq.)

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 5. Discharge of Indorsers and Accommodation Parties.
 a. Applicable Suretyship Defenses.

4 Witkin Sum. Cal. Law Neg Inst § 69

[§ 69] Applicable Suretyship Defenses.

(1) *Circumstances of Discharge.* U.C.C. 3605 sets forth several "suretyship defenses" under which indorsers, drawers of drafts that are accepted by someone other than a bank, and accommodation parties are discharged from liability on an instrument. (On applicability to drawers, see U.C.C. 3605(a).) These defenses are:

- (a) Extension of time to pay instrument. (See *infra*, §70.)
- (b) Material modification of obligation. (See *infra*, §71.)
- (c) Impairment of collateral. (See *infra*, §72.)

Although U.C.C. 3605 is concerned with traditional suretyship concepts in the context of negotiable instruments where an accommodation party is acting as a surety, it extends to indorsers who are not accommodation parties and to nonaccommodation party co-makers when collateral is impaired. (Official Comment 1; on general suretyship doctrine, see C.C. 2819 [surety or guarantor is exonerated if creditor acts to alter original obligation of principal, or to suspend or impair his or her rights against principal]; C.C. 2822(a) [acceptance by creditor of anything in partial satisfaction of obligation reduces obligation of surety in same measure as that of principal]; C.C. 2822(b) [agreement by creditor to accept from principal debtor sum less than balance owed on original obligation, without surety's prior consent or other change to underlying agreement between creditor and principal debtor, does not exonerate surety for lesser sum agreed on].)

(2) *Waiver of Defenses.* A party is not discharged under U.C.C. 3605 when:

(a) The party asserting discharge consents to the event or conduct that is the basis of the discharge (U.C.C. 3605(i)(1)); or

(b) The instrument or a separate agreement provides for waiver of discharge either specifically or by general language indicating that the parties waive defenses based on suretyship or impairment of collateral (U.C.C. 3605(i)(2)).

Because it is standard practice to include a waiver of suretyship defenses in notes given to financial institutions or

other commercial creditors, U.C.C. 3605 applies to the occasional case in which the creditor did not include a waiver clause in the instrument or the creditor did not obtain the surety's permission to take the action that triggered the defenses. (Official Comment 2.)

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5. Discharge of Indorsers and Accommodation Parties.

b. Extension of Due Date.

4 Witkin Sum. Cal. Law Neg Inst § 70

[§ 70] Extension of Due Date.

If a person entitled to enforce an instrument, with or without consideration, extends the date on which an obligor must pay the instrument, an indorser or accommodation party having a right of recourse against that obligor is discharged to the extent the indorser or accommodation party proves that the extension caused a loss with respect to the right of recourse. (U.C.C. 3605(c); see *11 Am.Jur.2d (1997 ed.), Bills and Notes §424.*) Under former Article 3, an extension of the time to pay discharged the surety without evidence of loss. Under U.C.C. 3605(c), extension results in discharge only to the extent the surety meets the burden of proving loss. (Official Comment 4.)

An accommodation party is not discharged under U.C.C. 3605(c) unless the person entitled to enforce the instrument knows of the accommodation or has notice under U.C.C. 3419(c) (*supra*, §51) that the instrument was signed for accommodation. (U.C.C. 3605(h).)

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 c. Material Modification.

4 Witkin Sum. Cal. Law Neg Inst § 71

[§ 71] Material Modification.

Former Article 3 did not provide for discharge as a result of material changes in the principal obligation other than an extension of time. Under U.C.C. 3605(d), a material alteration will result in discharge to the extent the change causes loss to the surety with respect to the right of recourse. (Official Comment 5.)

In particular, a person entitled to enforce an instrument may agree, with or without consideration, to a material modification of a party's obligation, other than an extension of the due date. The modification discharges an indorser or accommodation party having a right of recourse against the person whose obligation is modified to the extent the modification causes loss to the indorser or accommodation party with respect to the right of recourse. The loss suffered by the indorser or accommodation party equals the amount of the right of recourse, unless the person enforcing the instrument proves that no loss was caused by the modification or that the loss caused was less than the amount of the right of recourse. (U.C.C. 3605(d); see *11 Am.Jur.2d (1997 ed.), Bills and Notes §423.*)

An accommodation party is not discharged under U.C.C. 3605(d) unless the person entitled to enforce the instrument knows of the accommodation or has notice under U.C.C. 3419(c) (*supra*, §51) that the instrument was signed for accommodation. (U.C.C. 3605(h).)

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 d. Impairment of Collateral.

4 Witkin Sum. Cal. Law Neg Inst § 72

[§ 72] Impairment of Collateral.

(1) *Discharge of Sureties.* A party's obligation to pay an instrument may be secured by an interest in collateral. If a person entitled to enforce the instrument impairs the value of the interest in collateral, the obligation of an indorser or accommodation party having a right of recourse against the obligor is discharged to the extent of the impairment. The value of an interest in collateral is impaired to the extent (a) the value of the interest is reduced to an amount less than the amount of the right of recourse of the party asserting discharge, or (b) the reduction in value of the interest causes an increase in the amount by which the amount of the right of recourse exceeds the value of the interest. (U.C.C. 3605(e); see *93 A.L.R.3d 1283* [who is "party" discharged on negotiable instrument to extent of holder's unjustifiable impairment of collateral]; *11 Am.Jur.2d (1997 ed.), Bills and Notes §427 et seq.*) An accommodation party is not discharged under U.C.C. 3605(e) unless the person entitled to enforce the instrument knows of the accommodation or has notice under U.C.C. 3419(c) (*supra*, §51) that the instrument was signed for accommodation. (U.C.C. 3605(h).)

(2) *Discharge Where Collateral Is Not Provided by Accommodation Party.* A party's obligation may be secured by an interest in collateral not provided by an accommodation party. If someone entitled to enforce the instrument impairs the value of the interest in collateral, the obligation of any party who is jointly and severally liable with respect to the secured obligation is discharged to the extent the impairment causes that party to pay more than he or she would have been obliged to pay, taking into account rights of contribution, if impairment had not occurred. If the party asserting discharge is an accommodation party not entitled to discharge under U.C.C. 3605(e), the party is deemed to have a right to contribution based on joint and several liability rather than a right to reimbursement. (U.C.C. 3605(f); for illustration of application of U.C.C. 3605(f), see Official Comment 7.)

(3) *Examples of Impairment.* Impairing the value of an interest in collateral includes the following:

- (a) Failure to obtain or maintain perfection or recordation of the interest in collateral. (U.C.C. 3605(g)(1).)
- (b) Release of collateral without substitution of collateral of equal value. (U.C.C. 3605(g)(2).)
- (c) Failure to perform a duty to preserve the value of collateral owed, under U.C.C. 9101 et seq. or other law, to a debtor or surety or other secondarily liable person. (U.C.C. 3605(g)(3).)

(d) Failure to comply with applicable law in disposing of collateral. (U.C.C. 3605(g)(4).)

U.C.C. 3605(g) is illustrative. Courts may find impairment in other cases as well. (Official Comment 6; see *61 A.L.R.5th 525* [what constitutes unjustifiable impairment of collateral].) The burden of proving impairment is on the party asserting discharge. (U.C.C. 3605(e), (f).)

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CHAPTER VI - Negotiable Instruments

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III. BANKING

A. Banks and Banking Laws.

1. In General.

4 *Witkin Sum. Cal. Law Neg Inst* § 73

[§ 73] In General.

(1) *Types of Banks.* Banks are of three classes: (a) commercial banks; (b) industrial banks; and (c) trust companies. (*Fin.C. 103 et seq.*) They are regulated by the State Department of Financial Institutions within the Business, Transportation, and Housing Agency. The department is headed by the Commissioner of Financial Institutions. (See *Fin.C. 200, 210, 215.*) In California, a bank must be a corporation. An individual cannot conduct a banking business. (*Fin.C. 101, 102, 107.5.*)

(2) *Applicable Laws.* Banks may be organized under the National Bank Act or the California Banking Law (*Fin.C. 99 et seq.*). (See *30 Stanf. L. Rev. 1* [analysis of dual system of regulation (state and federal)]; *10 Am.Jur.2d (1997 ed.), Banks and Financial Institutions §1 et seq.*) The Commissioner of Financial Institutions may issue regulations making federal law governing national banks likewise apply to state banks whenever that law substantially differs from the Financial Code. (*Fin.C. 753(b)(1).*) The Commissioner may also issue regulations reflecting federal law on foreign (other nation) banks where it is substantially different from the Financial Code. (*Fin.C. 753(b)(2).*) (See *18 Pepperdine L. Rev. 561* [American parent bank liability for foreign branch deposits].)

The General Corporation Law (*Corp.C. 100 et seq.*, see *9 Summary (10th), Corporations, §5 et seq.*) applies to banks. However, whenever a provision of the Corporation Law conflicts with a provision of *Fin.C. 101 et seq.*, the Financial Code provision applies. (*Fin.C. 101.*)

Division 4 of the Commercial Code contains an elaborate treatment of "Bank Deposits and Collections." (U.C.C. 4101 et seq.; *infra*, §86 et seq.) (See *7 Anderson 3d (2000 ed.), §4-101:1 et seq.*; Brady (Bailey) §1.07 et seq. [bank checks]; *73 A.L.R.3d 1282* [maintenance of computer terminal in retail store for transfer of funds as conduct of banking business].) The Travelers Checks Act (*Fin.C. 1851 et seq.*) and the Payment Instruments Law (*Fin.C. 33000 et seq.*) govern the licensing of sellers of payment instruments.

The California Right to Financial Privacy Act (*Govt.C. 7460 et seq.*) restricts and regulates access by governmental agencies to the customer records of financial institutions. (For discussion of Act and of constitutional restrictions on disclosures of customer records, see *2 Cal. Evidence (4th), Witnesses, §§460, 461*; *7 Summary (10th), Constitutional Law, §603.*) The California Financial Information Privacy Act (*Fin.C. 4050 et seq.*) provides for notice and choice for consumers regarding the sharing or sale of their nonpublic personal information by financial institutions. (See *7*

Summary (10th), *Constitutional Law*, §607; 81 *A.L.R.4th* 377 [bank's liability for disclosing financial information concerning depositor].)

(3) *Customer Safety Standards for Automated Teller Machines*. *Fin.C. 13000* et seq. are intended to enhance the safety of persons using automated teller machines without discouraging placement of those machines in locations convenient to customers' homes and workplaces. (*Fin.C. 13000*.) Although *Fin.C. 13000* recognizes that "decisions concerning safety at automated teller machine sites are inherently subjective," and that "safety is a relative matter," standards are established for location and installation of automated teller machines (*Fin.C. 13030, 13031*), and for lighting the area around those machines (*Fin.C. 13040, 13041*). Issuers of devices allowing access to automated teller machines must furnish their customers with notices of basic safety precautions. (*Fin.C. 13050*.) *Fin.C. 13000* et seq. supersede and preempt all city, county, or agency rules and regulations concerning customer safety at automated teller machines. (*Fin.C. 13070*.) (See 22 *Southwestern U. L. Rev.* 483 [bank liability for criminal activity at automated teller machine].)

(4) *Disclosure of Fees for Using Automated Teller Machines and Point-of-Sale Devices*. A surcharge for use of an automated teller machine must be disclosed to the customer electronically on the machine. Unless the disclosure is made prior to the customer being obligated to pay, the customer must be provided an opportunity to cancel the transaction without incurring the surcharge. (*Fin.C. 13080(a)*.) If a good or service is sold at the automated teller machine, the total price of the good or service and any fee charged solely for use of the machine must be disclosed to the customer electronically. If disclosure does not occur prior to the customer being obligated to pay for the good or service, the customer must be provided with an opportunity to cancel the transaction without incurring any obligation. (*Fin.C. 13080(b)*.) If a surcharge is imposed on a customer using an access device not issued by the operator, the operator must disclose that the customer may also be charged an additional fee by his or her own institution. (*Fin.C. 13080(c)*.) (See *Bank of America v. San Francisco* (9th Cir. 2002) 309 *F.3d* 551, 560 [municipal ordinances prohibiting banks from charging ATM fees to nondepositors were preempted by federal law]; 74 *So. Cal. L. Rev.* 1353 [legality of local ban on automated teller machine surcharge].)

A fee for use of a point-of-sale device must be disclosed to the customer prior to the customer being obligated to pay for any goods or services. The fee disclosure must be placed on or at the point-of-sale device on a label meeting federal standards. Electronic disclosure is also required for point-of-sale devices purchased on or after January 1, 2001, that have electronic displays. (*Fin.C. 13081(b)*.) A point-of-sale device includes any device used for the purchase of a good or service where a personal identification number is required. (*Fin.C. 13081(c)* [excluding access devices defined in *Fin.C. 13020(b)*].) Whenever a point-of-sale system is modified to include a video touch screen or other nontactile keypad, the point-of-sale device must be equipped with a tactually discernible numerical keypad that meets specified standards. The keypad must enable a visually impaired person to enter his or her own personal identification number or other personal information necessary to process the transaction, with the same degree of privacy input and output available to all individuals. (*Fin.C. 13082(a)*.) Existing, nontactile keypads must be equipped with tactually discernible keypads by January 1, 2010. (*Fin.C. 13082(b)*.)

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Applicable Laws*.

Fin.C. 753(b)(1), (b)(2) were repealed and replaced without substantive change by *Fin.C. 219(b)(1)*, (b)(2), respectively, in 2008.

Division 4 of Commercial Code: See 7 Lawrence's Anderson 3d (2007 ed.), [Rev] §4-101 et seq. (replacing 7 Anderson 3d (2000 ed.), §4-101:1 et seq.); Clark, *The Law of Bank Deposits, Collections and Credit Cards* (Rev. ed.), Chap. 1.(4) *Disclosure of Fees for Using Automated Teller Machines and Point-of-Sale Devices*. *Fin.C. 13082(a)* was amended in 2005 to provide that, as an alternative to a tactually discernible numerical keypad, a point-of-sale device that includes a video touch screen or other nontactile keypad may be equipped with other technology, such as a radio frequency identification device, fingerprint biometrics, or some other mechanism that enables a visually impaired

person to access the video touch screen device with his or her personal identifier and process the transaction with the same degree of privacy input and output available to all individuals.

Fin.C. 13082(b) was amended in 2005 to provide that existing, nontactile keypads must be equipped with tactually discernible keypads or other technology described in *Fin.C. 13082(a)* by January 1, 2010.(5) (*New Reissuance of Consumer Deposit Account Number*. Starting July 1, 2006, a supervised financial institution is prohibited from issuing a consumer deposit account number to a customer if that account number was previously held by another customer of the institution, until at least 3 years have passed since the previous customer's account was closed. (*Fin.C. 4100*, added in 2005 [defining "consumer deposit account number" as account number that financial institution uses to identify natural person's checking account or share draft account established primarily for personal, family, or household purposes, and that includes routing number of institution that is used to identify institution responsible for payment of negotiable instruments].)



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III. BANKING

A. Banks and Banking Laws.

2. Contractual Relationship Between Bank and Customer.

4 *Witkin Sum. Cal. Law Neg Inst* § 74

[§ 74] Contractual Relationship Between Bank and Customer.

The relationship between a bank and a depositor usually arises from contract. (*Smiths' Cash Store v. First Nat. Bank of San Francisco* (1906) 149 C. 32, 34, 84 P. 663; see *Nordin v. Eagle Rock State Bank* (1934) 139 C.A. 584, 590, 34 P.2d 490 [relationship does not arise when unauthorized bank officer accepts funds outside bank until money is actually deposited]; 77 A.L.R.3d 597 [liability of bank in connection with night depository service]; on required authorization for release of demand deposit funds, see *Fin.C. 40500, 40501*.) However, the relationship may be debt, bailment, agency, or trust, depending on the nature of the deposit. (See *Perdue v. Crocker Nat. Bank* (1985) 38 C.3d 913, 923, 216 C.R. 345, 702 P.2d 503, 1 Summary (10th), *Contracts*, §339 [bank signature card as contract]; Cal. Civil Practice, 4 Business Litigation, §49:3 et seq.; 68 A.L.R.3d 1080 [liability of savings bank for payment to person presenting lost or stolen passbook or savings account card]; 10 *Am.Jur.2d* (1997 ed.), *Banks and Financial Institutions* §719 et seq.; *infra*, §75 et seq.; on privacy of bank records, see *infra*, §88; on unclaimed deposits, see 13 Summary (10th), *Personal Property*, §36 et seq.)

The former characterization of the bank and customer relationship as "quasi-fiduciary" (see *Commercial Cotton Co. v. United Calif. Bank* (1985) 163 C.A.3d 511, 516, 209 C.R. 551 [bank and depositor]; *Barrett v. Bank of America* (1986) 183 C.A.3d 1362, 1369, 229 C.R. 16 [bank and borrower]) has been rejected. (See *Copesky v. Superior Court* (1991) 229 C.A.3d 678, 693, 280 C.R. 338 [characterization in *Commercial Cotton Co.* is "now inappropriate"]; *Kim v. Sumitomo Bank* (1993) 17 C.A.4th 974, 981, 21 C.R.2d 834 [bank had no fiduciary duty to plaintiffs where relationship was that of normal lender-borrower; distinguishing *Barrett*]; *LaMonte v. Sanwa Bank Calif.* (1996) 45 C.A.4th 509, 517, 52 C.R.2d 861 [defendant drawee bank breached no fiduciary duty to plaintiff wife by honoring checks payable to her but intercepted and indorsed by her husband, where husband deposited checks into couple's joint account at another bank before withdrawing and misappropriating proceeds]; *Chazen v. Centennial Bank* (1998) 61 C.A.4th 532, 537, 541, 71 C.R.2d 462 [relationship of bank and depositor is founded on contract; there is no contractual obligation to persons other than account holder, no duty to police fiduciary accounts, and no liability for misappropriation of trust funds by trustee]; 20 *Loyola L.A. L. Rev.* 795 [criticizing *Commercial Cotton Co.* and *Barrett*]; 16 *Southwestern U. L. Rev.* 645 [*Commercial Cotton Co.*]; 21 *U.C. Davis L. Rev.* 1275 [criticizing *Commercial Cotton Co.*]; Cal. Civil Practice, 4 Business Litigation, §49:3 et seq.; 70 A.L.R.3d 1344 [existence of fiduciary relationship between bank and depositor or customer resulting in special duty of disclosure for bank].)

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III. BANKING

B. Types of Deposit.

1. General, Special, and Specific.

4 *Witkin Sum. Cal. Law Neg Inst* § 75

[§ 75] General, Special, and Specific.

(1) *General Deposit.* A general deposit is one in which the depositor's money is mingled with the general funds of the bank. The bank is a debtor. (*Fidelity Savings & Loan Assn. v. Rodgers* (1919) 180 C. 683, 686, 182 P. 426; see 10 *Am.Jur.2d* (1997 ed.), *Banks and Financial Institutions* §721.)

(2) *Special Deposit.* A special deposit is a bailment of particular funds, which are kept separate and returned. (*Anderson v. Pacific Bank* (1896) 112 C. 598, 601, 44 P. 1063.) Money given to a bank under an escrow agreement, and held in an escrow account, is a special deposit. Title does not pass to the bank, and in the event of liquidation the depositor has preference over the bank's general creditors. (*Burket v. Bank of Hollywood* (1937) 9 C.2d 113, 116, 69 P.2d 421; *Bank of America v. Board of Supervisors of Los Angeles* (1949) 93 C.A.2d 75, 80, 208 P.2d 772; see 10 *Am.Jur.2d* (1997 ed.), *Banks and Financial Institutions* §731.)

(3) *Specific Deposit.* A specific deposit is one in which the funds are to be used for a particular purpose, such as to pay some debt of the depositor. The bank thus becomes the agent of the depositor. (See *Bank of America v. California Savings & Commercial Bank* (1933) 218 C. 261, 274, 22 P.2d 704; *People v. California Safe Deposit & Trust Co.* (1913) 23 C.A. 199, 205, 137 P. 1111; *Engleman v. Bank of America* (1950) 98 C.A.2d 327, 331, 219 P.2d 868; 10 *Am.Jur.2d* (1997 ed.), *Banks and Financial Institutions* §732; 8 *A.L.R.4th* 998 [deposit for particular purpose as subject of attachment or garnishment to satisfy depositor's general obligations].)

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2. Deposit in Trust.

4 *Witkin Sum. Cal. Law Neg Inst* § 76

[§ 76] Deposit in Trust.

A trust or tentative trust may also be created in a bank deposit in favor of someone as beneficiary. (See *American Surety Co. of New York v. Bank of Italy* (1923) 63 C.A. 149, 159, 218 P. 466; *Kuck v. Raftery* (1931) 117 C.A. 755, 758, 4 P.2d 552; *Sherman v. Hibernia Savings & Loan Soc.* (1933) 129 C.A. Supp. 795, 797, 20 P.2d 138; *Bank of America v. Hazelbud* (1937) 21 C.A.2d 109, 112, 68 P.2d 385; *Desert Bermuda Properties v. Union Bank* (1968) 265 C.A.2d 146, 150, 71 C.R. 93; 5 *Pepperdine L. Rev.* 21 [reexamining savings bank trusts]; 10 *Am.Jur.2d* (1997 ed.), *Banks and Financial Institutions* §689 et seq.; 13 *Summary* (10th), *Trusts*, §8 et seq.; on trust accounts under Multiple-Party Accounts Law, see *infra*, §78 et seq.) A financial institution may treat an account in trust form as a trust account unless the financial institution is notified to the contrary in writing. (*Prob.C. 5406*; see *Chang v. Redding Bank of Commerce* (1994) 29 C.A.4th 673, 685, 35 C.R.2d 64, *infra*, §83 [whether bank had actual or constructive knowledge that funds were held in trust was question of fact].)

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B. Types of Deposit.

3. Multiple-Party Accounts Law.

a. Nature and Purpose of Statutes.

4 Witkin Sum. Cal. Law Neg Inst § 77

[§ 77] Nature and Purpose of Statutes.

Article 6 of the Uniform Probate Code, entitled "Nonprobate Transfers on Death," deals mainly with multiple-party accounts. (See 8 (Part 1) U.L.A. (Master Ed.), p. 425 et seq.) The Law Revision Commission in its 1982 report (16 Cal. Law Rev. Com. Reports 129) recommended enactment of the substance of Article 6 in conformity with the law of 20 states. (Com. Report, p. 133, and footnote 1.) The purpose of the statute, enacted as the California Multiple-Party Accounts Law (*Prob.C. 5100* et seq.), is to make it easier, particularly for those who have small estates, to transfer property on death without probate. (Com. Report, p. 137.) The Multiple-Party Accounts Law applies to banks, savings and loan associations, credit unions, industrial loan companies, and other similar organizations. (*Prob.C. 5128, 40.*)

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B. Types of Deposit.

3. Multiple-Party Accounts Law.

b. Definitions.

4 Witkin Sum. Cal. Law Neg Inst § 78

[§ 78] Definitions.

(1) *Account*. An account is a contract between a depositor and a financial institution for deposit of funds, including checking, savings, and share accounts and certificates of deposit. (*Prob.C. 5122(a)*.) "Account" does not include the following:

(a) An account established for deposit of funds of a partnership, joint venture, or other association for business purposes. (*Prob.C. 5122(b)(1)*.)

(b) An account controlled by one or more persons as the duly authorized agent or trustee for a corporation, unincorporated association, or charitable or civic organization. (*Prob.C. 5122(b)(2)*.)

(c) A regular fiduciary or trust account where the relationship is established other than by deposit agreement. (*Prob.C. 5122(b)(3)*.)

(d) An account established for the deposit of funds of the estate of a ward, conservatee, or decedent. (*Prob.C. 5122(b)(4)*.)

(2) *Financial Institution*. Financial institutions include industrial loan companies, banks, savings and loan associations, credit unions, and other like organizations. (*Prob.C. 5128, 40*.)

(3) *Multiple-Party Accounts*. A multiple-party account is a joint account, a P.O.D. account, or a Totten trust account. (*Prob.C. 5132*.)

(4) *Joint Account*. A joint account is an account payable on request to one or more of two or more parties whether or not mention is made of any right of survivorship. (*Prob.C. 5130*.)

(5) *P.O.D. Account*. A P.O.D. account is an account payable on request to one person during the person's lifetime and on the person's death to one or more P.O.D. payees (*Prob.C. 5140(a)*) or an account payable on request to one or more persons during their lifetimes and on the death of all of them to one or more P.O.D. payees (*Prob.C. 5140(b)*). (See *50 A.L.R.4th 272* [payable on death savings account as will]; on payment on death provisions, see *13 Summary*

(10th), *Wills and Probate*, §305 et seq.)

(6) *P.O.D. Payee*. A P.O.D. payee is a person designated on a P.O.D. account as one to whom the account is payable on request after the death of one or more persons. (*Prob.C. 5142*.)

(7) *Party*. A party is a person who, by the terms of the account, has a present right, subject to request, to payment from a multiple-party account other than as an agent. (*Prob.C. 5136(a)*.) A P.O.D. payee is a party, by reason of being a P.O.D. payee, only after the account becomes payable to the payee by reason of surviving all persons named as original payees. (*Prob.C. 5136(b)*.) A beneficiary of a Totten trust account is a party, by reason of being a beneficiary, only after the account becomes payable to the beneficiary by reason of surviving all persons named as trustees. (*Prob.C. 5136(c)*.)

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B. Types of Deposit.

3. Multiple-Party Accounts Law.

c. Ownership of Account.

4 Witkin Sum. Cal. Law Neg Inst § 79

[§ 79] Ownership of Account.

(1) *During Life of Parties.* While the parties are alive, an account belongs to the parties in proportion to the net contributions made by each to the sums on deposit, unless there is clear and convincing evidence of a different intent. (*Prob.C. 5301(a).*) A P.O.D. payee has no rights to the account during the lifetime of any party, in the absence of clear and convincing evidence of a different intent. (*Prob.C. 5301(b).*) A beneficiary has no rights to a Totten trust account during the lifetime of a party, in the absence of clear and convincing evidence of a different intent. If there is an irrevocable trust, the account belongs beneficially to the beneficiary. (*Prob.C. 5301(c).*) (See *62 A.L.R.2d 1091* [effect of incompetency of joint depositor on status and ownership of bank account]; *48 A.L.R.4th 1136* [nondrawing cosigner's liability for joint checking account overdraft]; *86 A.L.R.5th 527* [joint bank account as subject to attachment, garnishment, or execution by creditor of one joint depositor]; *10 Am.Jur.2d (1997 ed.), Banks and Financial Institutions §670 et seq.*)

(2) *Survivorship Rights for Joint Accounts.* At the death of a party, the account belongs to the surviving party or parties, rather than the estate of the decedent, unless there is clear and convincing evidence of a different intent. If there are two or more surviving parties, their respective ownerships during lifetime are in proportion to their previous ownership interests under *Prob.C. 5301* augmented by an equal share for each survivor of any interest the decedent may have owned in the account immediately before the decedent's death. The right of survivorship continues between the surviving parties. (*Prob.C. 5302(a)*; see *Estate of Auen (1994) 30 C.A.4th 300, 314*, footnote 8, *35 C.R.2d 557* [*Prob.C. 5302(a)* is inapplicable to account established for deposit of funds of partnership, joint venture, or other business association; this limitation, which is found in *Prob.C. 5122(b)(1)*, is made applicable to *Prob.C. 5302(a)* by *Prob.C. 5120*].)

(3) *Survivorship Rights for P.O.D. Accounts.* On the death of one of two or more original payees, rights are determined as set out in *Prob.C. 5302(a)*. (*Prob.C. 5302(b)(1)*.) On death of the sole party or of the survivor of two or more parties, any sums remaining on deposit belong to the P.O.D. payee or payees if surviving, or to the survivor of them if one or more die before the party. If two or more P.O.D. payees survive, any sums remaining on deposit belong to them in equal and undivided shares unless the terms of the account or deposit agreement expressly provide for different shares. If two or more P.O.D. payees survive, there is no right of survivorship in the event of death of a P.O.D. payee thereafter unless the terms of the account or deposit agreement expressly provide for survivorship between them.

(*Prob.C. 5302(b)(2).*)

(4) *Survivorship Rights for Totten Trust Accounts.* If fewer than all trustees die, rights to the account are determined as set out in *Prob.C. 5302(a)*. (*Prob.C. 5302(c)(1).*) On the death of the sole trustee or the survivor of two or more trustees, any sums remaining on deposit belong to the person or persons named as beneficiaries, if surviving, or to the survivor of them if one or more die before the trustee, unless there is clear and convincing evidence of a different intent. If two or more beneficiaries survive, any sums remaining on deposit belong to them in equal and undivided shares unless the terms of the account or deposit agreement expressly provide for different shares. If two or more beneficiaries survive, there is no right of survivorship in the event of death of any beneficiary thereafter unless the terms of the account or deposit agreement expressly provide for survivorship between them. (*Prob.C. 5302(c)(2).*)

(5) *Survivorship Rights in Other Cases.* The death of a party has no effect on beneficial ownership of a multiple-party account other than to transfer the decedent's rights as part of the decedent's estate. (*Prob.C. 5302(d).*) (See *Crocker-Anglo Nat. Bank v. American Trust Co.* (1959) 170 C.A.2d 289, 297, 338 P.2d 617 [ordinary bank signature card, not labeled "Joint Tenancy with Right of Survivorship," and merely containing names of two parties, simply allows withdrawal by either during their lives; card does not create joint tenancy and account does not vest in survivor].)

(6) *Survivorship Rights for "Tenancy in Common."* If an account is expressly described in the deposit agreement as a "tenancy in common" account, no right of survivorship will arise by terms of the account or under *Prob.C. 5302*, unless the terms of the account or deposit agreement expressly provide for survivorship. (*Prob.C. 5306.*) (See *Cordasco v. Scalero* (1962) 203 C.A.2d 95, 103, 21 C.R. 339 [joint tenancy established despite addition of "Tenants in Common" on signature card].)

(7) *Nature of Right of Survivorship.* Transfers resulting from application of *Prob.C. 5302* are effective because of the statute and terms of the account agreement. They are nontestamentary and are not affected by requirements for testamentary dispositions. (*Prob.C. 5304.*) The terms of a multiple-party account can be changed only by specified means. (*Prob.C. 5303(b).*) A testator cannot, by will, change a right of survivorship arising from the express terms of the account or by *Prob.C. 5302*, a beneficiary designation in a trust account, or a P.O.D. payee designation. (*Prob.C. 5302(e).*)

Prob.C. 5302 is subject to *Prob.C. 5600*, which generally invalidates nonprobate transfers on death to the transferor's former spouse. (See 13 *Summary* (10th), *Wills and Probate*, §317.)

(8) *Effect of Ownership on Withdrawals.* The provisions concerning beneficial ownership between parties, or between parties and P.O.D. payees or beneficiaries of multiple party accounts, are relevant only to controversies between these persons and their creditors and other successors and do not affect the power of withdrawal given these persons by the terms of their account contracts. (*Prob.C. 5201(a).*) *Prob.C. 5100* et seq. do not affect the law relating to transfers in fraud of creditors. (*Prob.C. 5202.*) (On status of deposits by married persons as community property or separate property, see *Prob.C. 5305*; 11 *Summary* (10th), *Community Property*, §22.)

Under the Multiple-Party Accounts Law, ownership of withdrawn funds that exceed the withdrawing party's net contribution passes to that party by way of gift, but only to the extent there is no independent legal obligation requiring the party to account for the proceeds. (*Lee v. Yang* (2003) 111 C.A.4th 481, 491, 493, 3 C.R.3d 819 [master agreement adding woman as signatory on three accounts owned by her fiance' gave her right to withdraw funds; in absence of agreement between parties restricting her right to withdraw and apply funds to her own benefit, ownership of funds passed to her by gift, and fiance' was not entitled to recover them].)

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CHAPTER VI - Negotiable Instruments

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III. BANKING

B. Types of Deposit.

3. Multiple-Party Accounts Law.

d. Protection of Financial Institutions.

4 *Witkin Sum. Cal. Law Neg Inst* § 80

[§ 80] Protection of Financial Institutions.

(1) *Payment Conditions.* The Multiple-Party Accounts Law authorizes financial institutions to enter into multiple-party accounts (*Prob.C. 5401(a)*) and establishes conditions under which funds in accounts may be paid (*Prob.C. 5401(b)*), (c) [generally], 5402 [joint account], 5403 [P.O.D. account], 5404, 5406 [Totten trust account], 5407 [payment to minor]). Payment according to the statutory conditions discharges the financial institution from liability with respect to the amounts paid (*Prob.C. 5405(a)*), unless, before payment, it has been served with a restraining order (*Prob.C. 5405(b)*). (See *35 A.L.R.4th 1094* [bank's liability to joint depositor for permitting withdrawal by other joint depositor without presentation of passbook]; *39 A.L.R.4th 1112* [bank's liability to joint depositor for removal of name from account at request of other joint depositor].)

In *Beizer v. Financial Savings & Loan Assn.* (1985) *172 C.A.3d 133*, *218 C.R. 143*, plaintiff opened a joint tenancy "T-Bill Plus" account at defendant savings association with his wife and daughter. The signature card permitted withdrawals by any of the joint tenants unless defendant received prior written notice to the contrary, in accordance with former *Fin.C. 6803* (now *Prob.C. 5401, 5405.*) The T-Bill certificate, however, contained a notation below the signature line that the certificate had to accompany a withdrawal request. Defendant nonetheless permitted plaintiff's daughter, who was not in possession of the certificate, to withdraw the entire account. Plaintiff sued for breach of contract, and judgment was entered for defendant. *Held*, affirmed.

(a) The contractual provisions of the account were set forth in the signature card and in certain numbered sections of the T-Bill appearing above the signature line, and none of these required presentation of the certificate in order to effect a withdrawal. (*172 C.A.3d 139.*)

(b) A contrary result might be warranted where a certificate or passbook contains different language or differently positioned terms, or where the terminology used lulls a depositor "into a false sense of security" that causes him "to forbear taking protective action he otherwise would have adopted." (*172 C.A.3d 139.*) Here, however, plaintiff admitted he had given no consideration to the certificate's presentation clause when he opened the account, and he failed to specify when or under what circumstances he first relied on that clause. (*172 C.A.3d 140.*)

(2) *Payment in Accordance With Written Instructions.* After receiving a written notice that withdrawals in

accordance with the terms of the account, other than a checking account, share draft account, or other similar third-party payment instrument, should not be permitted, except with the signatures of more than one of the parties during their lifetimes or of more than one of the survivors after the death of a party, the financial institution may only pay the sums on deposit in accordance with the written instructions pending determination of the rights of the parties or their successors. No liability attaches to the financial institution for complying with the written notice's terms. The written notice may be withdrawn by a subsequent written notice. (*Prob.C. 5405(c).*)

(3) *Effect of Statutory Protection.* The protection provided by *Prob.C. 5405* has no bearing on the rights of parties in disputes between themselves or their successors concerning the beneficial ownership of funds in, or withdrawn from, multiple-party accounts. The statutory protection is in addition to, and not exclusive of, protection provided to the financial institution by another provision of law. (*Prob.C. 5405(d).*)

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III. BANKING

C. Banker's Lien and Setoff.

1. Lien on Securities.

4 Witkin Sum. Cal. Law Neg Inst § 81

[§ 81] Lien on Securities.

A banker, or a savings and loan association, has a general lien, dependent on possession, on all property in the banker's or association's hands belonging to a customer, for the balance due to the banker or savings and loan association from the customer in the course of the business. (C.C. 3054(a).) This lien is on the securities, such as commercial paper, that are left with the bank by the customer in the course of business. (See *Gonsalves v. Bank of America (1940) 16 C.2d 169, 173, 105 P.2d 118*; *Rest., Security §62(c)*; *27 Stanf. L. Rev. 1150* [protecting bank customers with regard to banker's lien and equitable setoff]; *10 Am.Jur.2d. (1997 ed.), Banks and Financial Institutions §854 et seq.*) The exercise of this lien with respect to deposit accounts is subject to the limitations and procedures set forth in *Fin.C. 864 or 6660*. (C.C. 3054(b); see *infra*, §84.)

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2. Setoff Against Funds on Deposit.

a. Right Against Depositor.

1. In General.

4 *Witkin Sum. Cal. Law Neg Inst* § 82

[§ 82] In General.

The banker has a nonstatutory equitable right of setoff against the funds of a general depositor, which is usually, but incorrectly, termed a banker's lien. (See *Arnold v. San Ramon Valley Bank* (1921) 184 C. 632, 635, 194 P. 1012; *Engleman v. Bank of America* (1950) 98 C.A.2d 327, 330, 219 P.2d 868 [no right of setoff against special or specific deposit]; *Chazen v. Centennial Bank* (1998) 61 C.A.4th 532, 541, 71 C.R.2d 462 [bank's right of offset exists only if depositor is indebted to bank in same capacity as depositor holds account; thus, bank cannot apply trust funds to personal indebtedness of trustee]; 10 *Am.Jur.2d* (1997 ed.), *Banks and Financial Institutions* §865 et seq.; 68 *A.L.R.3d* 192 [bank's right of setoff, based on debt of one depositor, against funds in account standing in names of debtor and another].)

"The so-called 'lien' of the bank on the depositor's *account* or funds on deposit is not technically a lien, for the bank is the owner of the funds and the debtor of the depositor, and the bank cannot have a lien on its own property. The right of the bank to charge the depositor's fund with his matured indebtedness is more correctly termed a right of setoff, based upon general principles of equity." (*Gonsalves v. Bank of America* (1940) 16 C.2d 169, 173, 105 P.2d 118 [setoff right was enforceable in same manner as lien on commercial paper, by bank's own act without judicial intervention]; see *Bromberg v. Bank of America* (1943) 58 C.A.2d 1, 6, 135 P.2d 689 [bank may appropriate deposit to repay itself for previous overdraft]; 23 *Hastings L. J.* 1585 [attack on constitutionality of banker's setoff based on principles of procedural due process set forth in *Sniadach v. Family Finance Corp. of Bay View* (1969) 395 U.S. 337, 89 S.Ct. 1820, 23 L.Ed.2d 349, and *Randone v. Appellate Dept.* (1971) 5 C.3d 536, 96 C.R. 709, 488 P.2d 13 (6 *Cal. Proc.* (4th), *Provisional Remedies*, §§49, 50)]; 7 *A.L.R.3d* 908 [bank's right to apply or set off deposit against debt of depositor not due at time of depositor's death]; for restrictions on exercise of setoff, see *infra*, §84.)

If the obligation of the depositor is represented by a note secured by a mortgage, *C.C.P.* 726 prevents the bank from satisfying it by exercising its setoff; it must exhaust the security. (*Gnarini v. Swiss Amer. Bank of Locarno, Switzerland* (1912) 162 C. 181, 184, 121 P. 726; *Woodruff v. California Republic Bank* (1977) 75 C.A.3d 108, 110, 141 C.R. 915, quoting the text; *Bank of America v. Daily* (1984) 152 C.A.3d 767, 773, 199 C.R. 557, 4 *Summary* (10th), *Security Transactions in Real Property*, §133 [by first taking setoff "action" in violation of *C.C.P.* 726, bank waived right to foreclose trust deed]; 4 *Summary* (10th), *Security Transactions in Real Property*, §124.) But in an action against it, the

bank may cross-complain. (*C.C.P.* 428.10; *Nelson v. Bank of America* (1946) 76 C.A.2d 501, 510, 173 P.2d 322 [here, however, bank did first exhaust mortgage security by sale]; see 5 *Cal. Proc.* (4th), *Pleading*, §1095.)

SUPPLEMENT: [This section is current through the latest supplement]

See Clark, *The Law of Bank Deposits, Collections and Credit Cards* (Rev. ed.), Chap. 18.

Sniadach and Randone cases:

Cross-Reference: 6 *Cal. Proc.* (5th), *Provisional Remedies*, §50. *Bank's right to cross-complain:*

Cross-Reference: 5 *Cal. Proc.* (5th), *Pleading*, §1169.



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a. Right Against Depositor.

2. Validity of Setoff.

4 *Witkin Sum. Cal. Law Neg Inst* § 83

[§ 83] Validity of Setoff.

In *Kruger v. Wells Fargo Bank (1974) 11 C.3d 352, 113 C.R. 449, 521 P.2d 441*, plaintiff maintained a checking account and a Master Charge contract with defendant bank. She deposited unemployment compensation and state disability benefits (exempt from attachment and execution under former C.C.P. 690.175 [now C.C.P. 704.120]) in the account. The bank, exercising its setoff, applied the balance of her account to her Master Charge delinquency, and later dishonored checks written prior to the debiting but presented afterwards, and charged her for service on the dishonored checks. She sued as an individual and for the class of depositors whose governmental benefit payments were exempt from attachment and execution. *Held*, judgment for defendant on demurrer reversed.

(a) The due process challenge, under the rule in *Sniadach v. Family Finance Corp. of Bay View (1969) 395 U.S. 337, 89 S.Ct. 1820, 23 L.Ed.2d 349, 7 Summary (10th), Constitutional Law, §646*, is untenable. Private action alone is involved. (*11 C.3d 358 et seq.*; see *7 Summary (10th), Constitutional Law, §619*.)

(b) The setoff cannot, however, be exercised against exempt deposits. The bank's argument, that the exemption statute prohibits only attachment or execution, and that the right of setoff is absolute, is unsound. To allow a setoff against exempt property would defeat the policy of the exemption laws. (*11 C.3d 369*.) And the state policy regarding unemployment and disability benefits is clear. The legislative objective--to furnish the unemployed worker and his family subsistence income--would obviously fail if creditors could seize that income for past debts. (*11 C.3d 370*.)

(c) "With the growth of bank-sponsored credit systems, a bank may gather unto itself the debts incurred by a depositor for past living expenses and satisfy by setoff debts which, in the days before Master Charge and Bank Americard, would have been held by many separate merchants and enforceable only through execution. To permit a bank which has thus collected the past obligations of its depositor to satisfy those claims from unemployment insurance deposits would completely defeat the state policy of preserving such deposits for the daily living expenses of the depositor." (*11 C.3d 371*.)

In *Chang v. Redding Bank of Commerce (1994) 29 C.A.4th 673, 35 C.R.2d 64*, plaintiff property owner paid \$ 219,000 to a contractor, the money to be used by the contractor to pay its subcontractors. The contractor deposited the

money with defendant bank in its business checking account. Checks were issued by the contractor to the subcontractors, and defendant at first recorded the checks as paid. However, defendant, fearing that the contractor was going bankrupt, then reversed the transactions and seized the deposited money as a setoff against money owed to defendant by the contractor. Subsequently, the subcontractors filed mechanics' liens against plaintiff property owner, which were settled. Plaintiff then filed this action against defendant bank for unjust enrichment and imposition of a constructive trust on the money deposited by the contractor. Defendant moved for summary judgment on the ground that plaintiff, as a noncustomer of defendant, had no standing to challenge defendant's setoff against the contractor's account. The trial judge, though acknowledging that a triable issue might exist whether defendant had actual or constructive knowledge of the source and purpose of the deposited funds, granted defendant's motion on the ground that plaintiff lacked standing. *Held*, reversed.

(a) As between a bank and the depositor, money deposited in a general account becomes the property of the bank, which becomes the debtor of the depositor. If, in turn, the depositor is indebted to the bank, there is a mutuality of obligation, from which flows the equitable right of setoff, i.e., the bank may setoff its debt against the depositor's debt by taking funds from the depositor's account. (29 C.A.4th 681.)

(b) However, when the funds are trust funds, and the bank knows or has facts sufficient to put it on inquiry that the funds are held by the depositor in trust, it may not, as against the beneficiary (here, the subcontractors), apply those funds against the depositor's individual indebtedness to the bank. Here, defendant conceded that plaintiff satisfied the elements of equitable subrogation, so as to be able to pursue whatever remedies the beneficiaries might have in the disputed funds. Therefore, because the subcontractors had standing to sue if the funds were held in trust, the resolution of the trust question resolves the question of standing. (29 C.A.4th 682.)

(c) On the record, whether defendant had actual or constructive knowledge that the funds were held in trust was a question of fact. (29 C.A.4th 685.)

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a. Right Against Depositor.

3. Statutory Limitations on Exercise of Setoff.

4 *Witkin Sum. Cal. Law Neg Inst* § 84

[§ 84] Statutory Limitations on Exercise of Setoff.

(1) *Limitations Applicable to Setoffs Involving Consumer Debt.* The statutes restricting a bank's exercise of the right of setoff define customer as "one or more natural persons." (*Fin.C. 864(a)(1), 6660(a)(4).*) "Debt" is defined as an interest-bearing obligation or one payable in installments, that has not been reduced to judgment, "arising from an extension of credit to a natural person primarily for personal, family, or household purposes." Debt does not include a charge for bank or savings and loan services, or a debit for uncollected funds or for an overdraft imposed by a bank on a deposit account or by a savings association on a savings account. (*Fin.C. 864(a)(2), 6660(a)(5).*) Debt also excludes, in the case of a savings association, debits for dishonored checks cashed for a customer. (*Fin.C. 6660(a)(5).*)

In *Martin v. Wells Fargo Bank (2001) 91 C.A.4th 489, 110 C.R.2d 653*, defendant bank issued business credit cards to the law office of plaintiff husband, one in his name and one in the name of plaintiff wife, which they used for personal and household expenses. Defendant exercised a right of setoff for amounts due on the wife's card by debiting plaintiffs' joint checking account. Plaintiffs sued for damages, alleging that defendant improperly exercised the setoff by failing to comply with *Fin.C. 864(a)(1)*, which limits a bank's right to setoff a matured debt arising from an extension of credit primarily for personal, family, or household purposes. Plaintiffs contended that an "extension of credit" occurs when a debt is created by use of a credit card. *Held*, dismissal in favor of defendant affirmed.

(a) The application of *Fin.C. 864* is conditioned by the primary purpose for which credit is extended, and that is determined when the credit card is issued, rather than on each occasion when the card is used for a transaction or purchase. Because the primary purpose of a business credit card is commercial, and not the purchase of consumer goods, defendant could setoff the debts incurred in its use without needing to comply with the limitations of *Fin.C. 864*. (*91 C.A.4th 491, 492.*)

(b) When a bank issues a business credit card, "it does so on the basis of the business's credit rating. A cardholder may not have it both ways, apply for and receive a business credit card, but use it for personal purposes and expect to receive consumer protection. The difficulty and complexity of making a decision about the purpose of each transaction far exceeds anything the Legislature contemplated when it used the term 'extension of credit.'" (*91 C.A.4th 499.*) To avoid liability, a bank would have to comply with the limitations imposed by *Fin.C. 864*. The result would be that the

statute, which was intended to apply only to consumer debt, would become the rule rather than the exception. (91 C.A.4th 499.)

(2) *No Reduction of Balance to Below \$ 1,000.* The setoff must not result in an aggregate balance of less than \$ 1,000 for all demand deposit accounts in the bank or its branches (*Fin.C. 864(b)*), or for all accounts in the savings association or its branches (*Fin.C. 6660(b)*). (For definitions of "account," "account holder," and "charges," see *Fin.C. 6660(a)(1)*, (a)(2), (a)(3).)

(3) *Notice of Setoff.* The bank or savings and loan association must provide written notice to the customer, in at least 10-point type, not later than the day following the exercise of the setoff, delivered personally or sent by first-class mail. (*Fin.C. 864(c)*, *6660(c)*.)

The notice must contain the following:

(a) A statement that the setoff has been made, identifying the account, and giving the balances before and after the setoff. (*Fin.C. 864(c)(1)*, *6660(c)(1)*.)

(b) A statement identifying the debt and giving the balances due before and after the setoff. (*Fin.C. 864(c)(2)*, *6660(c)(2)*.)

(c) A statement that if the customer claims (1) that the debt has been paid or is not now owing, or (2) that the funds are expressly exempt under *C.C.P. 703.010* et seq., the customer may execute and return the notice not later than 20 days after the date of mailing or personal delivery. (*Fin.C. 864(c)(3)*, *6660(c)(3)*.)

(d) A statement (1) that if the notice is executed and returned, the bank may file an action to collect the debt, (2) that if a lawsuit is filed, the customer will be notified and have an opportunity to appear and defend, and (3) that if the bank or savings association is successful, the customer will be liable for costs and attorneys' fees "if the debt so provides." (*Fin.C. 864(c)(4)*, *6660(c)(4)*.)

(e) A response form (in at least 10-point type) for the customer to fill out and execute under penalty of perjury, with a checklist covering claims that the debt has been paid or is not owing, or that the account is not subject to setoff because the funds deposited are exempt under a listed statute. (*Fin.C. 864(c)(5)*, *6660(c)(5)*.)

(4) *Reversal of Setoff.* If the response form in *Fin.C. 864(c)* and *6660(c)* is received by the bank or savings association within the 20-day period, the setoff and any service charges resulting from it must be reversed. In the case of a bank, the amount must be credited to the deposit account not later than the end of the business day following receipt of the response. (*Fin.C. 864(d)*.) In the case of a savings association, the amount must be credited to the customer's account not later than the end of the third business day following receipt of the response. (*Fin.C. 6660(d)*.)

(5) *Exceptions to Limitations.* The limitations of *Fin.C. 864* and *6660* do not apply in the following situations:

(a) Where the account is one in which the bank or savings association has a security interest under a written contract as collateral for the debt. (*Fin.C. 864(e)*, *6660(e)*.)

(b) Where the customer previously has given the bank or savings association written authority to periodically debit a deposit account as the agreed method of payment for a debt. (*Fin.C. 864(f)*, *6660(f)*.)

Nothing in *Fin.C. 864* and *6660* prejudices a person's right to assert exemptions under *C.C.P. 703.010* et seq. or to assert a claim or defense in a judicial proceeding regarding the debt's validity. (*Fin.C. 864(h)*, *6660(h)*.)

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2. Setoff Against Funds on Deposit.

b. Right Against Depositor's Creditor.

4 Witkin Sum. Cal. Law Neg Inst § 85

[§ 85] Right Against Depositor's Creditor.

If the depositor is indebted to the bank and to others, and another creditor attempts to reach the deposit by garnishment proceedings, the bank may apply the deposit to the debt, and, if it does, the garnishment will be ineffective because nothing will be owing by the bank to the depositor. But it must in fact apply the deposit. If instead it permits the fund to be used by the debtor, it holds the fund also for the benefit of the attaching creditor. Otherwise the bank's offset would be used not for its proper purpose of protecting the bank, but to permit the debtor to defeat the claims of other creditors. (*Walters v. Bank of America (1937) 9 C.2d 46, 55, 69 P.2d 839*; see *3 A.L.R.4th 998* [effect of Unif.Com.C. Article 9 on conflict between secured creditor and bank claiming right of setoff]; *6 Cal. Proc. (4th), Provisional Remedies*, §201; on right of bank to apply trust funds and third person's funds deposited in debtor's name, see *10 Am.Jur.2d (1997 ed.), Banks and Financial Institutions* §887; *8 A.L.R.3d 235* [bank's right to apply third person's funds, deposited in debtor's name, on debtor's obligation].)

SUPPLEMENT: [This section is current through the latest supplement]

See Clark, *The Law of Bank Deposits, Collections and Credit Cards* (Rev. ed.), Chap. 21.

Cross-Reference: *6 Cal. Proc. (5th), Provisional Remedies*, §200.



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 1. Scope of Division 4.
 a. Applicability.

4 Witkin Sum. Cal. Law Neg Inst § 86

[§ 86] Applicability.

(1) *Overlap With Other Uniform Commercial Code Divisions.* Division 3 (U.C.C. 3101 et seq.) governs negotiable instruments and Division 8 (U.C.C. 8101 et seq.) governs investment securities. Both negotiable instruments and investment securities may be handled by banks for collection purposes. (Official Comment 1 to U.C.C. 4102.) To the extent that items within Division 4 are also within Divisions 3 and 8, they are subject to those divisions. If there is conflict, Division 4 governs Division 3, but Division 8 governs Division 4. (U.C.C. 4102(a); see *10 Am.Jur.2d (1997 ed.), Banks and Financial Institutions §718.*)

U.C.C. 4210 (infra, §106) governs conflicts between Divisions 4 and 9 (U.C.C. 9101 et seq.). Applicable federal law, such as the Expedited Funds Availability Act (*12 U.S.C., §4001 et seq., infra, §109*) and its implementing Regulation CC (12 C.F.R., §229 et seq.), may supersede Division 4. (Official Comment 1 to U.C.C. 4102.) (See Brady (Bailey) §18.01 et seq.)

(2) *Conflict of Laws.* The law of the place where a bank is located governs the bank's liability for action or nonaction with respect to an item it handles for presentment, payment, or collection. If the action or nonaction occurs at a bank's branch or separate office, the law of the place where the branch or separate office is located governs. (U.C.C. 4102(b); see *10 Am.Jur.2d (1997 ed.), Banks and Financial Institutions §718.*) This conflicts rule applies from the inception of the collection process through all phases of deposit, forwarding, presentment, payment, and remittance or credit of proceeds. (Official Comment 2.)

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D. Collections Under Division 4 of the Uniform Commercial Code.

1. Scope of Division 4.

b. Varying the Provisions of Division 4.

4 Witkin Sum. Cal. Law Neg Inst § 87

[§ 87] Varying the Provisions of Division 4.

(1) *General Rule.* The effect of Division 4's provisions may be varied by agreement. (U.C.C. 4103(a).) An agreement may be direct (between the owner and the depository bank) or indirect (the owner authorizes a procedure and a bank in the collection chain acts under the authorization), with respect to a single item or to all items handled for a particular customer, such as a general agreement when the customer opens an account. (Official Comment 2.) (See *60 A.L.R.2d 708* [effect on bank depositor's rights and those of bank, of printed rules in passbook that are not expressly accepted].)

Moreover, Federal Reserve regulations and operating circulars, clearing house rules, and the like, even when not specifically assented to by all parties interested in the items handled, may vary Division 4's provisions. (U.C.C. 4103(b).) The phrase "and the like" covers rules and regulations issued by public or quasi-public agencies under statutory authority. The phrase may include the rules and regulations of associations or agencies similar to clearing houses, but it does not include agreements between some or all of the banks in a particular area. (Official Comment 3.)

(2) *Exceptions to General Rule.* The parties to an agreement cannot disclaim a bank's responsibility for its lack of good faith or failure to exercise ordinary care. Nor can they limit the measure of damages for the lack or failure. However, they may agree to the standards by which the bank's responsibility is to be measured, if those standards are not manifestly unreasonable. (U.C.C. 4103(a); see *10 Am.Jur.2d (1997 ed.), Banks and Financial Institutions §729*; on standard of care, see *infra*, §88.)

(3) *Varying Time Limits.* A collecting bank in a good faith effort to secure payment of a specific item may waive, modify, or extend time limits imposed or permitted by the Code for up to 2 additional banking days without discharge of drawers or indorsers or liability to its transferor or a prior party. This waiver right does not apply to checks; the item must be drawn on a payor other than a bank. Although the bank does not need anyone's approval, an extension may not be exercised if the customer instructs otherwise. (U.C.C. 4109(a); Official Comment 1; see *infra*, §97.)

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1. Scope of Division 4.

c. Enforcing the Provisions of Division 4.

4 Witkin Sum. Cal. Law Neg Inst § 88

[§ 88] Enforcing the Provisions of Division 4.

(1) *Liability for Lack of Ordinary Care.* "Good faith" and "ordinary care" are defined in U.C.C. 3103 and made applicable to Division 4 by U.C.C. 4104. (Official Comment 4 to U.C.C. 4103.) Action or nonaction approved by Division 4 or under Federal Reserve regulations or operating circulars is the exercise of ordinary care. In the absence of special instructions, action or nonaction consistent with clearing house rules and the like or with a general banking usage not disapproved by Division 4 is prima facie the exercise of ordinary care. (U.C.C. 4103(c).) "General banking usage" means a general usage common to banks in the area concerned. The usage should be broader than a mere practice between two or three banks, but a nationwide usage is not required. A usage followed through a substantial portion of a state or a metropolitan area is sufficient. (Official Comment 4.) (See *Bullis v. Security Pac. Nat. Bank* (1978) 21 C.3d 801, 808, 148 C.R. 22, 582 P.2d 109 [failure to require signatures of coexecutors on withdrawals]; 7 A.L.R.4th 655 [bank's liability for payment or withdrawal on less than required number of signatures]; 34 U.C. Davis L. Rev. 1077 [financial institutions' duty of confidentiality to keep customer's personal information secure from identity theft].)

The specification or approval of certain procedures by Division 4 is not disapproval of other procedures that may be reasonable under the circumstances. (U.C.C. 4103(d).) Thus, a novel procedure adopted by a bank may be reasonable even though it is not specifically contemplated by Division 4 or by agreement, or has not yet been generally accepted as a bank usage. (Official Comment 5.)

(2) *Measuring Damages for Lack of Ordinary Care.* The measure of damages for failure to exercise ordinary care in handling an item is the amount of the item reduced by an amount that could not have been realized by the exercise of ordinary care. (U.C.C. 4103(e).) Hence, liability of the bank and some loss to the customer or owner must be established. (Official Comment 6.) If there is also bad faith, any other damages the party suffered as a proximate consequence are included. (U.C.C. 4103(e).) For this purpose, "bad faith" is the absence of good faith. (Official Comment 6.)

(3) *Statute of Limitations.* An action to enforce an obligation, duty, or right arising under Division 4 must be commenced within 3 years after the cause of action accrues. (U.C.C. 4111; see *Edward Fineman Co. v. Superior Court* (1998) 66 C.A.4th 1110, 78 C.R.2d 478, *infra*, §130.) This limitations period conforms to the one set by U.C.C. 3118(g)

(supra, §37) for actions for breach of warranty and to enforce other duties, obligations, and rights under Division 3.

The 1-year statute of limitation set forth in *C.C.P. 340(c)* for actions "by a depositor against a bank for the payment of a forged or raised check," rather than the 3-year period set forth in the more general U.C.C. 4111, applies to a depositor's action against its bank for payment of forged checks written on the depositor's account. (See *Chatsky & Associates v. Superior Court* (2004) 117 C.A.4th 873, 877, 12 C.R.3d 154, infra, §130.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Liability for Lack of Ordinary Care.* The definition of "good faith" in U.C.C. 3103(a)(4) was deleted in 2006. The definition of "good faith" in U.C.C. 1201(b)(20) applies to Division 4.



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 a. General Definitions.

4 Witkin Sum. Cal. Law Neg Inst § 89

[§ 89] General Definitions.

Unless the context requires otherwise, the following definitions apply in Division 4:

(1) An "account" is a deposit or credit account with a bank, including a demand, time, savings, passbook, share draft, or similar account. It does not include an account evidenced by a certificate of deposit. (U.C.C. 4104(a)(1).)

(2) "Afternoon" means the period of a day between noon and midnight. (U.C.C. 4104(a)(2).)

(3) The "banking day" is the part of the day when a bank is open to the public for carrying on substantially all of its banking functions. (U.C.C. 4104(a)(3).) It excludes times when a bank is open only for limited functions such as receiving deposits and cashing checks. (Official Comment 2.)

(4) A "clearing house" is an association of banks or other payors regularly clearing items. (U.C.C. 4104(a)(4).) Occasionally nonbanks deal directly with clearing houses. (Official Comment 3.)

(5) A "customer" is a person who has an account with a bank or for whom a bank has agreed to collect items. A bank that maintains an account at another bank is also a customer. (U.C.C. 4104(a)(5).)

(6) A "documentary draft" is a draft to be presented for acceptance or payment if specified documents, certificated securities or instructions for uncertificated securities, or other certificates, statements, or the like are to be received by the drawee or other payor before acceptance or payment of the draft. (U.C.C. 4104(a)(6); on certificated and uncertificated securities, see U.C.C. 8102, 9 *Summary* (10th), *Corporations*, §134.) The documents may, but need not, accompany the draft. They must be received by the drawee or other payor before acceptance or payment of the draft. (Official Comment 5.)

(7) A "draft" is a draft as defined in U.C.C. 3104 (*supra*, §11) or an item, other than an instrument, that is an order. (U.C.C. 4104(a)(7); for definition of order, see U.C.C. 3103, *supra*, §9.)

(8) A "drawee" is a person ordered in a draft to make payment. (U.C.C. 4104(a)(8).)

(9) An "item" is an instrument or a promise or order to pay money handled by a bank for collection or payment. (U.C.C. 4104(a)(9).) The meaning of the term is limited by the banking system's willingness to handle the instrument, undertaking, or instruction for collection or payment. (Official Comment 8.) A payment order governed by Division 11 is not an item; neither is a credit or debit card slip. (U.C.C. 4104(a)(9); on Division 11 (U.C.C. 11101 et seq.), see *infra*, §132 et seq.)

(10) A bank's "midnight deadline" is midnight on its next banking day following the banking day on which it receives the relevant item or notice or from which the time for taking action commences to run, whichever is later. (U.C.C. 4104(a)(10).) The midnight time limit provides uniformity and definiteness. (Official Comment 9.) (On extension of midnight deadline and other time limits imposed by Division 4, see U.C.C. 4109, *infra*, §97.)

(11) To "settle" means to pay in cash, by clearinghouse settlement, in a charge or credit or by remittance, or otherwise as agreed. A settlement may be either provisional or final. (U.C.C. 4104(a)(11).)

"Settle" conveniently characterizes a broad variety of conditional, provisional, tentative, and final payments of items. Examples of settlements include payments in cash, payment through the adjustment and offsetting of balances through clearing houses, debit or credit entries in accounts between banks, and the forwarding of remittance instruments. (Official Comment 10.)

(12) A bank "suspends payments" when supervisory authorities have ordered it closed, when a public officer has been appointed to take it over, or when it ceases or refuses to make payments in the ordinary course of business. (U.C.C. 4104(a)(12).) This definition provides an objective test to determine when a bank is no longer operating as a part of the banking system. (Official Comment 11.)

Other definitions applying to Division 4 are given in particular sections of Division 4 and in other divisions of the Code. They are listed in U.C.C. 4104(b) and (c). In addition, the general definitions and principles of construction and interpretation in Division 1 are applicable to Division 4. (U.C.C. 4104(d).)

SUPPLEMENT: [This section is current through the latest supplement]

(4) *Clearing house*: U.C.C. 4104(a)(4) was amended in 2006 to change the spelling of "clearing house" to "clearinghouse."



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b. Classification of Banks.

4 Witkin Sum. Cal. Law Neg Inst § 90

[§ 90] Classification of Banks.

(1) A "bank" is a person engaged in the business of banking, including a savings bank, savings and loan association, credit union, or trust company. (U.C.C. 4105(1).) "Bank" is defined in U.C.C. 1201(4) as "any person engaged in the business of banking." (See Brady (Bailey) §11.01.) The definition in U.C.C. 4105 specifically includes entities other than commercial banks. (Official Comment 2.) However, banks to which items are issued are excluded, because these banks do not generally take by transfer. (Official Comment 1.)

(2) A "depository bank" is the first bank to take an item, including a payor bank, unless the item is presented for immediate payment over the counter. (U.C.C. 4105(2).) A bank that takes an "on us" item for collection or for application to a customer's loan, or first handles the item for other reasons, is a depository bank even though it is also the payor bank. (Official Comment 3.)

(3) A "payor bank" is a bank that is the drawee of a draft. (U.C.C. 4105(3).) Its instruction to pay must be found in the item. A bank does not become a payor bank by being authorized to pay or by being given an instruction to pay not contained in the item. (Official Comment 4.)

(4) An "intermediary bank" is a bank to which an item is transferred in the course of collection, except the depository or payor bank. (U.C.C. 4105(4).) It includes the last bank in the collection process if the drawee is not a bank. (Official Comment 5.)

(5) A "collecting bank" is a bank handling an item for collection, except the payor bank. (U.C.C. 4105(5).)

(6) A "presenting bank" is a bank presenting an item, except a payor bank. (U.C.C. 4105(6).)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Bank*: U.C.C. 1201(4) was renumbered U.C.C. 1201(b)(4) and amended in 2006. The definition of "bank" is now the same as the one in U.C.C. 4105(1).



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c. Items "Payable Through" or "Payable At."

4 Witkin Sum. Cal. Law Neg Inst § 91

[§ 91] Items "Payable Through" or "Payable At."

An item may identify a bank that it is "payable through" or "payable at." If so, the item designates the bank as a collecting bank and does not by itself authorize the bank to pay the item. The item may be presented for payment only by or through the bank. (U.C.C. 4106(a), (b); see *11 Am.Jur.2d (1997 ed.), Bills and Notes §§72, 73.*)

If a draft names a nonbank drawee and it is unclear whether a bank named in the draft is a co-drawee or a collecting bank, the bank is a collecting bank. (U.C.C. 4106(c).) Thus, a bank named below the name of a drawee is not itself a drawee. The commercial understanding is that the bank is a collecting bank and is not accountable for holding an item beyond its deadline. (Official Comment 3.)

SUPPLEMENT: [This section is current through the latest supplement]



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d. Branch Offices.

4 Witkin Sum. Cal. Law Neg Inst § 92

[§ 92] Branch Offices.

Many bank branches function as separate banks in the handling and payment of items, and require time for doing so similar to that of a separate bank. (Official Comment 2.) Therefore, a bank's branch or separate office is a separate bank for the purpose of determining when and where action may be taken or notice or orders must be given under Divisions 3 and 4. (U.C.C. 4107; see *11 Am.Jur.2d (1997 ed.), Bills and Notes §325.*) The location of account records is not important in determining whether a branch is a separate bank. (Official Comment 5.)

By making each branch a separate bank for certain purposes only, the single legal entity of the bank as a whole is preserved. (Official Comment 4.) The alternative rule that a branch or office of a bank is always deemed a separate bank, while brief, produces illogical results in some cases. For example, warranties by one branch to another branch under U.C.C. 4207 and 4208 do not make sense. (Official Comment 3; on warranties, see *infra*, §102 et seq.)

West's Key Number Digest, Banks and Banking k.33

SUPPLEMENT: [This section is current through the latest supplement]



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 e. Electronic Presentment.

4 Witkin Sum. Cal. Law Neg Inst § 93

[§ 93] Electronic Presentment.

(1) *Definition.* An agreement for electronic presentment is an agreement, clearing house rule, or Federal Reserve regulation or operating circular, providing that an item may be presented by transmitting its image or information describing it ("presentment notice") rather than by delivering the item itself. The agreement may provide procedures governing retention, presentment, payment, dishonor, and other matters. (U.C.C. 4110(a).)

A bank is not likely to participate in an electronic presentment program without an agreement, either bilateral or multilateral. In the latter case, federal or other regulatory standards would likely supply the substance of the agreement. (Official Comment 2.) The parties affected by an electronic presentment agreement, except for the customer, can be expected to protect themselves. (Official Comment 3.)

(2) *When Presentment Is Made.* Presentment under an agreement is made when the presentment notice is received. (U.C.C. 4110(b).) This is the identifying characteristic of an electronic presentment agreement. (Official Comment 1.) If presentment is made by presentment notice, a reference to "item" or "check" in Division 4 means the presentment notice unless the context otherwise indicates. (U.C.C. 4110(c).)

(3) *Check Retention Distinguished.* The retention of items by payor banks is not an electronic presentment agreement because the item itself is presented to the payor bank. Payor bank check retention is governed by U.C.C. 4406(b) (*infra*, §127).

SUPPLEMENT: [This section is current through the latest supplement]



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f. Cutoff Hours.

4 Witkin Sum. Cal. Law Neg Inst § 94

[§ 94] Cutoff Hours.

For the purpose of allowing time to process items, prove balances, and make the necessary entries on its books to determine its position for the day, a bank may fix an afternoon hour of 2 p.m. or later as a cutoff hour for the handling of money and items and the making of entries on its books. (U.C.C. 4108(a).) The 2 p.m. cutoff hour allows a bank to leave its doors open later in the afternoon without requiring the settling and proving process to last into the evening. (Official Comment 1.)

If a bank receives an item or deposit of money after a fixed cutoff hour or after the close of the banking day, it may treat the item as being received at the opening of the next banking day. (U.C.C. 4108(b).) This is particularly important when a bank closes at 12:00 or 1:00 on a Saturday, but continues to receive items after that time. (Official Comment 2.)

SUPPLEMENT: [This section is current through the latest supplement]



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a. Status of Banks.

1. Collecting Bank.

4 Witkin Sum. Cal. Law Neg Inst § 95

[§ 95] Collecting Bank.

(1) *Status as Agent.* Until a collecting bank gives final settlement for an item, the bank is an agent or subagent of the item's owner and any settlement given for the item is provisional. This rule applies regardless of the form of indorsement or lack of indorsement and even though credit given for the item is subject to immediate withdrawal as of right or is in fact withdrawn. However, the owner's continuing ownership of an item and his or her rights to proceeds of the item are subject to the collecting bank's rights, such as those resulting from outstanding advances on the item and rights of recoupment or setoff. If banks handle an item for purposes of presentment, payment, collection, or return, Division 4 applies even when the parties' actions clearly establish that a particular bank has purchased the item and owns it. (U.C.C. 4201(a); see *Symonds v. Mercury Savings & Loan Assn. (1990) 225 C.A.3d 1458, 1468, 275 C.R. 871, infra*, §110 [relationship between depositor and bank was that of principal and agent, and not "quasi-fiduciary"].) Thus, Division 4 applies to nearly every item moving through banks for the purpose of presentment, payment, or collection. (Official Comment 1.)

(2) *Consequences of Rule.* The following results flow from the rule that a collecting bank's agency status continues until final settlement of an item:

(a) The risk of loss continues in the item's owner rather than the agency bank under U.C.C. 4214 (*infra*, §110).

(b) Pending final settlement, the owner has the preference rights of U.C.C. 4216 (*infra*, §111) and the direct rights of U.C.C. 4302 against the payor bank (*infra*, §116).

(c) Dollar limitations of federal deposit insurance are measured by the claim of the item's owner, not that of the collecting bank. (Official Comment 4.)

U.C.C. 4201(a) governs cases of attempted attachment of proceeds of a noncash item in the hands of the payor bank as property of the absent owner. A collecting bank that has made an advance on an item that is still outstanding has a right of reimbursement superior to the rights of the owner to the proceeds or to the rights of a creditor of the owner. (Official Comment 5.)

(3) *Exception to Rule.* The bank's agency status is subject to a clearly apparent contrary intent (U.C.C. 4201(a)), such as a statement on the item or in collateral papers that the item was sold absolutely to the depository bank (Official Comment 2).

(4) *Status as Holder.* After an item has been indorsed with the words "pay any bank" or similar words, only a bank may acquire the rights of a holder until the item has been either (a) returned to the customer initiating collection, or (b) specially indorsed by a bank to a person who is not a bank. (U.C.C. 4201(b).) This protects ownership rights to an item indorsed "pay any bank or banker" in the event the item is subsequently acquired under improper circumstances. (Official Comment 7.)

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a. Status of Banks.

2. Depository Bank.

4 Witkin Sum. Cal. Law Neg Inst § 96

[§ 96] Depository Bank.

If a customer delivers an item to a depository bank for collection, the depository bank becomes a holder of the item when it receives it, as long as the customer was a holder at the time of delivery. (U.C.C. 4205(a).) Under former Division 4, if a depository bank failed to supply its customer's indorsement, the bank's status as a holder was in doubt. (Official Comment; see *29 A.L.R.4th 631* [construction and application of former version of U.C.C. 4205, allowing depository bank to supply customer's indorsement on item for collection].) Under the revised version, the depository bank becomes a holder when it takes the item for deposit from a holder, regardless of whether it supplies the customer's indorsement. If the bank satisfies the other requirements of U.C.C. 3302 (*supra*, §27 et seq.), it is a holder in due course. (U.C.C. 4205(a).)

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b. Duties of Collecting Banks.

1. Collection and Return.

aa. In General.

4 Witkin Sum. Cal. Law Neg Inst § 97

[§ 97] In General.

(1) *Use of Ordinary Care.* Under U.C.C. 1203, a collecting bank is subject to the standard requirement of good faith. (Official Comment 1.) In addition, it must use ordinary care in performing the following basic collection tasks:

(a) Presenting an item or sending it for presentment. (U.C.C. 4202(a)(1).)

(b) Sending notice of dishonor or nonpayment or returning an item other than a documentary draft to the bank's transferor after learning that the item has not been paid or accepted. (U.C.C. 4202(a)(2).)

(c) Settling for an item when the bank receives final settlement. (U.C.C. 4202(a)(3).)

(d) Notifying the bank's transferor of a loss or delay in transit within a reasonable time after discovering it. (U.C.C. 4202(a)(4).)

If a bank forwards an item to be presented, ordinary care is required with respect to routing under U.C.C. 4204, *infra*, §99. (Official Comment 2.)

(2) *Significance of Midnight Deadline.* A collecting bank exercises ordinary care by taking proper action before its midnight deadline following receipt of an item, notice, or settlement. Taking proper action within a reasonably longer time may constitute the exercise of ordinary care, but the bank has the burden of establishing timeliness. (U.C.C. 4202(b); for definition of "midnight deadline," see *supra*, §89.) Action after the midnight deadline but sufficiently in advance of maturity for proper presentation is an example of a "reasonably longer time." (Official Comment 3.)

A collecting bank in a good faith effort to secure payment of an item may waive, modify, or extend the time limit imposed by U.C.C. 4202(b) for up to 2 additional banking days without discharge of drawers or indorsers or liability to its transferor or a prior party. However, the collecting bank's right to waive the time limit does not apply to checks. The item must be drawn on a payor other than a bank. Moreover, although the collecting bank does not need anyone's approval, an extension may not be exercised if the customer instructs otherwise. Because drawers and indorsers are not

discharged, an extension also extends the time for presentment or payment. (U.C.C. 4109(a); Official Comment 1.)

(3) *Effect of Delay.* Delay by a collecting bank or payor bank beyond the time limit prescribed by U.C.C. 4202(b) or by instructions is excused if (a) the delay is caused by interruption of communication or computer facilities, suspension of payments by another bank, war, emergency conditions, failure of equipment, or other circumstances beyond the control of the bank, and (b) the bank exercises such diligence as the circumstances require. (U.C.C. 4109(b).) The burden of proof of diligence is on the bank. (Official Comment 3.)

(4) *Liability for Acts of Others.* A collecting bank is responsible for using ordinary care in selecting properly qualified intermediary banks and agents and giving proper instructions to them. (Official Comment 4.) Although a bank must exercise ordinary care in presenting an item, it is not otherwise liable for another's insolvency, neglect, misconduct, mistake, or default or for loss or destruction of an item in the possession of others or in transit. (U.C.C. 4202(c).)

(4) *Effect of Transferor's Instructions.* Subject to the provisions concerning conversion of instruments (U.C.C. 3420, supra, §58) and restrictive indorsements (U.C.C. 3206, supra, §24), only a collecting bank's transferor can give instructions that affect the bank or constitute notice to it. A collecting bank may act in accordance with the instructions or an agreement with its transferor without incurring liability to prior parties. (U.C.C. 4203.) U.C.C. 4203 adopts a "chain of command" theory, under which an intermediary or collecting bank is not required to determine whether the transferor is authorized to give the instructions. It applies only to collecting banks. (Official Comment.)

West's Key Number Digest, Banks and Banking k.156 et seq.

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Use of Ordinary Care.* U.C.C. 1203 was renumbered U.C.C. 1304 in 2006.

See Clark, *The Law of Bank Deposits, Collections and Credit Cards* (Rev. ed.), Chaps. 5, 16.(2) *Significance of Midnight Deadline.* See Clark, *The Law of Bank Deposits, Collections and Credit Cards* (Rev. ed.), Chap. 6. *Correction:* Page 463, line 1, "(4)" should be "(5)".



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1. Collection and Return.

bb. Liability for Acts of Others.

4 Witkin Sum. Cal. Law Neg Inst § 98

[§ 98] Liability for Acts of Others.

In *Karen Kane v. Bank of America* (1998) 67 C.A.4th 1192, 79 C.R.2d 712, an employee of plaintiff clothing manufacturer wrongfully arranged to have plaintiff's accounts payable department issue checks for merchandise plaintiff never received. The scheme took place over a 2- or 3-year period, and involved more than 76 checks totaling approximately \$ 760,000. The checks were printed, unaltered, bore genuine signatures, and were deliberately issued by plaintiff in what appeared to be the regular course of business. The checks were cashed at a check cashing service and deposited by the service into its account at defendant collecting bank. Defendant then presented the checks to plaintiff's bank, which paid the checks and charged plaintiff's account. Neither the checks nor the indorsements were forged, and the funds were paid to payees selected by plaintiff, albeit as the result of internal fraud. Plaintiff sued defendant for negligence, alleging that unconventional indorsements and unbusinesslike negotiation for cash at a check cashing service gave defendant notice that the checks were probably issued as the result of an unlawful scheme, and created a duty, under general principles of negligence law, for defendant to inquire of plaintiff as to the validity of the obligation supporting the checks. *Held*, defendant complied with U.C.C. 4202, setting forth the duties of a collecting bank, and was not obligated to ask plaintiff whether a valid transaction supported the checks.

(a) *Volume and amount of checks did not alert defendant to foreseeability of harm to plaintiff.* The checks were generally in amounts ranging from \$ 7,000 to \$ 13,000, and on several occasions two or three checks were accepted by defendant for deposit on a single day. Further, plaintiff contended that large checks made out to business entities are not normally negotiated for cash. However, the checks were business to business checks and regular on their face. Plaintiff, as maker, had firsthand knowledge of the amount and frequency of the checks, yet was unable to discover the scheme in a timely manner. Thus, it is difficult to see how these factors could constitute notice of possible fraud to defendant. (67 C.A.4th 1198.)

(b) *Indorsements did not indicate wrongdoing.* The indorsements were unorthodox in that they did not involve use of an indorsement stamp or include an indorsement guarantee, and included two handwritten indorsements, either the payee company's name with an individual's name below it, or an individual's name with the payee company's name below it. However, the checks were genuine in all particulars, the indorsers were authorized by the payees to indorse,

and the funds were paid to the payees designated by plaintiff. Thus, there was no "red flag which should have alerted respondents, or any bank or check cashing service in respondents' shoes, to the possibility of internal fraud." (67 C.A.4th 1199.)

(c) *Plaintiff was in best position to prevent harm.* Plaintiff was not defendant's customer, and defendant had no preexisting relationship with plaintiff that would have given it an opportunity to learn plaintiff's business or establish a connection with plaintiff's personnel or financial practices. Defendant did not interfere with plaintiff's ability to examine its canceled checks, draw conclusions concerning the indorsements, and put an end to the scheme. Plaintiff had the ability to police its own financial practices, to take steps to avoid being victimized by its employees, and to obtain insurance against harm of the type here. A considerable burden would be imposed on banks and their customers if banks had to inquire into the activities of both the makers and payees of checks regarding the possibility of internal fraud, and the flow of commerce would be substantially impeded. (67 C.A.4th 1199.) In view of the sophistication of the scheme that victimized plaintiff, "it is unlikely that imposition of a duty of inquiry on institutions such as respondents would prevent future harm. Scoundrels who can defraud their own employers will no doubt also find means to deflect investigatory telephone calls from collecting banks and check cashing services." (67 C.A.4th 1200.)

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aa. In General.

4 Witkin Sum. Cal. Law Neg Inst § 99

[§ 99] In General.

(1) *Method of Sending Item.* A collecting bank must send items by a reasonably prompt method, taking into consideration relevant instructions, the nature of the item, the number of those items on hand, the cost of collection involved, and the method generally used by it or others to present those items. (U.C.C. 4204(a).) To preserve flexibility, U.C.C. 4204(a) avoids prescribing limited or precise methods of sending or forwarding items. (Official Comment 1; see Brady (Bailey) §11.10.)

(2) *To Whom Items Are Sent.* A collecting bank may send an item directly to the payor bank (U.C.C. 4204(b)(1)), through direct mail, express, messenger, or like presentment (Official Comment 2). It may send an item to a nonbank payor if authorized by its transferor or by Federal Reserve regulation or operating circular, clearing house rule, or the like. (U.C.C. 4204(b)(2), (b)(3).) This permits direct forwarding of items such as insurance loss drafts drawn by field agents on home offices. (Official Comment 3.) Documentary drafts, however, cannot be sent to a nonbank payor unless properly authorized by the transferor. (U.C.C. 4204(b)(2), (b)(3).)

(3) *Where Presentment Is Made.* Presentment may be made by a presenting bank at a place where the payor bank or other payor has requested that presentment be made. (U.C.C. 4204(c).) U.C.C. 3501(b) (supra, §59) specifies where presentment may be made, and is expressly subject to Division 4. (Official Comment 4 to U.C.C. 4204; see Brady (Bailey) §14.05 et seq.)

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bb. Presentment of Item Not Payable by, Through, or at Bank.

4 Witkin Sum. Cal. Law Neg Inst § 100

[§ 100] Presentment of Item Not Payable by, Through, or at Bank.

(1) *Collecting Bank's Duties.* Unless otherwise instructed, a collecting bank may present an item not payable by, through, or at a bank by sending a written notice to the party to accept or pay. The notice must state that the bank holds the item for acceptance or payment, and must be sent in time to be received on or before the day when presentment is due. The bank must meet the party's requirements to accept or pay under U.C.C. 3501 (supra, §59) by the close of the bank's next banking day after it knows of the requirement. (U.C.C. 4212(a).) Thus, a bank presenting an instrument must be close enough to the drawee to be able to exhibit the instrument by the business day after it is requested to do so. (Official Comment 3; on requirement that presenting party exhibit instrument, see U.C.C. 3501(b)(2), supra, §59.)

U.C.C. 4212 codifies the common practice in presentation of trade acceptances and documentary and other drafts drawn on nonbank payors. (Official Comment 1.) A drawee not receiving notice is not liable to the drawer for wrongful dishonor. (Official Comment 2.)

(2) *Treating Item as Dishonored.* If a presenting bank makes presentment by notice, it should receive payment, acceptance, or a request for compliance with a requirement under U.C.C. 3501 by the close of business on the day after maturity or, in the case of demand items, by the close of business on the third banking day after notice was sent. If it does not, the presenting bank may treat the item as dishonored and charge any drawer or indorser by sending it notice of the facts. (U.C.C. 4212(b).)

SUPPLEMENT: [This section is current through the latest supplement]



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b. Duties of Collecting Banks.

3. Liability of Collecting Bank to Drawer.

4 Witkin Sum. Cal. Law Neg Inst § 101

[§ 101] Liability of Collecting Bank to Drawer.

(1) *Former Law Prohibiting Cause of Action.* Under former California law, a drawer had no direct right of action against a depository or collecting bank that negotiated a check on a forged indorsement. The underlying theory was that the liability of the collecting bank arose from its implied warranty of the indorsement, that this liability was founded on contract, and that there was no contractual relation between the drawer and the collecting bank. (See *California Mill Supply Corp. v. Bank of America (1950)* 36 C.2d 334, 339, 223 P.2d 849; *Metropolitan Life Ins. Co. v. San Francisco Bank (1943)* 58 C.A.2d 528, 532, 136 P.2d 853.) The result was that the drawer pursued his or her remedies against the drawee bank that paid the check (see supra, §58, infra, §119), while the drawee bank in turn pursued its remedies against the collecting bank to whom it paid, with the loss ultimately falling on the depository bank that initially negotiated the check (see infra, §104).

(2) *Direct Cause of Action.* The rule was reexamined in *Allied Concord Financial Corp. v. Bank of America (1969)* 275 C.A.2d 1, 80 C.R. 622. Plaintiff made a check payable to S. An imposter intercepted it, forged the indorsement, and cashed it at defendant City Bank. Bankers Trust, the drawee, thereafter paid the check and charged the drawer's account. By the time plaintiff discovered the forgery, the 1-year statute of limitations (now U.C.C. 4406(f), infra, §130) had run on its claim against the drawee. Plaintiff therefore sued City Bank, the depository, on theories of warranty and conversion. *Held*, judgment for defendant on demurrer affirmed. Although the drawer had a direct cause of action against the depository bank, its claim was barred by the statute of limitations.

(a) *Breach of warranty.* On third-party beneficiary principles, the depository bank's warranty of genuineness of prior indorsements (see infra, §103) extended by implication to the drawer of the check. Thus "direct suit by the drawer against a depository bank is authorized under the Commercial Code." This result avoids circuitry of action by permitting suit by the party suffering the loss against the bank that first honored the forged indorsement. (275 C.A.2d 4.)

However, the drawer's action on contract was barred by limitations, whether brought against the drawee, the collecting bank, or the depository bank. (275 C.A.2d 7.) A drawer has a primary claim against his or her own drawee that improperly charged the drawer's account, following which the drawee can recoup from the collecting bank that warranted genuineness of the indorsement. But the drawer's right against a collecting bank is a secondary claim derived

from the drawee's rights against the collecting bank. Because the statute of limitations had run on the drawer's primary claim, the drawee was not liable to the drawer, the drawee therefore had no claim against the collecting bank, and consequently there was no right from which the drawer's secondary claim could be derived. (275 C.A.2d 5.)

"To summarize, the drawer enjoys the benefit of warranties extended by prior banks to the drawee bank, but he also remains subject to his statutory duties arising from his relationship with the drawee bank, and the depository bank, as a third-party beneficiary, is entitled to the benefit of the performance of these duties. Thus while the drawer is entitled to the benefit of the warranty of the genuineness of the endorsement given by the depository bank to the drawee bank, the depository bank in turn is entitled to the benefit of the performance of the drawer's statutory and contractual duties owed to the drawee bank to timely discover forged endorsements or suffer the charge against his account to stand." (275 C.A.2d 8.)

(b) *Conversion*. The drawer had no cause of action for conversion because it was not immediately injured by the wrongful payment of the check. The drawer may never be charged with the loss because the drawee may not honor the forged indorsement, or it may do so but never charge the drawer's account. In other words, when the depository or collecting bank pays money on a forged indorsement it has merely parted with its own funds and has not harmed the drawer. Conversion does not occur until the drawee bank charges the drawer's account, and then the action lies only against the drawee. (275 C.A.2d 7, 8.) (See *Sun 'N Sand v. United Calif. Bank* (1978) 21 C.3d 671, 681, 148 C.R. 329, 582 P.2d 920 [following *Allied Concord*]; *E.F. Hutton & Co. v. City Nat. Bank* (1983) 149 C.A.3d 60, 70, 196 C.R. 614; 31 *Hastings L. J.* 221 [criticizing *Sun 'N Sand*]; 69 A.L.R.4th 778 [liability of bank for diversion to presenter or third party of proceeds of check drawn to bank's order by drawer not indebted to bank]; Cal. Civil Practice, 4 Business Litigation, §49:21 et seq.)

In *Sehremelis v. Farmers & Merchants Bank* (1992) 6 C.A.4th 767, 7 C.R.2d 903, plaintiffs borrowed money to finance construction and deposited it in a construction account at the lending bank. Using allegedly fraudulent documents, the construction manager caused the lender to issue checks from the construction account to unauthorized subcontractors. The checks were then negotiated at defendant collecting bank with allegedly forged or unauthorized indorsements. Plaintiffs sued on a variety of theories, and defendant's demurrer was sustained. *Held*, reversed. The complaint stated causes of action for breach of warranty and negligence.

(a) *Breach of warranty*. Under former U.C.C. 4207 (now amended U.C.C. 4207, *infra*, §103), a collecting bank that obtains payment of a check warrants to the payor bank or other payor that the collecting bank has good title or is authorized to act on behalf of one who has good title. This warranty refers to the validity of the chain of necessary indorsements and imposes strict liability on the collecting bank, which is best able to assure the validity of indorsements. (6 C.A.4th 773.) Here, plaintiffs are "other payors" for purposes of U.C.C. 4207. Although the lending bank was technically both the drawer and the drawee, it acted in part as their agent, and paid the checks from their account. (6 C.A.4th 774.)

(b) *Negligence*. A collecting bank owes the drawer a duty of care in handling and depositing checks to take reasonable steps to insure the validity of indorsements. Although plaintiffs were not technically drawers, they occupy a similar position: the lending bank drew the checks on their accounts and on their behalf and they were within the "danger zone" of loss. (6 C.A.4th 775.) The pleaded facts justify a duty of care between the parties and the cause of action is legally sufficient against the demurrer. (6 C.A.4th 776.)

(c) *Conversion*. Plaintiffs cannot state a cause of action for conversion. Under *Allied Concord Financial Corp.*, and *Sun 'N Sand*, any right of conversion here would be against the drawee bank, not the collecting bank. (6 C.A.4th 776.)

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1. Depository Bank.

4 Witkin Sum. Cal. Law Neg Inst § 102

[§ 102] Depository Bank.

If a customer delivers an item to a depository bank for collection, the depository bank warrants that the amount of the item was paid to the customer or deposited to the customer's account. This warranty is made to collecting banks, the payor bank or other payor, and the drawer. (U.C.C. 4205(b).)

SUPPLEMENT: [This section is current through the latest supplement]

See *Mills v. U.S. Bank (2008) 166 C.A.4th 871, 884, 885, 83 C.R.3d 146* [U.C.C. 4205(b) does not create warranty that depository bank paid, or made deposit in favor of, *payee* of check, not just bank's customer; term "customer," defined in U.C.C. 4104(a)(5) (text, §89), is not synonymous with payee of check].



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2. Transfer.

4 Witkin Sum. Cal. Law Neg Inst § 103

[§ 103] Transfer.

(1) *Transfer Between Banks.* Any agreed method that identifies the transferor bank is sufficient for the item's further transfer to another bank. (U.C.C. 4206.) Hence, the simplest possible form of transfer from one bank to another is permissible. If the transfer is between banks, U.C.C. 4206 replaces the more formal requirements of U.C.C. 3201, *supra*, §20. (Official Comment.)

(2) *Nature of Transfer Warranties.* A customer or collecting bank that transfers an item and receives a settlement or other consideration warrants the following:

(a) The warrantor is entitled to enforce the item. (U.C.C. 4207(a)(1).)

(b) All signatures on the item are authentic and authorized. (U.C.C. 4207(a)(2); see *11 Am.Jur.2d (1997 ed.), Banks and Financial Institutions §920.*)

(c) The item has not been altered. (U.C.C. 4207(a)(3).)

(d) The item is not subject to a defense or claim in recoupment under U.C.C. 3305(a) against the warrantor. (U.C.C. 4207(a)(4).)

(e) The warrantor has no knowledge of any insolvency proceeding commenced with respect to the maker or acceptor or, in the case of an unaccepted draft, the drawer. (U.C.C. 4207(a)(5).)

(f) If the item is a demand draft, the person identified as drawer has authorized the item's creation according to the terms on its face. (U.C.C. 4207(a)(6).) If this warranty is not given by a transferor or collecting bank under applicable conflict of law rules, then the warranty is not given to that transferor when that transferor is a transferee nor to any prior collecting bank of that transferee. (U.C.C. 4207(f).)

(3) *Obligation To Pay.* For the most part, U.C.C. 4207 conforms to U.C.C. 3416 (*supra*, §49) and extends its coverage to items. However, U.C.C. 4207(b) provides that customers or collecting banks transferring items and

receiving settlement or other consideration undertake to pay any items that are dishonored. The transferor must pay the amount due on the item according to the terms of the item at the time it was transferred, or, if the transfer was of an incomplete item, according to its terms when completed as stated in U.C.C. 3115 (supra, §16) and U.C.C. 3407 (supra, §55). The transferor owes this obligation to the transferee and to any subsequent collecting bank that takes the item in good faith. (U.C.C. 4207(b).)

(4) *Enforcing Warranties.* The transfer warranties are made to the transferee and to any subsequent collecting bank. (U.C.C. 4207(a).) Those persons, if they took the item in good faith, may recover from the warrantor as damages for breach of warranty an amount equal to the loss suffered as a result of the breach. They may not, however, recover more than the amount of the item plus expenses and loss of interest incurred as a result of the breach. (U.C.C. 4207(c).) A cause of action for breach of a transfer warranty accrues when the claimant has reason to know of the breach. (U.C.C. 4207(e).) (See *Allied Concord Financial Corp. v. Bank of America (1969) 275 C.A.2d 1, 3, 80 C.R. 622*, supra, §101 [drawer of check may be third-party beneficiary of the warranties imposed by former U.C.C. 4207(1), predecessor to U.C.C. 4207(a)].)

(5) *Disclaiming Warranties.* The transfer warranties cannot be disclaimed with respect to checks. (U.C.C. 4207(d).) Moreover, a transferor cannot disclaim its obligation to pay under U.C.C. 4207(b), supra, by an indorsement stating that it is made "without recourse" or otherwise disclaiming liability. (U.C.C. 4207(b).)

(6) *Discharging Warranties.* A warrantor must be given notice of a claim for breach of warranty within 30 days after the claimant has reason to know of the breach and the warrantor's identity. Otherwise, the warrantor is discharged to the extent of any loss caused by the delay in giving notice. (U.C.C. 4207(d).)

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3. Presentment.

4 Witkin Sum. Cal. Law Neg Inst § 104

[§ 104] Presentment.

(1) *Presentment Warranties to Drawee.* If an unaccepted draft is presented to the drawee for payment or acceptance and the drawee pays or accepts it in good faith, the drawee receives certain presentment warranties. (U.C.C. 4208(a); see Brady (Bailey) §12.08 et seq.) Specifically, the person obtaining payment or acceptance, at the time of presentment, and a previous transferor of the draft, at the time of transfer, warrant the following:

(a) The warrantor is, or was at the time of transfer, entitled to enforce the draft or authorized to obtain payment or acceptance on behalf of a person entitled to enforce it. (U.C.C. 4208(a)(1); see *Sun 'N Sand v. United Calif. Bank* (1978) 21 C.3d 671, 684, 148 C.R. 329, 582 P.2d 920; *Joffe v. United Calif. Bank* (1983) 141 C.A.3d 541, 549, 190 C.R. 443; *Campbell v. Bank of America* (1987) 190 C.A.3d 1420, 1425, 235 C.R. 905 [bank did not breach title warranty of former U.C.C. 4207(1)(a) (now U.C.C. 4208(a)(1)) where indorsement of checks payable to first corporation, but indorsed by second corporation and deposited into second corporation's account, was authorized by first corporation].)

(b) The draft has not been altered. (U.C.C. 4208(a)(2).)

(c) The warrantor has no knowledge that the drawer's signature is unauthorized. (U.C.C. 4208(a)(3).)

(d) If the draft is a demand draft, the person identified as drawer authorized its creation according to the terms on its face. (U.C.C. 4208(a)(4).) If a transferor does not give this warranty under applicable conflict of law rules, then the warranty is not given to that transferor when that transferor is a transferee. (U.C.C. 4208(h).)

(2) *Presentment Warranties to Drawer, Indorser, or Other Obligor.* A presentment warranty is created when the drawer or an indorser of a dishonored draft pays it on presentment or when a party obliged to pay any other item pays it on presentment. The person obtaining payment and a prior transferor of the item warrant to the person making payment in good faith that the warrantor is, or was at the time of transfer, entitled to enforce the item or authorized to obtain payment on behalf of a person entitled to enforce it. (U.C.C. 4208(d).)

(3) *Consequences of Breach of Warranty.* A cause of action for breach of warranty accrues when the claimant has

reason to know of the breach. (U.C.C. 4208(f).)

(a) *Where warranty is to drawee who pays.* The drawee may recover, as damages for breach of warranty, the amount the drawee paid less the amount the drawee received or is entitled to receive from the drawer because of the payment. In addition, the drawee is entitled to compensation for expenses and loss of interest resulting from the breach. The drawee's right to recover damages is not affected by any failure of the drawee to exercise ordinary care in making payment. (U.C.C. 4208(b).)

If the drawer's conduct contributed to a loss from forgery or alteration, the drawee may not shift the loss from the drawer to the warrantor. (See U.C.C. 4208(c).)

(b) *Where warranty is to drawee who accepts.* If the drawee accepts the draft, breach of warranty is a defense to the acceptor's obligation. If the acceptor pays the draft, the acceptor is entitled to recover the amount the acceptor paid less the amount the acceptor received or is entitled to receive from the drawer because of the payment. In addition, the acceptor is entitled to compensation for expenses and loss of interest resulting from the breach. (U.C.C. 4208(b).)

(c) *Where warranty is to obligor other than drawee.* A person making payment under U.C.C. 4208(d) may recover an amount equal to the amount paid plus expenses and loss of interest resulting from the breach. (U.C.C. 4208(d).)

(4) *Disclaimer and Discharge.* The presentment warranties cannot be disclaimed with respect to checks. (U.C.C. 4208(e).) Furthermore, the warrantor must receive notice of a claim for breach of warranty within 30 days after the claimant has reason to know of the breach and the warrantor's identity. Otherwise, the warrantor's liability is discharged to the extent of any loss caused by the delay in giving notice. (U.C.C. 4208(e).)

(5) *Relation to Division 3.* U.C.C. 4208 conforms to U.C.C. 3417 (supra, §50), and extends its coverage to items. (Official Comment.)

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4. Encoding and Retention.

4 Witkin Sum. Cal. Law Neg Inst § 105

[§ 105] Encoding and Retention.

(1) *Encoding.* A person who encodes information on or with respect to an item after issue warrants that the information is correctly encoded. If the customer of a depository bank encodes, that bank also makes the warranty. (U.C.C. 4209(a).)

(2) *Effect of Miscoding.* A miscoding is not an alteration under U.C.C. 3407(a) (*supra*, §55), which defines alteration as changing the parties' contract. If the encoded amount is more than the check amount, the payor bank may debit the drawer's account only for the proper amount and may hold the depository bank liable for the amount paid over the proper amount, without first pursuing the person who received payment. Intervening collecting banks would not be liable. (Official Comment 2.)

If the encoded amount is less than the check amount, the payor bank is liable for the full amount, and its right against the depository bank depends on whether it has suffered a loss, which occurs only to the extent the drawer's account is less than the full amount. Before taking action against the depository bank for breach of warranty, the payor bank need not pursue collection against the drawer beyond the amount in the drawer's account. (Official Comment 2.)

(3) *Retention.* A person who retains an item under a electronic presentment agreement warrants that retention and presentment of the item comply with the agreement. If a customer of a depository bank undertakes to retain an item, that bank also makes this warranty. (U.C.C. 4209(b); Official Comment 3; on electronic presentment agreements, see *supra*, §93.)

(4) *Enforcing Warranties.* The encoding and retention warranties are made to any subsequent collecting bank and to the payor bank or other payor. (U.C.C. 4209(a), (b).) If a person to whom the warranties are made took an item in good faith, the person may recover from the warrantor as damages for breach of warranty an amount equal to the loss suffered as a result of the breach, plus expenses and loss of interest incurred as a result of the breach. (U.C.C. 4209(c).)

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d. Collecting Bank's Security Interest.

4 Witkin Sum. Cal. Law Neg Inst § 106

[§ 106] Collecting Bank's Security Interest.

(1) *Bank's Acquisition of Security Interest.* A collecting bank has a security interest in an item, any accompanying documents, or the proceeds of either the item or the documents if the bank makes an advance on or against the item. (U.C.C. 4210(a)(3).) In addition, when an item has been deposited in an account, the bank has a security interest to the extent to which credit given for the item has been withdrawn or applied. (U.C.C. 4210(a)(1).) Finally, if a bank has given credit available for withdrawal as of right for an item, the bank has a security interest to the extent of the credit given, whether or not the credit is drawn on or there is a right of chargeback. (U.C.C. 4210(a)(2).)

U.C.C. 4210(a) is not in derogation of a banker's general common law lien or right of setoff against indebtedness owing in deposit accounts. (See *supra*, §82 et seq.) It implements and extends the principle as part of the bank collection process. (Official Comment 1; see *10 Am.Jur.2d (1997 ed.), Banks and Financial Institutions §859.*)

(2) *Extent of Security Interest.* If credit given for several items received at one time or under a single agreement is withdrawn or applied in part, the security interest remains on all the items, any accompanying documents, or the proceeds of either. Credits first given are first withdrawn. (U.C.C. 4210(b).) Thus, the bank's security interest is spread over all items in a single deposit, or all items received under a single agreement and a single giving of credit. (Official Comment 2; see *10 Am.Jur.2d (1997 ed.), Banks and Financial Institutions §859.*)

(3) *Relation to Division 9.* U.C.C. 4210(c) correlates the security interest with the provisions of Division 9 (U.C.C. 9101 et seq., 4 *Summary* (10th), *Secured Transactions in Personal Property*, §21 et seq.), which may be useful in cases of noncollection. (Official Comment 3.) In particular, a collecting bank realizes on its security interest in the item, accompanying documents, and proceeds when it receives a final settlement for the item. As long as the bank does not receive final settlement for the item or give up possession of the item or accompanying documents for purposes other than collection, the security interest continues to that extent and is subject to Division 9. (U.C.C. 4210(c).) However, no security agreement is necessary to make the security interest enforceable. (U.C.C. 4210(c)(1); on enforceability of security interests, see U.C.C. 9203(b), 4 *Summary* (10th), *Secured Transactions in Personal Property*, §50.) Moreover, no filing is required to perfect the security interest (U.C.C. 4210(c)(2)), and the security interest has priority over conflicting perfected security interests in the item, accompanying documents, or proceeds (U.C.C. 4210(c)(3)). (See *10 Am.Jur.2d (1997 ed.), Banks and Financial Institutions §§859, 863, 864.*)

(4) *Effect of Interest on Bank's Status as Holder in Due Course.* For purposes of determining its status as a holder in due course, a bank has given value to the extent that it has a security interest in an item. The bank must also comply with the other requirements for being a holder in due course. (U.C.C. 4211; see *Bank of Costa Mesa v. Losack* (1977) 74 C.A.3d 287, 293, 141 C.R. 550 [security interest of collecting bank and its status as holder in due course]; on other requirements, see U.C.C. 3302, supra, §27 et seq.)

West's Key Number Digest, Banks and Banking k.134 et seq.

SUPPLEMENT: [This section is current through the latest supplement]

(3) *Relation to Division 9.* U.C.C. 4210(c) was amended in 2006. It now provides that the bank should not give up possession or control of accompanying documents, rather than just possession.



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e. Settlement and Payment.

1. Medium and Time of Settlement.

4 Witkin Sum. Cal. Law Neg Inst § 107

[§ 107] Medium and Time of Settlement.

(1) *General Rule.* Federal Reserve regulations or circulars, clearing house rules, or agreement may prescribe the medium and time of settlement by a bank. If not, the medium of settlement is cash or credit to an account in a federal reserve bank specified by the person to receive settlement. (U.C.C. 4213(a)(1); see Brady (Bailey) §17.02.) The time of settlement is as follows:

(a) With respect to tender of settlement by cash, a cashier's check, or teller's check, when the cash or check is sent or delivered. (U.C.C. 4213(a)(2)(A).)

(b) With respect to tender of settlement by credit in an account in a federal reserve bank, when the credit is made. (U.C.C. 4213(a)(2)(B).)

(c) With respect to tender of settlement by a credit or debit to an account in a bank, when the credit or debit is made or, in the case of tender of settlement by authority to charge an account, when the authority is sent or delivered. (U.C.C. 4213(a)(2)(C).)

(d) With respect to tender of settlement by a funds transfer, when payment is made under U.C.C. 11406 to the person receiving settlement. (U.C.C. 4213(a)(2)(D); on Division 11 (U.C.C. 11101 et seq.), see *infra*, §132 et seq.)

(2) *Exceptions.* In the unusual case where there is no agreement on the medium of settlement and the bank tenders settlement other than cash or Federal Reserve bank credit, no settlement has occurred unless the recipient accepts the settlement tendered. The time of settlement is deemed to be the time the settlement is accepted by the person receiving it. (U.C.C. 4213(b); Official Comments 1 and 2.)

(3) *Settlement by Remittance.* If settlement for an item is made by cashier's check or teller's check and the person receiving settlement, before its midnight deadline, presents or forwards the check for collection, settlement is final when the check is finally paid. (U.C.C. 4213(c)(1); on relationship between final settlement and final payment, see U.C.C. 4215(b), *infra*, §108.) If the person fails to present or forward the check for collection before its midnight deadline,

settlement is final at the midnight deadline of the person receiving settlement. (U.C.C. 4213(c)(2); for definition of "midnight deadline," see *supra*, §89.)

(4) *Settlement by Authority To Charge Account.* If settlement is made by giving the receiving bank authority to charge the account of the bank giving settlement, settlement is final when the receiving bank makes the charge, as long as there are sufficient funds available in the account. (U.C.C. 4213(d); on relationship between final settlement and final payment, see U.C.C. 4215(b), *infra*, §108.)

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e. Settlement and Payment.

2. Provisional and Final Payments.

4 Witkin Sum. Cal. Law Neg Inst § 108

[§ 108] Provisional and Final Payments.

(1) *When Settlement Constitutes Final Payment.* A payor bank makes final payment on an item by paying the item in cash. (U.C.C. 4215(a)(1); see Brady (Bailey) §15.02 et seq.) Thus, if an item deposited for collection in one state moves through several states to a payor bank, final payment does not take place on the journey of the item to the payor bank, nor does it occur on the journey of the proceeds back to the bank where it was deposited for collection. (Official Comment 2.)

The payor bank also finally pays an item by settling for the item without having a right to revoke the settlement under statute, clearing house rule, or agreement. (U.C.C. 4215(a)(2).) A payor bank cannot make a settlement provisional by unilaterally reserving a right to revoke the settlement. The right must come from statute, clearing house rule, or other agreement, for example, the deferred posting right conferred by U.C.C. 4301 (infra, §115). If an item has been presented over the counter for immediate payment, final payment has occurred unless a rule or agreement provides otherwise. (Official Comment 4.)

Finally, the payor bank makes final payment by making a provisional settlement for the item and failing to revoke the settlement in the time and manner permitted by statute, clearing house rule, or agreement. (U.C.C. 4215(a)(3).) With respect to checks, Regulation CC §229.30(c) allows an extension of the midnight deadline under certain circumstances. Also, if a bank does not expeditiously return a check, liability may accrue under Regulation CC §229.38. (Official Comment 7.) (See *Pupko v. Bank of America (1981) 114 C.A.3d 495, 499, 501, 170 C.R. 615* [mere recording or posting activities do not constitute payment]; *23 A.L.R.4th 203* [what constitutes final payment under former Unif.Com.C. 4-213 (now Unif.Com.C. 4-215)]; for definition of "midnight deadline," see supra, §89.)

If provisional settlement for an item does not become final, the item is not finally paid. (U.C.C. 4215(b).) Hence, if a payor bank makes provisional settlement for an item by sending a cashier's or teller's check and that settlement fails to become final under U.C.C. 4215(c) (infra, this section), final payment has not occurred. If the item is not paid, the drawee remains liable and the payor bank is accountable unless it has returned the item before its midnight deadline. In this regard, U.C.C. 4215(b) is an exception to U.C.C. 4215(a)(3). (Official Comment 8.)

(2) *Importance of Final Payment.* Final payment is important for a number of reasons:

- (a) It is a factor for determining relative priorities between items and notices, stop-payment orders, legal process, and setoffs under U.C.C. 4303, *infra*, §118.
- (b) It is the end of the collection process and the point commencing the return flow of proceeds.
- (c) It is the point at which many provisional settlements become final under U.C.C. 4215(c), *infra*, this section.
- (d) Final payment by a payor bank fixes preferential rights under U.C.C. 4216, *infra*, §111. (Official Comment 1.)

(3) *"Firming Up" Provisional Settlements.* If provisional settlement for an item between the presenting and payor banks is made through a clearing house or by debits or credits in an account between them, then to the extent that provisional debits or credits for the item are entered in accounts between the presenting and payor banks or between the presenting and successive prior collecting banks *seriatim*, they become final when the payor bank makes final payment of the items. (U.C.C. 4215(c).) This provision states the nationwide usage that when the item is finally paid by the payor bank under U.C.C. 4215(a), the final payment automatically "firms up" other provisional settlements made for it. (Official Comment 9.)

(4) *Collecting Bank's Accountability to Customer.* If a collecting bank receives a settlement for an item that is or becomes final, the bank is accountable to its customer for the amount of the item. Any provisional credit given for the item in an account with its customer becomes final. (U.C.C. 4215(d).) One means of accounting is to remit to the customer the amount received on the item. If the bank previously gave the customer a provisional credit for the item in an account, receipt of final settlement for the item "firms up" the provisional credit and makes it final. When this credit becomes final, the bank's agency status usually terminates and it becomes a debtor to its customer for the amount of the item. (Official Comment 10.)

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4 Witkin Sum. Cal. Law Neg Inst § 109

[§ 109] Availability of Funds for Withdrawal by Customer.

(1) *Credits*. Credit given by a bank for an item in a customer's account becomes available for withdrawal as of right when a provisional settlement received by the bank becomes final, the bank has had reasonable time to receive return of the item, and the item has not been received within that time. (U.C.C. 4215(e)(1).) The amount of time considered "reasonable" depends on the identity and location of the payor of the remittance instrument, the means for clearing the instrument, and other pertinent facts. (Official Comment 11.)

If the bank is both the depository bank and the payor bank, and the item is finally paid, the credit becomes available for withdrawal at the opening of the bank's second banking day following receipt of the item. (U.C.C. 4215(e)(2).) This avoids uncertainty and possible disputes between the bank and its customers as to exactly what hour of the day credit for a deposit becomes available. (Official Comment 12.)

(2) *Deposits*. As a general rule, a deposit of money becomes available for withdrawal as of right at the opening of the bank's next banking day after receipt of the deposit. (U.C.C. 4215(f).) The rules stated in U.C.C. 4215(e) and (f) are subject to applicable law stating a time for availability of funds and the bank's right to apply the credit or deposit to an obligation of the customer. (U.C.C. 4215(e), (f).)

Fin.C. 867 provides for expedited availability of funds deposited in an account. Funds deposited in an account at a depository institution in the form of a cashier's check, certified check, teller's check, or depository check must be available on the second business day after the business day they were deposited. (*Fin.C. 867(a)*.) However, this requirement applies only under the following conditions:

- (a) The check is indorsed only by the person to whom it was issued. (*Fin.C. 867(a)(1)*.)
- (b) The check is deposited in a receiving depository institution that is staffed by individuals employed by that institution. (*Fin.C. 867(a)(2)*.)
- (c) The check is deposited with a special deposit slip indicating that it is a cashier's check, certified check, teller's

check, or depository check. (*Fin.C. 867(a)(3).*)

(d) The check is deposited into an account of a customer that has maintained an account with the receiving depository institution for at least 60 days. (*Fin.C. 867(a)(4).*)

(e) The check is for \$ 5,000 or less. (*Fin.C. 867(a)(5).*)

Where the aggregate amount of checks deposited on any business day exceeds \$ 5,000, *Fin.C. 867(a)* applies only to the first \$ 5,000. (*Fin.C. 867(a)*; for definitions of "account," "business day," "cashier's check," "certified check," "depository check," "depository institution," and "teller's check," see *Fin.C. 867(c).*)

(3) *Exception for Uncollectible Checks.* *Fin.C. 867(a)* does not apply where the receiving depository institution reasonably believes that the check is uncollectible from the originating depository institution. "Reasonable cause to believe" that a check is uncollectible includes, but is not limited to, a belief that (a) the drawer or drawee of the check has been or will imminently be adjudicated as bankrupt or placed in receivership, or (b) the check may be involved in a fraud or "kiting" scheme. A depository institution reasonably believing that a check is uncollectible must notify the drawer and drawee not later than the close of the next business day following deposit of the check. (*Fin.C. 867(b).*)

(4) *Relation to Federal Act.* If a similar provision in the federal Expedited Funds Availability Act (12 U.S.C., §4001 et seq.) is suspended or modified, the effect of *Fin.C. 867* is similarly suspended or modified. (*Fin.C. 867(e)*; see 35 U.C.L.A. L. Rev. 1115 [federal act].)

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4 Witkin Sum. Cal. Law Neg Inst § 110

[§ 110] Failure To Receive Final Settlement.

(1) *Causes for Absence of Final Settlement.* A collecting bank may fail to receive final settlement for an item because of dishonor, suspension of payments by a bank, or otherwise. (U.C.C. 4214(a); Official Comment 2.)

(2) *Collecting Bank's Options.* If a collecting bank has made provisional settlement with its customer for an item and fails to receive final settlement, the bank may revoke the settlement it gave, charge back the amount of any credit given for the item to its customer's account, or obtain refund from its customer, whether or not it is able to return the item. The bank must, by its midnight deadline or within a longer reasonable time after it learns the facts, return the item or send notification of the facts. (U.C.C. 4214(a); for definition of "midnight deadline," see supra, §89.) The bank, in a good faith effort to secure payment of an item, other than a check, may waive, modify, or extend this time limit for up to 2 additional banking days without discharge of drawers or indorsers or liability to its transferor or a prior party. (U.C.C. 4109(a).)

These rights to revoke, charge back, and obtain refund terminate if and when a settlement for the item received by the bank is or becomes final. (U.C.C. 4214(a).) Failure to charge back or claim refund does not affect the bank's other rights against the customer or any other party. (U.C.C. 4214(e).)

(3) *Effect of Delayed Return.* If the return or notice is delayed beyond the bank's midnight deadline or a longer reasonable time after it learns the facts, the bank may still revoke the settlement, charge back the credit, or obtain refund from its customer, but it is liable for any loss resulting from the delay. (U.C.C. 4214(a).) Moreover, delay is excused if (a) the delay is caused by interruption of communication or computer facilities, suspension of payments by another bank, war, emergency conditions, failure of equipment, or other circumstances beyond the control of the bank, and (b) the bank exercises such diligence as the circumstances require. (U.C.C. 4109(b).) The burden of proof of diligence is on the bank. (Official Comment 3.)

(4) *Method of Return.* A collecting bank returns an item when it is sent or delivered to the bank's customer or transferor or pursuant to its instructions. (U.C.C. 4214(b).) U.C.C. 4214(b) applies only to noncheck items; Regulation CC §229.31 preempts U.C.C. 4214(b) with respect to checks by allowing direct return to the depository bank. (Official

Comment 4.)

(5) *Depository Bank's Options.* A depository bank that is also the payor may charge back the amount of an item to its customer's account or obtain refund in accordance with U.C.C. 4301 (infra, §115), governing return of an item received by a payor bank for credit on its books. (U.C.C. 4214(c).) Failure to charge back or claim refund does not affect the bank's other rights against the customer or any other party. (U.C.C. 4214(e).)

(6) *Effect of Other Events on Right To Charge Back.* The right to charge back is not affected by previous use of a credit given for the item. (U.C.C. 4214(d)(1).) Moreover, a charge-back is permitted even if nonpayment results from the bank's failure to exercise ordinary care with respect to the item. (U.C.C. 4214(d)(2).) The customer is protected by the bank's general obligation of good faith. (Official Comment 5.) Moreover, the bank remains liable for its negligence. (U.C.C. 4214(d).)

(7) *Determining Exchange Rate for Charge-Back or Refund.* If credit is given in dollars for an item payable in foreign money, the dollar amount of any charge-back or refund is based on the bank-offered spot rate for the foreign money prevailing on the day when the person entitled to the charge-back or refund learns that it will not receive payment in ordinary course. (U.C.C. 4214(f).) If the parties wish to fix a different time for determining the exchange rate, they may do so by agreement. (Official Comment 7.)

(8) *Effect of Delayed Collections.* In *Symonds v. Mercury Savings & Loan Assn.* (1990) 225 C.A.3d 1458, 275 C.R. 871, plaintiff deposited into her account with defendant savings and loan association a check in excess of \$ 5,000 from a third party. For 44 days after plaintiff's deposit, the third party's account contained sufficient funds to cover the check. However, defendant failed to properly process and present the check, despite informing plaintiff that it had been collected. Eight months after plaintiff's deposit, defendant learned that there were insufficient funds in the third party's account. Defendant then placed three of plaintiff's accounts on hold, dishonored one of plaintiff's checks, and informed plaintiff that it would continue to dishonor checks unless plaintiff signed a promissory note for the amount previously credited to her. Plaintiff filed a complaint stating a number of causes of action, all of which were dismissed. *Held*, reversed as to plaintiff's causes of action for negligence and intentional infliction of emotional distress.

(a) *Charge-back of plaintiff's account.* Under former U.C.C. 4212 (now U.C.C. 4214), when a payor bank timely dishonors a check, the collecting bank has the right to charge back the amount provisionally credited, unless the item has become final. Here, the credit plaintiff received from defendant did not become final under former U.C.C. 4211 (now U.C.C. 4213, supra, §107) or former U.C.C. 4213 (now U.C.C. 4215, supra, §108); neither did the mere passage of time operate to render final the provisional credit. Former U.C.C. 4212, Comment 1 (now U.C.C. 4214, Comment 1), which states that provisional settlements can become final simply with the lapse of time, refers only to the fact that a provisional settlement often becomes a final settlement where there has been no further action denying payment. Further, (1) defendant complied with former U.C.C. 4212, which limits the time within which a collecting bank may charge back its customer's account after notice of dishonor; and (2) although a collecting bank may be estopped from charging back its customer's account where the bank has represented that the check was final, plaintiff alleged no estoppel. (225 C.A.3d 1465, 1466.)

(b) *Negligence cause of action.* Former U.C.C. 4212 permits a collecting bank to charge back its customer's account even where nonpayment resulted from the bank's own negligence. However, the bank must use ordinary care in presenting the check for collection. Here, plaintiff alleged that, had defendant handled the check properly, there would have been sufficient funds for final settlement. Thus, plaintiff stated a negligence cause of action under former U.C.C. 4103 (now amended U.C.C. 4103, supra, §87), and former 4212. The measure of damages is the amount of the check, reduced by any amount which could not have been realized by the use of ordinary care. In addition, if plaintiff can establish bad faith, she would also be entitled to recover any damages proximately caused by defendant's breach of its duty of care. (225 C.A.3d 1466, 1467.)

(c) *No cause of action for wrongful dishonor, conversion, or breach of quasi-fiduciary duty.* Former U.C.C.

4212(4) bars an action for wrongful dishonor based upon the charge back. (225 C.A.3d 1467.) Neither can an action for conversion be maintained, since the settlement never became final; thus, any money defendant debited from plaintiff's account was merely a revocation of the provisional settlement, and not a taking of plaintiff's personal property. Plaintiff cannot maintain an action for breach of a "quasi-fiduciary" duty, since the relationship between it and defendant was that of principal and agent, with U.C.C. 4202 imposing upon defendant a duty of ordinary care. (225 C.A.3d 1468.)

(d) *Cause of action for intentional infliction of emotional distress.* To maintain this action, plaintiff must be able to establish outrageous conduct. (See 5 Summary (10th), *Torts*, §451.) Such conduct was sufficiently alleged where defendant's manager knew plaintiff was elderly and that the charge back placed her in a difficult financial situation; where the manager was told that plaintiff's health had suffered due to the loss of the money, yet she continued to call plaintiff daily to pressure her into signing a promissory note, and to threaten to attach her funds; and where the manager continued to call plaintiff after she had been directed to speak only with plaintiff's attorney. (225 C.A.3d 1469.)

SUPPLEMENT: [This section is current through the latest supplement]

(9) *(New) Action for Negligent Misrepresentation.* The right of a collecting bank, under U.C.C. 4214, to charge back a customer's account when the bank fails to receive final settlement of an item does not preclude the customer from bringing an action against the bank for negligence or negligent misrepresentation. (*Holcomb v. Wells Fargo Bank* (2007) 155 C.A.4th 490, 497, 499, 502, 66 C.R.3d 142 [plaintiff customer stated cause of action for negligent misrepresentation against his bank, where bank's manager had assured plaintiff that plaintiff could write checks against check plaintiff had deposited with bank, even though manager allegedly knew that another bank had dishonored deposited check].)



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4 Witkin Sum. Cal. Law Neg Inst § 111

[§ 111] Effect of Insolvency.

(1) *Closed Bank's Obligation To Return Unpaid Item.* If a payor or collecting bank that suspends payment possesses an item that has not been finally paid, the receiver, trustee, or agent in charge of the closed bank must return the item to the presenting bank or the closed bank's customer. (U.C.C. 4216(a).)

(2) *Preferred Claim by Item's Owner.* If a payor bank finally pays an item and suspends payments without making a final settlement for the item with its customer or the presenting bank, the item's owner has a preferred claim against the payor bank. (U.C.C. 4216(b).) Similarly, if a collecting bank receives final settlement for an item from subsequent parties, and the bank suspends payments without making a final settlement with its customer, the item's owner has a preferred claim against the collecting bank. (U.C.C. 4216(d).)

(3) *Final Settlement After Suspension of Payments.* If a payor bank gives or a collecting bank gives or receives a provisional settlement for an item and thereafter suspends payments, the suspension does not prevent the settlement from becoming final if the finality occurs automatically after a certain time or the happening of certain events. (U.C.C. 4216(c).)

(4) *Applicability of Provisions.* The purpose of U.C.C. 4216 is to fix a cutoff point for completing collection of items that happen to be in the collection process when a particular bank suspends payments, not to confer preferential positions following bank failures. (Official Comment 1.) It does not apply to national banks. (Official Comment 3.)

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1. Handling of Documentary Drafts.

4 Witkin Sum. Cal. Law Neg Inst § 112

[§ 112] Handling of Documentary Drafts.

A bank that takes a documentary draft for collection must present the draft and accompanying documents or send them for presentment. If it learns that the draft has not been paid or accepted in due course, the bank must "seasonably" notify its customer of the fact, even though it may have discounted or bought the draft or extended credit available for withdrawal as of right. (U.C.C. 4501.) This notification duty exists even if the bank has bought the draft, because if the underlying commercial transaction is not going through as planned, the customer should know it promptly. (Official Comment.)

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See Clark, *The Law of Bank Deposits, Collections and Credit Cards* (Rev. ed.), Chap. 13.



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2. Presentment of "On Arrival" Drafts.

4 Witkin Sum. Cal. Law Neg Inst § 113

[§ 113] Presentment of "On Arrival" Drafts.

If a draft or the relevant instructions require presentment "on arrival," "when goods arrive" or the like, the collecting bank need not present until in its judgment a reasonable time for arrival of the goods has expired. Refusal to pay or accept because the goods have not arrived is not dishonor; the bank must notify its transferor of the refusal but need not present the draft again until it is instructed to do so or learns of the arrival of the goods. (U.C.C. 4502.)

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f. Collection of Documentary Drafts.

3. Presenting Bank's Responsibility for Documents and Goods.

4 Witkin Sum. Cal. Law Neg Inst § 114

[§ 114] Presenting Bank's Responsibility for Documents and Goods.

(1) *General Rule.* A bank presenting a documentary draft must deliver the documents to the drawee on acceptance of the draft if it is payable more than 3 days after presentment. Otherwise, the draft must be delivered only on payment. (U.C.C. 4503(a).) U.C.C. 4503 should be read in connection with U.C.C. 2514, 4 *Summary* (10th), *Sales*, §143, specifying when documents are deliverable on acceptance, and when on payment. (Official Comment 1.)

On dishonor, either in the case of presentment for acceptance or presentment for payment, the presenting bank may seek and follow instructions from any referee in case of need designated in the draft. If the presenting bank does not choose to utilize the referee's services, it must use diligence and good faith to ascertain the reason for dishonor, notify its transferor of the dishonor and of the results of its effort to ascertain the reasons for it, and request instructions. (U.C.C. 4503(b).)

The presenting bank is not, however, under any obligation with respect to goods represented by the documents, except to follow reasonable instructions "seasonably" received. It has a right to reimbursement for expenses incurred in following instructions and to prepayment of or indemnity for those expenses. (U.C.C. 4503.)

(2) *Exceptions.* The rules stated in U.C.C. 4503(a) and (b) do not apply where the presenting bank has been otherwise instructed. Moreover, a draft drawn under a letter of credit is governed by Division 5 (U.C.C. 5101 et seq., *infra*, §136 et seq.). (U.C.C. 4503; Official Comment 2.)

(3) *Action by Presenting Bank in Absence of Instructions.* A presenting bank that, following the dishonor of a documentary draft, has seasonably requested instructions but does not receive them within a reasonable time may store, sell, or otherwise deal with the goods in any reasonable manner. (U.C.C. 4504(a).) For its reasonable expenses incurred by doing so, the presenting bank has a lien on the goods or their proceeds, which may be foreclosed in the same manner as an unpaid seller's lien. (U.C.C. 4504(b).)

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a. Return of Items and Recovery of Payment.

4 Witkin Sum. Cal. Law Neg Inst § 115

[§ 115] Return of Items and Recovery of Payment.

(1) *Deferred Posting by Payor Bank.* If a payor bank settles for a demand item before midnight of the banking day of receipt, it may revoke and recover the settlement by either returning the item or sending written notice of dishonor or nonpayment if the item is unavailable for return. It may not exercise this option if the demand item is a documentary draft or an item presented for immediate payment over the counter. The bank must take this action before it has made final payment and before its midnight deadline. (U.C.C. 4301(a); on excuse for delay caused by circumstances beyond bank's control, see U.C.C. 4109(b), *supra*, §110; for definition of "midnight deadline," see *supra*, §89.)

Deferred posting allows a payor bank that has settled for an item on the day of receipt to return a dishonored item on the next day before its midnight deadline, without regard to when the item was actually posted. (Official Comment 1.) When U.C.C. 4301(a) applies, the payor bank has a statutory right to revoke settlement; thus, U.C.C. 4215(a)(2) (*supra*, §108) is inoperable and the settlement is provisional. (Official Comment 2; for illustration of relationship of U.C.C. 4301(a) to final settlement and final payment under U.C.C. 4215, see Official Comment 3 to U.C.C. 4301.)

(2) *"Unavailable for Return."* In *Lincoln Nat. Bank v. Dworsky (1990) 218 C.A.3d 852, 267 C.R. 361*, debtors had borrowed money from plaintiff bank, and subsequently defaulted after attempting to pay their loan with a check from a third party drawn on an account at payor bank. The payor bank dishonored the check due to insufficient funds, and was required under U.C.C. 4301 to either return the check, or send written notice of dishonor if the check was otherwise "unavailable for return," before midnight of the next business day after the day it had received the check. The payor bank was unable to locate the check as the midnight deadline approached, and therefore reported the check lost and sent a timely notice of dishonor, along with a photocopy of the check, to a bank operating as correspondent bank for plaintiff. Debtors cross-complained against the payor bank, alleging that it had failed to comply with U.C.C. 4301 and was therefore liable for the amount of the check. *Held*, the check was "unavailable for return" within the meaning of U.C.C. 4301.

(a) The payor bank was not required to prove that the check was permanently lost or destroyed. " 'Available' means 'immediately utilizable' ... or 'that can be got, had, or reached; handy; accessible.' " (*218 C.A.3d 857.*)

(b) "The check was unavailable within these meanings at the time for meeting the midnight deadline. As the

midnight deadline approached, [the payor bank's] employees could not find the check; it could not be 'had' or 'reached.' Since the check was not at that time 'handy' or 'immediately utilizable' for return, [the payor bank] met the midnight deadline by giving notice of dishonor instead." (218 C.A.3d 857.)

(3) *Where Payor Bank Is Also Depository Bank.* A payor bank that receives a demand item for credit on its books may return the item or send notice of dishonor and may revoke any credit given or recover the amount withdrawn by its customer. To do so, it must act within the time limit and in the manner specified in U.C.C. 4301(a). (U.C.C. 4301(b).) However, there is no requirement that settlement be on the day of receipt. (Official Comment 4.)

(4) *When Dishonor Occurs.* Unless previous notice of dishonor has been sent, an item is dishonored when, for purposes of dishonor, it is returned or notice is sent in accordance with U.C.C. 4301. (U.C.C. 4301(c).) An item presented through a clearing house is returned when it is delivered to the presenting or last collecting bank or to the clearing house or is sent or delivered in accordance with clearing house rules. (U.C.C. 4301(d)(1).) In all other cases, the item is returned when it is sent or delivered to the bank's customer or transferor or pursuant to his or her instructions. (U.C.C. 4301(d)(2).) U.C.C. 4301(d) assumes that the item has not been finally paid under U.C.C. 4215(a). (Official Comment 6.)

West's Key Number Digest, Banks and Banking k.156 et seq.

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b. Responsibility for Late Return of Item.

1. General Rule of Accountability.

4 Witkin Sum. Cal. Law Neg Inst § 116

[§ 116] General Rule of Accountability.

(1) *Demand Item.* A payor bank is accountable for the amount of a demand item, other than a documentary draft, if it retains the item beyond midnight of the banking day of receipt without settling for it. However, this provision does not apply if the payor bank is also the depository bank. Whether or not it is also the depository bank, the payor bank is accountable if it does not pay or return the item or send notice of dishonor until after its midnight deadline. (U.C.C. 4302(a)(1); see *Bank of America v. Security Pac. Nat. Bank* (1972) 23 C.A.3d 638, 643, 100 C.R. 438, 3 Cal. Proc. (4th), *Actions*, §477 [discussing but not deciding whether U.C.C. 4302 applies to representment]; *Huntmix v. Bank of America* (1982) 134 C.A.3d 347, 359, 184 C.R. 551 [bank may be liable for failure to meet its midnight deadline with regard to representment of check]; 22 A.L.R.4th 10 [construction and effect of Unif.Com.C. §4-301 and §4-302 making payor bank accountable for failure to act promptly on item presented for payment]; on excuse for delay caused by circumstances beyond bank's control, see U.C.C. 4109(b), *supra*, §110; for definition of "midnight deadline," see *supra*, §89.)

(2) *Other Item.* A payor bank is accountable for the amount of a properly payable item other than a demand item unless, within the time allowed for acceptance or payment of the item, the bank either accepts or pays the item or returns it and accompanying documents. (U.C.C. 4302(a)(2).)

(3) *Exception For Fraud.* An accountable bank's liability is not absolute. (Official Comment 3.) It is subject to defenses based on breach of a presentment warranty or proof that the person enforcing the liability presented or transferred the item to defraud the payor bank. (U.C.C. 4302(b); on presentment warranties, see U.C.C. 4208, *supra*, §104.) Thus, a payor bank can defend an accountability action by showing fraud or that an item contained a forged indorsement or a fraudulent alteration. (Official Comment 3.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Demand Item.*

Bank of America case:

Cross-Reference: 3 Cal. Proc. (5th), Actions, §511.



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2. Illustrations.

4 Witkin Sum. Cal. Law Neg Inst § 117

[§ 117] Illustrations.

In *Los Angeles Nat. Bank v. Bank of Canton* (1991) 229 C.A.3d 1267, 280 C.R. 831, plaintiff depository bank sued defendant payor bank for failure either to pay, or to notify plaintiff that it would not honor, 28 checks prior to the midnight deadline of U.C.C. 4302. Plaintiff and defendant used a third bank as an intermediary "clearing house" to settle accounts for negotiable items passing between plaintiff and defendant. Defendant had also entered into an agreement with the intermediary bank requiring the intermediary to send checks and other items to D corporation, which defendant employed to sort, collate, and process checks and other items prior to delivery to defendant. On three separate occasions, plaintiff processed a number of checks drawn on a leasing company's account with defendant. Plaintiff sent the checks for collection to the intermediary bank, which provisionally settled and delivered them to defendant. Each time, defendant returned the checks for insufficient funds after expiration of the midnight deadline that had to be met in order to revoke the provisional settlement made by the intermediary bank. The trial judge granted summary judgment for defendant on the ground that plaintiff's loss was caused solely by the negligence of its employees in cashing the checks or giving credit to the principals of the leasing company, without first verifying that there were sufficient funds on deposit with defendant. *Held*, reversed.

(a) Under U.C.C. 1103, the general defense that a party's own negligence caused its loss may apply where not displaced by another provision of the Code. Here, however, that defense was displaced by the rule of strict liability under U.C.C. 4302. "In order to further the statutory objectives of certainty and finality, a bank that fails to return a check by the midnight deadline is deemed to have paid it and thus is held accountable." (229 C.A.3d 1278.)

(b) There was conflicting evidence as to whether defendant's employees orally communicated to plaintiff's employees that there were insufficient funds in the account and that defendant would not honor checks drawn on it. However, U.C.C. 4302, which requires a payor bank to return an item or send notice of dishonor prior to expiration of the midnight deadline, contemplates written notice. (229 C.A.3d 1280.)

(c) Defendant's argument that it returned the items prior to expiration of the applicable deadlines, if time is calculated from when it received the items from D corporation until when it sent notice of dishonor, was not persuasive. D corporation was defendant's agent for receipt of the items, not another collecting bank. "Were we to conclude

otherwise, a payor bank always could avoid the operation of section 4302 by interposing such an entity for receipt of items from the presenting bank, and that entity indefinitely could delay the final disposition of an item, thus defeating the protection sought to be afforded by imposing strict deadlines for final payment or 'dishonor.' " (229 C.A.3d 1280.)

In *Chicago Title Ins. Co. v. California Canadian Bank* (1991) 1 C.A.4th 798, 2 C.R.2d 422, defendant's depositor was engaged in a massive check fraud operation involving transactions in which plaintiff acted as an escrow agent. Plaintiff deposited checks, defendant dishonored them, and plaintiff sued on a variety of theories. In an earlier proceeding, the court held that defendant owed plaintiff no duty to disclose suspicions about the depositor's account. (See *Chicago Title Ins. Co. v. Superior Court* (1985) 174 C.A.3d 1142, 220 C.R. 507.) In this proceeding, plaintiff contended that defendant's dishonor of the checks was not timely. The checks had been sent by courier from defendant's San Mateo branch to its San Francisco data processing center before midnight, but did not reach the check clearing house until the following day. *Held*, defendant failed to return the checks by the midnight deadline and was strictly liable for the face amount.

(a) Return of the checks from defendant's branch to its own data processing center for subsequent forwarding to the clearing house was not sufficient to satisfy the midnight deadline of U.C.C. 4302 and its implementing regulations. Defendant's internal policy on returns was negligently drafted and its return of checks was routinely late. The usual practice in other banks was to return checks by delivering them to the clearing house before the midnight deadline. (1 C.A.4th 806.) Defendant could not suspend the midnight deadline merely by moving the checks from one of its facilities to another. (1 C.A.4th 807.)

(b) Defendant is accountable for the late return under U.C.C. 4302, and thus strictly liable for the amount of the checks. (1 C.A.4th 808, 809, citing *Bank of America v. Security Pac. Nat. Bank* (1972) 23 C.A.3d 638, 643, 100 C.R. 438, and *Los Angeles Nat. Bank v. Bank of Canton*, supra.) "[T]he Uniform Commercial Code is designed to banish from the law governing timely return of dishonored checks such fact-based theories of liability and defense as negligence, fault, estoppel, intentional tort, or illegality of the underlying transaction in the overriding public interest of promulgating the integrity, certainty, and finality of commercial transactions." (1 C.A.4th 811.) (See *Los Angeles Nat. Bank v. Bank of Canton* (1995) 31 C.A.4th 726, 739, 37 C.R.2d 389 [midnight deadline rule of U.C.C. 4302 begins to run when checks are made available for pickup, instead of when they are actually picked up; hence, payor bank was strictly liable, where checks were ready to be picked up before 2 p.m. on one day, but notice of their dishonor was not given by midnight of following day].)

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c. Items Subject to Notice, Stop-Payment Order, Process, or Setoff.

4 Witkin Sum. Cal. Law Neg Inst § 118

[§ 118] Items Subject to Notice, Stop-Payment Order, Process, or Setoff.

(1) *Events Affecting Payment.* While processing an item for payment, a payor bank may receive knowledge or notice of certain events affecting the item, such as that the drawer has filed a petition in bankruptcy or made an assignment for the benefit of creditors. The bank may receive a stop-payment order from the item's drawer or may be served with an order attaching the drawer's account. Finally, the bank itself may exercise a setoff against the drawer's account. U.C.C. 4303(a) states the rule for determining the relative priorities between the various legal events that may affect an item. (Official Comment 1; see *97 A.L.R.3d 714* [bank's right to stop payment on its own uncertified check or money order].)

(2) *Bank's Rights and Duties Following Events.* Knowledge, notice, stop-payment orders, legal process, and setoffs do not alter the bank's right or duty to pay an item or to charge its customer's account for the item unless they occur, with reasonable time for the bank to act on them, before any of the following:

(a) The bank accepts or certifies the item. (U.C.C. 4303(a)(1); see *Nautilus Leasing Services v. Crocker Nat. Bank (1983) 147 C.A.3d 1023, 1029, 195 C.R. 478* [setoff was timely; bank that had stamped "paid" on check had not yet accepted for purpose of U.C.C. 4303(1)(a) (now U.C.C. 4303(a)(1))].)

(b) The bank pays the item in cash. (U.C.C. 4303(a)(2).)

(c) The bank settles for the item without having a right to revoke the settlement under statute, clearing house rule, or agreement. (U.C.C. 4303(a)(3).)

(d) The bank becomes accountable for the amount of the item under U.C.C. 4302 (supra, §116), dealing with the payor bank's responsibility for late return of items. (U.C.C. 4303(a)(4).)

(e) With respect to checks, a cutoff hour no earlier than 1 hour after the opening of the next banking day after the banking day on which the bank received the check and no later than the close of that next banking day or, if no cutoff hour is fixed, the close of the next banking day after the banking day on which the bank received the check. (U.C.C. 4303(a)(5).)

(3) *Bank's Discretion.* As long as it complies with U.C.C. 4303(a), a payor bank may accept, pay, certify, or charge

an item to its customer's indicated account in any order. (U.C.C. 4303(b).) Thus, the bank may pay items for which it is itself liable ahead of those for which it is not. (Official Comment 7.)

(4) *Other Events.* With respect to the effect of a customer's bankruptcy, the bank's rights are governed by the Bankruptcy Code. U.C.C. 4405 (infra, §124) applies when a customer dies or is incompetent. (Official Comment 2.)

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1. Where Charge Creates Overdraft.

4 Witkin Sum. Cal. Law Neg Inst § 119

[§ 119] Where Charge Creates Overdraft.

(1) *Charge Authorized.* A bank may charge a customer's account for a properly payable item, even though the charge creates an overdraft. An item is properly payable if it is authorized by the customer and is in accordance with an agreement between the customer and bank. (U.C.C. 4401(a).) An item containing a forged signature or indorsement is not properly payable. (Official Comment 1; see *American Nat. Bank v. Stanfill* (1988) 205 C.A.3d 1089, 1097, 252 C.R. 861 [if individuals involved with charitable corporation were bank's customers, they could seek reimbursement for checks that bank paid on forged indorsements]; Brady (Bailey) §19.01 et seq.; 10 *Am.Jur.2d* (1997 ed.), *Banks and Financial Institutions* §770; 11 *Am.Jur.2d* (1997 ed.), *Banks and Financial Institutions* §§894, 897.)

A customer is not liable for the amount of an overdraft if the customer neither signed the item nor benefited from its proceeds. (U.C.C. 4401(b).) Thus, if more than one customer may draw on an account, a nonsigning customer who does not benefit from the proceeds of the item is not liable for the overdraft. (Official Comment 2.)

(2) *Charge for "Not Sufficient Funds" Check.* In *Perdue v. Crocker Nat. Bank* (1985) 38 C.3d 913, 216 C.R. 345, 702 P.2d 503, the court held that a complaint in a class action on behalf of persons with checking accounts at defendant bank, attacking the unilaterally set charge of \$ 6 for processing a no sufficient funds check as unconscionable, stated a cause of action. "[T]he bank structured a totally one-sided transaction. The absence of equality of bargaining power, open negotiation, full disclosure, and a contract which fairly sets out the rights and duties of each party demonstrates that the transaction lacks those checks and balances which would inhibit the charging of unconscionable fees. In such a setting, plaintiff's charge that the bank's NSF fee is exorbitant, yielding a profit far in excess of cost, cannot be dismissed on demurrer." (38 C.3d 928.) (For full discussion of *Perdue*, see 1 *Summary* (10th), *Contracts*, §339; see also 73 *A.L.R.4th* 1028 [bank's liability to customer for allegedly excessive service charges].)

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2. Where Check Is Postdated.

4 Witkin Sum. Cal. Law Neg Inst § 120

[§ 120] Where Check Is Postdated.

(1) *Charge Allowed.* A bank may charge a customer's account for a postdated check that is otherwise properly payable, unless the customer has notified the bank of the postdating by describing the check with reasonable certainty. (U.C.C. 4401(c); see *Wilson v. Lewis (1980) 106 C.A.3d 802, 808, 165 C.R. 396* [postdated check is not payment, but rather is credit instrument; in accepting it, payee is looking to promise of payment in future]; *11 Am.Jur.2d (1997 ed.), Banks and Financial Institutions §898.*) Under former Division 4, a postdated check was not properly payable. U.C.C. 4401(c) was added to revised Division 4 because the automated check collection system cannot accommodate postdated checks. (Official Comment 3.)

(2) *Notice Requirements.* The notice is effective for the period stated in U.C.C. 4403(b) (*infra*, §122) for stop-payment orders. The bank must receive the notice at a time and in a manner that affords the bank a reasonable opportunity to act on the notice before taking an action described in U.C.C. 4303, *supra*, §118. (U.C.C. 4401(c).)

(3) *Fees for Notice.* Division 4 does not regulate the fees banks charge for a notice of postdating. Under the principles of unconscionability or good faith and fair dealing, however, courts have reviewed fees and the bank's discretion in setting fees. (Official Comment 3.)

(4) *Bank's Liability for Improper Charge.* If a bank charges a customer's account before the date stated in the notice of postdating, the bank is liable for damages for the loss resulting from its act. The loss may include damages for dishonor of subsequent items under U.C.C. 4402, *infra*, §126. (U.C.C. 4401(c); see *Wright v. Bank of America (1959) 176 C.A.2d 176, 183, 1 C.R. 202* [drawee bank that cashed fraudulent, postdated check was free from negligence]; *31 A.L.R.4th 329* [bank's liability for early payment of postdated check].)

(5) *Requiring or Giving Postdated Check.* Subject to specified exceptions, it is an unlawful business practice to require or request a postdated check from a consumer. (*B. & P.C. 17538.6(a)*; see *4 Summary (10th), Sales, §376.*) A drawer may give a postdated check, knowing that he or she has no funds at the time the check is drawn. If the drawer informs the taker of that fact, the drawer is not liable criminally under P.C. 476a. (See *2 Cal. Crim. Law (3d), Crimes Against Property, §146.*)

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3. Where Item Is Altered or Incomplete.

4 Witkin Sum. Cal. Law Neg Inst § 121

[§ 121] Where Item Is Altered or Incomplete.

A bank that in good faith pays a holder may charge its customer's indicated account according to either (1) the original terms of an altered item, or (2) the terms of a completed item, even though the bank knows the item has been completed, unless the bank has notice that the completion was improper. (U.C.C. 4401(d).) This applies the rule stated in U.C.C. 3407 (supra, §55) to an altered item, allowing the bank to enforce its rights to the item by charging the customer's account. (Official Comment 4.)

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4. Contrary to Stop-Payment Order.

4 Witkin Sum. Cal. Law Neg Inst § 122

[§ 122] Contrary to Stop-Payment Order.

(1) *Drawer's Right To Stop Payment.* Stopping payment or closing an account is a service that depositors expect and are entitled to receive from banks notwithstanding the difficulty, inconvenience, and expense. (Official Comment 1 to U.C.C. 4403.) A customer may stop payment of an item drawn on the customer's account or close the account by an order to the bank. (U.C.C. 4403(a); see Brady (Bailey) §26.02 et seq.; *11 Am.Jur.2d (1997 ed.), Banks and Financial Institutions §955 et seq.*; *12 Am.Jur.2d (1997 ed.), Bills and Notes §456.*) A payee or indorsee has no right to stop payment. (Official Comment 2.)

The right to stop payment is not limited to checks. It extends to any item payable by a bank. (Official Comment 3.) However, a cashier's check or teller's check purchased by a debit to the purchaser's account is not a check drawn on the purchaser's account for purposes of U.C.C. 4403(a), and the purchaser has no right to stop payment on such a check. If the bank refuses to pay the check as an accommodation to the purchaser, its liability is governed by U.C.C. 3411 (*supra*, §43). (Official Comment 4.)

(2) *Requirements of Order.* The order must describe the item or account with reasonable certainty. (U.C.C. 4403(a).) The customer, in the absence of a contrary agreement, must meet the standard of "what information allows the bank under the technology then existing to identify the item with reasonable certainty." (Official Comment 5; see *29 A.L.R.4th 228* [oral or written nature of stop-payment order]; *35 A.L.R.4th 985* [sufficiency of description of check]; for forms, see Cal. Transactions Forms, 4 Business Transactions §26:34 et seq.)

The bank must receive the stop-payment order at a time and in a manner that affords the bank a reasonable opportunity to act on it before taking an action described in U.C.C. 4303 (*supra*, §118). If the signature of more than one person is required to draw on an account, any of the persons may stop payment or close the account. (U.C.C. 4403(a); see *55 A.L.R.2d 975* [bank's liability for payment of check drawn by one depositor after stop-payment order by joint depositor].)

(3) *Term of Order.* A stop-payment order is effective for 6 months, but it lapses after 14 calendar days if the original order was oral and was not confirmed in writing within that period. A stop-payment order may be renewed for

additional 6-month periods by a writing given to the bank within a period during which the stop-payment order is effective. (U.C.C. 4403(b).) When a stop-payment order expires, it is as though the order was never given. The bank may pay the item in good faith even though an order was once given. (Official Comment 6.)

(4) *Liability for Payment Contrary to Order.* A payment in violation of an effective direction to stop payment is an improper payment, even if it is made by mistake or inadvertence. Agreements to the contrary are invalid if the bank failed to exercise ordinary care in making the payment. Contrary agreements imposed on a customer as part of a standard form contract are evaluated in light of the general obligation of good faith. (Official Comment 7; see *1 A.L.R.2d 1155* [stipulation relieving bank from, or limiting its liability for disregard of, stop-payment order].)

The customer carries the burden of establishing the fact and amount of loss resulting from the payment of an item contrary to a stop-payment order or an order to close an account. The loss from payment of an item contrary to a stop-payment order may include damages for dishonor of subsequent items under U.C.C. 4402 (infra, § 126). (U.C.C. 4403(c); see *83 Cal. L. Rev. 1191* [restitution theory to permit recovery after bank mistakenly pays check over customer's stop-payment order].)

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5. For Check More Than Six Months Old.

4 Witkin Sum. Cal. Law Neg Inst § 123

[§ 123] For Check More Than Six Months Old.

A bank is under no obligation to a checking account customer to pay a check that is presented more than 6 months after its date. It may, however, charge its customer's account for a payment made after 6 months in good faith. (U.C.C. 4404; see *11 Am.Jur.2d (1997 ed.), Banks and Financial Institutions §899.*)

Certified checks are excluded from U.C.C. 4404 because they are the primary obligation of the certifying bank. (U.C.C. 4404; Official Comment.)

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6. Following Death or Incompetence of Customer.

4 Witkin Sum. Cal. Law Neg Inst § 124

[§ 124] Following Death or Incompetence of Customer.

(1) *Bank's Authority To Pay Item Unaffected.* A payor or collecting bank may accept, pay, or collect an item or account for proceeds of its collection, even if the bank's customer is incompetent at the time the item is issued or its collection is undertaken, unless the bank knows of an adjudication of incompetence. Neither death nor incompetence of a customer revokes the bank's authority to accept, pay, collect, or account until the bank knows of the fact of death or of an adjudication of incompetence and has reasonable opportunity to act on it. (U.C.C. 4405(a); see *10 Am.Jur.2d (1997 ed.), Banks and Financial Institutions §739; 12 Am.Jur.2d (1997 ed.), Bills and Notes §457.*)

This rule is necessary because a check is an order to pay that the bank must obey under penalty of liability for dishonor. With the tremendous volume of items handled, any rule requiring banks to verify the continued life and competency of drawers would be unworkable. (Official Comment 1.)

(2) *Payment of Checks for 10 Days After Death.* Even with knowledge, a bank may, for 10 days after the date of death, pay or certify checks drawn on or before that date unless ordered to stop payment by a person claiming an interest in the account. (U.C.C. 4405(b).) Thus, holders of checks drawn and issued shortly before death may cash them without the need to file a probate claim, although the personal representative may still recover the payment from the check holder. The validity of a transfer in contemplation of death is not affected by U.C.C. 4405(b). (Official Comment 2.)

A surviving relative, creditor, or claimant may direct the bank not to pay a check. Anyone interested in the estate, including the named executor even if the will has not been admitted to probate, is entitled to claim an interest in the account. (Official Comment 3.)

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7. Bank's Right to Subrogation on Improper Payment.

4 Witkin Sum. Cal. Law Neg Inst § 125

[§ 125] Bank's Right to Subrogation on Improper Payment.

(1) *Basis for Subrogation Right.* Under U.C.C. 4403 (supra, §122), a payor bank is prima facie liable when it pays an item over the drawer's or maker's stop-payment order, or after an account has been closed. It may also be liable under other circumstances giving the drawer or maker a basis for objection. To prevent unjust enrichment in the event of improper payment, the payor bank is given subrogation rights. (U.C.C. 4407; see *83 Cal. L. Rev. 1191, 1228* [restitution theory to permit bank to recover for mistaken payment of check over customer's stop-payment order].)

(2) *Rights of Holder in Due Course.* Although payment can be stopped against a holder in due course, the drawer or maker remains liable. (Official Comment 1.) Thus, the "sound rule" is that the bank is subrogated to the rights of a holder in due course on the item against the drawer or maker. (U.C.C. 4407(a); Official Comment 1.)

(3) *Rights of Payee or Other Holder.* The payor bank is subrogated to the rights of the payee or another holder of the item against the drawer or maker either on the item or under the transaction out of which the item arose. (U.C.C. 4407(b).) For example, where the drawer of a check buys goods from a payee and the goods are partially defective, the payee is not entitled to the full price. Nevertheless, the goods are still worth some amount, and if the drawer retains the goods, he or she is obligated to pay part of the agreed price. If the bank has paid the check, it should be subrogated to the payee's claim against the drawer. (Official Comment 2.)

(4) *Rights of Drawer or Maker.* The bank is subrogated to the rights of the drawer or maker against the payee or another holder of the item with respect to the transaction out of which the item arose. (U.C.C. 4407(c).) For example, where the payee is a fraudulent salesman who induces the drawer to issue a check for defective securities, and the bank pays the check over a stop-payment order but reimburses the drawer for the payment, the bank should have a basis for getting the money back from the fraudulent salesman. (Official Comment 3.)

(5) *No Double Recovery for Bank.* The bank's subrogation rights exist only to the extent necessary to prevent loss to the bank by reason of its payment of the item. (U.C.C. 4407.) Thus, the bank may not receive double recovery or benefit from its subrogation rights. (Official Comment 4.)

(6) *Effect on Bank's Other Rights.* U.C.C. 4407 does not negate a payor bank's other rights, including, for example, the defense that its customer, by conduct recognizing the payment, has ratified the bank's action in disregard of the stop-payment order, or the bank's right to recover money paid by mistake. (Official Comment 5.)

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b. Bank's Liability for Wrongful Dishonor.

4 Witkin Sum. Cal. Law Neg Inst § 126

[§ 126] Bank's Liability for Wrongful Dishonor.

(1) *Definition.* Except as otherwise provided in Division 4, a payor bank wrongfully dishonors an item if it dishonors an item that is properly payable. A bank may, however, dishonor an item that would create an overdraft, unless it has agreed to pay the overdraft. (U.C.C. 4402(a).) This states positively what was assumed under former Division 4. (Official Comment 1.) (See *88 A.L.R.4th 568* [what constitutes wrongful dishonor]; Brady (Bailey) §22.04.)

(2) *Damages.* A payor bank is liable to its customer for damages proximately caused by the wrongful dishonor of an item. (U.C.C. 4402(b); see Cal. Civil Practice, 4 Business Litigation, §49:36; for forms, see Cal. Transactions Forms, 4 Business Transactions §26:39 et seq.) This liability applies only to a customer. U.C.C. 4402 confers no cause of action on the holder of a dishonored item. (Official Comment 5.) (See *Kendall Yacht Corp. v. United Calif. Bank (1975) 50 C.A.3d 949, 956, 123 C.R. 848* [corporation's officers were entitled to recover for wrongful dishonor even though corporation was "customer"]; *Karsh v. American City Bank (1980) 113 C.A.3d 419, 421, 169 C.R. 851* [complaint sufficient under *Kendall*]; *88 A.L.R.4th 613* [who may recover for wrongful dishonor].)

Liability is limited to actual damages proved and may include damages for an arrest or prosecution of the customer or other consequential damages. Whether consequential damages are proximately caused by the wrongful dishonor is a question of fact to be determined in each case. (U.C.C. 4402(b); see *Weaver v. Bank of America (1963) 59 C.2d 428, 438, 30 C.R. 4, 380 P.2d 644* [holding, before codification of rule in U.C.C. 4402(b), that damages may be recovered for arrest or prosecution of customer and that whether consequential damages have been proximately caused by wrongful dishonor is question of fact in each case]; 5 Santa Clara Lawyer 103 [*Weaver*].) Whether a bank is liable for noncompensatory or punitive damages is determined by other rules of law. (Official Comment 1.)

Wrongful dishonor is different from "failure to exercise ordinary care in handling an item," and therefore the measure of damages is different from that in U.C.C. 4103(e) (*supra*, §88). (Official Comment 2.)

(3) *Bank's Determination of Insufficient Funds.* A payor bank's determination that a customer's account balance has insufficient available funds, on which a dishonor decision is based, may be made at any time between the time the bank receives the item and the time it returns the item or gives notice in lieu of return. No more than one determination need be made. (U.C.C. 4402(c).) Thus, the failure to make a second determination before the item is returned on the day

following presentment is not a wrongful dishonor, even if new credits were added to the account on that day that would have covered the amount of the check. (Official Comment 4.) If the payor bank elects to make a subsequent balance determination and reevaluate the dishonor decision, the account balance at that time determines whether a dishonor for insufficiency of available funds is wrongful. (U.C.C. 4402(c).)

(4) *Disputes Involving Joint Depositors.* In *AARTS Productions v. Crocker Nat. Bank* (1986) 179 C.A.3d 1061, 225 C.R. 203, plaintiff opened a checking account with defendant bank. There were four authorized signatories on the account, and the account agreement authorized defendant, in the event of conflicting demands, to withhold payment pending a court order or a joint order of the signatories. One signator, plaintiff's treasurer, requested that defendant honor no more checks drawn on the account because the checkbook had been stolen. Defendant, whose offer to release all funds to all signers of the account if they would receive them together was refused, filed an action in interpleader, deposited plaintiff's funds in court, and was discharged. Not more than a month after the treasurer had notified defendant, the other signatories informed defendant that the checkbook had not been stolen, and demanded that defendant honor checks drawn on the account. Defendant dishonored several checks thereafter, and plaintiff sued. *Held*, defendant was not liable for wrongful dishonor. Plaintiff's treasurer was not an "adverse claimant" within the meaning of *Fin.C. 952*, which requires a bank, in the absence of an affidavit or court order, to disregard notice from an adverse claimant requesting that the bank dishonor checks. (179 C.A.3d 1068.) *Fin.C. 952* is designed "to protect banks from getting caught in a crossfire between its depositors and strangers claiming entitlement to its accounts." (179 C.A.3d 1069.) Accordingly, *Fin.C. 952* does not apply to disputes arising between joint depositors. (179 C.A.3d 1069.)

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c. Communication Between Bank and Customer.

1. Statement of Account.

4 Witkin Sum. Cal. Law Neg Inst § 127

[§ 127] Statement of Account.

(1) *Information in Statement.* A bank that sends or makes available to a customer a statement of account showing payment of items for the account must either (a) return or make available the paid items, or (b) provide information in the statement sufficient to allow the customer "reasonably" to identify the items. A statement provides sufficient information if the item is described by item number, amount, and date of payment. (U.C.C. 4406(a); see *10 Am.Jur.2d (1997 ed.), Banks and Financial Institutions §746 et seq.*)

(2) *Bank's Obligation To Provide Paid Items.* If the bank does not return the items, it must provide in the statement the telephone number that the customer may call to request an item or a legible copy. (U.C.C. 4406(a).) The bank retaining the items must either retain the items or, if the items are destroyed, maintain the capacity to furnish legible copies for 7 years after receipt of the items. A customer may request an item from the payor bank, and the bank must provide in a reasonable time either the item or, if the item has been destroyed or is not otherwise obtainable, a legible copy. A bank must provide, on request and without charge to the customer, at least two items, or a legible copy of the items, for each statement of account sent to the customer. (U.C.C. 4406(b).)

Division 4 does not define the length of the reasonable time for a bank to provide the check or a copy or provide sanctions for failure to retain or furnish the item or legible copies. Nor does it regulate fees banks may charge for furnishing items or copies. (Official Comment 2.)

(3) *Repeal of Statute.* U.C.C. 4406 remains in effect only until January 1, 2010, unless a statute enacted before then deletes or extends that date. (U.C.C. 4406(g).) An alternative version of U.C.C. 4406 becomes operative January 1, 2010. In subdivision (a), it deletes (a) "reasonably" and (b) the provision that the statement of account provides sufficient information if the item is described by item number, amount, and date of payment.

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Bank's Obligation To Provide Paid Items.* U.C.C. 4406(a) was amended in 2005 to provide that if the bank does not return the items, it must provide in the statement the telephone number that the customer may call to request an item, a substitute check (defined in U.C.C. 4406(g)), or a legible copy.

U.C.C. 4406(b) was amended in 2005 to provide that if the paid item requested by a customer was presented as a substitute check, the bank must provide in a reasonable time either the substitute check or, if the substitute check has been destroyed or is not otherwise obtainable, a legible copy of the substitute check. A bank must provide, upon request and without charge to the customer, at least two items, substitute checks, or legible copies thereof, for each statement of account sent to the customer. (3) *Repeal of Statute.* U.C.C. 4406(g) was relettered U.C.C. 4406(h) in 2005.



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2. Reporting Unauthorized Signature or Alteration.

aa. Customer's Duty To Report.

4 Witkin Sum. Cal. Law Neg Inst § 128

[§ 128] Customer's Duty To Report.

(1) *Scope of Duty.* If a bank sends or makes available a statement of account or items under U.C.C. 4406(a) (supra, §127), the customer must examine the statement or the items to determine whether a payment was not authorized because of an alteration or because a purported signature of the customer was unauthorized. The customer must do so with "reasonable promptness." If, based on the statement or items provided, the customer should reasonably have discovered the unauthorized payment, the customer must promptly notify the bank of the relevant facts. (U.C.C. 4406(c); see Brady (Bailey) §32.01 et seq.; *11 Am.Jur.2d (1997 ed.), Banks and Financial Institutions §§904, 911.*)

The drawer has no duty under U.C.C. 4406 to look for unauthorized indorsements. (Official Comment 5.)

(2) *Effect of Failure To Report.* If the bank proves that the customer failed to comply with the duty to report under U.C.C. 4406(c), the customer cannot assert either of the following against the bank:

(a) The customer's unauthorized signature or an alteration on the item, if the bank also proves that it suffered a loss from the failure. (U.C.C. 4406(d)(1).)

(b) The customer's unauthorized signature or alteration by the same wrongdoer on another item paid in good faith by the bank, if the payment was made before the bank received notice from the customer of the unauthorized signature or alteration and after the customer had been afforded a reasonable period of time, not exceeding 30 days, in which to examine the item or statement of account and notify the bank. (U.C.C. 4406(d)(2).) (See *Espresso Roma Corp. v. Bank of America (2002) 100 C.A.4th 525, 530, 124 C.R.2d 549* [bank, which made statements and checks available to customer on monthly basis, was not liable to customer for paying series of checks forged by customer's employee, where almost 2 years had elapsed before customer discovered and reported forgeries; forgeries were all committed by same person, and failure to report first forged item within 30 days precluded customer from asserting subsequent forgeries]; *7 A.L.R.4th 1112* [application of reporting requirement of U.C.C. 4406 to cases involving check or withdrawal on less than required number of signatures].)

(3) *Electronic Fund Transfer Act (EFTA) and Unauthorized Electronic Transfer of Funds.* In *Kruser v. Bank of America* (1991) 230 C.A.3d 741, 281 C.R. 463, plaintiffs husband and wife claimed damages from defendant bank for unauthorized electronic withdrawals from their account by someone using the husband's "Versatel" card. Plaintiffs believed that the husband's card had been destroyed in September 1986. However, a December 1986 account statement mailed to plaintiffs indicated an unauthorized withdrawal of \$ 20 by someone using the husband's card at an automatic teller machine. Plaintiffs discovered the unauthorized transaction in August or September 1987, and reported it to defendant. In September 1987, plaintiffs received bank statements for July and August showing 47 unauthorized withdrawals, totaling \$ 9,020, which were made by someone using the husband's card at an automatic teller machine. Plaintiffs notified defendant a few days after receiving the statements showing the unauthorized withdrawals, but defendant refused to credit plaintiffs' account. *Held*, plaintiffs' failure to report the unauthorized \$ 20 withdrawal appearing on the December 1986 statement barred recovery for the subsequent unauthorized withdrawals.

(a) The Electronic Fund Transfer Act (15 U.S.C., §1693 et seq.) and related regulations require a depositor to report unauthorized withdrawals within 60 days after receiving a statement reflecting those withdrawals. The unauthorized transfer of \$ 20 was isolated in time and minimal in amount when compared to the later unauthorized withdrawals. However, defendant showed that the later transfers could have been prevented had plaintiffs notified it of the first unauthorized withdrawal, for defendant would have cancelled the husband's card. (230 C.A.3d 748.)

(b) Plaintiff wife's hospitalization and recuperation occurring during the first 7 months of 1987 did not entitle plaintiffs to an extension of time to notify defendant. Plaintiff wife was in fact able to review the bank statements, and there were no extenuating circumstances preventing plaintiff husband from reviewing the statements as well. (230 C.A.3d 748.)

(c) Defendant was not required to establish that plaintiffs, in addition to receiving the statement reflecting the unauthorized withdrawal, had actual knowledge of that withdrawal. "Such a construction of the law would reward consumers who choose to remain ignorant of the nature of transactions on their account by purposely failing to review periodic statements. Consumers must play an active and responsible role in protecting against losses which might result from unauthorized transfers. A banking institution cannot know of an unauthorized electronic transfer unless the consumer reports it." (230 C.A.3d 750.)

West's Key Number Digest, Banks and Banking k.148 et seq.

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bb. Effect of Bank's Failure To Exercise Ordinary Care.

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[§ 129] Effect of Bank's Failure To Exercise Ordinary Care.

If the customer is precluded from asserting an unauthorized signature or alteration, but the customer proves that the bank failed to exercise ordinary care in paying the item and that the failure contributed to loss, the customer and the bank must share the loss. The loss is allocated between the two parties according to the extent to which the customer's failure to comply with the duty to report and the bank's failure to exercise ordinary care contributed to the loss. If the customer proves that the bank did not pay the item in good faith, the preclusion under U.C.C. 4406(d) (*supra*, §128) does not apply. (U.C.C. 4406(e); see Brady (Bailey) §32.07.)

U.C.C. 4406(e) provides a modified comparative negligence test for determining liability. For purposes of this provision, "ordinary care" is defined in U.C.C. 3103(a)(7), which provides that, where instruments are taken for collection or payment by automatic means, reasonable commercial standards do not require the bank to examine the instrument if its procedure is reasonable and commonly followed by comparable banks in the area. (Official Comment 4; see *Pacific Indem. Co. v. Security First Nat. Bank* (1967) 248 C.A.2d 75, 98, 56 C.R. 142 [bank tellers ignored directions on face of checks, and violated bank's own rules in making no inquiry as to employee's authority to deposit them in his personal account; bank's negligence made it liable to drawer, and hence to plaintiff surety asserting its right of subrogation]; *Sun 'N Sand v. United Calif. Bank* (1978) 21 C.3d 671, 694, 148 C.R. 329, 582 P.2d 920 [following *Pacific Indem. Co.*]; 31 *Hastings L. J.* 221 [criticizing *Sun 'N Sand*]; 25 *Loyola L.A. L. Rev.* 57 [allocation of losses resulting from forged drawers' signatures]; 22 *Pacific L. J.* 1263 [allocation of loss for forged checks]; 42 *A.L.R.2d* 1070 [affect on drawee bank's liability of drawer's negligence in drawing check in manner that facilitates alteration of amount].)

The 1992 Legislature's addition of a more detailed definition of "ordinary care" in U.C.C. 3103(a)(7) was not a change in, but a clarification of, existing law. The revised statutes continue to provide that a bank may show that it used ordinary care in processing a forged instrument by establishing that it followed check cashing procedures consistent with general banking usage. (*Story Road Flea Market v. Wells Fargo Bank* (1996) 42 C.A.4th 1733, 1740, 50 C.R.2d 524; see *Espresso Roma Corp. v. Bank of America* (2002) 100 C.A.4th 525, 533, 124 C.R.2d 549 [bank exercised ordinary care in processing forged checks; its bulk processing system, which did not include sight review for signature

verification, was commercially reasonable and consistent with the practice of other comparably large banks in its area and in California.]

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2. Reporting Unauthorized Signature or Alteration.

cc. Preclusion Period and Statute of Limitations.

4 Witkin Sum. Cal. Law Neg Inst § 130

[§ 130] Preclusion Period and Statute of Limitations.

(1) *Preclusion Period.* Regardless of whether the bank or the customer exercised care, a customer has 1 year after the statement or items are made available to discover and report an unauthorized signature or an alteration on the item. After that the customer is precluded from asserting the unauthorized signature or alteration against the bank. (U.C.C. 4406(f).) If there is a preclusion under U.C.C. 4406(f), the payor bank may not recover for breach of presentment warranty under U.C.C. 4208 (supra, §104) with respect to the unauthorized signature or alteration to which the preclusion applies. (U.C.C. 4406(f).) (See *Roy Supply v. Wells Fargo Bank (1995) 39 C.A.4th 1051, 1057, 46 C.R.2d 309* [former U.C.C. 4406(4) (now U.C.C. 4406(f)) barred corporate bank customers from asserting that forged checks were negligently paid; *Sun 'N Sand v. United Calif. Bank (1978) 21 C.3d 671, 148 C.R. 329, 582 P.2d 920*, not followed so far as it held that former U.C.C. 4406(4) applied, not to common law negligence, but only to actions based on warranty under U.C.C.])

In *Edward Fineman Co. v. Superior Court (1998) 66 C.A.4th 1110, 78 C.R.2d 478*, plaintiff company maintained a payroll checking account at defendant bank. Under the terms of the account, withdrawals by certain authorized parties required two signatures. From January 1, 1991, until January 1, 1993, the bank paid 23 checks drawn on the account and signed by only one of the two required parties. Plaintiff sued defendant in 1997 for breach of contract and negligence. The trial judge granted defendant's motion for summary judgment, concluding that the claims were barred by U.C.C. 4406(f), which provides a customer 1 year to discover and report losses due to unauthorized signatures, and U.C.C. 4111, which provides that an action to enforce an obligation, duty or right under Division 4 of the California Uniform Commercial Code must be brought within 3 years after the cause of action accrues (see supra, §88). Plaintiff petitioned for a writ of mandamus. *Held*, petition denied.

(a) U.C.C. 4406 obligates a customer to examine monthly statements and canceled checks to discover and report a bank payment of an item bearing an unauthorized signature. U.C.C. 3403(b) provides that when the signature of more than one person is required to constitute the authorized signature of an organization, the signature is unauthorized if one of the required signatures is lacking. This provision must be interpreted according to the Official Comment to U.C.C. 3403(b), which declares that the statute simply "clarifies" existing law as to the meaning of "unauthorized" in cases

where an instrument contains less than all the signatures required as authority to pay a check. (66 C.A.4th 1124, 1125; contrary holding of *Far West Citrus v. Bank of America* (1979) 91 C.A.3d 913, 154 C.R. 464, 3 Cal. Proc. (4th), *Actions*, §456, is implicitly abrogated.) Thus, the checks here, which lacked a second required signature, are within the classification of items that must be timely discovered and reported under U.C.C. 4406(f). (66 C.A.4th 1125.)

(b) Plaintiff's claim falls under Division 4 of the California Uniform Commercial Code, and thus is also barred by U.C.C. 4111 because the action was not brought within 3 years after accrual. (66 C.A.4th 1125.) Retroactive application of a shortened limitations period is permissible if a party has a reasonable time to make use of the applicable remedy before the statute cuts off the right (see 3 Cal. Proc. (4th), *Actions*, §456). Here, U.C.C. 4111 was enacted in 1993, providing plaintiff an entire year to file its action. (66 C.A.4th 1125.)

The applicability of U.C.C. 4406(f) when a bank statement is sent to a deceased customer was examined in *Mac v. Bank of America* (1999) 76 C.A.4th 562, 90 C.R.2d 476. Shortly before decedent's death in February 1996, her nephew had forged her signatures on several checks. The checks cleared decedent's accounts at defendant banks after her death. Plaintiff, the administrator of decedent's estate, discovered the forgeries approximately 1 year after decedent's death, when she ordered statements and obtained copies of checks for each of the accounts. Defendants contended that plaintiff's action to recover the funds, filed over 18 months after decedent's death, was barred by U.C.C. 4406(f) and by the 1-year statute of limitations of C.C.P. 340(3) (redesignated as C.C.P. 340(c); see 3 Cal. Proc. (4th), *Actions*, §448), and the trial court agreed. *Held*, reversed.

Although statements reflecting the forged checks were sent within several months of decedent's death, no statements were furnished to an account holder until February 1997, when plaintiff obtained the statements, with authority to take possession and control of the estate property. Under U.C.C. 4406(f), the statement must be sent to a customer who can examine it for items paid on an unauthorized signature. (76 C.A.4th 566.) A dead customer, however, has no chance of discovering a forgery. (76 C.A.4th 567.) A statement can be "made available," as specified in U.C.C. 4406(f), only to a living customer. (76 C.A.4th 569.)

(2) *Limitations Period.* In *Chatsky & Associates v. Superior Court* (2004) 117 C.A.4th 873, 12 C.R.3d 154, plaintiffs had checking accounts at defendant bank. Plaintiffs notified defendant that some checks written on their accounts had been forged. On March 19, 2002, plaintiffs sued defendant for conversion, breach of contract, violation of U.C.C. 3420, and unfair business practices. The trial court granted defendant's motion for summary adjudication, finding that recovery on checks dated February 2001 or earlier was barred by the 1-year limitations period of C.C.P. 340(c) "by a depositor against a bank for the payment of a forged or raised check." *Held*, affirmed. The 1-year limitations period of C.C.P. 340(c), rather than the 3-year limitations period of U.C.C. 4111 (supra, §88), applies to claims by depositors against their bank for the payment of forged checks written on the depositors' accounts.

(a) C.C.P. 340(c) dovetails with U.C.C. 4406(f), which acts as an issue preclusion statute (rather than a statute of limitations). The official comments to U.C.C. 4406 expressly indicate that the 1-year preclusion period is consistent with the statute of limitations contained in C.C.P. 340(c). (117 C.A.4th 877.)

(b) C.C.P. 340(c) is the more specific statute. It expressly concerns the factual circumstances here: an action by a depositor against its bank for the payment of a forged check. U.C.C. 4111 generally applies to other actions arising between banks or a bank and its customers to enforce an obligation, duty, or right. "When so construed, the statutes work in harmony and do not contradict each other." (117 C.A.4th 878.)

(c) The Legislature did not impliedly repeal C.C.P. 340(c) when it enacted U.C.C. 4111. The two statutes are not irreconcilable or clearly repugnant, but can be harmonized. Moreover, nothing in U.C.C. 4111 or its history establishes that the Legislature intended to repeal C.C.P. 340(c). (117 C.A.4th 879.)

(d) *Edward Fineman Co.* did not hold that all actions under Division 4 are governed by U.C.C. 4111. There was no need for the bank in *Edward Fineman Co.* to move for summary adjudication under C.C.P. 340(c), or for the court to

discuss that statute, because the longer 3-year limitations period under U.C.C. 4111 had already expired. "It is axiomatic that cases are not authority for propositions not considered." (117 C.A.4th 879.) (See *Hughes Electronics Corp. v. Citibank Delaware* (2004) 120 C.A.4th 251, 265, 15 C.R.3d 244 [C.C.P. 340(c), rather than U.C.C. 4111, applied to action against bank arising from bank's payment on check bearing forged indorsement; citing *Chatsky & Associates*].)

West's Key Number Digest, Banks and Banking k.148 et seq.

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Preclusion Period.Far West Citrus case:*

Cross-Reference: 3 Cal. Proc. (5th), Actions, §489.

Retroactive application of shortened limitations period:

Cross-Reference: 3 Cal. Proc. (5th), Actions, §459.

C.C.P. 340(c):

Cross-Reference: 3 Cal. Proc. (5th), Actions, §481.



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6. Liability of Payor Bank to Noncustomer.

4 Witkin Sum. Cal. Law Neg Inst § 131

[§ 131] Liability of Payor Bank to Noncustomer.

In *Software Design & Application, Ltd. v. Hoefer & Arnett* (1996) 49 C.A.4th 472, 56 C.R.2d 756, plaintiff investors retained M, a financial consultant, to manage plaintiffs' valuable portfolio. M, with his sister's assistance, opened accounts under fictitious names with defendant banks and securities brokerage firms, transferred portfolio assets into the accounts, and then withdrew and misappropriated the funds from these accounts. Although plaintiffs were not customers of defendants, they sought to recover on theories of negligence, conversion, and violation of U.C.C. 11204 (acceptance of unauthorized or unenforceable payment order). The trial judge dismissed plaintiffs' complaint after sustaining demurrers to all causes of action. *Held*, affirmed.

(a) *Negligence*. Plaintiffs' claims that defendants owed noncustomers a duty to investigate entities opening accounts and to thereafter supervise and monitor account transactions were without merit.

(1) *Defendant banks*. Plaintiffs were not customers of defendant banks, and without extraordinary and specific facts, a bank does not owe a duty of care to a noncustomer. No such facts were present here. (49 C.A.4th 479.) Although a bank owes a limited duty of inquiry when a check presented for deposit bears some objective signs of fraud, defendant banks here owed no duty with respect to the transfer of funds into the accounts. The funds were deposited by wire transfers without indicia of fraud, and thus plaintiffs were not foreseeable and identifiable injured third parties. (49 C.A.4th 479.) In the absence of suspicious instruments, defendant banks owed no duty to plaintiffs to monitor the frequency with which M deposited and simultaneously withdrew funds. (49 C.A.4th 481.) Finally, defendant banks owed plaintiffs no duty with respect to M's opening of the accounts. Even if defendant banks violated internal rules, those rules were for their protection and were not intended to protect noncustomers. (49 C.A.4th 481.) Also, the circumstances here were not so suspicious as to trigger a duty to investigate, and even if defendant banks committed wrongdoing, the relationship between that wrongdoing and the harm to plaintiffs was tenuous. (49 C.A.4th 482, 483.)

(2) *Defendant brokers*. Any potential liability of a broker to a noncustomer requires sufficiently suspicious circumstances to place the broker on inquiry notice that its customer is committing fraud. The circumstances alleged here--(a) repeated withdrawal or transfer of funds in large quantities in rapid succession, (b) lack of documentation as to bona fides of the account holder, and (c) certain documentation allegedly indicating that transferred funds were owned and controlled exclusively by plaintiffs--did not, as a matter of law, amount to such suspicious circumstances. (49 C.A.4th 483, 484.)

(b) *Conversion.*

(1) *Commercial Code.* Plaintiffs could not state a claim under U.C.C. 3420 (supra, §58), because this statute governs conversion of negotiable instruments, not money or securities. Plaintiffs' complaint described their funds as "securities" and "money" and no instruments were involved. Also, plaintiffs were not proper plaintiffs for an action as to checks that M signed to withdraw funds from the bank accounts, since an action under U.C.C. 3420 may not be brought by a payee who does "not receive delivery of the instrument either directly or through delivery to an agent or a copayee." (49 C.A.4th 485.)

(2) *Common law.* Plaintiffs could not state a common law count for conversion of money. Conversion is an act of dominion wrongfully exerted over the personal property of another. However, money cannot be the subject of a conversion action unless a specific sum capable of identification is involved. As to defendant banks, there were no allegations that as money in varying amounts was wired into the accounts, it was held in escrow or some other segregated fund for plaintiffs' benefit. As to defendant brokers, they were bailees acting in good faith on instructions of M, their customer. (49 C.A.4th 485.)

(c) *Violation of U.C.C. 11204.* The statute did not apply here because (1) defendant brokers were not banks, let alone receiving banks, and (2) plaintiffs were not "customers" (see U.C.C. 11105) of either defendant banks or defendant brokers. (49 C.A.4th 486; see infra, §134.) (See *Central Bank v. Kaiperm Santa Clara Fed. Credit Union* (1987) 191 C.A.3d 186, 201, 236 C.R. 262 [payor bank was not liable for payment of money orders stolen from agent and forged; agent was not depositor and money orders were not negotiable instruments].)

In *Chicago Title Ins. Co. v. Superior Court* (1985) 174 C.A.3d 1142, 220 C.R. 507, plaintiff title company, not a customer of defendant bank, sued defendant for fraud, conspiracy to defraud, breach of the duty of good faith, and wrongful dishonor of checks, and for money had and received. Checks to plaintiff from R, one of defendant's depositors, were being covered by redeposit of plaintiff's own funds. Plaintiff alleged that defendant had become aware that R was using its account with defendant to defraud plaintiff, and that defendant failed to close the account as recommended by its auditors, and further failed to warn plaintiff. *Held*, no representation had been made by defendant to plaintiff, and defendant owed plaintiff neither a common law nor a statutory duty of disclosure. A bank's customer has a reasonable expectation that, in the absence of compulsion by legal process, matters revealed to the bank will be utilized only for internal banking purposes. "If ... banks had a duty to reveal suspicions about their customers, they would violate their customers' right to privacy, not to mention be forced to act as the guarantor of checks written by the depositors. We refuse to recognize such a duty by banks to inform on suspicious customers, and we thereby avoid the loss of privacy, expense and commercial havoc that would result from such a holding." (174 C.A.3d 1159.) (On Right to Financial Privacy Act, see supra, §73.)

SUPPLEMENT: [This section is current through the latest supplement]

See *Casey v. United States Bank Nat. Assn.* (2005) 127 C.A.4th 1138, 1148, 1149, 26 C.R.3d 401, 5 Summary (10th), *Torts*, Supp., §44, citing *Chicago Title Ins. Co. v. Superior Court* (1985) 174 C.A.3d 1142, 220 C.R. 507, text, p. 504, and *Software Design & Application, Ltd. v. Hoefler & Arnett* (1996) 49 C.A.4th 472, 56 C.R.2d 756, text, p. 503 [bank owes no duty to nondepositors to investigate or disclose suspicious activities on part of accountholder; thus, banks were not liable for aiding and abetting corporate fiduciaries in looting corporation where complaint failed to establish that banks had actual knowledge of fiduciaries' misappropriation of funds, notwithstanding allegations that banks allowed fiduciaries to open accounts with invalid tax identification numbers, withdraw large sums of cash, and violate banking regulations and banks' internal policies and procedures]; *Rodriguez v. Bank of the West* (2008) 162 C.A.4th 454, 457, 460, 463, 466, 75 C.R.3d 543 [following *Software Design & Application, Ltd. v. Hoefler & Arnett*; plaintiff attorney was never customer of defendant banks and thus was not owed duty of due care where, without plaintiff's knowledge or consent, plaintiff's office manager had forged plaintiff's signature, opened bank accounts in plaintiff's name, deposited money plaintiff had received in trust from clients, and then stole money from accounts; contract was between defendants and office manager, and case was one of identify theft for which court would not shift burden of loss from plaintiff victim to duped defendants].



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CHAPTER VI - Negotiable Instruments

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 III. BANKING
 E. Funds Transfers Under Division 11.
 1. In General.

4 Witkin Sum. Cal. Law Neg Inst § 132

[§ 132] In General.

(1) *Need for Comprehensive Statute.* The 1990 Legislature enacted Article 4A of the Uniform Commercial Code as Division 11 of the California Uniform Commercial Code (U.C.C. 11101 et seq.), entitled "Funds Transfers." The focus of the Article is a type of payment, commonly referred to as a "wholesale wire transfer," which is used almost exclusively between business or financial institutions. Payments made by wire transfer, as distinguished from payments made by checks or credit cards, or from electronically based consumer payments, require a separate body of law that addresses the unique operational and policy issues presented by the method. It was therefore the intent of the drafters of Article 4A to provide a comprehensive body of law to govern the rights and obligations resulting from wire transfers. (Prefatory Note to 1989 Act, 2B (Part II) U.L.A. (Master Ed.), p. 6 et seq.; see 7 Anderson 3d (2000 ed.), §4A-101:1 et seq.)

A typical funds transfer involves a large amount of money, multimillion-dollar transactions being common. Most transactions are completed in a single day; thus, funds transfers are efficient substitutes for payments made by delivery of paper instruments. An additional feature is low cost, in that transfers involving millions of dollars can be made for a few dollars. However, in the event a problem arises, risk of loss to banks may be high. Thus, "a major policy issue in the drafting of Article 4A is that of determining how risk of loss is to be allocated given the price structure in the industry." (Prefatory Note to 1989 Act, 2B (Part II) U.L.A. (Master Ed.), pp. 8, 9.)

(2) *Description of Funds Transfer Process.* The Prefatory Note describes a typical funds transfer as follows: "X, a debtor, wants to pay an obligation owed to Y. Instead of delivering to Y a negotiable instrument such as a check or some other writing such as a credit card slip that enables Y to obtain payment from a bank, X transmits an instruction to X's bank to credit a sum of money to the bank account of Y. In most cases X's bank and Y's bank are different banks. X's bank may carry out X's instruction by instructing Y's bank to credit Y's account in the amount that X requested. The instruction that X issues to its bank is a 'payment order.' X is the 'sender' of the payment order and X's bank is the 'receiving bank' with respect to X's order. Y is the 'beneficiary' of X's order. When X's bank issues an instruction to Y's bank to carry out X's payment order, X's bank 'executes' X's order. The instruction of X's bank to Y's bank is also a payment order. With respect to that order, X's bank is the sender, Y's bank is the receiving bank, and Y is the beneficiary. The entire series of transactions by which X pays Y is known as the 'funds transfer.' With respect to the funds transfer, X is the 'originator,' X's bank is the 'originator's bank,' Y is the 'beneficiary' and Y's bank is the 'beneficiary's bank.' In more complex transactions there are one or more additional banks known as 'intermediary banks'

between X's bank and Y's bank." (Prefatory Note to 1989 Act, 2B (Part II) U.L.A. (Master Ed.), pp. 7, 8.) (See *13 U.S.F. L. Rev.* 225 et seq. [symposium on electronic funds transfers]; Brady (Bailey) §20.01 et seq.)

(3) *Electronic Transmission Not Required.* Although in most cases, the payment order of each bank to the next bank in the chain is transmitted electronically, as is the payment order of the debtor to its bank, the means of transmission is legally insignificant. A payment order can be transmitted by any means, including first-class mail. Thus, Article 4A uses the broad term "funds transfer," rather than "wire transfer," to describe the payment transaction. (Prefatory Note to 1989 Act, 2B (Part II) U.L.A. (Master Ed.), p. 8.)

(4) *Effect of Federal Law.* Regulations of the Board of Governors of the Federal Reserve System and operating circulars of the Federal Reserve Banks supersede, to the extent of the inconsistency, any inconsistent provision of U.C.C. 11101 et seq. (U.C.C. 11107.) U.C.C. 11101 et seq. do not apply to a funds transfer governed by *15 U.S.C.*, §1693 et seq., the Electronic Fund Transfer Act of 1978. (U.C.C. 11108.)

(5) *Variation by Agreement.* Except as otherwise provided in U.C.C. 11101 et seq., the rights and obligations of a party to a funds transfer may be varied by agreement. (U.C.C. 11501(a).)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Need for Comprehensive Statute.* See 7 Lawrence's Anderson 3d (2007 ed.), §4A-101 et seq. (replacing 7 Anderson 3d (2000 ed.), §4A-101:1 et seq.).

(2) *Description of Funds Transfer Process.* See Clark, *The Law of Bank Deposits, Collections and Credit Cards* (Rev. ed.), Chap. 17.



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E. Funds Transfers Under Division 11.
2. Definitions.

4 Witkin Sum. Cal. Law Neg Inst § 133

[§ 133] Definitions.

Funds transfer refers to "the series of transactions, beginning with the originator's payment order, made for the purpose of making payment to the beneficiary of the order. The term includes any payment order issued by the originator's bank or an intermediary bank intended to carry out the originator's payment order. A funds transfer is completed by acceptance by the beneficiary's bank of a payment order for the benefit of the beneficiary of the originator's payment order." (U.C.C. 11104(a).)

A *payment order* is an instruction of a sender to a receiving bank, transmitted orally, electronically, or in writing, to pay, or to cause another bank to pay, a fixed or determinable amount of money to a beneficiary. (U.C.C. 11103(a)(1).) All of the following must apply for the instruction to be a payment order:

(1) The instruction must not state a condition to payment to the beneficiary other than the time of payment. (U.C.C. 11103(a)(1)(i).)

(2) The receiving bank will be reimbursed by debiting the sender's account or otherwise receiving payment from the sender. (U.C.C. 11103(a)(1)(ii).)

(3) The sender must transmit the instruction directly to the receiving bank, or to an agent, funds transfer system, or communication system for transmittal to the receiving bank. (U.C.C. 11103(a)(1)(iii).)

SUPPLEMENT: [This section is current through the latest supplement]



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 3. Procedure.

4 Witkin Sum. Cal. Law Neg Inst § 134

[§ 134] Procedure.

Procedures are established for issuing and accepting payment orders (U.C.C. 11201 et seq.), for the receiving bank's execution of the sender's payment order (U.C.C. 11301 et seq.), and for payment (U.C.C. 11401 et seq.). (See 29 *Loyola L.A. L. Rev.* 1107 [effect of Article 4A on law of international credit transfers].)

In *Bank of America v. Sanati* (1992) 11 C.A.4th 1079, 14 C.R.2d 615, plaintiff bank sued defendants, a wife and two children living in California, to recover an erroneous fund transfer. The husband and father of defendants had separated from his family and permanently left the United States. He maintained a separate account at plaintiff's London branch, and had instructed plaintiff to send the monthly interest from that account to an account he held jointly with defendant wife at one of plaintiff's California branches. Plaintiff erroneously sent to the joint account the principal from the husband's account, as well as the interest. When plaintiff discovered the error and requested reimbursement, defendants refused. The trial judge granted summary judgment for plaintiff on the restitution claim. *Held*, affirmed.

(a) *U.C.C. Division 11 did not apply.* The funds transfer provisions of U.C.C. Division 11 did not apply to the transfer here. Division 11 applies only to funds transfers in which the originator's payment order was transmitted on or after January 1, 1991. Here, the payment order was transmitted in April 1990. (11 C.A.4th 1085.)

(b) *Common law governing erroneous funds transfers.* At the time of the funds transfer here, general common law and equitable principles controlled the risks and liabilities of banks, beneficiaries and originators. That law entitled plaintiff to restitution for the amount of the unauthorized transfer, despite plaintiff's negligence, unless defendants had detrimentally relied on the erroneous payment without noticing the mistake, or had applied the payment in good faith to a preexisting debt owed them by their husband and father. (11 C.A.4th 1084, 1085, citing the text, 1 *Summary* (10th), *Contracts*, §§1017, 1025, 1027.) Neither exception applied here. Defendants did not contend that they changed their position to their detriment. Defendant wife was able to show no more than a potential quasi-community property interest in the funds in the London account, not a preexisting debt. (11 C.A.4th 1089.)

(c) *Plaintiffs would prevail even if U.C.C. Division 11 applied.* The Official Comment to U.C.C. 11303 states that a bank is entitled to recover from the beneficiary of an erroneous transfer the excess payment received, to the extent allowed by the law governing mistake and restitution. This Comment thus adopts the common law rule that defendants would have been entitled to retain the erroneously sent funds if they had been able to establish a good faith belief that

the funds had been sent to them in satisfaction of a preexisting debt. (11 C.A.4th 1086.) (See *Software Design & Application, Ltd. v. Hofer & Arnett* (1996) 49 C.A.4th 472, 486, 56 C.R.2d 756, supra, §131 [violations of U.C.C. 11204 (acceptance of unauthorized or unenforceable payment order) may not be alleged by noncustomers or used against securities brokers].)

SUPPLEMENT: [This section is current through the latest supplement]

Procedures regarding payment order: See *TME Enterprises v. Norwest Corp.* (2004) 124 C.A.4th 1021, 1025, 1034, 1035, 22 C.R.3d 146 [under federal regulations and U.C.C. 11207, bank accepting incoming wire transfer of funds that specifies both account number and named beneficiary may rely on account number, even if named beneficiary does not hold account identified by designated number, provided bank lacks actual knowledge of inconsistency; here, as part of fraudulent scheme, money sent by wire transfer ended up in personal account instead of trust account, but names were similar and bank, which lacked knowledge that name and account number did not refer to same person, was not liable].



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 4. Miscellaneous Provisions.

4 Witkin Sum. Cal. Law Neg Inst § 135

[§ 135] Miscellaneous Provisions.

Division 11 also governs the following:

(1) Creditor process, defined as "levy, attachment, garnishment, notice of lien, sequestration, or similar process issued by or on behalf of a creditor or other claimant with respect to an account." (U.C.C. 11502(a).)

(2) Orders restraining (a) a person from issuing a payment order to initiate a funds transfer, (b) an originator's bank from executing the payment order of the originator, or (c) the beneficiary's bank from releasing funds to the beneficiary or the beneficiary from withdrawing the funds. (U.C.C. 11503.)

(3) The sequence in which a receiving bank receiving more than one payment order may charge the sender's account. (U.C.C. 11504.)

(4) Notification to the receiving bank that the customer objects to a payment. (U.C.C. 11505.)

SUPPLEMENT: [This section is current through the latest supplement]

(4) *Notification to receiving bank that customer objects to payment:* In *Zengen v. Comerica Bank* (2007) 41 C.4th 239, 59 C.R.3d 240, 158 P.3d 800, plaintiff biopharmaceutical company opened accounts at defendant bank. L, plaintiff's chief executive officer, and Y, its chief financial officer, executed a business signature card and a funds transfer authorization agreement. Y's check signing authority was limited, and the funds transfer authorization agreement required that both L and Y authorize transfers exceeding \$ 50,000. Y subsequently embezzled \$ 4.6 million from plaintiff by directing four funds transfers from one of plaintiff's accounts with defendant to an account Y controlled. Plaintiff sued defendant, claiming that defendant was liable for the \$ 4.6 million loss because it should not have accepted the four unauthorized payment orders. The trial judge granted summary judgment for defendant on plaintiff's common law and California Uniform Commercial Code causes of action, and the Court of Appeal affirmed. *Held*, reversed.

(a) *California Uniform Commercial Code displaces common law.* In addition to seeking a refund from defendant under the California Uniform Commercial Code, plaintiff alleged common law causes of action for breach of contract, negligence, return of deposit, and money had and received. Each common law cause of action was based on the claim

that defendant should not have accepted and executed the fraudulent payment orders. Specifically, plaintiff alleged that defendant violated the funds transfer authorization agreement by failing to obtain L's authorization. Thus, the case concerned unauthorized wire funds transfers, for which Division 11 of the California Uniform Commercial Code provides a remedy. Accordingly, Division 11 preempts the common law causes of action. (41 C.4th 244, 251, 255.)

(b) *Required notice to bank.* To recover from a bank for an unauthorized payment, U.C.C. 11505 requires that the customer notify the bank of the customer's objection to the payment within 1 year after the customer received notification reasonably identifying the payment order. U.C.C. 11505 is a statute of repose, not a statute of limitation. It requires that the customer notify the bank of the claim, not actually commence an action. Prompt notification allows the bank to investigate, prepare a defense, anticipate possible liability, and take steps to guard against similar liability in the future. (41 C.4th 258.) The customer "must not merely inform the bank that the payment orders were unauthorized or fraudulent; it must inform the bank in some way that the customer objected to what the bank had done in accepting the payment orders. But the statute does not require any particular formulaic words. Rather, it is sufficient if, based on all of the circumstances, a reasonable bank would understand that the customer was objecting to what the bank had done in accepting the payment orders or otherwise considered the bank liable for the loss." (41 C.4th 244.) Thus, whether notification is sufficient in a particular case depends on the circumstances. (41 C.4th 259.)

(c) *Application of test.* Here, plaintiff arguably did more than just inform defendant that the payment orders were unauthorized. L testified that he told a bank official that *he* had not authorized the transactions; this testimony might be significant in light of the funds transfer authorization agreement. L further testified that at one point he and the official had engaged in a general discussion about defendant being sued. On remand, the Court of Appeal must determine the adequacy of plaintiff's notification in light of the above test. (41 C.4th 259.)



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 IV. LETTERS OF CREDIT
 A. Enactment of Division 5.

4 Witkin Sum. Cal. Law Neg Inst § 136

[§ 136] Enactment of Division 5.

(1) *Uniform Commercial Code Revision*. In 1995, the National Conference of Commissioners on Uniform State Laws and the American Law Institute approved a revised Article 5 of the Uniform Commercial Code, entitled Letters of Credit. It replaces former Article 5, originally enacted in 1963. The text of the revised article and the extensive official comments are set forth in 2B (Part II) U.L.A. (Master Ed.), p. 125 et seq. A Prefatory Note explains the purpose and benefits of the revision. (See 2B (Part II) U.L.A. (Master Ed.), p. 126 et seq.; 7A Anderson 3d (2001 ed.), §5-101:1 et seq.) In 1996, California enacted the revised article as Division 5 (U.C.C. 5101 et seq.), also entitled Letters of Credit. (Stats. 1996, Chap. 176.)

(2) *Uniform Customs and Practice for Documentary Credits*. Division 5, unlike other divisions of the Uniform Commercial Code, does not purport to be a comprehensive codification. "Because this article is quite short and has no rules on many issues that will affect liability with respect to a letter of credit transaction, law beyond Article 5 will often determine rights and liabilities. Even within letter of credit law, the article ... deals only with 'certain' rights of the parties." (U.C.C. 5103, Official Comment 2.) The parties and courts may thus turn to customs and practice such as the Uniform Customs and Practice for Documentary Credits, International Chamber of Commerce Publication No. 500, which is a private, international agreement adhered to by banks in practically all nations engaged in international commerce. Most letter of credit transactions are subject to the Uniform Customs because its provisions are invariably incorporated by reference into the agreement between the issuing bank and its customer as well as the letter of credit itself. The scope of the Uniform Customs is more limited than that of the Code because it is applicable only to documentary (commercial) credits and is declaratory of the custom and practice followed by banks only. Where the Uniform Customs are adopted but conflict with Article 5 and except where variation is prohibited, the terms of the Uniform Customs are permissible contractual modifications. (See U.C.C. 5103, Official Comment 2; U.C.C. 5116(c) [rules of custom or practice to which letter of credit is expressly made subject govern, except where rules conflict with nonvariable provisions specified in U.C.C. 5103(c)]; *Paramount Export Co. v. Asia Trust Bank, Ltd.* (1987) 193 C.A.3d 1474, 1479, 238 C.R. 920, infra, §142 [use of Uniform Customs]; 56 A.L.R.5th 565 [validity, construction, and application of Uniform Customs and Practice for Documentary Credits].)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Uniform Commercial Code Revision*. See 7A Lawrence's Anderson 3d (2008 ed.), [Rev] §5-101 et seq. (replacing 7A Anderson 3d (2001 ed.), §5-101:1 et seq.).



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IV. LETTERS OF CREDIT

B. Definitions.

4 Witkin Sum. Cal. Law Neg Inst § 137

[§ 137] Definitions.

(1) *Letter of Credit.* A letter of credit is "a definite undertaking," that satisfies the formal requirements of U.C.C. 5104 (infra, §139), by an issuer to a beneficiary at the request or for the account of an applicant to honor a documentary presentation by payment or delivery of an item of value. (U.C.C. 5102(a)(10); for definition of "issuer," see U.C.C. 5102(a)(9); for definition of "beneficiary," see U.C.C. 5102(a)(3); for definition of "applicant," see U.C.C. 5102(a)(2).) In almost all cases, the ultimate performance of the issuer under a letter of credit is the payment of money, but in rare cases, the issuer may be required to deliver stock certificates or the like. (U.C.C. 5102, Official Comment 6.) (See *44 A.L.R.4th 172* [what is letter of credit under UCC].)

A true guaranty or suretyship contract is not a letter of credit. (U.C.C. 5102, Official Comment 6; U.C.C. 5103, Official Comment 1.)

(2) *Documentary Presentation.* "Documentary presentation" refers to submission of "a draft or other demand, document of title, investment security, certificate, invoice, or other record, statement, or representation of fact, law, right, or opinion" that satisfies all of the following conditions:

(a) It is presented in a written or other medium permitted by the letter of credit or, unless prohibited by the letter, by the standard practice of banks that regularly issue letters of credit. (U.C.C. 5102(a)(6)(i); on standard practice, see U.C.C. 5108(e).)

(b) It is capable of being examined for compliance with the terms and conditions of the letter of credit. (U.C.C. 5102(a)(6)(ii).)

(c) It is not oral. (U.C.C. 5102(a)(6).)

"The definition of 'document' contemplates and facilitates the growing recognition of electronic and other nonpaper media as 'documents,' however, for the time being, data in those media constitute documents only in certain circumstances. For example, a facsimile received by an issuer would be a document only if the letter of credit explicitly permitted it, if the standard practice authorized it and the letter did not prohibit it, or the agreement of the issuer and beneficiary permitted it. The fact that data transmitted in a nonpaper (unwritten) medium can be recorded on paper by a recipient's computer printer, facsimile machine, or the like does not under current practice render the data so transmitted

a document. A facsimile or S.W.I.F.T. message received directly by the issuer is in an electronic medium when it crosses the boundary of the issuer's place of business. One wishing to make a presentation by facsimile (an electronic medium) will have to procure the explicit agreement of the issuer (assuming that the standard practice does not authorize it). Where electronic transmissions are authorized neither by the letter of credit nor by the practice, the beneficiary may transmit the data electronically to its agent who may be able to put it in written form and make a conforming presentation." (U.C.C. 5102, Official Comment 2.)

SUPPLEMENT: [This section is current through the latest supplement]



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IV. LETTERS OF CREDIT

C. Operation and Effect.

1. Typical Transaction.

4 Witkin Sum. Cal. Law Neg Inst § 138

[§ 138] Typical Transaction.

In practice, virtually all letter of credit transactions involve irrevocable, commercial letters issued by banks that specialize in international trade, on behalf of an applicant who uses the letter as a means of paying for goods purchased from a foreign seller. (For forms, see Cal. Transactions Forms, 4 Business Transactions §27:29 et seq.) In a typical transaction, a California buyer (called the "applicant") under a contract to purchase goods from a foreign seller (called the "beneficiary") applies to a California bank (called the "issuer") for issuance of an irrevocable, commercial letter of credit in favor of the beneficiary as payment for the goods. The issuer transmits the letter of credit to a correspondent bank located in the beneficiary's country. The correspondent bank then either advises the beneficiary of the letter or confirms the letter. (See *infra*, §140.) The beneficiary then presents documents to obtain payment and the issuer either honors or dishonors the presentation. If the issuer honors the presentation, it turns to the applicant for reimbursement. (See *infra*, §141.) The net effect of the letter of credit transaction is that the foreign seller is assured of payment before the goods leave the seller's possession, and the buyer receives documentary proof that the seller has complied with the terms of the contract before payment is made. (See 25 *Stanf. L. Rev.* 716 [bank solvency and guaranty letters of credit]; Cal. Civil Practice, 4 Business Litigation, §43:1 et seq.; Cal. Transactions Forms, 4 Business Transactions §27:1 et seq.; 50 *Am.Jur.2d* (1995 ed.), *Letters of Credit* §1 et seq.; on enforceability of letter of credit issued as additional collateral for obligation secured by real property, see 4 *Summary* (10th), *Security Transactions in Real Property*, §§125, 200.)

West's Key Number Digest, Banks and Banking k.191 et seq.

SUPPLEMENT: [This section is current through the latest supplement]

See Clark, *The Law of Bank Deposits, Collections and Credit Cards* (Rev. ed.), Chap. 14; 50 *Am.Jur.2d* (2006 ed.), *Letters of Credit* §1 et seq.



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IV. LETTERS OF CREDIT

C. Operation and Effect.

2. Types, Forms, and Expiration of Letter of Credit.

4 Witkin Sum. Cal. Law Neg Inst § 139

[§ 139] Types, Forms, and Expiration of Letter of Credit.

(1) *Types of Letters of Credit.* The type of letter of credit used in a transaction is determined by the kind of documents that must be presented to draw on the letter or by the circumstances under which the issuer must honor the letter. The following are the more important ones (see C.E.B., 18 California Business Reporter 177, 178 (March 1997):

(a) *Clean letter.* This letter only requires the beneficiary to present a payment draft for the issuer to honor the letter. However, in the case of a standby letter of credit (see *infra*, this section), the beneficiary may also be required to certify that the applicant has failed to pay or perform.

(b) *Documentary letter.* This letter requires the beneficiary to present documents in addition to a demand for payment, such as bills of lading or inspection certificates. (See *infra*, this section.)

(c) *Direct pay letter.* A beneficiary holding this letter expects to receive payment under the letter. This letter is most often used in transactions involving the international sale of goods.

(d) *Standby letter.* A beneficiary holding this letter expects the applicant to pay the beneficiary directly, and makes use of the letter only if the applicant fails to do so.

(2) *Form.* Although no particular form is required, the letter of credit must be a "record," i.e., "information that is inscribed on a tangible medium, or that is stored in an electronic or other medium and is retrievable in perceivable form" (see U.C.C. 5102(a)(14)). The letter also must be authenticated either (a) by a signature or (b) in accordance with the agreement of the parties or the standard practice of banks that regularly issue letters of credit. (U.C.C. 5104; on standard practice, see U.C.C. 5108(e).)

A letter will typically specify the beneficiary, the amount of the credit, the date when it expires, the place where presentation should be made, and the documents that must be furnished. Typically, these documents include an invoice, a bill of lading, an insurance certificate, and, in some cases, an inspection certificate. Payment under the letter of credit is conditioned on the beneficiary furnishing the specified documents. (See U.C.C. 5104, Official Comment 1.) Letter of credit status may be denied to documents that are unduly vague or incomplete. (U.C.C. 5102, Official Comment 6.)

Many letters of credit transactions are now conducted mostly by electronic means. For example, a computer service

may be used to electronically transmit a letter of credit from an issuing bank to an advising bank. The letter text so transmitted may be printed at the advising bank, stamped "original," and provided to the beneficiary in that form. The printed document may then be used to control and record payments. (See U.C.C. 5104, Official Comment 3; on other documentary requirements of electronic or facsimile letters, see *supra*, §137.)

(3) *Revocation and Expiration.* A letter of credit may be revocable or irrevocable, but it is revocable only if the letter so provides. (U.C.C. 5106(a).) Unless it states otherwise, a letter expires 1 year after the issuance date appearing in the letter, or if none, 1 year after it is issued. (U.C.C. 5106(c).) If the letter states that it is "perpetual," it expires 5 years after the issuance date appearing in the letter, or if none, 5 years after it is issued. (U.C.C. 5106(d).)

SUPPLEMENT: [This section is current through the latest supplement]



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IV. LETTERS OF CREDIT
C. Operation and Effect.
3. Transmission and Receipt.

4 Witkin Sum. Cal. Law Neg Inst § 140

[§ 140] Transmission and Receipt.

(1) *Transmission.* The letter of credit may be transmitted to the applicant or directly to the beneficiary, but generally it will be transmitted to a correspondent bank located in the same country as the beneficiary. Once the letter has been transmitted, it is enforceable against the issuer. (U.C.C. 5106(a).) If it is irrevocable, it can be modified or revoked only with the consent of the beneficiary. (U.C.C. 5106(b).) No consideration is necessary to issue or modify a letter of credit. (U.C.C. 5105.) (See *13 A.L.R.5th 465* [modification, revocation, or reformation of letter of credit].)

(2) *Advice or Confirmation.* Depending on the terms of the letter, the correspondent bank may take one of the following actions:

(a) The correspondent bank may "advise" the beneficiary of the issuance of the letter. An "adviser" (see U.C.C. 5102(a)(1)) does not assume any obligation to honor or give value for a presentation of documents or demands for payment made under the letter. (U.C.C. 5107(c); for definition of presentation, see U.C.C. 5102(a)(12).)

(b) The correspondent bank may "confirm" the letter of credit. A "confirmer" (see U.C.C. 5102(a)(4)) assumes the obligations of an issuer and acquires an issuer's rights. (U.C.C. 5107(a).)

SUPPLEMENT: [This section is current through the latest supplement]



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CHAPTER VI - Negotiable Instruments

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IV. LETTERS OF CREDIT

C. Operation and Effect.

4. Honor or Dishonor.

a. Statutory Requirements.

4 Witkin Sum. Cal. Law Neg Inst § 141

[§ 141] Statutory Requirements.

(1) *General Procedure.* When the beneficiary (or other presenter) presents documents to obtain payment under a letter of credit, the issuer, within a reasonable time not to exceed 7 business days, must in most cases do one of two things:

(a) Honor the presentation up to the limit of the letter of credit if the documents, as determined by the standard practice of banks that regularly issue letters of credit, appear on their face *strictly* to comply with the terms and conditions of the letter. (U.C.C. 5108(a), (b)(1); see *Lectrodryer v. SeoulBank (2000) 77 C.A.4th 723, 727, 91 C.R.2d 881* [issuer waived right to require strict compliance with terms of letter of credit; issuer delegated duty to evaluate documents to customer and obtained waiver of discrepancies from customer, indicating that issuer intended to comply with customer's instructions about whether payment should be made]; 8 *A.L.R.5th 463* [what constitutes compliance of documents presented with terms of letter of credit so as to require honor of draft]; for definition of presentation, see U.C.C. 5102(a)(12).)

(b) Dishonor the presentation if the documents do not strictly comply, notify the beneficiary of the discrepancies, and return the documents to (or hold them for) the beneficiary. (U.C.C. 5108(a), (b)(3), (h).)

Except in case of fraud, forgery, or expiration of the note, failure to notify the beneficiary of documentary discrepancies in a timely manner precludes the issuer from asserting the discrepancies as a basis for dishonor. (U.C.C. 5108(c), (d).)

(2) *Time Period for Issuer To Act.* Failure by the issuer to act within a reasonable time constitutes dishonor. (U.C.C. 5108, Official Comment 2.) Under the 1993 revision of the International Chamber of Commerce, Uniform Customs and Practice for Documentary Credits (UCP 500), made applicable to letters of credit by U.C.C. 5116(c) (*supra*, §136), a bank issuing a letter of credit has a reasonable time, not to exceed 7 banking days following the day it receives the documents from the beneficiary, to examine the documents, determine whether to take them up or refuse them, and inform the beneficiary. However, as noted in Official Comment 2 to U.C.C. 5108, the 7 day period is not a "safe harbor": the time within which an issuer must give notice is the lesser of a reasonable time or 7 business days. Thus, taking the full 7 days is not automatically reasonable where a bank seeks waiver of document discrepancies from the letter of credit applicant. (*DBJJJ v. National City Bank (2004) 123 C.A.4th 530, 535, 542, 546, 19 C.R.3d 904*)

[summary judgment in favor of bank was improper where bank did not show as matter of law that it provided timely notice to beneficiary of decision to refuse documents; neither would summary judgment for beneficiary be proper where it did not show as matter of law that bank exceeded reasonable time]; see 2 *A.L.R.4th* 665 [damages recoverable for wrongful dishonor under former Unif.Com.C. 5-115 (now Unif.Com.C. 5-111)]; 17 Proof of Facts 3d 541 [banking negligence: improper dishonor of letter of credit].)

(3) *Procedure in Case of Fraud or Forgery*. If a required document is forged or materially fraudulent, or if honoring the presentation would facilitate a material fraud by the beneficiary on the issuer or the applicant, the following procedures apply:

(a) If the documents appear on their face strictly to comply with the terms and conditions of the letter of credit, the issuer must honor a demand for payment presented by a holder (or similar person) who has acquired it under circumstances that would make the person essentially a holder in due course. (U.C.C. 5109(a)(1).) The issuer may, acting in good faith, honor or dishonor the presentation in any other case in which the documents appear on their face strictly to comply with the terms and conditions of the letter of credit. (U.C.C. 5109(a)(2).) (See *Mitsui Mfrs. Bank v. Texas Commerce Bank-Fort Worth* (1984) 159 C.A.3d 1051, 1057, 1058, 206 C.R. 218 [U.C.C. 5114(2)(b) (now U.C.C. 5109(a)(2)) does not prohibit enjoining beneficiary from drawing against letter of credit].)

(b) If the applicant makes the fraud or forgery claim, a court may temporarily or permanently enjoin the issuer from honoring a presentation or grant similar relief. (U.C.C. 5109(b).) (See 27 *Loyola L.A. L. Rev.* 619 [arguing that courts should not be allowed to enjoin payment of letters of credit in bankruptcy]; 25 *A.L.R.4th* 239 [fraud or forgery justifying refusal to honor, or injunction against honoring, under Unif. Com. C. §5-114(1), (2) (now Unif.Com.C. 5-109)].)

(4) *Effect of Honor*. When the issuer has duly honored presentation, the following rules apply:

(a) The issuer is entitled to reimbursement from the applicant. (U.C.C. 5108(i)(1).)

(b) The issuer takes the documents presented free of any claims by the beneficiary. (U.C.C. 5108(i)(2).)

(c) The issuer waives any right of recourse on a draft under U.C.C. 3414 and 3415 (see *supra*, §§46, 48). (U.C.C. 5108(i)(3).)

(d) The issuer generally is precluded from restitution of money paid or other value given by mistake to the extent the mistake concerns discrepancies in the documents that are apparent on the face of the presentation. (U.C.C. 5108(i)(4).)

(e) The issuer is discharged from its obligations under the letter of credit (unless it honored a presentation where a required signature of a beneficiary was forged). (U.C.C. 5108(i)(5).)

SUPPLEMENT: [This section is current through the latest supplement]



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IV. LETTERS OF CREDIT

C. Operation and Effect.

4. Honor or Dishonor.

b. Illustrations.

4 Witkin Sum. Cal. Law Neg Inst § 142

[§ 142] Illustrations.

(1) *Requirement of Strict Compliance by All Parties.* In *Paramount Export Co. v. Asia Trust Bank, Ltd.* (1987) 193 C.A.3d 1474, 238 C.R. 920, plaintiff exporter sued defendant bank for money due on a letter of credit that defendant had dishonored. The letter of credit was payable on plaintiff's presentation of a bill of lading indicating that a buyer had received a shipment of onions. A letter accompanying the letter of credit advised plaintiff that the bill of lading must state that the onions were stored "in ventilated containers with doors off." The letter of credit itself, however, stated no such requirement. The trial judge entered summary judgment against plaintiff on the ground that the bill of lading plaintiff submitted to defendant's advising bank did not state that the onions had been shipped "in ventilated containers with doors off," although it did state that the onions had been shipped "vent stowed," which meant the same thing. *Held*, reversed.

(a) Plaintiff was collaterally estopped from contending that the bill of lading conformed to the terms and conditions of the letter of credit, because that issue had been determined in a prior action plaintiff brought against the advising bank. (193 C.A.3d 1479.) However, defendant failed either to return the defective documentation or to hold it at the disposal of the advising bank, as required by Article 8, subdivision e, of the Uniform Customs and Practice for Commercial Documentary Credits. Thus, under subdivision f, defendant was precluded from asserting that the terms and conditions of the letter of credit had not been fulfilled. (193 C.A.3d 1481.)

(b) "The rigid, and sometimes unfair rules regarding letters of credit resulted in the trial court's judgment that appellant did not technically fulfill the credit's requirements even though it is undisputed that appellant shipped the produce in the manner requested and merely described the produce as 'vent stowed' rather than 'stored in ventilated containers with doors off.' Equally rigid rules of UCP, article 8 unequivocally state that if the issuing bank fails to return the defective documentation then it shall be 'precluded from claiming that the relative payment ... was not effected in accordance with the terms and conditions of the credit.' (Art. 8, subd. e.) If appellant is expected to abide by the strict rules surrounding letter of credit transactions, respondent is under an equal obligation to do so." (193 C.A.3d 1483.)

(2) *Applicant's Defenses Not Available to Issuer.* In *San Diego Gas & Elec. Co. v. Bank Leumi* (1996) 42 C.A.4th 928, 50 C.R.2d 20, plaintiff utility company entered into an agreement with a power producer calling for the power producer to construct a small power plant and sell its power to plaintiff. To secure the power producer's performance,

plaintiff required the power producer to obtain a "standby" letter of credit naming plaintiff as beneficiary. Defendant bank issued the letter, which provided that plaintiff could obtain payment by drafts drawn on defendant if accompanied by certification of the deficiencies in the power producer's performance. Some years later, plaintiff drew on the letter in the full amount after certifying that the power producer had failed to reach a "project development milestone." When defendant failed to honor the draft, plaintiff sued, alleging wrongful dishonor and other theories, and the trial judge granted summary judgment for plaintiff. The judge ruled that plaintiff was entitled to draw on the letter in the full amount of its demand, rejecting defendant's claims (a) that plaintiff owed a duty to mitigate its damages or (b) that irrespective of that duty, any actual mitigation by plaintiff was required to be deducted from its recovery. *Held*, affirmed.

(a) *Independence principle*. Under the independence principle embodied in former U.C.C. 5114(1) (now U.C.C. 5108(a), *supra*, §141) and mandated by the terms of the letter of credit here, a letter of credit is independent from the underlying sales contract. In the absence of fraud, the issuer must pay on proper presentment regardless of any defenses the applicant for the letter of credit may have against the beneficiary arising from the underlying transaction. Thus, the issuer of a letter of credit is never entitled to defend against payment based on extraneous defenses that might have been available to the primary obligor. (42 C.A.4th 934.)

(b) *Mitigation of damages*. Defendant's mitigation defenses were clearly extraneous defenses that might have been available to the power producer, as applicant for the letter, in an action brought against it by plaintiff on the underlying contract. However, under the independence principle, they were not defenses that defendant, as issuer of the letter of credit, was entitled to assert. (42 C.A.4th 935.) Former U.C.C. 5115 (now U.C.C. 5111) did not expressly impose a duty on a beneficiary of a letter of credit to mitigate damages. (42 C.A.4th 936.) Former U.C.C. 5115(1) did provide for a reduction of the beneficiary's recovery corresponding to actual mitigation effected by resale or other disposition of the subject matter of the transaction. But read strictly, this mitigation language applies only to commercial letters of credit, i.e., to cases in which the beneficiary is a seller of goods. Thus, under the weight of authority considering the issue of a beneficiary's recovery under a standby letter of credit, the independence principle prohibits inquiry into the underlying contract to determine the extent of the beneficiary's actual damages. (42 C.A.4th 936 [disagreeing with federal district court case to contrary].) (See *Western Sec. Bank v. Superior Court* (1997) 15 C.4th 232, 251, 252, 62 C.R.2d 243, 933 P.2d 507, 7 Summary (10th), *Constitutional Law*, §624 [citing *San Diego Gas & Elec. Co.*; absent fraud, issuer of letter of credit must pay on proper presentment regardless of defenses customer may have against beneficiary based in underlying transaction; thus, when viewed as additional security for note also secured by real property, standby letter of credit does not conflict with statutory prohibition of deficiency judgments]; *Lumbermans Acceptance Co. v. Security Pac. Nat. Bank* (1978) 86 C.A.3d 175, 178, 150 C.R. 69 [issuer of irrevocable letter of credit had no responsibility to determine customer's underlying rights and liabilities against beneficiary].)

SUPPLEMENT: [This section is current through the latest supplement]



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IV. LETTERS OF CREDIT
C. Operation and Effect.
5. Security Interest.

4 Witkin Sum. Cal. Law Neg Inst § 143

[§ 143] Security Interest.

An issuer or nominated person has a security interest in a document presented under a letter of credit to the extent the issuer or nominated person honors or gives value for the presentation. (U.C.C. 5118(a).) To the extent that an issuer or nominated person has not been reimbursed or has not otherwise recovered the value given with respect to a security interest in a document, the security interest continues and is governed by U.C.C. 9101 et seq., subject to the following:

(1) A security agreement is not necessary to make the security interest enforceable under U.C.C. 9203(b)(3) (4 *Summary* (10th), *Secured Transactions in Personal Property*, §50). (U.C.C. 5118(b)(1).)

(2) If the document is presented in a medium other than a written or other tangible medium, the security interest is perfected. (U.C.C. 5118(b)(2).)

(3) If the document is presented in a written or other tangible medium and is not a certificated security, chattel paper, a document of title, an instrument, or a letter of credit, the security interest is perfected and has priority over a conflicting security interest in the document so long as the document is not in the debtor's possession. (U.C.C. 5118(b)(3).)

SUPPLEMENT: [This section is current through the latest supplement]



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 V. CREDIT CARDS
 A. In General.

4 Witkin Sum. Cal. Law Neg Inst § 144

[§ 144] In General.

(1) *Nature and Types.* There are two general types of credit cards: the "two-party" credit card, typified by the traditional department store credit card or charge plate, and the "three-party" (or "multiparty") credit card, exemplified by the travel and entertainment credit card or the bank credit card.

In a two-party transaction, the credit card serves only to identify the cardholder as a creditworthy customer, and the legal relations between the buyer-cardholder and the seller-issuer are not affected. In a three-party transaction, the normal relationship of buyer and seller is altered because there are separate contractual relationships between each of the parties. The retailer sells goods or services to the cardholder in return for the issuer's promise to pay. The issuer assumes the credit risk and is obligated to pay the retailer whether the cardholder pays or not. The cardholder is independently obligated to reimburse the issuer irrespective of a defect in the underlying sale.

There may be more than three parties involved in a bank credit card plan. The retailer's agreement may be with a correspondent bank that has a separate agreement with the issuing bank. Many "three-party" cards can be used nationwide and worldwide, the parties to the transaction being located thousands of miles from one another. Although credit cards can be used to obtain cash advances, in the same manner as personal checks, ordinarily they are used to purchase goods or services, in a manner similar to the revolving charge account or retail installment contract. (On credit cards generally, see 1 Fonseca & Teachout 3d, Handling Consumer Credit Cases, Chap. 10; Cal. Civil Practice, 5 Business Litigation, §55:1 et seq.; Cal. Transactions Forms, 5 Business Transactions §32:95 et seq.; 4 *U. C. Davis L. Rev.* 335 [bank credit cards and usury law]; 4 *U. C. Davis L. Rev.* 357 [legal rights and duties in three-party credit card transactions]; 21 *U.C.L.A. L. Rev.* 278 [bank credit cards and enterprise liability]; 21 *U.C.L.A. L. Rev.* 1380 ["Instant Deduction Approach" to multiparty transaction]; 20 *Am.Jur.2d* (1995 ed.), *Credit Cards* §1 et seq.; on credit card crimes; see 2 *Cal. Crim. Law* (3d), *Crimes Against Property*, §190 et seq.)

(2) *Credit Card Legislation.* The primary California legislation governing the use of credit cards is the Song-Beverly Credit Card Act of 1971 (C.C. 1747 et seq.; *infra*, §145 et seq.), based in part on federal statutes and on regulations promulgated by the federal Reserve Board. (See 4 San Fernando Valley L. Rev. 215 [cardholder's rights and defenses under Song-Beverly Act and federal law].) Provisions in the Song-Beverly Act similar to provisions in the federal Truth In Lending Act (15 *U.S.C.*, §1601 et seq., 1 *Summary* (10th), *Contracts*, §483) should be construed in conformity with the Truth In Lending Act. (C.C. 1747.01.) A waiver of the provisions of the Song-Beverly Act is contrary to public policy, void, and unenforceable. (C.C. 1747.04.)

The "rights or responsibilities" created by the Song-Beverly Act have no effect with respect to "transactions that constitute an electronic fund transfer as defined by Regulation E of the Federal Reserve Board." (C.C. 1747.03(a)(1).) Also exempted are transactions that involve the use of a key or card key at an automated dispensing outlet to obtain petroleum products to be used primarily for business purposes. (C.C. 1747.03(a)(2).) However, the holder of a key or card key will not be liable for losses due to the loss or theft of the key or card key incurred after the issuer has received notification of the loss or theft. (C.C. 1747.03(b).)

Other statutes governing credit cards include *Govt.C. 6159*, which authorizes courts, local governments, and public agencies to accept credit cards, debit cards, or electronic funds transfer, under specified conditions, for payment of the following items:

(a) Bail deposits for an offense not declared to be a felony or for a court-ordered fee, fine, forfeiture, penalty, or assessment. (*Govt.C. 6159(b)(1)*.)

(b) Filing fees or other court fees. (*Govt.C. 6159(b)(2)*.)

(c) Vehicular towage or storage costs. (*Govt.C. 6159(b)(3)*.)

(d) Child, family, or spousal support, including the reimbursement of public assistance, and related expenses. (*Govt.C. 6159(b)(4)*.)

(e) Services rendered by a local governmental entity or other public agency. (*Govt.C. 6159(b)(5)*.)

(f) A fee, charge, or tax due a local governmental entity or other public agency. (*Govt.C. 6159(b)(6)*.)

The State Payment Card Act (*Govt.C. 6160 et seq.*) requires state agencies to accept payments made by a credit card or other payment device. (*Govt.C. 6163*.) A "payment device" is defined as a card or other means of access to a consumer's account for electronic funds transfer or a card permitting payment through value stored on the card. (*Govt.C. 6161(e)*.) An agency determining that acceptance of payment by these methods would not be cost-effective, would result in a net additional unfunded cost to the agency, or would result in a shortfall of revenues to the state may apply for an exemption. (*Govt.C. 6163(a)(2)*.) The statute likewise does not apply if the agency is unable to enter into implementing contracts on acceptable terms. (*Govt.C. 6163(a)(3)*.) (See *Govt.C. 6163(a)(4)* [if Franchise Tax Board does not accept payment by credit card or other payment device under Act, then prior law concerning credit card payments applies].)

West's Key Number Digest, Consumer Credit k.8.1

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Nature and Types.* See Clark, *The Law of Bank Deposits, Collections and Credit Cards* (Rev. ed.), Chap. 15.(2) *Credit Card Legislation.* *Acceptance of credit cards, debit cards, or electronic funds transfer under Govt.C. 6159:*

(a) *Bail deposits, fees, fines, forfeitures, penalties, or assessments:* *Govt.C. 6159(b)(1)* was amended in 2008 to additionally authorize the acceptance of credit cards, debit cards, or electronic funds transfer for payment of court-ordered restitution.

(g) *(New) Moneys payable to a sheriff pursuant to a levy under a writ of attachment or writ of execution.* (*Govt.C. 6159(b)(7)*), added in 2006 [if use of card or electronic funds transfer under *Govt.C. 6159(b)(7)* includes administrative fee charged by card issuer or company processing the account for the cost of the transaction, fee must be paid by person paying money to sheriff pursuant to levy].)



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 V. CREDIT CARDS
 B. Definitions.

4 Witkin Sum. Cal. Law Neg Inst § 145

[§ 145] Definitions.

(1) *Credit Card*. A credit card is a card, plate, coupon book, or other single credit device meant for use "from time to time" on presentation to obtain money, property, labor, or services on credit. (C.C. 1747.02(a); see *15 U.S.C.*, §1602(k).)

The following three devices are excluded from this definition:

(a) A single credit device used to obtain telephone property, labor, or services in a transaction under public utility tariffs. (C.C. 1747.02(a)(1).)

(b) A device that may be used to obtain credit through an electronic fund transfer but only if the credit is obtained under an agreement between a consumer and a financial institution to extend credit when the consumer's asset account is overdrawn or to maintain a specified minimum balance in the consumer's asset account. (C.C. 1747.02(a)(2).) This exclusion is designed to keep state law in conformity with federal regulations. (See *Stats. 1979, Chap. 574, §4*; *supra*, §144.)

(c) A key or card key used at an automated dispensing outlet to obtain or purchase petroleum products, as defined in *B. & P.C. 13401(c)*, which will be used primarily for business rather than personal or family purposes. (C.C. 1747.02(a)(3).)

(2) *Accepted Credit Card*. An accepted credit card is a credit card that the cardholder "has requested or applied for and received or has signed, or has used, or has authorized another person to use," to obtain money, property, labor, or services on credit. A renewal credit card becomes an accepted credit card when received by the cardholder. (C.C. 1747.02(b); see *15 U.S.C.*, §1602(l).)

(3) *Card Issuer*. A card issuer is a person who issues a credit card or the person's agent for that purpose. (C.C. 1747.02(c); see *15 U.S.C.*, §1602(n).)

(4) *Cardholder*. A cardholder is a natural person to whom a credit card is issued for consumer credit purposes, or a natural person who has agreed with the card issuer to pay consumer credit obligations arising from the issuance of a credit card to another natural person. For purposes of C.C. 1747.05 (issuance of credit cards), C.C. 1747.10 (liability for unauthorized use), and C.C. 1747.20 (issuance to 10 or more employees of an organization), a cardholder includes a

person to whom a credit card is issued for any purpose, including business, commercial, or agricultural use, or a person who has agreed with the card issuer to pay obligations arising from the issuance of a credit card to another person. (C.C. 1747.02(d); see *15 U.S.C.*, §1602(m).)

(5) *Retailer*. A retailer is a person other than a card issuer who furnishes money, goods, services, or anything else of value on presentation of a credit card by a cardholder. "Retailer" does not include the state, a city, a county, or public agencies. (C.C. 1747.02(e).)

SUPPLEMENT: [This section is current through the latest supplement]



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 C. Prohibited and Required Acts.
 1. In General.

4 Witkin Sum. Cal. Law Neg Inst § 146

[§ 146] In General.

A credit card may not be issued except in response to a request or application for it or as a renewal of or substitute for an accepted credit card. (C.C. 1747.05(a); see *15 U.S.C., §1642.*) A substitute credit card may be issued only if the card issuer provides an activation process whereby the cardholder must contact the card issuer to activate the credit card before the first use of the card. (C.C. 1747.05(b).) C.C. 1747.05 does not prohibit completion of an overdraft protection advance or a recurring-charge transaction that the cardholder previously authorized on an accepted credit card. (C.C. 1747.05(c).)

A card issuer must not do any of the following:

(a) "Knowingly" give untrue credit information concerning a cardholder to another person. (C.C. 1747.70(a).)

(b) Communicate unfavorable credit information concerning the cardholder to other persons after receiving an inquiry concerning a billing dispute and before responding to the inquiry in a timely manner (see *infra*, §153), solely because of the cardholder's failure to pay the disputed amount. (C.C. 1747.70(b).)

(c) Cancel or refuse to renew a credit card because the cardholder has obtained relief under C.C. 1747.50 (*infra*, §153). (C.C. 1747.70(c).)

Wilful violation of these provisions subjects the issuer to liability for treble damages plus reasonable attorneys' fees and costs. (C.C. 1747.70(d).)

A card issuer may not refuse to issue a credit card solely because of the applicant's race, religious creed, color, national origin, ancestry, or sex. (C.C. 1747.80(a).) Violation subjects the issuer to liability for "actual damages" plus a penalty of \$ 250, and the court may order the issuer to issue a credit card to the aggrieved party. (C.C. 1747.80(b).)

Card issuers who issue cards to married women must issue them in their maiden or married names as directed (C.C. 1747.81(a)), but may require a new account if issuance is in a married woman's maiden name (C.C. 1747.81(b)).

SUPPLEMENT: [This section is current through the latest supplement]

Refusal to issue credit card: C.C. 1747.80(a) was amended in 2007 to provide that a card issuer may not refuse to issue

a credit card solely because of the applicant's sex, race, color, religion, ancestry, national origin, disability, medical condition, marital status, or sexual orientation.



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C. Prohibited and Required Acts.

2. Cash Discounts and Credit Card Surcharges.

4 Witkin Sum. Cal. Law Neg Inst § 147

[§ 147] Cash Discounts and Credit Card Surcharges.

A provision in a contract between a card issuer and a retailer that has the effect of prohibiting price discounts to cash customers is contrary to public policy and void. (C.C. 1748.) If a retailer elects to offer a cash discount, that discount must be offered to all prospective buyers. A retailer in a sales, service, or lease transaction may not, however, impose a surcharge on a cardholder electing to use a credit card in lieu of cash. (C.C. 1748.1(a).) Wilful violation subjects the retailer to liability for treble damages plus reasonable attorneys' fees and costs. (C.C. 1748.1(b).) (See *Thrifty Oil Co. v. Superior Court (2001) 91 C.A.4th 1070, 1076, 111 C.R.2d 253* [gasoline retailer's clearly posted pricing system, charging cash customers four cents per gallon less than credit card customers, was permissible discount, not unlawful surcharge; two-tier pricing was offered to all customers, and was based on additional cost to retailer for credit card sales].)

A consumer will not be deemed to have elected to use a credit card in lieu of another means of payment, if only credit cards are accepted by a retailer in payment for orders over the telephone, but only cash is accepted at the retailer's public store. (C.C. 1748.1(c).) Charges for third-party credit card guarantee services, when added to the price charged if cash were to be paid, must be deemed surcharges under C.C. 1748.1 even if they are payable directly to the third party or charged separately. (C.C. 1748.1(d).)

SUPPLEMENT: [This section is current through the latest supplement]

C.C. 1748.1 does not prohibit charges for payment by credit or debit card that are made by an electrical, gas, or water corporation and approved by the Public Utilities Commission under *Pub.Util.C. 755*. (C.C. 1748.1(f), added in 2005.) *Pub.Util.C. 755*, added in 2005, permits, under specified circumstances, an electrical, gas, or water corporation that offers customers credit or debit card bill payment options to recover reasonable transaction costs incurred by the corporation from those customers choosing to pay by credit or debit card.



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C. Prohibited and Required Acts.
3. Statements.

4 Witkin Sum. Cal. Law Neg Inst § 148

[§ 148] Statements.

(1) *Annual Statement of Charges.* A card issuer must furnish a cardholder with an annual statement of finance charges assessed on an account during the preceding year if the cardholder requests the statement. The cardholder may make only one request per year. The card issuer must respond in writing only if the request is in writing. The issuer may satisfy this requirement by including the required statement in a periodic billing or account statement furnished to the cardholder. (C.C. 1748.5(a).) However, retail sellers who issue or use their own credit cards and are governed by the Unruh Act (see C.C. 1810.11, 4 *Summary* (10th), *Sales*, §282) continue to be exempt from the requirements of the statute. (C.C. 1748.5(b).)

(2) *Information Regarding Time Needed To Repay Balance.* Credit card issuers, under specified circumstances, must provide with each billing statement information concerning the length of time required to pay off the account balance if the cardholder makes minimum payments. (C.C. 1748.13.)

SUPPLEMENT: [This section is current through the latest supplement]



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4. Cancellation.

4 Witkin Sum. Cal. Law Neg Inst § 149

[§ 149] Cancellation.

Unless requested by the cardholder, the issuer cannot cancel a credit card without giving the cardholder 30 days' written notice of its intention to do so. Exceptions are made, however, where (1) the cardholder is or has been in default or in violation of a provision of the agreement within the last 90 days; or (2) the issuer "has evidence or reasonable belief" that the cardholder is unable or unwilling to repay obligations incurred or that an unauthorized use of the card may be made. (C.C. 1747.85; see *53 A.L.R.4th 231* [issuer's liability for cancellation].)

A card issuer may place an account on inactive status if the cardholder has not used the card for more than 18 months. If the cardholder subsequently uses the card, the issuer may require the cardholder to furnish information to be used in verifying the cardholder's current credit worthiness. (C.C. 1747.85.)

SUPPLEMENT: [This section is current through the latest supplement]



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C. Prohibited and Required Acts.

5. Personal Identification Information.

4 Witkin Sum. Cal. Law Neg Inst § 150

[§ 150] Personal Identification Information.

(1) *General Rule Against Requiring Information.* A person or firm that accepts credit cards must not request or require the cardholder to provide personal identification information on the credit card transaction form or otherwise. A form containing preprinted spaces designated for filling in cardholder personal identification information is also prohibited. (C.C. 1747.08(a).) "Personal identification information" is information concerning the cardholder other than that set forth on the credit card, and includes the cardholder's address and telephone number. (C.C. 1747.08(b).) Violators are subject to a civil penalty of \$ 250 for a first offense, and \$ 1,000 for each subsequent violation. However, no penalty will be assessed for unintentional violations resulting from bona fide errors made despite the existence of procedures designed to avoid those errors. (C.C. 1747.08(e).)

In *Florez v. Linens 'N Things* (2003) 108 C.A.4th 447, 133 C.R.2d 465, plaintiff customer brought various items to a cashier in defendant store. Pursuant to defendant's policy, the cashier asked plaintiff for her telephone number. Plaintiff complied, believing that this was necessary to complete the transaction, and the cashier typed the telephone number into an electronic cash register. Plaintiff then used her credit card to pay for her purchases. Defendant's practice was to employ computer software to match an address to a telephone number, and then create a record containing a customer's name, credit card number, telephone number, and address. The contents of the record could then be used or sold by defendant. *Held*, plaintiff stated a viable cause of action for violation of former C.C. 1747.8(a) (now C.C. 1747.08(a).)

(a) A 1991 amendment adding the word "request" to C.C. 1747.8(a) (now C.C. 1747.08(a)), which prohibits a business that accepts credit cards from requiring or requesting that a cardholder provide personal identification information, was intended to prevent retailers from requesting this information and then matching it with a customer's credit card number, as was done here. A customer might misperceive that the "request" is in fact a condition of credit card payment. Thus, the amendment "prevents a retailer from making an end-run around the law by claiming the customer furnished personal identification data 'voluntarily.'" (108 C.A.4th 453.) The legislative intent suggests that the amendment merely clarifies that a request for personal identification information is prohibited if it immediately precedes the credit card transaction, even if the customer's response is voluntary and made only for marketing purposes. To adopt defendant's interpretation that the statute allows a retailer to request a telephone number before the manner of payment is known, thereby eliminating any concern that providing the information is a condition of credit card payment, would completely undermine the purpose of the statute, which is to protect the privacy of consumers who use

credit cards. (108 C.A.4th 453.)

(b) Retailers may solicit a customer's address and telephone number for a store's mailing list, provided the information is furnished voluntarily. One option is to delay the request until the customer tenders payment or makes the preferred method of payment known. If the payment is made with cash, and the customer is willing, personal identification information may then be recorded. Another option would be to delete a customer's personal identification information as soon as the customer reveals an intention to pay by credit card. Thus, "the statutory mandate can hardly be described as draconian. None of these alternatives represents any great imposition on retailers." (108 C.A.4th 452.)

(2) *Exceptions.* C.C. 1747.08 does not apply in the following situations:

(a) If the credit card is being used as a deposit to secure payment in the event of default, loss, damage, or similar occurrence. (C.C. 1747.08(c)(1).)

(b) Cash advance transactions. (C.C. 1747.08(c)(2).)

(c) If the person or firm accepting the card is contractually required to provide personal identification information in order to complete the transaction or is obligated by federal law to collect and record the personal identification information. (C.C. 1747.08(c)(3).)

(d) If the information is required for a special purpose, such as shipping or servicing the purchased merchandise. (C.C. 1747.08(c)(4).)

C.C. 1747.8 does not prohibit a person or firm from requiring the cardholder to provide reasonable forms of positive identification, which may include a driver's license, California state identification card, or, when one of these is unavailable, another form of photo identification. However, none of the information from the identification material may be written or recorded on the credit card transaction form or elsewhere. An exception is made if the cardholder pays for the transaction with a credit card number and does not make the credit card available on request to verify the number, in which case the cardholder's driver's license number or identification card number may be recorded on the form or otherwise. (C.C. 1747.08(d).)

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Exceptions.*

(e) (New) C.C. 1747.08 does not apply to merchandise returns. (*TJX Cos. v. Superior Court* (2008) 163 C.A.4th 80, 83, 87, 89, 77 C.R.3d 114 [plain meaning of statutory language is that C.C. 1747.08 does not prohibit businesses from requiring personal identification information from credit card customers when merchandise is returned; merchandise returns present substantial opportunities for fraud, and there would be need to identify person who returned merchandise that later turns out to have been used, damaged, or stolen]; *Absher v. AutoZone* (2008) 164 C.A.4th 332, 335, 341, 346, 78 C.R.3d 817 [same; C.C. 1747.08 does not prohibit businesses from requiring credit card customers returning merchandise to write name and phone number on return voucher, which was document separate from return receipt showing reversal of credit card charge, and which could be used also for return of item purchased by cash or check]). *Correction:* Page 525, first line of last paragraph, C.C. 1747.8 should be C.C. 1747.08.



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C. Prohibited and Required Acts.

6. Condition of Accepting Negotiable Instrument.

4 Witkin Sum. Cal. Law Neg Inst § 151

[§ 151] Condition of Accepting Negotiable Instrument.

(1) *General Rule Against Requiring Credit Card.* A person accepting a negotiable instrument as payment for goods or services sold or leased at retail must not require the payor to provide a credit card as a condition of acceptance of the negotiable instrument (C.C. 1725(a)(1)), or to sign a statement agreeing to allow the credit card to be charged to cover the negotiable instrument if returned (C.C. 1725(a)(2)). The person accepting the instrument may not record a credit card number in connection with the transaction (C.C. 1725(a)(3)), or contact a credit card issuer to determine whether the amount of credit available to the cardholder will cover the negotiable instrument (C.C. 1725(a)(4)). Violators are subject to a civil penalty of \$ 250 for a first offense, and \$ 1,000 for each subsequent violation. However, no penalty will be assessed for unintentional violations resulting from bona fide errors made despite the existence of procedures designed to avoid those errors. (C.C. 1725(e).)

(2) *Distinctions.* C.C. 1725 does not prohibit the following:

(a) Requiring the cardholder to provide other reasonable forms of positive identification, such as a driver's license, a California state identification card, or another form of photo identification, as a condition to acceptance of a negotiable instrument. (C.C. 1725(c)(1).)

(b) Requesting, but not requiring, a purchaser to display a credit card as evidence of creditworthiness or financial responsibility, or as an additional identification, where the information recorded is limited to the type of card displayed, the card's issuer, and the card's expiration date. Retailers who request display of a credit card must inform customers, by specified methods, that displaying a credit card is not a requirement for check writing. (C.C. 1725(c)(2).)

(c) Requesting or recording a credit card number as a condition for cashing a negotiable instrument that is being used solely to receive cash back. (C.C. 1725(c)(3).)

(d) Requesting, receiving, or recording a credit card number in lieu of requiring a deposit to secure payment in the event of default, loss, damage, or other occurrence. (C.C. 1725(c)(4).)

(e) Requiring, verifying, and recording the purchaser's name, address, and telephone number. (C.C. 1725(c)(5).)

(f) Requesting or recording a credit card number on a negotiable instrument used to make a payment on the credit

card account. (C.C. 1725(c)(6).)

SUPPLEMENT: [This section is current through the latest supplement]



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7. Contents of Receipt.

4 Witkin Sum. Cal. Law Neg Inst § 152

[§ 152] Contents of Receipt.

A person, firm, partnership, association, corporation, or limited liability company that accepts credit cards for the transaction of business must not print the expiration date or more than the last five digits of the account number on any receipt provided to the cardholder. (C.C. 1747.09(a).) C.C. 1747.09 applies only to electronically printed receipts, and not to transactions in which the sole means of recording the credit card number is by handwriting or by an imprint or copy of the credit card. (C.C. 1747.09(b).)

SUPPLEMENT: [This section is current through the latest supplement]

C.C. 1747.09 was amended in 2005 to apply to debit cards as well as to credit cards. It was further amended and subdivided in 2006. The prohibition against printing the expiration date or more than the last five digits of the account number on a receipt provided to the cardholder is now in C.C. 1747.09(a)(1). Beginning January 1, 2009, the same prohibition will apply to a receipt retained by the person, firm, partnership, association, corporation, or limited liability company, if the receipt is printed at the time of the purchase, exchange, refund, or return, and if (1) the receipt is signed by the cardholder (C.C. 1747.09(a)(2)), or (2) the receipt is not signed by the cardholder because the cardholder used a personal identification number to complete the transaction (C.C. 1747.09(a)(3)). (On operative date of C.C. 1747.09(a)(2) and (a)(3), see C.C. 1747.09(d), added in 2006.) C.C. 1747.09 does not apply to documents, other than the receipts described in C.C. 1747.09(a), used for internal administrative purposes. (C.C. 1747.09(c), added in 2006.)



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D. Billing Errors and Cardholder Inquiries.

4 Witkin Sum. Cal. Law Neg Inst § 153

[§ 153] Billing Errors and Cardholder Inquiries.

(1) *Definition.* A "billing error" is an error in posting a debit or credit, or an error in computation or accounting in a statement given the cardholder by the card issuer. It does not include a dispute as to the value, quality, or quantity of goods, services, or other benefit obtained in a credit card transaction. (C.C. 1747.02(j); see *53 A.L.R.4th 231* [issuer's liability for wrongful billing].)

(2) *Sanctions.* A card issuer must correct a billing error "within two complete billing cycles, but in no event later than 90 days, after receiving an inquiry." (C.C. 1747.50(a).) A retailer must correct a billing error within 60 days after mailing of an inquiry concerning the error. (C.C. 1747.60(a).) (As to form, content, and manner of making inquiry, see C.C. 1747.02(g) [inquiry to card issuer must be received by issuer no more than 60 days after transmission of first statement reflecting alleged error]; C.C. 1747.60(d) [inquiry to retailer].)

Failure to correct the error subjects the issuer or retailer to the following sanctions:

(a) A card issuer is barred from recovering not only the amount of the error, but also interest or other charges "on the obligation giving rise to the billing error." (C.C. 1747.50(b).)

(b) A retailer is liable to the cardholder for the amount of the billing error, plus interest or other charges on the obligation giving rise to the error. (C.C. 1747.60(b).)

(c) If the failure to correct was wilful, the cardholder may bring an action against the card issuer or retailer for treble damages, plus reasonable attorneys' fees and costs. (C.C. 1747.50(c), 1747.60(c).)

In *Young v. Bank of America* (1983) 141 C.A.3d 108, 190 C.R. 122, treble damages were awarded under C.C. 1747.50(c) and 1747.70(d) (see supra, §146) against a card issuer that (a) had refused to correct plaintiff's statement within the statutory time limit and continued to demand payment despite repeated notice from plaintiff that she had cancelled the card and legitimately disputed the charges, (b) had reported negative credit information to a credit reporting service without first attempting to resolve the dispute, and (c) even after the trial court found the charges unauthorized, had failed to supply correct information to the credit reporting service. This conduct was a wilful violation of the statute, constituting "callous indifference." (141 C.A.3d 116.)

If the card issuer merely fails to give a "timely response" to an inquiry from a cardholder as to a debit or credit

applicable to a credit card obligation (see C.C. 1747.02(h), (i)), the issuer cannot collect interest or other charges on the obligation from the date when the inquiry was mailed to the date when the response was mailed. (C.C. 1747.40.)

A card issuer is not liable for a retailer's billing error (C.C. 1747.65(a)), and a retailer is not liable for an issuer's billing error (C.C. 1747.65(b)).

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 E. Liability for Unauthorized Use.

4 Witkin Sum. Cal. Law Neg Inst § 154

[§ 154] Liability for Unauthorized Use.

(1) *In General.* The "unauthorized use" of a credit card is the use by a person, other than the cardholder, (a) who does not have actual, implied, or apparent authority for that use and (b) from which the cardholder receives no benefit. (C.C. 1747.02(f); 15 U.S.C., §1602(o).) "Unauthorized use" does not include use by someone who has been authorized by the cardholder. For termination of the authorization to be effective against the issuer, the cardholder must comply with the issuer's procedures. However, once the issuer has received oral or written notice from the cardholder, it must follow its usual procedures to bar further use by an unauthorized person. (C.C. 1747.02(f); see *Young v. Bank of America (1983) 141 C.A.3d 108, 190 C.R. 122*, supra, §153 [use of stolen card was "unauthorized," despite cardholder's initial permission, where permission had been to friend for one transaction and limited time period but friend had disappeared with card].)

Before enactment of state and federal statutes limiting cardholder liability, it was generally held that the cardholder was not liable for unauthorized purchases in the absence of (a) a contractual provision imposing liability for that use, or (b) some degree of culpability on the cardholder's part. However, most credit card agreements contained a provision purporting to make the cardholder liable for all purchases, whether authorized or not, and some courts had held that these provisions were effective to impose liability on the cardholder. (See *13 Stanf. L. Rev. 150* [limitations on credit cardholder's liability for unauthorized purchase]; *4 U.C. Davis L. Rev. 377* [apportionment of credit card fraud loss]; *20 Am.Jur.2d (1995 ed.), Credit Cards and Charge Accounts §46 et seq.*; *15 A.L.R.3d 1086* [liability of credit cardholder for purchases made by another person]; as to criminal liability of person making unauthorized use of credit card, see *2 Cal. Crim. Law (3d), Crimes Against Property, §193.*)

(2) *California Statutes.* The cardholder is liable for unauthorized use only if all of the following conditions are met:

- (a) It is an accepted card. (C.C. 1747.10(a).)
- (b) Liability is no more than \$ 50. (C.C. 1747.10(b).)
- (c) The issuer gives the cardholder adequate notice of his or her potential liability. (C.C. 1747.10(c).)
- (d) The issuer has told the cardholder how to notify the issuer of loss or theft of the card. (C.C. 1747.10(d).)
- (e) The unauthorized use occurs before the issuer has been notified that unauthorized use has occurred or may occur

as a result of loss, theft, or otherwise. (C.C. 1747.10(e).)

(f) The issuer has established a method whereby the user of the card can be identified as an authorized person. (C.C. 1747.10(f).) (See *Young v. Bank of America, supra* [liability for unauthorized use under C.C. 1747.10]; on similar conditions for debit cards, see C.C. 1748.31(a), 1748.32 [prohibiting waiver].)

Issuers issuing 10 or more cards to employees of an organization may reach an agreement with the organization regarding liability for unauthorized use without regard to C.C. 1747.10. However, liability may be imposed on an employee, either by the issuer or the organization, only in accordance with C.C. 1747.10. (C.C. 1747.20.)

(3) *Federal Statutes.* The federal statute is substantially similar to C.C. 1747.10, except that it includes a provision for determining what constitutes notification to a card issuer. (See *15 U.S.C., §1643(a)*.) The federal statute does not apply to credit cards used for business, commercial, or agricultural purposes, or to government agencies or to organizations. (*15 U.S.C., §1603(1)*.)

(4) *Issuer Must Verify Address of Person Responding to Offer or Solicitation.* When a credit card issuer receives a completed credit card application listing an address different from the address on the offer or solicitation that the issuer had mailed, the issuer must verify the change of address by contacting the person to whom the offer or solicitation was mailed. (C.C. 1747.06(a).) If the issuer fails to verify the change of address before issuing the credit card, the person to whom the offer or solicitation was made will not be liable for unauthorized use of the card unless the issuer proves that this person actually incurred the charge. (C.C. 1747.06(b).)

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F. Processing of Credit Card Charge Without Furnishing Goods or Services.

4 Witkin Sum. Cal. Law Neg Inst § 155

[§ 155] Processing of Credit Card Charge Without Furnishing Goods or Services.

(1) *Practice Prohibited.* Processing, depositing, negotiating, or obtaining payment of a credit card charge through a retailer's account with a financial institution or agreement with a financial institution or card issuer is prohibited, if that retailer did not furnish or agree to furnish the goods or services that are the subject of the charge. (C.C. 1748.7(a), (b).)

(2) *Exemptions.* The following persons or businesses are exempt:

(a) Persons who furnish goods or services on the business premises of a general merchandise retailer (defined in C.C. 1748.7(h)(1)) and who process, deposit, negotiate, or obtain payment of a credit card charge through the retailer's account or agreement. (C.C. 1748.7(c)(1).)

(b) General merchandise retailers who permit persons furnishing goods or services on their premises to process, deposit, negotiate or obtain payment of a credit card charge through the retailer's account or agreement. (C.C. 1748.7(c)(2).)

(c) Franchisees who furnish the cardholder with goods or services that are provided by the franchisor, and who process, deposit, negotiate or obtain payment of a credit card charge through the franchisor's account or agreement. (C.C. 1748.7(c)(3).)

(d) Franchisors who permit a franchisee to process, deposit, negotiate, or obtain payment of a credit card charge through the franchisor's account or agreement. (C.C. 1748.7(c)(4).)

(e) Credit card issuers or financial institutions or a parent, subsidiary, or affiliate of a card issuer or financial institution. (C.C. 1748.7(c)(5).)

(f) Persons who process, deposit, negotiate, or obtain payment of less than \$ 500 of credit card charges in any one year through a retailer's account or agreement. (C.C. 1748.7(c)(6).)

(3) *Remedies.* In addition to any other remedies provided by law, a person injured by a violation of C.C. 1748.7 may bring an action for the recovery of damages, equitable relief, and reasonable attorneys' fees and costs. (C.C. 1748.7(d), (f).)

(4) *Criminal Liability.* In addition to other penalties provided by law, persons violating C.C. 1748.7 are guilty of a misdemeanor. (C.C. 1748.7(e), (f).)

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 G. Cardholder's Defenses.

4 Witkin Sum. Cal. Law Neg Inst § 156

[§ 156] Cardholder's Defenses.

(1) *In General.* In a "two-party" credit card transaction, the use of a credit card neither adds to nor subtracts from the rights of the parties. The transaction amounts to nothing more than a furnishing of goods or services on account. If the seller, who is also the card issuer, breaches its agreement with the cardholder, the cardholder has all the ordinary contract rights, including the right to assert the defenses the cardholder may have if the seller brings an action to recover on the account. (See C.C. 1747.90(a)(2) [conditions set forth in C.C. 1747.90(a)(1), *infra*, this section, do not apply to "two-party" transactions].) In a "three-party" transaction, while the retailer is obligated to perform its agreement with the cardholder, the cardholder is independently obligated to pay the card issuer. (See *supra*, §144.) Also, most, if not all, three-party credit card agreements previously contained a term whereby the cardholder waived, as against the issuer, the defenses the cardholder may have had against the retailer. Thus, where a retailer in a three-party transaction breached the agreement with a cardholder, there was some uncertainty as to whether the cardholder could refuse to pay the issuer. (See *48 Cal. L. Rev. 471*; *1 Loyola L.A. L. Rev. 61*.)

The Legislature settled this issue in 1971 by enacting C.C. 1747.90, which gives the cardholder a right to assert against a card issuer defenses that the cardholder has against the retailer, subject to certain conditions and limitations. (See *18 U.C.L.A. L. Rev. 1079* [analysis and criticism of statute]; *4 San Fernando Valley L. Rev. 215* [same].)

(2) *Conditions.* A card issuer is subject to all claims and defenses, other than tort claims, arising out of a transaction in which the card is used, provided that the following conditions are met:

(a) The cardholder has made a good faith effort to resolve a disagreement or problem with the person honoring the card. (C.C. 1747.90(a)(1)(A).)

(b) The initial transaction amount exceeds \$ 50. (C.C. 1747.90(a)(1)(B).)

(c) The location of the transaction was in California, or, if not in California, within 100 miles of the cardholder's address in California. (C.C. 1747.90(a)(1)(C).)

However, if the person honoring the credit card is also the issuer, is controlled by the issuer or under direct or indirect common control with the issuer, is a franchised dealer for the issuer, or has obtained the disputed order through a mail solicitation in which the issuer was involved, then the cardholder needs only to make a good faith effort to

resolve the problem, as required by C.C. 1747.90(a)(1)(A). Compliance with C.C. 1747.90(a)(1)(B) and (a)(1)(C) is not necessary. (C.C. 1747.90(a)(2).)

(3) *Limitations.* The amount of claims or defenses asserted by the cardholder may not exceed the amount of credit outstanding with respect to the disputed transaction at the time the cardholder first notifies the issuer or the person honoring the card of the claim or defense. (C.C. 1747.90(b) [also specifying order in which payments and credits are to be applied to determine amount of credit outstanding].) However, C.C. 1747.90 does not apply to the use of a check guarantee card or debit card in connection with an overdraft credit plan, or to a check guarantee card used in connection with cash advance checks. (C.C. 1747.90(c).)

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H. Disclosures in Advertising and Solicitation.
 1. Nature and Purpose of Legislation.

4 Witkin Sum. Cal. Law Neg Inst § 157

[§ 157] Nature and Purpose of Legislation.

(1) *Primary Statutes.* The three primary statutes governing disclosures in credit card advertising and solicitation are:

- (a) The Areias Credit Card Full Disclosure Act of 1986 (C.C. 1748.10 et seq., infra, §158 et seq.).
- (b) The Areias-Robbins Charge Card Full Disclosure Act of 1986 (C.C. 1748.20 et seq., infra, §161 et seq.).
- (c) The Areias Retail Installment Account Full Disclosure Act of 1986 (C.C. 1810.20, 1810.21, infra, §164 et seq.).

The purpose of these statutes is to provide consumers with a simple and direct means for comparing the most significant attributes of credit cards. (Stats. 1986, Chap. 1397, §1.)

(2) *Subsequent Solicitation Supersedes Terms of Prior Solicitation.* The terms of a solicitation for an application for an open-end credit card account that does not include (a) a specific expiration date, or (b) a statement that the terms are subject to change, are superseded by the terms of a subsequent solicitation by the creditor or retail seller, provided the recipient of the earlier solicitation has not yet applied for the account. It is not necessary that the recipient have actual knowledge of the change in terms. (Stats. 1986, Chap. 1397, §6.)

(3) *Waiver Prohibited.* A waiver of the provisions of C.C. 1748.10 et seq. or C.C. 1748.20 et seq. is contrary to public policy, void, and unenforceable. (C.C. 1748.14, 1748.23.)

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H. Disclosures in Advertising and Solicitation.

2. Credit Card Disclosures.

a. Scope of Requirement.

4 Witkin Sum. Cal. Law Neg Inst § 158

[§ 158] Scope of Requirement.

(1) *Applications and Solicitations Covered.* The required disclosures (see *infra*, §159) must accompany or be contained in an application form or preapproved written solicitation for an open-end credit card account to be used for personal, family, or household purposes. The disclosure requirements apply to applications and solicitations to a consumer residing in California, whether or not the creditor is located in California. (C.C. 1748.11(a).) Application forms for open-end credit card accounts distributed in California other than by mail must contain either the required disclosures or a statement offering to send the disclosures if the applicant checks a box printed on the form. (C.C. 1748.11(g).)

(2) *Applications and Solicitations Excluded.* The disclosure requirements do not apply to the following:

(a) Application forms or solicitations included in magazines, newspapers, or other publications distributed by someone other than the creditor. (C.C. 1748.11(a).)

(b) Application forms or advertisements for open-end credit card accounts where the credit extended is to be secured by a lien on real or personal property or both. (C.C. 1748.11(h).)

(3) *Inapplicable to Persons Covered by Other Act.* The disclosure requirements do not apply to a person who is subject to C.C. 1810.20 et seq. (see *infra*, §164). (C.C. 1748.11(i).)

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H. Disclosures in Advertising and Solicitation.

2. Credit Card Disclosures.

b. Matters To Be Disclosed.

4 Witkin Sum. Cal. Law Neg Inst § 159

[§ 159] Matters To Be Disclosed.

(1) *Rates.* The application or solicitation must disclose the periodic rate or rates to be applied to the account, expressed as an annual percentage. If the account is subject to a variable rate, the creditor may instead either (a) disclose the rate as of a specific date and indicate that the rate may vary, or (b) identify the index and any amount or percentage added to, or subtracted from, that index and used to determine the rate. (C.C. 1748.11(a)(1)(A).)

(2) *Fees.* A membership or participation fee for a credit card account must be disclosed, expressed as an annualized amount. (C.C. 1748.11(a)(1)(B).) Disclosure must also be made of a "per transaction" fee imposed on purchases, expressed as an amount or as a percentage of the transaction. (C.C. 1748.11(a)(1)(C).)

(3) *"Free Period."* If the creditor provides a period in which the consumer may pay the balance in full without additional finance charges, the creditor must do one of the following:

(a) Disclose the number of days of that period, calculated from the closing date of the prior billing cycle to the date designated in the billing statement as the date by which that payment must be received to avoid additional charges. (C.C. 1748.11(a)(1)(D).)

(b) Describe the manner in which the period is calculated. (C.C. 1748.11(a)(1)(D).)

In addition, creditors who do not provide a "free period" must disclose that fact. (C.C. 1748.11(a)(1)(D).)

(4) *Additional Information.* C.C. 1748.11 does not prohibit a creditor from disclosing additional terms, conditions, or information in conjunction with the required disclosures. (C.C. 1748.11(d).)

(5) *Secured Credit.* In every advertisement or solicitation for a secured credit card, the issuer must do all of the following:

(a) Expressly identify the credit instrument offered as a "secured credit card." (C.C. 1747.94(a).)

(b) Prominently disclose that credit extended under the card is secured. (C.C. 1747.94(a).)

(c) Describe the security by item or type. (C.C. 1747.94(a).)

A deed of trust executed in connection with a secured credit card must contain a statement that it is security for a secured credit card obligation. (C.C. 1747.94(b) [failure to include statement does not invalidate deed of trust].)

C.C. 1747.94 does not apply to a credit card issued under an agreement or other instrument creating *only* a purchase money security interest in property purchased with the credit card, nor to loans or extensions of credit subject to the Federal Home Equity Loan Consumer Protection Act of 1988. (C.C. 1747.94(c).) A violation of C.C. 1747.94 constitutes unfair competition under *B. & P.C. 17200* (see 13 *Summary* (10th), *Equity*, §105 et seq.). (C.C. 1747.94(d).)

(6) *Cardholder's Right To Prohibit Disclosure of Information.* The credit card issuer must provide a written notice to the cardholder that clearly and conspicuously describes the cardholder's right to prohibit the disclosure of marketing information concerning the cardholder that discloses the cardholder's identity. The notice must be in 10-point type and must advise the cardholder of the ability to respond either by completing a preprinted form or by calling a toll-free telephone number to exercise this right. (C.C. 1748.12(b); for definitions of "cardholder," "credit card," and "marketing information," see C.C. 1748.12(a).)

The requirements of C.C. 1748.12(b) must be satisfied by furnishing the notice to the cardholder in accordance with the following:

(a) At least 60 days before the initial disclosure of marketing information concerning the cardholder by the credit card issuer. (C.C. 1748.12(c)(1).)

(b) For all new credit cards issued on or after April 1, 2002, on the form containing the new credit card when the credit card is delivered to the cardholder. (C.C. 1748.12(c)(2).)

(c) At least once per calendar year, to every cardholder entitled to receive an annual statement of billings rights under 12 C.F.R., §226.9 (Regulation Z). The notice required by this paragraph may be included on or with any periodic statement or with the delivery of the renewal card. (C.C. 1748.12(c)(3).)

Compliance with a federal law requiring disclosure to cardholders concerning the use of personal information constitutes compliance with C.C. 1748.12. (C.C. 1748.12(f).)

The cardholder's election to prohibit disclosure of marketing information is effective only as to information disclosed to a party beginning 30 days after the credit card issuer has received notice from the cardholder. (C.C. 1748.12(d)(1).) The credit card issuer may communicate cardholder information to a corporate subsidiary or affiliate to the extent permitted under the Fair Credit Reporting Act. (C.C. 1748.12(e)(3).)

(7) *Effect of Using Preprinted Check or Draft.* A credit card issuer that extends credit to a cardholder through use of a preprinted check or draft must disclose on the front of an attachment affixed by perforation or other means to the preprinted check or draft all of the following information, in clear and conspicuous language:

(a) That "use of the attached check or draft will constitute a charge against your credit account." (C.C. 1748.9(a)(1).)

(b) The annual percentage rate and the calculation of finance charges, as required by federal regulations, associated with use of the attached check or draft. (C.C. 1748.9(a)(2).)

(c) Whether the finance charges are triggered immediately on use of the check or draft. (C.C. 1748.9(a)(3).)

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2. Credit Card Disclosures.

c. Methods of Compliance.

4 Witkin Sum. Cal. Law Neg Inst § 160

[§ 160] Methods of Compliance.

(1) *Disclosure Satisfying Regulation Z.* As an alternative to disclosing the matters set forth in C.C. 1748.11(a)(1) (supra, §159), a disclosure statement is sufficient if it satisfies the initial disclosure requirements of Regulation Z (defined in C.C. 1748.11(c)). (C.C. 1748.11(a)(2).)

(2) *Statutory Chart.* A creditor need not present the required disclosures in a chart or use a specific terminology other than that expressly provided by C.C. 1748.11. However, if a chart with captions substantially as stated in C.C. 1748.11(b) is completed, with the applicable terms the creditor is offering, or if the creditor presents the terms in tabular, list, or narrative form using terminology substantially similar to the chart captions, the disclosures are conclusively presumed to satisfy C.C. 1748.11(a)(1). (C.C. 1748.11(b).)

(3) *Compliance With Federal Law.* If a creditor is required under federal law to disclose on applications or solicitations the terms applicable to a credit card account, the creditor is deemed to have complied with C.C. 1748.11(a)(1) with respect to those applications or solicitations if the creditor complies with the federal requirements. (C.C. 1748.11(e).)

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3. Charge Card Disclosures.

a. Scope of Requirement.

4 Witkin Sum. Cal. Law Neg Inst § 161

[§ 161] Scope of Requirement.

(1) *In General.* Charge card applications must contain specified disclosures (see C.C. 1748.20 et seq., *infra*, §162). A "charge card" is a card, plate, or other credit device pursuant to which the charge card issuer extends credit to the charge cardholder, primarily for personal, family, or household purposes, where (a) the credit extended does not subject the charge cardholder to a finance charge, and (b) the charge cardholder cannot automatically access credit that is repayable in installments. (C.C. 1748.21(a).) A "charge cardholder" is the person to whom a charge card is issued. (C.C. 1748.21(b).) A "charge card issuer" is a person who issues a charge card or that person's agent. (C.C. 1748.21(c).)

(2) *Applications and Solicitations Covered.* The required disclosures must appear "clearly and conspicuously" in a charge card application form or preapproved written solicitation for a charge card mailed to a consumer residing in California. The requirements apply whether or not the charge card issuer is located in California. (C.C. 1748.22(a).) Charge card application forms distributed in the state other than by mail must contain either the required disclosures or a statement offering to send the disclosures if the applicant checks a box printed on the form. (C.C. 1748.22(e).)

(3) *Applications and Solicitations Excluded.* The disclosure requirements do not apply to application forms or solicitations included in magazines, newspapers, or other publications distributed by someone other than the charge card issuer. (C.C. 1748.22(a).)

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b. Matters To Be Disclosed.

4 Witkin Sum. Cal. Law Neg Inst § 162

[§ 162] Matters To Be Disclosed.

(1) *Fees.* A fee or charge for the issuance or renewal of the charge card must be disclosed, expressed as an annualized amount and denominated as an "annual fee." (C.C. 1748.22(a)(1).) Disclosure is also required for a fee for an extension of credit to a charge cardholder under the following circumstances:

(a) The extension is made by the charge card issuer. (C.C. 1748.22(a)(3).)

(b) The extension is not a credit sale. (C.C. 1748.22(a)(3).)

(c) The charge cardholder receives the extension in cash or through use of a preprinted check, draft, or similar credit device provided by the charge card issuer. (C.C. 1748.22(a)(3).)

This fee must be denominated as a "cash advance fee." (C.C. 1748.22(a)(3).)

(2) *No Deferred Payment.* It must be disclosed that the charge cardholder may not defer payment of charges incurred by use of the charge card on receipt of a periodic statement of charges from the charge card issuer. (C.C. 1748.22(a)(2).)

(3) *Additional Information.* C.C. 1748.22 does not prohibit a charge card issuer from disclosing additional terms, conditions, or information in conjunction with the required disclosures. (C.C. 1748.22(c).)

(4) *Statement Required by Regulation Z.* If the charge card issuer offers the charge cardholder an opportunity to access open-end credit, the charge card issuer must provide the initial disclosure statement required by Regulation Z (defined in C.C. 1748.11(c)). (C.C. 1748.22(d).)

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c. Methods of Compliance.

4 Witkin Sum. Cal. Law Neg Inst § 163

[§ 163] Methods of Compliance.

A charge card issuer is conclusively presumed to have complied with the disclosure requirements of C.C. 1748.22(a) (supra, §162) by completing the table set out in C.C. 1748.11(b) (supra, §160). The applicable terms must be set out in a "clear and conspicuous" manner, and the completed table must be provided along with the charge card application or solicitation. (C.C. 1748.22(b).)

The charge card issuer must include as part of the table the following sentences in the boxes (or in a footnote outside the boxes) relating to the interest rate disclosure: "This is a charge card which does not permit the charge cardholder to pay for purchases made using this charge card in installments. All charges made by a person to whom the charge card is issued are due and payable upon the receipt of a periodic statement of charges by the charge cardholder." (C.C. 1748.22(b).)

The conclusive presumption of compliance with the disclosure requirements of C.C. 1748.22(a) is not lost by:

(a) Including or excluding an expiration date with the table, or using footnotes in the table's boxes to set out information required to be disclosed outside the boxes. (C.C. 1748.22(b).)

(b) Employing in the appropriate box or footnote a phrase such as "not offered" or "not required," where the charge card issuer does not offer or require one of the selected attributes of credit cards. (C.C. 1748.22(b).)

(c) Employing in the appropriate box or footnote a phrase such as "not applicable," if one of the selected attributes of charge cards required to be disclosed is not applicable to the charge card issuer. (C.C. 1748.22(b).)

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H. Disclosures in Advertising and Solicitation.

4. Retail Installment Account Disclosures.

a. Scope of Requirement.

4 Witkin Sum. Cal. Law Neg Inst § 164

[§ 164] Scope of Requirement.

(1) *Applications and Solicitations Covered.* The required disclosures (see *infra*, §165) must accompany or be contained in any application form or preapproved written solicitation for a credit card issued in connection with a retail installment account. The disclosure requirements apply to applications and solicitations mailed by a retail seller to a retail buyer residing in California, whether or not the retail seller is located in California. (C.C. 1810.21(a).) Application forms or accompanying retail installment agreements distributed in California other than by mail must contain either the required disclosures or a statement offering to send the disclosures if the applicant checks a box printed on the form. (C.C. 1810.21(g).)

(2) *Applications and Solicitations Excluded.* The disclosure requirements do not apply to application forms or solicitations included in magazines, newspapers, or other publications distributed by someone other than the retail seller. (C.C. 1810.21(a).) In addition, the following applications or solicitations are excluded from the disclosure requirements:

(a) Applications or solicitations for a retail installment account credit card where the credit extended is to be secured by a lien on real or personal property or both. (C.C. 1810.21(h)(1).)

(b) Applications or solicitations that invite a person to apply for a card and that are included as part of a catalog sent by a creditor in order to facilitate a credit sale of goods offered in the catalog. (C.C. 1810.21(h)(2).)

(c) An advertisement that does not invite an application for a card. (C.C. 1810.21(h)(3).)

(d) Applications or written advertisements included in magazines, newspapers, or other publications distributed in more than one state by someone other than the creditor. (C.C. 1810.21(h)(4).)

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4. Retail Installment Account Disclosures.

b. Matters To Be Disclosed.

4 Witkin Sum. Cal. Law Neg Inst § 165

[§ 165] Matters To Be Disclosed.

(1) *Rates.* The application or solicitation must disclose the periodic rate or rates that will be used to determine the finance charge on the balance due under the terms of the account, expressed as an annual percentage. (C.C. 1810.21(a)(1)(A).)

(2) *Fees.* A membership or participation fee for a retail installment account in connection with which a credit card is issued must be disclosed, expressed as an annualized amount. (C.C. 1810.21(a)(1)(B).)

(3) *"Free Period."* If the retail seller provides a period during which the buyer may pay the balance in full without additional finance charges, the retail seller must do one of the following:

(a) Disclose the minimum number of days of that period, calculated from the closing date of the prior billing cycle to the date designated in the billing statement as the date by which that payment must be received to avoid additional charges. (C.C. 1810.21(a)(1)(C).)

(b) Describe the manner in which the period is calculated. (C.C. 1810.21(a)(1)(C).)

In addition, retail sellers who do not provide a "free period" must disclose that fact. (C.C. 1810.21(a)(1)(C).)

(4) *Additional Information.* C.C. 1810.21 does not prohibit a retail seller from disclosing additional terms, conditions, or information in conjunction with the required disclosures. (C.C. 1810.21(e).)

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4. Retail Installment Account Disclosures.

c. Methods of Compliance.

4 Witkin Sum. Cal. Law Neg Inst § 166

[§ 166] Methods of Compliance.

(1) *Disclosure Satisfying Regulation Z.* As an alternative to disclosing the matters set forth in C.C. 1810.21(a)(1) (supra, §165), a disclosure statement is sufficient if it satisfies the initial disclosure requirements of Regulation Z (defined in C.C. 1810.21(d)). (C.C. 1810.21(a)(2).)

(2) *Notice on Application Mailed to Buyers in More Than One State.* If an unsolicited application is mailed or delivered to retail buyers in more than one state, the disclosure requirements of C.C. 1810.21(a) are satisfied if the application or solicitation (a) contains a notice that credit terms may vary from state to state, and (b) provides the disclosures required by C.C. 1810.21(a), or an address or phone number for the customer to use to obtain these disclosures. The notice must be in boldface type no smaller than the largest type used in the narrative portion of the solicitation. (C.C. 1810.21(b).)

(3) *Statutory Chart.* A retail seller need not present the required disclosures in a chart or use any specific terminology other than that expressly provided by C.C. 1810.21. (C.C. 1810.21(c).) However, if a chart with captions substantially as stated in C.C. 1810.21(c) is completed, with the applicable terms the seller is offering, or if the seller presents the terms in tabular, list, or narrative form using terminology substantially similar to the chart captions, the disclosures are conclusively presumed to satisfy C.C. 1810.21(a)(1). (C.C. 1810.21(c).)

(4) *Compliance With Other Laws.* A retail seller who complies with C.C. 1748.11 is deemed to have complied with the requirements of C.C. 1810.21. (C.C. 1810.21(e).) Moreover, if a retail seller is required under federal law to disclose on applications or solicitations the terms applicable to a retail installment account, the seller is deemed to have complied with C.C. 1810.21(a)(1) with respect to those applications or solicitations if the seller complies with the federal requirements. (C.C. 1810.21(f).)

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I. Consumer Credit and Charge Card Fees.

4 Witkin Sum. Cal. Law Neg Inst § 167

[§ 167] Consumer Credit and Charge Card Fees.

(1) *Scope of Fee Limitations.* The fees that may be charged pursuant to a consumer credit or charge card agreement are limited by *Fin.C. 4000* et seq. A "consumer credit agreement" is a written instrument that provides for the extension of unsecured open-end credit for personal, family, or household purposes and that governs the relationship between a supervised financial organization and one or more consumers. (*Fin.C. 4000(a)(3)*.) A "supervised financial organization" is a state or federally regulated bank, savings association, savings bank, or credit union, or a subsidiary of those institutions. (*Fin.C. 4000(a)(9)*.) A "charge card agreement" is a written instrument that creates and governs the relationship between a charge card issuer and one or more consumers. (*Fin.C. 4000(a)(4)*); for definition of "charge card issuer," see C.C. 1748.21(a), supra, §161.)

(2) *Permissible Charges.* *Fin.C. 4001(a)* sets forth the late payment charges and overlimit charges a supervised financial organization or charge card issuer may assess. In addition to these charges, a supervised financial organization may assess a finance charge at the rates set forth in the consumer credit agreement on the outstanding balance, which may include any late payment or overlimit fee charged on a prior billing statement. (*Fin.C. 4001(b)*.) Whenever a consumer fails to make a minimum payment by the due date specified in the billing statement, plus the applicable late payment grace period, the supervised financial organization or charge card issuer may assess a late payment fee, but it may impose no more than one late payment fee with respect to any monthly billing cycle. (*Fin.C. 4001(c)*.)

(3) *Permissible Billing Cycle.* *Fin.C. 4001(d)* specifies the minimum number of days a supervised financial organization must provide between the monthly billing statement date and the date on which the minimum payment is due, and also specifies the minimum number of days a charge card issuer must provide between the monthly billing statement date and the date on which the applicable late payment grace period begins to run.

(4) *Disclosures.* The late payment grace period and fee must be disclosed in the consumer credit agreement, and the late payment grace period must be disclosed in the consumer credit or charge card agreement but need not be disclosed in the monthly or other billing statement. The amount and conditions for imposition of any fee for overlimit activity must also be disclosed in the consumer credit or charge card agreement. (*Fin.C. 4001(e)(1)*.) If a consumer credit or charge card agreement contains a provision for a late payment fee or overlimit fee, each monthly or other billing statement must disclose the amount of the late payment and overlimit fee and the date the minimum payment is due. (*Fin.C. 4001(e)(2)*.)

(5) *Out-of-State Customers.* In *Smiley v. Citibank* (1996) 517 U.S. 735, 116 S.Ct. 1730, 135 L.Ed.2d 25, plaintiff credit cardholder, a California resident, was charged late fees on two credit cards issued by defendant, a national bank located in South Dakota. Although the late fees were in an amount permitted by South Dakota law, plaintiff contended that the fee amount violated California law and could not be imposed on defendant's California cardholders. Defendant argued that 12 U.S.C., §85 (§30 of the National Bank Act), which provides that a national bank may charge its loan customers "interest at the rate allowed by the laws of the State ... where the bank is located," preempted plaintiff's claim. The trial judge granted judgment on the pleadings for defendant. *Held*, affirmed.

(a) *Interest determined by laws of bank's home state.* Under 12 U.S.C., §85, a national bank may charge out-of-state credit card customers interest at a rate allowed by the bank's home state, even when that rate is higher than what is permitted by the various states in which the cardholders reside. This issue was resolved in *Marquette Nat. Bank of Minneapolis v. First of Omaha Service Corp.* (1978) 439 U.S. 299, 99 S.Ct. 540, 58 L.Ed.2d 534. (116 S.Ct. 1732, 135 L.Ed.2d 30.)

(b) *Agency interpretation of "interest" as including late fee is entitled to deference.* The meaning of the term "interest," as used in 12 U.S.C., §85, is ambiguous. "It is our practice to defer to the reasonable judgments of agencies with regard to the meaning of ambiguous terms in statutes that they are charged with administering." Here, the Comptroller of the Currency issued a regulation while this case was pending in the lower courts providing that "interest" includes, among other things, late fees. (116 S.Ct. 1732, 1733, 135 L.Ed.2d 30.)

(1) It is irrelevant that the regulation was issued more than 100 years after the statute was enacted; nor does it matter that the regulation was prompted by litigation, including the present action. (116 S.Ct. 1733, 135 L.Ed.2d 31.)

(2) The regulation makes a logical distinction between payment compensating a creditor for extending credit, such as a late fee, and all other payments, such as an appraisal fee or document preparation fee. (116 S.Ct. 1734, 135 L.Ed.2d 32.)

(3) The regulation does not represent a change of the agency's official position, but even if it did, that fact alone would not be fatal to the rule of deference. (116 S.Ct. 1734, 135 L.Ed.2d 32.)

(4) There is no question that 12 U.S.C., §85 preempts state law. Because the issue here is not *whether* the statute preempts state law, but rather the meaning of one of the statute's provisions, the rule of deference fully applies. (116 S.Ct. 1735, 135 L.Ed.2d 33.)

(c) *Agency interpretation of "interest" is reasonable.*

(1) "Interest" is not limited to charges expressed as a function of time or of amount owing. Neither the dictionaries available at the time the National Bank Act was enacted, nor United States Supreme Court cases decided during that time, restricted the definition of "interest" in that way. Moreover, the phrase "at the rate allowed" does not require a time- or rate-based definition of interest. Such a requirement would be pointless because a flat charge may be readily converted to a percentage charge. (116 S.Ct. 1735, 135 L.Ed.2d 34.)

(2) In 12 U.S.C., §85, the term "interest" is not used in contradistinction to the term "penalty" and there is no reason why "interest" cannot include interest charges imposed as penalties. (116 S.Ct. 1736, 135 L.Ed.2d 35.)

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