

Michigan Law Review

Volume 73 | Issue 2

1974

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Michigan Law Review

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Recommended Citation

Michigan Law Review, *Blocking Payment on a Certified, Cashier's, or Bank Check*, 73 MICH. L. REV. 424 (1974).

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Blocking Payment on a Certified, Cashier's, or Bank Check

When disputes arise between buyers and sellers over completed commercial transactions and payment has been delivered to the seller in the form of a negotiable instrument,¹ a dissatisfied buyer may seek to suspend the instrument's payment obligation.² By blocking payment the buyer strengthens his bargaining position and prevents the seller from dissipating the proceeds of the sale before the buyer can establish the merit of his claim. Blocking payment forces the seller to enforce the commercial agreement through court action³ or satisfy the buyer's grievances.⁴

When the buyer pays with a personal check, his right to compel the drawee bank to stop payment is protected by statute.⁵ The payee's remedy on the check is against the buyer only; the bank is not responsible.⁶ Sellers wary of the buyer's control over a personal check may insist on payment in the form of a certified, cashier's, or bank check (hereinafter business check).⁷ A *certified* check is a personal check drawn by a depositor on his account and signed by an autho-

1. UNIFORM COMMERCIAL CODE [hereinafter UCC] § 3-104(1) provides the basic definition of a negotiable instrument:

- (1) Any writing to be a negotiable instrument within this Article must
 - (a) be signed by the maker or drawer; and
 - (b) contain an unconditional promise or order to pay a sum certain in money and no other promise, order, obligation or power given by the maker or drawer except as authorized by this Article; and
 - (c) be payable on demand or at a definite time; and
 - (d) be payable to order or to bearer.

2. It will be assumed, for the purpose of discussing the problems raised in this note, that the seller always has possession of the payment instrument.

3. The seller can sue a maker, drawer, or acceptor on the instrument under UCC § 3-413, or, in the alternative and in specified circumstances, he can sue the buyer on the underlying contractual obligation. UCC § 3-802(1)(b).

4. The seller may also seek to void the agreement, either by self-help or through judicial procedures. For example, he can withhold delivery of the goods, *Portal Galleries, Inc. v. Tomar Prods., Inc.*, 60 Misc. 2d 523, 302 N.Y.S.2d 871 (Sup. Ct. 1969); UCC § 2-703(a), secure a judgment levy on goods that have been delivered, or, in some circumstances, personally repossess the delivered property. *Girard v. Anderson*, 219 Iowa 142, 257 N.W. 400 (1934); *Cherno v. Bank of Babylon*, 54 Misc. 277, 232 N.Y.S.2d 114 (Sup. Ct. 1967), *affd.*, 29 App. Div. 2d 767, 288 N.Y.S.2d 862 (1968); UCC § 9-503.

5. "A customer may by order to his bank stop payment of any item payable for his account but the order must be received at such time and in such manner as to afford the bank a reasonable opportunity to act on it prior to any action by the bank with respect to the item described in Section 4-303." UCC § 4-403(1).

6. "A check or other draft does not of itself operate as an assignment of any funds in the hands of the drawee available for its payment, and the drawee is not liable on the instrument until he accepts it." UCC § 3-409(1). *See also* UCC § 3-410.

7. The lack of security of payment on personal checks has caused sellers to require with increasing frequency that payment be made by certified check. *Roberts & Morris, The Effect of a Stop Payment Order on a Certified Check*, 5 Wyo. L.J. 170, 170 (1951). From a seller's viewpoint, a cashier's check and a bank check offer the same security of payment as a certified check. *See* text at notes 12-18 *infra*.

rized bank officer.⁸ The officer's signature constitutes a legal acceptance of the check,⁹ and creates contractual privity between the check payee and the drawee bank.¹⁰ The sum charged to the check is withdrawn by the bank from the drawer's account and held as a deposit to the credit of the check.¹¹ A *cashier's* check is drawn by a bank upon its own funds at the solicitation of a purchasing customer.¹² It is issued by an authorized officer of the bank and authorizes the payee to demand and receive from the bank, upon presentation of the instrument, the amount of money represented by the check.¹³ The bank, as drawer and drawee of the check, is primarily liable to the payee for the check's stated amount.¹⁴ A *bank* check or draft is drawn by one bank on its account with another bank at the solicitation of its customer.¹⁵ If the drawee bank refuses to honor the check, the drawer bank is liable for the amount stated on the instrument.¹⁶ All three instruments allow the payee-seller to

8. J. BRADY, *THE LAW OF BANK CHECKS* 148 (4th ed. H. Bailey 1969).

9. "Acceptance is the drawee's signed engagement to honor the draft as presented. It must be written on the draft, and may consist of his signature alone. It becomes operative when completed by delivery or notification." UCC § 3-410(1).

10. The drawee-bank, as an "acceptor," enters into a statutory contract with the payee. "The maker or acceptor engages that he will pay the instrument according to its tenor at the time of his engagement or as completed pursuant to Section 3-115 on incomplete instruments." UCC § 3-413(1).

11. J. BRADY, *supra* note 8, § 7.1, at 148-49.

12. *Pennsylvania v. Curtiss Natl. Bank*, 427 F.2d 395, 398 (5th Cir. 1970); *Kaufman v. Chase Manhattan Bank*, 370 F. Supp. 276, 278 (S.D.N.Y. 1973); J. BRADY, *supra* note 8, § 1.6, at 10.

13. *National Newark & Essex Bank v. Giordano*, 111 N.J. Super. 347, 350, 268 A.2d 327, 328 (L. Div. 1970).

14. Most courts simply state that the act of issuance constitutes an acceptance by the issuing bank for the purpose of UCC § 3-413(1). *E.g.*, *Pennsylvania v. Curtiss Natl. Bank*, 427 F.2d 395, 399 (5th Cir. 1970); *Kaufman v. Chase Manhattan Bank*, 370 F. Supp. 276, 278 (S.D.N.Y. 1973). One court has stated that the signature of an authorized employee of the issuing bank on a cashier's check constitutes acceptance under UCC § 3-410(1). *National Newark & Essex Bank v. Giordano*, 111 N.J. Super. 347, 351, 268 A.2d 327, 329 (L. Div. 1970). As an "acceptor," the issuing bank enters into a statutory contract with the payee "to pay the instrument according to its tenor at the time of engagement." UCC § 3-413(1). *See* note 10 *supra*.

An alternative explanation for the bank's contractual liability on a bank check could be that the bank as a drawer is obligated to pay the amount of the draft under UCC § 3-413(2): "The drawer engages that upon dishonor of the draft and any necessary notice of dishonor or protest that he will pay the amount of the draft to the holder or to any indorser who takes it up."

15. J. BRADY, *supra* note 8, § 1.6, at 10.

16. UCC § 3-413(2). *See* note 14 *supra*. The courts are in conflict over the drawer bank's right to issue a stop-payment order to the drawee bank. Two New York lower court cases held that the drawer bank does not have the right. *Ruskin v. Central Fed. Sav. & Loan Assn.*, 3 UCC REP. SERV. 150 (N.Y. Sup. Ct. 1966); *Malphrus v. Home Sav. Bank*, 44 Misc. 2d 705, 254 N.Y.S.2d 980 (Albany County Ct. 1965). A Georgia appeals court disagreed, holding that a bank that draws a check on a second bank is a "customer" under UCC § 4-104(1)(e), and therefore is entitled to stop payment on its check under UCC § 4-403. *Fulton Natl. Bank v. Delco Corp.*, 128 Ga. App. 16, 18, 195 S.E.2d 455, 457 (1973). Even if the drawer bank can issue a stop-payment order, however,

recover on the instrument from a solvent bank if the check is not honored.¹⁷ They thus offer more certainty of payment than a personal check when in the seller's hands, and are regarded as a near equivalent of cash.¹⁸

The bank's status as drawer or acceptor on business checks denies the buyer-customer the right to issue a binding stop payment order on the check. Section 4-303 of the Uniform Commercial Code (Code) explicitly states that a stop order "comes too late" if the drawee has accepted or certified the check, as is the case with certified¹⁹ and cashier's checks.²⁰ A bank check is not an "item payable for his [the buyer-customer's] account,"²¹ and therefore is not subject to a stop payment order under section 4-403(1).

Although deprived of the statutory right to stop payment, the buyer can attempt to persuade the issuing or certifying bank to withhold payment. While banks want to maintain their reputation by having their business checks accepted as cash, they also wish to provide their customers with protective services in specific circumstances.²² If the aggrieved buyer convinces the issuing bank to breach its contract with the payee-seller on a business check, and the payee-seller subsequently sues the bank for payment, the bank

it remains contractually liable on the instrument under UCC § 3-413(2) as a drawer. *Fulton Natl. Bank v. Delco Corp.*, 128 Ga. App. 16, 195 S.E.2d 455 (1973); J. WHITE & R. SUMMERS, *HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE* 580 (1972).

17. Acceptance of a business check is complete upon delivery of the check or notification to the payee, UCC § 3-410(1), and drawer liability is established upon delivery of the check. See *Ryan v. Ryan*, 298 A.2d 343 (Del. Super. Ct. 1972); UCC §§ 1-201(20); 3-410(1), Comment 4; 3-603(1).

In fact, the buyer is released from all payment liability to the seller unless the seller has procured the buyer's endorsement: "Unless otherwise agreed where an instrument is taken for an underlying obligation (a) the obligation is pro tanto discharged if a bank is drawer, maker or acceptor of the instrument and there is no recourse on the instrument against the underlying obligor . . ." UCC § 3-802(1)(a).

18. J. WHITE & R. SUMMERS, *supra* note 16, at 579 n.91; Roberts & Morris, *supra* note 7, at 170.

19. See text at notes 10-11 *supra*.

20. See note 14 *supra*.

21. A bank check is credited to the drawer bank's account with the drawee bank. See text at notes 15-16 *supra*.

22. Certainly it is in a bank's best interest to have its cashiers checks and checks certified by it accepted without question as the equivalent of cash in the settlement of commercial and consumer transactions and we cannot conceive of a bank refusing payment of any such check merely to accommodate a customer who feels aggrieved by the payee's action or non-action in the underlying transaction. It must be recognized, however, that, in very rare instances, transactions may be so charged with fraud or similar criminal activity, a bank might decide it would be unconscionable to effect payment of such checks. There are, of course, other equitable considerations which might dictate the dishonoring of such checks.

Letter from Thomas J. McNanus, Assistant Resident Counsel, Morgan Guaranty Trust Company of New York, to the *Michigan Law Review*, April 11, 1974 [hereinafter McNanus Letter].

may seek to raise the defenses of its customer with respect to the obligation underlying the check. If the bank cannot be persuaded to withhold payment, the buyer may seek to prevent payment by asserting an "adverse claim." These procedures, if routinely available, would vest in the buyer a good deal of control over the funds credited to a business check, and would significantly dilute a business check's similarity to cash. The business check would be operationally similar to a personal check; the only remaining difference would be that a bank and not the buyer would be liable if the seller-payee is successful in a suit on the merits. However, the right of a bank to raise its customer's claims and defenses, and the availability of the adverse claim doctrine, are unclear. This note will investigate the rights and obligations of the three basic parties involved—the bank,²³ the buyer-customer,²⁴ and the seller-payee²⁵—under present law, and suggest amendments to the Code that will clarify those rights and balance the interests of the parties in light of the Code's basic policy objectives.

The ability of an obligor (*e.g.*, the bank) to raise a defense on an instrument (*e.g.*, a business check) based upon the rights of a third party (*e.g.*, the buyer-customer) is rooted in the common law doctrine of *jus tertii*.²⁶ Under that doctrine the defendant admits that he owes a debt on the instrument but denies that he owes it to the plaintiff because of a superior outstanding right in a third party.²⁷ By asserting the rights of the third party the defendant seeks to prove that the plaintiff's title to the instrument is either defective or non-existent.²⁸

23. It is assumed here that the bank that issues or certifies the business check is also the recipient of the seller's initial payment demands; it is the depository, collecting, and presenting bank, as well as the drawee bank. See UCC § 4-105; J. WHITE & R. SUMMERS, *supra* note 16, at 493.

24. The buyer-customer is the person who procures the business check with a view to delivering the check in fulfillment of contractual payment obligations. He is the drawer of a certified check, see text at notes 8-14 *supra*, or the remitter of a cashier's or a bank check. See W. BRITTON, HANDBOOK OF THE LAW OF BILLS AND NOTES § 75, at 177 (2d ed. 1961).

25. It is assumed that the payee of the delivered business check is receiving the check as consideration pursuant to a contract, and that he has not endorsed the instrument to another party. If the instrument has been endorsed to a third party, that party may qualify as a holder in due course, UCC § 3-302, and will take the instrument free from "all claims" and "all defenses" of the buyer, UCC § 3-305. The payee of a business check may also be a holder in due course, UCC § 3-302(2), if he satisfies the requirements of UCC § 3-302(1). See especially Comment 2a. However, if the payee has "dealt" with the buyer, he is not entitled to the rights of a holder in due course as against the buyer, UCC § 3-305(2), and his rights will be defined under UCC § 3-306. Cf. *Hall v. Westmoreland*, Hall & Bryan, 123 Ga. App. 809, 182 S.E.2d 539 (1971).

26. *Jus tertii* literally means the right of a third party. BLACK'S LAW DICTIONARY 1000 (rev. 4th ed. 1968).

27. Note, *Jus Tertii Under Common Law and the N.I.L.*, 26 ST. JOHN'S L. REV. 135, 135 (1951).

28. *Id.*

The nature of the third-party right alleged is crucial to a successful *jus tertii* defense. The defendant will prevail if he can prove that legal title to the instrument, as opposed to equitable title or a contract defense,²⁹ is in a third party.³⁰ A common case for the application of *jus tertii* arises when a drawer prepares a negotiable instrument payable to a specified party and a thief steals it from the drawer or payee, forges the payee's endorsement, and attempts to secure payment by presenting the check to a collecting bank.³¹ An instrument with a forged endorsement is considered wholly inoperative; the possessor has no right to retain it or to enforce payment against any party to it.³² The obligor on the instrument, by proving that the third party's legal title to the instrument is superior to that of the thief, avoids tendering payment.³³

29. The classic definitions of legal title, equitable title, and contract defenses as applied to negotiable instruments were given by Zechariah Chafee, Jr., in 1918. W. BERRON, *supra* note 24, at 456-62.

Chafee formulated the following definition of legal title: "The legal title to a negotiable instrument throughout its existence belongs to the person to whom the promises run by the terms of the instrument if he has possession, no matter how that possession came to him." Chafee, *Rights in Overdue Paper*, 31 HARV. L. REV. 1104, 1112 (1918). Under this formulation a thief has legal title to a negotiable instrument payable to bearer or endorsed in blank, but a possessor under a forged instrument has no legal title because he is not a promisee under the terms of the instrument.

Chafee's distinction between equities of ownership and equities of defense is based on the dual nature of a negotiable instrument. Equities of ownership relate to the instrument as a chattel:

It is a chattel, a tangible scrap of paper, sometimes valuable for its own sake if sufficiently ancient or bearing the autograph of some historic debtor . . . , always available for framing or even papering the walls, for which purpose unlucky investors have used their coupon bonds. As a chattel, it is the subject of conversion which gives rise to trover, has been held to be covered by the designation "goods and chattels" in the Statute of Frauds, and is taxable where situated, though the owner and the obligor reside elsewhere.

Id. at 1109. Any equitable claim of right to possession of the actual paper is a claim of equitable ownership. For example, if the payee of an instrument is induced by fraud to endorse and deliver the instrument to a third party, the payee has an equitable right to restitution of the document.

Equities of defense relate to the negotiable instrument as a "bundle of contracts." *Id.* "Instead of being property rights . . . , they are set up by a defendant as defenses . . . to litigation on a contract." *Id.* at 1111. Equities of defense are the ordinary personal defenses, such as failure of consideration, fraud, duress, nonfulfillment of a condition precedent, that can be asserted by a party of a commercial transaction to void his payment instrument.

30. *E.g.*, *Lum v. Robertson*, 73 U.S. (6 Wall.) 277 (1867); *Bond v. Maxwell*, 40 Ga. App. 679, 150 S.E. 860 (1929); *Hays v. Hathorn*, 74 N.Y. 486 (1878). *See Note, supra* note 27, at 139.

31. *E.g.*, *Lancaster v. Baltzell*, 28 Am. Dec. 233 (Md. 1836); *Corn Exch. Bank v. Nassau Bank*, 91 N.Y. 74 (1883). *See J. WHITE & R. SUMMERS, supra* note 16, at 492.

A second common application of the doctrine occurs when an instrument payable to a corporation is endorsed by an unauthorized corporate officer or agent. *See, e.g.*, *Gilbert v. Miller*, 68 Cal. App. 40, 228 P. 662 (Dist. Ct. App. 1924); *Hirsch v. Allendorf*, 117 N.J.L. 404, 189 A. 82 (Ct. Err. & App. 1937).

32. *Lancaster v. Baltzell*, 28 Am. Dec. 233 (Md. 1836); *Corn Exch. Bank v. Nassau Bank*, 91 N.Y. 74 (1883).

33. *E.g.*, *Gilbert v. Miller*, 68 Cal. App. 40, 228 P. 662 (Dist. Ct. App. 1924); *Bond*

The weight of authority at common law would not allow an obligor to defend by pleading that the instrument is subject to an equity of ownership or a contractual defense in a third party.³⁴ Courts and commentators have advanced several reasons for this limitation, including protecting the defendant from double liability,³⁵ eliminating relitigation on the same issues in a separate suit by the third party against either the obligor or the instrument holder,³⁶ protecting the obligor who is unaware of the third party's claims,³⁷ and precluding the obligor from escaping all liability by prevailing against the plaintiff on a third-party defense and against the third party in a separate suit.³⁸ These arguments, however, can also be used to attack the *jus tertii* defense when it is based on a third party's legal title.³⁹

A more convincing reason exists for the distinction between claims of legal and equitable title. If the obligor tenders payment on a forged signature to one who does not possess legal title to the instrument, the obligor is liable for the paid amount to the rightful payee under the doctrine of conversion.⁴⁰ The obligor, therefore, must verify the claimant's title at its peril; an incorrect assessment might subject the obligor to double liability.⁴¹ The law creates a

v. Maxwell, 40 Ga. App. 679, 150 S.E. 860 (1929); Lancaster v. Baltzell, 28 Am. Dec. 233 (Md. 1836); Hays v. Hathorn, 74 N.Y. 486 (1878).

34. E.g., Caldwell v. Lawrence, 84 Ill. 161 (1876); Richards v. Betzer, 53 Ill. 466 (1870); Prouty v. Roberts, 60 Mass. (6 Cush.) 19 (1850); Brown v. Penfield, 36 N.Y. 472 (1867); J. BRANNAN, NEGOTIABLE INSTRUMENTS LAW § 59, at 884-85 (7th ed. 1948). *Contra*, Parsons v. Utica Cement Mfg. Co., 82 Conn. 333, 73 A. 785 (1909); Merchant's Exch. Natl. Bank v. New Brunswick Sav. Inst., 33 N.J.L. 170 (Sup. Ct. 1868).

35. Allowing *jus tertii* might mean that the defendant cannot simply discharge his obligation by payment to the plaintiff. For example, if the defendant fails successfully to assert *jus tertii*, the third party, in a later suit, may sue the defendant for paying the wrong party, for the earlier judgment is not binding upon the owner of the outstanding equity. Denying *jus tertii* frees the obligor from a potential duty to assert third party claims. W. BRITTON, *supra* note 24, § 159, at 468. Cf. Gilbert v. Miller, 68 Cal. App. 40, 45, 228 P. 662, 664 (Dist. Ct. App. 1924).

36. Either the successful plaintiff, *see* Note, *Personal Money Orders and Teller's Checks: Mavericks Under the U.C.C.*, 67 COLUM. L. REV. 524, 544 (1967), or the unsuccessful defendant-obligor, *see* materials cited note 34 *supra*, may be liable in a suit by the third party.

37. *See* W. BRITTON, *supra* note 24, § 159, at 468. Cf. Gage v. Kendall, 15 Wend. 640 (N.Y. Sup. Ct. 1836).

38. Note, *supra* note 27, at 137. Cf. City Bank v. Perkins, 29 N.Y. 554, 567 (1864).

39. *See, e.g.*, Gilbert v. Miller, 68 Cal. App. 40, 45, 228 P. 662, 664 (Dist. Ct. App. 1924); City Bank v. Perkins, 29 N.Y. 554, 567 (1864).

40. E.g., FDIC v. Marine Natl. Bank, 431 F.2d 341 (5th Cir. 1970) (instrument lacked endorsement of joint payee); Harry H. White Lumber Co. v. Crocker-Citizens Natl. Bank, 253 Cal. App. 2d 368, 61 Cal. Rptr. 381 (Ct. App. 1967) (forgery); Salsman v. National Community Bank, 102 N.J. Super. 482, 246 A.2d 162 (L. Div. 1968), *aff'd.*, 105 N.J. Super. 164, 251 A.2d 460 (App. Div. 1969) (unauthorized signature); UCC § 3-419 (1)(c) ("An instrument is converted when . . . it is paid on a forged indorsement.").

41. The payor (obligor), however, would have the right to recover on a quasi-

strong incentive for the bank to follow carefully a negotiable instrument's directions in paying the party or parties with legal title. A necessary corollary to potential liability for conversion is the obligor's ability to protect himself by defeating an instrument possessor's claim for payment by asserting that legal title is in a third party.

On the other hand, when the third party asserts equitable title and the instrument possessor has legal title, the obligor (assuming he has no notice of the claims) may tender payment to the possessor in discharge of his liability on the instrument without incurring the risk of subsequent liability to the third party.⁴² Under common law the obligor is required to withhold payment on the instrument only if it is notified of the third-party claims,⁴³ or, under the Code, only if the third party secures a court order restraining payment or proffers a bond indemnifying the bank against loss.⁴⁴ Even then the obligor does not have to raise *jus tertii*; payment is simply withheld for a reasonable time to enable the third-party claimant to seek his own judicial remedies.⁴⁵ These rules have merit, for a tremendous burden would be placed on the obligor if it were held liable to a third party alleging an equitable claim because it (the obligor) failed to assert a successful *jus tertii* defense against a possessor. The obligor would be forced to ascertain, raise, and argue all of the third party's allegations in a suit initiated by the possessor of the instrument. The dispute may involve an alleged breach of warranty, a claim of inadequate performance, or another of the numerous controversies that may arise between parties to a commercial transaction. Where the dispute involves legal title the conversion doctrine forces the obligor to investigate only the identity and authorization of the instrument bearer, but where equitable title is involved the obligor would be forced to intervene in a multifaceted dispute between other parties.

The cases under the Negotiable Instruments Law⁴⁶ were split

contract theory the sum erroneously paid to the party without legal title. W. BRITTON, *supra* note 24, § 159, at 468. The bank can always protect itself by refusing to honor the instrument, but unjustified refusals to pay cast doubt on the security of the bank's services. See McNanus Letter, *supra* note 22. Cf. *Ross v. Peck Iron & Metal Co.*, 264 F.2d 262 (4th Cir. 1959).

42. 2 T. PATON, PATON'S DIGEST OF LEGAL OPINIONS 1656 (rev. 1942).

43. See text at notes 83-84 *infra*.

44. See text at note 100 *infra*.

45. *Gendler v. Sibley State Bank*, 62 F. Supp. 805, 810 (N.D. Iowa 1945); *Drum-Flats Comm. v. Gerlach Bank*, 107 Mo. App. 426, 433-34, 81 S.W. 503, 505 (1904).

46. The Negotiable Instruments Law was the first American uniform code on commercial paper. It was drafted by John J. Crawford and adopted by the National Conference of Commissioners on Uniform State Laws. Between 1898 and 1924 it was adopted by all fifty states, but amendments and conflicting judicial interpretations became so frequent that its uniformity from state to state was destroyed. See J. BRANNAN, *supra* note 34, at 73-90. The Uniform Commercial Code, adopted by all states except Louisiana by 1968, has superseded the Negotiable Instruments Law.

on the applicability of the *jus tertii* doctrine. Several cases asserted its demise and held that a drawee sued by the payee could not set up the defenses of the drawer against the payee.⁴⁷ However, in the leading case of *Sutter v. Security Trust Co.*,⁴⁸ the court stated in dictum that if certification has been procured by the drawer of the check, "the bank can urge and have the benefit of any defense that the drawer could have against the payee, establishing that such payee obtained the instrument, or any signature thereto, by fraud, duress, or force and fear, or other unlawful means, or for an illegal consideration."⁴⁹ The case established the applicability of the *jus tertii* doctrine under the Negotiable Instruments Law, and expanded the doctrine by eliminating the common law distinction between legal title and equitable title claims. Although the court limited its opinion to checks certified by the drawer, as opposed to those certified by the payee or the holder,⁵⁰ many courts adopted the dictum without the limitation.⁵¹

The Uniform Commercial Code, which superseded the Negotiable Instruments Law,⁵² limited the *Sutter* case and returned to the common-law outlines of the *jus tertii* doctrine. Section 3-306(d) states that the obligor may raise the defenses that the instrument was acquired by theft or that payment would be inconsistent with the terms of a restrictive endorsement, but "[t]he claim of any third person to the instrument is not otherwise available as a defense to any party liable thereon . . ." Justification for the provision is offered by Comment 5: "The exception made in the case of theft is based on the policy which refuses to aid a proved thief to recover, and refuses to aid him indirectly by permitting his transferee to recover unless the transferee is a holder in due course." The *Sutter* doctrine, allowing the assertion of *jus tertii* for equitable title claims, was rejected because

[t]he contract of the obligor is to pay the holder of the instrument, and the claims of other persons against the holder are generally not his concern. He is not required to set up such a claim as a defense, since he usually will have no satisfactory evidence of his own on the issue; and the provision that he may not do so is intended as much for his protection as for that of the holder.⁵³

47. *E.g.*, *Jones v. National Bank*, 95 N.J.L. 376, 113 A. 702 (Sup. Ct. 1921); *Bulliet v. Allegheny Trust Co.*, 284 Pa. 561, 131 A. 471 (1925).

48. 96 N.J. Eq. 644, 126 A. 435 (Ct. Err. & App. 1924).

49. 96 N.J. Eq. at 648, 126 A. at 437.

50. 96 N.J. Eq. at 647, 126 A. at 437.

51. *E.g.*, *Leo Syntax Auto Sales, Inc. v. Peoples Bank & Sav. Co.*, 6 Ohio Misc. 226, 215 N.E.2d 68 (C.P. 1965). *See also* *Kup Winston v. Kasper Am. State Bank*, 36 Ill. App. 2d 423, 184 N.E.2d 725 (1962).

52. *See* note 46 *supra*.

53. UCC § 3-306, Comment 5.

Section 3-306(d) is thus a codification, with historical rationale intact, of earlier case law that allowed the obligor of a negotiable instrument to raise only the *jus tertii* defense of legal title.

The common law grafts one significant exception onto the *jus tertii* doctrine, however: *Jus tertii* is allowed when the third party asserts equitable ownership⁵⁴ of the negotiable instrument if he is brought into the suit between the obligor and payee.⁵⁵ When the third party has been joined,⁵⁶ when interpleader has been requested and granted,⁵⁷ or when the third party has intervened in the suit,⁵⁸ the difficulties with allowing *jus tertii* for equitable title claims disappear. The third party's submission to the jurisdiction of the court greatly reduces the obligor's evidentiary burden. Presumably the third party, because he will be bound by the judgment, will present his claims fully, and the obligor can assume a passive role in the proceedings.⁵⁹ Furthermore, the presence of the third party allows the court to settle the dispute finally between all parties. Relitigation between any of the involved parties is foreclosed, eliminating

54. See note 29 *supra*.

55. *E.g.*, *Horrigan v. Wyman*, 90 Mich. 121, 51 N.W. 187 (1892); *Bathgate v. Exchange Bank*, 199 Mo. App. 583, 205 S.W. 875 (1918); *Merchants Exch. Natl. Bank v. New Brunswick Sav. Inst.*, 33 N.J.L. 170 (Sup. Ct. 1868). See J. BRANNAN, *supra* note 34, § 59.

56. Modern court rules allow liberal joinder of defendants. It is commonly provided that parties may be joined if they are claimed to be jointly or severally liable on the basis of the same transaction or occurrence, and if any question of law or fact common to them will arise in the action. *E.g.*, *Fulton Natl. Bank v. Delco Corp.*, 128 Ga. App. 16, 17, 195 S.E.2d 455, 457 (1973); CAL. CIV. PRO. CODE § 379 (West 1970); N.Y. CIV. PRAC. LAW § 1002(b) (McKinney 1963); FED. R. CIV. P. 20(a); MICH. GEN. CT. R. 206; MINN. DIST. CT. R. 20.

57. Interpleader, originally an equitable proceeding, protects a debtor subject to conflicting claims to the same fund or property. H. McCLINTOCK, *HANDBOOK OF EQUITY* 493 (2d ed. 1948). The debtor, or stakeholder, is permitted to pay the contested proceeds to an appropriate court and force the contesting claimants to litigate the matter between themselves. The procedure is now largely codified by statute or court rule. *E.g.*, *Federal Interpleader Act*, 28 U.S.C. § 1335 (1970); CAL. CIV. PRO. CODE § 386 (West 1970); N.Y. CIV. PRAC. LAW § 1006 (McKinney 1963); FED. R. CIV. P. 22; MICH. GEN. CT. R. 210; MINN. DIST. CT. R. 22.

58. Intervention is a procedural device that allows a person not a party to the suit to assert a claim or defense in a pending action. See, *e.g.*, *Rocca v. Thompson*, 223 U.S. 317, 330 (1912). The intervenor must show that he claims an interest relating to the property or transaction that is the subject of the suit and that any disposition of the action without his participation would impair his ability to protect that interest, *Nuesse v. Camp*, 385 F.2d 694, 704 (D.C. Cir. 1967); *Atlantis Dev. Corp. v. United States*, 379 F.2d 818, 825 (5th Cir. 1967), or that his claim or defense and those involved in the main action have a question of law or fact in common. *SEC v. United States Realty & Improvement Co.*, 310 U.S. 434, 458-60 (1940); *Shipley v. Pittsburgh & L.E. Ry. Co.*, 70 F. Supp. 870 (W.D. Pa. 1947); *Jewell Ridge Coal Corp. v. Local 6167, UMW*, 7 F.R.D. 251, 254 (W.D. Va. 1943). Intervention is now expressly authorized by court rule or statute in most jurisdictions. *E.g.*, CAL. CIV. PRO. CODE § 387 (West 1970); N.Y. CIV. PRAC. LAW § 1012-13 (McKinney 1963); FED. R. CIV. P. 24; MICH. GEN. CT. R. 209; MINN. DIST. CT. R. 24.

59. In an interpleader action the obligor would become a neutral stakeholder. See note 57 *supra*.

potential double liability problems and added court and litigant expense.

The few courts that have dealt with this exception have limited it to cases involving third-party assertions of equitable title and have excluded third-party assertions of contract defenses.⁶⁰ The limitation is questionable in light of its reliance upon a historical but presently meaningless distinction between equitable title claims and contractual defenses.⁶¹

The Uniform Commercial Code retains the exception in section 3-306(d): "The claim of any third person to the instrument is not otherwise available as a defense to any party liable thereon unless the third person himself defends the action for such party." The Code is ambiguous, however, with respect to the type of third-party assertions that can be raised. The language of section 3-306(d) seems to adopt the common-law distinction between claims of equitable title and contract defenses by referring to "[t]he *claim* of any third party." Moreover, Comment 5 states: "The provision includes all claims for rescission of a negotiation, whether based in incapacity, fraud, duress, mistake, illegality, breach of trust or duty or any other reason. It includes claims based on conditional delivery or delivery for a special purpose. It includes claims of legal title, lien, constructive trust or other equity against the instrument or its proceeds."⁶² All of the examples given in Comment 5 are equitable claims.⁶³ This, plus the fact that the Code draftsmen used the historically encumbered term "claim" in sections 3-306(a) and (d), but used the term "defenses" in section 3-306(b), provides considerable support for arguing that the Code follows the common law and limits the exception to equitable title claims. The only case interpreting the provision, *Fulton National Bank v. Delco Corp.*,⁶⁴ has so held.⁶⁵

The device used to bring a third party into the suit, so as to allow the obligor to raise the third party's equitable title claims under section 3-306(d), may be court-ordered or plaintiff-requested

60. *E.g.*, *McAdoo v. Farmers State Bank*, 106 Kan. 662, 189 P. 155 (1920); *Carnegie Trust Co. v. First Natl. Bank*, 213 N.Y. 301, 107 N.E. 693 (1915). *Cf.* *Welch v. Bank of the Mahattan Co.*, 264 App. Div. 906, 35 N.Y.S.2d 894 (1942).

61. *See* text at notes 98-104 *infra*.

62. Comment 5 also provides that "[n]othing here stated is intended to prevent any interpleader, deposit in court or other available procedure under which the defendant may bring the claimant into court or be discharged without himself litigating the claim as a defense."

63. *See* note 29 *supra*.

64. 128 Ga. App. 16, 195 S.E.2d 455 (1973).

65. "A 'claim' is more than a mere 'defense.' . . . The word descends from the law merchant and indicates certain rights in the instrument on which the suit is based rather than mere reasons why the alleged debtor is not liable for the fund." 128 Ga. App. at 19, 195 S.E.2d at 457.

joinder of the third party as a defendant,⁶⁶ third-party-initiated intervention,⁶⁷ or obligor-initiated interpleader.⁶⁸ Interpleader—a form of equitable relief given to a debtor who is willing to pay but who is besieged by adverse claimants on the same debt—is the best alternative from the standpoint of the obligor: It allows the obligor to assume the position of a passive stakeholder and is initiated at its request.⁶⁹ Furthermore, interpleader is not a true *jus tertii* defense; if it is granted the bank need only assert a third party's claim, and does not have to prove it.

In spite of the obvious advantages of interpleader in terms of justice and ease of judicial administration, the courts have limited the situations in which it may be used. Equity courts originally established four stringent requirements for the availability of interpleader: (1) The same debt, duty, or thing must be claimed by the adverse parties; (2) the claimants must derive their claims to title from a common source; (3) the stakeholder must not assert any claim or have any interest in the subject matter; and (4) the stakeholder must have incurred no independent liability to either of the claimants.⁷⁰ Even after statutory modifications of interpleader rules, several jurisdictions still require that the stakeholder not be under an independent liability to one of the parties.⁷¹ In those jurisdictions the drawee-bank would apparently be precluded from obtaining interpleader on a claim by a business check payee because of its independent liability to the payee as the acceptor or drawee of the check.⁷²

Although the Code draftsmen apparently favored the use of interpleader to force the third party to participate in a suit by the payee against the obligor,⁷³ the Code does not provide standards or a special statutory basis for the use of interpleader. The availability of the device is thus often governed by contradictory local law. The resulting confusion is illustrated by two cases from the

66. See note 56 *supra*.

67. See note 58 *supra*.

68. See note 57 *supra*.

69. See note 57 *supra*.

70. H. McCLINTOCK, *supra* note 57, §§ 182-87, at 493-506. The rules originally were formulated in J. POMEROY, EQUITY JURISPRUDENCE § 1322 (1883). See Hazard & Maskovitz, *An Historical and Critical Analysis of Interpleader*, 52 CALIF. L. REV. 706, 725-49 (1964).

71. *E.g.*, Federal Interpleader Act, 28 U.S.C. § 1335 (1970); *Hurlbut v. Shell Oil Co.*, 131 F. Supp. 466 (W.D. La. 1955) (construing the Federal Interpleader Act to retain the rule that the stakeholder must be under no independent liability to any of the claimants). Compare *Poland v. Atlantis Credit Corp.*, 179 F. Supp. 863 (S.D.N.Y. 1960) (rule still valid), with *Knoll v. Socony Mobil Oil Co.*, 369 F.2d 425 (10th Cir. 1966), *cert. denied*, 386 U.S. 977 (1967) (rule no longer valid).

72. See text at notes 8-17 *supra*.

73. See note 62 *supra*.

New York Supreme Court. On similar facts one court expressly denied interpleader in a bank check dispute,⁷⁴ while another allowed interpleader in a certified check dispute.⁷⁵ A clear provision in the Code specifying interpleader requirements is needed to implement the drafters' policy intentions.

A further complication on the use of interpleader is the confusion of at least one court, and possibly several others,⁷⁶ over the application of the "stop payment" concept. In *Ruskin v. Central Federal Savings & Loan Assn.*,⁷⁷ the defendant savings bank issued a teller's check for its customer and later withheld payment at the customer's request. The court, without discussing the possibility of allowing the bank to raise a *jus tertii* defense, denied interpleader and granted summary judgment for the payee, stating that a teller's check was accepted as the equivalent of cash and could not be countermanded.⁷⁸ The court reasoned that "the defendant had no right to stop payment on the check. . . . [T]he defendant is primarily liable to the plaintiff and is not a stakeholder besieged by adverse claimants since . . . the bank could not be liable to its depositor."⁷⁹ By holding that the third party had no claim to the instrument the court found that one of the crucial requirements of interpleader was lacking, because the parties did not claim the same debt, duty, or thing.⁸⁰ But, while the court was correct in asserting that the bank customer does not have the authority to issue a stop-payment order on a business check, the court was incorrect in asserting that this lack of authority deprives the third party of the status of an adverse claimant. At common law and under the Code, a party who has been defrauded on an instrument can assert an "adverse claim" against the funds in the bank to pro-

74. *Ruskin v. Central Fed. Sav. & Loan Assn.*, 3 UCC REP. SERV. 150 (N.Y. Sup. Ct. 1966). See text at notes 77-78 *infra*.

75. *Lincoln Sec. v. Morgan Guar. Trust Co.*, 8 UCC REP. SERV. 215 (N.Y. Sup. Ct. 1970). The drawee-bank of a certified check stopped payment at the request of its customer, who claimed that the check was obtained by the payee in a fraudulent transaction. The court, citing two common law cases, *Greenberg v. World Exch. Bank*, 277 App. Div. 413, 237 N.Y.S. 200 (1929), and *Llop v. First Natl. Bank*, 178 Misc. 436, 35 N.Y.S.2d 867 (Sup. Ct. 1942), stated that "where the drawer notifies the bank that there is substantial possibility of fraud in connection with the transaction, interpleader has been held proper." 8 UCC REP. SERV. at 216.

76. Several cases have arisen under the Code with fact situations that would allow a *jus tertii* defense. However, it is not clear from the opinions whether such a defense was properly asserted, and the court summarily decided the cases on the ground that the customer had no right to stop payment. See, e.g., *Kaufman v. Chase Manhattan Bank*, 370 F. Supp. 276 (S.D.N.Y. 1973); *National Newark & Essex Bank v. Giordano*, 111 N.J. Super. 347, 268 A.2d 327 (Super. Ct. 1970); *Malphrus v. Home Sav. Bank*, 44 Misc. 2d 705, 254 N.Y.S. 2d 980 (Albany County Ct. 1965).

77. 3 UCC REP. SERV. 150 (N.Y. Sup. Ct. 1966).

78. 3 UCC REP. SERV. at 151.

79. 3 UCC REP. SERV. at 152.

80. 3 UCC REP. SERV. at 152. See text at notes 70-72 *supra*.

tect his equitable claim of ownership.⁸¹ The crucial issue is not whether a third party can stop payment, but whether the third party is or can be a valid "adverse claimant."

The court's failure to recognize the adverse claim doctrine is especially serious when the double aspect of that doctrine is considered. An adverse claim is both a requirement of the bank's interpleader action and a mechanism by which a customer creates an obligation in the bank not to honor a demand for payment in certain circumstances. If the bank ignores an adverse claim and pays an instrument possessor, the claimant can sue the bank for the face value of the check.⁸² The bank faced with an adverse claim need not argue *jus tertii*; it can suspend payment simply on the basis that it is subject to a conflicting claim. At common law an adverse claim was quite easy to assert; the third-party claimant, upon notifying the obligor, bound the obligor to withhold payment on the instrument for a reasonable length of time, allowing the third party to press his claims against the payee in court.⁸³ Common law cases explicitly applied the doctrine to the business check situation.⁸⁴ The "claims-defenses" distinction⁸⁵ again proved crucial, however, for the third-party claimant under the common law must have asserted a legal or equitable claim of ownership, as opposed to a contractual defense.⁸⁶

The Code allows adverse claims to be made under section 3-603, which is significantly more restrictive than the common law. Under that section the bank is discharged from liability to the extent that it has made payment, even if it had knowledge of an adverse claim to the instrument by another person. However, the obligor is required to withhold payment in recognition of an adverse claim in two situations: where the adverse claimant obtains an injunction against payment to the current holder of the instrument in an action in which both the adverse claimant and the current holder of the instrument are parties, and where the adverse claimant supplies the bank with indemnity. An illustrative case under the first situation

81. See text at notes 82-101 *infra*.

82. *E.g.*, *Gendler v. Sibley State Bank*, 62 F. Supp. 805 (N.D. Iowa 1945); *Nielsen v. Planters Trust & Sav. Bank*, 183 La. 645, 164 S. 613 (1935); *Brunswick v. Peoples Sav. Bank*, 194 Mo. App. 360, 190 S.W. 60 (1916); *Miller v. Bank of Washington*, 176 N.C. 152, 96 S.E. 977 (1918); *Huff v. Oklahoma State Bank*, 87 Okla. 7, 207 P. 963 (1922).

83. J. BRADY, *supra* note 8, at 276-77; 5A THE MICHIE CO., BANKS AND BANKING § 82 (1950); 2 T. PATON, *supra* note 42, at 1656-59.

84. *E.g.*, *Greenberg v. World Exch. Bank*, 277 App. Div. 413, 237 N.Y.S. 200 (1929); *Llop v. First Natl. Bank*, 178 Misc. 436, 35 N.Y.S.2d 867 (Sup. Ct. 1942).

85. See note 29 *supra*.

86. *E.g.*, *First State Bank & Trust Co. v. First Natl. Bank*, 314 Ill. 269, 145 N.E. 382 (1924); *Nielsen v. Planters Trust & Sav. Bank*, 183 La. 645, 164 S. 613 (1935); *Peter Adams Co. v. National Shoe & Leather Bank*, 9 N.Y.S. 75 (Sup. Ct. 1887); *First Natl. Bank v. Bache*, 71 Pa. 213 (1872).

is *Jefferies & Co. v. Arkus-Duntov*.⁸⁷ The plaintiff, a stockbroker, purchased securities from the two defendants with certified checks, intending to resell the securities to its customers. The sale turned out to be part of the Equity Funding scandal, and it was discovered that the securities had been sold by the defendant in violation of the securities laws. The plaintiff's customer refused to accept delivery on the stocks, and the plaintiff became a "forced purchaser." The plaintiff obtained a temporary restraining order and later an injunction against payment on the checks to the defendant Duntov, although a similar injunction with respect to the other defendant, a holder in due course, was denied.⁸⁸ The court also ordered Duntov to return the check to the plaintiff, on the condition that the plaintiff post an indemnity bond.⁸⁹

There are serious shortcomings in the Code provision regarding the use of an injunction to assert an adverse claim. The injunction must be brought against the current holder of the instrument, who may be beyond the reach of process. Furthermore, the Code provides no standards to govern the issuance of an injunction; a decision on whether to grant one may turn on the peculiarities of local law or the unpredictable discretion of the courts.⁹⁰ Stringent requirements may effectively block the buyer's assertion of adverse claims.⁹¹

In section 3-603(1) the Code allows a party to establish an adverse claim without an injunction if he provides indemnity deemed adequate by the bank. The indemnity is intended to protect the bank against any loss it might incur in a suit by the payee for the wrongful refusal of payment on his check, assuming that the adverse claim is judged invalid.⁹² The Code apparently intends that upon posting of the indemnity the claimant will be joined or interpleaded into any suit brought by the payee, or that the claimant will initiate his own suit against the payee to assert the adverse claim.

In *National Newark & Essex Bank v. Giordano*,⁹³ the only case dealing with the indemnity provision, the defendant had purchased

87. 357 F. Supp. 1206 (S.D.N.Y. 1973).

88. 357 F. Supp. at 1216.

89. 357 F. Supp. at 1216.

90. In *Jefferies*, for example, the court relied on cases involving the general discretionary injunctive power of the federal courts. 357 F. Supp. at 1215-16.

91. An interlocutory injunction has not been regarded as a matter of right, even if the plaintiff faces irreparable injury. *Pritchett v. Wade*, 261 Ala. 156, 162, 73 S.2d 533, 537-38 (1954); *State Compensation Ins. Fund v. Maloney*, 121 Cal. App. 2d 33, 43, 262 P.2d 662, 668 (1953); *Smith v. Kansas City*, 167 Kan. 684, 689-90, 208 P.2d 233, 238 (1949); *Tide Water Associated Oil Co. v. Hamlen*, 141 N.J. Eq. 217, 219-30, 56 A.2d 722, 724 (Ch. 1948).

92. The indemnity provision in UCC § 3-603(1) is a carryover from state adverse claim statutes designed to protect banks from possible double liability. 2 T. PATON, *supra* note 42, at 1657.

93. 111 N.J. Super. 347, 268 A.2d 327 (1970).

two trucks from the seller by obtaining a loan from the plaintiff bank. The defendant gave the bank an installment sale security agreement⁹⁴ in exchange for a cashier's check payable to the seller. After the check had been delivered to the seller, the defendant-buyer found the trucks to be defective and asked the bank to withhold payment on the check. The bank refused, even though the defendant offered to post an indemnity bond. The defendant then refused to pay on the installment agreement, and the bank brought suit. The court held that, since there is no right to stop payment on a cashier's check, the defendant was liable for his breach of the installment contract.⁹⁵ The court failed to consider whether the bank had a duty to withhold payment under section 3-603. Although it could be argued that the result was correct, because the defendant asserted a defense to the installment contract and not an adverse claim to the check funds,⁹⁶ the court's reasoning indicated a fundamental misunderstanding: The fact that payment cannot be stopped on a business check does not affect a party's right to assert an adverse claim under section 3-603.

The major difficulty with the indemnity provision is its vagueness. The indemnity need only be "deemed adequate by the party seeking the discharge." A bank could apparently waive its indemnity rights by accepting a trifling sum, in effect requiring only notice. Alternatively, the bank might not accept any amount as adequate, nullifying the provision entirely. A "reasonableness" requirement could be read into the section, but if courts must second-guess bank decisions on the adequacy of the indemnity, much of the effectiveness of section 3-603 will be lost.

Section 3-603 continues to adhere to the common-law distinction between "claims" and "defenses."⁹⁷ The section refers to the "claim of another person," and section 1-103 makes the common law applicable to Code provisions if not "displaced by the particular provisions of [the] Act." Although many cases of consumer dissatisfaction involve fraud, allowing the assertion of adverse claims based on equitable title, more often a third party will claim failure of consideration, breach of warranty, or unconscionability. These are contract defenses and are insufficient to give rise to an adverse claim under section 3-603.

In sum, the law on *jus tertii* and adverse claims allows a bank

94. In an installment sale security agreement the purchaser of the check obtains a loan from the bank for the amount of the check. The bank files a security interest agreement on the assets that the customer purchases with the check. See UCC §§ 9-105, -201. The purchaser must repay the loan installments or the bank can repossess the purchased items. See UCC § 9-501 to -505.

95. 111 N.J. Super. at 352, 268 A.2d at 329.

96. See text at notes 97-98 *infra*.

97. See text at notes 85-86 *supra*.

that voluntarily withholds payment on a business check to assert the legal title claims of its customer, as well as equitable title claims if the customer is joined in the suit. If the bank refuses to comply voluntarily with a customer's request to withhold payment, the customer may force the bank to withhold by obtaining an injunction or by posting an indemnity bond. There is considerable confusion in the courts over the mechanics of third-party claims on funds credited to business checks, probably stemming from the Code's ambiguity. The right to interpleader under section 3-306(d), the standards for granting an injunction under section 3-603(1), the mechanics of the indemnity bond provision in section 3-306(1), and the "claims-defense" distinction under sections 3-306 and 3-603(1) are unspecified, and left to common-law doctrines for resolution. The common-law doctrines are inconsistent and may frustrate Code policy. At the very least, then, the Code must be amended to clarify these ambiguities.

Furthermore, modern commercial practice requires two substantive changes in the rights of the parties in an adverse-claim situation. First, the common-law distinction between "claims" and "defenses" should be eliminated. Many cases of consumer dissatisfaction rest on failure of consideration, breach of warranty, or unconscionability, which are insufficient to establish the claim of ownership required under the adverse-claim statute. There is no sound reason for the distinction: A valid defense defeats the payee-seller's right to payment just as effectively as a superior equitable claim of ownership.⁹⁸ The adverse-claim action was originally an adaptation of an action in trover, used to regain physical possession of an instrument,⁹⁹ but it is presently used to avoid a contractual obligation by withholding payment on a check possessed by an alleged wrongdoer.¹⁰⁰ Modern commercial policy should protect against breach of warranty, failure of consideration, or unconscionable business dealings as much as against fraud, illegality, or theft.¹⁰¹ Indeed, the distinction between fraud, which gives rise to a claim of equitable title in the defrauded party, and unconscionability is only a matter of degree, and the concepts have been used interchangeably.¹⁰² Fraud and breach of

98. See, e.g., *Tallahassee Bank & Trust Co. v. Raines*, 125 Ga. App. 263, 187 S.E.2d 320 (1972) (failure of consideration); *Northern Plumbing Supply, Inc. v. Gates*, 196 N.W.2d 70 (N.D. Sup. Ct. 1972) (breach of warranty); UCC §§ 306(b)-(c).

99. See note 29 *supra*.

100. See *Fulton Natl. Bank v. Delco Corp.*, 128 Ga. App. 16, 195 S.E.2d 455 (1973); *Bathgate v. Exchange Bank*, 199 Mo. App. 583, 205 S.W. 875 (1918); *Welch v. Bank of the Manhattan Co.*, 264 App. Div. 906, 35 N.Y.S.2d 894 (1942).

101. See Comment, *Adverse Claims and the Consumer: Is Stop Payment Protection Available?*, 67 Nw. U. L. Rev. 915, 924-25 (1973).

102. I A. CORBIN, *CONTRACTS* § 128, at 551 (1963); Note, *Unconscionable Business Contracts: A Doctrine Gone Awry*, 70 YALE L.J. 453, 453 (1961). See, e.g., *Schaeffer v. Moore*, 262 S.W.2d 854 (Mo. 1953).

warranty are also basically similar in their development; both were derived from the early tort action of deceit.¹⁰³ Although elimination of the claims-defenses distinction may hinder the negotiability of business checks by enlarging the class of buyers that can make use of the adverse-claim procedure,¹⁰⁴ protection from frivolous payment stoppages by consumers is an argument for generally expanding seller protections, not for continuing an outmoded common-law distinction.

Second, the third-party claimant should not be able to assert an adverse claim simply by posting indemnity "deemed adequate" by the bank, or by otherwise inducing the bank voluntarily to withhold payment on the instrument. The third-party claimant should instead be required to initiate suit to protect his claims. This would aid the efficient settlement of commercial disputes in jurisdictions that adhere to the "no independent liability" doctrine and thus refuse to allow interpleader when the payee brings suit against the bank on the instrument.¹⁰⁵ In those jurisdictions the bank must convince the court to order joinder, which may not even be available, or the third party must voluntarily intervene, if the claims of all parties are to be adjudicated in one proceeding.¹⁰⁶ Moreover, the importance of the free flow and negotiability of business checks in commercial transactions¹⁰⁷ militates against allowing the bank customer routinely to defeat payment on those instruments. If the buyer wants stop-payment rights he should negotiate to pay by personal check. By agreeing to pay by business check he waives his right to stop payment, and he should be forced to initiate court action to redress his claims. Allowing the buyer to persuade a bank to withhold payment voluntarily, or to waive its indemnity rights under the Code, decreases the certainty that business checks will be honored and detracts from their value as commercial tools. The buyer would still be able to prevent immediate dissipation of the funds credited to a business check by obtaining a court injunction.

Similarly, some cases have held that gross inadequacy of consideration is conclusive evidence of fraud. *E.g.*, *Herbert v. Lankershim*, 9 Cal. 2d 409, 71 P.2d 220 (1937); *Size-more v. Miller*, 196 Ore. 89, 247 P.2d 224 (1952); *Texas Employers Ins. Assn. v. Kelly*, 261 S.W.2d 480 (Tex. Civ. Ct. App. 1953); *Jackson v. Seymour*, 193 Va. 735, 71 S.E.2d 181 (1952).

103. See 1 T. STREET, *FOUNDATIONS OF LEGAL LIABILITY* 374-75 (1906); Note, *Warranty: Tort and Contract Characterization: Statutes of Limitation*, 43 CAL. L. REV. 546, 549 (1955); Note, *Necessity for Privity of Contract in Warranties by Representation*, 42 HARV. L. REV. 414, 414-15 (1929).

104. See Comment, *supra* note 101, at 923.

105. See text at notes 70-72 *supra*.

106. See notes 56, 58 *supra*.

107. See *Kaufman v. Chase Manhattan Bank*, 370 F. Supp. 276, 278-79 (S.D.N.Y. 1973); *Jefferies & Co. v. Arkus-Duntov*, 357 F. Supp. 1206, 1217 (S.D.N.Y. 1973); *National Newark & Essex Bank v. Giordano*, 111 N.J. Super. 347, 352, 268 A.2d 327, 329 (1970).

To effectuate the needed clarification in the area, to eliminate the "claim-defense" distinction, and to require the adverse claimant to initiate court action, sections 3-306(d) and 3-603 might be re-drafted as follows [the bracketed phrases are language in the present provisions that should be deleted; the underlined phrases should be added]:

§ 3-603. Payment or Satisfaction

(1) The liability of any party is discharged to the extent of his payment or satisfaction to the holder even though it is made with knowledge of a claim or defense of another person to the instrument unless prior to such payment or satisfaction the person [making the] asserting such claim or defense [either supplies indemnity deemed adequate by the party seeking the discharge or enjoins payment or satisfaction by order of a court of competent jurisdiction in an action in which the adverse claimant and the holder are parties.] enjoins such payment or satisfaction by order of a court pursuant to subsection (2). This subsection does not, however, result in the discharge of the liability

(a) of a party who in bad faith pays or satisfies a holder who acquired the instrument by theft or who (unless having the rights of a holder in due course) holds through one who so acquired it; or

(b) of a party (other than an intermediary bank or a payor bank which is not a depository bank) who pays or satisfies the holder of an instrument which has been restrictively indorsed in a manner not consistent with the terms of such restrictive indorsement.

(2) Any court of general jurisdiction of this state shall issue an order to withhold payment on any instrument, order the bank on which the instrument was drawn to deposit the funds represented by the instrument into the court, order the bank discharged from liability in whole or in part to any party, and set the cause for trial to determine the validity of the claim or defense, whenever

(a) any party files a complaint and affidavit with the court stating that he:

(i) has a claim of ownership, a claim of restitution, or a defense that would defeat the present holder's right to payment on the contractual obligation underlying the instrument; and

(ii) will deposit with the court, if the court so requires, a bond equal to twice the face value of the instrument; and

(iii) has caused the present holder of the instrument to be served with a copy of the complaint; or

- (b) any party files a complaint and affidavit with the court stating that he:
- (i) has a claim of ownership, a claim of restitution, or a defense that would defeat the present holder's right to payment on the contractual obligation underlying the instrument; and
 - (ii) will deposit with the court, if the court so requires, a bond equal to twice the face value of the instrument; and
 - (iii) has been unable, after the exercise of reasonable diligence, to cause the present holder of the instrument to be served with a copy of the complaint; and
 - (iv) will bring suit on the claim as specified in the complaint as soon as jurisdiction over the holder's person can be obtained.

If the court finds the claim or defense invalid, it shall have the discretion to award to the holder court costs, reasonable attorney's fees, and consequential damages.

[(2)] (3) Payment or satisfaction may be made with the consent of the holder by any person including a stranger to the instrument. Surrender of the instrument to such a person gives him the rights of a transferee (Section 3-201).

§ 3-306. Rights of One Not Holder in Due Course

Unless he has the rights of a holder in due course any person takes the instrument subject to

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- (d) the defense that he or a person through whom he holds the instrument acquired it by theft, or that payment or satisfaction to such holder would be inconsistent with the terms of a restrictive indorsement. The claim of any third person to the instrument is not otherwise available as a defense to any party liable thereon [unless the third person himself defends the action for such party.], subject to the provisions of § 3-603.

The redrafting would allow a third party to block payment on a business check only after obtaining an injunction directed to the obligor bank. The injunction would issue on the assertion of a claim of equitable title to the check and/or a contract defense on the instrument's underlying obligation. Upon the issuance of the injunction the obligor bank is ordered to relinquish the funds credited on the instrument to the court, and is discharged from all further liability on the instrument. If the court questions the solvency or the good faith of the third party, it may condition its injunction on the third party's posting of a bond. If the third party's allegations are not sustained, the court may award court costs, attorney's

fees, and consequential damages to the holder, to be paid from the bond proceeds if a bond has been posted.

The obligor bank cannot raise *jus tertii* in a suit brought by the checkholder-seller except to plead that it has been subjected to a valid injunction obtained pursuant to section 3-603. If an injunction has been awarded, the bank's liability will have been discharged under section 3-603, and any suit against it should of course be dismissed.
