

UNIFORM COMMERCIAL CODE ANNOTATIONS

acceptance because of a breach of the sales contract, he must give the seller notice of the defect within a reasonable time after he discovers or should have discovered the breach. By reason of Section 2-608(2) the buyer must also give the seller notice of his revocation within a reasonable time after he discovers or should have discovered the defect under Section 2-608(2). Notice of revocation of acceptance under Section 2-608(2) must also be given before there is any substantial change in the condition of the goods not due to defects attributable to the seller.

R.W.D.

ARTICLE 3: COMMERCIAL PAPER

SECTION 3-302. Holder in Due Course

- (1) A holder in due course is a holder who takes the instrument
 - (a) for value; and
 - (b) in good faith; and
 - (c) without notice that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person.

ANNOTATION

NORMAN V. WORLD WIDE DISTRIB., INC.

— Pa. Super. —, 195 A.2d 115 (1963)

Plaintiff purchased a breakfront from defendant World Wide with the added inducement of a referral plan under which plaintiff would be paid five dollars for each letter he wrote to a friend requesting an appointment with a salesman of World Wide. The plaintiff signed a purchase agreement and an attached judgment note in blank. Under the terms of the purchase agreement, the plaintiff agreed to sign the attached note providing for thirty equal monthly installments totaling \$1,079.40, with the first payment due in forty-five days. The defendant later inserted in the note the correct amount of \$1,079.40 but it was made payable in three days to "State Wide Products". Three days later the note was purchased for \$831 by Peoples, which, during the prior year, had purchased similar notes from this company under three different corporate names. Peoples called the plaintiff to inquire into his satisfaction with the transaction and to indicate that Peoples in no way had anything to do with the referral plan. Plaintiff did not complain about the transaction at this time. Peoples entered judgment on the note against the plaintiff. The plaintiff was granted relief in equity against World Wide (no longer in existence) and Peoples; the sales agreement was rescinded on grounds of fraud and the holder's judgment on the note was declared void.

Upon appeal, the court affirmed, dismissing Peoples' contention that it was a holder in due course and should collect on the note despite payee's fraud. It held that under Pennsylvania case law, since the plaintiff had entered a defense of fraud against the payee, the holder of the note has the burden of establishing its claim as a holder in due course, and that Peoples was not a holder in due course since it did not act in good faith as required

by Sections 1-201(19) and 3-302(1). It asserted that good faith under the circumstances of this case required the holder to make inquiry into the circumstances surrounding the note.

COMMENT

Section 3-307(3) supports the court's determination that Peoples had the burden of establishing itself as a holder in due course. That section provides that once a defense is shown, the burden then falls upon the party claiming as a holder in due course to so prove himself.

Section 2-302(1) was correctly cited to determine whether Peoples met the requirements of a holder in due course. The court refused Peoples the status of a holder in due course due to its apparent lack of good faith, a criterion required by Section 3-302. "Good faith" is defined by Section 1-201(19) as "honesty in fact in the conduct or transaction." The court complimented this definition with Pennsylvania case law which declares a person not to be a holder in due course upon "the failure to make inquiry [arising] . . . from a suspicion that inquiry would disclose a vice or defect in the title" By reading the Code's provisions for good faith in conjunction with equitable doctrines provided in its case law, the court has raised problems which it could have avoided.

The court should simply have held that Peoples had notice of the maker's defense to the note which precluded it from being a holder in due course under Section 3-302(1)(c). To determine that Peoples had notice, the court would have relied on Section 3-304(1)(b), and in light of the notice definition in Section 1-201(25)(c), it could easily have determined that from all the circumstances Peoples had reason to know of the maker's defense against the payee.

By the position assumed by the court in the instant case, purchasers of commercial paper in Pennsylvania will now be faced, as they were prior to the Code, with the vague problem of what constitutes circumstances of suspicion requiring their inquiry in order to act in good faith and what will satisfy this inquiry. This court demanded inquiry beyond conversation between the holder and the maker during which no complaints to the transaction had been made. The uncertainty generated by this decision as to the status of holders of instruments was intended to have been removed by Article 3.

T.H.T.

SECTION 3-304. Notice to Purchaser

- (1) The purchaser has notice of a claim or defense if
 - (a) the instrument is so incomplete, bears such visible evidence of forgery or alteration, or is otherwise so irregular as to call into question its validity, terms or ownership or to create an ambiguity as to the party to pay; or

CASES ANNOTATED UNDER OTHER SECTIONS

NORMAN V. WORLD WIDE DISTRIB., INC.

— Pa. Super. —, 195 A.2d 115 (1963)

See the Annotation to Section 3-302(1), *supra*.

SECTION 3-305. Rights of a Holder in Due Course

To the extent that a holder is a holder in due course he takes the instrument free from

- (2) all defenses of any party to the instrument with whom the holder has not dealt except
- (c) such misrepresentations as has induced the party to sign the instrument with neither knowledge nor reasonable opportunity to obtain knowledge of its character or its essential terms; and

ANNOTATION

*MOORE V. SOUTHERN DISCOUNT CO.

— Ga. App. —, 132 S.E.2d 201 (1963)

An admitted holder in due course of a note sued the maker who set up the defense of fraud in the procurement. The maker alleged that the payee had substituted a note for \$433.92 by trickery in place of a note for \$250 which the maker had intended to sign. Plaintiff's motion for judgment N.O.V. was granted after the jury returned a verdict for the maker.

On appeal, the court affirmed, holding that under a Georgia statute as construed in Georgia cases, fraud in the procurement was a valid defense for a maker against a holder in due course only if the present holder participated in the fraud. Since the plaintiff in this action was a holder in due course and did not perpetrate the fraud, the maker's defense was invalid. The court intimated that it did not agree with the statute as it had been construed, but that any change would have to come from the legislature. The court added, though it did not hold, that apparently the Code, Section 3-305(2), would not change this statutory rule, had it been in effect.

COMMENT

Fraud as a defense by a maker against a holder in due course in an action on a note at common law was divided into distinct types. As such, there was a confusion as to which type constituted a valid defense for a maker against a holder in due course. This confusion is eliminated by Section 3-305 which sets out the defenses available against a holder in due course. Official Comment 7 following Section 3-305 states that this section is intended to cover all situations which meet the requirements regardless of the type of fraud. The result of the proper application of this section is, contrary to the dicta of the court in the instant case, to allow the defenses provided therein to a maker against a holder in due course regardless of the label the alleged fraud had been assigned under prior law. Based on the reported facts, the defense under 3-305(2)(c) would have been available to the maker in this case.

R.W.D.

* Code constructed but did not govern the case.

CASES ANNOTATED UNDER OTHER SECTIONS

PITTSBURGH NAT'L BANK V. KEMILWORTH RESTAURANT CO.

— Pa. Super. —, 195 A.2d 919 (1963)

See the Annotation to Section 3-403, *infra*.

**SECTION 3-307. Burden of Establishing Signatures,
Defenses and Due Course**

(3) After it is shown that a defense exists a person claiming the rights of a holder in due course has the burden of establishing that he or some person under whom he claims is in all respects a holder in due course.

CASES ANNOTATED UNDER OTHER SECTIONS

NORMAN V. WORLD WIDE DISTRIB., INC.

— Pa. Super. —, 195 A.2d 115 (1963)

See the Annotation to Section 3-302(1), *supra*.

SECTION 3-403. Signature by Authorized Representative

(2) An authorized representative who signs his own name to an instrument

- (a) is personally obligated if the instrument neither names the person represented nor shows that the representative signed in a representative capacity;
- (b) except as otherwise established between the immediate parties, is personally obligated if the instrument names the person represented but does not show that the representative signed in a representative capacity, or if the instrument does not name the person represented but does show that the representative signed in a representative capacity.

ANNOTATION

PITTSBURGH NAT'L BANK V. KEMILWORTH RESTAURANT CO.

— Pa. Super. —, 195 A.2d 919 (1963)

Laura Dasey, the secretary of the defendant company, signed a judgment note in the following manner: "Kemilworth Restaurant Co., Inc. [and under this designation] Homer H. Dasey (seal), Laura W. Dasey (seal)." The assignee of the payee obtained a judgment by confession against Mrs. Dasey and subsequently reassigned the note to the payee. In an action to have the judgment opened, Mrs. Dasey alleged in her pleadings that she had signed the note in a representative capacity only and by mistake this fact had been omitted from the terms of the note. The payee, in its pleadings, contended that since Mrs. Dasey had signed individually, she was liable and that her representative signature had been inadvertently omitted. From an order opening the judgment, the payee appealed.

In affirming, the court held that Mrs. Dasey had a valid defense under Section 3-403(2)(b). The court decided that although the note did not

show that she had signed in a representative capacity, considering the pleadings of both parties together, the contrary was established between the parties.

COMMENT

Section 3-403(2) of the 1953 Official Version of the Code did not allow the maker of a note the use of parol evidence to prove the capacity in which he had signed a note. The 1958 and 1962 Official Versions removed this prohibition and allows such proof.

It should be noted that had the plaintiff not been the payee, but rather a holder in due course, Mrs. Dasey would not have prevailed since the defense of her signing in a representative capacity would not have been available under Section 3-305.

R.W.D.

ARTICLE 4: BANK DEPOSITS AND COLLECTIONS

SECTION 4-406. Customer's Duty to Discover and Report Unauthorized Signature or Alteration

(4) Without regard to care or lack of care of either the customer or the bank a customer who does not within one year from the time the statement and items are made available to the customer (subsection (1)) discover and report his unauthorized signature or any alteration on the face or back of the item or does not within three years from that time discover and report any unauthorized indorsement is precluded from asserting against the bank such unauthorized signature or indorsement or such alteration.

ANNOTATION

*INDEMNITY INS. CO. OF NORTH AMERICA V. FULTON NAT'L BANK
— Ga. App. —, 133 S.E.2d 43 (1963)

Defendant banks paid checks of drawer, plaintiff's assignor, bearing forged indorsements. Approximately two months after the last check bearing a forgery was paid, the drawer notified the banks that there were "some irregularities" concerning the genuineness of indorsements of checks in their accounts. One year and a half after the last forged checks had been cashed, the drawer sent a detailed notice to the banks together with photostats of the checks with forged indorsements. In affirming the lower court's sustaining of the banks' demurrer, the court held that the first notice was not sufficient since the identity and circumstances of payments were not given. The last notice was sufficient but it was not given within the one year limitation provided by statute and therefore ineffective. The court added in a footnote that the applicable but not then effective UCC Section 4-406(4) modifies

* Code constructed but did not govern the case.