1979

Contractual Defenses as Claims to the Instrument: The Right to Block Payment on a Banker's Instrument

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Contractual Defenses
As Claims to the Instrument:
The Right to Block Payment
On a Banker's Instrument

COMMONLY, a buyer of goods will finance a sale by having a bank\(^1\) issue\(^2\) a negotiable instrument\(^3\) signed by it and payable on demand to the order of the seller—hereinafter referred to as a "banker's instrument." In practice, banker's instruments are bills of exchange or drafts\(^4\) and are classified according to whether or not they are drawn on the drawer itself.\(^5\) Thus, when drawn by a bank on itself, the banker's instrument is called either a cashier's check\(^6\) or a bank money order.\(^7\)

\(^{1}\) "'Bank' means any person engaged in the business of banking." U.C.C. §1-201(4).
\(^{2}\) "'Issue' means the first delivery of an instrument to a holder or a remitter." U.C.C. § 3-102(1) (a).
\(^{3}\) "Any writing to be a negotiable instrument . . . 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 (c) be payable on demand or at a definite time; and (d) be payable to order or to bearer." U.C.C. § 3-104(1) (a)-(d).
\(^{4}\) A writing which complies with the requirements of U.C.C. § 3-104 (1) is "a 'draft' ('bill of exchange') if it is an order." U.C.C. § 3-104(2) (a). An "order" is a direction to pay that identifies the person to pay with reasonable certainty. U.C.C. § 3-102(1) (b).
\(^{5}\) The classification, though adopted by the courts, is not backed by the provisions of article 3 of the Uniform Commercial Code. Indeed, the Code neither uses the expression nor treats separately the subject of "banker's instruments."
\(^{6}\) See, e.g., Laurel Bank & Trust Co. v. City Nat'l Bank, 33 Conn. Supp. 641, 365 A.2d 1222 (1976); Missouri ex rel. Chan Siew Lai v. Powell, 536 S.W.2d 14, 16 (Mo. 1976).
\(^{7}\) See, e.g., Thompson Poultry, Inc. v. First Nat'l Bank, 199 Neb. 8, 255 N.W.2d 856 (1977). "A bank money order is essentially the same as a cashier's check." Id. at 9, 225 N.W.2d at 857.
When drawn on another bank, banker's instruments are further subdivided according to the type of drawer bank. While a banker's instrument drawn by a commercial bank is known as a bank draft, when drawn by a savings bank or a savings and loan association it is called a teller's check.

Bearing the authorized signature of the issuing bank, a banker's instrument differs fundamentally from a personal check or personal money order. Indeed, a banker's instrument constitutes an obligation of the bank itself. Its effect, unless otherwise agreed, is to discharge the buyer's obligation under the contract for sale. As it is not "merely an order to a bank to make payment," but rather an obligation of the bank itself, it is not subject to the buyer's right to order stop payment under section 4-403 of the Uniform Commercial Code (Code).

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8 Though "bank," see note 1 supra, is broader than "commercial bank," it is narrower than "financing agency" as defined in U.C.C. § 2-104(2). The classification of banks is a non-Code classification.


11 A check is "a draft drawn on a bank and payable on demand." U.C.C. § 3-104(2) (b). Not having signed the check, the drawee bank is not liable thereon. U.C.C. § 3-401(1). See also U.C.C. § 3-409(1) ("A check or other draft does not of itself operate as an assignment of any funds in the hands of the drawee . . . and the drawee is not liable on the instrument until he accepts it."). U.C.C. §§ 3-410 and 3-411 govern the drawee bank's liability under acceptance or certification.


13 The presence or absence of one's "signature," U.C.C. § 1-201(39), determines whether one becomes liable on an instrument. U.C.C. § 3-401(1). Unlike a certified check, see note 11 supra, a banker's instrument does not bear the signature of the customer and is not drawn originally on his account.

14 U.C.C. § 3-802(1) (a). The buyer's obligation is also discharged when the holder procures certification of the buyer's check. U.C.C. § 3-411(1).

15 The nature of the instrument as a mere order is the rationale for the customer's "right to revoke such order before it is carried out." Universal C.I.T. Credit Corp. v. Guaranty Bank & Trust Co., 161 F. Supp. 790, 791 (D. Mass. 1958).

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This Article considers whether the obligation on a banker's instrument is autonomous in relation to a financed contract for sale or dependent on its performance. It examines the effect a seller's breach has on the obligation under a banker's instrument held or presented for payment by the seller. It is thus designed to determine whether, upon such breach, the buyer has the right to "block payment" on the instrument. Exploring possible alternative avenues, the Article examines the right in light of its doctrinal basis and relevant policy considerations. It goes beyond previous studies in presenting a broader framework for dealing with policy considerations as well as with the rules of law designed to implement them.

Following the introduction, Part I presents the policy arguments concerning the desirable result in this commercial situation. Part II considers the autonomy of the letter of credit as suggesting a possible

This Article does not question the right of a remote party to the transaction claiming holder in due course status under U.C.C. § 3-302 to recover the full amount of the instrument. See U.C.C. § 3-305.

The term is taken from Note, Blocking Payment on a Certified, Cashier's, or Bank Check, 73 Mich. L. Rev. 424 (1975). Its use distinguishes between the present issue and a customer's right to order "stop payment" under U.C.C. § 4-403. See note 16 and accompanying text supra.


Fox, Stopping Payment on a Cashier's Check, 19 B.C.L. Rev. 683 (1978); Note, supra note 18; Comment, Adverse Claims and the Consumer: Is Stop Payment Protection Available?, 67 W. L. Rev. 915 (1973).

Policy considerations are set forth in Part I infra. See also Parts III and VI infra. In comparing the discussion in this Article to the treatment of policy considerations in previous studies, note that the author of Comment, supra note 20, and the author of Note, supra note 18, went too far in undermining the cash quality of banker's instruments. The former would give the buyer the right to block payment upon providing indemnity, without intervention of a court. Comment, supra note 20, at 928. The latter, while insisting on court intervention, would not limit the right to cases where the seller's right to the price is denied. Nor would the latter insist on an early determination of the issue. Note, supra note 18, at 440-41. Fox, supra note 20, does not discuss policy extensively.

See Parts II-V infra. The conclusions of this Article on the construction of the Code provisions differ from those in Comment, supra note 20, and Note, supra note 18. See Parts V-VI infra. While Fox concludes that the buyer can block payment by rescinding the underlying contract (a point also argued in Part VI of the present Article), he sees only serious complaints as giving rise to "the right of rescission of the underlying transaction." Fox, supra note 20, at 692. The focus of Fox's article is limited to "the courts' treatment of the issue." Id. at 686.
framework for dealing with the autonomy of the banker's instrument. Part III proceeds to examine closely the relations among the participants in a banker's instrument transaction and thereby indicates why a principle derived from the autonomy of the letter of credit is inapplicable. This result, it is demonstrated, corresponds to the difference between the policies inherent in each transaction. The discussion then focuses on the applicability of article 3 of the Code to rights under a banker's instrument. Part IV argues that a seller who breaches the financed contract for sale takes the banker's instrument as one not a holder in due course. As such, the seller takes it subject to all claims to it. Whether a buyer's contractual defenses fall into this category is examined in Parts V and VI. Part V focuses on the construction of section 3-306 in light of the principles underlying it, its historical background, and its relation to other provisions of article 3. Part VI deals more specifically with the contractual defenses of the procurer of a banker's instrument (the "remitter") as forming "claims" to it. This is discussed in the context of the buyer's right to reject a tender of non-conforming goods. The scope of the right to block payment as a corollary of the rejection right and relevant policy considerations are then examined. The Article concludes that upon the exercise of the right to rescind the contract on the basis of any contractual defense, the remitter-buyer establishes a "claim" to the instrument, which gives rise to the right to block payment. In this framework, it is concluded, the right is roughly consistent with the proper balance between fairness considerations and the cash quality of a banker's instrument.

I

Policy Arguments—Striking a Balance Between Fairness Considerations and the Cash Quality of a Banker's Instrument

A buyer's effective use of the right to block payment would deprive the seller of the sum of the instrument until the breach is remedied.\(^2\) This appears to put the seller under "credit strain," thereby either increasing efficiency in redressing existing breaches\(^2\) or encouraging blackmail by unscrupulous buyers.

Both views are oversimplistic. The ability of a buyer to block payment

\(^2\) Whether, on blocking payment, the buyer will gain the use of the sum of the instrument depends on whether the bank is required to pay the money into court, and on whether the buyer provides the bank with adequate security. The interpleader procedure contemplates payment of the money into the court. See, e.g., Dziurak v. Chase Manhattan Bank, 58 App. Div. 2d 103, 106-07, 396 N.Y.S.2d 414, 416 (1977).

\(^2\) See Comment, supra note 20, at 920.
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on a banker’s instrument is relevant only when dissatisfaction manifests itself immediately after the transaction and before the instrument is paid or transferred to a holder in due course. Its relevance is further limited to circumstances where the buyer is not entitled to recover from the bank under the recent Federal Trade Commission holder-in-due-course trade regulation rule and similar state consumer protection statutes. Buyers’ attempts to block payment are therefore unlikely to arise frequently. Also, since banker’s instruments are used mainly on the retail level, withholding payment on one contract could not produce a significant credit strain. Blocking payment on a banker’s instrument is therefore quite ineffective in pressing a breaching seller to provide redress or in persuading an innocent one to compromise when he believes he should not.

Nor would the right to block payment affect the amount of litigation over breach of contract for sales financed with banker’s instruments. Absent the right, the paid seller would be subject to a buyer’s action for breach of contract. Effective exercise of the right would lead to an action by the unpaid seller on the instrument. A seller who would have defended the buyer’s action is unlikely to give up his cause of action on the instrument.

The right to block payment on a banker’s instrument can best be supported on the basis of fairness. Absent strong policy arguments to the contrary, recovery should be denied to a breaching party. A

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25 See note 17 supra. Under U.C.C. § 4-209(1) a collecting bank with whom the instrument is deposited may qualify as a holder in due course when credit given for the instrument has been withdrawn, when credit available for withdrawal has been given as of right, or when the bank makes an advance on or against the instrument. U.C.C. § 4-208(1).

26 Generally speaking, these circumstances involve financiers of consumer goods who have a business relationship or experience with the seller.


30 Adding the bank as a party to the seller’s action will not significantly affect the amount of litigation, because the adversaries will continue to be the buyer and seller. But see note 34 and accompanying text infra.

31 For example, a party in breach who is required by judgment to return a sum of money is left with the “earning differential” (the difference between the earnings on the sum and the legal interest). See Schwartz, Optimality and the Cutoff of Defenses Against Financers of Consumer Goods, 15 B.C. Indus. & Com. L. Rev. 499, 505 (1974).
countervailing policy argument, however, is the adverse effect of the right to block payment on the attractiveness of banker's instruments as a substitute for cash.32 The desirable result in determining the existence or scope of the right to block payment should therefore strike a balance between fairness considerations and the cash quality of a banker's instrument. Thus, the right to block payment should be given only to a buyer who is able to establish, and not merely allege, in short and fast proceedings, the existence of a breach resulting in the denial of the seller's right to the price of the goods.33 If preliminary ex parte injunctions are granted, they should be quickly followed by such proceedings.34 Where complex issues of fact make early and fast determination unlikely, the seller should be allowed to recover the sum of the instrument. This would not prejudice the buyer in pursuing any remedy in the main action against the seller for the alleged breach of contract.

II

THE AUTONOMY OF THE LETTER OF CREDIT—
A POSSIBLE FRAMEWORK FOR THE AUTONOMY OF THE BANKER'S INSTRUMENT

A letter of credit is an engagement by a bank or other person, made at the request of a customer, that as issuer it will honor drafts or other demands for payment upon compliance with the conditions specified in the letter.35 In the context of sales financing, it is a promise by the issuer made at the request of the buyer to pay to the seller the price of the goods or to accept a draft drawn by the seller for that amount, provided that the shipping documents representing the goods are tendered to the banker before a specified date.36 Letters of credit are most commonly used in financing inventory purchases by merchants.

32 See notes 77-85 and accompanying text infra.
33 While proof of actual danger of insolvency or absconding would help the buyer gain the sympathy of the court, such sympathy would be of no avail if breach cannot be established. At the most, such proof will lead to a lesser burden in establishing breach.
34 Although such a proceeding will compound the stages of litigation and add to the workload of courts, see note 30 and accompanying text supra, the proceeding is essential in order to strike a proper balance between fairness considerations and the cash quality of a banker's instrument.
36 Ellinger, The Relationship Between Banker and Buyer Under Documentary Letters of Credit, 7 U.W. Austl. L. Rev. 40, 40 n.1 (1966). The present discussion is limited to an irrevocable credit, i.e., to a definite undertaking of the issuer that it cannot unilaterally withdraw. E. Ellinger, Documentary Letters of Credit 8 (1970).
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The issuance of a letter of credit involves three legal relationships: (1) the contract for sale between the seller and the buyer, calling for payment by the letter of credit; (2) the financing transaction between the buyer and the issuer, where the former undertakes to reimburse the latter for the advances made to the seller under the letter; and (3) the undertaking of the issuer towards the seller embodied in the letter itself. 37

It is a fundamental rule that the letter of credit is autonomous in relation to the contract for sale that it finances. 38 The issuer's engagement towards the seller "is quite independent of the primary agreement" between the seller and the buyer. 39 It "constitutes a bargain between the banker and the vendor of goods, which imposes upon the banker an absolute obligation to pay, irrespective of any dispute there may be between the parties as to whether the goods are up to contract or not." 40

The independence of the issuer's engagement is the letter of credit's primary feature and distinguishes it from a guaranty, which is secondary to the buyer's promise to pay the price. 41 The absolute nature of the obligation is based on the terms of the letter of credit as agreed upon by the buyer and the issuer and as accepted by the seller. 42 The characteristics of independence and absolute nature are fundamental to the concept of letters of credit. Thus, "[W]here . . . the substantive provisions require the issuer to deal not simply in documents alone, but in facts relating to the performance of a separate contract . . ., all distinction

37 See generally Ellinger, supra note 36, at 40-43.
38 E. Ellinger, supra note 36, at 183. The rule is stated in U.C.C. § 5-114(1).
41 E. Ellinger, supra note 36, at 47.
42 Urquhart Lindsay & Co. v. Eastern Bank, Ltd., [1922] 1 K.B. 318. By authorizing the issuer "to undertake to pay the amount of the invoice as presented," the buyer "is taken for the purposes of all questions between himself and his banker or between his banker and the seller to be content to accept the invoices of the seller as correct." Id. at 323.
between a letter of credit and an ordinary guaranty contract would be obliterated by regarding the instrument as a letter of credit."  

Fraud is the only exception to the autonomy of the letter of credit.  

"[T]he principle of the independence of the bank's obligation under the letter of credit should not be extended to protect the unscrupulous seller." This is, however, a rule of public policy that "must be narrowly limited to situations . . . in which the wrongdoing . . . has so vitiated the entire transaction that the legitimate purposes of the independence of the issuer's obligation would no longer be served." Thus, fraud must be "very clearly established" and not merely alleged. In its proper sense, the exception does not apply to a breach of warranty, though made fraudulently, but rather is limited to situations of total failure of consideration, where "[t]he facts . . . speak for themselves."  

Limited to cases of total failure of consideration, the buyer's right to block payment on a letter of credit fits into the framework of the merchant buyer's rejection rights contemplated by Karl Llewellyn. Emphasizing the ability of the merchant buyer to use defective goods by

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44 U.C.C. § 5-114(2)(b).  


46 Intraworld Indus., Ltd. v. Girard Trust Bank, 461 Pa. 343, 359, 336 A.2d 316, 324-25 (1975); see text accompanying notes 64-67 infra.  


49 See Ellinger, The Tender of Fraudulent Documents Under Documentary Letters of Credit, 7 Malaya L. Rev. 24, 38 (1965). Ellinger suggests that the rule of the Sztejn case would be applied only in such situations. Thus, "The description of old, worthless, newspapers as 'class I typing paper' is inconsistent with anything but a fraud. But, if the goods shipped are not altogether worthless, the banker should be advised not to rely on the fraud rule." Id.; see note 45 and accompanying text supra (Sztejn rule). See also E. Ellinger, supra note 36.  

50 Karl Llewellyn was the "Code's chief architect." See, e.g., Carroll, Harpooning Whales, of Which Karl N. Llewellyn is the Hero of the Piece; or Searching for More Expansion Joints in Karl's Crumbling Cathedral, 12 B.C. Indus. & Com. L. Rev. 139, 142 (1970).
either adaptation or resale, he, and later Professor Honnold, were opposed to rejection by merchant buyers as long as the seller would grant a "price allowance" to compensate for the defect. Consequently, their opposition does not apply to situations of total failure of consideration; when the goods are worthless, rejection by a merchant buyer appears permissible.

Yet, Llewellyn's proposals on rejection by merchant buyers were not explicitly adopted in full in the provisions of the Code. Thus, the drafters allowed rejection of goods by any buyer "if the goods or the tender of delivery fail in any respect to conform to the contract." While the right to reject is conditioned by certain prerequisites that are especially burdensome to a merchant buyer, the present scope of the right is broader than the right to block payment on a letter of credit under the fraud exception. Indeed, the rejection right cannot provide the rationale underlying the limits to the autonomy of the letter of credit.

The fraud exception to the autonomy of the letter of credit can be explained, not by the conduct of the seller towards the buyer, but by the seller's conduct towards the issuer. Thus, in making advances under the letter of credit, the issuer "acts not merely upon the credit of its customer, but upon the credit also of the merchandise which is to be tendered as security." Therefore, in misrepresenting or failing to provide to the issuer "the security upon which the advances are de-

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54 Id. at 971.
55 U.C.C. § 2–601 (emphasis added).
56 See, e.g., U.C.C. §§ 2–504, –614 (rejection is generally precluded where the nonconformity relates to the manner of delivery); U.C.C. § 2–508 (seller's right to cure defective tender).
57 Priest, supra note 53, at 972–73; see notes 188–91 and accompanying text infra.
58 The right to cure expires when the time for performance expires, U.C.C. § 2–508(1), unless the seller "had reasonable grounds to believe" that the nonconforming tender would be acceptable, in which case he has "a further reasonable time to substitute a conforming tender," U.C.C. § 2–508(2). Cases where mere nonconformity would entitle the buyer to reject the goods are still conceivable. Also, a seller will not cure unless his loss after resale exceeds his investment in curing the defect.
60 Maurice O'Meara Co. v. National Park Bank, 239 N.Y. 386, 402, 146 N.E. 636, 641 (1925) (Cardozo, J., dissenting).
manded," the seller commits a breach of his contract with the issuer. Since forfeiture of the seller's right depends on the worthlessness of the goods as security, and not on their conformity to the terms of the contract for sale, the fraud exception does not undermine the autonomy of the letter of credit.

III

DIRECT RELATIONSHIP BETWEEN THE DRAWER OF A BANKER'S INSTRUMENT AND THE PAYEE

To justify the autonomy of the letter of credit, it is said that the "elaborate commercial system" of financing sales of goods by irrevocable credits "would break down completely if a dispute as between the vendor and the purchaser was to have the effect of 'freezing' ... the sum in respect of which the letter of credit was opened." Underlying this observation are the large sums involved in the typical letter of credit, the distance between the seller and the buyer, and the function of the letter of credit as a source of credit to the seller. These factors seldom exist in connection with banker's instruments, which are used most commonly to finance retail purchases from merchants who are in the same general geographic area as the buyers. Nonpayment neither puts the seller under credit strain nor forces him to pursue the buyer into a remote jurisdiction. As an obligation under a banker's instrument is backed by the bank's credit, the utility of the instrument is not necessarily dependent only on the autonomy of the obligation on it.

Yet, by analogy to the contractual relations under a letter of credit, it is possible to argue under general principles of law that upon

61 Id.
62 With respect to the theoretical basis of this relationship, see E. Ellinger, supra note 36, at 39-125. General contract law governs the relationship between the issuer and the seller. H. Gutteridge & M. Megrah, supra note 59, at 65.
63 Indeed, in Maurice O'Meara Co. v. National Park Bank, 239 N.Y. 386, 146 N.E. 636 (1925), the misdescription related only to the quality of the goods. For that reason, the court's majority did not apply Judge Cardozo's view. See H. Finkelstein, supra note 48, at 226-31.
65 See, e.g., V. Countryman & A. Kaufman, Commercial Law: Cases and Materials 712 (1971); cf. Comment, supra note 40, at 776 (the letter of credit as a deliberate tool for shifting the credit strain to the buyer in case of a dispute).
66 See text accompanying notes 23-34 supra.
67 See Comment, supra note 20, at 926.
68 For cases explicitly addressing a contractual relationship between the issuer of a letter of credit and the beneficiary thereunder, see Lamborn v. National Park Bank, 240 N.Y. 520, 523-28, 148 N.E. 664, 665-66 (1925); Shanghai Commercial
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delivery of goods to a buyer on the basis of an undertaking contained in a banker's instrument, a contractual relationship is created between the seller and the drawer of the instrument. Thus, it is said, "[A] cashier's check establishes a debtor-creditor relationship between the issuing bank and the payee."⁶⁹

Nonetheless, a direct contractual relationship between the drawer and the seller does not necessarily mean that the latter would discharge the obligations under the contract by merely presenting the instrument for payment. Such a right would depend on the substantive terms of the contract. Indeed, underlying the autonomy of the letter of credit is not the mere existence of a direct relationship between the issuer and the seller, but rather the content of that relationship. The substantive provisions in the letter of credit, which require the banker "to deal . . . in documents alone,"⁷⁰ provide the basis for the absolute obligation.⁷¹

It is sometimes said, however, that "[t]he cashier's check . . . stands on its own foundation as an independent, unconditional and primary obligation of the bank,"⁷² and that "[t]o allow the bank to stop payment on such an instrument would be inconsistent with the representations it makes in issuing the check."⁷³ "Payee and drawer . . . have an implied contractual relationship: payee has a duty to present the check and the right to receive payment, while drawer . . . has a duty to pay the check upon presentment."⁷⁴

Insofar as these statements are based on the fact that a banker's instrument contains "an unconditional promise or order to pay a sum certain in money,"⁷⁵ as well as on the absolute terms of the drawer's


⁶⁹ Moon Over the Mountain, Ltd. v. Marine Midland Bank, 87 Misc. 2d 918, 920, 386 N.Y.S.2d 974, 975 (N.Y. City Civ. Ct. 1976); see note 86 infra.

⁷⁰ Wichita Eagle & Beacon Publishing Co. v. Pacific Nat'l Bank, 493 F.2d 1285, 1286 (9th Cir. 1974).

⁷¹ See notes 42-43 and accompanying text supra.


⁷⁵ U.C.C. § 3-104(1)(b) (emphasis added).
contract under section 3-413, they represent a fundamental misconception. Neither the language of a negotiable instrument nor that of the drawer's engagement under section 3-413 determines the right to enforce payment for the full amount of an instrument. Rather, when claims and defenses arise from actual dealings with respect to an instrument, the right to enforce full payment depends on whether the plaintiff in taking the instrument is a holder in due course and on the power of that position to defeat relevant claims and defenses.

The language of an obligation, however, can be given a "particular meaning" and be supplemented or qualified by a usage of trade. Thus, it has been said that banker's instruments circulate "in the commercial world as the equivalent of cash." Insofar as this means that the taking of a banker's instrument is treated as the taking of the funds thereunder, this usage of trade gives an absolute content to an obligation under a banker's instrument.

Nonetheless, while the existence of such usage of trade is theoretically possible, in order to be effective it should be "in the vocation or trade in which the parties are engaged or of which they are or should be aware." Also, its "existence and scope are to be proved based on the fact that they are negotiable instruments. Miller v. Race, 1 Burr. 452, 457, 97 Eng. Rep. 398, 401 (1798). See generally Waterman, The Promissory Note as a Substitute for Money, 14 Minn. L. Rev. 313 (1930).

It does not mean that a banker's instrument is cash so as to be irreconcilable with U.C.C. § 4-104(1) (g). But see Dziurak v. Chase Manhattan Bank, 88 Misc. 2d 641, 655, 388 N.Y.S.2d 496, 500 (Sup. Ct. 1976) ("To say that a cashier's check is the equivalent of cash appears to be irreconcilable with section 4-104(g). . . . Thus one may argue that a cashier's check is not money and therefore not cash.") rev'd on other grounds, 58 App. Div. 2d 103, 396 N.Y.S.2d 414 (1977).

as facts." None of the reported cases consider these elements in connection with a banker's instrument. Moreover, while most parties to a banker's instrument probably treat it as the equivalent of cash, it does not follow that such treatment covers clear situations where a seller would be denied the right to recover the price of the goods. Indeed, the parties typically regard payment by a personal check as the transfer of the funds. Yet it has not been understood to entitle the holder to recover over the defenses of the drawer, unless he is a holder in due course.

Thus, the possibility of a direct relationship between the drawer and the seller is unhelpful in the search for the autonomy of a banker's instrument. By itself, under general principles of law, it falls short of establishing that autonomy; the language of the undertaking should be considered as well. Yet, under the law of negotiable instruments, the unconditional language does not determine the right to enforce full payment of the instrument. While usage of trade could give a particular meaning to an obligation, the scope of such usage has not been established with respect to banker's instruments.

IV

THE PAYEE UNDER A BANKER'S INSTRUMENT AS A PURCHASER THEREOF

The possibility of a direct "debtor-creditor relationship between the issuing bank and the payee" of a banker's instrument is actually inconsistent with the law of negotiable instruments. The idea that one who procures the issuance of a banker's instrument payable to the order of another (the "remitter") is the first owner and in position "to confer a

82 U.C.C. § 1-205(2). See generally Kirst, Usage of Trade and Course of Dealing: Subversion of the UCC Theory, 1977 U. ILL. L.F. 811; Levie, supra note 81, at 1109. See also U.C.C. § 1-205(6).

83 See, e.g., Engstrom v. Wiley, 191 F.2d 684, 686-87 (9th Cir. 1951) (the court considered the sale of wheat, paid for by check, as a cash sale in which the "wheat and the money were equivalent").

84 But a "check does not of itself operate as an assignment of . . . funds." U.C.C. § 3-409(1). It also does not give an absolute discharge to the underlying obligation. U.C.C. §§ 2-511(3), -802(1).

85 U.C.C. § 3-305 governs the rights of a holder in due course.

86 See notes 68-69 and accompanying text supra. Of course, such a direct relationship would exist where the banker's instrument is given to the payee in discharge of an obligation owed by the bank. See, e.g., Myers v. First Nat'l Bank, 42 App. Div. 2d 657, 658, 345 N.Y.S.2d 204, 206 (1973).

87 See generally Beutel, Rights of Remitters and Other Owners Not Within the Tenor of Negotiable Instruments, 12 MINN. L. REV. 584 (1928); Comment, The Rights of a Remitter of a Negotiable Instrument, 8 B.C. INDUS. & COM. L. REV. 260 (1967).
title to the bill upon the payee" preceded the enactment of the English Bills of Exchange Act. The idea is also supported by provisions of the Code that regard the remitter as the first person to whom the instrument is issued. Accordingly, in suing the drawer, the seller-payee acts not as a direct party to the promise, but rather as one having a derivative title to the instrument embodying it.

The payee of a banker’s instrument, as a purchaser thereof and a remote party to the drawer, could claim holder in due course status at common law and definitely can do so under the Code. Yet under section 3–302(1), to be a holder in due course, the seller must take the instrument “for value; . . . in good faith; and . . . without notice . . . of any defense against or claim to it on the part of any person.”

Undoubtedly, a seller who commits fraud on the buyer or otherwise knowingly breaks the contract falls outside the good faith and without-notice requirements. When the seller breaks the contract innocently, the inquiry turns on the value requirement.

Section 3–303(a) provides that “[a] holder takes the instrument for value . . . to the extent that the agreed consideration has been performed.” This apparently means that breach of contract leads to non-compliance with the value requirement. Nonetheless, an examination of several Code provisions in historic perspective introduces some complexity. For example, in medieval common law, a seller’s undertaking to provide a sound horse was treated as separate from his primary undertaking to provide a horse. While some aspects of this view can be traced into modern English law, it is explicitly rejected by article 2 of the Code, where the general “obligation of the seller is to


89 1882, 45 & 46 Vict., c. 61.

90 U.C.C. § 3–102(1)(a). While “a person who is in possession of . . . an instrument . . . issued . . . to him” is a “holder,” U.C.C. § 1–201(20) (emphasis added), the negative implication from U.C.C. § 3–102(a) is that a remitter is not a holder. See also U.C.C. § 3–102, Comment 1.

91 See generally Aigler, Payees as Holders in Due Course, 36 Yale L.J. 608, 609–13 (1927).

92 “A payee may be a holder in due course.” U.C.C. § 3–302(2). U.C.C. § 3–302, Comment 2, Example a, explicitly deals with the remitter as a holder in due course.

93 “‘Good faith’ means honesty in fact in the conduct or transaction concerned.” U.C.C. § 1–201(19). “Notice” is actual knowledge, receiving notice, or having “reason to know.” U.C.C. § 1–201(25).

transfer and deliver . . . in accordance with the contract." Curiously, however, article 3 appears to turn the wheel back by differentiating between "defenses . . . which would be available in an action on a simple contract" and the defense of "failure of consideration." Thus, one can argue that by providing the goods, though in breach of warranty, the bona fide seller performed "the agreed consideration" within the meaning of section 3-303(a).

Nonetheless, the Code's explicit reference to "failure of consideration" follows the treatment given to this subject in Negotiable Instruments Law (N.I.L.) section 28. Section 28 codifies the doctrine of consideration in relation to bills and notes and does not reflect a carefully designed scheme differentiating between the defense of failure of consideration and other defenses under the contract. Therefore, "the agreed consideration" under section 3-303(a) should be read, on the basis of article 2, as the seller's obligation "to transfer and deliver . . . in accordance with the contract" as provided in section 2-301. Since a seller in breach of the contract has not taken the instrument "for value," he cannot become a holder in due course under section 3-302(1).

V

CONTRACTUAL DEFENSES AS CLAIMS TO THE INSTRUMENT—CONSTRUING U.C.C. SECTION 3-306

As one not a holder in due course, the seller can only enforce the banker's instrument against its drawer "subject to (a) all valid claims to it on the part of any person; and (b) all defenses of any party which would be available in an action on a simple contract." 95

95 U.C.C. §2-301 (emphasis added). This language includes the seller's undertakings under the warranty sections. U.C.C. §§ 2-312 to 315. This interpretation of U.C.C. § 2-301 is endorsed in J. White & R. Summers, Handbook of the Law Under the Uniform Commercial Code § 12-12, at 394 & n.197 (1972).

96 U.C.C. § 3-306(b).

97 U.C.C. §§ 3-306(c), 408.

98 Id.

99 The N.I.L. is the predecessor of article 3 of the Uniform Commercial Code. N.I.L. § 28 provides: "Absence or failure of consideration is matter of defense as against any person not a holder in due course; and partial failure of consideration is a defense pro tanto, whether the failure is an ascertained and liquidated amount or otherwise." J. Brannan, Negotiable Instruments Law 129 (7th ed. F. Beutel 1948).

100 For the codification of the doctrine of consideration under N.I.L. § 28, see W. Britton, supra note 88, at 211.

101 Failure of consideration and breach of contract are interchangeable. See Note, Failure of Consideration in Negotiable Instruments, 25 Colum. L. Rev. 83 (1925).

102 See note 95 and accompanying text supra.

103 U.C.C. § 3-306(a)–(b). See notes 135–36 and accompanying text infra.
Not having signed the instrument, the buyer-remitter is not liable thereon\(^{104}\) and therefore is not a party thereto.\(^{105}\) While section 3–306 (b) does not specify subjection to “defenses of any party to the instrument,”\(^{106}\) and although “party” under the general definitions of the Code is “a person who has engaged in a transaction or made an agreement within this Act,”\(^{107}\) in the context of article 3, “party” should be read as a “party to the instrument.”\(^{108}\) Therefore, section 3–306(b) does not govern the question whether the remitter’s contractual defenses are available to the drawer in the seller’s action on the instrument. Furthermore, “defenses” are an insufficient basis for the buyer to join an existing litigation between the holder and an obligor on an instrument,\(^{109}\) or to enjoin the drawer from making payment thereon.\(^{110}\) Both options contemplate the existence of a “claim.” Thus, the availability of the buyer’s contractual defenses in the seller’s action on the instrument against the drawer depends on whether they form “valid claims to it” under section 3–306(a).

*Fulton National Bank v. Delco Corp.* recently held that a “claim” in sections 3–305 (1) and 3–306 (a) “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.”\(^{111}\) Insofar as this view suggests that contractual defenses cannot establish a claim to the instrument,\(^{112}\) it fails to see that the contractual defenses of an obligor were considered in the common law as “equities” to the title of an assignee to a chose in action.\(^{113}\) Moreover, in the framework of a comprehensive “theory of negotiable instruments,” Professor Chafee indicated that “equitable claims to ownership” and “equitable defenses to liability on the con-

\(^{104}\) U.C.C. § 3–401(1).

\(^{105}\) Note however that “the merchants of the sixteenth and seventeenth centuries not only regarded the remitter as a . . . party to the bill [of exchange], but also conceived that [the remitter] had substantial rights and duties on the instrument.” Beutel, *supra* note 87, at 593. Of course, this is not the current law.

\(^{106}\) U.C.C. § 3–305(2) (emphasis added) (rights of a holder in due course).

\(^{107}\) U.C.C. § 1–201(29).

\(^{108}\) Cf. U.C.C. art. 3, pt. 4 (“Liability of Parties”). “No person is liable on an instrument unless his signature appears thereon,” U.C.C. § 3–401(1), therefore, “party” is “party to the instrument.”

\(^{109}\) U.C.C. § 3–306(d), second sentence.

\(^{110}\) U.C.C. § 3–603(1), first sentence.


\(^{112}\) With the exception of fraud, this was the conclusion of Note, *supra* note 18, at 438.

\(^{113}\) See, e.g., W. ANSON, ANSON’S LAW OF CONTRACT 435 (24th ed. A. Guest 1975); 4 A. CORBIN, CORBIN ON CONTRACTS § 900 & n.40 (1951).
tract" are the classes of "equities affecting a negotiable instrument." ¹¹⁴

This classification, according to Professor Chafee, "correspond[s] to
the duplex nature of the negotiable instrument itself" as a chose in
action and a chattel. Indeed, while "[t]he equities as to ownership are
property rights in a chattel with its dependent obligations," the "equities
as to liability are at the opposite end of those obligations . . . , [to be]
set up by a defendant as defenses (exceptions) to litigation on a contract."
Yet, "Instead of waiting until he is sued on the bill or note and setting
up his equitable defense at law, the obligor may use it as the basis of a
bill of equity to enjoin negotiation and have the paper surrendered for
cancellation so that it may not get into the hands of a holder in due
course and the defense be lost." ¹¹⁵

Unlike equitable claims to ownership, equitable defenses to liability
do not establish property rights. ¹¹⁶ Their effect on the property in a
negotiable instrument can be easily seen as following from the "reifica-
tion" of the debt claim under the instrument or its "merger" into the
paper embodying it. ¹¹⁷ Thus, a right to the debt claim constitutes prop-
erty in the instrument. ¹¹⁸ Whatever affects the right to the debt claim
in turn encumbers the property in the instrument.

Professor Warren suggested, however, that the differentiation be-
tween "claims" and "defenses" in sections 3–305 and 3–306 of the Code
is modeled on Professor Chafee's distinction between "equities as to
ownership" and "equities as to liability." "Claims" under sections
3–305(1) and 3–306(a) therefore would correspond only to the for-
er. ¹¹⁹ But this opinion overlooks the Code drafters' acknowledgement
that "[t]he language 'all claims to . . . [the instrument] on the part of
any person' is substituted for 'any defect of title of prior parties' in the
original section 57," ¹²⁰ and that the concept of "defect of title," borrowed
from section 38(2) of the English Bills of Exchange Act, ¹²¹ was sub-

¹¹⁴ Chafee, Rights in Overdue Paper, 31 Harv. L. Rev. 1104 (1918).
¹¹⁵ Id. at 1109–12.
¹¹⁶ Id. at 1111.
1954); Gilmore, The Commercial Doctrine of Good Faith Purchase, 63 Yale L.J.
1057, 1064 (1954).
¹¹⁸ "The right to hold the paper and the right to enforce the obligation are in
the same person." Chafee, supra note 114, at 1109. "Property" in the instrument
is the right to possession. See W. Britton, supra note 88, at 250.
¹¹⁹ See Warren, Cutting Off Claims of Ownership Under the Uniform Com-
mercial Code, 30 U. Chi. L. Rev. 469 (1963); Comment, supra note 20, at 921.
¹²⁰ U.C.C. § 3–305, Comment 2. N.I.L. § 57 provides: "A holder in due course
holds the instrument free from any defect of title of prior parties, and free from
defenses available to prior parties among themselves, and may enforce payment
of the instrument for the full amount thereof against all parties liable thereon."
J. Brannan, supra note 99, 141.
¹²¹ 1882, 45 & 46 Vict., c. 61, § 38(2). The language of § 38(2) of the Act is
almost identical to that of N.I.L. § 57. See note 140 infra.
substituted for the common-law concept of "equity attaching to the bill." The latter, according to Professor Chafee, includes equities of liability as well as equities of ownership.

Linguistically, contractual defenses are more readily classified as defects of title than as claims to the instrument. While the former focuses on what property the holder does not have by virtue of these defenses, the latter stresses what property the claimant has. Nonetheless, inasmuch as contractual defenses may be used as a basis for a claim to enjoin negotiation and have the instrument either cancelled or properly noted so that it will not reach the hands of a holder in due course, they can be seen as forming a basis of "claims" to the instrument. In light of the history of the term as acknowledged by the drafters and the doctrinal analysis suggested by Professor Chafee to N.I.L. section 57, sections 3-305(1) and 3-306(a) should be construed to include the buyer's defenses as "claims" to the instrument.

Case law in jurisdictions that adopted statutes modeled on the English Bills of Exchange Act, however, consistently views in a narrow perspective "equities as to liability" that affect title to an instrument. Although it is usually accepted that the examples given by the Act of defects of title "do not exhaust the category," a summary of the case law demonstrates that "the only equities that attach to the instruments... are basically those that [arise] at its inception or subsequent negotiation." From a doctrinal standpoint, this is an erroneous view. As was demonstrated by a Canadian court that regarded breach of contract as a defect of title, the view is based on an historical anomaly.

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123 See note 115 and accompanying text supra.
124 See note 116 and accompanying text supra.
125 The jurisdictions are set forth in J. Falconbridge, supra note 122, at 431-32.
126 The examples enumerated in the English Bills of Exchange Act, 1882, 45 & 46 Vict., c. 61, § 29(2), refer to obtaining the instrument or its acceptance "by fraud, duress, or force and fear, or other unlawful means, or for an illegal consideration, or... [negotiating] it in breach of faith, or under such circumstances as amount to a fraud." This is basically the language of N.I.L. § 55.
128 Donald, Negotiation of an Overdue Bill of Exchange or Promissory Note, 8 Alta. L. Rev. 75, 86 (1970). Note that this formulation is broader than that of fraud. See text accompanying note 112 supra.
129 A. Barak, The Nature of the Negotiable Instrument 53-67 (in Hebrew) (adopting Chafee's analysis, see note 115 and accompanying text supra). This work presents a comprehensive theory underlying the complex nature of a negotiable instrument as a chattel, as an obligation, and as a subject matter governed by the law merchant.
and "there is probably no longer a reason for continuing it." Furthermore, whatever the situation in the Commonwealth jurisdictions, Professor Britton concluded that in the context of the N.I.L., "defect of title" includes contractual defenses. The Code's treatment of the assertion of third persons' claims against one not a holder in due course lends further support for reading contractual defenses into "claims" under sections 3-305(1) and 3-306(a). Thus, under section 3-306(d), "The claim . . . is not otherwise available as a defense to any party . . . unless the third person himself defends the action for such party." If "claim" does not include "defense," the negative implication of section 3-306(d) is that the defendant is always free to raise a third person's defenses. Yet, under section 3-603(1), "[T]he liability of any party is discharged to the extent of his payment . . . even though it is made with knowledge of a claim of another person to the instrument." As this section does not provide for discharge if payment is made with knowledge of a "defense," the negative implication is that the party must raise the third person's defenses. At the same time, the third person cannot join the litigation and assert his own defenses. The right to defend the action under section 3-306(d), as well as the right to enjoin payment "by order of a court of competent jurisdiction" under section 3-603(1), is limited to one having a "claim." The anomaly becomes more apparent in the light of the premises of the drafters that "[w]hen the party to pay is notified of an adverse claim... he has normally no means of knowing whether the assertion is true," and that "except in cases of theft or restrictive indorsement there is not good reason to put him to inconvenience because of a dispute between two other parties." As to the intent of the drafters in specifying "defenses of any party" as a separate category in sections 3-305(2) and 3-306(b), it should be observed that the overlap among the paragraphs of section 3-306 is not confined to paragraphs (a) and (b). The defenses of "want or failure of consideration [and] nonperformance of any condition precedent"
under paragraph (c) are defenses "available in an action on a simple contract" under paragraph (b). The defense of "non-delivery, or delivery for a special purpose" under paragraph (c) is, according to Professor Chafee, "an equitable defense of lack of value" as well as "an equitable claim to get the . . . [instrument] back." As such, it is already covered by paragraphs (a) and (b). Finally, paragraph (d) speaks of "the defense that . . . [the plaintiff] 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." Both defenses establish "claims" to the instrument under paragraph (a). Indeed, notwithstanding the use of the word "and" at the end of each section 3-306 paragraph, the overlap among them is conspicuous.

Apparently, in sections 3-305 and 3-306, the drafters were more concerned about complete coverage than about establishing mutually exclusive provisions. Having in mind certain concepts, issues, and provisions of the N.I.L., they tailored the new paragraphs and subsections to correspond to each of them separately. However, having failed to fit the various pieces into one picture, they carried into the Code the overlaps among the issues and among some of the N.I.L. provisions dealing with them. Thus, inasmuch as the terms "claim" and "defense" were designed to succeed to the N.I.L. expressions "defect of title" and "infirmity in the instrument" as "key concepts" under the Code, they reenacted the overlap of their predecessors. Likewise, the freedom of a holder in due course under section 3-305 from "all claims to . . . [the instrument] on the part of any person; and [from] all defenses of any party to the instrument with whom the holder has not dealt," is reminiscent of the language of N.I.L. section 57 under which a holder in due course holds the instrument free from "any defect of title of prior parties, and . . . from defenses available to prior parties among themselves." Indeed, "claims" in U.C.C. section 3-305(1) corresponds to "defect of title" in N.I.L. section 57. Inasmuch as

135 See notes 94–102 and accompanying text supra.
136 Chafee, supra note 114, at 1112.
137 Britton, Defenses, Claims of Ownership and Equities—a Comparison of the Provisions of the Negotiable Instruments Law with Corresponding Provisions of Article 3 of the Proposed Commercial Code, 7 Hastings L.J. 1, 2 (1955). "Infirmity in the instrument" in N.I.L. § 52(4) corresponds to "defense" in U.C.C. § 3-302(c), which deals with the conditions for becoming a holder in due course. The former expression was mentioned neither in N.I.L. § 57 (rights of a holder in due course) nor in N.I.L. § 58 (rights of one not a holder in due course).
138 W. Britton, supra note 88, at 258.
139 See note 120 and accompanying text supra.
"defenses" in N.I.L. section 57 is covered by "defect of title,"\textsuperscript{140} the overlap was carried into the Code.

In tracing the overlaps among section 3–306 paragraphs into the provisions of the N.I.L., the subject matter of each paragraph should be considered separately. Thus, in providing in section 3–306(a) that one not a holder in due course takes the instrument subject to "all valid claims to it," the drafters added a provision with no explicit counterpart in the N.I.L. They sought thereby to reject Professor Chafee's view that a bona fide purchaser of an overdue instrument is free from some of the equities to the instrument.\textsuperscript{141} Then, in providing in paragraph (b) for the availability of contractual defenses, the drafters purported to restate "the first sentence of... [N.I.L.] Section 58,"\textsuperscript{142} under which, "[i]n the hands of any holder other than a holder in due course, a negotiable instrument is subject to the same defenses as if it were non-negotiable." Nonetheless, in restating the similarity between the position of one not a holder in due course and of an assignee of a non-negotiable chose in action, the drafters failed to see that this had already been stated in paragraph (a), where they had focused on a different issue, which was not dealt with in the N.I.L.

Section 3–306(c) codifies some general\textsuperscript{143} and specific\textsuperscript{144} doctrines of contract law relating to negotiable instruments. Drafted in a manner that focuses not on the doctrines, but on the defenses that arise from deviations from them, the paragraph overlaps those preceding it. Paragraph (d) concerns the question of when the "claim" of a third person

\textsuperscript{140} See note 131 and accompanying text supra. The corresponding section in the English Bills of Exchange Act, 1882, 45 & 46 Vict., c. 61, § 38(2), speaks of the freedom of the holder in due course from "mere personal defenses available to prior parties among themselves" (emphasis added to the words missing from N.I.L. § 57), an expression that refers to defenses arising outside the transaction giving rise to the instrument and that do not form a "defect of title." J. Falconbridge, supra note 122, at 667.

\textsuperscript{141} W. Hawkland, Commercial Paper 90 (1959). Professor Chafee argued that a bona fide purchaser of an overdue instrument, while not a holder in due course, takes it free from "equities as to ownership," but not from "equities as to liability." Chafee, supra note 114, at 1119–27.


\textsuperscript{143} "[W]ant or failure of consideration," see notes 98–101 and accompanying text supra, and "nonperformance of any condition precedent."

\textsuperscript{144} "[N]on delivery, or delivery for a special purpose" (previously dealt with in N.I.L. § 16).
is available against one not a holder in due course.\textsuperscript{145} Its first sentence,\textsuperscript{146} however, gives the false impression that it adds a new defense not covered already by the preceding paragraphs.

The paragraphs and subsections of sections 3-305 and 3-306 are piecemeal legislation dealing with specific issues. As the issues themselves overlap, so do the paragraphs and subsections dealing with them. Specifying "defenses of any party" as a separate category in sections 3–305(2) and 3–306(b) does not mean that they are not also included in "claims" under sections 3–305(1) and 3–306(a).

VI

THE REMITTER'S CONTRACTUAL DEFENSES AS CLAIMS TO THE INSTRUMENT—THE SCOPE OF THE RIGHT TO BLOCK PAYMENT AND RELEVANT POLICY CONSIDERATIONS

It was argued in the preceding discussion that contractual defenses form a "claim" to the instrument because of potential liability to a holder in due course.\textsuperscript{147} Therefore, regardless of the scope of section 3–306-(b),\textsuperscript{148} only defenses of a party to the instrument fall within the category of claims to it. Certainly a remitter does not face the possibility of losing his defenses to a holder in due course, because he is not liable on the instrument.\textsuperscript{149}

Nonetheless, it is submitted that a remitter-buyer of goods who rescinds the contract for sale thereby establishes a claim to the instrument and can recover it from the hands of the seller. This right is explained by the effect of the rescission of a contract. "To rescind a contract is . . . to abrogate and undo it from the beginning . . . ."\textsuperscript{150} As rescission "has the legal effect of entitling each of the parties to be restored to the condition in which he was before the contract was made,"\textsuperscript{151} it "requires the surrender of any consideration or advantage

\textsuperscript{145} The N.I.L. was ambiguous in regard to this issue. W. Britton, supra note 88, at 464–77.

\textsuperscript{146} One not a holder in due course "takes the instrument subject to . . . (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 restrictive indorsement."

\textsuperscript{147} See notes 115 & 124 and accompanying text supra. See generally text accompanying notes 103–46 supra.

\textsuperscript{148} See notes 106–08 and accompanying text supra.

\textsuperscript{149} See notes 104–05 and accompanying text supra.

\textsuperscript{150} Sylvania Indus. Corp. v. Lilienfeld's Estate, 132 F.2d 887, 892 (4th Cir. 1943) (quoting 1 H. Black, Rescission of Contracts and Cancellation of Written Instruments § 1, at 3 (2d ed. 1929)).

\textsuperscript{151} Hayes v. City of Nashville, 80 F. 641, 645 (6th Cir. 1897).
received by either party.’152 Thus, by rescinding the contract, the buyer establishes a claim to receive the banker’s instrument back from the seller.

Indeed, prior to the delivery of the instrument to the seller, the buyer is the owner.153 In conferring “a title to the bill upon the payee” in return for the goods,154 the remitter assumes the position of a buyer of a new car who in part payment of the price trades in an old car to which he is entitled on the effective rescission of the contract.155 Thus, if a remitter in possession of an instrument “after the payee has refused to accept it” is “the owner thereof,”156 he should be considered to resume ownership and right to possession upon “the placing of the parties in statu[s] quo”157 as a result of the contract rescission.

The Code drafters abandoned the ambiguous term “rescission”158 as a remedy for breach of contract.159 Rather than speaking of the buyer’s right to “[r]escind the contract,”160 they speak of the right to reject the goods161 or to “revoke... acceptance.”162 Yet, “[A] right to reject is


154 See note 88 and accompanying text supra.

155 See, e.g., Schutt v. Scott, 62 Cal. App. 539, 217 P. 565 (1923) (upon rescission of the sale by consent, buyer is entitled to the car that he traded in); Frazier v. Allison, 315 Ill. App. 253, 42 N.E.2d 967 (1942) (no right in a buyer to recover the trade-in tractor when contract is not rescinded); Seligman v. Duff, 109 Misc. 533, 179 N.Y.S. 419 (App. Term 1919) (rescission of sale by buyer entitles him to recover the note given to the seller). Obviously, the buyer’s right to the old car that was traded in, as well as to the banker’s instrument, comes to an end by a sale to a bona fide purchaser.

156 W. Britton, supra note 88, at 179.


159 See generally J. White & R. Summers, supra note 95, § 8-1, at 248-49. See also U.C.C. § 2-608, Comment 1. “Rescission” is still used in U.C.C. § 2-721, arguably only for fraud. J. White & R. Summers, supra note 95, § 8-1, at 248 n.9.

160 Uniform Sales Act § 69(1) (d) (predecessor of U.C.C. art. 2).

161 U.C.C. § 2-601.

162 U.C.C. § 2-608(1).
merely a particular form of the right to rescind.”

The cross references to the Uniform Sales Act in the Code Comments clearly indicate that the concepts of rejection and revocation of acceptance supersede the pre-Code concept of rescission.

Thus, where “the buyer rightfully rejects or justifiably revokes acceptance,” he may recover “so much of the price as has been paid.”

While nothing is said about the right to obtain what was given in return for the goods apart from money, this right is implicit in the right to recover the price paid. “A ‘sale’ consists in the passing of title from the seller to the buyer for a price.”

Recovery of the price embodies the idea of recovering everything given to the seller for the passing of title in the goods, be it money, an old car, or a banker’s instrument.

The buyer’s right to assert a “claim” to a banker’s instrument is therefore coextensive with the right to reject goods under section 2-601 and to revoke acceptance under section 2-608. The right of rejection appears to be much more relevant to banker’s instruments. The right to revoke acceptance typically arises after the buyer has held the goods long enough so that “acceptance” has occurred. Usually, by that time the seller would have already obtained payment on the banker’s instrument.

On the other hand, rejection of goods must be exercised “within a reasonable time after their delivery or tender” and could occur before payment on the instrument. A valid ground for rejecting goods can thus secure a claim to the instrument.

Section 2-601 provides that whenever “the goods or the tender of delivery fail in any respect to conform to the contract, the buyer may . . .

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164 Note the reference to the Uniform Sales Act § 69 (dealing with rescission) in the Comments to U.C.C. § 2-601 (applicable to rejection on improper delivery) and to U.C.C. § 2-608 (revocation of acceptance).

165 U.C.C. § 2-711(1).


167 U.C.C. § 2-106(1).

168 See Jerome v. Clements Motor Sales, Ltd., 15 D.L.R.2d 689 (Ont. Ct. App. 1958) (a car that had been traded in as part payment for a new car was regarded as part of the “full purchase price” under the contract).

169 Accord, Fox, supra note 20, at 692. However, Fox states that only serious complaints give rise to “the right of rescission of the underlying transaction.” Id.

170 J. White & R. Summers, supra note 95, § 8-2, at 253.

171 The seller could also have transferred the instrument to a holder in due course. See note 25 and accompanying text supra.

172 U.C.C. § 2-602(1).
reject...[them]." This is the perfect tender rule, under which the slightest deviation from the terms of the contract constitutes a basis for the buyer's right to reject the goods. Thus, the buyer can use every contractual defense as a ground for a claim to the instrument. While the right of rejection is seriously curtailed by the seller's section 2-508 right to cure a rejected tender or delivery, the restriction relates to the selection of the ultimate remedy, and not to the buyer's initial ability to exercise the right to reject the goods for any nonconformity. Thus, where the right to reject the goods is ultimately denied, a buyer who paid with a banker's instrument can deprive the seller of the funds until final curative tender by rejecting the goods and asserting a claim to the instrument in the meantime.

The correlation between the buyer's right to reject the goods and the right to block payment on the banker's instrument leads to the application of the latter only when the seller is denied the right to the price. This seems to contribute to a proper balance between fairness considerations and the cash quality of a banker's instrument. The treatment of the right to assert a claim to the instrument under article 3, however, may seriously impair the balance. Thus, the buyer can effectively exercise the right either by enjoining "payment...by order of a court of competent jurisdiction" or by supplying the drawer bank with "indemnity deemed adequate by" it. Then, in the seller's action on the instrument, the buyer can defend "the action for" the drawer. Both alternatives fail to require the establishment of the claim in a short and fast proceeding. While the first alternative contemplates an injunction issued by a court, the Code fails to specify the standards for granting it. A court presented merely with some serious ground for a claim could thus grant a temporary injunction to be effective until final resolution of the dispute between the seller and the buyer, rather

173 (emphasis added). The exercise of the right to reject an improper delivery under § 2-601 is subject "to the provisions of this Article on breach in installment contracts (section 2-612) and...[to an agreement] under the sections on contractual limitations of remedy (sections 2-718 and 2-719)." U.C.C. § 2-601.


175 J. White & R. Summers, supra note 95, § 8-4, at 266.

176 See generally Priest, supra note 53.

177 But see text accompanying note 191 infra.

178 See notes 31-33 and accompanying text supra.

179 U.C.C. § 3-603(1).

180 U.C.C. § 3-306(d).

181 See text accompanying notes 31-34 supra.

182 U.C.C. § 3-603(1).

183 A preliminary injunction is designed to maintain the status quo pending a final determination of the merits. Checker Motors Corp. v. Chrysler Corp., 405
than until interim, short, and fast proceedings determine the existence of a claim as a basis for blocking payment.\textsuperscript{184}

The second alternative fails altogether to take into account the cash quality of a banker’s instrument. Without a court order, merely on “indemnity deemed adequate,”\textsuperscript{185} the drawer bank is free to withhold payment until final resolution of the seller-buyer dispute.\textsuperscript{186} Thus, both alternatives significantly undermine the cash quality of a banker’s instrument and detract from its value as a commercial tool.\textsuperscript{187}

Offsetting this detraction considerably, however, is the scope of the right to reject goods in general and in particular in most transactions financed with banker’s instruments. Since any nonconformity in the goods constitutes a ground for rejection,\textsuperscript{188} the burden of establishing the right in short and fast proceedings can easily be shouldered. Moreover, the provisions of the Code that preclude or limit rejection when the nonconformity relates to the manner of delivery\textsuperscript{189} are inapplicable to most retail transactions, where deliveries are usually over the counter. Thus, they are irrelevant in the context of banker’s instruments, which are used mainly on the retail level.\textsuperscript{190}

Also, the right to cure defective tender under section 2-508 is inapplicable to most retail transactions. The right is absolute under section 2-508(1) when “the time for performance has not yet expired.” Yet a “time for performance” different from the time of actual delivery is unusual in retail transactions. At the same time, under section 2-508(2), the right to cure extends up to “a further reasonable time” beyond the time for delivery under the contract, but only if the seller had “reasonable grounds to believe” that the initial tender would be acceptable to the buyer. This seems to apply only to ongoing business relationships that could give the seller reason to believe that a nonconforming tender would be acceptable. Most retail transactions are thus excluded from the coverage of the right to cure.

\textsuperscript{184} See notes 33-34 and accompanying text supra.

\textsuperscript{185} U.C.C. § 3-603(1).

\textsuperscript{186} In this case, under the applicable state interpleader procedure, the bank will probably be required to pay the money into the court. See, e.g., Dziurak v. Chase Manhattan Bank, 58 App. Div. 2d 103, 106-07, 396 N.Y.S.2d 414, 416 (1977).

\textsuperscript{187} See Note, supra note 18, at 440.

\textsuperscript{188} See notes 173-74 and accompanying text supra.

\textsuperscript{189} U.C.C. §§ 2-504, -614.

\textsuperscript{190} See text accompanying notes 23-24 supra.
Indeed, the remedy of rejection is easily proved and not easily lost in retail transactions. As a result, it is the ultimate remedy in most transactions financed with banker's instruments.191

A retail buyer can also quite easily meet the standard for revocation of acceptance under section 2-608. Under that standard, a buyer may revoke acceptance if the "non-conformity substantially impairs...[the] value [of the goods] to him."192 This is a subjective standard, which stresses the personal values of the buyer and appears relevant only in the case of consumers,193 the most typical retail buyers. The prerequisites for exercising the right to revoke acceptance—accepting the goods either "on the reasonable assumption that...[the] non-conformity would be cured"194 or on the reasonable inducement by "either...the difficulty of discovery before acceptance or...the seller's assurances"195—are also easily sustained in the case of a retail buyer.196 Thus, in the few cases where revocation of acceptance is exercised before payment on the instrument to the seller,197 the standard can be met in short and fast proceedings.

This analysis extends the right to block payment on a banker's instrument to every breach of most financed contracts for sale. Yet, the light burden involved in establishing the right, as well as the unlikelihood of complications leading to its subsequent loss prior to litigating its basis, is consistent with reasonable limitations on the cash quality of the instrument.

**Conclusion**

The buyer's right to block payment on a banker's obligation coincides with the buyer's right of rejection when the sale is financed with a banker's instrument and with the limits thereof when the sale is financed with a letter of credit. While in the case of a letter of credit this is a

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191 *But see* notes 175–77 and accompanying text *supra*. The analysis with respect to the propriety of rejection in retail transactions is drawn from Priest, *supra* note 53, at 972–73. Indeed, Karl Llewellyn and Professor Honnold viewed rejection as the most appropriate remedy for consumers. *Id.; see* notes 50–58 and accompanying text *supra*. "Consumer" in this context is a buyer for use rather than resale, which is broader than the definition in U.C.C. § 9–109.

192 U.C.C. § 2–608(1) (emphasis added).

193 Priest, *supra* note 53, at 973. "The phrase [see U.C.C. § 2–608(1) and text accompanying note 192 *supra*] has little application and uncertain meaning for merchant buyers since the value of defective goods on the resale market is likely to be the same for one merchant as for another." *Id.*

194 U.C.C. § 2–608(1)(a).

195 U.C.C. § 2–608(1)(b).

196 *See* Priest, *supra* note 53, at 979.

197 *See* notes 170–71 and accompanying text *supra*. 
mere coincidence, in the case of a banker's instrument rejection is the basis of the right to block payment. Thus, a seller who fails to transfer and deliver goods "in accordance with the contract"\textsuperscript{198} takes the banker's instrument as one not a holder in due course. Thus, the seller takes it subject to "all . . . claims to it on the part of any person."\textsuperscript{199} Contractual defenses may be used to enjoin negotiation of an instrument and, as such, they form a "claim" to it on the part of any party thereon. They also can be used as a ground for rejection of the goods when their assertion establishes a claim to the instrument on the part of the remitter.

Since the scope of the buyer's rejection right extends to every seller's breach, there is no meaningful area of autonomy for the obligation on a banker's instrument. Nonetheless, as the right to reject nonconforming goods is easily proved and not easily lost in most retail transactions, the buyer's right to block payment does not seriously impair the cash quality of banker's instruments. Indeed, the Code provisions dealing with the assertion of a third party's claims to an instrument demand clarification and improvement. Yet, a proper balance between fairness considerations and the cash quality of a banker's instrument may nonetheless be achieved in the framework of the existing scope of the right to block payment.

\textsuperscript{198} U.C.C. § 2-301.
\textsuperscript{199} U.C.C. § 3-306(a).