HOUSE RESEARCH ORGANIZATION bill analysis | 5/8/95 | HB 1728 Grusendorf (CSHB 1728 by Janek)

SUBJECT: Negotiable instruments and banking in Uniform Commercial Code

COMMITTEE: Business and Industry — committee substitute recommended

VOTE: 6 ayes — Brimer, Brady, Corte, Giddings, Janek, Rhodes

0 nays

3 absent — Crabb, Eiland, Solomons

WITNESSES: For — W. David East, Darryl B. Robertson & Arthur Val Perkins, Texas Business Law Foundation

Against — None

BACKGROUND: The Uniform Commercial Code was established to promote uniformity among states in business law. The National Conference of Commissioners on State Laws and American Law Institute approved revised Articles 3 and 4 in 1990. Chapter 3 deals with negotiable instruments, which are written legal documents that evidence a right to payment of money that is transferred in the ordinary course of business with any necessary indorsement or assignment. Checks are an example of negotiable instruments.

DIGEST: CSHB 1728 would add to the Texas Business and Commerce Code (TBCC) Article 3 of the Uniform Commercial Code (UCC) dealing with negotiable instruments. The bill would also amend Chapter 4 of the TBCC to make it consistent with the UCC's Article 4 provisions governing bank deposits and collections.

General changes. The addition of UCC Article 3 would amend definitions of terms related to negotiable instruments, revise the current rules regarding negotiation, transfer and endorsement of negotiable instruments, and update language regarding the enforcement of negotiable instruments, the liability of parties and the dishonor, discharge and payment of negotiable instruments. The addition of UCC Article 3 would clarify the relationship between state and federal law, expressly deferring to the regulations of the

Federal Reserve System's board of governors. The title of Chapter 3 would be changed to "Negotiable Instruments" from "Commercial Paper."

UCC Article 4 concerns bank deposits, collections, collecting banks, payor banks, the relationship between the payor bank and its customer and the collection of documentary drafts. The addition would also take into account the automated processing of checks and the emergence of an electronic-based payments system to replace a paper-based payment system.

Provisions affecting users. Chapters 3 and 4 would expand the definition of good faith to include observance of reasonable commercial standards of fair dealing. The good faith standard applies to the performance of all duties and obligations established under the chapters.

Chapter 3 would impose strict standards for obtaining holder-in-due-course rights by a person dealing with a defaulting agent or fiduciary. It also lists circumstances under which a person would have notice of a breach of fiduciary duty and resulting liability. Any notice required by the Federal Trade Commission "Holder Rule" would not destroy negotiability, but only limit holder-in-due-course status.

Interest is not included within the "sum certain" requirement. A check not payable to the order of or to bearer would be fully negotiable.

Payees would be able to avoid unintentional accord and satisfaction rules by returning funds or by giving a notice that requires checks to be sent to particular office where such proposals can be handled. The drawer of a full settlement check would be protected from the instrument being endorsed with protest.

Chapter 3 would provide disincentives against wrongful dishonor of bank obligations such as cashiers checks. Chapter 3 would also give more time to hold a check before the user loses endorser liability.

Chapter 3 would allow a representative to show the parties did not intend individual liability as to corporate instruments signed by agents without adequate indication and representation, except as a against a holder in due course. Full protection would be afforded to an agent who signs a corporate check, even though the check does not show representative status. Chapter 3 would specify that a signature of an organization is considered unauthorized if more than one signature is required and a signature is missing.

Provisions affecting the banking community. Chapter 3 provides clarification of what types of contracts are within Chapter 3 and how they are to be treated. Checks that omit "words of negotiability" would be included as fully negotiable. The rules regarding travelers checks would be clarified. Variable-rate instruments would be included. The following issues are also addressed: the impact of the FTC "Holder" Rule, ordinary money orders as checks rather than bank obligations and the ability of parties to an instrument to contract for the application of its rules to their contract.

Chapters 3 and 4 would define ordinary care to clarify that financial institutions taking checks for processing or for payment by automated means need not manually handle each instrument if that is consistent with the institutions' procedures and the procedure used did not vary unreasonably from the general usage of banks. The definition of ordinary care would relate to those specific instances in the code where the standard is set forth.

Chapters 3 and 4 would change the definition of a bank to include savings and loans and credit unions so that their checks would be directly governed by the code. Chapter 4 would clarify that checks drawn on credit lines are subject to the rules for checks drawn on deposit accounts. Chapter 4 would authorize electronic presentment of checks.

Chapters 3 and 4 contain some nonuniform changes to the revised UCC Articles 3 and 4, such as slight revisions in the comparative negligence area and those that carry forward the existing state policy requiring stop payment orders to be in writing.

The bill would take effect January 1, 1996.

SUPPORTERS SAY:

Texas needs to adopt Chapter 3 of the UCC and also to adopt the major revision to the Chapter 4 adopted by the state in the 1960s. Approval of CSHB 1728 would make Texas provisions governing negotiable instruments and bank deposits and collections uniform with the majority of states that have already adopted these chapters. Uniformity among the state's laws would make the nation's bank collection system faster, more efficient and less costly.

Adding the UCC articles to the Texas Business and Commerce Code would remove numerous uncertainties that exist in the current provisions and reduce the risk to the payment system and slow appropriate planning by its users and operators. By providing for modern banking technologies, the articles would lower costs to banks and their customers.

OPPONENTS SAY:

No apparent opposition.

NOTES:

The committee substitute made correcting changes and corrected the definition of the word "draft" to conform with the definition in the UCC. The substitute also changed the effective date from September 1, 1995, to January 1, 1996.