predicated, as in the instant case, on the fact that the finance company is better able to bear the risk than is the innocent purchaser, the courts thereby ignoring or discarding both precedent and statutory language which require a contrary result. Some cases show clearly that the finance company, in its dealing with the seller, had actual knowledge of the fraudulent scheme.[35] In such an event the UCC unequivocally excludes it from holder-in-due-course status since the subjective test for good faith is not satisfied. But short of a finding of actual knowledge and in the absence of a governing statute, courts should require only a showing of subjective good faith[36] and refrain from decisions, such as that in the instant case, which open the way for a return to the "suspicious circumstances" test of *Gill v. Cubitt*.[37]

FORREST W. BARNES

Negotiable Instruments—Stop Payment Order on a Certified Check—Effect of the Uniform Commercial Code.—***Winston v. Kasper Am. State Bank.***[1]—This action was brought to recover the amount of a certified check. Plaintiff, a real estate broker, was the payee of a check dated August 31, 1956, drawn on and certified by defendant bank before delivery. Instead of cashing the check, the plaintiff instituted an action against the drawer for the full amount of the commission which he believed to be due him. Subsequently, in May 1957, when the drawer learned that the plaintiff was not a licensed real estate broker as required by a Chicago ordinance, he stopped payment on the check and caused an indemnity bond to be posted. The drawer was not a party to the present action but a petition to intervene was filed by the assignee of one-half of the drawer's interest in the security deposit held by the casualty company. On June 30, 1960 the plaintiff

that defendant finance company was not a holder in due course. The author of the note disagreed with the decision even under an "objective test" for good faith.

[35] See G.M.A.C. v. Daigle, 225 La. 123, 72 So. 2d 319 (1954), noted in 53 Yale L.J. 877 (1955).

[36] See note, 33 N.C.L. Rev. 608, 613 (1955), where the following comment appears:

> If, in fact, there is present a situation so fraught with the possibility of fraud or unfairness that the statutory provisions of the NIL are not adequate, then it seems that legislation is the only sound solution. Nothing but uncertainty can arise out of an encroachment upon these statutory provisions by judicial decisions. Undoubtedly this situation presents a ripe opportunity for collusion between unscrupulous finance companies and dealers to take advantage of the buyer. Clearly in some cases the finance company has actually participated in the transaction to such an extent that it cannot be a holder in due course within the statutory provisions. But in other cases there is no evidence of such direct participation in the transaction by the finance company as would charge it with 'actual notice' or bad faith as required by the NIL. In the absence of additional legislation, it is submitted that innocent finance companies that come within the definition of holder in due course under the existing statutes, should not be deprived of that position because of a tendency of the courts to 'catalogue' them in the same class with unscrupulous companies by the indiscriminate or deliberate use of such terms as 'close connection.'

[37] Supra note 17.

[1] 184 N.E.2d 725 (Ill. App. 1962), appeal denied by Sup. Ct. of Ill., Nov. 28, 1962.

endorsed the check and presented it to defendant for payment which was refused. Plaintiff's basic contention was that payment on a certified check may never be stopped. HELD: The drawer of a check which has been certified at his request before a conditional delivery has the right to require the certifying bank to refuse payment as against a payee who is not a holder in due course; and a contract entered into as a real estate broker without a license is void and unenforceable, and thus furnishes a complete defense to this action.

The right of a drawer to stop payment on a check arose as a corollary to the contract of deposit and has been preserved by the NIL and UCC[2] as a necessary service to depositors. Although the underlying obligation is temporarily suspended by the issuance of a check given in satisfaction thereof, the drawer is not discharged, and upon dishonor for any reason, the holder has recourse not against the drawee bank with whom he has no privity, but against the drawer both on the instrument and on the underlying obligation.[3]

Certification, on the other hand, if procured by the holder or payee constitutes a novation and the drawer is thereby discharged.[4] In *Times Square Auto. Co. v. Rutherford*[5] a stop payment order was honored, but in the action by the payee the court refused the certifying bank the benefit of the drawer's defense of fraud. Similarly, in *Jones v. Nat'l Bank*[6] the drawer's defense that the check, subsequently certified at the holder's request, was given for an illegal consideration was not available to the bank as a defense to its contract of acceptance. In effect, the court reasoned that the holder had requested the bank to retain his money for him until he asked for it and the bank so agreed. If a certifying bank for any reason such as insolvency was unable to make good its obligation, the loss would fall entirely on the holder. Since the effect of certification procured by the holder approaches the legal equivalent of payment, and the holder is content with the obligation of another rather than cash, both results are logical.[7] The protection afforded the holder of a check thus certified is complete.

However, where the drawer procures certification, courts have treated the resulting rights and liabilities differently, as in the instant case. Such certification has been found not to release the drawer from liability but

[2] UCC § 4-403. NIL § 189 provided that a check was not of itself an assignment of funds. The courts justified the right to stop payment on the ground that a check was a mere order and could therefore be revoked at any time prior to payment. Second Nat'l Bank v. Meek Appliance Co., 244 S.W.2d 769 (Ky. 1951); Speroff v. First-Cent. Trust Co., 149 Ohio St. 415, 79 N.E.2d 119 (1948); Thomas v. First Nat'l Bank, 376 Pa. 181, 101 A.2d 910 (1954). Before the NIL all checks in some jurisdictions operated as pro tanto assignments of funds, terminating the drawer's control thereof and the stop payment order was not allowed. First Nat'l Bank v. Keith, 183 Ill. 475, 56 N.E. 179 (1899); Loan & Sav. Bank v. Farmers & Merchants Bank, 74 S.C. 210, 54 S.E. 364 (1906).

[3] NIL § 61, UCC §§ 3-413 & 3-802(1)(b).

[4] NIL § 188, UCC § 3-411.

[5] 77 N.J.L. 649, 73 Atl. 479 (1909).

[6] 95 N.J.L. 376, 113 Atl. 702 (1921).

[7] Blake v. Hamilton Dime Sav. Bank Co., 79 Ohio St. 189, 87 N.E. 73 (1908). Certification operates as a pro tanto assignment and the drawer loses control over the funds represented by the check.

merely to superimpose on his liability as drawer that of the certifying bank.[8] The resulting liability is primary on the part of the acceptor and secondary on the part of the drawer. Consequently, on failure of the acceptor to perform, the holder may still look to the drawer for satisfaction.[9] The general recognition of the resulting liabilities is best illustrated by the widespread existence of statutes requiring bids on public construction to be accompanied by checks certified before delivery.[10]

In *Sutter v. Security Trust Co.*[11] the distinction made according to who procured the certification was applied to stop payment orders. There, the drawer of a check had it certified and delivered to the payee. After discovering what he alleged to be fraud, the drawer stopped payment. The drawee demanded indemnification which the drawer declined to furnish, and the check was paid over the stop payment order to one purporting to be a holder in due course. The drawer sued the certifying bank for the amount of the check charged to his account. The court held as controlling the distinction between checks certified at the request of the payee or holder and those certified by the drawer. In the latter situation it was held that the drawer of the check could issue a stop payment order and require the certifying bank to refuse payment to the payee if such payee was not a bona fide holder for value but had obtained the instrument by perpetrating a fraud upon the maker. The court determined that should such payee bring suit against the certifying bank upon its refusal to pay, the bank could have the benefit of any of the drawer's defenses which establish that the instrument was obtained by fraud, duress or other unlawful means, or for an illegal consideration. The court ruled in favor of defendant bank because it would have been obligated to pay the payee since plaintiff failed to show that she had obtained the check by fraud.

On the issue of permitting payment to be stopped on a check certified at the request of the drawer, *Sutter* and *Winston* are in agreement. Thus, in the jurisdictions where the distinction is made according to who procured certification, should a bank which has certified at the drawer's request pay over a stop payment order, it does so at its risk for it may still be liable to its depositor if the latter's defense is eventually deemed adequate by the courts. If it defends against the payee, the allowance of interpleader,[12] impleader or availability of the *jus tertii* could be a matter of speculation.

It is possible to conclude from the language of the *Sutter* case that the *jus tertii* privilege is narrowly confined to those situations where the more serious business transgressions have been committed. But confusion as to

[8] Florida Power & Light Co., v. Tomasello, 103 Fla. 1076, 139 So. 140 (1932); Welch v. Bank of Manhattan Co., 264 App. Div. 906, 35 N.Y.S.2d 894 (1942). The result is a corollary to NIL § 188.

[9] Borne v. First Nat'l Bank, 123 Ind. 78, 24 N.E. 173 (1890). However, the drawer is discharged to the amount of the loss suffered as a result of the holder's failure to present the certified check for payment in due course. Heartt v. Rhodes, 66 Ill. 351 (1872). See UCC §§ 3-601(1)(i) & 3-502(1)(b).

[10] Note, The Law of Certification of Checks, 78 Banking L.J. 376, 378 (1961).

[11] 96 N.J. Eq. 644, 126 Atl. 435 (1924).

[12] The contract of certification may negate the neutral status of the stake holder as between the parties required by strict rules of interpleader. Kimball Trust & Sav. Bank v. Olsen, 239 Ill. App. 609 (1926).

the scope of the rule abounds. For example, in *McAdoo v. Farmers State Bank*[13] the drawer stopped payment on a check originally certified at his request. The payee sued the certifying bank upon its refusal to pay and joined the drawer as a party defendant. The court refused to allow the certifying bank the benefit of the drawer's defense of lack of consideration even though the plaintiff was not a holder in due course.[14] However, a New York court[15] allowed the certifying bank to interplead the drawer and intimated that his defense of breach of contract would be available to the bank if it was established. The court further pointed out that it was only where certification was procured by the payee or holder that a bank may not resist the enforcement of its contract of acceptance.

The *Sutter* decision led to legislation in New Jersey and New York abolishing the right to stop payment on a certified check regardless of who procured the certification.[16] The UCC, now in effect in Illinois, also abolishes this right,[17] and except in cases of theft categorically prohibits the obligor from setting up the *jus tertii* unless the third party himself defends the action.[18] It should be noted that the elimination of the *jus tertii* privilege under the Code is not intended to abrogate local rules of intervenor, interpleader, impleader, etc. should the certifying bank choose to refuse payment and stand suit, provided that such rules are consistent with the objective of relieving the disinterested obligor bank of the duty of litigating the claim.[19]

The element of indemnity, not present in the *Sutter* case, poses an interesting problem within the context of the UCC. Assuming the facts of the *Winston* case in a Code jurisdiction, would indemnification, as treated in section 3-603,[20] terminate or modify the bank's right with respect to the item granted by section 4-303?[21] Section 3-603, dealing with adverse

[13] 106 Kan. 662, 189 Pac. 155 (1920).

[14] The court did not emphasize the fact that the drawer procured certification and this may indicate that the Kansas courts do not recognize the *Sutter* distinction. The distinction seems to have been operative in Indiana, Nardine v. Kraft Cheese Co., 114 Ind. App. 399, 52 N.E.2d 634 (1944); and Missouri, Bathgate v. Exchange Bank, 199 Mo. App. 583, 205 S.W. 875 (1914). But cf. Kellog v. Citizens Bank, 176 Mo. App. 288, 162 S.W. 643 (1915). The distinction appears not to have been operative in Arkansas, Merchants & Planters Bank v. First Nat'l Bank, 116 Ark. 1, 170 S.W. 852 (1914); Florida, Florida Light & Power Co. v. Tomasello, 103 Fla. 1076, 139 So. 140 (1932).

[15] Welch v. Bank of Manhattan, supra note 8.

[16] N.J. Rev. Stat. § 17: 9A-225(a) (1925); N.Y. Negotiable Instr. Law § 325-a (1944). But see Fiss Corp. v. National Safety Bank & Trust Co., 191 Misc. 397, 77 N.Y.S.2d 293 (N.Y. City Ct. 1948).

[17] The elimination is two pronged: UCC §§ 4-403 & 4-303.

[18] UCC §§ 3-306 & 3-603 & comments thereto.

[19] Ibid. See also UCC §§ 3-803 & 4-407.

[20] Section 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 of another person to the instrument unless prior to such payment or satisfaction the person making the claim 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. This subsection does not, however, result in the discharge of the liability. . . .

[21] Section 4-303. When Items Subject to Notice, Stop-Order, Legal Process or Setoff; Order in Which Items May Be Charged or Certified. (1) Any knowledge,

claims, discharges the liability of a party to the extent of his payment notwithstanding knowledge of the claim of another person to the instrument unless prior to such payment or satisfaction the claimant posts indemnity or enjoins payment or satisfaction in an action in which the adverse claimant and the holder are parties. Comment 3 thereto explains that the contract of an obligor is to make payment to the holder, and except in cases of theft or restrictive endorsement, there is no good reason to put him to inconvenience because of a dispute between two other parties unless he is indemnified or served with appropriate legal process.

Usually the word "pay" and its derivatives used with respect to an item in the Code denote not payment in cash but some action taken by the payor bank the effect of which is to substitute its own liability in place of the drawer. Section 4-303 directs itself toward designating the winner of a race between the holder of an item and creditors of the drawer or the drawer himself for the amount of the item. All of the instances, legal process, stop payment order, etc., note by this section come too late to nullify any *prior* act of the payor bank constituting final payment including certification.[22]

Unquestionably the term "legal process" is not intended to include "injunction" otherwise, the opportunity provided by section 3-603 would be substantially impaired. Thus an injunction would be effective to preclude the bank from performing its obligation notwithstanding prior certification of the item. There seems to be no reason under the Code why the effect of posting adequate indemnity (the counter-part of an injunction in section 3-603) should not be equally effective. Consequently, the *Winston* case would fall within the purview of section 3-603 which would require the bank to stand suit, whereas the *Sutter* case would be controlled by section 4-303 which would permit the drawee to pay over the stop order without remorse.

The Code's approach eliminates prior difficulties by clearly defining the positions occupied by the drawer and drawee. Whether the drawee's refusal to honor a certified check is mandatory by virtue of indemnity or voluntary in its absence, the drawer must defend the action.[23] If the drawer refuses, his defenses (except for theft) will not be available to the drawee and the court will decide in favor of the holder.[24] The decision will bind the drawer and preclude his having recourse against the drawee.[25] Thus the Code treats the drawer as an adverse claimant once an injunction is obtained or indemnity is posted. The outcome is made to depend upon the drawer's initiative, if not upon who procured certification. It is apparent, therefore, that under the UCC

notice or stop-order received by, legal process served upon or setoff exercised by a payor bank, whether or not effective under other rules of law to terminate, suspend or modify the bank's right or duty to pay an item or to charge its customer's account for the item, comes too late to so terminate, suspend or modify such right or duty if the knowledge, notice, stop-order or legal process is received or served and a reasonable time for the bank to act thereon expires or the setoff is exercised after the bank has done any of the following:

(a) accepted or certified the item; . . .

[22] UCC § 4-213(1).

[23] UCC §§ 3-306, 3-803 & 3-603.

[24] UCC §§ 3-411 & 3-413.

[25] UCC §§ 3-803 & 4-303.

certified checks have been removed from the embrace of the problems inherent in stop payments orders, and henceforth will be governed by the law of adverse claims.

TIMOTHY DALY

Securities—Issuance of "Put" and "Call" Options—Applicability of Section 16(b) of the Securities and Exchange Act of 1934.—***Silverman v. Landa.***[1]—Plaintiff shareholder, relying on sections 16(b) and 16(c) of the Securities and Exchange Act of 1934, commenced this action on behalf of his corporation,[2] against Alfons Landa, a director of the Fruehauf Trailer Company, to recover alleged insider short-swing profits. Landa had simultaneously issued a put and a call option on Freuhauf common stock. The call option was given for a premium, and entitled the optionee to buy from Landa, at any time within the following year, 500 shares at a predetermined price. The put, similarly issued for a retained premium, provided the bearer with the option of selling to Landa, at any time within the following year, 500 shares at the same predetermined price. The call options were allowed to lapse, whereas the put was subsequently exercised. The United States District Court for the Southern District of New York granted defendant's motion for summary judgment and was affirmed by the Court of Appeals for the Second Circuit. HELD: The matched sale of put and call options did not, in and of themselves, constitute a "purchase and sale" of the underlying security within the purview of section 16(b), and there having been no sale, section 16(c) could not have been violated.

Section 16(b) requires an "insider"[3] to account to his corporation for any trading profits made by him in any six month period from the purchase and sale or sale and purchase of the issuer's stock or similar security.[4] "Purchase" is elsewhere defined as including any "contract to buy, purchase or otherwise acquire,"[5] and "sale," as including any "contract to sell or otherwise dispose of,"[6] the corporation's securities. Section 16(c), in essence, prohibits "selling short" or, if the trader in fact owns the security, his failure to deliver it within twenty days of the sale.[7]

The court, faced with the novel question of the applicability of these statutory provisions to the issuance of a "straddle"[8] (*i.e.*, the simultaneous

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[1] 306 F.2d 422 (2d Cir. 1962).

[2] The Securities and Exchange Act provides for a corporate cause of action, and if said corporation fails to take advantage of it or prosecute it diligently within a given period, any security owner can sue to recover on behalf of the corporation any profits made by the trader. 48 Stat. 896 (1934), 15 U.S.C. § 78p(b) (1958). See Lattin, The Law of Corporations 277 (1959); Cook & Feldman, Insider Trading Under the Securities and Exchange Act, 66 Harv. L. Rev. 385, 408 (1953).

[3] The statute specifically refers to any director, officer, or beneficial owner of more than 10% of any class of equity security registered on a national securities exchange.

[4] 48 Stat. 896 (1934), 15 U.S.C. § 78p(b) (1958).

[5] 48 Stat. 882 (1934), 15 U.S.C. § 78c(a) (13) (1958).

[6] 48 Stat. 882 (1934), 15 U.S.C. § 78c(a) (14) (1958).

[7] 48 Stat. 896 (1934), 15 U.S.C. § 78p(c) (1958).

[8] The context within which this decision was reached was clearly stated by the