**Liability of the Parties on a Negotiable Instrument**

Welcome to this podcast on Liability of the Parties on a Negotiable Instrument brought to you by CALI. I am Professor Jennifer S. Martin. The topic of this podcast is the basics of who is liable on a negotiable instrument and to whom. Why is this important? Oftentimes an examination question will simply ask who’s liable. It is important to use the correct legal terminology when describing responsible parties and claims and to organize claims either by responsible party or the party making the claim. In this podcast we will look at responsibility of drawers, makers, drawee banks, depositary banks, indorsers, transferees and presenters.

Whether a party has liability on an instrument typically involves three steps: (1) did the person sign the instrument; (2) in what capacity did they sign the instrument; and (3) to whom is liability owed.

Let’s begin with signing of an instrument. Most often liability on a negotiable instrument will turn on whether a party signed an instrument and in what capacity. The rule of § 3-401 makes clear that a person is not liable on an instrument unless they signed it themselves or an agent signed on their behalf. Moreover, the signature includes not only traditional signing of names, but also words, marks and symbols that authenticate a writing. While often times an examination question will disclose the fact that someone made a signature, be on the lookout for a problem where the signer made a thumbprint or other mark on an instrument. A thumbprint or other mark can qualify as the signature.

The capacity in which a person signs an instrument will tell us whether they have liability on an instrument and whether they might have a claim against another party. The parties that sign an instrument are most often drawers, makers, indorsers, an accepting bank, transferors, and presenters.

Let’s look at drawers. A drawer of a check will have liability as a signer of an instrument if the check is dishonored. If the draft is accepted then the drawer is discharged. A claim against a drawer may be made by a person entitled to enforce the draft (a PETE) or to an indorser who paid the draft after dishonor under § 3-415. For instance, presume I write a check for $35 to Sarah for my son’s clarinet lesson and the check is dishonored. Sarah as a PETE would be able to bring a claim against me as drawer of the check. This would be true even if the check was written on a joint account I have with my husband, Tom. Sarah could not bring a claim against Tom because he did not sign the check.

You might ask whether Sarah could circumvent the bank and just bring the check directly to me. The answer is no. When a payee takes a check for an obligation, under § 3-310, the obligation to pay the payee is suspended until dishonor. Meaning, Sarah will have to go to the bank and cannot ask me for the $35 unless the check is dishonored.

The same is true with respect to a maker of a note. A maker of a note has absolute liability according to the terms of the note as issued or as to an incomplete instrument, as completed. This liability is owed to a PETE or an indorser paying the instrument under § 3-415. Notice that with a note there’s no dishonor requirement because there’s no bank involved.

What about the drawee bank on a check? A drawee bank that does not sign an instrument does not have liability. With my check written to Sarah, if the drawee bank dishonors the check, the bank will have no liability and Sarah cannot bring a claim against the bank. This would be true even if the bank should have honored the check. Of course, if the bank wrongfully dishonors a check it may have liability to the account holder, me, under the rule of § 4-402. However, once the drawee accepts the check, meaning the drawee has signed it in a way to indicate its agreement to pay the check, the drawee then has liability and has agreed to pay it as presented according to the rules of § 3-413. A bank that certifies a check has accepted it under the rule of §3-409. We sometimes call the drawee that has accepted a check an acceptor. The liability of a drawee bank on a check is owed to a PETE, the drawer or an indorser who paid the draft.

Let’s turn to indorsers, meaning those who do not issue an instrument, but rather sign the instrument for the purposes of negotiation. Most often the signature is on the reverse side of the instrument. An indorser has liability on the instrument only if it has been dishonored and timely notice within 30 days of the indorsement is given. If there are multiple indorsers, the rule of § 3-415 holds each indorser liable to all prior indorsers. Liability is owed to any PETE or subsequent indorser obligated to pay on its own indorsement. Presume I write a check for $100 to my friend Scott. Scott, needing lunch money, indorses the back of the check and gives it to Sharlene in exchange for $95. Sharlene deposits the check at her bank, which presents it for payment. When my bank dishonors the check because I am short of funds, Sharlene may bring a claim against Scott under an obligation as an indorser.

Those who transfer an instrument, whether or not they indorse it, are called transferors and make a transfer warranty under § 3-416 and § 4-207. If the warranty is breached, then the transferor has liability. This liability is owed to later transferees in the chain, not including the payor bank. The transferor makes a warranty that includes, among other things, that the warrantor is a PETE, all signatures on the instrument are authentic and authorized and that the instrument has not been altered. Presume Thief steals a check from my mailbox made out to me, indorses it with a blank indorsement and sells it to Scott. Scott then sells the check to Sharlene. Putting aside the Thief, Scott would be a transferor who made a warranty to Sharlene that he was a PETE and that all signatures were authentic. Because the warranty is not true, Scott would have liability to Sharlene as a transferor. In this case, Scott might take the loss if he cannot find the Thief.

The payee and all other parties in the chain through the depositary bank are called presenters and make a presentment warranty under § 3-417 and § 4-208. If the warranty is breached, then the presenter has liability. This liability is owed only to the payor bank that makes payment or accepts the draft in good faith. Presentment warranties are slightly more narrow than transfer warranties and include, among other things, that the presenter is a PETE, the draft has not been altered and the presentor has no knowledge that the signature of the drawer is unauthorized. Recall the check stolen by Thief and transferred to Scott and Sharlene. If Sharlene deposits the check at Depositary Bank and Payor Bank honors the check, Depositary Bank, Sharlene, Scott and Thief will have made presentment warranties to Payor Bank. The presentment warranties would be breached because none of the parties would be a PETE due to the theft of the check from my mailbox.

Before we conclude, a word about the liability of representatives. Keep in mind that sometimes a representative of a business may be the signer and will bind the represented person under the rules of agency pursuant to § 3-402. The representative is not signing the instrument in their personal capacity and will not be liable on the instrument so long as the signature unambiguously indicates that it is made on behalf of the represented person. However, the representative could be liable as a signer of an instrument in their own capacity if the signature does not unambiguously indicate the representative capacity or the represented person is not identified in the instrument, unless the representative can prove that the original parties did not intend the representative to be liable on the instrument. That said, in cases of ambiguity, the representative will be liable to a holder in due course without notice of the representative capacity.

At this point, you should be able to describe who has liability on an instrument and to whom such liability is owed.

I hope you’ve enjoyed this podcast on Liability of the Parties.

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