

ABA Business Law Section
Uniform Commercial Code Committee
[General Provisions and Relation to Other Law Subcommittee](#)

Kristen David Adams, Chairperson

What Notice Does – and Doesn't – Mean

At the upcoming Spring 2009 Business Law Section Annual Meeting in Vancouver, the General Provisions and Relation to Other Law Subcommittee and the Sale of Goods Subcommittee will meet jointly, for the purpose of exploring the concept of notice. This brief article is meant as something of a preview of this discussion.

The recent case of *Rib Roof Metal Systems, Inc. v. National Storage Centers of Redford, Inc.*, 2008 WL 4104348 (E.D. Mich. 2008), serves as a useful reminder of what Article 1's definition of notice does – and does not – mean, as applied in the context of Article 3's definition of a holder in due course.

Plaintiff Rib Roof Metal Systems, Inc. filed suit seeking a declaratory judgment that it could keep almost \$140,000 that had been paid to it by check. The defendant and drawer of the check, National Storage Centers of Redford, Inc., had no relationship with Plaintiff but issued the check at the direction of a third party, Gary Gerrits ("Gerrits"). Gerrits accomplished this by fabricating an agreement under which Plaintiff, Defendant, and Gerrits were ostensibly all in a business relationship together. The sole purpose of the fabricated agreement was to fraudulently induce Defendant to issue the check in question to Plaintiff in payment of Gerrits' previous debt to Plaintiff in an entirely separate business enterprise. Plaintiff had no knowledge of Gerrits' deceit but was surprised to receive the check, as (1) Plaintiff did not believe Gerrits had the resources to repay the debt, and (2) Plaintiff had no business relationship with Defendant. Even so, Plaintiff deposited the check and filed the declaratory judgment action in question, seeking to establish its rights in the check as a holder in due course.

Plaintiff sought summary judgment on this claim, among others. Defendant responded with its own motion for summary judgment, seeking to establish, among other things, that Plaintiff could not satisfy the "notice" requirement of 3-302 (a) (2). To qualify as a holder in due course, this subsection requires that a holder give value and take an instrument in good faith "without notice" of the following:

(iii) . . . that the instrument is overdue or has been dishonored or that there is an uncured default with respect to payment of another instrument issued as part of the same series; (iv) . . . that the instrument contains an unauthorized signature or has been altered; (v) . . . of any claim to the instrument described in Section 3-306, and (v) . . . that any party has a defense or claim in recoupment described in Section 3-305 (a).

The question in the case at bar was whether Plaintiff had notice of Defendant's conversion and unjust enrichment claims under Section 3-306. In considering the issue, and in denying Plaintiff's motion for summary judgment on this count, the court applied Section 1-202 (a)'s definition of "notice":

Subject to subsection (f) [regarding notice to an organization], a person has "notice" of a fact if the person:

- (1) has actual knowledge of it;
- (2) has received a notice or notification of it; or
- (3) from all the facts and circumstances known to the person at the time in question, has reason to know that it exists.

Since the court found no evidence that Plaintiff had any actual knowledge of Gerrits' deception of Defendant and there was no indication that Defendant contended Plaintiff had received a notice or notification of Gerrits' conduct, its opinion centered on whether Plaintiff "had reason to know" of Gerrits' deception, "from all the facts and circumstances known to [Plaintiff] at the time in question." Specifically, Defendant contended that (1) Plaintiff knew Defendant had no involvement with the project giving rise to Gerrits' debt to Plaintiff and thus should have been suspicious of receiving payment from Defendant, (2) because Plaintiff knew of Gerrits' previous financial problems, Plaintiff had reason to be suspicious of the fact that he suddenly was able to repay the debt, and (3) along the same lines, Plaintiff knew Gerrits had not yet been paid on his transaction with Defendant.

In agreeing with Defendant that these facts precluded summary judgment for Plaintiff on its holder-in-due-course claim, the court distinguished cases such as *Grand Rapids Auto Sales, Inc. v. MBNA America Bank*, 227 F. Supp.2d 721 (W.D. Mich. 2002), involving an employee who wrongfully drew checks on her employer's account to pay her husband's credit card bills. Under facts like those presented in *Grand Rapids*, courts have routinely allowed banks who are the payees of such checks to retain the funds under a holder-in-due-course theory, finding that (1) there are many legitimate reasons why an employer might pay an individual's credit-card debt (as in the case of moving expenses, for example), and (2) automated processing of checks written for payment of credit-card bills is a commercially reasonable practice that precludes individual examination of each check. In the case at bar, by contrast, the facts showed that Plaintiff received and processed no more than one check per day. In addition, Plaintiff had failed to show any legitimate reason why Defendant might be paying Gerrits' debt. For these reasons, the court denied Plaintiff's motion for summary judgment on this count.

I see this case as a reminder that payees cannot ignore suspicious circumstances surrounding checks they receive and cannot rely on the fact that the face of the check itself shows no particular irregularity, other than the mysterious fact of its being issued by a party with no relationship to the payee. I also see this case as a warning that opinions like *Grand Rapids* may be limited to the specific circumstances of (1) automated check

processing and (2) employers' payment of employees' personal debts. Thus, payees must not assume that they can adopt a general strategy of refusing to follow-up on suspicious circumstances and relying on the holder-in-due-course doctrine to protect their interests.

I hope this article has provided some insight into how notice has been applied in the Article 3 context, and specifically the difference between notice and knowledge. At the Vancouver meeting, we will further explore the concept of notice, looking at the way in which the concept has been treated in different Articles of the UCC.

If there are particular cases (or articles) discussing the contours of notice that you would like us to incorporate into the April discussions in Vancouver, please send them my way at adams@law.stetson.edu. I hope to see many of you there.