**Instruments Signed for Accommodation**

Welcome to this podcast on Instruments Signed for Accommodation brought to you by CALI. I am Professor Jennifer S. Martin. The topic of this podcast is the obligations and rights of accommodation parties and accommodated parties under Article 3 of the Uniform Commercial Code (U.C.C.), including issues that arise with respect to the settlement of the obligation of the primary obligor. Why is this important? Guarantee transactions present themselves frequently in practice and, because issues can arise under Article 3, the issue sometimes comes up on the bar examination in terms of liability. The primary code provisions covered in this podcast are §§ 3-419 and 3-605, which you should read carefully. It is important to use the correct terminology when describing responsible parties and claims. In this podcast, we will examine accommodation parties and accommodated parties primarily, but these transactions can also involve the terminology maker, drawer, acceptor, or indorser.

Recall that most often the liability on a negotiable instrument will turn on whether a party has 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. 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. This basic hierarchy will be important when you are looking at instruments signed for accommodation.

Let’s begin with identifying the primary parties. An accommodation party is a person who signs an instrument to benefit the accommodated party, either by signing at the time value is obtained by the accommodated party or sometimes later. Moreover, an accommodation party is someone who is not a direct beneficiary of the value obtained for the instrument. An accommodation party is often a comaker on a promissory note or anomalous indorser. The accommodated party is the other party to an instrument, which signed the instrument for the purpose of incurring liability. Typically, a maker of a promissory note or a drawer of a check.

An instrument signed for accommodation is simply one where the instrument is issued for value given for the benefit of the accommodated party, and the accommodation party signed the instrument for the purpose of incurring liability, without being a direct beneficiary for the value given on the instrument. An accommodation party on an instrument may sign as maker, drawer, acceptor or indorser and is obligated to pay the instrument in the capacity in which the accommodation party signs. The obligation can be enforced, even without consideration for the accommodation or compliance with the statute of frauds. A party taking an instrument with words noting that the signer is acting as a surety or guarantor, is a notice that the instrument is signed for accommodation.

Let’s look at an example. Uncle sold Nephew a sandwich shop that Nephew had been managing for Uncle. Nephew paid for the shop with $10,000 cash and a $10,000 promissory note made payable to the order of Uncle. Nephew signed the note as maker. To show her faith in her son, Nephew’s mother, Mom, signed the note with the words Mom, as guarantor. Her signature appears on the front of the note, immediately below Nephew’s signature and under the additional word Guaranteed.

In this case, Uncle would be the payee on the promissory note. Nephew would be the maker of the promissory note and also an accommodated party. Mom would be the accommodation party. The promissory note was signed for accommodation because Mom incurred liability on the instrument when she signed it as guarantor, even though she was not a beneficiary of the value given to Nephew for the instrument, the sandwich shop. Mom would also be a maker of the note as she signed the front of the note as a person undertaking to pay. As a maker, she is obliged to pay the instrument when it is presented. If Nephew does not pay the promissory note and Mom does not have a defense, she’ll have to pay the amount due.

Let’s look at the liability of an accommodation party. Unless the guarantee is one of collection, rather than payment, an accommodation party is obliged to pay the amount due on an instrument to a person entitled to enforce the instrument (a PETE) in the same circumstances as the accommodated party would be obligated to, without resort to the accommodated party by the PETE. If the guarantee is unambiguously stated to be one of collection, then the accommodation party only has to pay a PETE if: (i) execution of judgment against the obligor is returned unsatisfied; (ii) the obligor is insolvent or in an insolvency proceeding; (iii) the obligor cannot be served with process; or (iv) it is otherwise apparent the payment cannot be obtained from the other party. However, an accommodation party that pays the instrument is entitled to reimbursement from the accommodated party and is entitled to enforce the instrument against the accommodated party. An accommodated party that pays the instrument, though, does not have recourse against the accommodation party.

So, how does all this work? Let’s go back to the sandwich shop hypothetical. Presume further that when they signed the note, Uncle, Nephew, and Mom orally agreed that Uncle would not seek payment of the note until the shop was making a good profit and that Uncle would negotiate the note only with Nephew’s and Mom’s consent. Three months after the note was signed and before any payment had been made, Uncle indorsed the note and sold it to Acme Finance Co. for $9,000 cash. Uncle did not obtain Nephew’s or Mom’s consent to this sale. Acme had no knowledge of the oral agreement among Uncle, Nephew, and Mom. Nephew has paid $1000 on the note.

So, what are the rights of the parties here? First, it’s important to note that any agreement not to seek payment on the note until the shop was making a profit was not reduced to writing and placed in the promissory note. As such, any defense of Mom on this point would be a personal defense arising under § 3-117 as a separate agreement modifying an obligation on a note, which would not be good against a holder in due course. Here, Acme Finance seems to be a holder in due course because they paid value, in good faith and without notice of the defense. Acme Finance can enforce the note without reference to the oral agreement.

Second, Mom as an accommodation party will have liability on the note under the rule of §3-419. Although the face value of the note was $10,000, Mom’s liability will be $9000 as it is reduced by the amount paid on the debt by Nephew.

Sometimes, when an accommodated party is unable to pay an instrument, they might seek to settle the debt for a lesser amount. Of course, this raises issues about the responsibility of the accommodation party. Under the rule of § 3-605 when a PETE releases the obligation of the principal obligor to pay the instrument, the secondary obligor is also discharged to the same extent as the principal obligor from any unperformed portion of the obligation of the instrument. A PETE that settles a debt can retain rights against the secondary obligor, the accommodation party, by specifying in the release. Absent an explicit retention of rights, though, the secondary obligor is released.

Back to the sandwich shop. Presume now that when Acme sought payment from Nephew, Nephew persuaded Acme that any effort to collect full payment from him would be futile. Acme, therefore, gave Nephew a written release from his obligations under the note in exchange for the payment of the $1,000. Acme then brought suit against Mom for payment of the $9,000 still due on the note.

Now, Mom will not have liability as an accommodation party on the note. Acme accepted $1000 and released Nephew from his obligation on the note. Mom, as the secondary obligor or accommodation party, is also discharged by the release. Acme did not expressly retain any rights against Mom.

At this point, you should be able to describe who are the parties when there is an accommodation, as well as when an accommodation party will have liability on an instrument, particularly when there is a settlement.

I hope you’ve enjoyed this podcast on Instruments Signed for Accommodation.

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