***First Wednesday* — A Monthly Discussion of Employment Law Issues and Other Hot Topics for Management**

By Jeffrey A. Snyder - Issue No. 8: March 5, 2003

Jeff is a Shareholder of Thoits, Love, Hershberger & McLean,
specializing in employment law and commercial litigation.
He can be reached at (650) 327-4200 or jsnyder@thoits.com.

Beware the "Payment-In-Full" Check

An employee owes his employer some principal and interest due on a promissory note. The parties seek to have the entire note repaid early, but disagree on the amount owing. The employee tenders a check for the lesser amount, which he believes to be the correct amount owing. Written on the back of the check is the phrase "Given in full and final satisfaction of the Promissory Note dated February 11, 2003." The employer crosses out the phrase, cashes the check, and then sues for the balance. What is the likely outcome in court?

The employee wins this case based on the "accord and satisfaction" rules in the Uniform Commercial Code ("the Code"). The Code (Section 3311) describes this procedure as an informal method of dispute resolution carried out by the use of a negotiable instrument, typically a check. Upon receiving the check, the employer was faced with a choice. Either accept the check in full satisfaction of the claim, or return the check and sue for the full balance. But the creditor (the employer in this case) cannot have it both ways – cashing the check in part payment and filing a lawsuit.

Recent California case law has confirmed that the Code's treatment of this issue is controlling and that a previously-enacted statute, California Civil Code section 1526, does not apply. Section 1526 describes a time-honored cross-out procedure but, since the Commercial Code does not allow it, the cross-out procedure is unreliable and, most likely, legally unenforceable.

What Elements are Needed to Create a Binding "Accord and Satisfaction?"

The Code requires the debtor (the employee in my hypothetical) to prove each of the following: (1) the check was tendered in "good faith" in full satisfaction of the claim; (2) the amount of the claim was unliquidated (unsettled) or subject to a bona fide dispute; and (3) the check cleared. With some exceptions (discussed below), if these elements are shown, the claim is satisfied and discharged if the check or an accompanying written communication includes a "conspicuous statement" stating that the instrument is given in full satisfaction of the claim. Typically, a phrase such as "for full and final settlement of your claim regarding _X_" is written on the check itself. An explanatory letter can also be sent with the check.

Several factual issues are raised by this procedure. For example, what is meant by "good faith" and what is a "conspicuous statement." Courts will address these issues on a case-by-case basis, but the following Code definitions will be applied.

"Good faith" means honesty in fact and the observance of reasonable commercial standards of fair dealing. It would not be in "good faith," for example, if a debtor routinely tendered partial checks bearing pre-printed language that acceptance constitutes full satisfaction of any and all claims.

A statement is considered "conspicuous" if it is so written that a reasonable person against whom it is to operate should have noticed it. Thus, if an individual is cashing the check, the "paid-in-full" statement should appear on the back of the check, near the endorsement line where the person will sign the check. In the case of a business entity, however, it might be more conspicuous and reasonable for the statement to appear on the front of the check.

An explanatory letter sent with the check might help the debtor prove "good faith," "bona fide dispute" and "conspicuousness" under the particular facts and circumstances.

What are the Exceptions?

The Code provides two exceptions to the creation of an accord and satisfaction by mere acceptance of a check or instrument. These exceptions are designed to protect creditors from inadvertent cashing of "paid-in-full" checks.

In the first exception, an organization can protect itself by sending out a pre-dispute notice stating that all communications regarding disputed debts (including "paid-

in-full" checks) must be sent to a designated person, office or place. If these conditions are not met, then the "paid-in-full" check, even if cashed, will not create an accord and satisfaction scenario.

Alternatively, in the second exception, within ninety (90) days after receiving payment on the check, the creditor can avoid accord and satisfaction treatment by repaying the debtor the full amount of the check. Essentially this gives the creditor some time to catch its mistake, refund the money and start over (by demanding full payment, negotiating further or suing).

Finally, there is a Code section that trumps both exceptions. Thus, even if either exception were to otherwise apply, if the debtor can prove the creditor knew a "paid-in-full" check was made in full satisfaction of a claim, then the claim is satisfied and discharged. Here, the debtor must prove that the creditor had "actual knowledge" of the fact that the debtor intended her partial payment to fully satisfy the claim. For example, a customer making partial payment based on a claim that the goods purchased in a retail outlet of a large chain store were somehow defective, might need to show that the retail personnel saw her "paid-in-full" check, as opposed to the CEO, who would typically lack knowledge of the details of such a transaction.

Summary

Any creditor in a dispute situation should be on the lookout for checks purporting to make "payment-in-full." Creditors cannot safely rely on the "cross-out" procedure (cashing the check, then suing for the remainder). Instead, the creditor should either return the check and pursue the full balance or cash the check and give up any claim to the remainder.

For the debtor in a dispute situation, proper use of the "payment-in-full" check procedure might achieve a "poor man's release," where the parties cannot come to final terms or neither side wants to prepare a full-blown written release. While the partial payment check might be worth an attempt, if the goal is to achieve finality, it is nowhere near as good protection as using a properly written "release" document, signed by the debtor and creditor, releasing any and all claims in exchange for the payment.

(© Jeffrey A. Snyder and Thoits, Love, Hershberger & McLean)

First Wednesday Distribution List:

- If you are not receiving this newsletter directly, please send me your e-mail address and I will add you to the First Wednesday Distribution List.

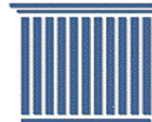
- If you no longer want to receive this newsletter, please send me an e-mail with "Remove" in the subject line.

- If you would like this newsletter redirected to others within your organization, please send me their e-mail addresses.

- First Wednesday is a publication of general applicability and not specific to any set of facts. Thus, it should not be relied upon for any specific case or matter without further discussion. No attorney-client relationship is formed as a result of your reading or replying to this newsletter, which is not intended to provide legal advice on any specific matter, but rather to provide insight into current developments and issues.

Jeffrey A. Snyder
Thoits, Love, Hershberger & McLean
245 Lytton Avenue, Suite 300
Palo Alto, California 94301-1426
Telephone: (650) 327-4200
Facsimile: (650) 325-5572
E-mail: jsnyder@thoits.com

THOITS
LOVE
HERSHBERGER
& McLEAN
Attorneys at Law



A Professional Corporation