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“PAYMENT IN FULL” CHECKS – PROCEED WITH CAUTION

How many times has this happened to you: You send a bill to a customer in a specific sum. The customer sends you a check for less than the total amount owed with the words “full and final payment” on the check. Now you face a dilemma. If the customer has an obligation that has remained unpaid for some time, you are no doubt relieved to receive any payment at all. However, considering the amount of the check is only for a portion of the full amount owing, what do you do? Do you return the check to the customer and risk waiting further for the customer to deliver a new check for the full amount owing, or, worse, not receiving any payment at all? Do you strike out the “payment in full” notation or other restrictive endorsement, deposit the check, and pursue payment of the balance due?

For many years, businesses and other creditors faced this dilemma without clear guidance concerning how they should proceed and without certainty about the ramifications of their actions. This ambiguity was the result of a conflict between two bodies of California law: Section 1526 of the California Civil Code, enacted in 1987, and Section 3311 of the California Commercial Code, enacted in 1992.

Under California Civil Code Section 1526, a creditor could cash a check written for less than the full amount owing and reserve its rights to pursue the debtor for the remaining balance, if, prior to cashing said check, the creditor strikes the “payment in full” language and designates (on the check and/or in a subsequent notice to the debtor) that the check is being accepted and deposited “under protest” or “without prejudice.”

However, under Commercial Code Section 3311, if a debtor, in good faith, tenders a check as payment in full (when the check amount is less than the amount the creditor believes is due and owing) with written notice, either on the face of the check or in an accompanying letter, that the check is intended as full satisfaction of the debt owed by the debtor to the creditor, then the debtor’s obligation is discharged in full if the check is deposited by creditor. The check tendered by the debtor constitutes a counteroffer to the demand of the creditor for payment and the cashing of the check constitutes the creditor’s acceptance of the debtor’s counteroffer. Under Commercial Code Section 3311, the creditor has two choices, either: (1) reject the check and pursue a claim for what it believes is the full amount owing; or (2) accept the check and waive its rights to seek recovery of the balance. It is irrelevant under the Commercial Code whether the creditor strikes the “payment in full” notation or whether the creditor informs the debtor that it is accepting the check as partial, and not full, payment, prior to negotiating the check.

The conflict with the two statutes appears to have been resolved in 2002, when the Court in Woolridge v. J.F.L. Electric (2002) 96 Cal.App.4th Supp. 52, held that, where a check marked “full and final payment” but written for a sum less than a creditor believes was actually owed is tendered by a debtor in good faith as full payment for its obligations, the cashing of the check by the creditor constitutes acceptance of the amount on the check as full payment and discharges any claim by the creditor for recovery of any additional funds. Woolridge, 96 Cal.App.4th Supp. at 60-61. In Woolridge, the Court acknowledged that both statutes

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PAYMENT IN FULL CHECKS (cont'd)

were applicable, but held that, because the conflict between the two statutes could not be harmonized and since it was the most recently enacted of the two statutes, California Commercial Code Section 3311 governed. *Id.* at 60. Although the Court in *Woolridge* did not explicitly repeal Civil Code Section 1526, its holding has been recognized as repealing it by implication. Therefore, cashing of a check containing a "payment in full" notation or other similar restrictive endorsement is deemed as acceptance that the amount on the check settles the entire debt and constitutes a waiver of any claims the creditor may have to seek additional payments.

The lesson of *Woolridge* and California Commercial Code Section 3311 is that you should think twice before striking the "full payment" or similar endorsement on checks. Even though turning down any payment is difficult to do when dealing with delinquent accounts, cashing a check bearing any type of restrictive endorsement will serve to release all claims you possess against the debtor for additional funds. If you decide to accept the check and waive your right to seek payment of the balance of the obligation, you should consider obtaining an appropriate mutual release from the

debtor to protect yourself against any claims which the debtor might wish to bring against you in connection with the goods, services or acts giving rise to its obligation to pay.

On the other hand, if you decide not to cash the check, you should either return the check immediately with a demand for full payment and the amount constituting full payment or retain the check while negotiating further payment. If you decide to hold on to the check and attempt to negotiate with the debtor for payment of the additional funds, you should notify the debtor in writing that you are retaining the check for a short period of time in order to negotiate a mutually agreeable resolution. If the negotiations fall through, you should return the check immediately, since holding on to the check for a long period or after negotiations have failed, may expose you to a claim by the debtor that your retention was presumed to be acceptance of the check in full satisfaction of the entire obligation.

The decision whether or not to cash a check for less than the total amount due as "full and final payment" is, ultimately, a business decision. However, depending on the circumstances surrounding your receipt of a check containing such a restrictive endorsement, you should consult an attorney to discuss how you should proceed. As briefly set forth in this article, the manner in which you accept such a check and/or the ramifications of and risks that may arise with respect to acceptance or rejection of the same has significant legal consequences involving both claims you may have against debtor and any claims debtor may have against you.

The information presented here is intended as a brief summary of the impact of restrictive endorsements on checks. It is provided as a general overview and not meant to suggest that it will have exact application to every creditor's or business owner's situation. If you have specific questions concerning "full payment" checks or questions regarding the particulars of your situation, please contact Frances F. Yee at *Figgevald Abbott & Beardsley LLP* by telephone at (510) 451-3300 or by e-mail.