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The "Demandable" Note and the Obligation of Good Faith

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Recent cases have illustrated a significant confusion about promissory notes: whether there is any difference between a note payable at a certain time, but containing a clause allowing the holder to mature the note at his absolute discretion at any time, and a note payable "on demand, but if no demand is made," on a definite date or dates. The authors refer to the second type of instrument as a "demandable note" and consider the implications on it of the statute of limitations and the requirement of "good faith."

The article concludes with some practical drafting suggestions to further alleviate the uncertainty brought about by recent cases such as K.M.C. Co. v. Irving Trust Co. *and assure the demand character of the note.*

Case law, developed over the centuries and embodied in the Uniform Commercial Code, defines a demand note as one that entitles the holder, by the note's express terms, to the unrestricted and unilateral right to determine the time for payment.[1] That same case law, however, has created certain rules that limit the right of the holder, as otherwise expressed in the note, to indefinitely delay the note's due date.[2] Because of such rules, a

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The reader will note that the authors, Texas attorneys, have tended to favor Texas case citations in this article when available. Except in rare instances, the authors were unable to find any appreciable difference in the approach of the courts in the various common-law states to the basic issues discussed here. Accordingly, although this article may have a decidedly Texas flavor, its applicability is not so limited.

[1] See notes 30-49 *infra* and accompanying text. The definition set forth previously is derived from, but not directly stated in, the sources cited.

[2] See notes 60-75 *infra* and accompanying text.

demand note is deemed due the date it is made, and in the absence of an express contrary intent (other than merely providing for payment "on demand"), no actual demand is necessary prior to instituting suit against the maker.[3]

Over time, significant confusion has developed in applying these basic rules to those demand notes that are most commonly used in lending transactions, specifically, those demand notes that provide for payment on demand, or in its absence, in installments. Are such notes true "demand instruments," or are they, in reality, installment or term notes subject to acceleration "at will," to which the obligation of good faith imposed by Section 1-208 of the UCC is applicable? Though not answering the question, the Sixth Circuit's recent decision in *K.M.C. Co. v. Irving Trust Co.*[4] served to illustrate the confusion when, in dicta, the court analogized the demand feature of a financing agreement to an acceleration clause.

Irving Trust, a significant decision in the area of lender liability,[5] was a suit by a wholesale grocer against a lender for damages based on the lender's refusal to fund a requested advance under a financing agreement. The financing agreement provided that all advances were at the lender's discretion and were repayable "on demand."[6] Because of the compelling facts of *Irving Trust,* the Sixth Circuit affirmed a $7.5 million judgment in favor of the grocer, despite the express discretion granted to the lender in making advances under the financing agreement. Those compelling facts included the nature of the wholesale grocery business[7]; the agreed means of funding to cover checks already written[8]; the "blocked account" arrangement whereby all of the

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[3] See *infra* note 49.

[4] 757 F.2d 752 (6th Cir. 1985).

[5] See, e.g., *Emerging Theories of Lender Liability* (H. Chaitman ed. 1987); Tyler, "Emerging Theories of Lender Liability in Texas," 24 Hous. L. Rev. 411, 416-418 (1987); Ebke & Griffin, "Lender Liability to Debtors: Toward a Conceptual Framework," 40 Sw. L.J. 775, 776-777 (1986).

[6] Irving Trust, 757 F.2d at 759; see also District court memorandum op. at 2, *reprinted in* 1 *Emerging Theories of Lender Liability,* note 5 *supra,* at 84.

[7] The nature of the wholesale grocery business is such that inventory is sold very rapidly by the wholesaler to retailers. District court memorandum op. at 6, *reprinted in* 1 *Emerging Theories of Lender Liability,* note 5 *supra,* at 88 (quoting testimony of Connolly).

[8] During the period between May 31, 1979 and March 1, 1982 (the date the requested advance was refused), there developed a "consistent and uninterrupted course of dealing

grocer's income was deposited into an account under the lender's control to pay down the loan, thereby depriving the grocer of any source of funds other than through advances under the financing agreement[9]; the lack of any notice to the grocer prior to refusing funding under the financing agreement[10]; and the fact that the lender was fully secured by a security interest in all of the receivables and inventory of the grocer.[11] In affirming the judgment in favor of the grocer, however, the Sixth Circuit merely held that under the facts present, an implied obligation of good faith limited the absolute discretion of the lender to refuse funding under the financing agreement, such obligation of "good faith" requiring "a period of notice to [the grocer] to allow it a reasonable opportunity to seek alternate financing, absent valid business reasons precluding [the lender] from doing so."[12]

Despite the stated limits of its holding, the Sixth Circuit felt obliged to address the lender's argument on the "demand" feature of the financing agreement. According to the court, the lender's argument was "that an implied requirement that the bank provide a period of notice before discontinuing financing up to the maximum credit limit would be inconsistent with the provision in the agreement that all monies loaned are repayable on demand."[13] In rejecting the lender's argument as to the effect of the demand provision, however, the court concluded as follows:

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between the parties" (757 F.2d at 759) whereby the grocer would purchase its replacement inventory by writing checks to its suppliers. District court memorandum op. at 12, *reprinted in* 1 *Emerging Theories of Lender Liability*, note 5 *supra*, at 94; Plaintiff's Complaint at 3-4, *reprinted in* 1 *Emerging Theories of Lender Liability*, note 5 *supra*, at 581-582. The grocer's checks would then be "covered" by the lender advancing funds under the financing agreement by wire transfer to the grocer's account. *Id.* The amounts advanced by the lender "on a daily basis" averaged several hundred thousand dollars. *Id.*

[9] 757 F.2d at 759, 761; see also Plaintiff's Complaint at 2-3, *reprinted in* 1 *Emerging Theories of Lender Liability*, note 5 *supra*, at 580.

[10] 757 F.2d at 759.

[11] *Id.* at 762. Indeed, an audit conducted a few months prior to March 1, 1982 disclosed that even in a liquidation of the grocer, the lender would suffer no loss. *Id.* Because the inventory was readily marketable, the loan balance would quickly be repaid "on demand" as inventory was sold. *Id.*

[12] *Id.* at 759.

[13] *Id.*

> We agree with the Magistrate that just as [the lender's] discretion whether or not to advance funds is limited by an obligation of good faith performance, so too would be its power to demand repayment. The demand provision is a kind of acceleration clause, upon which the Uniform Commercial Code and the courts have imposed limitations of reasonableness and fairness.[14]

Because the lender had not "called" the loan[15] but rather had refused additional advances thereunder, the foregoing language from *Irving Trust* is clearly dictum.[16] In rendering this dictum, however, the Sixth Circuit relied on Section 1-208 of the UCC[17] and on *Brown v. Avemco Investment Corp.*,[18] a Ninth Circuit case purporting to apply Texas law.

Although at least one author has predicted that the *Irving Trust* dictum may be a forerunner of future decisions whereby "the strict standards now applied to installment debt will likewise be applied to demand debt,"[19] well-reasoned support for the *Irving Trust* dictum cannot be found either in Section 1-208 of the UCC or in *Brown*.

Section 1-208 provides as follows:

> A term providing that one party or his successor in interest may accelerate payment or performance or require collateral or additional collateral "at will" or "when he deems himself insecure" or in words of similar impact shall be construed to mean that he shall have the power to do so only if he in good faith believes that the prospect of payment or performance is impaired. The burden of establishing lack of good faith is on the party against whom the power has been exercised.[20]

This section appears designed to protect the expectancies of the parties to a term or installment note or contract when, despite the existence of a clause giving one party the right to require performance immediately, the parties are presumed to intend

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[14] *Id.* at 760 (citing U.S.C. § 1-208 and Brown v. Avemco Inv. Corp., 603 F.2d 1367, 1375-1380 (9th Cir. 1979)).

[15] Indeed, the lender consistently maintained throughout the trial that it had not "called" the loan. District court memorandum op. at 10, *reprinted in* 1 *Emerging Theories of Lender Liability*, note 5 *supra*, at 92.

[16] See also Reply Brief of Appellant in Centerre Bank v. Distributors at 20, *reprinted in* 2 *Emerging Theories of Lender Liability*, note 5 *supra*, at 816.

[17] U.C.C. § 1-208.

[18] 603 F.2d 1367 (9th Cir. 1979).

[19] W. Baggett, *Texas Foreclosure Law & Practice* § 1.03 (1984).

[20] U.C.C. § 1-208.

that the party having such right to "accelerate" may not do so, absent an indication that the other party will not be able to perform in the time and manner originally agreed.[21] As will be discussed in detail later in this article, however, the parties to a demand note have contracted for a debt that is always due and payable, not a debt that is originally payable at a definite date or dates during a specified term.[22] Accordingly, a demand note is not subject to acceleration.[23] As a result, application of Section 1-208 to a demand note would result in a holder being unable to enforce payment despite the note being presently due, until he honestly believed the likelihood of collecting the note was in doubt. By applying Section 1-208 to a demand note, the holder could not enforce payment until the maker was less able to pay. This result is totally inconsistent with the policy behind the rules that govern demand notes.[24]

Consequently, the official comments to Section 1-208 of the Code clarify that it was not intended that "demand instruments" be covered by the section. The official comments provide that the section "[o]bviously has no application to demand instruments or obligations whose very nature permits call at any time with or without reason. This section applies only to an agreement or paper which in the first instance is payable at a future date."[25]

Brown, the Ninth Circuit case, likewise lends no support to the *Irving Trust* dictum.[26] *Brown* held that under Texas common law[27] and pursuant to Section 1-208 of the Code, the exercise of an option to accelerate a debt, even upon the occurrence of an express event of default, was subject to reasonableness and good faith. There was no statement in *Brown,* however, even hinting at its application to a "demand" note. Acceleration may be a

[21] See Annotation, "What Constitutes 'Good Faith' Under Uniform Commercial Code § 1-208 Dealing With 'Insecure' or 'At Will' Acceleration Clauses," 61 A.L.R.3d 244 (1975).

[22] See note 47 *infra*.

[23] See note 48 *infra*.

[24] See notes 60-75 *infra* and accompanying text.

[25] U.C.C. § 1-208 comment.

[26] Brown v. Avemco Inv. Corp., 603 F.2d 1367 (9th Cir. 1979).

[27] Texas common law does impose certain conditions on the exercise of "acceleration clauses." See, e.g., Davis v. Pletcher, 727 S.W.2d 29 (Tex. Ct. App. 1987) (writ ref'd n.r.e.). Nevertheless, none of those conditions appear to be applicable to "demand" notes.

harsh remedy that equity will prevent from being exercised oppressively to frustrate the parties' bargained-for objectives, but parties to a demand note have bargained for a note that is due immediately.

Perhaps the only explanation[28] for the *Irving Trust* dictum is that under its peculiar facts, the obligations evidenced by the financing agreement were not in reality payable "on demand" despite the apparent existence of a demand note. Instead, they were payable "in the first instance . . . at a future date" (i.e., the date each group of inventory was sold and the proceeds were deposited into the "blocked account"[29]), with the "demand" provision being equivalent to a clause permitting the lender to "accelerate" payment of the debt "at will" prior to the date it would otherwise become due "in the first instance." This explanation is not stated in *Irving Trust*, nor is it endorsed by this article, but the possibility of this explanation and its potential application to notes thought by many to be "demand" notes, free from the good-faith requirements of Section 1-208, formed the basis for this article.

This article will examine the history and current law applying to "demand instruments" and will thereby answer whether there is any difference between a note payable at a certain time, but containing a clause allowing the holder to mature the note at his absolute discretion at any time, and a note payable "on demand, but if no demand is made," on a definite date or dates.

Basic Principles Governing Demand Notes

The Demand Note Defined

Section 3-108 of the Code states: "Instruments payable on demand include those payable at sight or on presentation and

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[28] Actually, there is another explanation: The Sixth Circuit was wrong. See Spencer Cos. v. Chase Manhattan Bank, N.A., 81 Bankr. 194 (D. Mass. 1987); Flagship Nat'l Bank v. Gray Distribution Sys., Inc., 485 So. 2d 1336, 1340 (Fla. Dist. Ct. App. 1986), *reh'g denied*, 497 So. 2d 1217 (Fla. 1986).

[29] The financing agreement and the "blocked account" had the effect of modifying the otherwise expressed due date ("on demand") of the note. See, e.g., Weaver v. Weaver, 171 S.W.2d 898 (Tex. Civ. App. 1943) (writ ref'd w.o.m.).

those in which no time for payment is stated."[30] Obviously, "demand instruments also include instruments made expressly payable 'on demand.' "[31] Notes providing for payment "when called for,"[32] "on demand or 180 days,"[33] "on demand after date,"[34] "one year or upon request after date,"[35] "in any time within six (6) years from this date,"[36] "on demand, after three months' notice,"[37] and "when demanded"[38] are likewise all demand notes[39] because the holder has the express right to determine the time for payment.

A note in which the date for payment has been left blank is also a demand note because no time for payment is specified.[40] Accordingly, inserting the words "on demand" into the blank originally left for the payment date of a note is not a material alteration of such note because the note is a demand note with or without the added phrase.[41]

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[30] U.C.C. § 3-108. "Instrument" is defined in U.C.C. § 3-102 as "a negotiable instrument." The authors, however, have been unable to discern any difference between the treatment of nonnegotiable "demand" notes and negotiable "demand" notes in the cases, the UCC apparently embodying the common law with respect to demand notes. In any event, a note is still a note even if it is nonnegotiable. Mauricio v. Mendez, 723 S.W.2d 296 (Tex. Ct. App. 1987) (no writ); Strom v. Dickson, 360 S.W.2d 823 (Tex. Civ. App. 1962) (no writ). "A note is a written unconditional promise to pay another a certain sum of money at a certain time, or at a time which must certainly arrive." FDIC v. Eagle Properties, Ltd., 664 F. Supp. 1027, 1034 (W.D. Tex. 1987). Nevertheless, U.C.C. § 1-208 may not apply to a nonnegotiable note because nonnegotiable notes are not within the coverage of the Code. A nonnegotiable note secured by an Article 9 security interest, however, would appear to be within the coverage of § 1-208.

[31] Seattle-First Nat'l Bank v. Schriber, 282 Ore. 625, 580 P.2d 1012, 1013 (1978) (citing 2 R. Anderson, *Anderson on the Uniform Commercial Code* § 3-108.4 (3d. ed. 1981); cf. Bank of Nova Scotia v. St. Croix Drive-In Theater, Inc., 552 F. Supp. 1244, 1249 (D.V.I. 1982), *aff'd*, 728 F.2d 177 (3rd Cir. 1984) (merely to state that a note is payable "on demand" does not make it so).

[32] Eborn v. Zimpleman, 47 Tex. 503 (1877), *cited in* Annotation, 71 A.L.R.2d 284, 301 (1960).

[33] Stavert Properties, Inc. v. Republic Bank, 696 S.W.2d 278 (Tex. Ct. App. 1985) (writ ref'd n.r.e.).

[34] United States Rubber Co. v. Engle, 153 S.W.2d 983 (Tex. Civ. App. 1941) (no writ), *cited in* Annotation, note 32, *supra*, at 298.

[35] Brown v. First Nat'l Bank, 261 Ala. 565, 75 So. 2d 141 (1954), *cited in* Annotation, note 32 *supra*, at 301.

[36] Young v. Weston, 39 Me. 492 (1855), *cited in* Annotation, note 32 *supra*, at 301.

[37] Knapp v. Greene, 79 Hun. 264, 29 N.Y.S. 350 (N.Y. 1894), *cited in* Annotation, note 32 *supra*, at 301.

[38] Kingsbury v. Butler, 4 Vt. 458 (1832), *cited in* Annotation, note 32 *supra*, at 301.

[39] See also 10 *C.J.S.* "Bills & Notes" § 247 (1936).

[40] E.g., Gill v. Commonwealth Nat'l Bank, 504 S.W.2d 521, 523 (Tex. Civ. App. 1973) (writ ref'd n.r.e.).

[41] Holliday v. Anderson, 428 S.W.2d 479, 480 (Tex. Civ. App. 1968) (no writ).

Despite its failure to state a specific date for payment, however, a note payable "after date at [the maker's] convenience" is not a demand note.[42] Notes payable "at the earliest possible time," "as soon as circumstances permit [the maker]," "when [the maker] was able," or "as soon as [the maker] could" are likewise not demand notes.[43] Rather, payment of such notes is conditioned upon the occurrence of the event described with respect to the maker, the holder not having the absolute right to determine when the note is payable.[44]

As previously stated, a demand note is any note that entitles the holder to the unrestricted and unilateral right to determine the time for payment in the first instance. By virtue of the application of common-law rules developed as early as the sixteenth century[45] and embodied in the UCC,[46] however, such a note is nevertheless due and owing the date it is made.[47] Because a demand note is due and owing the day it is made, it is not subject to acceleration, as it begins and remains due and payable throughout its existence.[48] Likewise, despite its name, the demand note ordinarily requires no prior actual demand to enforce its payment.[49] Accordingly, the holder of a demand note faces acute problems regarding the application of the statute of limitations governing the enforcement of debts. Although a demand

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[42] Charles H. Netherson Co. v. Oklahoma Waste Material Co., 258 S.W.2d 369 (Tex. Civ. App. 1953) (writ ref'd n.r.e.).

[43] Williams v. Cooper, 504 S.W.2d 564, 566 (Tex. Civ. App. 1973) (no writ).

[44] *Id.* at 566.

[45] E.g., Capp against Lancaster, Cro. Eliz. 548, 78 Eng. Rep. 794 (1597); see also J. Holden, *The History of Negotiable Instruments In English Law* 109 (1955), in which the author notes that by the early 1700s, the basic rule applicable to a promissory note payable on demand (i.e., that no demand other than action brought is necessary to enforce payment) was being formulated. *Id.* at 109 (citing Capp and Rumball against Ball, 10 Mod. R. 38, 88 Eng. Rep. 616 (1711)).

[46] See note 51 *infra*.

[47] E.g., Cook v. Cook, 19 Tex. 434 (1857); Henry v. Roe, 18 S.W. 806 (Tex. 1892).

[48] Put another way, to the extent acceleration of a "demand" note is possible, "acceleration occurs concurrently with the execution of the loan documents." Weissman, "Lender Liability: The Obligation to Act in Good Faith and Deal Fairly," J. Com. Bank Lending (1986), *reprinted in* 4 *Emerging Theories of Lender Liability*, note 5 *supra*, at 181, 189.

[49] "As the term [demand instrument] applies to the maker of a note, it is somewhat anomalous since no demand need be made by the holder." Hart & Willier, "Commercial Paper," in 2 Bender's U.C.C. Serv. § 5.02[2] (1988); see also W. Hawkland, *UCC Series* § 3-122:03 ("Since there is no requirement that the holder make demand before commencing an action, the name 'demand' instrument is a misnomer.").

note "permits call at any time with or without reason"[50] by being deemed due the date it is made, such a "call" must generally be made within the applicable limitations period measured from the date of the note.

The Statute of Limitations and the Demand Note

Section 3-122(a)(2) of the Code provides that a cause of action against a maker of a demand instrument accrues "upon its date or, if no date is stated, on the date of issue."[51] Indeed, as previously stated, it has long been recognized that a demand note is due immediately upon execution, and no actual prior demand is necessary to bring an action to enforce its payment.[52] Accordingly, a demand provision ordinarily constitutes "a waiver of not only presentment, notice of dishonor, and protest, but also demand upon the maker."[53] As a result, the statute of limitations normally begins to run immediately on the date of a demand note.[54]

Despite the fact that an ordinary demand note is due immediately, such a note may require an actual demand as a condition precedent to the accrual of the cause of action thereon (by express language in addition to or in place of the words "on demand").[55] Accordingly, in *Schruam v. Nolte*,[56] a note dated April 26, 1872 and payable "after a six month's notice is given" was held to require an actual notice or demand prior to the accrual of the cause of action thereunder and the commence-

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[50] U.C.C. § 1-208 comment.

[51] U.C.C. § 3-122(2)(b).

[52] See note 45 *supra*; see also note 47 *supra*.

[53] Knick v. Green, 545 S.W.2d 269, 272 (Tex. Civ. App. 1976) (writ ref'd n.r.e.).

[54] See, e.g., Estate of Amend, 107 Misc. 2d 497, 435 N.Y.S.2d 235 (Sup. Ct. 1980); Shields v. Prendergast, 36 N.C. App. 633, 244 S.E.2d 475 (1978); *In re* Culver's Estate, 26 Ore. App. 809, 554 P.2d 541 (1976); DiBattista v. Butera, 104 R.I. 465, 244 A.2d 857 (1968); National Bank v. Preston, 16 Wash. App. 678, 558 P.2d 1372 (1977); Cantonwine v. Fehling, 582 P.2d 592 (Wyo. 1978). But see Fla. Stat. Ann. § 95.031 (West 1986) (statute of limitations on demand note does not begin to run until a written demand for payment is made).

[55] Cook v. Cook, 19 Tex. 434, at 438 (1857); Mallin v. Spickard, 105 Ga. App. 561, 125 S.E.2d 93 (1962); Belhaven College v. Downing, 216 Miss. 299, 62 So. 2d 372 (1953); C&T Discount Corp. v. Sawyer, 123 Vt. 238, 185 A.2d 462 (1962); Hopper v. Hemphill, 19 Wash. App. 334, 575 P.2d 746 (1978) (dicta).

[56] 1 Tex. Civ. Cas. 657 (Civ. App. 1881).

ment of the statute of limitations.[57] Nevertheless, the court held that such actual notice or demand must be given within a reasonable period of time after the date of the note in order for the statute of limitations to run from the date of such actual notice or demand as opposed to the date of the note.[58] Therefore, even when an actual demand is required, the "reasonable period" within which an actual demand must be made is ordinarily the period of limitations otherwise applicable to a demand note for which no prior actual demand is necessary.[59]

The apparent purpose behind the requirement of an actual demand within a reasonable period after the date of the note is to prevent the holder of such a note from thwarting the purpose of the statute of limitations as applied to demand notes. That purpose was described in the early Supreme Court of Michigan case of *Palmer v. Palmer*.[60] In *Palmer,* the lower court had concluded that the statute of limitations did not begin to run against a note payable "thirty days after demand" until an actual demand was made.[61] Accordingly, even though the applicable statute of limitations was six years, the note was dated October 16, 1867, and demand was not made until May 22, 1874, the lower court concluded that suit on the note "was not barred."[62] In discussing the holding of the lower court, the Supreme Court of Michigan stated as follows:

> If the judgment is correct, it can only be so because, by the terms of the contract the holder had a right to postpone the maturity of the debt as long as he chose to do so. *For if the debt did not become payable until fixed by demand, and the demand was optional with the creditor, no tender could be made which would bind him, and he could keep the debt alive in spite of the debtor, for an indefinite period.* If there was any infirmity in the consideration, or any defect in the binding character of the obligation, he

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[57] *Id.* Interestingly, cases construing similar language have held that while the notice requirement is a condition to the bringing of suit by the payee against the maker, the statute of limitations nevertheless begins to run on the date of the note if it is, in fact, a demand note. See, e.g., Environics, Inc. v. Pratt, 50 A.D.2d 552, 376 N.Y.S.2d 510 (1975) ("30 days after demand"), *cited in* Hart and Willier, note 49 *supra*, § 5.02[2]; Cantor v. Newton, 4 Mass. App. 686, 358 N.E.2d 247 (1976) ("on demand, with 30 days notice").

[58] 1 Tex. Civ. Cas. at 658.

[59] *Id.*

[60] 36 Mich. 487 (1877), *cited in* Schruam, 1 Tex. Civ. Cas. at 657.

[61] *Id.* at 490.

[62] *Id.*

> might retain it until all testimony was lost, and defeat the defense. This is the mischief which the statutes of limitation were intended to remedy. If this case is not within them, it is not because it ought not to be covered by them.[63]

Accordingly, in reversing the judgment of the lower court, the Michigan court announced the rule as follows:

> It is no stretch of language to hold that a cause of action accrues for the purpose of setting the statute in motion as soon as the creditor by his own act, and in spite of the debtor, can make the demand payable. It may be otherwise, possibly, where delay is contemplated by the express terms of the contract, and where a speedy demand would manifestly violate its intent. But where no delay is contemplated the rule is just and reasonable; and the presentment should be reasonably prompt, or the creditor should be subjected to the operation of the statute.[64]

In a more recent case, *Foreman v. Graham*,[65] the court more clearly summarized the rule as follows:

> The parties to a contract should be permitted to make an agreement that the money loaned was not to become due until a demand was made, thereby making a demand a condition precedent to the accrual of the cause of action. Such demand must be made within a reasonable time, which depends upon the circumstances of each case, and ordinarily is a question of fact for the jury. In the absence of mitigating circumstances, a time coincident with the running of the statute will be deemed reasonable, and if demand is not made within that period the action will be barred.[66]

The apparent effect of this rule is that the enforcement of a demand note that specifically requires a prior demand (i.e., "this note is payable on demand, and we mean an actual demand") would still be barred upon the expiration of the applicable period of limitations after its date, unless an actual prior demand was made (absent some mitigating circumstances of which the jury could be convinced).[67] If an actual demand was made within the

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[63] *Id.* at 491 (emphasis added). A demand note not only permits the holder to require payment at any time, but it also permits the maker to make payment at any time. Utay v. Urbish, 433 S.W.2d 905, 910 (Tex. Civ. App. 1968) (writ ref'd n.r.e.).

[64] *Id.*

[65] 363 S.W.2d 371 (Tex. Civ. App. 1962) (no writ).

[66] *Id.* at 372.

[67] But see Keithler v. Foster, 22 Ohio St. 27 (1871), and Thrall v. Estate of Mead, 40 Vt. 540 (1868), both cited by the court in Schruam, 1 Tex. Civ. Cas. at 657, and both implying that when an actual demand is required, the statute commences (as opposed to

applicable period of limitations after the date of the note, however, the statute of limitations would apparently begin to run from the date of such actual demand.[68]

The court in *Palmer* noted, however, that although a "cause of action accrues for the purpose of setting the statute in motion as soon as the creditor by his own act . . . can make the demand payable[, *i*]*t may be otherwise, possibly, where delay is contemplated by the express terms of the contract, and where speedy demand would manifestly violate its intent.*"[69] The implication of the emphasized language in *Palmer* is that the parties may, when a demand note requires an actual demand, designate by

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expires) upon the expiration of the period of limitations that would otherwise be applicable following the date of the note because a demand is presumed to have occurred on that date.

[68] Foreman, 363 S.W.2d at 372. When a demand note actually requires a demand prior to beginning the running of the statute of limitations is difficult to ascertain. The general rule has been simply stated as follows:

> Although the maker of a demand note is not in default until he refuses payment until after demand therefor, it is generally held that a note payable on demand is due immediately, so that suit may be maintained on it at any time after delivery without any other demand than the suit. *This rule may not apply, however, when there is something on the paper,* or in the circumstances under which it was given, *to show that it was not the intention that it should become due immediately.*

10 *C.J.S.* "Bills and Notes" § 247 (1936), *quoted in* Bank of Nevada v. United States, 251 F.2d 820, 827 (9th Cir. 1957), *cert. denied,* 356 U.S. 938 (1958) (emphasis added).

Applying that rule, however, is another matter. For example, is an actual demand required with respect to a note "payable on demand after date?" In United States Rubber Co. v. Engle, 153 S.W.2d 983 (Tex. Civ. App. 1941) (no writ), *cited in* Annotation, note 32 *supra*, at 298, the court answered no, finding that such language was no different from a note "payable on demand." But see Shapleigh Hardware Co. v. Spiro, 141 Miss. 38, 106 So. 209 (1925), *on appeal after remand,* 118 So. 429 (Miss. 1928), *aff'd on reh'g,* 119 So. 206 (Miss. 1928), *cited in* Annotation, note 32 *supra*, at 312.

The rule that the statute of limitations commences to run on the date of the demand note, without the necessity of any actual demand, has likewise been applied notwithstanding language indicating an actual prior demand was contemplated. See, e.g., North Am. Trading & Transp. Co. v. Byrne, 4 Alaska 26 (1910) ("on demand on or before September 15, 1902, after date"), *cited in* Annotation, note 32 *supra*, at 313.

A note payable "_____ days after date, but also providing that it was to become due 60 days after notice of request for payment," however, was held to require an actual demand prior to the commencement of the statute of limitations. Schoonover v. Caudill, 65 N.M. 335, 337 P.2d 402 (1959), *cited in* Annotation, note 32 *supra*, at 313.

When a demand note is tied to a separate agreement that indicates that the demand note is only to be demanded when the conditions set forth in the agreement occur, the courts appear more ready to delay the commencement of the statute of limitations until the occurrence of the condition set forth in the separate agreement. See, e.g., Washington v. Martin, 503 S.W.2d 330 (Tex. Civ. App. 1973) (no writ); Annotation, note 32 *supra*, at 317-319.

[69] 36 Mich. at 443 (emphasis added).

agreement the "reasonable period" during which a demand must be made, even if that period exceeds the limitations period that would otherwise run from the date of the note.

In the early Supreme Court of Missouri case of *Jameson v. Jameson,*[70] for example, the note was payable "one day after date," with the further proviso that "the condition of the above obligation is such that if the above named Elizabeth Jameson [the holder] shall demand any or all of the above during her natural life, it shall be due and payable according to the tenor of above; but in case of her death before any or all of the above shall be liquidated, it shall remain with me [the maker] and my heirs forever as my portion of her estate."[71] The court cited *Palmer* as "a type" of a "class of cases . . . in which it is held that if an act on the part of a creditor, such as demand or notice, be necessary to complete his cause of action, such demand must be made within the statutory period for bringing an action on the contract, and if not made within the statutory period from the date of the contract, the action will be barred."[72] The court noted, however, that this same "class of cases," of which *Palmer* was "a type," also "hold[s] that this principle does not extend nor apply to a case where delay in making the demand is contemplated by the express terms of the contract."[73] Because the payment of the note in *Jameson* was "unequivocally conditioned upon demand made at any time during the life of the payee," the court felt it was "clear that it was the evident purpose and intention, both of the payor and payee, that there should be a delay in making the demand, and the limit to the delay, as agreed upon by the parties, was the lifetime of the payee."[74]

Summary

The foregoing discussion may be summarized as follows:

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[70] 72 Mo. 640 (1880), *cited in* Annotation, note 32 *supra*, at 314.

[71] *Id.* at 641.

[72] *Id.* at 642.

[73] *Id.*

[74] *Id.*; see also Harris v. Townsend, 101 Miss. 590, 58 So. 529 (1912), *cited in* Annotation, note 32 *supra*, at 302 (cause of action on note payable "on demand or at my death" held to accrue upon occurrence of latter event).

1. A demand note is due and payable the date it is made. As a result, a cause of action accrues and the statute of limitations ordinarily begins to run on a demand note upon its execution, and no prior actual demand is necessary for it to mature. The apparent reason for this rule is that the holder of such a note could otherwise delay the demand and keep the debt alive indefinitely, without the maker's consent.

2. A demand note may, by its express terms (other than merely by providing for payment "on demand") or by reference to another agreement, indicate that an actual demand is required prior to the accrual of a cause of action thereon.

3. To the extent a demand note requires an actual prior demand to accrue the cause of action, the demand must be made within a reasonable period of time following the date of the note. A reasonable period of time is ordinarily the applicable limitations period running from the date of the note. The reason for this rule appears to be the same as that for rule 1 above.

4. The parties to a demand note requiring an actual demand may specify the period during which the actual demand must be made, in which case the limitations period commences to run on the earlier of an actual demand or the expiration of the specified period.[75] This rule appears to be premised upon the fact that by specifying the limit of time during which a demand may be made, the purpose behind rules 1 and 3 have not been thwarted.[76]

Unfortunately, the courts have had difficulty in both recognizing and applying the foregoing rules, thereby causing considerable confusion. Many times, the courts have simply recognized rule 1 as the only operative rule for demand notes, with the result that any note that fails to fit within that rule, particularly

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[75] Actually, *Jameson* implies that the statute expires, not commences, upon the expiration of the specified period absent a prior demand. But see note 67 *supra*. A properly drafted note fitting within rule 4, however, would provide that a demand is deemed to have occurred upon the expiration of the specified period. It is the properly drafted "demandable note" to which our rule 4 is applicable. See notes 77-97 *infra*.

[76] Because U.C.C. § 3-122(1)(b) states that a cause of action accrues on a demand note upon its date, a question may be raised whether a note that comes within the foregoing rules loses its negotiability by virtue thereof or whether, if the note is negotiable, § 3-122(1)(b) overrides rule numbers 2, 3, and 4. Because U.C.C. § 1-102(3) provides that the "provisions of this title may be varied by agreement," the authors believe the answer to these questions should be no.

any note covered by rule 4, is simply not a demand note. Nowhere has the failure of the courts to recognize all four rules been more readily apparent than in those cases construing a note that is payable on demand, but that provides that it will mature at a fixed date in the absence of demand.

The "Demandable" Note

In an attempt to retain the right to demand payment at any time but also avoid the operation of the rule that the statute of limitations commences immediately, many "demand" notes are drafted to provide that they are payable "on demand, or, if no demand is made," on a definite date or dates. The courts have given inconsistent treatment to such notes, particularly when other language in the note, such as acceleration or default clauses, conflicts with the demand character of the note.[77] Indeed, many courts appear to view such notes as either ordinary demand notes upon which the statute of limitations commences immediately or installment notes subject to acceleration only upon default, or "at will," but thereby implying that Section 1-208 of the Code would be applicable.[78] Texas appears to be the only state to have developed a specific line of cases recognizing special rules of construction regarding this type of note.[79]

The first Texas case to consider such a note was *Loomis v. Republic National Bank.*[80] In *Loomis,* the note was dated July 30, 1976 and provided that it was payable "on demand or if no demand be made 1-31-77."[81] The note also apparently provided for monthly installments of $1,000 each until maturity. The note was not paid in full on January 31, 1977, as provided. On January 28, 1981, approximately four years and six months after the date of the note, Republic filed suit to collect same. In response, the maker of the note argued that the note was a demand note upon

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[77] See generally Note, "Negotiable Promissory Notes Containing Time and Demand Provisions: The Need for Consistent Interpretation," 19 Ga. L. Rev. 717 (1985).

[78] *Id.*

[79] Although there are numerous cases from other jurisdictions construing such notes, the authors did not locate a consistent and developed line of cases in any other jurisdiction that appeared to recognize the "demandable" note as a special category of demand instruments.

[80] 653 S.W.2d 75 (Tex. Ct. App. 1983) (writ ref'd n.r.e.).

[81] *Id.* at 77.

which the statute of limitations had run on July 30, 1980; the applicable statute of limitations in Texas being four years. The court responded by noting the previously discussed rule that "the statute of limitations begins to run on a demand note on the date of making, unless demand is a condition precedent to suit on the note, in which case limitations begins to run on the date of demand."[82]

The court noted in a footnote, however, that because the note had expressly waived "demand, presentment, notice of dishonor and protest," the rule that allowed the statute of limitations to run from the date of demand, as opposed to the date of the note, was not applicable because demand was therefore not a precondition to suit on the note.[83] Accordingly, the court limited its inquiry to whether the note was a demand note, stating: "If it is, Republic's suit was barred by limitations."[84] Finding no Texas authority on this issue, the court relied on the Supreme Court of Oklahoma's decision in *First National Bank v. Bell.*[85] The court quoted from the Supreme Court of Oklahoma in *Bell* as follows:

> If the note in the instant case had said, "on demand, on or before December 1, 1922, I promise to pay," etc., it would have been a demand note, and the statute would have begun to run against the same from the date thereof; but the note does not so read. It reads: "On demand, and *if no demand is made,* then on Dec. 1, 1922, I, we, or either of us promise to pay. . . ." So it will be seen that the note, in plain terms, makes a preliminary demand necessary in order to mature the same prior to December 1, 1922. The language used is plain, unambiguous, and can convey no other meaning. The words used in the note, "On demand, and *if no demand is made,* then on Dec. 1, 1922," amount to an express covenant and agreement that, unless a prior demand is made, the note should not mature until December 1, 1922. To hold otherwise would be to give this clause of the contract no force and effect, and would amount to a holding that this clause in the note is absolutely meaningless.[86]

Adopting the reasoning of the Oklahoma court, the court held that because the note itself was inconsistent with a demand note

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[82] *Id.* (citations omitted).
[83] *Id.* at 77 n.1.
[84] *Id.* at 77.
[85] 140 Okla. 24, 282 P. 147 (1929).
[86] Loomis, 653 S.W.2d at 78 (quoting First Nat'l Bank v. Bell, 282 P. at 148-149).

because it contained a provision waiving demand, the rule set forth in *Bell* was "sound." Accordingly, the court held that the note was not a demand note, stating:

> We construe the note to mean that it was due on January 31, 1977, unless a prior demand had been made. In the event that no demand was made prior to January 31, 1977, the note provides that demand was waived. We hold that the note matured on January 31, 1977, and that suit was brought thereon within the four year statute of limitations.[87]

The holding in *Loomis* is disturbing because the court apparently felt obliged to hold that the note in question was not a demand note in order to avoid the operation of the rule that the statute of limitations ordinarily commences to run on the note's date. The court's acknowledgement that a demand could have been made prior to January 31, 1977 implies that such a demand would be in the nature of an acceleration, the *Loomis* note being apparently due in the "first instance" on January 31, 1977. Whether this note would, therefore, be subject to the obligation of good faith under Section 1-208 of the Code, in the event of a demand being made prior to January 31, 1977, is certainly open to question because the exclusion from the effects of that section only applies to "demand instruments."

It would have been more appropriate for the court in *Loomis* to have followed the rule announced in *Foreman*, holding that although the note was a demand note, actual demand was a condition precedent to suit on the note if made prior to January 31, 1977. The court could have then maintained the "demand" character of the note and still have ruled that the statute of limitations commenced to run from the earlier of an actual demand or January 31, 1977 (the latter date being the extent of the reasonable period of time permitted for an actual demand under *Jameson*). The court could also have dealt with the waiver-of-demand provision by noting, as it does later in its opinion,[88] that the clause only applied upon the maturity date if no prior demand has been made, the note being interpreted to require an actual demand at any time prior to January 31, 1977, but on January 31, 1977 demand was deemed made.

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[87] *Id.*
[88] *Id.*

In a subsequent Texas case citing *Loomis, G & R Investment v. Nance,*[89] the court construed a note payable "on demand or if no demand be made, on February 2, 1978," to determine when the period of limitations began. The *Nance* court, like the court in *Loomis,* cited the familiar rule that the statute of limitations begins to run on the date of a demand note, unless demand is a condition precedent to suit, in which case, the statute of limitations does not begin to run until demand is actually made.[90] Although purporting to follow *Loomis,* the court did not hold or imply that the note in *Nance* was not a demand note. Rather, the court seemingly applied the rule in *Foreman,* holding that "the terms of the Nance note did make demand a condition precedent."[91] Therefore, a suit filed on January 29, 1982, was not barred by the four-year statute of limitations, even though the note was dated August 12, 1976, because no demand was made prior to February 2, 1978, which was the deemed date of demand absent a prior actual demand. Consequently, *Nance* is consistent with *Jameson* and *Foreman* and reflects a proper application of the rules previously discussed.

Likewise, in a subsequent Texas case, *Conte v. Greater Houston Bank,*[92] the note was payable "On Demand, But If No Demand Is Made" in stated installments, finally maturing fifteen years after the date of the note.[93] Greater Houston Bank, the holder of the note, had brought suit seeking a declaration that it was entitled "at its sole discretion" to "accelerate payment upon demand" of such note. In construing the note, the *Conte I* court agreed, holding as follows:

> Appellant cites no Texas case holding that a note payable "on demand, but if no demand is made," at a stated time or times should be construed as not capable of being demandable as to the balance due any time prior to payment in full. All of the cases cited by appellant from other jurisdictions allowed demand to be made as an optional alternative to the date or dates specified for payment in the absence of a demand. No case or logic

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[89] 683 S.W.2d 727 (Tex. Civ. App. 1984) (writ ref'd n.r.e.).
[90] *Id.* at 728.
[91] *Id.*
[92] 641 S.W.2d 411 (Tex. Civ. App. 1982) (writ ref'd n.r.e.) [hereinafter Conte I].
[93] *Id.* at 412.

> requires disregarding the express right to make demand and thereby mature the obligation.[94]

Later, in an appeal of a suit brought after the note had actually been demanded, *Greater Houston Bank v. Conte,*[95] the maker of the note urged that the statute of limitations had expired prior to the bank's action. Citing its earlier decision in *Conte I*, the court in *Conte II* held as follows:

> The four-year statute of limitation as applied to *demand* instruments begins at the date of execution of the note. However, this court held in *Conte v. Greater Houston Bank* that the note was *demandable,* payable at the convenience of the holder, either on demand or in installments. 641 S.W.2d at 418. Since the statute of limitations on a *"demandable"* instrument does not begin until demand is made, a contrary holding that the four-year statute of limitations had run from the date of execution would directly conflict with our prior holding.[96]

Implicit in the *Conte* holdings is that a "demandable" note is simply a "demand" note that requires an actual demand to begin the running of the statute of limitations under the rule in *Foreman,* with the otherwise-stated maturity date governing the period during which actual demand must be made under the rule in *Jameson* or demand will be deemed made on the stated maturity date. Following the terminology of *Conte II,* a note payable "on demand but if no demand is made" on a definite date or dates will hereinafter sometimes be referred to as a "demandable note." It is the authors' contention that a demandable note should be considered no less a "demand instrument" even though an actual demand is required within a specified time period as a condition precedent to its enforcement and the commencement of the statute of limitations.[97]

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[94] *Id.* at 418.

[95] 666 S.W.2d 296 (Tex. Civ. App. 1984) (writ ref'd n.r.e.) (hereinafter Conte II).

[96] *Id.* at 300 (emphasis added).

[97] Though not directly addressing the statute of limitations, other cases appear to reach results similar to those reached by the foregoing Texas cases. For example, in Rogers v. Security Bank, 658 F.2d 638 (8th Cir. 1981), there were two notes, one payable "on demand and until demand be made" and the other payable "on demand and until demand be made" but then setting forth a payment schedule. Relying heavily on the "beginning language of the note," the court held that "the note was payable on demand" and that "the payment schedule in the second note only clarifies how the debt should be paid, assuming no demand is made." *Id.* at 639. But cf. Bank of Nova Scotia v. St. Croix Drive-In Theatre, 552 F. Supp. 1244 (D.V.I. 1982), *aff'd*, 728 F.2d 177 (3d Cir. 1984)

The "Demandable Note" as a "Demand Instrument" for the Purposes of Section 1-208

With the possible exception of *K.M.C. Co. v. Irving Trust Co.*,[98] courts that have considered the applicability of Section 1-208 of the Code to demand notes have had little difficulty concluding that no concept of good faith should be applicable to demand notes, at least when there was no question whether the note involved was actually a true "demand" note.[99] Although these cases are encouraging reaffirmations of the authors' original conclusion that the *Irving Trust* dictum (i.e., comparing a demand provision to an acceleration clause) has no general applicability to "demand notes," we are still faced with the possibility that a "demandable" note may not, in fact, be a "demand instrument." Indeed, each of these cases appear to base their conclusions that the obligation of good faith is not applicable to a demand instrument on the fact that a demand note's due date is "regulated by the contract," a demand instrument being due immediately,[100] with the only duty imposed on the holder of a demand instrument being to enforce its payment, without prior demand, within the applicable statute of limitations running from the date of the instrument.[101]

A recent case, *Spencer Co. v. Chase Manhattan Bank, N.A.*,[102] however, appears to directly address the issue of whether a "demandable note" is a "demand instrument" for purposes of Section 1-208. In *Spencer*, the borrower had brought an action against the lender alleging numerous causes of action arising from the lender's abrupt termination of their credit relationship and the lender's setoff of the borrower's accounts. The

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(despite designation in notes as payable "on demand," notes were installment notes when evidence showed parties intended that principal be paid on installment basis). See also Blanchard v. Progressive Bank & Trust Co., 413 So. 2d 589 (La. Ct. App. 1982).

[98] K.M.C. Co. v. Irving Trust Co., 757 F.2d 752 (6th Cir. 1985), discussed in text at note 3 *supra*.

[99] Fulton Nat'l Bank v. Willis Denney Ford, Inc., 154 Ga. App. 846, 269 S.E.2d 916 (1980); Centerre Bank v. Distributors, Inc., 705 S.W.2d 42 (Mo. Ct. App. 1985); Flagship Nat'l Bank v. Gray Distrib. Sys., Inc., 485 So. 2d 1336 (Fla. Dist. Ct. App. 1986), *reh'g denied*, 497 So. 2d 1217 (Fla. 1986). U.C.C. § 1-203 was likewise held to be inapplicable to a demand note in *Fulton* and *Centerre*.

[100] See, e.g., Fulton, 269 S.E.2d at 918-919.

[101] *Id.*

[102] 81 Bankr. 194 (D. Mass. 1987).

borrower had executed two demand notes to establish the credit relationship, one dated June 1, 1983 and the other dated January 22, 1985. In the early part of 1986, the lender advised the borrower that it desired to terminate the credit relationship. Although the lender apparently worked with the borrower to move the loan, the lender announced in the latter part of 1986 that it would no longer honor its previous practice of allowing the borrower to withdraw funds from its accounts based on uncollected deposits. Rather, the lender required that funds be deposited for six days before they could be withdrawn from the borrower's accounts. As a result, several checks thereafter written in violation of these new procedures were dishonored. The lender then set off one of the borrower's accounts with the lender (referred to in *Spencer* as the "general account") against the balance of the loan. While the lender apparently sent a demand notice to the borrower, it was unclear whether this demand was made before or after the setoff of the general account. Eight days after the general account was set off, the borrower's remaining account (referred to in *Spencer* as the "expense account") was also set off. The borrower was then "forced" into bankruptcy "as a result of" these setoffs.[103]

The borrower asserted, among other claims, that the lender had wrongfully set off the general account because the lender had "failed to make demand or alternatively, failed to give Spencer [the borrower] an opportunity to respond to its demand for payment before it set off the General Account."[104] The borrower further asserted that the lender had dishonored its checks when the lender followed the new procedure requiring six days between deposit and withdrawal in order to build up the accounts' balances in preparation for the setoff.

To conclude that the setoff was proper, the court was obligated to determine whether the loan was "properly due and payable at the time of the setoff."[105] Citing the general rule that demand notes are "due and payable immediately upon their

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[103] *Id.* at 197.
[104] *Id.*
[105] *Id.*

execution with or without prior demand,"[106] the court noted that a bank holding a demand note may ordinarily set off a depositor's account without a prior demand. Like the rule announced in *Foreman,* however, the court states as follows:

> Although a formal demand is not required to mature an obligation evidenced by a demand note, the parties to a lending arrangement can agree that a note will become due and payable only after a formal demand is made. Moreover, the mere fact that the parties choose to label the instruments which evidence their obligations as demand notes does not automatically mean that no prior demand is required. Where the terms and conditions of a so-called demand note indicate that the parties intended the obligation to become due and payable upon the happening of a future event, the debt is not mature upon execution of the note. The obligation matures only when the agreed upon future event occurs.[107]

Applying this rule to the *Spencer* notes, the court held that even though neither note contained a "specific term stating that a demand is required prior to maturity," an actual demand for payment was required before they became due.[108] The court reached this conclusion for two reasons. First, the 1983 note provided for one interest rate to apply prior to maturity and a different interest rate to apply after maturity.[109] Second, the 1985 note specifically listed a number of "contingencies" that would render the note due and payable immediately.[110]

Because the *Spencer* notes required an actual demand, the court could have followed other courts in concluding that the note was not a demand note because a demand note is generally defined to be immediately due, without prior demand. Indeed, the borrower alleged that Section 1-208 of the Code was applicable to the *Spencer* notes because a prior demand was required. The court rejected the borrower's contention, however, and held as follows:

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[106] *Id.* at 198. The court identified three requirements in order to exercise a right of setoff: "First, the use of the funds deposited in the account must be unrestricted. Second, mutual obligations must exist between the bank and the depositor. Third, the debt which the bank seeks to set off must be due and payable." *Id.* at 197. The court found that the first and second requirements were clearly met.

[107] *Id.* at 198 (citations omitted).

[108] *Id.*

[109] *Id.* The court really stretched to find the requirement of an actual demand. The court's reasoning on this point is, however, identical to that of the Supreme Court of Arizona in Peterson v. Valley Nat'l Bank, 102 Ariz. 434, 432 P.2d 446, 451 (1967).

[110] 81 Bankr. at 198.

> Although I agree with [the borrower] that a demand for payment was a prerequisite to a proper setoff in this case, I disagree with [the borrower's] contention that the good faith obligations imposed by the U.C.C. prohibited [the lender] from acting in an arbitrary and capricious manner in requiring payment of the notes. The holder of a demand note does not need a good faith reason or any reason at all to demand payment.[111]

The court also rejected *Irving Trust*, noting, that "The court [in *Irving Trust*] apparently overlooked the Comment to [Section 1-208] . . . which excuses the holder of demand instruments from the obligations imposed by § 1-208."[112]

Spencer appears to stand for the proposition that a "demandable note" is a "demand instrument" despite the fact that an actual demand is required to enforce payment. The *Spencer* notes, however, did not include a reference to a specific maturity date in the absence of demand, nor was the application of the statute of limitations at issue. Moreover, the *Spencer* notes do not appear to have been burdened with acceleration and default clauses, which the courts frequently find so troublesome.

Installment or Term Note

There are a substantial number of cases that hold or imply that a note payable "on demand" is not a demand note if it includes specific payment dates or other indicia of an installment or term note.[113] Instead, this type of note has been held to be an

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[111] *Id.* at 199 (emphasis added). Interestingly, the court did find that although the lack of good faith in the *motivations for* the demand are immaterial, good faith in the *manner of* the demand may be material:

> The complaint also indicates that Chase's demand for payment may not have been made in good faith. Spencer asserts that the letter demanding payment was sent to Spencer's officers at a time when Chase knew that the officers would not be available to receive the letter. The letter was also delivered immediately prior to the deadline set for payment, if not thereafter, ensuring that Spencer would not have an opportunity to respond to the demand before Chase set off the General Account. While Spencer was not entitled to notice of the setoff, Chase was required to exercise good faith in performing its contractual obligation to make a demand. If it deliberately sent the demand letter in a manner calculated to disadvantage Spencer, then a claim for the violation of good faith obligation imposed by the U.C.C. has been stated.

Id. at 203.

[112] *Id.* at 199.

[113] See, e.g., Bank of Nova Scotia v. St. Croix Drive-In Theatre, 552 F. Supp. 1244 (D.V.I. 1982), *aff'd*, 728 F.2d 177 (3d Cir. 1984); Kersten v. Continental Bank, 129 Ariz. 44, 628 P.2d 592, 597-598 (Ariz. Ct. App. 1981); Brown v. Maguire's Real Estate Agency,

installment or term note, subject to the holder's right to accelerate payment upon demand at any time, thereby implying that the good-faith obligations of Section 1-208 are applicable.[114] In other cases, moreover, not only has the inclusion of specific payment dates or other indicia of an installment or term note, in a note otherwise payable "on demand," rendered the note a time instrument (as opposed to a demand instrument), but the holder's right to demand payment has been totally eviscerated.[115]

Included in this latter line of cases is *Reese v. First Missouri Bank & Trust Co.*[116] In *Reese*, homeowners brought an action seeking to enjoin the foreclosure of a deed of trust on their home. The deed of trust secured a promissory note payable as follows:

> On demand and if no demand be made then principal and interest is payable in monthly installments of $1,040.96 commencing on April 6, 1981, and on that day of each succeeding month until maturity, March 6, 1984. A final payment in the amount of $91,544.30 due March 6, 1984, plus accrued interest subject to refinance at the option of the bank.[117]

The promissory note also contained a clause giving the holder the right to accelerate payment upon default. A separate "demand note" in the same amount as the promissory note, first stated that it was payable "on demand" but later stated that "payment hereunder is conditioned upon default in payment of

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101 S.W.2d 41 (Mo. Ct. App. 1937), *rev'd on other grounds*, 121 S.W.2d 754 (Mo. 1942); Baucom v. Friend, 52 A.2d 123 (D.C. Ct. App. 1947). In the authors' opinion, the court's reasoning in certain of these cases is, at best, suspect. In *Kersten*, for example, the court relied on the Supreme Court of Arizona's decision in Peterson v. Valley Nat'l Bank, 102 Ariz. 434, 432 P.2d 446 (1967), to conclude that the notes, which were due "on demand, if no demand in 90 days," were "not demand notes." Kersten, 628 P.2d at 597. This reliance was clearly misplaced. The court, in *Peterson*, while explaining that an actual demand is required to mature this sort of note, nevertheless continued to refer to such an instrument as a "demand note." *Peterson*, 432 P.2d at 451.

In *Brown*, the court found that a note payable "on demand, or if no demand be made, then on the first day of February, 1933" was not payable on demand. Yet, in a statement clearly inconsistent with this conclusion, the court, in *Brown*, recognized that the note could be matured prior to its due date: "We think the intent of the note is that it does not mature . . . prior to February 1, 1933, *without demand for its payment first having been made*." Brown, 101 S.W.2d at 49 (emphasis added).

[114] Greiner v. Rogers, 450 S.W.2d 665 (Tex. Civ. App. 1969) (no writ). Contra Huth v. Huth, 110 S.W.2d 1011 (Tex. Civ. App. 1937) (writ dism'd).

[115] See generally Note, note 77 *supra*.

[116] 664 S.W.2d 530 (Mo. Ct. App. 1983); see also Reid v. Key Bank of Southern Maine, Inc., 821 F.2d 9 (1st Cir. 1987).

[117] Reese, 664 S.W.2d at 531.

[the foregoing promissory note]."[118] The "demand note" further stated that it was pledged as security for the loan and did not represent an obligation in addition to the promissory note. The deed of trust contained an acceleration clause upon default and otherwise indicated an installment obligation was intended. Finally, the federal Truth in Lending statement executed in connection with this transaction calculated the interest in a manner that did not disclose that an early demand of the promissory note, if one was actually intended to be permitted, would have varied the effective interest rate. Accordingly, based on a construction of all of the foregoing documents as one agreement,[119] the court held "that the promissory note was an installment note and that it was payable on demand only in the event of default in the making of the installment payments or the performing of the obligations imposed on [the borrowers] by the deed of trust."[120]

In reaching its conclusion based on a construction of the documents as a whole, however, the court did mention a number of facts that clearly indicated that the lender had misled the borrower.[121] Accordingly, though purporting to base its decision

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[118] *Id.* at 533. This "demand note" that was given as security, should not be confused with the main promissory note, which was also payable "on demand."

[119] Pursuant to U.C.C. § 3-119(1) and the common-law rule that instruments executed as part of the same transaction are to be construed together as one instrument.

[120] 664 S.W.2d at 536-537.

[121] These facts included the following:

1. The bank had issued a commitment for an $80,000 loan, with a term of three years requiring acceptance within ten days and the payment of a $1,600 loan service charge. *Id.* at 532.

2. The borrowers had accepted the commitment within the stated time frame and delivered their check for $1,600, but the bank had misplaced the check. *Id.*

3. The borrower had asked why the check had not been cashed and had been told that it had been lost but that he could pay the loan service charge upon the closing of the loan. *Id.*

4. The bank had thereafter agreed to increase the loan to $92,300, the borrower paid a larger loan service charge of $1,846, and the borrower closed the loan by executing the documents previously described. *Id.*

5. A report to the bank's loan committee described the loan as "36 months on 25-year amortization," with "maturity date" of three years. *Id.* at 533.

6. The report also contained a notation: "This loan was committed back in October when prime was in the 13-14 percent range." *Id.*

7. One month after the loan closed, the bank sent a letter to the borrower purportedly to "clarify the bank's position." *Id.* at 534.

8. The letter stated that the loan "was to serve as interim financing until you were able to obtain permanent financing." *Id.*

9. The letter further provided as follows:

primarily on a construction of the closing documents, the court did note, "The proud owners of a new house, faithful in their payments, would understandably be disheartened if the law accepted [the lender's] position *under the facts here.*"[122]

Likewise, in *Shaughnessy v. Mark Twain State Bank,*[123] the Missouri Court of Appeals for the same district that decided the *Reese* case determined that a note was not a "demand note" that provided for payment "on demand, and if no demand [is] made, then on February 16, 1980," especially if the stated maturity date of the note was later extended to February 16, 1981 and the deed of trust and the security agreement contained language listing numerous events of default and permitting acceleration on default.

A careful reading of both *Reese* and *Shaughnessy,* as well as the numerous other cases that have determined that a note payable "on demand," but otherwise specifying payment dates or other indicia of an installment obligation, is not a "demand note," discloses that the courts have reached their conclusions based on the premise that a demand note is only a note that is due immediately without prior demand (i.e., a note coming within our rule 1). Accordingly, any provision that purports to be at odds with the note being immediately due and payable, without prior demand, is viewed as being inconsistent with a demand note. The courts in both *Shaughnessy* and *Reese* imply that a promissory note payable "on demand, or if no demand is made," on a stated maturity date, is not a demand note because

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The bank will exercise its demand provisions if the loan is not refinanced within six months. We assume you are aware that the October 24 commitment for $80,000 expired on November 3, 1980, since you had neither paid the $1,600 commitment fee or signed your acceptance by the time.

Id.

10. A secretary for the bank testified that she refused to initial a similar letter mailed to the borrower after the foregoing letter because she knew it was false in stating that the $1,600 had not been received. *Id.*

11. Although the borrower had informed the bank that he had returned the commitment letter and the $1,600 loan fee, the bank replied, "We must request that you make arrangements to move this loan by September 6, 1981, so that it will be unnecessary for us to make demand." *Id.*

12. The bank thereafter made formal demand and posted the property for foreclosure. *Id.*

[122] *Id.* at 536 (emphasis added).

[123] 715 S.W.2d 944, 946 (Mo. Ct. App. 1986).

it is not due or payable immediately without prior demand. This appears to be true even without all of the background facts and the additional provisions of the related loan documents.

In contrast to cases like *Reese* and *Shaughnessy* are cases such as *Simon v. New Hampshire Savings Bank.*[124] In *Simon,* the Supreme Court of New Hampshire considered a note that was payable as follows:

> On demand with interest at 6% per annum payable monthly, giving the bank the right of collecting this note at any time . . . [but with the further agreement] without the bank waiving the right to demand payment in full at any time, that $144.00 be paid monthly to apply first on interest and balance upon principal.[125]

The mortgage securing the note had a similar payment provision to that contained in the note, as well as an acceleration clause for failure to perform any of the conditions contained therein. The mortgage covered the borrower's home. The borrower argued that the provisions for installment payments converted the mortgage note from a demand note to an installment note that could only be demanded upon default in payment of the installments. Interestingly, however, there was no specific maturity date in the *Simon* note, nor was there a specified number of installments that were to be paid. In any event, in construing this note and mortgage and finding Section 1-208 inapplicable, the court stated:

> The mortgage note in the case before us is not to be considered any less a demand note because in addition to requiring the monthly payment of interest, it also required the monthly payment of installments of principal. The repeated reservation to the bank of the right to demand payment in full at any time leaves no room for an interpretation of the transaction which would nullify both the promise to pay on demand, and the reserved right to demand payment regardless of whether other conditions of the mortgage were breached or not.[126]

Although affirming the demand character of the note, however, the holding in *Simon* does not address whether the statute of limitations began to run immediately on the *Simon* note. After all, the holder of a demandable note may be just as harmed by a

[124] 112 N.H. 372, 296 A.2d 913 (1972).
[125] *Id.* at 914-915.
[126] *Id.* at 915.

holding that the note is an ordinary demand note, upon which the statute of limitations begins immediately, as by a holding that the note is a time instrument allowing acceleration only upon default or "at will," but subject to the good-faith requirements of Section 1-208.

Time Note Subject to Acceleration

One author has attempted to avoid the extremes of characterizing a demandable note as either an ordinary demand note or an installment or term note that can be demanded only upon default in the specified payment terms. In doing so he concludes that a more appropriate approach is to "construe promissory notes that contain both time and demand provisions as time notes subject to 'at will acceleration,' and acceleration under such notes should be subject to the requirement of good faith as set forth in Section 1-208."[127]

This conclusion is based on several factors. First, "construing notes containing time and demand provisions as demand notes violates the intentions of the parties . . . , [because] a note which contains time provisions was obviously not intended to be automatically due upon its issue."[128] Likewise, construing such notes "as time notes also does not uphold the intention of the parties" because "the presence of the demand provisions reflects the understanding of the parties that the holder would have the right to accelerate full payment, at least under certain reasonably contemplated circumstances."[129] Second, this conclusion is justified to its partisans because it fits within the specific language of Section 3-109 of the Code defining a time instrument.[130] Finally, this conclusion is stated to be justified because it "conforms to the Code's underlying policies of simplifying, expanding, and making uniform the law governing commercial transactions."[131]

A premise underlying this viewpoint is that there should be no difference between a note payable at a definite date in the future, subject to the holder's right to accelerate the payment

[127] Note, note 77 *supra*, at 736.
[128] *Id.* at 732.
[129] *Id.*
[130] *Id.* at 736.
[131] *Id.*

date to an earlier time, and a note payable on demand but also providing for specified payment dates. This is because the latter type of note "represents the same underlying compromise between the creditor and the debtor that is reflected by a time note subject to acceleration."[132] The compromise is that "payments will mature at a fixed time, and that, although payment may be demanded at any time, demand will only be made to protect the holder against non-payment and not for arbitrary or capricious reasons."[133] According to this view, the result should be the same whether the words "demand" or "accelerate at will" are used in a note containing specific payment dates; otherwise, "merely by using a demand clause instead of an acceleration clause, the holder would have employed a note that operates like a time note subject to acceleration but that is not subject to any good faith restrictions."[134] The proponent of this view concludes:

> Construing notes with both time and demand provisions as simply time notes or demand notes is unfounded and based on rules of construction that have only caused inconsistent results. These results impede progress of commercial financing by creating uncertainty over whether the agreement of the parties to a financial transaction will be upheld. Adopting the proposal—that notes containing time and demand language should be construed as time notes subject to at-will acceleration—will remove such impediments by upholding the parties intentions under the agreement.[135]

In evaluating this view, it is certainly inappropriate to construe a note containing time and demand provisions as either a time note or an ordinary demand note. The premise that the parties' true intentions will necessarily be realized by construing a note containing both time and demand provisions as a time note subject to acceleration at will, however, is flawed. This premise ignores the long-established rules governing demand notes and the application of the statute of limitations thereto.[136] It is incorrect to suggest that the presence of a specified payment date as an alternative to payment "on demand" necessarily reflects an intention that the note be due "in the first instance" at

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[132] *Id.* at 737.
[133] *Id.* at 737-738.
[134] *Id.* at 739.
[135] *Id.* at 746.
[136] See notes 60-76 *supra* and accompanying text.

the specified future payment date. Notes that are intended in the first instance to be payable "on demand" are frequently drafted to include a clause setting an outside maturity date, not because the parties intend this outside date to be the due date "in the first instance," subject to acceleration, but because the outside date provides a means for delaying the commencement of the statute of limitations that otherwise runs from the date the note is made.

For example, in a loan workout situation a bank might agree to an extended payment schedule but provide for payment "on demand." The original debt may be already due, and the bank may have already instituted legal proceedings against the borrower and guarantors prior to restructuring. The bank's intent in requiring a demand note in this situation (as well as the borrower's) might be to recognize the bank's immediate right to payment despite the extended payment schedule. The extended payment schedule would merely give the bank the option of delaying the enforcement of the debt beyond the otherwise applicable period of limitations (a result that may also benefit the borrower). To the extent the bank demands payment, the bank's reasons for demanding payment may or may not have anything to do with whether the bank honestly believes the prospect for payment at the scheduled dates has been impaired. For example, the bank might want to demand payment in the event that it is being disadvantaged relative to other creditors, or the workout proves unsuccessful, or the borrower at last has the ability to pay and the bank no longer wants the reduced interest rate provided in the workout.

There are many other instances in which, despite the existence of specified payment dates, the parties may have clearly and simply intended that the lender could call the loan for any reason at any time, although the borrower later realizes he was unwise to do so.[137] To presume a contrary intent in all instances

[137] For example, consider a situation in which the son of a wealthy woman marries a lady of lesser means. The mother, intending to provide a home for the newlyweds of a standard commensurate with that to which her son had become accustomed, loans the couple the entire purchase price for their new home, secured by a deed of trust covering the home. The mother's stated intent is to keep the loan outstanding until she "desires" the money. Her "desire" is not based on need, but literally on the whim of the holder.

is unnecessary and "would impede [the] progress of commercial financing."[138]

Many times, of course, neither the creditors nor the debtors have expressed or even know what they intended by executing and accepting a note that is payable "on demand, but if no demand is made," at a definite date or dates.[139] Many times, lenders and borrowers do actually intend that "demand" would only be made if there is a default in payment under the specified payment schedule.[140] To encourage certainty in commercial transactions, however, there has been and should be a continued recognition that the words "on demand" have a specific and well-recognized meaning (i.e., to create a note that is presently due and with respect to which "acceleration" is irrelevant and literally inapplicable). Rules of construction are designed, after all, to divine the parties' express intent, not the intent they had but failed to express.[141]

Centuries of jurisprudence mandate that parties executing notes payable "on demand" intend to create a debt that is presently owing (rule 1). That same jurisprudence permits the

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The note may have been drafted to be "payable when the holder desires." Because the note was to be unconditional as to the maker's obligation but was to permit the holder to call for payment at any time, such a note is a demand note and as such is deemed due the date it is made. However, because the mother may not "desire" the money until, and the son intends to permit the mother to delay making demand until, a date substantially in excess of the expiration of the statute of limitations that would ordinarily run from the date of the note, the note may actually be drafted to be payable "on demand, but if no demand is made on" a specified date substantially in the future.

If this note is construed as a note that is due "in the first instance" on the specified future date, subject to the right of the holder to accelerate (demand) payment "at will," it would limit the mother's absolute right to demand payment to a situation in which she believes that her prospects for repayment on the specified future date are impaired. This was not the parties' real intent, nor should it be the parties presumed intent, statutorily or by common law.

[138] Note, note 77 *supra*, at 739.

[139] Many times form notes are used without any thought as to their effect.

[140] The authors have been privy to a number of negotiation sessions in which a borrower will request that the "on demand" clause be deleted from a note only to have the loan officer respond that "it's bank policy to retain the demand clause, but the bank will only make demand upon default."

[141] See, e.g., Moran v. Prather, 90 U.S. 492 (1874); Estes v. Republic Nat'l Bank, 450 S.W.2d 397, 401 (Tex. Civ. App. 1969), *aff'd*, 462 S.W.2d 273 (Tex. 1970); Dedier v. Grossman, 454 S.W.2d 231, 234-235 (Tex. Civ. App. 1970) (writ ref'd n.r.e.). For a thorough discussion of the meaning of "intent of the parties" in interpreting contracts, see Rutledge, *Interpretation and Construction of Oil & Gas Leases, Volume I, General Problems of Interpretation* (June 1959) (unpublished thesis in SMU Law Library).

parties to require an actual demand, as in *Foreman* (rule 2), and to agree to a specified period during which such actual demand must be made, as in *Jameson*, to delay the commencement of the statute of limitations that would otherwise run from the date of the note (rules 3 and 4). The collective purpose behind the foregoing rules is to balance the policy favoring the rights of parties to contract as they wish and the policy that discourages a noteholder from indefinitely delaying actual demand and thereby thwarting the purpose behind the statute of limitations. The basic premise underlying the foregoing rules is that the parties have "in the first instance" agreed that the note may be demanded or called at any time for any reason. The effect of the rules is to impose an immediate due date requiring no actual demand on a note that would otherwise permit the holder to delay an action on the note indefinitely by withholding actual demand. At the same time, however, the rules permit the parties to modify the effect of the statute of limitations by an express provision requiring an actual demand, coupled with a specified period within which actual demand must be made.

The demandable note is, therefore, simply a demand note that responds to the existence of the foregoing rules. Accordingly, although a demandable note is due and payable immediately, an actual demand is a condition precedent to its enforcement and the time period during which such demand must be made has been determined by express agreement of the parties.

A better approach, then, to the admitted confusion in the courts over notes containing both time and demand provisions is to honor the use of the words "on demand" as a term of art and to recognize the continued validity of the rules of *Foreman* and *Jameson*. This approach permits the parties to create a note that is due and payable at any time without reason yet avoids doing violence to the policies underlying the statute of limitations; it thereby promotes the UCC's aim to "permit the continued expansion of commercial practices through custom, usage and agreement of the parties."[142] To adopt an approach that construes any note containing a demand and a time clause as a time note subject to acceleration at will would frustrate this policy of

[142] U.C.C. § 1-102(2)(b); see also Note, note 77 *supra*, at 736, 743.

the UCC; there would be no way to utilize the rules of *Foreman* and *Jameson* to create a note that is payable "on demand" but that provides for a specific time during which such demand must be made. The only demand note that could be created is one on which the statute of limitations commenced immediately and on which a suit would be barred upon the expiration of the applicable limitations period following the date of the note. Any note that relied on the rules in *Foreman* and *Jameson* would be deemed "in the first instance" to be a time note subject to acceleration at will, rather than a "demandable" note, which may have really been intended.

The expectations of the parties to a note that, in "the first instance," is payable "on demand" are already well protected by the rules applicable to demand notes and that determine the application of the statute of limitations. To impose the additional good-faith requirements of Section 1-208 of the Code, which apply to notes due at a future date subject to acceleration, to the existing rules applicable to demand notes is to add unnecessary protection to interests for which protection already exists.

This approach would not necessarily change the result in cases such as *Reese* and *Shaughnessy,* in which misrepresentations and sharp dealings by a lender (in *Reese*) and patent ambiguities caused by poor draftsmanship (in *Reese* and *Shaughnessy*) resulted in legal decisions that cast doubt on otherwise valid demandable notes.[143] Rather, this approach merely

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[143] While preparing this article, one of the authors, acting as attorney for a debtor, was confronted with a situation in which a note was payable "on demand but if no demand is made," in specified installments and finally maturing on a definite date in the future. The debtor was behind in the installments and had entered into a workout arrangement, as part of which the outside maturity date of the note was to be extended. It was the debtor's expectation that the demand character of the note was to be eliminated. A draft of the Modification of Note Agreement prepared by the lender's counsel stated simply: "The maturity date of the note is hereby extended until [a year later than the date originally stated in the note]."

The debtor believed that this language effectively eviscerated the demand character of the note. See Shaughnessy, 715 S.W.2d at 952. Upon inquiring of the lender's counsel as to their intent to eliminate the note's demand character, the lender's counsel insisted that it was against bank policy to remove the "on demand" language and the modification was not intended to do so. Better draftsmanship to effectuate the lender's intent would have been to state: "The maturity date of the note, in the absence of prior demand, is hereby extended until . . . ." As it worked out, the lender ultimately agreed to amend the note to specifically delete the "on demand" clause, but not without the deal coming perilously close to "blowing."

recognizes the judicial precedent governing the meaning of a note payable "on demand" and holds the parties to their presumed intent as expressed by the language of the note. The words "payable on demand" should be recognized as decidedly different from the words "accelerate at will." This will permit parties to enter into a transaction that is by its very nature "subject to call at any time without reason" but that does not expire by virtue of the statute of limitations, contrary to the express agreement of the parties. The solution to many problems in this area, such as those in *Shaughnessy*, is clear drafting. The way to avoid the problems that developed in *Reese* is embodied in the cause of action for fraud and in the consumer protection statutes.

Drafting Suggestions to Assure the Demand Character of Notes

To preserve the viability of the "demandable note," the authors offer the following drafting suggestions.

The Ordinary Demand Note

It is relatively simple to draft a note with the intention that it mature on its date and require no prior demand. The following payment provisions will suffice: "This Note is payable on demand." It is not necessary to actually waive demand, but the inclusion of a provision expressly waiving demand should not be fatal.[144] Nevertheless, it is both unnecessary and harmful to include default and acceleration clauses in such a note, as the holder may enforce payment of a demand note at any time without reason.

For certainty, one should consider including a provision to this effect: "This note is a demand note due and owing immediately, without prior demand of the holder; and immediate action to enforce its payment may be taken at any time without notice." Although the courts appear consistently to allow banks, as holders of an ordinary demand note, to set off the debtor's accounts without prior demand or notice,[145] this clause should

[144] Contra Loomis v. Republic Nat'l Bank, 653 S.W.2d 75 (Tex. Ct. App. 1983).

[145] See Stavert Properties, Inc. v. RepublicBank of Northern Hills, 696 S.W.2d 278 (Tex. Ct. App. 1985) (writ ref'd n.r.e.); State Trust & Sav. Bank v. Malitz, 44 S.W.2d 1070 (Tex. Civ. App. 1931) (writ dism'd).

remove any possible reluctance by a court to allow a setoff in a specific instance.

Providing for interest to be payable currently in stated installments should not affect the demand character of the note[146] as long as the note does not provide an event of default for nonpayment. No provision should be included, however, that could be construed as indicating that a future due date for principle is intended. All printed forms should be examined for possible offensive clauses. In *Spencer*, for example, the inclusion of a provision requiring a higher interest rate after maturity converted an ordinary demand note into a "demandable note."[147] Accordingly, the typical provision requiring the payment of a higher rate of interest after default should be modified to read as follows:

> If the holder hereof makes an actual demand to the undersigned for the payment of this Note (the holder being under no obligation to make such demand), or if the holder brings a cause of action to collect this Note, interest shall be thereafter payable on the principal balance hereof, and, to the extent permitted by applicable law, on all accrued but unpaid interest hereon, at the maximum rate of interest permitted by applicable law.

In the case of a "demandable note," this provision should also be inserted, except that the parenthetical phrase should be deleted.

The advantage of an ordinary demand note is that is permits immediate action at any time, for any reason, without demand or notice. For a bank having deposit accounts of the debtor, this immediate action would include the right to set off the debtor's accounts against the balance of the note, without prior notice. The disadvantage of an ordinary demand note is that the statute of limitations begins to run immediately,[148] and should the holder fail to bring suit within the applicable limitations period after the

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[146] E.g., United States Fidelity & Guar. Co. v. Krebs, 190 So. 2d 857, 860 (Miss. 1966); Todd v. Third Nat'l Bank, 113 S.W.2d 740, 741 (Tenn. 1938).

[147] See note 108 *supra*.

[148] An additional disadvantage is that a purchaser of a demand note is statutorily on notice that the note is overdue (and therefore he is not a holder in due course) if "he is taking a demand instrument after demand has been made or more than a reasonable period of time after its issue." U.C.C. § 3-304(3)(c). The authors would argue with respect to a "demandable note," however, that the "reasonable period of time after issue" is specified by the parties as being the specified maturity date.

date it is made, it is barred.[149] Keeping an ordinary demand note current, however, would merely require the debtor to execute a renewal note on a periodic basis.

The Demandable Note

The demandable note requires a little more thought than the ordinary demand note, but it is still fairly simple. The payment clause could be drafted in one of the following ways:

> 1. This Note is due and payable in the first instance, on demand; provided, however, that an actual demand is required as a condition precedent to the accrual of a cause of action hereunder if made prior to the maturity date hereinafter set forth. Upon the occurrence of the maturity date hereinafter set forth, however, demand will be deemed made without the necessity of actual demand, which is hereby waived. In the absence of an actual demand hereon, this Note is payable in _____ installments of _____, plus interest on the _____ day of each month, commencing on _____ and continuing on the _____ day of each month thereafter and finally maturing, unless sooner actually demanded, on _____; or
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> 2. This Note is due and payable on demand, but if no demand is made in _____ installments of _____, plus interest, on the _____ day of each month, commencing on _____ and continuing on the _____ day of each month thereafter and finally maturing, unless sooner actually demanded, on _____.

In either case, inclusion of the following clause is also suggested:

> This Note is a demand note subject to being called at any time without reason upon actual demand by the holder. The inclusion of a payment schedule in this Note is merely to provide terms for payment in the absence of actual demand, and does not affect or impair the holder's absolute right to demand payment of this Note at any time without reason. The maker has agreed that the holder may delay demand until, or make demand at any time before, the maturity date otherwise specified above.

Default or acceleration clauses should not be included, because they are unnecessary and detrimental. Including certain

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[149] Paying interest on a demand note, however, has been held to toll the statute of limitations during the continuation of such payments, each payment constituting a reacknowledgment of the debt. Guild v. Meredith Village Sav. Bank, 639 F.2d 25 (1st Cir. 1980). Contra Gabriel v. Alhabbal, 618 S.W.2d 894, 897 (Tex. Civ. App. 1981) (writ ref'd n.r.e.).

events that will mature the note in the absence of a prior demand is permissible, but these events should be referred to as "maturing events," not "events of default." A provision similar to this should be sufficient: "Notwithstanding the failure of the holder hereof to make prior actual demand hereon, this note shall mature and be due and payable at once, without demand, upon the occurrence of any of the following events (a 'Maturing Event')."

The statute of limitations, however, will begin running from the occurrence of any maturing event without any action on the part of the holder. If a provision for maturing events is included, the payment provision should be modified to refer to them in addition to the specified maturity date. Alternatively, the specified maturity date could be included as a maturing event, and the payment provision could be modified to refer to maturing events and not to a maturity date.

A demandable note requires an actual demand prior to the stated maturity date. It is unwise, therefore, to include a waiver-of-demand provision, unless it is clearly applicable only upon the stated maturity date.[150]

A demandable note limits the creditor's rights prior to the note's maturity date or the actual demand. Prior to actual demand or the maturity date, a debtor's account cannot be set off, nor can a lender otherwise enforce a demandable note or the security agreement securing it. Fortunately, case law does not appear to require any grace period or notice prior to enforcing the demandable note on a date other than the maturity date, only a demand is required.[151]

The advantage of a demandable note is that it may be actually demanded at any time without reason within the limits of the stated maturity date. Moreover, in the absence of prior demand, the statute of limitations does not commence until the stated maturity date. The disadvantage of a demandable note is that an actual demand is required prior to the stated maturity date, and this actual demand may limit a lender's freedom of setoff.

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[150] See note 83 *supra* and accompanying text.
[151] See note 110 *supra* and accompanying text.

Conclusion

Case law, developed over the centuries and embodied in the Uniform Commercial Code, provides meaning to the term "demand note." The construction given to the express terms of certain instruments and the examples cited in the case law and statutes suggest that a demand note should be defined as any note that entitles the holder to the unrestricted and unilateral right to determine the time for payment in the first instance. Case law and statutes also prescribe four rules for dealing with demand notes:

1. A demand note is due the date it is made, and therefore, a cause of action accrues and the statute of limitations ordinarily begins to run on the date of a demand note's execution;
2. A demand note may, by its express terms or by reference to another agreement, indicate and require that an actual demand is necessary prior to the accrual of a cause of action;
3. To the extent a demand note requires an actual demand to accrue the cause of action, such demand must be made within a reasonable period of time following the date of such note; and
4. The parties to a demand note requiring an actual demand may specify the period during which an actual demand must be made, in which case the limitations period commences to run on the earlier of an actual demand or the expiration of the specified period (to the extent the note is properly drafted to make the expiration of the specified period a deemed demand).

These rules are not used to decide whether a note is a demand note but instead are applied to a note that has been determined to be a demand note because the holder has the unilateral right to determine the time for payment in the first instance.

A note "payable on demand, but if no demand is made" on a specified payment date, or similar terms, should be construed to be a demand note. The accrual of a cause of action on such a demand note would not commence, however, until the earlier of actual demand or the specified payment date. Because such a

note is a demand note, the reason for actually demanding the note should not be subject to the "good faith" requirements of Section 1-208 of the Code.

Attorneys have failed to recognize and apply these rules in drafting promissory notes intended to be demand instruments on which a cause of action would not accrue until the earlier of actual demand or a specified date in the future. This situation has left the courts with the impossible task of discerning an unexpressed intent. Courts have responded by rendering inconsistent and often illogical decisions. This article should provide both the theoretical basis and some practical guidance in drafting "demandable notes" so that they will be easily recognizable and readily construed as "demand instruments." A demandable note, as a "demand instrument," should be subject to being demanded at any time without reason. Because a demandable note anticipates an actual demand to accrue a cause of action prior to its specified maturity date, however, the statute of limitations should not commence to run until the earlier of an actual demand or the specified maturity date.