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New Mexico's Uniform Commercial Code: Presentment Warranties and the Myth of the Shelter Provision

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NEW MEXICO'S UNIFORM COMMERCIAL CODE: PRESENTMENT WARRANTIES AND THE MYTH OF THE "SHELTER PROVISION"

If the business world is to be served, commercial paper must be negotiable—sufficiently negotiable to satisfy the needs of commerce. To encourage negotiability, not only must the holder in due course[1] be able to take paper free of claims and personal defenses,[2] he must be able to dispose of the paper similarly free of such defenses. If such a holder is unable to sell the paper he holds free of third party claims, he will be reluctant to become a holder initially. Section 3-201 of the Uniform Commerical Code[3] attempts to protect the holder's power to dispose of the paper. Subsection (1) of this section—termed the "shelter provision" or "umbrella clause"—reads as follows:

> Transfer of an instrument vests in the transferee such rights as the transferor has therein, except that a transferee who has himself been a party to any fraud or illegality affecting the instrument or who as a prior holder had notice of a defense or claim against it cannot improve his position by taking from a later holder in due course.

The extent of the protection accorded by the shelter provision,

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1. N.M. Stat. Ann. § 50A-3-302 (1953).

New Mexico's version of the Uniform Commerical Code, N.M. Stat. Ann. §§ 50A-1-101 to -9-507 (1953), is based on the 1958 Official Text, promulgated jointly by the American Law Institute and the National Conference of Commissioners on Uniform State Laws.

All references to New Mexico's version of the Code, often designated UCC both in footnotes and text, will omit the full statutory citation. Citations to "Comments" are those accompanying the 1958 Official Text.

References to the Uniform Negotiable Instruments Law, N.M. Laws 1907, ch. 83, §§ 1-197, repealed by N.M. Laws 1961, ch. 96, § 10-102, will be to "NIL."

2. Hawkland, Commercial Paper 78 (1959):

> Personal defenses are those which do not deny the existence of a contract between prior parties, but which assert that the contract, by reason of some act or circumstances occurring contemporaneously or subsequently, has become voidable or defeasible, in whole or in part, between the original parties—as, for example, failure or absence of consideration, breach of warranty, fraud in the inducement, duress, mistake, and the like. *These defenses may be asserted only against non-holders-in-due-course.* [Emphasis added.]

3. UCC § 3-201.

as it relates to presentment warranties[4] under the Code, is analyzed herein. Although examined in some depth, presentment warranties are considered primarily in the context of the shelter provision. And an inquiry is made into the finality-of-payment doctrine[5]—the so-called codification of *Price v. Neal*[6]—as it relates to the shelter and presentment warranties provisions.

The three basic areas of inquiry—shelter provision, presentment warranties, and finality of payment—are inter-related: the status of the transferee under the shelter provision will determine what warranties he can make; the tranferee's status and capacity to make the presentment warranties will determine whether or not such payment or acceptance is final. An understanding of all three concepts is necessary in order to comprehend the conclusion reached —that as applied to the warranties of presentment, the shelter provision's protection is, in part, a myth.

I

SHELTER PROVISION

Subject to two exceptions, the shelter provision (3-201(1)) vests all rights of the transferor in his transferee. Both exceptions are aimed at preventing the transferee from profiting by his own fraud. The exceptions prevent a transferee from a holder in due course from improving his position if he either has participated in any fraud or illegality affecting the instrument, or, as a prior holder, had notice which would prevent him from being a holder in due course in his own right.

By operation of the shelter provision, the transferee acquires whatever rights his transferor had—title if the transferor had title, less than that if he did not.[7] A donee acquires all of the rights of a donor despite the failure to give value.[8] Under the shelter provision all rights of the tranferor are vested in the transferee by the transfer of the instrument. Thus when the transferor is a holder in due course, the transferee takes in that status, *i.e.*, he has vested in him rights that would have vested in him had he taken as an

4. UCC § 3-417(1).
5. UCC § 3-418.
6. 3 Burr. 1353, 97 Eng. Rep. 871 (1762). See notes 37-43 *infra* and accompanying text.
7. UCC § 3-201, Comment 1.
8. UCC § 3-201, Comment 2.

original holder in due course.[9] Although he obtains all rights as a holder in due course, the transferee need not satisfy the Code-established conditions precedent for such status.[10] He can take without value, in bad faith, with notice of a claim or defense against the instrument, and after maturity yet still achieve status as a holder in due course.

If the shelter provision were held to transfer every and any interest in the instrument as held by the transferor, including the transferor's good faith (or lack of it) and other incidents of his holding, the transferee would always be in the same position as his transferor. In short, the transferee would be substituted for the transferor. The shelter provision, however, is not that complete—nor should it be. What the shelter provision does is vest the transferor's rights in the transferee. Since both good and bad faith are conditions of the mind or a state of knowledge, they can hardly be rights. Hence, they are not transferred.

The essence of the shelter provision is deceptively simple. Its application is basically mechanical. However, knowledge of its operation is necessary to understand the position and, perhaps, the plight of the transferee who in the future will make the presentment warranties.

The following three hypothetical problems illustrate the shelter provision's operation:

1. *A* is a holder in due course acting in good faith. *B*, not acting in good faith, acquires the instrument from *A*. Under the shelter provision, *B* takes the rights of his transferor, a holder in due course acting in good faith. But since *B* is not acting in good faith, and since good faith is not transferable, *B* has the status of a holder in due course not acting in good faith.

The result would be the same if *B* took with all the attributes of a holder in due course, excepting the requirement of good faith, or if he took in good faith but acquired guilty knowledge while holding.

2. *C* is an "original"[11] holder in due course. While holding, he

9. UCC § 3-201, Comment 1.

10. UCC § 3-302; (1) A holder in due course is a holder who takes the instrument
(a) for value; and
(b) in good faith; and
(c) without notice that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person.

11. "Original" holder in due course is used to distinguish a transferee under the

learns of a defense to the instrument. Thereafter, *C*, without disclosing the existence of the defense, transfers the instrument to *D* who takes in good faith. *D* would take with all the rights of *C* as a holder in due course. However, he would not be burdened with *C*'s guilty knowledge.

3. *E*, a holder in due course acting in bad faith, transfers to *F* who takes without value, not in good faith, and with notice of a defense to the paper. *F* transfers to *G* who takes without value and after maturity. *G* is vested with *E*'s rights which were vested in *F* by *E*. If in addition *G* acts in good faith, he is a holder in due course acting in good faith. Here *G* merely adds the good faith element to the rights transferred to him by *E*, a holder in due course.

Each of these three problems demonstrates the non-transferability of the transferor's faith—whether it be good or bad. Good or bad faith is not a right, hence it is not transferred, and must therefore arise, if at all, in the transferee. Since only rights are transferred, it follows that the rights transferred by a holder in due course are the same whether or not he was acting in good faith. Good faith is tested subjectively.[12] Thus, it is conceivable that the transferee acting in bad faith at the time of taking could be acting in good faith at the time of presenting.[13]

II

PRESENTMENT WARRANTIES

Before considering the specific presentment warranties, attention must be given to the general concept of warranties in the commercial paper area. Section 3-417(1), which contains the presentment warranties, starts as follows: "Any person who obtains pay-

shelter provision who because of the provision's application becomes a holder in due course, and a transferee who takes as a holder in due course in his own right—an original holder in due course. Of course, the rights of both are the same.

12. UCC § 1-201(19): "'Good faith' means honesty *in fact* in the conduct or transaction concerned." (Emphasis added.)

Obviously, good or bad faith is a *personal* thing. As such, it must be tested by a subjective standard, *i.e.*, whether or not the actor used good faith, not whether a reasonable man would have been acting in good faith.

See, Fagan, *The Concept of Good Faith in Negotiable Instrument Law*, 32 Ind. L.J. 8 (1957); Farnsworth, *Good Faith Performance And Commercial Reasonableness Under the Uniform Commercial Code*, 30 U. Chi. L. Rev. 666 (1963).

13. Apparently this situation could arise if at the time of presenting the presenter had forgotten his prior notice.

ment or acceptance and any prior transferor warrants to a person who in good faith *pays* or *accepts* . . . ." [Emphasis added.]

Under the NIL, warranties are regarded as part of negotiation[14] or indorsement,[15] but not as part of a payment or acceptance transaction. The warranties are given only to certain holders,[16] and to be such a holder the paper must have been negotiated to the person claiming status as such as holder.[17] Section 191 of the NIL defines a holder as a payee or indorsee in possession, or one in possession of bearer paper.[18] Under this definition, an acceptor can not be a holder. However, a payor bank might be an indorsee if the person presenting indorsed the paper to the bank's order. Upon payment, the bank obtains possession of the paper. Thus, the bank would be an indorsee in possession. Despite this, the NIL provides no warranty because once paid the paper is discharged and no longer negotiable. Nevertheless, many courts have ignored the technical requirement and have given the benfit of warranties to drawees (payor banks[19]) basing their decisions upon some elusive "implied" warranties.[20]

Under the Code, courts no longer need to search for implied non-statutory warranties. Acceptors and payors are specifically included within the Code's warranties. Negotiation, therefore, is not the basis of warranty protection under the Code.[21]

There is no provision in either the NIL or the Code relating to the measure of damages for breach of warranty.[22] Recovery for a breach of a presentment warranty is predicated upon a covenant

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14. NIL § 65.

15. NIL § 66.

16. *Ibid.*

17. NIL § 30.

18. " 'Holder' means the payee or indorsee of a bill or note, who is in possession of it, or the bearer thereof." NIL § 191.

19. "In this Article unless the context otherwise requires:

* * * *

(b) 'Payor bank' means a bank by which an item is payable as drawn or accepted . . . ."

UCC § 4-105. See UCC § 3-102(3) which states that the above definition applies to Article 3.

20. The payor can rely on the indorser's guaranty of prior indorsements and on the *implied* warranties of negotiation. Land Title Bank & Trust Co. v. Cheltenham Nat'l Bank, 362 Pa. 30, 66 A.2d 768 (1949). An unrestricted indorsement misleads the drawee into a belief that the paper is what it purports to be. Cairo Banking Co. v. West, 187 Ga. 666, 2 S.E.2d 91 (1939).

21. UCC § 3-417(1): "Any person who *obtains payment or acceptance* and any prior *transferor* warrants . . . ." (Emphasis added.)

22. Hawkland, Commercial Paper 70-71 (1959).

independent of the endorsement contract. Damages recoverable under one obligation may differ from that recoverable under the other.[23] A qualified endorsement, *e.g.*, "without recourse,"[24] imposes no contractual liability on the indorser. However, the qualified endorser is still subject to certain warranty obligations.[25] Again, the warranty undertaking may be to a more limited group that that to which the endorsement contract is directed. For purposes of non-warranty contractual liability, "no person is liable on an instrument unless his signature appears thereon."[26] But warranties of presentment are imposed even in the absence of signature.[27]

A. Warranty of Good Title

UCC section 3-417(1)(a) provides:

> Any person who obtains payment or acceptance and any prior transferor warrants to a person who in good faith pays or accepts that
>
> (a) he has a good title to the instrument or is authorized to obtain payment or acceptance on behalf of one who has a good title . . . .

Before analyzing the operation of section 3-417(1)(a), it seems necessary to determine what is meant by "good title". The Code fails to define either "good title" or "title." As a personal property concept, "good title" means "general and full ownership of the goods."[28] It appears that this is the meaning to be given the term

23. Damages for breach of warranty are limited to actual damages sustained by the tranferee—damages that the transferee could have recovered from the maker if the warranty had not been breached. McNaghten Loan Co. v. Sandifer, 137 Kan. 353, 20 P.2d 523 (1933) (Decided under the NIL). Recovery is limited to the value given by the transferee, plus interest, less payments received on the instrument. First Discount Corp. v. Sutton, 96 Ohio App. 256, 121 N.E.2d 657 (1954) (decided under the NIL).

24. UCC § 3-414(1):

> Unless the endorsement otherwise specifies (as by such words as "without recourse") every endorser engages that upon dishonor and any necessary notice of dishonor and protest he will pay the instrument according to its tenor at the time of his endorsement to the holder or to any subsequent endorser who takes it up, even though the endorser who takes it up was not obligated to do so.

The language of this section clearly indicates what is the contract of a qualified endorser.

25. UCC § 3-417(1), (2).

26. UCC § 3-401(1). The other contractual warranty is to the effect that the endorser will pay the instrument upon notice of dishonor. UCC § 3-414.

27. UCC § 3-417(1) refers to "any prior transferor."

28. See Dixon, Special Property Under the Uniform Commercial Code: A New Concept In Sales, 4 Natural Resources J. 98 (1964). UCC § 1-103 adopts supplementary

as used in section 3-417(1)(a). Good title to commercial paper seems to embrace rightful ownership of the paper against the world.[29] It should be understood that a person may be the rightful owner against the whole world and thus have good title, despite the fact that the drawer's signature has been forged, and despite the fact that the paper has been materially altered. The *property right* exists although the contract rights represented by the paper may not be as they appear on the face of the paper. Rightful ownership of the paper has no necessary connection to the contract rights represented thereby. As used in section 3-417(1)(a), the warranty of good title is probably a warranty that all necessary indorsements[30] in the chain of title are valid.

Despite the fact that courts traditionally have separated the contract rights represented by the paper and the paper itself, it seems incongruous to speak of a person having good title to forged paper. In the case of a chattel, it would seem that title could emanate only from the owner. The drawer of a check would seem comparable to an owner of a chattel. Title to a check passes under the Code, however, although the drawer's signature is forged. The warranty concerning the drawer's signature is set out separately in the Code, as is the warranty of no material alteration.[31]

The Code's warranty of title is made by "any person who obtains payment or acceptance and any prior transferor . . . to any person who in good faith pays or accepts. . . ."[32] Thus, this warranty of title is made by every transferor and presenter regardless of his status or good faith. And unlike the other two presentment warranties—no knowledge that the drawer's signature is unauthorized, and against material alteration—the holder in due course who acts

principles of law. Bonds have been held to be personal property, McCulloch v. McCulloch, 337 S.W.2d 870 (Ark. 1960). Within the definition of a larceny statute, checks are personal property. Abbott v. State, 149 P.2d 514, 78 Okl. Cr. 407 (1944). Bugan, When Does Title Pass 3 (2d ed. 1951): "Like property, the word 'title' also conveys many shades of meaning. However, in legal parlance it refers to that which is the subject of ownership."

29. 2 Williston, Sales § 258 n.1 (Rev. ed. 1948).

30. Bearer paper requires no indorsement to transfer. "If payable to bearer it is negotiated by *delivery*." (Emphasis added.) UCC § 3-202(1).

However, the transferee as part of the transfer agreement may require the transferor to indorse the bearer instrument. But such an indorsement is not a *necessary* indorsement to a normal transfer of the instrument.

However, "unless otherwise agreed any transfer for value of an instrument *not then payable to bearer* gives the transferee the specifically enforceable right to have the unqualified indorsement of the transferor." (Emphasis added.) UCC § 3-201(3).

31. UCC § 3-417(1)(b), (c).

32. UCC §3-417(1).

in good faith is in no favored position and must make the same title warranty as made by every other transferor and presenter.

The shelter provision vests title in the transferee if the transferor had it, but only to that extent. Thus, application of the shelter provision cannot result in the transferee taking better title than that of his transferor. This conclusion is opposed to the possible result reached under the other two warranties wherein a transferee may be benefitted by the shelter provision and thus be in a better position than his tranferor.

B. Warranty of No Knowledge that the Drawer's Signature is Unauthorized

Neither the presenting party's knowledge or lack thereof nor his good or bad faith affects the warranty of good title. It is a warranty that a certain condition exists. The warranty of section 3-417(1)(b) concerning the validity of the drawer's signature is less rigid. The presenting party merely warrants his *lack of knowledge* of the invalidity of the drawer's or maker's signature. Section 3-417(1)(b) provides:

> Any person who obtains payment or acceptance and any prior transferor warrants to a person who in good faith pays or accepts that
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> * * * *
>
> he has *no knowledge* that the signature of the maker or drawer is unauthorized, except that this warranty is not given to a holder in due course acting in good faith
>
> (i) to a maker with respect to the maker's own signature; or
> (ii) to a drawer with respect to the drawer's own signature, whether or not the drawer is also the drawee; or
> (iii) to an acceptor of a draft if the holder in due course took the draft after the acceptance without knowledge that the drawer's signature was unauthorized . . . . [Emphasis added.]

The Code states that a person can know a fact only "when he has actual knowledge of it."[33] If a fact is non-existant, a person cannot have "actual knowledge of it." Hence, if the signature is autho-

33. UCC § 1-201(25):
A person 'knows' or has 'knowledge' of a fact when he has actual knowledge of it. 'Discover' or 'learn' or a word or phrase of similar import refers to knowledge rather than to reason to know.

rized, there can be no knowledge of an "unauthorized" signing. Therefore, if the signing is authorized, the presenter's belief to the contrary, even if he acts in bad faith, is irrelevant.

If the presenter is a holder in due course acting in good faith, he makes the basic (1)(b) warranty to the paying or accepting bank but not to the classes of persons designated by clauses (i), (ii), and (iii).

When is the presenting holder in due course (HDC) "acting in good faith"? "Good faith" is defined by the Code as "honesty in fact."[34] "Acting in good faith" is not defined as a separate term, but applying the definition of "good faith" to the word "acting", the presenting HDC, to avoid making warranties to those listed in clauses (i), (ii), and (iii) must be "acting honestly in fact" when presenting the paper. He may have had knowledge or notice of the defect in the drawer's signature, but if, in fact, he has forgotten it, he can present in good faith and without knowledge. "Good faith" is a condition precedent if the HDC is to limit this warranty to certain classes of people, *i.e.*, a maker, a drawer, and under additional circumstances, an acceptor. This limitation as to whom the warranty is made is offered also by the warranty of no material alteration,[35] if the presenter is acting in good faith. Since both the warranties of the drawer's signature and the warranty of no material alteration present this same limitation in the case of a presenting HDC acting in good faith, the application of "acting in good faith" as it affects these two warranties will be analyzed only once. This analysis is found under the discussion concerning the warranty of no material alteration.[36]

Subsection (1)(b) of 3-417 clearly adopts the doctrine of *Price v. Neal*[37]—a drawee on acceptance or payment of a bill admits the genuiness of the drawer's signature. This is an admission which the drawee cannot subsequently deny against a good faith holder for value. In *Price v. Neal*, two bills, each bearing a forged signature of the drawer, were paid by the drawee. The first bill was presented for payment, the presenter having taken the bill after acceptance. The second bill was presented for payment without an intervening acceptance. In both presentments, the drawee and presenter were acting in good faith. Upon discovery of the forgery, the drawee

34. UCC § 1-201(19), quoted in note 12 *supra*.
35. UCC § 3-417(1)(c).
36. See text at 408-10 *infra*.
37. 3 Burr. 1354, 97 Eng. Rep. 871 (1762).

sought recovery from the presenter. The court found for the presenter, rejecting the claim of mutual mistake offered by the drawee.

The Code adopts the result of *Price v. Neal* via the use of warranties and the finality of payment section, 3-418.[38] Thus, if the payor pays to a holder in due course who makes the warranty of no knowledge that the drawer's signature is unauthorized, and the warranty is not breached, the payor will not be able to recover the payment from the presenter if in fact the warranted signature was authorized. This was the situation posed by the second bill that was presented in *Price v. Neal*. The court's rationale was that the drawee had the best opportunity to discover the forgery of the drawer's signature. Today, the need for finality of payment is the widely accepted reason.[39] As in the case of the first bill presented in *Price*, if the presenter is an innocent holder in due course who takes after acceptance, recovery for an unauthorized drawer's signature is denied to the payor. The basis for such a conclusion is the presenter's reliance on the acceptance.[40] But while the drawee has the burden of recognizing the signatures of his drawers, he is not responsible for ascertaining the validity of the indorsements. Thus, the good title warranty is breached if in fact good title is not presented. But lack of knowledge, not the fact of forgery, controls the warranty of the validity of the drawer's signature. The distinction is justified. The "drawee is in a position to verify the drawer's signature by comparison with one in his hand, but has ordinarily no opportunity to verify an indorsement."[41] At least one court has held that in the case of a double forgery (where both the drawer's signature and payee's indorsement are forged) the instrument will be considered essentially as bearing only a forged drawer's signature.[42]

Price v. Neal concerned not only an innocent presenter, but an innocent payor. The Code maintains the rule that the warranties of presentment are given only "to a person who in good faith pays or accepts."[43]

38. See UCC § 3-418, Comments 1 and 2.

39. UCC § 3-418, Comment 1: "It is highly desirable to end the transaction on an instrument when it is paid . . . ."

40. UCC § 3-417, Comment 4.

41. UCC § 3-417, Comment 3.

42. Trust Co. of America v. Hamilton Nat'l Bank, 127 App. Div. 515, 112 N.Y.S. 84 (1908). In this case the payee was never intended to receive the instrument or its proceeds. In effect then, the instrument became bearer paper. Recovery by the payor, if at all, would be predicated on a breach of warranty of the drawer's signature.

43. UCC § 3-417(1).

C. Warranty of No Material Alteration

The third and last presentment warranty is that the instrument has not been materially altered. Section 3-417(1)(c) provides:

> Any person who obtains payment or acceptance and any prior transferor warrants to a person who in good faith pays or accepts that
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> * * * *
>
> the instrument has not been materially altered, except that this warranty is not given by a holder in due course *acting in good faith*
>
> (i) to the maker of a note; or
>
> (ii) to the drawer of a draft whether or not the drawer is also the drawee; or
>
> (iii) to the acceptor of a draft with respect to an alteration made prior to the acceptance if the holder in due course took the draft after the acceptance, even though the acceptance provided "payable as originally drawn" or equivalent terms; or
>
> (iv) to the acceptor of a draft with respect to an alteration made after the acceptance. [Emphasis added.]

Some resemblance to the two prior warranties is immediately noted. Like the warranty of good title, the warranty of no material alteration is stated as an objective fact—the presenter's knowledge being irrelevant. And like the warranty of no knowledge that the drawer's signature is unauthorized, a holder in due course acting in good faith warrants only to a smaller class of people—thus, often being relieved of liability.

An "alteration" must be distinguished from a "forgery." A forged indorsement involves the warranty of title.[44] A material alteration is an alteration which changes the contract of any party to the instrument in any respect,[45] such as a change in the date payable.[46] It includes the completing of an incomplete instrument other than as authorized by the maker.[47] If an alteration is made by the

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44. See note 30 *supra* and accompanying text.

45. UCC § 3-407(1):

> Any alteration of an instrument is material which changes the contract of any party thereto in any respect, including any such change in
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> (a) the number or relations of the parties; or
>
> (b) an incomplete instrument, by completing it otherwise than as authorized; or
>
> (c) the writing as signed, by adding to it or by removing any part of it.

46. See UCC § 3-407, Comment 1.

47. UCC § 3-407(1)(b).

holder, which is both material and fradulent, a party whose contract is thereby changed is discharged on the instrument except as against a holder in due course.[48] With any other alteration, the instrument may be enforced in accordance with its original tenor.[49] Since in order to discharge parties, a *holder* must materially alter the instrument, any alteration by a non-holder, *e.g.,* spoliation, or a non-fradulent alteration by a holder, will not affect the rights of a later holder.[50]

Similar to the warranty of the maker's or drawer's signature, the warranty of no material alterations is not made to a maker, a drawer, or an acceptor (under certain conditions) if the persenter is a holder in due course acting in good faith. The drafters of the Code thought that the maker or drawer should be able to recognize the instrument as having been altered,[51] since such maker or drawer himself drew the instrument. Thus, if a maker accepts or pays an altered instrument to a holder in due course acting in good faith, such action is final. However, if the presenter is not a holder in due course acting in good faith and the instrument has been materially altered, payment or acceptance is not final. The acceptor or payor then may recover from the presenter as he could both at common law[52] and under the NIL.[53]

In addition, the HDC acting in good faith does not make this warranty to the acceptor if the alteration is prior to acceptance and the presenter took thereafter. Again, as under the warranty of no knowledge that the drawer's or maker's signature is unauthorized, reliance on the prior acts of the acceptor is the basis for protecting the good faith HDC. The Code changes the positions of both the common law and the NIL and adopts the NIL minority position that "according to tenor of acceptance" of NIL section 62 means at the time of acceptance, *i.e.*, "the drawee's signed engagement to honor the draft as presented."[54] Clause (iii) of section 3-417(1)(c)

48. UCC § 3-407(2)(a).
49. UCC § 3-407(2)(b).
50. See UCC § 3-407, Comment 3a.
51. See UCC § 3-417, Comment 5.
52. Espy v. Bank of Cincinnati, 18 Wall. (85 U.S.) 604 (1873); Bank of Commerce v. Union Bank, 3 N.Y. 230 (1850).
In both cases, all parties were acting in good faith. And in both cases recovery by the drawee was based on the pre-Code doctrine of mutual mistake.
53. Interstate Trust Co. v. United States Nat'l Bank, 67 Colo. 6, 185 Pac. 260 (1919). NIL warranties were not made to payors. The payor recovered under the doctrine of mutual mistake.
54. UCC § 3-410(1).

additionally negates any attempt by an acceptor or payor to by-pass the warranty, *i.e.*, the warranty is not given "even though the acceptance provided 'payable as originally drawn' or equivalent terms. . . ."[55]

The last clause in this last presentment warranty (section 3-417(1)(c)(iv)) states that a warranty of no material alteration is not given by a HDC acting in good faith "to the acceptor of a draft with respect to an alteration made after the acceptance." This exception was not in the 1952 Official Text but has been included in the 1958 and 1962 versions. Prior to the inclusion of this exception, the HDC acting in good faith was not exempted from the warranty of no material alteration made after acceptance. The basis for protecting the good faith HDC is analogous to that for protecting him against the claim of a maker who has paid or accepted. The acceptor has records of acceptance which can be used to verify the presented instrument as to its contents when accepted. He should know what he accepted. If, nevertheless, the acceptor pays, such payment is final.

III

MYTH OF THE SHELTER PROVISION

Three hypothetical problems are set out below. Each demonstrates the operation of a single warranty. In each hypothetical, the other two warranties not discussed are assumed to have not been breached.

1. *Warranty of good title.* Since the warranty of good title is good title in fact, neither good faith nor a lack of it on the part of the presenter is relevant to a breach. If the warranty is breached, recovery may be had by the payor. The shelter provision has no effect.

2. *Warranty of no knowledge that the drawer's signature is unauthorized.* *A*, an HDC, transfers the instrument to *B* after its maturity. Under the shelter provision (section 3-201(1)), *B* acquires all of *A*'s rights as an HDC. But if *A* did not know that the drawer's signature was forged and *B* did, *B*'s guilty knowledge will cause him to breach the warranty. Had *A* presented, payment to him would have been final. Thus, the shelter provision can help *B*

55. UCC § 3-417(1)(c)(iii).

as regards this warranty only if, in his own right, he lacks knowledge of the forgery. The reverse would be true if *A* learned of the unauthorized drawer's signature before he transferred to *B*, and *B* took after maturity but without knowledge of the invalidity of the signature. Here *B* could retain what was paid to him despite *A*'s guilty knowledge.[56] The shelter provision affords no protection for *B* when he has guilty knowledge. It protects him from being burdened with *A*'s guilty knowledge, however, in that such knowledge is not attributed to him through the shelter provision.

3. *Warranty of no material alteration.* *C*, an HDC, transfers an instrument to *D* after maturity. Under the shelter provision, *D* acquires all of *C*'s rights as an HDC. Assuming that the instrument was materially altered, but that an HDC could enforce it according to its original tenor, then, under the shelter provision, *D* can enforce the instrument according to its original tenor.

The warranty of no material alteration is breached by *D* when he presents the instrument. Thus, if a drawee of a check pays *D* the altered amount of the check, *D*, having presented an altered instrument, will be required to disgorge all he received over and above the amount for which the original check was drawn. He will have to do this whether he acted in good or bad faith.

But, if *D* took a note and presented it to the maker for payment, and was paid, *D*'s good faith apparently would be determinative of whether he could be forced to disgorge. A holder in due course acting in good faith makes no warranty concerning alteration, to the maker, the drawer, and, under additional circumstances, to the acceptor.[57] If *C*, who is *D*'s HDC transferor, had neither knowledge nor suspicion of the alteration at the time he transferred to *D*, but *D* had such knowledge or suspicion, *D* could not rely on *C*'s good faith. He would breach the warranty to the maker and could be forced to disgorge everything over the amount for which the instrument was originally drawn. If *C* had the guilty knowledge or suspicion, but *D* did not, *D* could rely on his own good faith and retain whatever the maker paid him. Here again the shelter provision affords no protection to *D*, the person taking under it, against the burdens of his own bad faith. Again, *C*'s bad faith is not transferred to the party taking under the shelter provision.

56. However, since the presentment warranties are also imposed upon "any prior transferor," (section 3-417(1)), *A* would be liable for the breach of warranty.

57. UCC § 3-417(1)(c)(iii).

CONCLUSION

The scope of the warranty of no knowledge that the drawer's or maker's signature is unauthorized and of the warranty of no material alteration is affected by the presenter's status as an HDC acting in good faith. As discussed earlier,[58] good faith is non-transferable. Thus, while all of the "rights" of an HDC can be transferred under the shelter provision (section 3-201(1)), his "right" to be relieved of warranty liability under section 3-417(1) is not transferred. Where an HDC acting in good faith (in warranty terms) transfers to one who has guilty knowledge, the transferee, while having all of the rights of the HDC, warrants to a wider group of people than would his transferor; he warrants to makers, drawers, and acceptors. The shelter provision cannot provide the good faith necessary to protect him. To this extent, at least, its protection is a myth.

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58. See note 12 *supra* and accompanying text.

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