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CHECK PAYMENT: FINALITY UNDER THE UNIFORM COMMERCIAL CODE

by John P. Finan*

MAY A BANK which pays a check by mistake recover the payment? The answer has traditionally depended upon the law of restitution as modified to fit the peculiar necessities of the law of bills and notes.¹ Such law determines whether payment may be recovered by balancing the equities between the parties.² The leading case in this field is *Price v. Neal*,³ which holds that if the payor and the person paid are equally innocent, the law will not shift the loss from one innocent person to another. In *Price* the signature of the drawer was forged.

Unlike the Negotiable Instruments Law⁴ which treated the problem of finality of payment or acceptance in a fragmentary manner, the Uniform Commercial Code has provided for the problem rather exhaustively in §§ 3-417(1)⁵ and 3-418.⁶ Section

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¹ Restatement of Restitution §§ 30-38 (1941). The Negotiable Instruments Law § 62 (5 U.L.A. § 62) partially codified the rule, and the doctrine of *Price v. Neal*, 3 Burr. 1354, 96 Eng. Rep. 221 (1762), was deemed to be in force under the N.I.L. Britton, *Britton on Bills and Notes* 380-382 (2d ed. 1961). A few common law decisions in this country rejected the doctrine of *Price v. Neal* and allowed recovery on a showing of mutual mistake. *Id.* at 379.

² Ames, *The Doctrine of Price v. Neal*, 4 Harv. L. Rev. 297 (1890). See also Uniform Commercial Code, § 3-417, Comment 4, 1962 Official Text with Comments. [Hereinafter all Code references, and all section references are to the 1962 text unless otherwise indicated.]

³ 3 Burr. 1354, 96 Eng. Rep. 221 (1762).

⁴ 5 U.L.A. § 62 (1943).

⁵ § 3-417(1) provides:

"(1) 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; and

(b) he has no knowledge that the signature of the maker or drawer is unauthorized, except that this warranty is not given by a holder in due course acting in good faith

(i) to a maker with respect to the maker's own signature; or

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3-418 provides that payment or acceptance of any negotiable instrument is final in favor of a holder in due course, or a person who has in good faith changed his position in reliance on the payment. There are two exceptions. Payment is not final if a presentment warranty has been breached⁷ or if the payor bank may recover a payment improperly made by returning the item or sending notice of dishonor within the time limits of § 4-301. Sections 3-418 and 3-417(1)⁸, taken together, codify prior law⁹ in those areas where the question of finality is determined by balancing the equities between the parties. The Article 4 excep-

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- (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 or obtained the acceptance without knowledge that the drawer's signature was unauthorized; and
- (c) 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."

⁶ § 3-418 provides:

"Except for recovery of bank payments as provided in the Article on Bank Deposits and Collections (Article 4) and except for liability for breach of warranty on presentment under the preceding section, payment or acceptance of any instrument is final in favor of a holder in due course, or a person who has in good faith changed his position in reliance on the payment."

⁷ Literally, only the warranties of § 3-417(1) are exceptions to finality under § 3-418, *supra* n. 6. The Article 4 exception to finality refers to § 4-301, not § 4-207(1), which is the functional equivalent of § 3-417(1) and which provides identical warranties in almost identical language for customers and collecting banks. Despite the literal language, it is inconceivable that § 4-207(1) would not constitute an exception. See § 4-102(1). See also Bunn, *Bank Deposits under the Uniform Commercial Code*, 1964 Wis. L. Rev. 278 (1964).

⁸ Reference to § 3-417(1) includes § 4-207(1) where that is the applicable section.

⁹ The Code has been enacted in 49 states, the District of Columbia, and the Virgin Islands. Uniform Commercial Code (U.L.A.) 1968 Supp. p. 9.

tion¹⁰ codifies the law on accountability of payor banks in the check collection process. Phrased another way, the first exception, found in § 3-418, provides that payment is not final if a payor bank is not accountable for an item.¹¹

A bank becomes accountable for a check¹² which is received otherwise than for immediate payment over the counter, when it makes an authorized settlement before midnight of the banking day of receipt and (a) finally pays the check or (b) fails to return the check or send written notice of dishonor or non-payment before its midnight deadline.¹³ If it makes final payment, it becomes accountable under § 4-213 (1). And if it fails to take action within the time prescribed by § 4-301, it becomes accountable under § 4-302. Three situations are suggested: (A) Payment may be final under § 3-418 though it is not final under § 4-213 (1);¹⁴ (B) Payment may be final under § 4-213 (1) though it is not final under § 3-418;¹⁵ and (C) Payment may be final under both sections.¹⁶ The last seems redundant; final payment is final. In fact, no redundancy exists as the word "final" is used equivocally. Under § 4-213 (1) it is used to distinguish final payment from provisional payment. Under § 3-418 it deprives a drawee who has finally paid off a cause of action for the recovery of payment except as provided by the Code for breach of presentment warranty.

What is the difference between payment which is final only under § 4-213 (1) and payment which is final under both sections? If payment is final under both sections, no recovery may

¹⁰ § 4-301.

¹¹ § 4-104(g). "Item" means any instrument for the payment of money even though it is not negotiable but does not include money."

¹² § 3-104(2)(b). A check is a negotiable instrument drawn on a bank and payable on demand.

¹³ §§ 4-301(1), 4-302. See also § 4-104(h) for definition of "midnight deadline."

¹⁴ If the payor bank, though it has not finally paid an item under § 4-213(1), becomes accountable under §§ 4-301 and 4-302, and there is no breach of presentment warranty, payment is final by the terms of § 3-418.

¹⁵ If an item is finally paid under § 4-213 to a person who is neither a holder in due course nor a person who has in good faith changed his position in reliance on payment, payment is not final under § 3-418. (Absent breach of presentment warranty, it may be final under supplementary principles of law and equity.)

¹⁶ If final payment under § 4-213 is made to a holder in due course or a person who has in good faith changed his position in reliance on payment, it is final under § 4-213(1) and § 3-418.

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be had by a bank except as specifically provided by the Code.¹⁷ If payment is final only under § 4-213 (1) however, resort may be had not only to the breach of warranty provisions of the Code, but also to supplementary principles of law and equity.¹⁸

Returning to the principal problem of this paper—recovery of payment once a payor bank has become accountable—§ 3-418, comment one, provides that “[t]he section follows the rule of *Price v. Neal* . . . under which a drawee who accepts or pays an instrument on which the signature of the drawer is forged is bound on his acceptance and cannot recover back his payment.” The rule of *Price v. Neal*^{18a} has frequently been subject to attack and suffers from the lack of an acceptable rationale.¹⁹ Two rationales are suggested in comment 1 to § 3-418. The comment states that “[t]he traditional justification for the result is that the drawee is in a superior position to detect a forgery because he has the maker’s signature and is expected to know and compare it; . . .” This reasoning is not persuasive. Even if the forgery were so expert that no bank employee could reasonably be expected to tell the difference between it and the true signature, the rule would still apply. The drafter of the Comment apparently recognized the weakness of the rationale by suggesting that “. . . a *less fictional rationalization* is that it is highly desirable to end the transaction on an instrument when it is paid rather than reopen the same and upset a series of commercial transactions at a later date when the forgery is discovered.”²⁰ (Emphasis added.) The second rationale, whatever else its merits, suffers from being inconsistent with the Code’s rule that a payor bank may recover for breach of warranty if it has paid over a forged endorsement.²¹ It is singular that comment 3 to § 3-417 justifies the distinction between forgery of a drawer’s signature

¹⁷ According to the 1956 Recommendation of the Editorial Board for the Uniform Commercial Code § 4-209 at 146, the deletion from § 3-417 of a warranty of no knowledge of any effective direction to stop payment evidences no intent to change the common law insofar as there are common law decisions on the subject. Does this mean that despite final payment under § 4-213(1) to a holder in due course or other party protected under 3-418, the person paid might be liable in an action by the bank to recover payment, although no presentment warranty under the Code were breached? If so, this casts doubt on meaning of the word “final” in § 3-418.

¹⁸ 2 New York Law Revision Commission Report, Study of the Uniform Commercial Code, at 310-317 [1072-1079] (1955).

^{18a} 3 Burr. 1354, 96 Eng. Rep. 221 (1762).

¹⁹ Britton supra n. 1 at 377.

²⁰ § 3-418, Comment 1.

²¹ § 3-417 (1) (a), § 4-207 (1) (a).

and forgery of an endorsement on the basis that the ". . . drawee is in a position to verify the drawer's signature by comparison with one in his hands, but has ordinarily no opportunity to verify an endorsement." It would have been more enlightening if the comment suggested how these provisions could be distinguished on the basis of the "less fictionalized" rationale.

The Code balances the equities²² between persons who obtain payment or acceptance and prior transferors on the one hand and payors on the other by the use of warranties and provides that any person who obtains payment or acceptance and any prior transferor warrants to the payor bank that he has no actual²³ knowledge that the signature of the maker or drawer is unauthorized.²⁴ According to prior law, one who at the time of payment suspected, or had reason to know of the mistake of the payor, was subject to an action of restitution.²⁵ This constituted an "exception"²⁶ to the rule of *Price v. Neal* and is consistent with the rationale of that case, for while there is no reason to shift the loss from one innocent man to another, there is reason to place the loss upon one who either knew or had reason to know that the signature was forged.

The Code position, however, is that the person who obtains payment or acceptance has equities equal or superior to the bank which pays on a forged order unless the person paid has actual knowledge of the forgery. This position is objectionable in that it fails to recognize that a person paid who suspects or has reason to know of the mistake has less equities than a payor who is without fault or whose fault is at most constructive. But even this warranty, limited as it is, is weakened by complex exceptions which reflect a poor policy choice.

The Code provides that the warranty given in § 3-417(1)

²² § 3-417, Comment 4.

²³ 1-201(25) "A person 'knows' or has 'knowledge' of a fact when he has actual knowledge of it."

²⁴ See text of statute *supra* n. 5.

²⁵ Restatement of Restitution § 34b (1941).

²⁶ "The doctrine of *Price v. Neal* is not available to a holder who (1) is guilty of bad faith, or (2) has been negligent." *First Nat. Bank v. United States Nat. Bank*, 100 Or. 264, 197 Pac. 547 at 551 (1921). Negligence in taking the instrument or bad faith in obtaining payment will be referred to hereinafter as "exceptions" to the rule of *Price v. Neal*, but it is probably more accurate to say that the rule itself has no application to those whose equities have been diminished by bad faith or negligence when such equities are being compared to a payor bank whose only "fault" is constructive. *Ibid.*

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(b)²⁷ is not given by a holder in due course to a maker with respect to the maker's own signature, nor to a drawer with respect to the drawer's own signature, whether or not the drawer is also the drawee.²⁸ Prior law afforded equal treatment to a party who paid over his own forged signature and a drawee who paid a bill on which the drawer's signature was forged.²⁹ In both cases the rule of *Price v. Neal* applied, and in both instances the "exceptions" to that rule applied.³⁰ The drafters of the Code, for reasons which are not explained, have made a distinction between drawees who are not drawers on the one hand and makers and drawers on the other. How the fact that the drawee is also the drawer changes the equities between the parties is not apparent. Certainly no distinction can be made on the basis of the Code's explicit rationale for the rule in *Price v. Neal*. A drawer, whether or not he is also the drawee, has no greater opportunity to verify the signature of the drawer than a drawee who is not the drawer; and the desirability of finality of payment seems equal in both cases. One might surmise that the drafters thought that the situations listed in § 3-417(1)(b)(i) and (ii) represented greater folly on the part of the payor. Certainly makers and drawers should know their own signatures. Frequently, however, makers and drawers who have made the mistake denounced in § 3-417(1)(b)(i) and (ii) are large institutions, or even the United States Government³¹ (to which the Code probably applies),³² and although such institutions may be faulted for not

²⁷ See text accompanying n. 5 *supra*.

²⁸ My criticism of §§ 3-417(1)(b)(i) and (ii) does not apply to (iii) in that an acceptor of a draft is liable under § 3-413 to a holder in due course who took the draft after the acceptance. This rule of § 3-413 seems desirable when the holder in due course relies on the acceptance. But see Britton, *Defenses, Claims of Ownership and Equities*, 7 *Hastings L. J.* at 39 and 40 (1955). The rule of § 3-417(1)(b)(iii) is clearly right, since it would be ludicrous to give a person a right to obtain payment, and then allow recovery. Section 3-417(1)(b)(iii) also protects a holder in due course who obtains the acceptance without knowledge that the drawer's signature is unauthorized. Section 3-413 also protects such holder. Whether or not this is wise (see Britton, *supra*), it is necessary to make payment final as to such holder, since he has a right to demand payment under § 3-413.

²⁹ Restatement of Restitution § 30 (1941).

³⁰ *Id.* at § 34(b).

³¹ See *Hartsman v. Henshaw*, 11 How. 177 (1854); F. Beutel, *Beutel's Branman Negotiable Instruments Law*, § 62 at 906-907 (7th ed. 1948).

³² *Clearfield Trust Co. v. U.S.*, 318 U.S. 363, 58 S. Ct. 817 (1943), holds that the rights of the United States on Commercial paper which it issues are governed by federal common law and not local law under *Erie R. Co. v. Tompkins*, 304 U.S. 64, 58 S. Ct. 817 (1938). In *New York, N. H. and H. R.*

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setting up internal mechanisms to detect forgery, it is not evident why they should be forced to be more efficient in their internal control mechanisms than a drawee who is not also the drawer. Furthermore, as comment 4 to § 3-417 points out, “. . . one who presents an instrument knowing that the signature of the maker or drawer is forged or unauthorized commits an obvious fraud upon the party to whom the presentment is made.” That same comment recognizes that subsection 1(b) is dealing with competing equities of parties accepting or paying instruments bearing unauthorized makers' or drawers' signatures. I submit that the folly of the party who pays does not deprive him of equities superior to one who has committed an obvious fraud.

In order to be excused from the warranties of § 3-417(1)(b) the holder in due course must act in good faith. This qualification adds an enigma to a section which is already undesirable on policy grounds. Good faith is defined by the Code as “honesty in fact in the conduct or transaction concerned.”³³ How may one with actual knowledge that the signature of the maker or drawer is a forgery act in good faith in obtaining payment to which he has no right? Such action coupled with such knowledge is incompatible with honesty. And yet the courts in interpreting this section will be faced with a dilemma. If they hold that good faith is incompatible with knowledge, §§ 3-417(1)(b)(i) and (ii) will be rendered surplusage; for the warranty is not breached unless there is knowledge and the exceptions do not apply unless there is good faith. If they hold that good faith is not compatible with knowledge, they will violate the basic rule of statutory construction that every word in a statute must be given a meaning, and that no language must be considered surplusage.³⁴ They may avoid the dilemma by noting that maxims of statutory construction do not decide cases,³⁵ and that this maxim does not apply if

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Co. v. Reconstruction Finance Corp., 180 F.2d 241, 244 (2d Cir. 1950) Judge Learned Hand said: “[T]he Negotiable Instruments Law has been enacted in every state of the Union [UCC in 49 states] as well as the District of Columbia; it is a source of ‘federal law’—however that phrase may be construed—more complete and more certain, than any other which can conceivably be drawn from those sources of ‘general law’ to which we were accustomed to resort in the days of *Swift v. Tyson*.”

³³ § 1-201(10).

³⁴ 2 J. Sutherland *Statutory Construction* § 4705 at 339 (3rd ed. 1943). 46 P.A. § 551.

³⁵ K. N. Llewellyn, *The Common Law Tradition: Deciding Appeals* 520 (1960). See also Frankfurter, *Some Reflections on the Reading of Statutes*, 47 Colum. L. Rev. 529, 530 (1947).

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the words in question are the result of an obvious mistake or error.³⁶ There is authority under the Code that when a statute leads to an absurdity, even its plain meaning will be rejected.³⁷ Perhaps the courts will decide that §§ 3-417(1)(b)(i) and (ii) and the functionally equivalent §§ 4-207(1)(b)(i) and (ii) are the products of mistakes.

Professor Mellinkoff asserts that “. . . [T]he UCC is a slipshod job of draftsmanship.”³⁸ In the catalog of drafting misfortunes which he cites to support this assertion he mentions the problem we are discussing. He asks how a party paid “. . . may walk up to the pay window with a black conscience . . . and still be *acting in good faith*. . . .”³⁹ He concludes that this is an “unexplained mystery,” stating:

“Nestled in the protective camouflage of a 245-word sentence, *holder in due course acting in good faith* may be unobtrusive enough. Flushed out it amounts to doubletalk. The time for rationalizing the language was in the drafting stage.”⁴⁰

Professor Mellinkoff sees the instant problem as one of draftsmanship. Certainly it is that, but the law which this draftsmanship enacts is the product of a policy choice.

According to § 3-417, comment 4, although an obvious fraud is committed when the party obtaining payment or acceptance has knowledge that the signature of the maker or drawer is unauthorized, this simple fact situation is presented in only a few cases. The draftsman of the comment argues that

“. . . [i]f the signature of the maker or drawer has been forged, the parties include the dishonest forger himself, and usually one or more innocent holders taking from him. Frequently the state of knowledge of a holder is difficult to determine and sometimes a holder takes such a forged instrument in perfect good faith but subsequently learns of the forgery. Since in different fact situations holders have equities of varying strength, it is necessary to have some exceptions to the basic warranty.”

³⁶ Sutherland, *supra* n. 34, at § 4705.

³⁷ *Roto-Lith Ltd. v. Bartlett & Co.*, 297 F.2d 497 (1st Cir. 1962). In construing § 2-207 the court *inferred* that acceptance of an offer was conditional and concluded that acceptance was *expressly* made conditional since otherwise “the statute would lead to an absurdity.” The court suggested that “the statute is not too happily drafted.”

³⁸ Mellinkoff, *The Language of the Uniform Commercial Code*, 77 Yale L. J. 185 (1967).

³⁹ *Id.* at 219.

⁴⁰ *Id.* at 220.

This explanation is hardly convincing. The Code protects a holder in due course even if it can be proved beyond a shadow of a doubt that he had knowledge that the signature of the maker or drawer was unauthorized at the time payment was obtained; or at the time of transfer in the case of a prior transferor. The objective stated in the comment could have been achieved by placing on the maker or the drawer the burden of proving the knowledge of the holder in due course who obtained payment. The Code could have required clear and convincing evidence or even, if its policy was strong enough, the criminal standard—proof beyond a reasonable doubt. The Code is clear, however, that degree of proof has nothing to do with the matter. The only limitation is good faith, and good faith has nothing to do with the amount of proof available to show knowledge. In any event, the comment⁴¹ does not restrict itself to considering standards of proof. It suggests that, under some circumstances at least, a holder in due course with actual knowledge of a forgery may obtain payment, and yet possess equities which are equal or superior to the payor's. It does not explain its suggestion. Such a holder in due course commits an "obvious fraud" and there is nothing in the comment suggesting a fact situation, of any complexity, which would shift the equities so as to favor the perpetrator of such a fraud. Despite the comment, the rationale for assuming that a fraudulent presentor may have equal or superior equities to the payor is not apparent. Even if we could conjure up a fact situation so complex that the equities would be as suggested by the Code comment, it would constitute no justification for the policy choice the Code has made. For §§ 3-417(1)(b)(i) and (ii) are not limited to such obscure situations. The comment may, however, offer a way out of the dilemma posed above. A court may find that, in any given fact situation, good faith is incompatible with knowledge and yet preserve a function for §§ 3-417(1)(b)(i) and (ii) by suggesting that these provisions apply in some obscurely complex fact situation which has not as yet been presented to the court. A more forthright approach would be to define knowledge objectively. The Code defines knowledge as actual knowledge (a subjective test) but this definition is subject to the proviso "... unless the context otherwise requires..."⁴² Taking advantage of this proviso and defining knowledge objectively would

⁴¹ § 3-417, Comment 4.

⁴² § 1-201.

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permit a court to avoid the absurd holding that fraud is compatible with good faith, and still provide a function for §§ 3-417 (1) (b) (i) and (ii), which would apply in those instances where a holder in due course obtained payment with reason to know but no actual knowledge that the signature of the maker or drawer was unauthorized. Thus an objective definition would remove the objection that §§ 3-417(1) (b) (i) and (ii) would be rendered surplusage by a finding that fraud and good faith are incompatible. An incidental benefit of an objective definition, in my opinion, would be a fairer balancing of the equities between the payor and person paid.

In addition to the warranty just discussed and the warranty of title, the Code also provides another exception to finality of payment in § 3-417 (1): "Any person who obtains payment or acceptance and any prior transferor warrants to a person who in good faith pays or accepts that . . . (c) the instrument has not been materially altered. . . ." This warranty is also subject to exceptions. It 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."⁴³

The basic exceptions seem sound. If one is to determine finality of payment on the basis of balancing the equities in this area, as well as in the area of a forged order,⁴⁴ it is arguable that

⁴³ § 3-417(1) (c).

⁴⁴ In answering the question how far the exceptional rule of *Price v. Neal*, as codified in a fragmentary manner by § 62 of the N.I.L. (5 ULA § 62), may be carried by analogy, Professor Britton includes among "actualities and possibilities" erasure of a genuine signature and substitution of a forgery and the filling in of words and figures in blank spaces. There is authority that at common law the analogy to the rule of *Price v. Neal* was held inapplicable to rights of a drawee to recover on a materially altered instrument. However where ". . . a bill was drawn upon the drawer a payment thereof was not recoverable on the grounds of estoppel." Britton, *Britton on Bills and Notes* 399 (2d ed. 1961). *United States v. National Exchange Bank of Baltimore*, 270 U.S. 527, 46 S. Ct. 388 (1926), is cited by Britton (*Id.* note 2), for the proposition that ". . . the paying drawer-drawee could not recover money paid out on a raised check because the payor was deemed to know the amount for which the check was drawn, . . ." Compare this with the rationale for *Price v. Neal* that the drawee is in a superior position to detect the forgery.

a holder in due course who obtains payment (or a prior transferor) has equities equal or superior to the maker of a note, the drawer of a draft, or an acceptor covered by § 3-417(1)(c)(iv),⁴⁵ who arguably should know the instrument was altered. In these cases, unlike those where the order has been forged, the skill of the person making the alteration can never make the altered item conform to the records kept by the issuer of the instrument. This rule puts a severe strain on large organizations, but a policy to encourage them to be cautious in their cashing practices does not seem unwarranted. What, however, happens if the holder in due course has actual knowledge that the instrument has been materially altered? If one looks at this as an initial proposition, it would seem clear that the exceptions to the warranty do not apply, since their applicability is dependent upon the holder in due course acting in *good faith*. The meaning of the term "good faith," however, is obscured by its use in § 3-417(1)(b), discussed above. I submit that even if a court should find that good faith is compatible with knowledge that the signature of the maker or drawer is unauthorized, such a finding of compatibility ought not to be applied beyond the limited situation which has given rise to it. Clearly, § 3-417(1)(c) does not require a holding that good faith be compatible with guilty knowledge. The exceptions to the warranty against material alterations are not surplusage even though we find incompatibility. They apply in those situations where the instrument has been materially altered, but the holder in due course has no knowledge of the alteration.

Section 3-417(1)(c)(iii) presents a serious problem. The Code has a basic policy of freedom of contract.⁴⁶ Yet in that section the provision "payable as originally drawn" and equivalent terms are stripped of meaning. An example will illustrate the problem presented.

Assume that a bank has certified a check which was altered prior to certification and that a holder in due course takes the check after certification. The certifying bank is liable to pay the instrument according to its tenor at the time of its engagement.⁴⁷

⁴⁵ Section 3-417(1)(c)(iii) is clearly justified since the party protected had, prior to payment, a contractual right to payment (§ 3-413(1)) according to the tenor of the instrument at the time of acceptance. But see discussion, *infra*, concerning contractual limitations.

⁴⁶ §§ 1-102(2) and (3).

⁴⁷ Section 3-413(1) provides that ". . . [an] acceptor [certification of a check is acceptance, § 3-411(1)] engages that he will pay the instrument according to its tenor at the time of his engagement or as completed pursuant to section 3-115 on incomplete instruments."

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Assuming that the check was for \$1,000 and was raised to \$10,000, the bank would be liable to pay \$10,000. Furthermore, payment would be final in favor of a holder in due course, even if the holder in due course had actual knowledge at the time he obtained payment that the check was altered.⁴⁸ (Of course, he could have no such knowledge when he took the check; otherwise he would not be a holder in due course.) What happens if the accepting bank has certified the check "payable as originally drawn"? Once the check has been paid, the Code makes payment final in the altered amount despite this language. Why is the language given no effect? Comment 5 to § 3-417 explains that ". . . certifying checks 'payable as originally drawn' leaves the subsequent purchaser in uncertainty as to the amount for which the instrument is certified and so defeats the entire purpose of certification, which is to obtain the definite obligation of the bank to honor a definite instrument." This rationale hardly seems consistent with the Code's stated policy in § 1-102(1)(b) ". . . to permit the continued expansion of commercial practices through custom, usage, and agreement of the parties." If checks certified "payable as originally drawn" should prove commercially unacceptable, presumably economic compulsion would cause deletion of the offending phrase. Why a code should decide, a priori, that under no circumstances should such a clause be effective is unclear. It is especially unclear in view of the general policy of the Code expressed in § 1-102(3) that "[t]he effect of provisions of this Act may be varied by agreement, . . ." It is also inconsistent with the omission from § 3-413(1) of any limitation on freedom of contract. The result of this omission is that a certifying bank may limit its engagement under § 1-102(3). Apart from policy problems, this limitation on freedom of contract also raises an issue in the interpretation of the words "good faith" in § 3-417(1)(c).

One with knowledge of a material alteration may act in good faith in obtaining payment in the altered amount if he has a right to such payment, and such a right is granted under § 3-413. But what if a check is certified "payable as originally drawn"? Section 3-413 is subject to § 1-102(3), which gives effect to such contractual limitations. Thus, if a bank certifies "payable as

⁴⁸ Such a holder would be acting in good faith, since the bank is under an obligation (§ 3-413(1)) to pay regardless of the alteration, and hence knowledge is immaterial. Restatement of Restitution § 34(b) (1941).

originally drawn," such a bank is presumably liable only according to the original tenor of the item; in our hypothetical example, \$1,000. It follows that if a holder in due course of a certified check acquires knowledge that it is altered, and it was certified "payable as originally drawn," such a holder acts in bad faith in obtaining payment in accordance with the altered tenor. The distinction drawn between the effect of the language "payable as originally drawn" or its equivalent in §§ 3-413 and 3-417 (1) (c) (iii) is anomalous, and one is tempted to try to find a solution by imposing on §3-413 the limitations on contractual freedom found in § 3-417 (1) (c) (iii). However, the wording of the statute is clear on this point, and no compelling reason is manifest why the language of the Code should be departed from.

It has been seen that the Code gives special protection to holders in due course both in §§ 3-417 (1) (b) and (c) and in § 3-418. This use of the holder-in-due-course concept is subject to criticism.⁴⁹ In an article on the doctrine of *Price v. Neal*,⁵⁰ Professor Aigler states that the protection of holders in due course has policy roots which are similar to the basis of giving protection to bona fide purchasers of property in other situations. According to another recognized authority,⁵¹ the ordinary reason for giving protection to a holder in due course, the facilitation of the free circulation of commercial instruments, is not applicable to the doctrine of *Price v. Neal*.

"[S]ince even a holder in due course cannot enforce a forged instrument, he should not necessarily be able to retain a payment made on such an instrument. He must show a greater claim to protection than the ordinary policy favoring free circulation of a commercial instrument which protects negligent purchases of genuine paper. He must show a meritoriousness greater than that of the ordinary holder in due course in order to make the equities equal as between himself and the drawee bank."⁵²

Professor Aigler agrees: . . . "[I]n determining whether a drawee shall be allowed to recover back money paid on a forged order the whole problem is one of equitable relief, often invoking a

⁴⁹ Britton, *supra* n. 1, at 386; N.Y. Law Revision Commission Report *supra* n. 18, at 313, 314 [1075, 1076].

⁵⁰ Aigler, *The Doctrine of Price v. Neal*, 24 Mich. L. Rev. 809 at 825 (1926).

⁵¹ F. Beutel, *Beutel's Brannan Negotiable Instruments Law*, § 62 at 915 (7th ed. 1948).

⁵² *Ibid.*

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delicate weighing of equitable considerations on each side.”⁵³ Early drafts of the Code recognized the inappropriateness of the holder-in-due-course concept in the context of finality of payment. It was provided⁵⁴ that acceptance or payment was to be final “. . . to the extent that any party has paid for the instrument in good faith.” Later the Code accepted the holder-in-due-course standard.

Are there any exceptions to the rule that payment is final in favor of holders in due course? At common law there were two exceptions, negligence and bad faith. The negligence exception has been abrogated to the extent that the Code applies. According to comment 4 to § 3-418: “[t]he section rejects decisions . . . permitting recovery on the basis of mere negligence of the holder in taking the instrument.” What of other exceptions to the rule of *Price v. Neal*? What of the exception that if the party paid acts in bad faith he must disgorge his gain?

The fact situation in Illustration 2, Restatement of Restitution, § 34 illustrates this problem.

“A receives a check from B drawn on the C bank, being told by B that he does not have enough in the bank to cover it but that he hopes to have a sufficient amount in a few days. A immediately takes the check to the C bank, which pays it, the paying teller, as A suspects, mistakenly believing that B’s account is sufficient to cover the check.”

Under the Restatement, C is entitled to restitution from A because of A’s fraudulent non-disclosure. Under the Uniform Commercial Code, is C entitled to restitution from A, if A is a holder in due course? Presumably not, if we read the language of the Code literally. Section 3-418 makes payment final; the only exception allowed is breach of presentment warranty under § 3-417 (1), and there is no such breach.

In developing the law with respect to finality of payment, the Code drafters had to make a choice between competing equities. It seems that making payment final in this instance was a poor choice. Section 3-418 uses general language. Obviously the drafters of the Code could not have every situation in mind. Is it possible that if they had considered this particular situation, they would have decided in a manner contrary to the dictates of the literal language of the Act? And would a court depart from

⁵³ Aigler, *supra* n. 50, at 825.

⁵⁴ § 512 of the proposed final drafts #2, 1948.

the literal language in order to give effect to such a decision? Possibly yes,⁵⁵ but it is not necessary to resort to inference to preserve the bad faith defense to the doctrine of *Price v. Neal*. Section 1-203 provides that “[e]very contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.” A holder in due course obtaining payment has certain duties; among these are the duties imposed by § 3-417. Whatever other duties may be imposed on one obtaining payment, the Code is explicit that an obligation of good faith is included. That obligation means “honesty in fact”⁵⁶ and, in the hypothetical example we are discussing,⁵⁷ the person paid acted dishonestly. Reading the good faith requirement into § 3-418, payment is not made final by that section, and since there is no breach of warranty under § 3-417 (1), we must resort to supplementary principles of law and equity.⁵⁸ These principles include the law of restitution developed under non-Code law, specifically the special rules for bills and notes which modify the basic rules of restitution. And under such rules, payment is not final in favor of a holder in due course who has acted in bad faith in obtaining payment.⁵⁹

The above analysis assumes that supplementary principles of law and equity apply. Section 1-103 dictates that they should, but caution is suggested by an examination of prior cases under uniform acts, many of which have ignored express provisions

⁵⁵ Section 62 of the N.I.L. was received as a legislative affirmation of the rule of *Price v. Neal*, even though, by its terms, it only applied to acceptance and not to payment. Some courts extended it to payment and others decided that finality of payment was a *casus omissus* and applied the common law. What happened to the exceptions to the rule of *Price v. Neal* to the extent that § 62 was applied? § 62 N.I.L. was by its terms absolute: “The acceptor by accepting the instrument engages that he will pay it according to the tenor of his acceptance; and admits—1. The existence of the drawer, the genuineness of his signature, and his capacity and authority to draw the instrument. . . .” Nevertheless, the courts preserved the exceptions, reasoning that “it is inconceivable that the framers of the act designed to make § 62 absolute and free from the exceptions which had been previously recognized.” *First Nat. Bank v. United States Nat. Bank* 100 Or. 264, 197 P. 547, 553 (1921). It was reasoned that just as the courts adopted *Price v. Neal* with its exceptions, so did the legislature, although the exceptions were not expressed. *Ibid.* Since the UCC explicitly follows the rule of *Price v. Neal* (§ 3-418 Comment 1), it is certainly arguable that abrogation of exceptions, though absolute in terms, was not intended, at least with regard to the good faith exception. See § 1-203.

⁵⁶ § 1-201 (19).

⁵⁷ Illustration 2, Restatement of Restitution § 34 (1941).

⁵⁸ § 1-103.

⁵⁹ Restatement of Restitution § 34(b) (1941).

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requiring application of supplementary principles of law and equity and have decided that the statutory scheme was exhaustive. "Where common-law principles, associated with the subject matter with which a statute deals, are not expressly affirmed or denied, the extent to which the common law is altered or changed is left to implication."⁶⁰ One reason for deciding that a statute is not exhaustive, even if comprehensive, is that the drafters cannot anticipate in advance every situation which may be affected by the statute. A typical case involved a delegation of broad powers to an administrative agency to prescribe the warning signals and the safety devices at railroad crossings. Initially it was held that compliance with the regulations released the railroad from common law negligence. A few years later the court reversed itself in line with the weight of authority.⁶¹ "Similar difficulty has been experienced with reference to uniform state laws, and despite express provisions requiring cases not within the language of the statute to be governed by the common law."⁶² The problem with reference to uniform state laws can be illustrated by contrasting two cases decided under the Uniform Negotiable Instruments Act.

The first of these cases is *Howard National Bank and Trust Co. v. Newman*,⁶³ which holds that a person secondarily liable on an instrument is not discharged by release of the principal debtor on the instrument, if the person secondarily liable consents to the release. The court reached this result, despite N.I.L. § 120(5) which provides that release of the principal debtor discharges persons secondarily liable ". . . unless the holder's right of recourse against the party secondarily liable is expressly reserved. . . ." Such language as "unless the party secondarily liable consents to the release" is omitted from N.I.L. § 120(5), but the court preserved the common law effect of consent. It reasoned that although some courts have held that §§ 119 and 120 N.I.L.⁶⁴ are exclusive on the question of the discharge of negotiable instruments, some force and effect must be given to N.I.L. § 196, which provides for the application of supplementary

⁶⁰ 3 J. Sutherland *Statutory Construction* § 5305 at 12 (3rd ed. 1943).

⁶¹ *Id.* at 14, 15.

⁶² *Id.* at 15, 16.

⁶³ 115 Vt. 61, 50 A.2d 896 (1947).

⁶⁴ N.I.L. §§ 119 and 120 are the provisions on discharge. Section 119 deals with discharging a negotiable instrument, and § 120, with discharging persons secondarily liable on the instrument.

principles of law and equity unless displaced by the provisions of this Act.⁶⁵ *Cellers v. Meachem*,⁶⁶ on the other hand, decided that § 119 of the N.I.L. provides the exclusive method of discharging primary parties. It held that an extension of the time of payment granted to the principal debtor without the consent of the surety-co-maker, did not discharge the surety despite the common law to the contrary. The *Cellers* court relied on the maxim, "What is expressed in an Act is exclusive when it is creative or in derogation of some existing law or of some of the provisions of a particular Act."⁶⁷ The court also relied upon the maxim *expressio unius est exclusio alterius*. It is submitted that neither these maxims nor § 196 of the N.I.L. is dispositive. If the subject matter of the statute is discharge of a primary party who is also the principal debtor by *discharge of the instrument*, then clearly the common law applies.⁶⁸ If, however, the subject matter of the statute is discharge of any party primarily liable on a negotiable instrument whether or not such party is the principal debtor, and whether or not *the instrument* is discharged, then the common law is abrogated under both maxims quoted by the *Cellers* court and also by the provisions of Section 196 of the Negotiable Instruments Law. Neither N.I.L. § 196 nor the quoted maxims define the subject matter of the statute.

A similar question arises under § 1-103 of the Uniform Commercial Code, which provides: "Unless displaced by the particular provisions of this Act, the principles of law and equity . . . shall supplement its provisions." If the principles of law and equity we are talking about are all the principles relating to the law of finality of payment and acceptance, then the Uniform Commercial Code is exhaustive and the common law is abrogated. If "principles of law and equity" is defined more narrowly to include only those principles relating to finality of payment when payment is made to a holder in due course or a person who has, in good faith, changed his position in reliance on payment, plus the law and equity pertaining to those fact situations which would give rise to a breach of presentment warranty under the Code, then the Code is not exhaustive.

⁶⁵ Section 196 N.I.L. provides that "In any case not provided for in this act the rules of [law and equity including] the law merchant shall govern.

⁶⁶ *Cellers v. Meachem*, 49 Or. 227, 89 Pac. 426 (1907).

⁶⁷ *Id.* at 428.

⁶⁸ Britton, *supra* n. 1, at 701-02, argues for the application of the common law: "The discharge of a primary party who is also a surety is thus untouched by the Negotiable Instruments Law."

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In 1960, a commentator on the UCC stated that “[s]ections 3-417 (1) and 3-418, operating together, seem to eliminate rights of payors and acceptors based on quasi-contract and to limit their rights of recovery to theories of warranty.”⁶⁹ Did he mean that rights of payors and acceptors based on quasi-contract were eliminated with respect to all payments and acceptances based on mistake of fact, or is his statement limited to those areas specifically covered by the Code? Two examples will aid in exploring this problem. Example one involves a holder in due course who is negligent in taking an instrument. He obtains payment with no knowledge that the signature of the maker has been forged, and now the payor seeks recovery on the theory of quasi-contract. Under pre-code law it is clear, at least in many jurisdictions, that the payor would have recovered because of the holder’s negligence. However, the Code says that payment is final, and that the only exceptions to finality are the warranties in § 3-417 (1) and possibly lack of good faith.⁷⁰ Neither is found here, so payment certainly seems final.

Example 2 involves a holder who takes an instrument in good faith. He is not a holder in due course for the perfectly innocuous reason that he took a demand instrument 31 days after its issuance.⁷¹ It is clear that if such a person is not a holder in due course, and is not a person who has in good faith changed his position in reliance on payment, he is not protected by § 3-418. However, assuming no breach of warranty under § 3-417 (1), the Code does not apply, and it seems clear that under Article One, § 1-103, there will be resort to general principles of law and equity. According to these principles, if the holder acted in good faith in obtaining payment and was not negligent in taking the instrument, restitution will not be allowed; the payment is final.

Under familiar principles of statutory construction it might be argued that since payment is not made final under § 3-418, it

⁶⁹ R. Steinheimer, *Michigan Negotiable Instruments Law and the Uniform Commercial Code* 115 (1960).

⁷⁰ See discussion *supra* concerning the preservation of the good faith exception to the rule of *Price v. Neal*.

⁷¹ To be a holder in due course, a holder must take 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. § 3-302. Under § 3-304(3) “. . . a purchaser has notice that an instrument is overdue if he has reason to know (c) that he is taking a demand instrument . . . more than a reasonable length of time after its issue. A reasonable time for a check drawn and payable within the states and territories of the United States and District of Columbia is presumed to be thirty days.”

is by implication not final.⁷² This conclusion is unacceptable. If payment is not final, what is the basis of the payor's recovery? There is no breach of presentment warranty under § 3-417(1) and if he resorts to common law, that law decrees that payment is final. Furthermore, under the same principles of statutory construction, it might also be suggested that whenever there is no breach of presentment warranty under § 3-417(1), payment is final. This interpretation must also be rejected. Not only would it render § 3-418 surplusage, but it would make payment final in many instances where the equities clearly suggest recovery.⁷³ Furthermore, the Code is explicit that "the principles of law and equity, including the law merchant and the law relative . . . to mistake . . . shall supplement its provision."⁷⁴ According to § 1-103, comment 1, ". . . all supplemental bodies of law except insofar as they are *explicitly* displaced by this Act" remain applicable to commercial contracts. Certainly in those areas not covered by either § 3-417(1) or § 3-418 there is no explicit displacement, and courts should be cautious about drawing negative implications in light of the requirement of § 1-103 requiring "particular provisions" to displace the common law. Furthermore, as is clear from the above discussion, the negative implications cancel each other out.

Another facet of the problem respecting the applicability of supplementary principles of law and equity involves the question whether payors have a duty of acting equitably in giving notice of breach of warranty within a reasonable time after discovering it. Section 3-417 imposes no such burden. Indeed it is suggested that:

"The inclusion in article 4 of the Code of a requirement that a claim for breach of warranty be made within a reasonable time on penalty of discharge of liability to the extent of any loss caused by the delay, coupled with the omission of such a requirement from article 3, [§ 3-417] would seem to preclude a court from imposing the requirement by the application of equitable principles."⁷⁵

⁷² Section 3-418 comment 3 has language supporting this negative inference: "If he [the holder] has taken the instrument in bad faith or with notice [which includes taking the instrument 31 days after issue, § 3-304(3)(c)] he has no equities as against the drawee." See also Britton, *supra* n. 1, at 383-384.

⁷³ For example, such a negative implication makes payment final if a bad faith purchaser procured payment, provided only that bad faith does not include a breach of a presentment warranty under the Code.

⁷⁴ § 1-103.

⁷⁵ 17 Stan. L. Rev. 77, 83 (1964).

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Why should a court be so precluded? Apparently because the omission from one section of that which is included in a functionally equivalent section shows by implication a legislative intent that a corresponding rule of law shall not be applicable. The potency of this rule of negative implication is such that the Code has specific provisions negating it in certain cases: "The omission from either Part 2 or Part 3 of this Article [Article 7] of a provision corresponding to a provision made in the other Part does not imply that a corresponding rule of law is not applicable."⁷⁶ The Code section just quoted by its terms does not apply to the relationship between § 3-417 and the corresponding § 4-207. It might be argued that § 1-103, making applicable general principles of law and equity unless displaced by the particular provisions of this Act, forbids a negative implication. It does not for at least three reasons. First, cases under provisions similar to § 1-103 have not prevented negative implications. These cases, though not dispositive, represent persuasive authority. Second, such an interpretation of § 1-103 would render surplusage § 7-105; and finally, limiting the term "particular provisions" found in § 1-103 to express provisions would unduly and unwisely restrict courts in interpreting the Act. It does not follow, however, that because a negative inference is permissible, it is mandatory. The maxim *expressio unius est exclusio alterius* does not decide cases.⁷⁷ It is a rule of logic and is employed when there is a basis for making the inference that a provision is exhaustive; but it is disregarded when there is no such basis.⁷⁸ Whether or not there is such a basis depends on the legislative intent, to be determined by considering the statute as a whole, together with its legislative history and any other available aids. The maxim should not be applied mechanically, and only a mechanical application would reprove a warrantor under § 3-417 of a discharge to the extent of any loss caused by warrantee's delay in making claim.⁷⁹ There is nothing in the Code as a whole depriving the

⁷⁶ § 7-105. See also § 1-102(4), § 5-102(3).

⁷⁷ See Llewellyn, *supra* n. 35.

⁷⁸ 2 J. Sutherland, *Statutory Construction* §§ 4915-4917 (3rd ed. 1943).

⁷⁹ *Agar v. Orda*, 264 N.Y. 248, 190 N.E. 479 (1934), the approach of which is specifically endorsed by Comment 1, § 1-102, supports a rejection of negative implication and indeed development of a common law rule by analogy to § 4-207. See also Pound, *Common Law and Legislation*, 21 Harv. L. Rev. 383 at 385-86 (1908); Stone, *The Common Law in the United States*, 50 Harv. L. Rev. 4 (1936). These articles suggest that legislation might be received into the body of the law not only as a rule to be applied but as a principle from which to reason.

courts of the power to formulate rules respecting the shifting of equities caused by delay. There is a certain lack of judicial sympathy for the rule that presumes that unreasonable delay has caused damage.⁸⁰ Perhaps hostility against one who breaches a warranty accounts for this. But once it is proved that unreasonable delay has caused loss, judicial and legislative sympathy shift in favor of the warrantor whose breach, after all, is without fault in many instances.⁸¹ A court might decide that in certain instances involving bad faith on the part of the warrantor his liability was not discharged. But any rule is intolerable which forbids a court from deciding that liability for breach of a presentment warranty may never be discharged. A finding that the legislatures, adopting the Code, intended such a rule should not be left to inference.

We have already discussed the rule that mere negligence of the holder in taking an instrument does not affect finality of payment under § 3-418. According to comment 4 to that section:

“If such negligence amounts to a lack of good faith as defined in this Act (§ 1-201) or to notice under the rules (§ 3-304) relating to notice to a purchaser of an instrument, the holder is not a holder in due course and is not protected; but otherwise the holder's negligence does not affect the finality of the payment or acceptance.”

However, if a holder does not qualify for protection under § 3-418, negligence does affect finality of payment to him under the common law of many jurisdictions,⁸² which, if the above analysis of § 1-103 is correct, will continue to be the law when neither § 3-417 (1) nor 3-418 apply. Is it possible that enactment of the UCC may influence a change in this rule of common law? Courts frequently develop common law by reasoning by analogy from statutes, and the UCC drafters encourage courts to reason from the Code's basic policies.⁸³ There is case support suggesting that courts will accept this encouragement.⁸⁴ The following example illustrates this problem: A holder takes an instrument in good faith and for value, but notice is attributed to him because he took the instrument more than 30 days⁸⁵ after issue. Such

⁸⁰ *Clearfield Trust Co. v. United States*, 318 U.S. 363, 63 S. Ct. 573 (1943).

⁸¹ Annot., 116 A.L.R. 1470 (1938).

⁸² Beutel, *supra* n. 50, § 62 at 915.

⁸³ *Supra* n. 77.

⁸⁴ *Vitex Manufacturing Co. v. Caribtex Corp.*, 377 F.2d 795 (3d Cir. 1967).

⁸⁵ § 3-304(3)(c).

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holder was negligent in taking the instrument. According to Britton,⁸⁶ there is a conflict of authority on the question of whether the drawee may recover the money paid out on a forged bill or check from one who was negligent in his purchase of such instrument. In jurisdictions which allow recovery, does the Code alter the common law in any way? One of the policies of the Code, as expressed in § 3-418, is that negligence will not defeat finality of payment so long as such negligence is compatible with holder-in-due-course status. Is it not arguable that the common law of restitution should be modified by analogy and that only negligence which is incompatible with holder-in-due-course status should defeat finality of payment? This result would have at least two beneficial results. It would promote uniformity by harmonizing the applicable common law rules, and it would eliminate in an important area the drastic difference in treatment afforded those protected by § 3-418 and those not so protected. Such difference in treatment is hard to justify in those instances where lack of holder-in-due-course status is the product of a technicality.

The Code provides that a transferee from a holder in due course is vested with such rights as the holder in due course possesses.⁸⁷ These rights include freedom from "all claims to the instrument on the part of any person; and . . . all defenses of any party to the instrument with whom the holder has not dealt"⁸⁸ (subject to the exception of "real" defenses).⁸⁹ It would seem further that a transferee from a holder in due course is vested with the rights granted a holder in due course by § 3-418. Doubt, however, has been expressed whether a donee from a holder in due course is protected by § 3-418. The genesis of this doubt is uncertain. "Transfer" within the meaning of § 3-201 (1) includes gift. When the Code drafters desired to limit legal benefits conferred by § 3-201 to a "transferee for value," they so provided.⁹⁰ Section 3-201, comment 2, is explicit that when an instrument is transferred as a gift "the donee acquires whatever right the donor had." What, then, is the basis of the doubt?

It springs from the different considerations relevant to (1)

⁸⁶ Britton, *supra* n. 1, at 382.

⁸⁷ § 3-201 (1).

⁸⁸ § 3-305.

⁸⁹ *Id.* at (2) (a), (b), (c), (d) and (e).

⁹⁰ § 3-201 (3).

a determination whether a holder should take free of personal defenses, the traditional area in which holder-in-due-course status is granted; and (2) the considerations relevant to determining whether payment is final. The policy of allowing a holder in due course to take free of personal defenses is the stimulation of the free flow of commercial paper. The equities of the parties dictate the choice when the issue is finality of payment. Thus it is argued that when § 3-418 makes payment final in favor of a holder in due course, it is granting not the ordinary rights of a holder in due course, but *special rights* and, it is argued further these *special rights* are not among the rights granted by the shelter provision of the Uniform Commercial Code.⁹¹ It is argued that since the holder in due course concept is inappropriate in the context of finality of payment, its range of effect ought to be limited. The basic weakness of this argument is that the legislatures adopting the UCC have rejected the argument that holder in due course status is inappropriate, and it would be strange to attribute to the drafters of the Code the intent to reject the *inappropriateness* argument but accept the inferences to be drawn therefrom. It is interesting to note that a similar problem arises in another connection.

Under § 3-305, to the extent that he is a holder in due course, a holder takes the instrument free from all the defenses of any parties to the instrument *with whom the holder has not dealt*. This language deprives payee-holders in due course,⁹² who take directly from the drawer, of the *ordinary* protection of a holder in due course which § 3-305 affords. But clearly if he is a holder in due course such a payee is protected under § 3-418.

A fundamental objection to the *special rights* argument is revealed in an examination of the policy of § 3-201, which is to assure holders in due course a free market for their paper,⁹³ and

⁹¹ 2 New York Law Revisions Commission Report, Study of the U.C.C. at 314, 315 [1076, 1077] (1955).

⁹² A payee may be a holder in due course (§ 3-302(2)) if he complies with § 3-302(1).

⁹³ Prof. Aigler characterized as extravagant the view of Poffenberger, J. in *Bank of Williamson v. McDowell County Bank*, 66 W. Va. 545, 66 S.E. 761 (1909) that the lack of the rule in *Price v. Neal* ". . . would not only impede commercial transactions, but also introduce unnecessary and grave elements of uncertainty and danger, and render the whole commercial system unstable and treacherous as well as too slow to meet ordinary business demands." Aigler, *Doctrine of Price v. Neal*, 24 Mich. L. Rev. 809, 819 (1926). It is difficult to believe that a prospective transferee, who is willing to take the risk that the check may be dishonored, is not willing to take the risk of a bank recovery, if, perchance the bank pays by mistake.

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more importantly, the policy of § 3-418, which is to make certain business transactions final. The *special rights* argument is made with respect to a donee from a holder in due course, but presumably if the argument is acceptable there, it will apply when the transferee is a taker for value. The bases of this assumption are: (1) the logic of the *special rights* argument applies with equal force to those transferees for value who are holders not in due course; and (2) the language of §§ 3-418 and 3-201 (1), taken together, gives absolutely no support for a selective application of the benefits afforded by § 3-418.

The policy of § 3-418 is to protect holders in due course. If transferees from holders in due course are not given the protection of § 3-418, this policy is frustrated whenever the transferee has an action over against the holder in due course, either for breach of a transferor's warranty,⁹⁴ or for breach of contract⁹⁵ if the instrument is transferred by endorsement. The following example illustrates this point. A holder not in due course takes an instrument under such circumstances that the payor would have a right of action against such holder except for the provisions of § 3-418. Such holder has not changed his position in reliance on the payment. If we accept the *special rights* argument, the transferee, now compelled to return the payment, has a cause of action against the holder in due course under many circumstances. For example, if the drawer's signature is a forgery, a cause of action exists under § 3-417 (2), which provides that "any person who transfers an instrument and receives consideration warrants to his transferee and if the transfer is by endorsement to any subsequent holder who takes the instrument in good faith that . . . (b) all signatures are genuine or authorized." Under such circumstances the holder in due course would ultimately have to pay. Does this not frustrate the policy of § 3-418, which disallows direct suit against the holder in due course? Examples could be multiplied. But what of the donee? He does not receive the benefit of the transferor's warranties under § 3-417 (2). But he does receive the benefits of the endorser's engagements under § 3-414.⁹⁶ A donee has no equities as

⁹⁴ § 3-417 (2), § 4-207 (2).

⁹⁵ § 3-414 (1).

⁹⁶ Comment one states that the endorser's liability is incurred "whether or not the endorser transferred the instrument for value or received consideration for his endorsement."

a donee. His equities are derivative. If the holder in due course must ultimately bear the loss of allowing recovery, then the equities to be balanced are those of the payor and the holder in due course, who as a practical matter would either be impleaded or, if jurisdiction is lacking, vouched in.⁹⁷

In conclusion, although the use of the warranty doctrine in the context of finality of payment has been severely criticized,⁹⁸ in most instances, the courts can probably balance the equities fairly within the conceptual framework provided by the Code. However, in some of the areas discussed legislative action may be necessary.

⁹⁷ § 3-803.

⁹⁸ Britton, *Defenses, Claims of Ownership and Equities*, 7 *Hastings L. J.* 1, at 40 and 41 (1955).