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Actions on Commercial Paper: Holder's Procedural Advantages Under Article Three

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ACTIONS ON COMMERCIAL PAPER: HOLDER'S PROCEDURAL ADVANTAGES UNDER ARTICLE THREE

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MANY lawyers, even experienced trial lawyers, either are not aware of the special procedural provisions in Articles Three and Eight of the Uniform Commercial Code[1] (Code), or else do not fully understand their significance. These provisions are derived from several sections of the Uniform Negotiable Instruments Law[2] (NIL) and afford a claimant in an action on a negotiable instrument[3] significant procedural advantages as compared with a claimant in an ordinary action for breach of contract. As a result of their lack of awareness or understanding, counsel sometimes fail to obtain for their clients the full procedural benefits incident to the holdership of negotiable paper.

Perhaps this unawareness of these procedural provisions exists because they have been tucked away inconspicuously among the mass of substantive law in the NIL and the Code. They do not appear in most procedural codes or rules of civil procedure and they tend to be neglected in the study of procedure in addition to being brushed aside by writers and teachers of negotiable instruments law as "mere

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The author's field of specialization is commercial and contract law, not procedure. Since discussion of the special procedural rules in Article Three of the Uniform Commercial Code [hereinafter cited as U.C.C.] necessarily involves some aspects of non-Code procedural law, wisdom suggested counsel from someone learned in that area, and the author gratefully acknowledges the helpful information, criticism, and suggestions generously furnished by his Minnesota colleague, Professor James L. Hetland, Jr. All blame for inadequacies in the article, of course, rests with the author.

1. The principal provisions are in §§ 3-307 & 8-105(2). Section 3-307 is quoted in the text following note 55 *infra*. All Code citations are to the 1962 Official Text and Comments.

2. UNIFORM NEGOTIABLE INSTRUMENTS LAW §§ 11, 16, 24, 28, 45, 46 & 59, discussed in notes 36-38 *infra* and accompanying text. [Hereinafter cited as N.I.L.]

3. Normally the claimant in an action *on* a negotiable instrument—to enforce or recover for breach of the obligations of the signer—will be the *holder* of the instrument, since the obligations of the instrument, by its terms (or indorsements, if any), are performable to the holder. The term "holder" as used throughout the Code is defined in § 1-201(20) as "a person who is in possession of a document of title or an instrument or an investment security drawn, issued or indorsed to him or to his order or to bearer or in blank." Occasionally, the claimant in such an action may be a remitter who has purchased but not delivered an instrument payable to another, or a transferee who has acquired the rights of the holder without an indorsement necessary to his own holdership. See U.C.C. §§ 3-201 & 8-301. Such claimants, by establishing the basis of their claim, may be entitled to the procedural advantages of §§ 3-307 & 8-105(2). See comment 2 to U.C.C. § 3-307.

matters of procedure." Or it may be simply that actions on negotiable instruments do not comprise a significant portion of the average lawyer's litigation practice. At any rate, the importance of the procedural provisions when such actions do arise, is sufficient to justify some discussion and analysis.

Unlike the NIL, which purportedly governed all negotiable instruments, the Code deals separately with different classes of negotiable paper. Thus, Article Three is restricted[4] to commercial paper: checks and other drafts, promissory notes (other than bonds), and promissory certificates of deposit.[5] Article Eight deals with bonds, stocks, and other forms of investment securities[6] and is essentially a new "negotiable instruments law,"[7] tailored to the functions of such paper. A number of Article Eight's provisions,[8] like those in section 8-105(2), which parallels section 3-307, are very similar to counterpart provisions in Article Three, since both are in part derived from the NIL. To avoid confusion it seems expedient to confine this discussion mainly to actions on Article Three instruments and to the provisions of section 3-307. Nevertheless, by virtue of section 8-105(2), much of what is said will be applicable to actions by holders of investment securities against the issuers and other obligors.

The discussion will also be concerned primarily with the usual action "on the instrument": an action by the holder to enforce payment by a person who has signed it as maker, acceptor, certifier, drawer, indorser, or guarantor and has thus become "liable on" it.[9] These instruments, of course, may be involved in other types of actions, such as: an action for conversion of the instrument (section 3-419); an action to recover damages for breach of the warranties of a collector or transferor (sections 3-417 and 4-207); an action to compel indorsement (section 3-201); an action to enjoin payment (section 5-114(2)(b)); or an action to obtain reformation, cancellation, or other redress. To the extent that the procedural provisions in section 3-307 may be relevant in such actions—for example, the provisions

4. In determining the scope of Article Three, one must start with the definition of "instrument" provided in § 3-102(1)(e) and then apply the exclusions and refinements found in §§ 3-103, 3-104 & 3-805.

5. Certificates of deposit are within Article Three only if they contain "an engagement to repay" the acknowledged deposit. U.C.C. § 3-104(2)(c).

6. Section 8-102(1)(a) defines, in a highly functional manner, the instruments which may qualify as a "security" governed by Article 8. For a discussion of this definition, see Folk, *Article Eight: A Premise and Three Problems*, 65 MICH. L. REV. 1379-418 (1967).

7. Comment to U.C.C. § 8-101.

8. *E.g.*, U.C.C. §§ 8-201, 8-202, 8-203, 8-205, 8-206 & 8-301 to -311.

9. Section 3-401(1) provides that "no person is *liable on an instrument* unless his signature appears thereon." (Emphasis added.)

in subsection (1) governing validity of signatures[10]—there appears to be no persuasive reason why they should not apply. In general, however, the language and purposes of section 3-307 contemplate actions by holders against signers to enforce the latter's liability to pay the instrument.

Before discussing the specific procedural provisions, it will be helpful, as background for evaluating their significance and purposes, to consider briefly the relationship between negotiable notes, checks, and drafts and the debts or other legal obligations which normally underlie such instruments, and to discuss the nature and basis of a holder's right to maintain an action *on such an instrument* to enforce payment by its signer.

I. Relation of the Instrument to the Underlying Obligation

A negotiable note, check, or draft is usually issued or transferred either in connection with a concurrent contractual transaction between the signer and the holder or to evidence, secure, pay, or collect a pre-existing debt or other monetary obligation. These instruments were invented and developed by merchants and bankers[11] to facilitate the transfer, collection, and payment of the monetary obligations which arose from commercial loans, deposits, or purchases of goods or services. Even though at present such paper is widely used by non-merchants, it still almost always represents underlying debts or other monetary obligations of the signers which result from contractual or other legal commitments. Of course, an occasional note is issued for accommodation or to evidence a charitable subscription or other promise of gift, and checks are often issued as Christmas, birthday, or wedding presents, but these are insignificant in number in comparison with the millions of instruments issued every day[12] in connection with the creation, extension, transfer, or payment of legally binding obligations.

Checks, drafts, and promissory notes, however, are not and do not purport to be simply written evidence of transactions or mere acknowledgments of monetary obligations like I.O.U.'s or non-promissory certificates of deposit. Rather, they are distinct and self-contained monetary commitments or directives, serving separate and

10. See text accompanying note 59 *infra*.

11. See generally Holden, The History of Negotiable Instruments in English Law (1955).

12. Presently, checks alone are being cleared at the rate of 70 million per day according to Clarke, *Check-Out Time for Checks*, 83 Banking L.J. 847 (1966), reprinted from 21 Bus. Law. 931 (1966).

distinct commercial purposes. By expressing an unqualified promise or order to pay a specified sum, on demand or at a prescribed time, either to the bearer or to the order of a named person, they make the right to receive such payment expressly transferable, that is, "negotiable." Thus, the usual purpose of a negotiable *promissory note* or *promissory certificate of deposit* is not only to make explicit and definite the monetary commitment but also to split it off, in a sense, from the transaction or occasion that gave rise to it, and to put the commitment in such a form as to be readily and completely transferable by way of sale, discount, pledge, or collection. Similarly, the usual purpose of a negotiable *check* or *bank draft* is to use one underlying obligation—the bank deposit debt owed to the drawer—to pay another underlying obligation owed by the drawer-depositor to the payee by means of a payment directive by the drawer to the bank drawee, and to put this directive in transferable form in order to facilitate its cashing, its collection, or the making of a further payment through its indorsement and transfer by the payee. Finally, the purpose of a *seller's* negotiable *draft* on the *buyer* is not only to facilitate bank collection of payment for the goods sold but also, in many cases, to make possible the financing of the seller through discount of the draft.

All of these instruments thus have financing or payment functions distinct from the objectives of the underlying obligations and transactions in which they arise or on which they are based. In many cases, moreover, these functions could not readily be achieved by mere assignment of the underlying monetary claim, even if such claims had always been legally assignable. Therefore, ever since the days of the ancient law merchant,[13] our law, as eventually codified in the NIL and in Article Three of the Code, has recognized that such instruments embody separate obligations and that the holder—simply by virtue of his holdership and of the form and terms of the instrument—has a legal right to receive payment and to discharge the obligations,[14] as well as a right to enforce the obligations by an action in his own name.[15] Moreover, that law has prescribed, in considerable detail, the nature and extent of the primary or secondary payment obligations of the maker,[16] drawer,[17] acceptor,[18] and

13. See generally MALYNES, CONSUETUDO, VEL, LEX MERCATORIA (1622); MARIUS, ADVICE CONCERNING BILS OF EXCHANGE (3d ed. 1686).
14. U.C.C. § 3-603; N.I.L. §§ 88 & 119.
15. U.C.C. § 3-301; N.I.L. § 51.
16. U.C.C. § 3-413(1); N.I.L. § 60.
17. U.C.C. § 3-413(2); N.I.L. § 61.
18. U.C.C. § 3-413(1); N.I.L. § 62.

indorser[19] to the holder in the event that the instrument is not paid when due or is dishonored;[20] and has also established rules governing transfer and negotiation,[21] the requirements for being a holder in due course,[22] and the special rights of such a holder.[23]

That these instruments embody rights and obligations distinct from those involved in the underlying obligation or transaction is clear when the holder is a subsequent transferee who is not a party to the issuance, or to a prior transfer, of the instrument and has not received an express assignment of the underlying claim.[24] Yet even between the immediate parties—between the maker or drawer and the payee, or between an indorser and his immediate indorsee—the instrument constitutes a *separate basis* for claim and action since the instrument does not normally merge or replace the underlying obligation but rather creates a sort of alter-ego obligation that coexists until one or the other is finally paid or satisfied. This has been clarified by the following new provision in the Code:

Section 3-802. Effect of Instrument on Obligation for Which It Is Given.

(1) Unless otherwise agreed where an instrument is taken for an underlying obligation

(a) The obligation is pro tanto discharged if a bank is drawer, maker or acceptor of the instrument and there is no recourse on the instrument against the underlying obligor; and

19. U.C.C. §§ 3-414 & 3-415; N.I.L. §§ 64, 66 & 67.

20. There is a distinction between mere *default* in payment which subjects a maker or acceptor to liability under § 3-413(1) of the Code (§ 70 of the N.I.L.) for not paying a time note or draft when due even though payment has not been demanded, and *dishonor* by refusal or failure to pay or accept upon due presentment which results in drawer or indorser liability under §§ 3-413(2) & 3-414 of the Code (§§ 61 & 66 of the N.I.L.). Although a cause of action against the maker or acceptor/certifier of a *demand* instrument (other than a certificate of deposit) accrues, for purposes of the statute of limitations, on the date of issue (§ 3-122(1)(b) of the Code), such an instrument is not technically in default for purposes of damages until dishonor on demand. U.C.C. § 3-122(4)(a). The rules governing presentment, dishonor, notice and protest are found in §§ 3-501 to -511 of the Code and in §§ 70–118 & 143–160 of the N.I.L.

21. U.C.C. §§ 3-201 to -207; N.I.L. §§ 30–50.

22. U.C.C. §§ 3-302 to -304; N.I.L. §§ 52–56.

23. U.C.C. § 3-305; N.I.L. § 57.

24. Although under modern law the holder of an instrument may either negotiate it or explicitly assign to his transferee the holder's rights on the underlying monetary obligation (provided they are not personal to him), it is not clear whether the mere negotiation of the instrument carries with it an implied assignment of such holder's rights. See RESTATEMENT, CONTRACTS, §§ 148-77 (1932). There would appear to be no good reason why such an assignment should not be implied if there exists any need for an implication, but it is difficult to see how the transferee could derive any advantages from such an assignment beyond those rights which he acquires through the negotiation of the instrument.

(b) in any other case the obligation is suspended pro tanto until the instrument is due or if it is payable on demand until its presentment. If the instrument is dishonored action may be maintained on either the instrument or the obligation; discharge of the underlying obligor on the instrument also discharges him on the obligation.

(2) The taking in good faith of a check which is not postdated does not of itself so extend the time on the original obligation as to discharge a surety.

In some instances, of course, commercial paper will be taken as an immediate satisfaction and discharge of the underlying obligation between the parties, as when an obligor obtains a cashier's check or a bank draft which is payable directly to his obligee and delivers it as a remitter without indorsing it.[25] Immediate discharge may also occur when, in settlement of a *disputed* claim, the claimant agrees to take the other party's note for a specified amount as an accord and satisfaction.[26] In most instances, however, the giving of the obligor's note for a debt, the issuance of his check in payment, or the indorsement and delivery of third-party paper by the obligor, as security for or in payment of the obligation, merely "suspends" the obligation until the instrument is due or presented.[27] In such cases, the instrument is regarded either as *representing* or *securing* the obligation or as a *conditional payment* of it, and not as itself being a final payment or satisfaction.[28] If the instrument is paid or the signer is otherwise discharged,[29] his underlying obligation is also discharged pro tanto[30] because the claim on the instrument is based upon and represents that obligation. If, however, the instrument is not paid at maturity or is dishonored,[31] the underlying obligation remains unsatisfied and the obligee may either disregard the instrument and sue the obligor to enforce the original obligation, or,

25. U.C.C. § 3-802(1)(a).

26. It has even been held that the mere receipt and retention for an unreasonable time of a check which has been tendered in satisfaction of a disputed claim will constitute an accord and satisfaction. Curran v. Bray Wood Heel Co., 116 Vt. 21, 68 A.2d 712 (1949); Annot., 13 A.L.R.2d 736 (1950).

27. U.C.C. § 3-802(1)(b).

28. "Where payment is made by check drawn by a debtor on his banker, this is merely a mode of making a cash payment. . . . Such payment is only conditional, or a means of obtaining the money." National Bank v. Chicago, B. & N. RR., 44 Minn. 224, 229, 46 N.W. 342, 344 (1890).

29. The various ways in which a signer may be discharged from liability on an instrument are catalogued in U.C.C. § 3-601.

30. U.C.C. § 3-802(1)(b).

31. U.C.C. § 3-507.

as holder, sue on the instrument to enforce the obligor's liability as signer.[32] When he chooses the latter course, the obligee has the procedural advantages with which we are here concerned, since these advantages are for the benefit of any holder, or person having the rights of a holder under section 3-201 of the Code, regardless of whether he is a remote holder or the party with whom the signer dealt and to whom the underlying obligation is directly owed. Unlike most of the special privileges incident to the holdership of negotiable paper, the procedural advantages in suing on such paper are not restricted to that "most favored plaintiff in the law,"[33] the holder in due course.

II. The Procedural Provisions

Neither the NIL nor the Code attempts to prescribe comprehensive rules of pleading and proof for actions on negotiable paper. In the main, such actions are governed either by the statutory procedural codes or by the rules of procedure which are generally applicable to civil actions in each jurisdiction.[34] Thus, counsel must look to those codes or rules for answers to most of their procedural questions.

Nevertheless, the NIL and the Code do contain the few special procedural rules which are discussed below. These rules, which have been developed over the years to expedite holders' actions, resulted from the unique financing and payment functions of negotiable paper. To fulfill these functions, such paper must be as completely acceptable to creditors, obligees, and financers as is possible; and it will be so only if it is both easily collectable and readily marketable by the taker, that is, cashable, saleable, pledgeable, and discountable. Paper will not have these qualities in full measure unless it can be both enforced by holders without the burden of establishing the original obligation and transferred to good faith takers for value free from most of the defenses and defects which may inhere in the obligation that exists between the original parties.[35] The same policy considerations—the need to facilitate and encourage the taking and free transferability of commercial paper—which underlie the preferred position of the holder in due course with respect to a signer's defenses also require special procedural advantages for holders when it

32. U.C.C. § 3-802(1)(b).

33. An appellation frequently used by the late James Paige, formerly Professor of Law at the University of Minnesota, and my negotiable instruments teacher.

34. For a summary indicating which states have retained code procedure and which states have now adopted rules of civil procedure based on the Federal Rules of Civil Procedure, see 1 Barron & Holtzoff, Federal Practice and Procedure (Wright ed. 1960) §§ 9-9.53 [hereinafter cited as Barron & Holtzoff].

35. U.C.C. § 3-305; N.I.L. § 57.

becomes necessary for them to institute an action to enforce a signer's obligations. Such an action will normally have to be brought in the signer's bailiwick, and, frequently, will be heard by a judge and jury who know the signer and who may be more sympathetic to his reasons for resisting payment than to the holder's right to receive payment.[36]

In general, then, the special procedural provisions favor the plaintiff-holder: they greatly lighten and simplify his task of pleading and proving his cause of action; and they correspondingly increase the defendant-signer's burden of establishing a basis for avoiding or reducing his payment obligation on the instrument.

A. *The NIL Provisions*

The procedural provisions in the NIL were stated in terms of certain matters being "prima facie" true or "presumed." Thus, for example, NIL section 16 provided that a valid and intentional *delivery* by a signer no longer in possession of the instrument was "presumed" conclusively as to a holder in due course. NIL section 24 stated that "every negotiable instrument is deemed prima facie to have been issued for a valuable consideration; and every person whose signature appears thereon to have become a party thereto for value."[37] Section 59 of the NIL further provided that "every holder is deemed prima facie to be a holder in due course; but when it is shown that the title of any person who has negotiated the instrument was defective, the burden is on the holder to prove that he or some person under whom he claims acquired the title as holder in due course."[38]

However, the NIL contained no definitions of "presumed," "presumption," or "prima facie" and thus left the precise meaning and procedural effect of these somewhat ambiguous terms[39] for determination by each jurisdiction in accordance with its own rules and precedents concerning the effect of presumptions and prima facie evidence in general.[40] This meant that, in application and effect, the

36. This aspect of the procedural provisions is further elaborated in the text accompanying notes 123 & 124 *infra*.

37. Under the NIL "absence or failure of consideration is matter of defense as against any person not a holder in due course . . . ." N.I.L. § 28.

38. The date on an instrument "is deemed prima facie to be the true date." N.I.L. § 11. "[E]very negotiation is deemed prima facie to have been effected before the instrument was overdue" unless an indorsement is dated after maturity. N.I.L. § 45. "[E]very indorsement is presumed prima facie to have been made at the place where the instrument is dated" unless the contrary is apparent. N.I.L. § 46.

39. "One ventures the assertion that 'presumption' is the slipperiest member of the family of legal terms, except its first cousin 'burden of proof' . . . ." McCORMICK, EVIDENCE § 308, at 639 (1954).

40. See generally, 1 JONES, EVIDENCE §§ 23-28 (2d ed. rev. 1926); McCORMICK, EVIDENCE §§ 308-17 (1954); THAYER, A PRELIMINARY TREATISE ON EVIDENCE 513-89 (1898);

NIL provisions lacked the uniformity desired of a uniform law. It is clear, of course, that under the NIL presumptions the holder always had the procedural advantages of not having to plead or introduce first proof on the following issues: the original delivery of a negotiable instrument; the delivery by successive holders; the existence of consideration for a signer's obligation; the actual furnishing of that consideration; the status of the holder-plaintiff as a holder in due course.[41] However, the NIL provided no uniform rules as to what showing or evidence a defendant-signer was required to present in order to rebut the presumptions or the prima facie inferences, and it did not indicate who had the ultimate burden of persuasion once conflicting evidence on any of these issues was before the court.[42]

The Code, on the other hand, defines the meaning of "presumption" and "presumed" with fair precision.[43] As explained below, the procedural provisions in Article Three are phrased primarily in terms of pleading and proof rather than in terms of presumptions, but, where the term "presumption" is used,[44] its procedural meaning and effect are governed in all cases by the general Code definitions (uniformly construed, we hope) and are not left open for varying local interpretations.

The NIL also did not provide presumptions or procedural rules with regard to the issue of the genuineness or authenticity of signatures and indorsements on negotiable paper; thus, the questions of who had to raise this issue, how it could be raised, and who had the burdens of first proof and ultimate persuasion, were left for nonuniform determination by each jurisdiction under its applicable procedural law.[45] When the issue has been properly raised under local

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9 WIGMORE, EVIDENCE §§ 2490–93 & 2499–540 (3d ed. 1940). The various conflicting views as to the nature, theory, and effect of presumptions have also been elaborated in numerous law review articles. See, *e.g.*, Bohlen, *The Effect of Rebuttable Presumptions of Law Upon the Burden of Proof*, 68 U. PA. L. REV. 307 (1920); Brosman, *The Statutory Presumption*, 5 TUL. L. REV. 178 (1931); Gausewitz, *Presumptions*, 40 MINN. L. REV. 391 (1956); McBaine, *Presumptions: Are They Evidence?*, 26 CALIF. L. REV. 519 (1938); McCormick, *Charges on Presumptions and the Burden of Proof*, 5 N.C.L. REV. 291 (1927); Morgan, *Some Observations Concerning Presumptions*, 44 HARV. L. REV. 906 (1931).

41. Comment, *Burden of Proof of Due Course Holding Under Negotiable Instruments Law*, 1 IND. L.J. 49 (1926).

42. For a general discussion of the NIL case law on these matters, see BRITTON, BILLS AND NOTES §§ 102–05 (2d ed. 1961).

43. " 'Presumption' or 'presumed' means that the trier of fact must find the existence of the fact presumed unless and until evidence is introduced which would support a finding of its non-existence." U.C.C. § 1-201(31). For a comprehensive discussion of the problems concerning presumptions and evidence under the various code provisions, see 1 GA. L. REV. 44 (1966).

44. See, *e.g.*, § 3-114(3) with respect to dates; § 3-307(1)(b) with respect to genuineness and authenticity of signatures; and § 3-416(4) with respect to guarantees.

45. See notes 34 *supra* and 50 *infra*.

procedural law, the claimant generally has been held to have the ultimate burden of persuasion as to the genuineness of the defendant's signature[46] and of any indorsement which was necessary to the claimant's rights as holder.[47] As we shall see, the Code does not change this ultimate burden.[48] Prior to the Code, however, there was no uniformity under local procedural law as to how the issue of genuineness could be raised in the pleadings or as to who had the burden of first proof when the issue was raised. In many states there were no specific code or rule provisions governing these questions; thus, the answers depended upon judicial interpretation and the application of the relevant general provisions in each state's procedural code or rules.[49] Other states had specific statutory or rule provisions governing the pleading and proof of the genuineness of signatures on some or all written instruments.[50] These provisions varied greatly from state to state but need not be analyzed in detail since they have been largely superseded[51] by sections 3-307(1) and 8-105(2)(a) and (b) of the Code, which are discussed below. Typically the state codes or rules provided that the validity of signatures on specified instruments would be deemed admitted, or prima facie established unless their validity was challenged by a prescribed denial under oath.[52] The apparent ration-

46. *In re* Estate of Work, 212 Iowa 31, 233 N.W. 28 (1931); Engel v. Schloss, 134 Md. 72, 106 Atl. 169 (1919); Hardison v. Jones, 196 N.C. 712, 146 S.E. 804 (1929); Niles v. Rexford, 105 Vt. 492, 168 Atl. 714 (1933).

47. Whitman v. Fournier, 228 Mass. 93, 117 N.E. 3 (1917); Van Syckel v. Egg Harbor Coal & Lumber Co., 109 N.J.L. 604, 162 Atl. 627 (1932); Lycoming Trust Co. v. Allen, 102 Pa. Super. Ct. 184, 156 Atl. 707 (1931).

The issue of genuineness is essential to plaintiff's cause of action because "no person is liable on the instrument whose signature does not appear thereon . . . ." (N.I.L. § 18; *accord*, U.C.C. § 3-401) and forged or unauthorized signatures are "wholly inoperative." N.I.L. § 23; U.C.C. § 3-404. Additionally, a valid indorsement is necessary to the negotiation and subsequent holdership of order paper, and in order to sue on an instrument under § 3-301, one must be a holder. N.I.L. § 51; U.C.C. § 3-301. For the definition of holder, see note 3 *supra*. Holdership of order paper by a person other than the named payee requires the valid indorsement of the payee (and of his and successive special indorsees, if any). N.I.L. §§ 30, 31, 33 & 34; U.C.C. §§ 3-202 & 3-204.

48. U.C.C. § 3-307(1)a.

49. Lack of uniformity in the relevant provisions of the various state procedural codes and rules renders futile or misleading any attempt to generalize from the decisions on these issues. Determination on a state-by-state basis is necessary.

50. See, *e.g.*, ILL. REV. STAT. c.110, § 34 (1963); MINN STAT. § 600.15 (1961); N.J. REV. STAT. § 2:98-3 (1937); WIS. STAT. ANN. §§ 328.25-.26; Mich. Gen. Ct. R. 602 (1963); Iowa R. Civ. P. 100 & 102 (1943).

51. Where these provisions applied only to negotiable instruments, they have generally been repealed upon adoption of the Code. See, *e.g.*, WIS. STAT. ANN. § 328.26 (1958). On the other hand, where they applied to all written instruments, they have occasionally been amended in order to conform to the Code provisions. See, *e.g.*, MINN. STAT. ANN. § 600.15 (1965).

52. Representative was the Minnesota statutory provision which provided in pertinent part that:

> In actions brought on promissory notes or bills of exchange by the endorsee, the possession of the note or bill shall be prima facie evidence that the same was en-

ale for such provisions was that, since the task of proving the genuineness or authenticity of another's signature may be difficult,[53] and since most signatures are genuine or authorized, a plaintiff should not be required to establish the validity of a signature unless the defendant appropriately demonstrated that a real issue of genuineness was involved.[54]

B. *The Code Provisions*

In keeping with the policy, which is evidenced throughout Article Three, of eliminating the unnecessary NIL provisions and condensing, rewording, and consolidating the remaining rules as much as possible, the draftsmen of the Code have attempted to state in one section, section 3-307, the procedural effect of the former NIL presumptions and prima facie provisions relating to delivery, consideration, and holders in due course.[55] In addition, section 3-307 contains new procedural provisions on the validity of signatures and on defenses in general. The section reads as follows:

Section 3-307. Burden of Establishing Signatures, Defenses and Due Course.

(1) Unless specifically denied in the pleadings each signature on an instrument is admitted. When the effectiveness of a signature is put in issue
(a) the burden of establishing it is on the party claiming under the signature; but
(b) the signature is presumed to be genuine or authorized except where the action is to enforce the obligation of a purported signer who has died or become incompetent before proof is required.

(2) When signatures are admitted or established, production of the instrument entitles a holder to recover on it unless the defendant establishes a defense.

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dorsed by the person by whom it purports to be endorsed. Every written instrument purporting to have been signed or executed by any person shall be proof that it was so signed or executed until such person shall deny the signature or execution of the same by his oath or affidavit; but this shall not extend to instruments purporting to have been signed or executed by a person who has died before the requirement of such proof.
MINN. STAT. § 600.15 (1961).

53. Where plaintiff or his witnesses were not present when the signature was made so that they are unable to testify as to who made it, the genuineness of the signature will have to be established by a comparison with available genuine specimens, if any, and perhaps by testimony of handwriting experts or by other means. Proof of agency and authority to sign when signatures purport to be signed by an agent will of course be difficult and burdensome in many instances.

54. See comment 1 to U.C.C. § 3-307.

55. N.I.L. §§ 16, 24, 28 & 59.

(3) After it is shown that a defense exists a person claiming the rights of a holder in due course has the burden of establishing that he or some person under whom he claims is in all respects a holder in due course.

Except for the presumption in subsection (1)(b), these provisions do not purport to set up presumptions; rather, they prescribe direct procedural requirements as to who must plead and who must "establish" various facts on which liability or recovery depend.

The Code avoids using the traditional terms "proof," "proved," and "burden of proof," because of their tendency to confuse the question of who has the burden of producing first evidence of a fact with the question of who has the burden of ultimate persuasion as to that fact. Instead, the Code employs in this and other sections the terms "establish," "established," "shown," and a new phrase, "burden of establishing." The latter is defined in section 1-201(8) as "the burden of persuading the triers of fact that the existence of the fact is more probable than its nonexistence." The words "establish" and "established" are not separately defined, but apparently are to be interpreted as denoting the introduction of a sufficient quantum of evidence on a fact to satisfy the "burden of establishing" that fact. The term "shown," however, is used in section 3-307(3), but is not defined anywhere; thus, the question is raised as to whether "shown" means shown by pleading (or by admission) or evidence, and if the latter, whether by *any* evidence or by a quantum sufficient to "establish" the fact. It is reasonable to assume that the draftsmen used "shown" merely as a synonym for "established" or "admitted," but since the term is susceptible of different meanings, it either should not have been used or should have been defined and clarified.

The Code's changes in terminology have been criticized as an unwarranted departure from familiar and traditional procedural language;[56] however, the ambiguities in "proof" and "burden of proof" seem to justify the use of novel terminology as an attempt at clarification. Nevertheless, it remains to be seen whether the new terms, in the context in which they are used in section 3-307 and other Code provisions, will achieve the desired clarity or merely create new ambiguities. We can only hope that knowledge of the old ambiguities will provide incentive for a uniform interpretation of the new terms or will lead to amendments clarifying the Code's terminology.

Subsection (1) of section 3-307 requires that the party (normally

56. Britton, *Holder in Due Course—A Comparison of the Provisions of the Negotiable Instruments Law With Those of Article 3 of the Proposed Commercial Code*, 49 Nw. U.L. Rev. 417, 446-50 (1954).

the defendant) who desires to challenge the validity of his purported signature on the instrument (or of an indorsement or other signature necessary to his liability in the action) must raise the issue by a specific denial in his pleading.[57] Otherwise, validity is admitted. Once the issue is thus raised, subsection (1)(a) places the ultimate burden of persuasion on the party (usually the holder-plaintiff) whose rights depend upon the signature's validity; however, by subsection (1)(b), such party has the benefit of a presumption of validity except in the specified cases of dead or incompetent signers. This means, under the Code definition of "presumption" in section 1-201(31), that he will prevail unless the party challenging the signature "introduces evidence which would support a finding" of non-validity. In other words, the challenging party must first specifically raise the issue in his pleading and then introduce evidence sufficient to warrant a finding that the signature was not authorized or genuine before the party claiming under the signature is given the task of going forward and sustaining his burden of persuading the trier of fact that validity is more probable than invalidity.

Subsection (2) of section 3-307 is something of a masterpiece of condensation and, arguably, of understatement. This one short sentence not only purportedly indicates, largely by implication, what matters the defendant has the burden of pleading and establishing as "defenses" in order to reduce or avoid liability, but it also assumes or ignores some facts that the plaintiff-holder must plead and prove in order to establish a cause of action and a right of recovery against certain signers.

The phrase "unless the defendant establishes a defense" seems clearly to imply that defendant must plead, introduce first evidence, and carry the ultimate burden of persuasion as to any matter that constitutes a "defense" other than signature validity, since subsection (2) contains no provisions like those in subsection (1) which divide the burdens in the case of signature defenses. What constitutes a "defense" for purposes of subsection (2) presumably must be determined from other provisions in Article Three. For example, section 3-305(2) specifically labels as "defenses" infancy, other incapacity,

57. The purpose of requiring a specific denial is to apprise the other party that he must answer to a claim of forgery or lack of authority to sign. See comment 1 to § 3-307. The phrase "unless specifically denied in the pleadings" leaves room, of course, for technical interpretations as to what constitutes a sufficient specific denial under the codes or rules governing pleading in the particular jurisdiction in which the action is brought. See, *e.g.*, Granite Trust Bldg. Corp. v. Great Atl. & Pac. Tea Co., 36 F. Supp. 77 (D.C. Mass. 1940), in which the court held that defendant's denial of execution of a writing was sufficiently specific under the Federal Rules although possibly not sufficiently specific under a Massachusetts statute requiring specific denial of execution.

nullifying illegality, fraud in the essence, and the rest of the so-called "real" defenses that may be asserted even against a holder in due course. Section 3-306 lists as "defenses" a number of so-called "personal" defenses that can be asserted against one who is not a holder in due course, including: "want or failure of consideration, non-performance of any condition precedent, non-delivery, or delivery for a special purpose. . . ."[58] Finally, section 3-407, which deals with alterations and their effect upon liability, provides in subsection (2) that "as against any person other than a subsequent holder in due course (a) alteration by the holder which is both fraudulent and material discharges any party whose contract is thereby changed unless that party assents or is precluded from asserting *the defense* . . . ."[59] It thus seems clear that the Code, through section 3-307(2) and these various "defense" provisions in other sections, has retained the procedural effect of the NIL presumptions as to delivery and consideration simply by requiring a defendant to establish all "defenses."

The first phrase in section 3-307(2)—"when signatures are admitted or established, production of the instrument entitles a holder to recover on it . . . ."—may be misleading since it either presupposes or ignores a number of things, in addition to mere "production of the instrument," that a plaintiff may need to establish in his case in chief before he is entitled to recover on the instrument from the particular signer being sued. The phrase assumes that the plaintiff is the holder, or has the rights of the holder,[60] and that this fact has either been admitted by the defendant or established by the plaintiff's evidence of his possession of the instrument as the named payee or indorsee, or as bearer[61] or transferee. It also presupposes that the facts necessary to the liability of, and to the accrual of a cause of action[62] against, the particular defendant-signer have been admitted,

58. Section 3-408 also specifies that want or failure of consideration is a defense.

59. (Emphasis added.) This indicates that a defendant's assertion that the terms of an instrument have been altered or are incorrect is "a defense" that he must establish under section 3-307(2). The pre-Code decisions concerning how a defendant must plead alteration and who must offer first proof and/or carry the burden of ultimate persuasion on that issue were almost as diverse and confusing as those dealing with signature validity. *E.g., compare* Farmers' Loan & Trust Co. v. Siefke, 144 N.Y. 354, 39 N.E. 358 (1895), *with* Fudge v. Marquell, 164 Ind. 447, 72 N.E. 565, *aff'd on rehearing*, 73 N.E. 895 (1905).

60. Under § 3-201, one may acquire the rights of a holder by transfer without negotiation and thus be entitled to enforce payment although not a holder in one's own right. Comment 2 to § 3-307 indicates that such a non-holder transferee, by proving the transfer, is entitled to recover under subsection (2).

61. " 'Bearer' means the person in possession of an instrument, document of title, or security payable to bearer or indorsed in blank." U.C.C. § 1-201(5).

62. U.C.C. § 3-122, a new section with no counterpart in the NIL, spells out when a cause of action accrues against various signers of the instruments governed by Article Three.

are shown by the terms of the instrument, or have been established by the plaintiff's evidence. If the defendant has signed as maker, acceptor, or certifier and is thus primarily liable to pay the instrument when due[63] and without demand,[64] the instrument itself will presumably show that it is overdue and that the plaintiff is thus entitled to recover on it from such signer. However, if the instrument is a certificate of deposit on which the cause of action against the issuing bank does not accrue until demand for payment and refusal,[65] then, in addition to production of the instrument, both demand and refusal must be admitted by the defendant or established by the plaintiff's evidence. Moreover, if the defendant-signer is a drawer or an indorser whose secondary liability[66] depends upon due presentment,[67] dishonor,[68] notice,[69] and in some cases protest[70] (or waiver or excuse thereof),[71] production of the instrument by the plaintiff must be accompanied by appropriate evidence of these facts[72] unless they too are admitted. Finally, if the defendant signed as a guarantor of payment or collection,[73] the conditions necessary to his liability in that capacity must appear, be established by the plaintiff, or be admitted.

Obviously, then, in many cases the holder will not be able to establish his right "to recover" from a particular signer simply by "production of the instrument." Section 3-307(2) would convey a clearer understanding of the plaintiff's procedural burdens if it contained some additional language indicating that recovery by a holder depends upon his production of the instrument *plus* the defendant's admission or the holder's establishment of such additional facts as are necessary to establish the liability of, and a cause of action againt, the particular signer being sued.

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63. U.C.C. §§ 3-413(1) & 3-411(1).

64. U.C.C. § 3-501, which prescribes when presentment (defined as a "demand" in § 3-504) is necessary to charge parties with liability, applies only to secondary parties, not to makers, acceptors, or certifiers.

65. U.C.C. § 3-122(2).

66. U.C.C. §§ 3-413(2) & 3-414.

67. U.C.C. §§ 3-503 & 3-504.

68. U.C.C. § 3-507.

69. U.C.C. § 3-508.

70. U.C.C. § 3-509.

71. U.C.C. § 3-511.

72. U.C.C. § 3-510 provides that a certificate of protest, or a bank's dishonor stamp, ticket, or regular book or record showing dishonor, "are admissible as evidence and create a presumption of dishonor and of any notice of dishonor therein shown." This is a new provision, not derived from the NIL, which greatly simplifies proof of the holder's case in chief against drawers and indorsers.

73. U.C.C. § 3-416, another new provision in the Code, spells out the nature and terms of the obligations of parties who sign instruments as guarantors of payment or collection.

Subsection (3) of section 3-307 is applicable only in cases in which the parties were not immediate parties to the instrument: when the plaintiff did not take the instrument directly from the defendant-signer but rather acquired it from a remitter or an intervening holder. If the plaintiff in such cases took the instrument as a holder in due course,[74] or, in some cases, from a holder in due course,[75] he is entitled to recover against the signer free from claims and defenses other than the so-called "real" defenses.[76] Thus, if the defendant-signer has shown that a defense exists by his pleading and by introducing evidence, and if such defense is a "personal" defense not available against a holder in due course,[77] the plaintiff may wish to avoid it on the basis that "he or some person under whom he claims is in all respects a holder in due course." Subsection (3) places on the plaintiff the burden of establishing his status as a holder in due course—he must introduce evidence on all aspects of his status[78] and ultimately persuade the trier of fact on this issue. This is essentially the rule in the first sentence of section 59 of the NIL,[79] but the Code rule is stated in terms of a direct procedural requirement rather than in terms of a prima facie status and is clarified by the elimination of the "title . . . defective" language which had led some courts to make a technical distinction between defenses which made a negotiator's title defective under NIL section 55 and those which did not.[80]

The above analysis of section 3-307 reveals that, despite the Code's change in approach and wording, it gives the holder of commercial paper the same basic procedural advantages in suing on the instrument that he enjoyed under the NIL presumptions. Moreover, the Code gives the holder some additional advantages, borrowed from non-uniform statutes, in establishing the validity of signatures. Certainly the Code's method of stating the procedural rules is more direct and, in many respects, is clearer and more definite than was the NIL approach, and the Code therefore should achieve greater uniformity in application. There still exists some room for improvement and further clarification, however, if misunderstanding and conflicting interpretations of section 3-307 are to be avoided.

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74. U.C.C. §§ 3-302, 3-303 & 3-304.
75. U.C.C. § 3-201 and comment 3 thereon.
76. U.C.C. § 3-305.
77. *Id.*
78. See comment 3 to U.C.C. § 3-307.
79. "Every holder is deemed prima facie to be a holder in due course; but when it is shown that the title of any person who has negotiated the instrument was defective, the burden is on the holder to prove that he or some person under whom he claims acquired the title as holder in due course."
80. See BRITTON, BILLS & NOTES 355-60 (2d ed. 1961).

III. The Significance of the Procedural Rules—Some Comparisons

The full significance of the Code rules in section 3-307 and the extent of the holder's resulting procedural advantages become apparent only by comparing his burdens in an action on the instrument with his burdens as a plaintiff in an ordinary action for breach of contract based upon the underlying transaction in which the instrument was issued or transferred. The remainder of this discussion is, therefore, devoted to such a comparison in the setting of a simple contract-for-sale transaction.

A. *The Transaction*

B contracts to buy a power-mower from S for $200. This may be a cash deal in which B agrees to pay the $200 to S on delivery of the mower, or it may be a credit deal with payment to be made, either in full or in installments, at some specified future time or times. Upon delivery of the mower in the cash deal, or when the deferred payment comes due in the credit deal, B may, of course, make payment in money. It is more likely, however, that B will tender and S will take either B's own check payable to S's order or, perhaps, B's paycheck or other third-party check or draft indorsed by B to S. Possibly, B will give S a bank money order, a cashier's check, or a bank draft which is payable directly to the order of S as payee and which B has purchased for this transaction and does not sign or indorse. In this last case, as was noted above, S's taking of the unindorsed bank paper is considered final payment, like the receipt of money, and discharges B's $200 contractual obligation to S.[81] However, when S takes B's own check or indorsed third-party paper, this merely "suspends" the contractual obligation pending the final payment or dishonor of the instrument.[82] In the credit deal, of course, S may require, upon delivery of the mower, that B sign as maker, and issue to S as payee, a negotiable promissory note for the $200 plus interest, payable at such future time as is specified in the contract. Such a note also merely "suspends" the underlying obligation until it is finally paid or dishonored, and the note may be secured by an additional accommodation signature[83] or by S retaining a "security interest"[84] in

81. U.C.C. § 3-802(1)a, quoted in text accompanying notes 24-25 *supra*.

82. U.C.C. § 3-802(1)b. B may, of course, buy and make payment with a postal money order, commercial traveler's check, or other non-bank payment paper on which S may have no recourse against B if the paper is dishonored; but such payment apparently comes within § 3-802(1)b and merely "suspends" the contract obligation.

83. U.C.C. § 3-415.

84. Defined in U.C.C. § 1-201(37).

the mower through a conditional sale or other security agreement[85] with B.

When S takes commercial paper, he may retain the beneficial ownership of it, transferring and indorsing it to his bank as only a holder-agent for collection.[86] Alternatively, if S needs funds immediately, he may transfer both holdership and beneficial ownership by indorsing and cashing the check, by drawing against it pending collection,[87] by making a payment with it to a third party, or by selling, discounting, or pledging the note. In any case, if the instrument is paid or otherwise satisfied or discharged, both B's obligation on it as a signer and his underlying $200 contractual obligation are discharged.[88]

For our purposes, however, assume that B claims fraud by S or that the mower was never delivered or was defective and was returned to S, and that B refuses to pay the note or stops payment on the check. In such a case, the Code provides that "if the instrument is dishonored action may be maintained on either the instrument or the obligation . . . ."[89] Therefore, if S still owns the instrument or has taken it up from a subsequent holder following dishonor and thus has reacquired rights as a holder,[90] and if S disputes B's claim concerning the mower, S has an option either to sue B for breach of the contract or to bring suit on the instrument.

In either case, of course, S as plaintiff has the burden, in his pleading and proof, of establishing B's legal obligation to pay him $200. Also, since S dealt directly with B, S cannot be a holder in due course as to B and, if S sues on the instrument, B can set up all the defenses he could have asserted if S had sued for breach of contract.[91] Of course, in either action the full burden of pleading and establishing all of the so-called "affirmative defenses" such as payment, misrepresentation, breach of warranty, statute of frauds, and others, is on the defendant B.[92] Nevertheless, it is still to S's advantage to sue B on the instrument because the establishment of B's basic obligation and liability is much more simple in such an action than in the contract action. Moreover, if the instrument is no longer owned by S but has

85. Defined in U.C.C. § 9-105(1)h. The validity, perfection, priority, and enforcement of such a security agreement is governed by the provisions in Article Nine of the Code.

86. See U.C.C. § 4-201.

87. In which case the bank acquires a security interest in the paper under U.C.C. § 4-208.

88. U.C.C. § 3-802(1)b.

89. *Id.*

90. See U.C.C. §§ 3-208 & 3-603(2).

91. U.C.C. § 3-306.

92. See, *e.g.*, FED. R. CIV. P. 8(c); CLARK, CODE PLEADING 610-18 (2d ed. 1947).

been negotiated to a bank or other subsequent holder, it is obviously much simpler for the subsequent holder to establish B's liability on the instrument than to establish a cause of action as an ordinary assignee of S's contractual claim against B.

B. *The Action for Breach of Contract*

If S elects to sue B for the $200 price of the mower on the basis of B's breach of the contract rather than on the instrument, S's complaint under the fact pleading of the procedural codes[93] must contain appropriate allegations showing the elements of his cause of action:[94] the making and the terms of the contract between S and B; the furnishing of consideration (the power mower) to B; the fulfillment of any other conditions precedent to B's obligation to pay the $200; and B's breach.[95] Under rule procedure, of course, the pleading in a complaint for breach of contract is simplified, but S must still show the basis on which he is entitled to relief.[96]

B, in his responsive pleading, can put in issue the basic facts contained in the complaint by general or specific denial.[97] To the extent that B puts these facts in issue, S has not only the burden of introducing first evidence of such facts but also the ultimate burden of persuading the trier of fact.[98] Thus, except as admitted by B, S has the full burden of establishing the making and the terms of the contract, his own performance and fulfillment of conditions precedent, B's breach, and S's damages. Of course, if there is a writing purportedly signed by B which evidences the contract, S may have a statutory presumption in his favor as to the writing's validity,[99] or there may be no dispute as to that issue, so that S may have no difficulty in establishing the existence and terms of the contract. Yet he still has the burden of persuasion as to the other three elements of his action, and the real controversy between S and B is frequently over these matters.

If S has sold and delivered the mower to B on credit *without* taking a note and has then sold or otherwise assigned the account to a bank or finance company, and if S is not in a position to reimburse the assignee when B defaults, the assignee may have to sue B for

93. CLARK, *op. cit. supra* note 92, at 22-23, 225-39; POMEROY, CODE REMEDIES 620-28 (5th ed. 1929).

94. CLARK, *op. cit. supra* note 92, at 127-46; POMEROY, *op. cit. supra* note 93, at 628-67. See generally Clark, *The Code Cause of Action*, 33 YALE L.J. 817 (1924).

95. CLARK, *op. cit. supra* note 92, at 276–86.

96. See, *e.g.*, FED. R. CIV. P. 8(a) & (e), 9(c) and Appendix of Forms 5; 1A BARRON & HOLTZOFF § 259.

97. CLARK, *op. cit. supra* note 92, at 581-97; FED. R. CIV. P. 8(b) & 9(c).

98. MCCORMICK, EVIDENCE 635-39 (1954).

99. See, *e.g.*, MINN. STAT. § 600.15 (1961), quoted in note 52 *supra*.

breach of the contract. In such an action, the assignee-plaintiff not only has the same burden of pleading and proof that S would have as plaintiff in the contract action, but also has the full burden of pleading and establishing both a valid assignment by S to the plaintiff[100] and the latter's right, as the real party in interest, to sue B.[101]

C. *The Action on the Instrument by S*

If S chooses to sue B "on the instrument"—as maker of the dishonored note, drawer of the dishonored check, or indorser of the dishonored third-party paper—S still has the basic procedural burden of establishing B's obligation and liability to him. However, S's mere possession of the instrument, which is negotiable in form, purportedly signed by B, and payable by its terms or indorsements to S or to bearer, enables S to satisfy that burden with a minimum of pleading and proof.

In an action on the *note*, S's complaint must both allege that B signed or executed the note in question *as maker* and show the terms of the note usually by setting them out *in haec verba*.[102] Thus, the complaint will disclose that the note is negotiable in form, that the date for payment is past and that the note is thus overdue, and that S is the payee named in the note and is thus entitled to payment by its terms.[103] There is no need to allege presentment and dishonor, since, as maker, B is primarily obligated to pay at maturity without demand.[104]

If, however, the action is against B *as drawer of the check* or *as indorser* of third-party paper, S's complaint should allege, and in any event S must prove (in addition to the terms of the instrument, B's signing, and S's holdership), either the due presentment of the instrument to the drawee, its dishonor by the drawee, and any required protest or notice of dishonor to B, or facts constituting an excuse for non-fulfillment of these prerequisites to the secondary liability of drawers and indorsers.[105]

S's complaint in either of the above actions, however, need not allege how or under what circumstances the note, check, or draft was signed by B, that there was a contract for the sale of the power mower,

100. RESTATEMENT, CONTRACTS §§ 148-51 (1932); U.C.C. § 2-210(2) & (3).

101. CLARK, *op. cit. supra* note 92, at 155, 163-66, 171-72; FED. R. CIV. P. 17; 2 BARRON & HOLTZOFF § 482, at 14-19.

102. See, *e.g.*, FED. R. CIV. P. 8(e) and Appendix of Forms 3.

103. The complaint will also demand judgment for the face amount plus interest from maturity. See, *e.g.*, FED. R. CIV. P. 8(a)(3) and Appendix of Forms 3.

104. See text accompanying note 64 *supra*.

105. See text accompanying notes 66-72 *supra*.

that there was any consideration for B's signature, or that he received the mower. All of these matters involve "defenses" which B must establish.[106] The mere fact that S, a payee or holder, possesses overdue or dishonored negotiable paper, which has been signed by B, and which unconditionally promises or orders payment of a specified amount of money on demand or at a definite time to the bearer or to a specified person, is deemed sufficient to raise a presumption that the signer is liable to the holder. This presumption is not just a peculiar quirk of mercantile law; rather, it is based upon the obvious fact that negotiable paper is almost always issued or transferred in order to evidence, pay, or collect legal debts or other monetary obligations.[107] It is also founded upon the strong inference that, if the instrument is still in the possession of a holder, the legal obligation has not yet been satisfied. These commercial realities together with the policy of encouraging the transfer of negotiable paper justify placing upon signers the burden of establishing the absence of a legal obligation[108] and the resulting procedural advantages to holders.

In B's responsive pleading, then, a general denial merely puts into issue the existence of the alleged instrument and S's possession as a holder. B must specifically plead invalidity of signatures if he claims that defense,[109] just as he must plead any of the ordinary "affirmative defenses" to contractual liability.[110] Furthermore, even if B claims that he never consummated a binding contract with S, that he either never received the power mower or rejected it as defective, or that he never delivered the instrument to S or only delivered it conditionally, B must raise these issues in his pleading since "want or failure of consideration is a defense . . . ,"[111] as is "non-performance of any condition precedent, non-delivery, or delivery for a special purpose . . . ."[112]

At trial, S's case in chief is very simple. He merely has to produce the instrument showing B's purported signature, testify that he (S) is the named payee, the indorsee, or the possessor (if the instrument is indorsed in blank or otherwise payable to bearer), and introduce it in evidence. If the action is against B as drawer or indorser, rather than as maker, S also must introduce evidence of due presentment, dishonor, and so forth, or evidence showing excuse of those

106. See text accompanying notes 58 & 59 *supra.*
107. See text accompanying notes 11-12 *supra.*
108. U.C.C. § 3-307(2).
109. U.C.C. § 3-307(1).
110. FED. R. CIV. P. 8(c).
111. U.C.C. § 3-408.
112. U.C.C. § 3-306. Compare FED. R. CIV. P. 9(c).

prerequisites.[113] From this point on, the onus is upon B. He must introduce first proof of the invalidity of signatures even though S thereafter has the burden of establishing their effectiveness,[114] and, as to all other matters, B has the full burden of first proof and ultimate persuasion.

D. *The Action on the Instrument by a Subsequent Holder*

If S has indorsed and negotiated the instrument to a subsequent holder for value and then is unavailable or unable to take up the instrument when it is dishonored,[115] the holder normally will seek payment from B as maker, drawer, or prior indorser and may sue B on the instrument to enforce payment. In such an action, the allegations in the subsequent holder's complaint and the evidence necessary to establish his case in chief as holder will be essentially the same as when S sues as holder of the instrument. The plaintiff's holdership will rest upon the indorsement of S and, possibly, upon an intermediate indorsement if there has been more than one negotiation; however, as already explained, the validity of an indorsement is presumed and the holder does not have to show how he acquired the instrument or that he took as a holder in due course "unless the defendant establishes a defense."[116] If the defense, although established, is one that is not available against a holder in due course, the plaintiff may avoid it and recover the amount of the instrument by introducing evidence that will sustain his "burden of establishing that he or some person under whom he claims is in all respects a holder in due course."[117] The typical plaintiff—either a merchant who has cashed B's check, or a bank or finance company which has advanced funds against B's check or has purchased B's note—normally will have little difficulty in proving his status as a holder in due course by presenting convincing evidence that the instrument was taken for appropriate value in the ordinary course of business, in good faith, and without notice of the facts of the S-B transaction or of B's personal defenses. B, on the other hand, may have some difficulty in adducing evidence sufficient to negate the existence of any of these requirements.

Even though B has pleaded a defense, the plaintiff-holder may wait until B establishes the defense before attempting to avoid it by

113. See text accompanying notes 63-72 *supra*.

114. U.C.C. § 3-307(1)b.

115. Normally the subsequent holder will seek recourse from his transferor-indorser when the instrument "bounces" and will look to prior parties only when such recourse is unobtainable.

116. U.C.C. § 3-307(2).

117. U.C.C. § 3-307(3).

presenting proof of his status as a holder in due course. However, when the plaintiff has clear evidence that he took as a holder in due course, it will usually be tactically advantageous for him to introduce that evidence in his case in chief. If the plaintiff can show at the outset by clear and convincing evidence, which is unshaken on cross-examination, that he took as a holder in due course, that issue will not usually be sufficiently doubtful to require submission to the jury unless B introduces rebutting evidence. Thus, when B starts to put in his evidence, the plaintiff can object to any proof of B's personal defenses against S, until B introduces credible evidence that casts doubt upon the plaintiff's status as a holder in due course, since personal defenses are irrelevant if the plaintiff is conclusively shown to be such a holder.[118] If B has no evidence sufficient to make a jury issue of the holder in due course question, he can be blocked from showing his defense and plaintiff probably can get a directed verdict.[119] This procedure avoids the time-consuming, and in these circumstances unnecessary, process of introducing extensive evidence as to the transaction between S and B and as to the facts of the defense. Moreover, if discovery procedures[120] are properly used, it may be possible to obtain a summary judgment[121] for the plaintiff and thus avoid a trial entirely.

Finally, introducing evidence of his holder in due course status in his case in chief may protect the plaintiff's substantive rights in the following type of situation. Frequently B's defense is based upon outright fraud or other sharp dealings by S. If B is an individual consumer or even a small local merchant being sued for the price of a worthless product or one that he never received from S, it may seem very unjust to a judge and jury in his locality[122] to require him to pay the check or note which he was duped into signing, particularly if the plaintiff-holder is a large bank or finance company doing business in another city. That plaintiff *is* a holder in due course and that the policies underlying the law of negotiable paper require payment to such holders by signers like B in order to facilitate the use of such paper will not weigh heavily with a judge and jury of B's peers once the facts of S's conduct are before them. If the plaintiff waits until

118. See M & M Securities Co. v. Dirnberger, 190 Minn. 57, 250 N.W. 801 (1933); Kipp v. Welsh, 141 Minn. 291, 170 N.W. 222 (1918).

119. See BRITTON, BILLS & NOTES 265-68 (2d ed. 1961) for discussion and analysis of the cases on plaintiff's right to a directed verdict in this situation.

120. See, *e.g.*, FED. R. CIV. P. 30–37.

121. See, *e.g.*, FED. R. CIV. P. 56.

122. Normally the venue of the action will be defendant B's locality. See, *e.g.*, 28 U.S.C. § 1391 (1964).

B's sordid story is told before proving his innocent taking of the paper, his evidence may at that point seem sufficiently inconclusive to the judge to require submission of the holder in due course issue to the jury despite the absence of any substantial rebutting evidence.[123] Moreover, the jury, despite proper instructions, may well doubt that the plaintiff was wholly unaware of S's wrongdoing and may find in B's favor.[124] Thus, counsel for a plaintiff bank or finance company that clearly took the paper as a holder in due course should try to avoid the situation just described by establishing the plaintiff's due course status as conclusively as possible in his case in chief. This should not result in any unfairness to the defendant, since he should be able on cross-examination to bring out any weaknesses in the plaintiff's claimed due course status. In addition, if there are no weaknesses—if the plaintiff is unquestionably a holder in due course —he is entitled to protection against the possible misguided sympathies of a hostile jury.

Court procedure should aid, not hamper, the policies deemed necessary to the effective working of our payment and financing system as embodied in the rights of holders in due course. It must be remembered, that a recovery by the holder in due course from B free from B's personal defenses merely means that B must seek redress from S, the person who swindled him, just as he would have had to do if he had paid cash to S. The risk that S might be judgment-proof or unavailable should be borne by B, who dealt with S, rather than by the good faith holder who cashed, discounted, or otherwise took B's commercial paper for value in the ordinary course of business or financing without notice of S's wrongdoing. One who signs and issues or transfers negotiable paper invites merchants, bankers, and others who do business with such instruments to deal with the paper in the customary fashion. When they do so in good faith and without notice of anything amiss, the signer should not expect them to bear the burden of his failure to get the deal he bargained for. They assume the risks of his capacity, his credit, and of the genuineness of the paper.[125] He should bear the other risks.

123. See, *e.g.*, Arnd v. Aylesworth, 145 Iowa 185, 123 N.W. 1000 (1909).

124. See, *e.g.*, National City Bank v. Kirk, 85 Ind. App. 120, 134 N.E. 772 (1922); Rohweder v. Titus, 85 Wash. 441, 148 P. 583 (1915).

125. U.C.C. §§ 3-305(2) & 3-404(1).