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NEGOTIABLE INSTRUMENTS UNDER THE UNIFORM COMMERCIAL CODE

*George E. Palmer**

THE ambitious undertaking of the American Law Institute and the National Conference of Commissioners on Uniform State Laws to draft a "Uniform Commercial Code" includes a proposed revision of the Negotiable Instruments Law. This is not merely an attempt to patch up the present statute. It is virtually a complete rewriting. It includes many changes and additions in substance as well as a radical reorganization and rephrasing of language where no change in substance is designed. It includes the much needed separation of the provisions relating to investment instruments such as corporate bonds from those relating to bills, checks, notes and other like instruments. The latter class of instruments is covered in Article 3 ("Commercial Paper"), the former, in Article 8 ("Investment Securities"). Article 3 also includes a division on bank collections, a subject not heretofore treated in any uniform act of the Commissioners on Uniform State Laws.[1]

In the present paper discussion is limited to Article 3 dealing with the traditional types of negotiable instruments, excluding however that part of the Article on bank collections. Even thus limited, we are confronted with a proposed statute which encompasses every section of the Negotiable Instruments Law. The indications are that this portion of the Code is largely settled, both in form and substance, as it appears in the draft issued in May 1949.[2] It seems appropriate, therefore, to

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[1] The "Bank Collection Code," which has been adopted by many states, was sponsored by the American Bankers Association.

[2] Prior to this draft, Article 3 had gone through several "Preliminary Drafts," three "Tentative Drafts" and two "Proposed Final Drafts." These were accompanied by excellent "Notes and Comments" on the present state of the law, presumably prepared by the Reporter for Article 3, Dean William L. Prosser. The Chief Reporter for the entire code is Professor Karl N. Llewellyn.

discuss this draft on the assumption that even in details of language it represents the final form. The discussion will be by reference to the section numbers as they appear in the draft.[3] There is no attempt to comment on every aspect of the proposal which is worth comment. That would require a treatise. The general quality of the revision is high indeed. This is a large undertaking and it is to be expected that any commentator will find some faults. The fact that faults are suggested in this paper is not a fair reflection of the overall worth of the performance.

At the outset it was decided to frame what the Reporter, Dean Prosser, described as a "tight statute."[4] Like the NIL, the earlier drafts provided that no instrument would be negotiable unless it satisfied the formal requirements of the statute. In the latest draft there is some departure from this rigidity. The instrument must conform in order to be negotiable "within this Article," which as explained in the "official comment"[5] leaves open the possibility that new types of instruments may be "recognized by the common law as negotiable, or as having some attributes of negotiability." The shift of position indicates the inherent difficulty of a choice which must be made between certainty and flexibility. There is no sure answer. It seems wise to resolve the doubt in favor of permitting judicial recognition of new types of negotiable paper.

Sections 103, 105 and 112—Unconditional Promises and Luggage. The familiar requirements for negotiability are stated in section 103, with elaboration left to succeeding sections. One portion of section 103 provides that in order to be negotiable the instrument must "contain an unconditional promise or order to pay a sum certain in money and no other promise, order, obligation or power given by the maker or drawer except as authorized by this Article." This of course includes a number of the formal requirements, but discussion will be centered on two: that the promise be unconditional and that in general there shall be no promises other than the principal money promise.

[3] The section numbers are 3-101 et seq. They will be referred to as sections 101 et seq., omitting the digit which identifies the article of which the section is a part.

[4] Notes to Tentative Draft No. 1 (1946) 11. For a discussion of this aspect of the NIL, see Aigler, "Recognition of New Types of Negotiable Instruments," 24 COL. L. REV. 563 (1924).

[5] The code uses the novel device of "official comments" which, by section 1-102, "may be consulted by the courts to determine the underlying reasons, purposes and policies of this Act and may be used as a guide in its construction and application."

Elaboration of the unconditional promise requirement is found in section 105, which eliminates some present uncertainties and differences of opinion. There is now some uncertainty with respect to the negotiability of an instrument which contains on its face sufficient to show that the promise or order is subject to implied conditions. This uncertainty doubtless will be removed by the provision in section 105 to the substantial effect that the condition must be "expressly stated" on the instrument in order to make the order or promise conditional. The common recital in instruments "as per contract" is specifically dealt with by providing that it does not affect negotiability. There is substantial doubt under the NIL as to the negotiability of an instrument issued by an unincorporated association or a trustee where the promise is limited to the assets of the association or the trust estate.[6] It is proposed to settle the question by providing that negotiability is not affected in either case, nor in the case of a similar limitation of liability by a partnership.

Where an instrument given for the price of goods purchased on conditional sale contract refers to the contract in some manner, there is conflict on the issue of negotiability. Two general types of clauses have been involved. One simply refers to the fact that there is a conditional sale contract.[7] The other embodies the terms of the contract, either in whole or in that part which provides for retention of title in the seller. Neither the cases nor the writers have suggested separate consideration of the two types of clauses, though it is clear that they raise separable issues.[8] The only substantial issue under the first type is whether the promise is conditional. There is little excuse for a holding that it is. The clause is fairly covered by NIL section 3, which permits a "statement of the transaction which gives rise to the instrument." In addition, any court which recognizes that the conditional sale contract is a security arrangement should treat the instrument the same as one which refers to the fact that it is secured by

[6] Bonds of an unincorporated association with the promise so limited were held negotiable in Hibbs v. Brown, 190 N.Y. 167, 82 N.E. 1108 (1907). Bonds of a business trust with a comparable limitation were held non-negotiable in Lorimer v. McGreevy, 229 Mo. App. 970, 84 S.W. (2d) 667 (1935). Cf. Charles Nelson Co. v. Morton, 106 Cal. App. 144, 288 P. 845 (1930).

[7] Continental Guaranty Corp. v. Peoples Bus Line, 31 Del. 595 at 598 (1922). ("This note is given covering deferred installments under conditional sale contract for a motor vehicle. . . ." Held: the clause does not destroy negotiability).

[8] Britton, for example, lumps together the two types of cases, treating them both as involving the effect on negotiability of a "recital on a note of an underlying contract of conditional sale." BRITTON, BILLS AND NOTES 62 (1943).

mortgage. It is almost universally recognized that the mere reference to a mortgage does not make the promise conditional or otherwise affect negotiability. Although the two types of clauses have not been carefully distinguished, it is significant that the cases found denying negotiability have dealt with the second. Under the revision, it is clear that a provision of the first type will be consistent with negotiability.

The real difference of opinion has been over clauses of the second type. The tendency both before and after adoption of the NIL has been to uphold negotiability,[9] but there are cases to the contrary. The clause involved in *Central National Bank v. Hubbel*[10] is typical:

> "This note . . . having been given to said . . . [payee] as per contract for certain apparatus, it is hereby agreed that . . . title to said apparatus remain in said . . . [payee] until this note is fully paid."

The Massachusetts court held the note non-negotiable primarily on the ground that the promise was conditional. The conditional promise theory has been the one most commonly used by those courts which deny negotiability. They have not agreed on exactly what the condition is, and the differing explanations all seem to rest upon a misconception of the purpose and legal operation of a conditional sale contract.[11] Another ground sometimes used is that the clause is not permissible "luggage,"[12] that is, it is a promise in addition to the money promise which is not consistent with negotiability.[13]

[9] BRITTON, BILLS AND NOTES 62 (1943); note, 25 MICH. L. REV. 668 (1927); comment, 7 TULANE L. REV. 607 (1933).

[10] 258 Mass. 124 at 125, 154 N.E. 551 (1927).

[11] In the Hubbel case, 258 Mass. 124, 154 N.E. 551 (1927), the court was satisfied with the statement that the promise was "contingent upon fulfilment" of the conditional sale contract, combined with reliance upon Sloan v. McCarty, 134 Mass. 245 (1883), a common law decision. That case went on the ground that if the horse which was the subject of the contract died before due date this would excuse payment of the price. The usual rule is to the contrary on the sales question, placing the risk of loss on the buyer. VOLD, SALES 281 (1931). In Third Nat. Bank v. Armstrong, 25 Minn. 530 at 533 (1879), the court said that there was an implied promise of the payee-seller to transfer title on payment of the note, that this promise and the money promise were "concurrent conditions . . . in the nature of mutual conditions precedent," and that this made the promise to pay conditional. But viewed as a security arrangement, payment of the price operates to discharge the lien and there is no necessity for the conditional seller to "transfer title." VOLD, SALES 276 (1931). For a more complete discussion see comment, 7 TULANE L. REV. 607 (1933).

[12] The word is taken of course from Gibson's assertion that "a negotiable bill or note is a courier without luggage." Overton v. Tyler, 3 Pa. 346 at 347 (1846).

[13] Sloan v. McCarty, 134 Mass. 245 (1883); Killam v. Schoeps, 26 Kan. 310 (1881).

The revision is ambiguous on whether a provision such as that in the *Hubbel* case prevents negotiability. It probably does not make the promise conditional since section 105 provides that a promise is not conditional where the instrument "states that it is secured, whether by mortgage, reservation of title or otherwise." But section 103 provides that an instrument is not negotiable if it is "subject to requirements of public filing or recording for the effectiveness against third parties of any term therein." The clause in the *Hubbel* case evidenced a conditional sale, which is commonly subject to recording acts. This would seem to settle the matter in favor of the *Hubbel* view, were it not for the fact that the revisers apparently intend to reject that holding. The official comment to section 105 says that the portion of the section already quoted is intended to settle a conflict in the decisions, "over the effect of 'title security notes' and other instruments which recite the security given" and to adopt "the position of the great majority of the courts." The majority view rejects the holding of the *Hubbel* case. And in his comments to an earlier draft, the Reporter stated that section 105 "rejects the holdings of such cases as *Central Trust Co. v. Hubbel*, . . . that a recital of security destroys the negotiability of the instrument."[14] Nonetheless, a fair reading of the statute itself leads to acceptance of that holding and to rejection of the position which has generally been accepted since 1890 when the Supreme Court decided *Chicago Railway Equipment Co. v. Merchants Bank*.[15]

It may be, as will be suggested later,[16] that the law relating to negotiability of notes issued in connection with conditional sale contracts needs re-examination in the light of current practices. One effect

[14] Notes to Tentative Draft No. 1 (1946) 32.

[15] 136 U.S. 268 (1890). An official comment to section 103 cites as an example of the kind of instrument which should not be negotiable that involved in Abingdon Bank & Trust Co. v. Shipplett-Moloney Co., 316 Ill. App. 79, 43 N.E. (2d) 857 (1942). The holding in favor of negotiability is criticized on the ground that the writing was "in substance and essence a conditional sale." What made it a conditional sale was a sentence reading:

> "This note (with one other) is given for John Deere Tractor and I hereby agree that title thereto, and to all repairs and extra parts furnished therefor, shall remain in the payee, owner or holder of this note until this and all other notes given therefor shall have been paid in money."

There is no significant difference between this clause and that in the Hubbel case. True the clause refers to another note but that is not the reason given by the Reporter for condemning it. Nor is there any significant difference in the following provision found in the Chicago Railway Equipment case: ". . . it is agreed by the maker hereof that the title to said cars shall remain in the said payee until all the notes . . . are fully paid. . . ."

[16] See infra, p. 267, under Section 120.

of negotiability has been to insulate a finance company from the defaults of a seller with whom it has close business relationships. But the revision does not rest on this consideration, nor will it be effective to change the present pattern since the note easily can be made negotiable. The consideration which has dominated this part of the revision is to eliminate from the field of negotiability what the Reporter has called "cluttered paper."[17] This is reminiscent of Gibson's attempt a century ago to make negotiable paper a "courier without luggage."[18]

Reference has been made to the occasional holding under the NIL that a title retention clause destroys negotiability because it is a promise in addition to the money promise which is not permitted by section 5. The clause is not specifically authorized by that section; nonetheless, it has generally been thought consistent with negotiability. The listing of permissible provisions has not been treated as exhaustive. The revision will make an important change in this respect, for it apparently attempts an exhaustive list of permissible clauses which contain a "promise, order, obligation or power." No such clause is permitted "except as authorized by this Article." Exceptions are contained principally in section 112. It is a mistake to attempt exhaustive enumeration. Decisions before and under the NIL show a process of change guided by a useful principle. This is exemplified by the acceptance of a maker's agreement to furnish additional security, specifically recognized in section 112. The present statute is silent on the point, but most decisions have upheld negotiability.[19] It has been viewed, in the words of the New York court, as a promise "to do an act in aid of, and incidental to, the payment of money."[20] The court relied on Chafee's generalization:[21]

> "The question in every case is not whether the act is technically 'additional' to the payment of money, but whether it is substantially so. If its real purpose is to aid the holder to secure the payment of money and protect him from the risks of insolvency, if it steadies the value of the note, and makes it circulate more readily, then it should not be fatal to negotiability."

[17] Notes to Tentative Draft No. 2 (1947) 20.

[18] Supra note 12.

[19] Kennedy v. Broderick, (C.C.A. 7th) 216 F. 137 (1914); Finley v. Smith, 165 Ky. 445, 177 S.W. 262 (1915); City Nat. Bank v. Adams, 266 Mass. 239, 165 N.E. 470 (1929); First Nat. Bank v. Blackman, 249 N.Y. 322, 164 N.E. 113 (1928).

[20] First Nat. Bank v. Blackman, 249 N.Y. 322, 164 N.E. 113 (1928).

[21] Chafee, "Acceleration Provisions in Time Paper," 32 HARV. L. REV. 747 at 783 (1919).

This approach is not new. It guided the courts at common law. Gibson looked with disfavor, in *Overton v. Tyler*,[22] upon a waiver of the benefit of appraisement laws but twenty-five years later, when the issue was squarely before the Pennsylvania court, it held for negotiability.[23] The court observed that the effect of the provision was to "facilitate the collection by waiving certain rights which ... [the maker] might exercise to delay or impede it. Instead of clogging its negotiability it adds to it, and gives additional value to the note." The NIL recognizes the propriety of such a waiver clause, as does the revision. Both also recognize clauses authorizing the sale of collateral security or a confession of judgment at maturity. Each of these gained recognition at common law, not by accident, but because they were merely incidental to the main obligation and "facilitated its collection." Instead of the vain attempt at exhaustive ènumeration we need in the statute a recognition of this guiding principle.

Section 108—Demand Instruments. This section deals more explicitly than the present statute with the question as to when a cause of action arises on a demand instrument. The relevant provision reads:

> "A cause of action against the maker of a note payable on demand accrues upon its issue, or if postdated upon the stated date. A cause of action on a certificate of deposit does not accrue until demand."

Under the NIL the cause of action on a demand note has been held to arise at the time of issuance, with the result that the failure of the holder to enforce payment during the period prescribed by the statute of limitations bars his claim.[24] This is the position taken in the present section as to notes, but the section wisely excepts certificates of deposit, on which courts have differed. The rule proposed for certificates of deposit undoubtedly fits common understanding and follows the present majority view.[25] A bank depositor surely does not conceive that his deposit claim against a bank may be barred by the passage of time, nor is it apart from special statute. In much the same way, he doubtless looks upon a demand certificate of deposit primarily as written evidence of "money on deposit." Apparently the section is

[22] Supra note 12.

[23] Zimmerman v. Anderson, 67 Pa. 421 at 422 (1871).

[24] BRITTON, BILLS AND NOTES 776 (1943).

[25] Note, 37 MICH. L. REV. 1306 (1939); BRITTON, BILLS AND NOTES 776-7 (1943).

not intended to apply to time certificates of deposit, though the applicable sentence does not exclude them.

The section is defective in making provision only for notes and certificates of deposit, for the same problem has arisen in connection with certified checks. In *Dean v. Iowa-Des Moines National Bank,*[26] the court held that the statute of limitations did not begin to run on a demand certificate of deposit until demand and that the same rule applied to a check certified at the request of the holder. Upon certification, the court concluded, the check "became in legal effect an ordinary demand certificate of deposit."[27] The conclusion is highly debatable. A certified check may be the equivalent of a demand certificate of deposit on a purely formal level, in that the holder of each instrument has a claim against a bank payable on demand. But the two instruments serve different business purposes. A check is used as a means of making payment and it seems unlikely that certification would be thought by the holder to put him in the position of a bank depositor. In any event, the problem should be dealt with in the statute whether the view of the *Dean* case is accepted or rejected.

Section 109—Time Certainty. This section reads in part:

> "(1) An instrument is payable at a definite time if by its terms it is payable at a stated date or
> (a) at a fixed period after a stated date; or
> (b) at a fixed period after sight; or
> (c) at a definite time subject to any acceleration; or
> (d) at a definite time subject to extension at the option of the holder, or to extension to a further definite time at the option of the maker or automatically upon a specified act or event."

1. The principal change is with respect to the negotiability of an instrument containing an acceleration provision. Adhering to a common law tendency, the decisions under the NIL usually have held that power to accelerate at the "whim or caprice" of the holder is incompatible with negotiability.[28] On the other hand, negotiability usually is not affected by acceleration at the option of the maker, or at the option of the holder upon the happening of an event which is

[26] 227 Iowa 1239, 281 N.W. 714, 290 N.W. 664 (1940).

[27] 227 Iowa at 1256. Accord: Girard Bank v. Bank of Penn Twp., 39 Pa. 92 (1862).

[28] ". . . a note containing language providing for the power of acceleration of the due date upon the caprice or whim of the holder is thereby rendered nonnegotiable." American Finance Corp. v. Bourne, 190 Okla. 332 at 333, 123 P. (2d) 671 (1942).

either within the control of the maker or is not controlled by either party, or which occurs automatically upon the happening of such an uncontrolled event.[29] Section 109 eliminates this distinction by the provision that the time of payment is sufficiently certain where an instrument is payable "at a definite time subject to any acceleration."

However, the actual operation of an option given the holder is affected by section 119 which provides in part that

> "A holder's option to accelerate at will or 'where he deems himself insecure' or the like . . . gives power to do so only in the good faith belief that the prospect of payment is impaired but the burden of establishing lack of good faith is on the obligor."

It has always been difficult to explain why an uncontrolled power of acceleration in the holder should destroy negotiability. By reference to a historic test for determining negotiability it would seem that paper is more readily marketable when the power is in the holder than when it is in the maker. Evidently the true motivation has been the feeling that an arbitrary power in the holder gives him an unfair advantage over the maker. This has been expressed, not by invalidating or limiting the power itself, but by holding that it makes the instrument non-negotiable for lack of the requisite time certainty. The revisers propose to recognize the underlying reason and give it a more rational expression.

This raises another problem however. Trouble is encountered under the NIL when an instrument containing an acceleration clause which has been exercised is negotiated prior to the fixed due date but after the accelerated due date. If the holder takes without knowledge of the acceleration, is he a purchaser before maturity so that he can be a holder in due course? A forceful argument has been made for reading the statute to reach an affirmative answer.[30] Certainly this is the desirable result, but there is scant authority to support it.[31] The problem is solved in an almost satisfactory fashion by sections 302 and 304. By the former a holder in due course must take the instrument "without notice that it is overdue." Thus a purchaser may

[29] The problems are discussed in Chafee, "Acceleration Provisions in Time Paper," 32 HARV. L. REV. 747 (1919); Aigler, "Time Certainty in Negotiable Paper," 77 UNIV. PA. L. REV. 313 (1929).

[30] Chafee, "Acceleration Provisions in Time Paper," 32 HARV. L. REV. 747 at 759 et seq. (1919).

[31] Some support is found in Taylor v. American Nat. Bank, 63 Fla. 631, 57 S. 678 (1912) and Marion Nat. Bank v. Harden, 83 W. Va. 119, 97 S.E. 600 (1918). Contra: Hodge v. Wallace, 129 Wis. 84, 108 N.W. 212 (1906).

be a holder in due course of overdue paper if he buys before the stated due date without notice of acceleration. By section 304, he has such notice if "he has reasonable grounds to believe . . . that the instrument has become due by acceleration." But section 119 introduces an unnecessary difficulty in the application of the language just quoted. Instruments may provide, as in an Indiana case,[32] that the holders have "full power to declare this note due . . . at any time they may deem this note insecure, even before maturity of the same." Under section 119 an attempted exercise of this power would not be operative unless the holder had a "good faith belief that the prospect of payment is impaired." If the purchaser bought without notice of the attempted exercise there is no difficulty. If he bought with notice, however, whether he is a holder in due course apparently will depend upon the finding made on the good faith issue. This introduces an element of uncertainty which is better avoided. Knowledge of the attempted exercise of the power should be sufficient to prevent holding in due course.[33]

2. Notes commonly provide that the "makers, indorsers and guarantors of this note, and the sureties hereon, severally . . . consent that the time of its payment may be extended without notice."[34] Some courts have found that the language means what it literally says, that is, the holder can extend maturity without consent of the maker, from which it is concluded that the time of payment is uncertain.[35] Others have construed the language to authorize extension only with the consent of a principal maker, thereby sustaining negotiability.[36] This is in recognition that the probable purpose of the clause is to preserve the secondary or suretyship liability of parties to the instrument, including an accommodation maker, when time is extended to the principal obligor. The revision will eliminate the interpretation problem,

[32] Guio v. Lutes, 97 Ind. App. 157 at 158, 184 N.E. 416 (1933) (held non-negotiable).

[33] It could be argued that knowledge of an attempted acceleration gives a later purchaser "reasonable grounds to believe" that the instrument is overdue, whether or not it is in fact. But the basic requirement of the revision is that the instrument be taken "without notice that it is overdue." It is difficult to read this as covering a case in which the instrument is not in fact overdue. The official comment to section 302 pretty well forecloses the possibility. It explains that the language "without notice that it is overdue" is used "in order to make it clear that the purchaser of an instrument which is in fact overdue may be a holder in due course if he takes it without notice that it is overdue."

[34] The language is taken from Security Nat. Bank v. Gunderson, 52 S.D. 25 at 26, 216 N.W. 595 (1927). The note was held negotiable.

[35] Quinn v. Bane, 182 Iowa 843, 164 N.W. 788 (1917); Smith v. Van Blarcom, 45 Mich. 371 (1881).

[36] National Bank of Commerce v. Kenney, 98 Tex. 293, 93 S.W. 368 (1904).

for section 119 provides that "Notwithstanding any term of the instrument, the holder may extend it only with the consent of the maker at the time of extension." Nor will the clause affect negotiability since it is covered explicitly by subsection 1(d) of the present section.

Section 111—Bearer Paper. Where an instrument reads "pay to the order of ——," and is issued with the blank space untouched, it is very likely order rather than bearer paper under the NIL. However, there is not much authority and the conclusion is not free of doubt. The common law cases considered such paper payable to bearer[37] and the NIL is ambiguous. Probably the better statutory construction is to treat the instrument as incomplete order paper. When issued it is not negotiable for lack of a payee; the later filling in of a payee's name turns it into a negotiable order instrument.[38]

Under section 111 an instrument is to be payable to bearer when payable to " 'cash' or the order of 'cash,' or any other words which do not purport to designate a specific payee." This should remove most of the uncertainty since the language makes it pretty clear that something must be written in the blank. One problem is not satisfactorily solved however. If the maker draws a line through the blank space, the instrument should be bearer paper just as though he had written in "cash."[39] In each case he has issued an instrument which is complete in the form he intended. In order to give the same treatment to the two cases it will be necessary to say that a line is "words."

Sections 116 and 406—Incomplete Instruments. Under NIL section 14, where an instrument is issued with blanks and completed in excess of authority, a holder in due course can recover on the instrument as completed. Under NIL section 16, where an instrument has been completed but not delivered, a holder in due course can recover on the instrument despite the lack of delivery. Under NIL section 15, non-delivery of an incomplete instrument is a defense even against

[37] BIGELOW, BILLS, NOTES AND CHECKS, Lile's ed., 103 (1928).

[38] Tower v. Stanley, 220 Mass. 429, 107 N.E. 1010 (1915). However, this classification does not seem to correspond to practices with respect to traveler's checks. They are issued with the name of the payee blank and are dealt with as negotiable paper in that form. Since it is necessary to fit paper into either the order or bearer category, such a check might be treated as bearer paper until a payee's name is inserted whereupon it becomes order paper. American Express Co. v. Anadarko Bank & Trust Co., 179 Okla. 606, 67 P. (2d) 55 (1937). It is questionable whether the revision makes adequate provision for such checks. See generally, note, 47 YALE L. J. 470 (1938).

[39] The contrary conclusion was reached at common law in Gordon v. Lansing State Sav. Bank, 133 Mich. 143, 94 N.W. 741 (1903).

a holder in due course. In short, either element alone constitutes a personal defense but the two in combination are a real defense.

It is proposed to continue the rules of sections 14 and 16 but to change that of section 15 by protecting a holder in due course against the defense of non-delivery of an incomplete instrument.[40] The desirability of the change is suggested by the decision in *City Nat. Bank of Galveston v. American Express Co.*[41] The Express Company signed traveler's checks containing blanks (or so the court held) and turned them over to a bank for issuance. When the checks were stolen and filled in by the thief the court applied section 15 and held that a holder in due course could not recover from the Express Company. This ought to be considered a business risk of the Express Company, which it can of course cover by insurance. Certainly it is in a better position than the purchaser to protect itself.

The holder in due course is to be protected where "an instrument signed when incomplete" is thereafter completed in excess of authority. A problem arises as to the meaning of "instrument," one which also arises under NIL section 14 but which is more acute under the revision with less help given to its solution. Clearly if a man signs his name in the usual place on the usual check form this is an "instrument" within the meaning of these sections. It should be equally clear that if he signs his name on a blank page in an autograph book this is not an "instrument." This is clear under the NIL, for section 14 furnishes a guide: "a signature on a blank paper delivered by the person making the signature *in order that the paper may be converted into a negotiable instrument*. . . ."[42] No comparable guide to decision appears in the revision. This is especially unwise because the change in NIL

[40] Section 116 reads:

"(1) An instrument signed when incomplete in any necessary respect cannot be enforced until completed, but when it is completed in accordance with authority given it is valid as completed.

(2) If the completion is authorized [sic] the rules as to material alteration apply (Section 3-406), *even though the paper was not delivered by the maker or drawer;* but the burden of establishing that any completion is unauthorized is on the party so asserting." (Italics added).

The relevant portion of section 406 reads:

"A subsequent holder in due course may in all cases enforce the instrument according to its original tenor [this applies to alterations], and when an incomplete instrument has been completed, before he takes, he may enforce it as completed."

[41] (Tex. 1929) 16 S.W. (2d) 278. A different conclusion was reached in American Express Co. v. Anadarko Bank & Trust Co., 179 Okla. 606, 67 P. (2d) 55 (1937), on the ground that the instrument was complete when stolen. It was in the same form as the check involved in the Galveston Bank case.

[42] This seems to have been the test used at common law. NORTON, BILLS AND NOTES, 4th ed., 349 (1914).

section 15 will increase the need for some basis of differentiation between what is an "instrument" and what is not.

Section 120—Contemporaneous Instruments. This deals with one of the most puzzling situations in the field of negotiable instruments. It is axiomatic that the purchaser's knowledge that the instrument was given for an executory promise does not affect his standing as a holder in due course.[43] He knows that the consideration may fail through breach of contract by the payee, but this is not notice of an infirmity. There is ample justification for this general position. Its rejection probably would mean that in a high percentage of cases negotiable instruments taken in normal business transactions would not be taken in due course.[44] Nor would it be wise to penalize so extensively the careful buyer who investigates the transaction in which the instrument had its inception. This general position is adopted in section 304 of the revision by the following provision:

> "Knowledge of the following facts does not of itself give the purchaser notice of an infirmity or claim . . . (b) that . . . [the instrument] was issued or negotiated in return for an executory promise or accompanied by a separate agreement, unless the purchaser has notice of any defense or claim arising from the terms thereof."

On the other hand there are situations in which a purchaser who knows the terms of a separate writing should take subject to those terms. In *National Bank of Watervliet v. Martin,*[45] a note for $7500 payable three months after date was issued in connection with a separate written agreement which provided for renewal every three months upon payment of $250 against principal. The plaintiff bought the note with knowledge of this agreement. A divided court held that the plaintiff could recover the full principal amount, free of any right in the maker to renew pursuant to the terms of the agreement. The

[43] Grinnell Sav. Bank v. Gordon, 195 Iowa 208, 191 N.W. 852 (1923). Cases are cited in BEUTEL'S BRANNAN, NEGOTIABLE INSTRUMENTS LAW, 7th ed., 788 (1948).

[44] Smith v. Ellis, 142 Miss. 444 at 456, 107 S. 669 (1926). ("it is a matter of common knowledge that a considerable part of commercial paper in circulation has for its consideration executory agreements by the payees").

[45] 203 App. Div. 390, 196 N.Y.S. 714 (1922); affirmed on the ground that the maker did not make proper tender of $250 and a renewal note, 235 N.Y. 611, 139 N.E. 755 (1923). In Federal Credit Bureau v. Zelkor Dining Car Corp., 238 App. Div. 379, 264 N.Y.S. 723, 729 (1933), the appellate division concluded that the court of appeals meant to disapprove the ground of decision in the Watervliet case as described in the text. This reads a great deal into a one-sentence memorandum opinion.

decision seems outrageous. The separate writing related to the terms of the note itself and could be given meaning only by recognizing that those terms were affected. Surely a purchaser with knowledge of such facts should not be permitted to enforce the note according to its terms alone.

If the *Watervliet* decision is rejected, and the revisers intend to reject it by the present section,[46] there remains the difficult task of formulating a test which will differentiate such a case from the usual executory promise case. Broadly the problem is the extent to which the negotiable note will be separated from the underlying transaction. It is basic to the concept of negotiability that there may be such a separation. In the usual executory promise case the separation is feasible. For breach of the agreement the maker will have his remedies against the payee even though the breach is not a defense to an action on the note by a purchaser. But the separation is not complete, as demonstrated by the settled view that knowledge of a breach when the note is taken subjects the purchaser to the breach as a defense. In the *Watervliet* case the separation should not be made in favor of a purchaser with notice of the contract because the terms of the contract were such that it would necessarily be broken by enforcement of the note pursuant to its terms alone. This suggests a working rule, admittedly vague but perhaps as precise as the situations permit: If the separate agreement necessarily affects or clearly was intended to affect the obligation on the negotiable instrument itself, a purchaser with notice of the agreement takes subject thereto.[47]

Section 120, which is intended to cover this problem, provides in its relevant parts:

> "As between the obligor and his immediate obligee or any transferee the terms of an instrument may be modified or affected by any other written agreement executed as part of the same transaction, except that . . . a holder in due course is not affected by any limitation of his rights arising out of the separate agreement of which he had no notice when he took the instrument."

[46] The official comment to section 120 says that a holder in due course who takes with notice takes subject to a provision in the separate writing "that under certain conditions the note shall be extended for one year."

[47] Of course, this does not automatically solve all cases. A difficult question is raised, for example, by the separate agreement in Securities Inv. Co. v. Maxwell, 131 Misc. 160, 226 N.Y.S. 273 (1928). A note was given in connection with a conditional sale contract which provided that if the buyer was not satisfied with the goods he could return them within thirty days and the seller would "return all money paid" and cancel the contract. A purchaser with notice was held to take subject to this provision.

This is open to various interpretations—it can only be suggested that it is susceptible of a reading in the terms described above. The key words are "modified or affected" and "limitation of his rights." It is a mistake to use both phrases, for only one concept is involved. If the separate agreement "modifies" the negotiable instrument and the purchaser takes with notice of the fact, this should end the matter. Inquiry into whether the separate agreement "limits his rights" will only lead to confusion and possible circularity of reasoning. In the ordinary executory promise case, if the purchaser with notice is held subject to the terms of the separate writing his rights are thereby limited—but this gives no help in determining whether the agreement contains that kind of limitation of rights which will bind him.

So far we have not touched upon the aspect of the problem which has most troubled the courts, that is, the case in which the purchaser takes an assignment of the separate agreement along with the note. In *First & Lumberman's National Bank v. Buchholz*[48] the defendant executed a conditional sale contract for the purchase of an automatic coal burner which the seller agreed to install. Defendant also executed a negotiable note payable to the seller which was attached to the contract by a perforated line. Prior to installation of the burner the note and contract were sold to plaintiff bank in this form. In an action on the note it was held that defendant could offset the damage resulting from faulty installation. The court recognized the general rule that notice that the note was given for an executory promise does not subject the purchaser to the defense of breach of that promise, but held the rule inapplicable. The central fact was the assignment of the contract with the note.

The cases are in sharp disagreement.[49] Strong arguments can be marshaled against the *Buchholz* decision. The purchaser does not assume the seller's obligations on the contract and allowance of the defense therefore cannot properly be rested on the ground that the breach is his breach. He takes the assignment merely as security for

[48] 220 Minn. 97, 18 N.W. (2d) 771 (1945).

[49] The following cases held for the purchaser; United States v. Novsam Realty Corp., (C.C.A. 2d, 1942) 125 F. (2d) 456 (conditional sale—New York law applied); United States v. Bryant (D.C. Fla., 1945) 58 F. Supp. 663 (conditional sale—Florida law applied); Royal Tire Service, Inc. v. Shades Valley Boys' Club, 232 Ala. 357, 168 S. 139 (1936); Coral Gables, Inc. v. Heim, 120 Conn. 419, 181 A. 613 (1935) (land contract—Florida law applied); Robertson v. Northern Motor Securities Co., 105 Fla. 644, 142 S. 226 (1932) (conditional sale); Credit Alliance Corp. v. Buffalo Linen Supply Co., 238 App. Div. 18, 263 N.Y.S. 39 (1933) (conditional sale); Petroleum Acceptance Corp. v. Queen Anne Laundry Serv., 265 App. Div. 692, 40 N.Y.S. (2d) 495 (1943).

the note and ought not to be in a worse position than if he took an unsecured note. Even though the contract is not expressly assigned, as a security arrangement it will pass with the transfer of the note—and no case has suggested that the purchaser takes subject to the contract terms except where there is an express assignment.[50] In the face of such impressive arguments it is almost equally impressive that they have been rejected by a substantial number of courts.[51] Usually the reasoning goes no further than this: as is true between the original parties, the instruments "must be read together whenever they are found together in the hands of the holder of the note."[52] This is a refusal to separate the note from the contract when they are in fact treated as evidencing parts of a single transaction by the seller and his financing agency.

Sections 120 and 304 of the revision apparently are intended to reject the *Buchholz* view.[53] That case presents a group of related problems which need to be considered as a whole. The obvious initial question is whether the note was rendered non-negotiable by the fact that it was attached to a conditional sale contract.[54] When the issue presented has been that of the *Buchholz* case, negotiability usually has been assumed. But suppose that the note had been detached from the contract and negotiated alone to the purchaser. Here the issue most frequently raised has been material alteration and decision usually has turned on whether the detachment was authorized. If unauthorized, the assumption has been either that the note was not negotiable while attached to the contract,[55] or that the purchase of the writing

[50] In addition it has been argued that the effect of subjecting the financing agency to the maker's defenses will be to increase the cost of such financing, to the detriment of this part of our credit structure. Kripke, "The 'Secured Transactions' Provisions of the Uniform Commercial Code," 35 VA. L. REV. 577 at 588-9 (1949).

[51] The following cases are in accord with the Buchholz decision: Culbreath v. Guiterman, Rosenfield & Co., 217 Ala. 259, 115 S. 303 (1927), 219 Ala. 382, 122 S. 619 (1929); Todd v. State Bank of Edgewood, 182 Iowa 276, 165 N.W. 593 (1917) (land contract); Cooke v. Real Est. Trust Co., 180 Md. 133, 22 A. (2d) 554 (1941) (conditional sale contract); Von Nordheim v. Cornelius, 129 Neb. 719, 262 N.W. 823 (1935) (conditional sale contract); General Contract Purchase Corp. v. Moon Carrier Corp., 129 N.J.L. 431, 29 A. (2d) 843 (1942); State Nat. Bank v. Cantrell, 47 N.M. 389, 143 P. (2d) 592 (1943) (conditional sale); Federal Credit Bureau v. Zelkor Dining Car Corp., 238 App. Div. 379, 264 N.Y.S. 723 (1933).

[52] Federal Credit Bureau v. Zelkor Dining Car Corp., 238 App. Div. 379 at 386, 264 N.Y.S. 723 (1923).

[53] Notes to Tentative Draft No. 2 (1947) 64.

[54] Even though the contract is considered a part of the note, this does not necessarily affect negotiability under the NIL since all of its provisions may be consistent with negotiability.

[55] General Motors Acc. Corp. v. Garrand, 41 Idaho 151, 238 P. 524 (1925) (condi-

in its original form would have subjected the purchaser to defenses on the contract. Unless one of these assumptions is made it is difficult to see why the separation is material. Courts have made no attempt to correlate decisions in the two areas.

The material alteration sections of the NIL do not explicitly cover such a case but this is to be remedied by section 406 of the revision. An alteration of an instrument is material if it "changes the contract" of any party "by removing any part of" the instrument. If it is not assented to by such party, a holder in due course can enforce the instrument "according to its original tenor." There is apt to be uncertainty as to how this section applies to the *Buchholz* situation. Solution is fairly easy if it is held, as some courts have,[56] that the perforated line amounts to assent to the separation. If this is denied, section 406 seems controlling. The rejection of *Buchholz* means that the revisers are assuming the negotiability of the note while attached and are asserting that purchase in that form does not subject the purchaser to defenses on the contract. In order to give effect to section 406, however, this should be limited to a case in which separation is authorized.

If the decision in the *Buchholz* case has merit this is primarily because of its effects in connection with installment sales of consumers' goods. Several factors stand out: the treatment of the two instruments as one by the discounting agency; the possibility that many buyers of consumers' goods who sign negotiable instruments have no idea of the usual legal consequences of negotiability; and finally, the frequent close business relation between the finance agency and the seller-payee. It is a major task to work out a balanced solution. Probably it would be unwise, and almost certainly it would prove ineffective, to subject the purchaser to defenses on the contract simply because it was assigned to him. When the note and contract are on one paper and are transferred in that form it is suggested that results should depend upon whether the maker fairly can be held to have authorized separation. If not, the two instruments were expected to be treated as one and should be so treated when purchased without separation. Presumably the note is non-negotiable under section 103. Separation should be a material alteration so that even a holder in due course can enforce only "according to the original tenor." If separation is

tional sale); Harrison v. Union Store Co., 179 Ky. 672, 201 S.W. 31 (1918); Toledo Scale Co. v. Gogo, 186 Mich. 442, 152 N.W. 1046 (1915) (conditional sale).

[56] Muskegon Citizens Loan & Inv. Co. v. Champayne, 257 Mich. 427, 241 N.W. 135 (1932); BRITTON, BILLS AND NOTES 1063 (1943).

authorized, then negotiability of the note should be determined from its terms alone, and purchase of the two instruments even while attached should not of itself subject the purchaser to defenses on the underlying contract. This seems to provide an acceptable solution insofar as solution turns on the unity or separateness of the two instruments. It is believed that the revision can be read this way.

Overreaching this analysis however is the problem of breaking down the present insulation of the finance agency from the defaults of a seller-payee in circumstances where it should be treated as a party to the original transaction. The direction has been pointed by a lower court decision in New York in which the court reached this result, saying:[57]

> "It is common knowledge that, whatever the situation as to finance companies was in the past, today they have become *de facto* departments of the great automobile businesses, without which these industries could no more operate than *sans* their assembly lines. The fiction has been permitted to flourish that these finance companies are foreign and distinct organizations, a fiction which no one, however, believes. All sales, when credit is sought, are approved by these financial agencies, and future collections are placed immediately in their hands. They have become integrated in the business, part and parcel of the one thing.
>
> "In the smaller industries, which could not afford the organization of separate finance companies, the same work has been done by institutions such as the bank plaintiff in this case, who, in their turn, take over the credit management and collection of accounts for, and become as integral a part of, the operation of these smaller enterprises as do the individually-owned finance corporations of the greater merchandising companies.
>
> "Looking, without the distortion of ancient notions, at the picture thus presented, we find the actual control and management of the credit and finance of sellers doing a conditional sale business in the hands of these finance corporations."

[57] Buffalo Ind. Bank v. De Marzio, 162 Misc. 742 at 744, 296 N.Y.S. 783 (1937), reversed without passing on the merits, 6 N.Y.S. (2d) 568 (1937). To the same general effect, though with more emphasis on the close relation in the particular case, are Commercial Credit Co. v. Childs, 199 Ark. 1073, 137 S.W. (2d) 260 (1940); Palmer v. Associates Discount Corp., (App. D.C. 1941) 124 F. (2d) 225; United States v. Schaeffer, (D.C. Md. 1940) 33 F. Supp. 547; Taylor v. Atlas Security Co., 213 Mo. App. 282, 287, 249 S.W. 746 (1923). Cases to the contrary are collected in 128 A.L.R. 729 (1940). The general problem is discussed in 57 YALE L. J. 1414 (1948).

Article 3 of the proposed Code does not recognize these factors, but they may have influenced the provisions of Article 7 on "Secured Transactions." Under that article the purchaser of the note may assert the rights of a holder in due course in an action on the note but he takes subject to defenses on the conditional sale contract or other security arrangement if he seeks to enforce the security. Moreover, if he asserts rights as a holder in due course of the note the security interest "lapses." In effect, where the seller-payee is in default, the purchaser must make a choice between (a) personal action against the maker free of the usual defenses and (b) enforcement of the security, perhaps with a personal claim, subject to the maker's defenses.[58] It still remains true, however, that the holder can if he chooses recover on the note as a holder in due course. If there is to be any recognition of the factors emphasized by the New York court it will have to be outside the rather rigid framework of Article 3.

Section 201—Reacquisition. Although the scope of the section is broader than reacquisition, the most important change is to limit explicitly the area within which one who holds an instrument subject to defenses or title claims may improve his position by negotiating to a holder in due course and then repurchasing. Courts and writers have agreed that it is generally undesirable to permit this;[59] and courts usually have been able to reach the desired end in spite of the shortcomings of the NIL (section 58). One of the most troublesome cases is where the payee obtains an instrument by fraud and negotiates to *P* who takes with notice of the fraud. If *P* negotiates to a holder in due course and then reacquires the instrument, he is entitled under section 58 to assert his indorser's right to recover free of the defense unless he was a "party to the fraud." Although it is difficult to find that *P* was a party to the fraud, the few decisions have tended to follow the common law view that *P* took subject to the defense.[60] After the revision such holdings can be based on what the statute says for the "transferee" of the instrument is to get

[58] Sections 7-108 and 7-612. This solution is criticized by Kripke, ["The 'Secured Transactions' Provisions of the Uniform Commercial Code," 35 VA. L. REV. 577 at 586 et seq. (1949)] who argues that negotiability of both note and contract should be recognized.

[59] In one situation at least there is no great danger in recognizing that a holder may improve his position by sale and reacquisition. This is where the holder is a donee who is unaware of a defense or title defect when he sells. The revision will permit him to stand in the shoes of the holder in due course from whom he reacquires.

[60] Berenson v. Conant, 214 Mass. 127, 101 N.E. 60 (1913); Chafee, "The Reacquisition of a Negotiable Instrument by a Prior Party," 21 COL. L. REV. 538 at 542 (1921).

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

Section 204—Special Indorsement of Bearer Paper. There is doubt under the NIL as to whether a special indorsement of bearer paper prevents further negotiation by delivery. For example, the payee of a note indorses it in blank and delivers to *Y* who indorses "Pay to Z." The note is stolen from Z, his indorsement is forged, and the instrument is taken by a good faith purchaser. If the purchaser must trace his title through the forged indorsement he gets none and Z may recover the paper. But the note became bearer paper, negotiable by delivery alone, when the payee indorsed in blank. If the bearer quality of the paper continued after the special indorsement to Z, the purchaser can ignore the forged indorsement and if he is a holder in due course will take free of Z's title claim.

The relevant sections of the NIL look in different directions and in consequence the law is highly uncertain.[61] The solution of the problem of statutory interpretation which has found favor with many writers is that the special indorsement controls when the paper was theretofore in bearer form only by reason of blank indorsement; but that it does not control when the paper was originally payable to bearer.[62] This has the merit of giving some effect to each of two apparently conflicting sections. No court has adopted the distinction. Only two courts seem to have passed on the point. Each case involved order paper which was converted into bearer form by blank indorsement. In each it was held that the paper remained negotiable by delivery despite a subsequent special indorsement.[63]

[61] NIL, section 9, says that an instrument is payable to bearer when the "only or last indorsement is an indorsement in blank." In the situation described in the text the last indorsement is not in blank. But section 40 says that "where an instrument, payable to bearer, is indorsed specially, it may nevertheless be further negotiated by delivery. . . ."

[62] McKeehan, "The Negotiable Instruments Law," 50 AM. L. REG. 437, 461 (1902); Goble, "Effect of a Special Indorsement on a Bearer Instrument," 5 ILL. L. REV. 247, 248 (1923); CRAWFORD, THE NEGOTIABLE INSTRUMENTS LAW, 4th ed., 83-84 (1918); BEUTEL'S BRANNAN, NEGOTIABLE INSTRUMENTS LAW, 7th ed., 628 et seq. (1948).

[63] Parker v. Roberts, 243 Mass. 174, 137 N.E. 295 (1922); Christian v. California Bank, (Cal. 1946) 173 P. (2d) 318, affd. on different grounds, 30 Cal. (2d) 421, 182 P. (2d) 554 (1947).

The present section rejects different treatment of the two situations, but provides in each that the special indorsement controls.[64] Thus, on the facts suggested above, the purchaser would get no title and the result would be the same if the paper were originally payable to bearer. The rejection of the suggested distinction seems unfortunate. The problem has been considered at length by others and all of the considerations involved will not be repeated.[65] The factor which should control stems from the rule that a maker who pays one having no title is not discharged but remains liable to the true owner. The issuer of bearer paper should not be forced to run the risk of forged indorsements. He engaged to pay to bearer, not to one holding through a valid indorsement. Such a risk can fairly be placed, however, on the maker of order paper since that requires an indorsement for its initial negotiation.

Section 206—Restrictive Indorsements. This section along with several sections of the bank collection material deals with what lawyers now know as restrictive indorsements, a term which has been abandoned in the revision. No attempt will be made to discuss the effect of the revision upon indorsements for collection. The problems are closely related to that part of the code on bank collections, which is not within the scope of this paper. The section also covers the so-called "trust indorsement," for example, "pay to *T* in trust for *B*." As to this indorsement the shortcomings of the NIL are well known. It seems to say, and has been held to say, that the indorsee, *T*, cannot be a holder in due course.[66] Nor has he the power to transfer to another

[64] The section provides in part: "Any instrument specially indorsed becomes payable to the order of the special indorser [sic] and may be further negotiated only by his indorsement." In Notes to Tentative Draft No. 2 (1947) 49, it is erroneously said: "In Parker v. Roberts . . ., the only case dealing with the question, it was held that the indorsement of the special indorsee was necessary." In the Roberts case, a note payable to order was indorsed in blank by the payee. This was followed by a special indorsement with no indorsement by the special indorsee. Recovery was granted against the maker, over a challenge to plaintiff's title, the court saying: "The right of the plaintiff to omit tracing his title in the declaration through all subsequent indorsers, and to allege that he is the holder under the previous blank indorsement is conferred by the statute. The note therefore would be transferable by delivery and in effect a note payable to bearer."

[65] See Turner, "A Factual Analysis of Certain Proposed Amendments to the Negotiable Instruments Law," 38 YALE L. J. 1047, 1051 (1929).

[66] Gulbranson-Dickinson Co. v. Hopkins, 170 Wis. 326, 175 N.W. 93 (1919). The relevant sections of the NIL are 36, 37 and 47. They might be interpreted differently but no court seems to have done so. Smith, "The Concept of 'Negotiability', as used in section 47 of the Negotiable Instrument Law," 7 TEX. L. REV. 520 (1929).

the rights of a holder in due course.[67] Nor can he recover against his indorser as a party secondarily liable.[68] There is no justification for such treatment of the trustee. He is a purchaser of negotiable paper and should have the rights of any other purchaser, subject to the limitations imposed upon him as a trustee. Each of these results will be changed by the revision.

Section 302—Holder in Due Course. The section, reprinted in full in the footnote,[69] contains several important departures from its counterpart in the NIL (section 52). The statement that a payee may be a holder in due course seeks to eliminate the existing difference of opinion on the point. Although the decisions verbally differ on this issue, the more important difference is over when a payee is a holder in due course. The revision takes the position, advocated by some writers,[70] that the tests are the same as for any other holder. It rejects the elusive distinction which has been suggested between a payee who takes as purchaser and one who takes as promisee.[71] It settles in favor of the payee a number of troublesome situations; for example, where the payee takes from a co-maker who has used the instrument in breach of his understanding with the other co-maker.[72] Under the revision, the latter cannot assert the misuse as a defense if the payee meets the usual requirements of holding in due course. The solution proposed is workable and on the whole is to be preferred.

The third subsection lists some exceptional situations in which courts have held that the holder is not a holder in due course even though he meets the statutory requirements. The interesting

[67] The conclusion is virtually inescapable because of the statement in NIL, section 37, that "all subsequent indorsees acquire only the title of the first indorsee under the restrictive indorsement."

[68] First Nat. Bank v. John Morrell & Co., 53 S.D. 496, 221 N.W. 95 (1928).

[69] "(1) A holder in due course is a holder who takes the instrument (a) for value; and (b) in good faith; and (c) without notice that it is overdue or has been dishonored or of any infirmity in it or claim against it on the part of any person.

(2) A payee may be a holder in due course.

(3) The following are not holders in due course: (a) a purchaser at a judicial sale or any other person who acquires the instrument under legal process; (b) a representative who acquires the instrument in taking over an estate; (c) one who purchases or otherwise takes in bulk the assets of a prior holder in a transaction not in the ordinary course of business of such holder."

[70] Feezer, "May the Payee of a Negotiable Instrument be a Holder in Due Course?" 9 MINN. L. REV. 101 (1925); Britton, "The Payee as a Holder in Due Course," 1 UNIV. CHI. L. REV. 728, 738 (1934).

[71] Aigler, "Payees as Holders in Due Course," 36 YALE L. J. 608 (1927).

[72] In Vander Ploeg v. Van Zuuk, 135 Iowa 350, 112 N.W. 807 (1907), it was held that the payee was not a holder in due course. Contra: Ex Parte Goldberg & Lewis, 191 Ala. 356, 67 S. 839 (1914).

thing is that they all involve a taking of the instrument which is not "in due course of business." This idea appeared early in the cases, as in Mansfield's statement in *Peacock v. Rhodes* that the jury "have found it [a bill of exchange] was received in the course of trade, and, therefore, the case is clear."[73] But beyond furnishing a name for the "holder in due course," the idea found no place in the NIL. Nonetheless, the decisions on which the third subsection is based show that it still has vitality. Under the revision the problem is likely to arise as to whether it can be used in the solution of situations not specifically listed. The case of *Childs & Co. v. Harris Trust & Sav. Bank*[74] provides a good illustration.

Harris by mistake delivered to Childs a package containing $23,000 in bearer bonds which were intended for another. An employee of Childs wrongfully took the package. Later, when Childs was shipping out bonds for sale, the employee abstracted $23,000 in bonds from the shipment and substituted the Harris bonds. Childs innocently sold the latter and when Harris sued for conversion, Childs defended on the ground that it became a holder in due course by purchasing the Harris bonds with its own bonds. The defense was rejected, partly on the ground that a holder in due course must take by negotiation and that there was none. The revision eliminates any requirement of negotiation, so some other basis will have to be found to support a good result.[75] One reason why the result seems good is that this was not a transaction in the ordinary course of trade. If a court concludes that this is the unifying principle in the situations covered by the third subsection, the revision gives it the opportunity to apply the principle to the *Childs* situation. In an official comment to section 1-102, applicable in the construction of the Code as a whole, it is said:

> "This Act adopts the trend of those cases which extend the principle of a statute either to fill a gap in the language or to apply to a situation outside of the statute's explicit scope where reasons and policy justify such extension. . . .

[73] Doug. 633 at 636, 99 Eng. Rep. 401 (1781). What this made clear to Mansfield was that the purchaser of a stolen bill, indorsed in blank, could enforce it free of the defense of theft. See also Miller v. Race, 1 Burr. 452 at 458, 97 Eng. Rep. 398 at 402 (1758) in which Mansfield observed that a lost or stolen instrument "never shall be followed into the hands of a person who bonâ fide took it in the course of currency, and in the way of his business."

[74] (C.C.A. 7th, 1928) 27 F. (2d) 633.

[75] Perhaps the result could be supported on the theory that Childs did not give value, its bonds not being a bargained for consideration. See State v. Nebraska State Sav. Bank, 127 Neb. 262, 255 N.W. 52 (1934), noted 33 MICH. L. REV. 630 (1935).

"Where situations which are governed in a commercial sense by a general applicable principle, are covered one by one, any seemingly restricted language should be expanded to fit the reason and principle of the situation."[76]

Section 303—Value. The section is as follows:

"A holder takes for value:

(a) to the extent that the agreed consideration has been performed or that he acquires a contractual lien on the instrument; or

(b) when he takes the instrument in payment of or as security for an antecedent claim against any person whether or not the claim is due; or

(c) when he gives a negotiable instrument for it or makes an irrevocable commitment to a third person."

Evidently this is intended to continue the present general rule that "value is any consideration sufficient to support a simple contract."[77] The section also adheres to the view that an antecedent debt is value and to the majority rule[78] that an executory promise, including bank credit, is not. In earlier drafts it was proposed that the giving of bank credit ("immediately available checking credit") should be value,[79] but this has been abandoned.

In order to decide whether a depositary bank is a holder in due course, it will be necessary, as it now is, to determine what constitutes a withdrawal of deposits. There is a conflict in the decisions which it is clearly desirable to eliminate. The only provision found which bears on the problem is section 612 of the bank collection material, which reads in its relevant parts as follows:

"(1) To the extent that credit for an item taken as a cash item [this includes checks] has been withdrawn or applied to an overdraft, the crediting bank has a lien upon the item or its proceeds. . . .

"(4) For the purposes of this section, credits first given shall be deemed the first to be withdrawn, but credit not available for

[76] In discussing the luggage problem under section 103, I made the statement that the list of permissible clauses which appears in the revision is exhaustive. The quoted statement suggests otherwise. It seems unlikely, however, that the statement will be of any force in view of the explicit provision in section 103 that *no* promise, order, etc. is permissible "except as authorized by this Article." The Reporter's comments show that he thinks this language means what it says. Notes to Tentative Draft No. 2 (1947) 6.

[77] NIL, §25.

[78] BRITTON, BILLS AND NOTES 394 (1943). For an argument contra see BEUTEL'S BRANNAN, NEGOTIABLE INSTRUMENTS LAW, 7th ed., 498 et seq., 721 et seq. (1948).

[79] Tentative Draft No. 3 (1947) §44.

withdrawal as of right shall be deemed to be used only if necessary to prevent an account from being or continuing to be overdrawn when balances are posted."[80]

When a check drawn on one bank is deposited with another, this section treats the depositary bank as an agent for collection with a lien on the instrument to the extent of withdrawals. The objective doubtless is to give the bank a value position to the extent of its lien for the purpose of holding in due course. But the language of section 303 is not happily chosen to accomplish this purpose, since it covers only a "contractual" lien. Obviously the argument will be made that the bank's lien is statutory, especially if the bank has not stipulated for a lien.

The few decisions under the NIL are in conflict on whether withdrawals must be before maturity.[81] It would be preferable not to impose this requirement.[82] The revision is ambiguous but probably will be construed to require withdrawals before maturity. Under section 302 a holder in due course must take "without notice that ... [the instrument] is overdue ... or of any infirmity in it." The NIL is explicit that the holder has a value position only to the extent of withdrawals before notice of an infirmity.[83] The revision is unwisely silent on the point but undoubtedly will be construed to mean what the NIL says. If so, it will be difficult to escape the conclusion that the withdrawals also must be before notice that the instrument is overdue.

Section 304—Notice and Good Faith. This section, covering almost two pages, deals in detail with the important specific problems which have arisen on the question of notice. Before considering a few of the detailed provisions, something should be said concerning the general test of notice and the closely related problem of good faith. The language on these questions may create serious uncertainties.

1. In 1824, in *Gill v. Cubit,*[84] the King's Bench approved an instruction to find whether the purchaser took the instrument "under

[80] The first clause of the second subsection follows the prevailing "first in-first out" rule. BEUTEL'S BRANNAN, NEGOTIABLE INSTRUMENTS LAW, 7th ed., 506 (1948). The final clause apparently is intended to reject application of this rule as between a cash deposit and the usual credit given on deposit of a check for collection.

[81] It was held that withdrawals must be before maturity in Central Savings Bank & Trust Co. v. Stotter, 207 Mich. 329, 174 N.W. 142 (1919). Contra: National Bank of Commerce v. Armbruster, 42 Okla. 656, 142 P. 393 (1914).

[82] The arguments against the requirement were forcefully stated by Brewer in Fox v. Bank of Kansas City, 30 Kan. 441 at 447 (1883).

[83] Section 54.

[84] 3 Barn. & Cress. 466 at 467, 107 Eng. Rep. 806 (1824).

circumstances which ought to have excited the suspicion of a prudent and careful man." Twelve years later, in *Goodman v. Harvey*,[85] the King's Bench condemned this instruction with the statement that "where the bill has passed to the plaintiff without any proof of bad faith in him, there is no objection to his title." This test, that good faith means simply absence of bad faith, gained currency in this country and was adopted by the NIL. It is generally said that *Goodman v. Harvey* simply reinstated the rule of the law merchant which had prevailed until 1824.[86] It is generally said also that the test is subjective, the absence of actual bad faith.[87]

Actually the courts have been searching since the early cases for an objective standard. During the formative period the English judges, especially Mansfield, apparently thought of good faith in connection with taking "in due course of trade."[88] Surely this was a search for an external standard. More recently the Second Circuit Court of Appeals concluded that a man does not take in good faith if he has "knowledge of some truth that would prevent action by those *commercially honest men* for whom law is made."[89] This development is to be expected and it seems wise to give it explicit recognition in the statute. It is to be expected because of the necessity of judging a man's state of mind by observable facts. It seems wise because the law's need for generalized treatment justifies limiting the extraordinary protection given a holder in due course to one who measures up to the usual conduct of honest men.

The revisers' definition of good faith appears in the general definitions section, applicable to the whole Commercial Code, as follows:

> " 'Good faith' means honesty in fact in the conduct or transaction concerned. Good faith includes good faith toward all prior parties and observance by a person of the reasonable commercial standards of any business or trade in which he is engaged."

[85] 4 Adol. & El. 870 at 876, 111 Eng. Rep. 1011 (1836).

[86] BENJAMIN'S CHALMERS, BILLS, NOTES AND CHECKS, 2d Am. ed., 102 (1889); Goodman v. Simonds, 20 How. (61 U.S.) 343 at 368 (1857).

[87] Thus, in the Commissioners' Notes to Section 1 of the Uniform Fiduciaries Act, it is said: "The NIL uses the term 'bad faith,' but does not define it. The courts have held, however, that the test of good faith is the subjective test of honesty, and not the objective test of due care."

[88] Supra, note 73.

[89] Gerseta Corp. v. Wessex-Campbell Silk Co., (C.C.A. 2d, 1924) 3 F. (2d) 236 at 238. See also Soma v. Handrulis, 277 N.Y. 223, 14 N.E. (2d) 146 (1938) ("bad faith in a commercial sense"); Fehr v. Campbell, 288 Pa. 549, 137 A. 113 (1927) ("commercial bad faith"). (Italics added).

The first sentence follows *Goodman v. Harvey* and the NIL. The second sentence adopts an objective standard, applicable however only to one engaged in trade or business. A trade or business presumably has standards of honest conduct and standards of prudent conduct. Which set of standards is to be used is not clear. In the context a court probably will read the words to mean standards of honest conduct, the "commercially honest man" test.

But most situations raising an issue of good faith also can be viewed as raising an issue of notice. The general test of notice given in section 304 is "that upon all the facts and circumstances known to the purchaser he has reasonable grounds to believe that there is an infirmity in the instrument or a claim against it or that it is overdue or dishonored." In operation this may take us almost back to the prudent man approach. Certainly it is quite different from the statement in NIL, section 56: "knowledge of such facts that his action in taking the instrument amounted to bad faith." Nor is it the same test as that found in the good faith definition, if the definition means "commercial honesty." There should be a single standard, whether the issue is good faith or notice.

2. A troublesome problem under the NIL may be stated in this general form: If a purchaser is on notice of an infirmity or title defect, is he denied the rights of a holder in due course even though the defense asserted is unrelated to such infirmity or title defect? Thus the payee of a note who held as a fiduciary for X negotiated the note in breach of trust to a holder with notice of the breach. Can the maker defend the holder's action on the ground of failure of consideration? If the maker has no defense going to his ultimate liability it is probable that he can not assert X's title claim to defeat the action.[90] But this does not settle the question whether he can use the transaction between the payee and the plaintiff to show that the latter is not a holder in due course and therefore holds subject to the maker's defense of failure of consideration. As a matter of language it seems reasonably clear under the NIL that he may do so and there is some supporting authority.[91] But there is authority to the contrary, which one writer relies upon as enunciating the "general

[90] See note 97, infra.

[91] Nat. Bank of Commerce of Detroit v. Marr & Co., 254 Mich. 333, 237 N.W. 56 (1931); Walker v. Bartlesville State Bank, 91 Okla. 231, 216 P. 928 (1923); Fehr v. Campbell, 288 Pa. 549, 137 A. 113 (1927).

rule."[92] The revision is no better and no worse than the NIL in its treatment of the question. It points to the conclusion that the defense asserted may be quite unrelated to the infirmity or title defect of which the purchaser has notice. In view of the present difference of opinion, however, a more explicit provision seems advisable.

3. Under the NIL, where paper is issued with blanks and thereafter is completed in excess of authority, a holder in due course may recover on the instrument as completed. If the purchaser knows when he buys that blanks have been filled, there is considerable uncertainty as to whether he is a holder in due course.[93] It is proposed to so treat him, so that in effect he is entitled to assume that the authority to fill has been properly exercised. The choice is a difficult one and a fairly arbitrary one, as is true in many instances in which one of two innocent persons must bear a loss caused by the wrongdoing of a third person. Perhaps the Reporter has selected what should be the controlling factor when he argues that anyone so "foolish as to set a blank instrument in circulation" ought to take the consequences;[94] though the foolishness often seems to consist of what may be an uncommon faith in the integrity of others. In any event, the argument does not apply to one situation. As we have seen, the revision will change present law by providing that a holder in due course takes free of the defense of non-delivery of an incomplete instrument.[95] It may happen that a purchaser will take without notice of the non-delivery but with notice of the fact that blanks were filled. Under the revision he will be protected, a result which certainly cannot be justified on the ground that the maker has put blank paper in circulation. The purchaser is getting greater protection than he should.

Sections 305 and 306—Defenses and Title Claims. Section 305, covering generally the rights of a holder in due course, enumerates the so-called real defenses. In the main, existing real defenses are codified. If the section is open to criticism it is because the enumeration is in terms exhaustive. A holder in due course, it is said, takes the instrument free from *all* defenses *except* those listed. If this can be viewed as "seemingly restricted language," perhaps a court will

[92] BRITTON, BILLS AND NOTES 488 (1943). The only case cited by Professor Britton which actually supports his position is Baird v. Lorenz, 57 N.D. 804, 224 N.W. 206 (1929).

[93] BEUTEL'S BRANNAN, NEGOTIABLE INSTRUMENTS LAW, 7th ed., 353 (1948); BRITTON, BILLS AND NOTES 337 (1943).

[94] Notes to Tentative Draft No. 3 (1947) 64.

[95] See discussion under §106.

feel free to follow the admonition already mentioned to "expand" such language to fit the "reason and principle of the situation."[96]

The rights of one not a holder in due course are treated in section 306. One significant provision concerns the question of the *jus tertii*, that is, the attempt to defend on the ground that a third person has better title to the instrument than the plaintiff. It limits the defense to the single case of theft, which is probably a statement of present law with the possible exception of the finder situation.[97] This means that the defendant can defeat the action if the instrument was stolen and the plaintiff is not a holder in due course. If the plaintiff is a holder in due course the title claim of the third person would not succeed in any event,[98] and it cannot therefore be asserted by the defendant. For all other cases it is provided that "the claim of any third person to the instrument is not... available as a defense to any party liable thereon unless the third person himself defends the action for such party." Although there is a slight possibility of confusion, it is reasonably clear that this language does not apply to forged indorsements. That is, where the maker of a note is sued he can defeat recovery on the ground that the plaintiff must trace his title through an indorsement which is forged. Arguably this is defending by proof that title is in a third person, but the revision does not treat this as a "defense." Proof of the genuineness of the indorsement is a part of the plaintiff's case.[99]

[96] But cf. note 76, supra.

[97] In the case of a lost instrument writers have differed on whether the loss can be asserted as a defense in an action by the finder. Aigler takes the position that the defense may be asserted. AIGLER, CASES ON BILLS AND NOTES 643 (1947). Chafee argued for the contrary position [BRANNAN'S, NEGOTIABLE INSTRUMENTS LAW, 4th ed., 544 (1926)] and the argument is adopted in BEUTEL'S BRANNAN, NEGOTIABLE INSTRUMENTS LAW, 7th ed., at p. 889 (1948). The case which has appeared in the reports most frequently involves a title which is defective because of fraud or negotiation in breach of trust. For example, *X* obtained a note from the payee by fraudulent representations and negotiated it to *P*. In an action by *P* against the maker there was good common law authority that the maker could not defeat recovery by asserting the payee's title claim, even though *P* was not a holder in due course. Prouty v. Roberts, 60 Mass. 19 (1850) (fraud); Kinney v. Kruse, 28 Wis. 183 (1871) (breach of trust). The same conclusion was reached under the NIL in Bowles v. Oakman, 246 Mich. 674, 225 N.W. 613 (1929) (breach of trust), though without citing the statute. As to theft, it was taken for granted from an early date that the maker could raise the issue. Peacock v. Rhodes, 2 Doug. 633, 99 Eng. Rep. 40 (1781); Gill v. Cubit, 3 Barn. & Cress. 446, 107 Eng. Rep. 806 (1824).

[98] Of course this statement slides over the fact that decision on the holding in due course issue will not be res judicata in a subsequent action by the third person.

[99] The analysis and result are the same under the NIL. BRITTON, BILLS AND NOTES 749 (1943).

Section 306 rejects the holding of *Justice v. Stonecipher*[100] and similar cases, that good faith purchase after maturity cuts off the title claim of a prior holder who voluntarily intrusted another with the instrument and claims that it was negotiated in breach of trust. Under the revision the claim can be effectively asserted against any purchaser who is not a holder in due course. The fact that an instrument has not been paid at maturity suggests that the obligor may have asserted a defense. This probably explains the formulation of the rule that only a purchaser before maturity took free of defenses—overdueness put a purchaser on notice of possible defenses. On the *Stonecipher* issue, perhaps the critical inquiry should be whether overdueness also suggests the possibility of title defects.[101] Any answer is speculative but there is enough reason to believe that it does to warrant rejection of the *Stonecipher* position.[102] The favored position of the holder in due course is better limited in this situation to one who *is* a holder in due course.

Section 404—Fictitious Payees and Impostors.[103] This is a first-rate achievement. It should go a long way to eliminate the existing necessity of drawing fine distinctions which ought to make no difference.

1. The NIL does not deal with the impostor situation as a separate problem. This has made it necessary to reach a solution, formally

[100] 267 Ill. 448, 108 N.E. 722 (1915). The authorities are divided. BEUTEL'S BRANNAN, NEGOTIABLE INSTRUMENTS LAW, 7th ed., 844 et seq. (1944).

[101] ". . . the mere fact that the note is overdue does not . . . put a purchaser upon inquiry any more than a purchaser is bound in any other case to inquire into the title of his vendor." Gardner v. Beacon Trust Co., 190 Mass. 27 at 30, 76 N.E. 455 (1906). Accord: Chafee, "Rights in Overdue Paper," 31 HARV. L. REV. 1104 at 1126 (1918).

[102] ". . . inquiry among banks has indicated that the overdue promissory note and the stale check are suspect; that they do not circulate, and almost never are taken without inquiry. . . ." Notes to Tentative Draft No. 2 (1947) 70. Compare this statement with the proposal to protect a drawee bank which pays a stale check, discussed infra under section 414.

[103] The section provides:

"(1) With respect to a holder in due course or a person paying the instrument in good faith an indorsement is effective when made in the name of the specified payee by any of the following persons, or their agents or confederates:

(a) an impostor who through the mails or otherwise has induced the maker or drawer to issue the instrument to him or his confederate in the name of the payee;

(b) a person signing as or on behalf of a drawer who intends the payee to have no interest in the instrument;

(c) an agent or employee of the drawer who has supplied him with the name of the payee intending the latter to have no such interest.

(2) Nothing in this section shall affect the criminal or civil liability of the person so indorsing."

at least, by discovery of the maker's or drawer's intent. When a check is made payable in the name *X* and is delivered to *Y* who represented himself to be *X*, did the drawer intend *X* or *Y* as the payee? Even if it is possible to answer the question at all, it must be recognized that the answer is not easy. The generally accepted approach is to seek the drawer's "dominant intent" and the generally accepted hypothesis is that his primary intent was to make the check payable to the one with whom he dealt, that is, the impostor.[104] At least this is true where he dealt face to face with the impostor; there is more doubt if the dealings were by mail.[105] The revision eliminates any distinction between dealings by mail and face to face. It will change the law in those states which have not accepted the general rule just stated.[106] In the whole range of cases it will make effective, in favor of a holder in due course or good faith payor, the impostor's signature in the name of the specified payee. The applicable language provides for such effectiveness when the indorsement is made by "the following persons, or their agents or confederates: (a) an impostor who through the mails or otherwise has induced the maker or drawer to issue the instrument to him or his confederate in the name of the payee. . . ."

Despite general acceptance of the dominant intent approach, it still is necessary in many situations to weigh the precise facts in the attempt to discover this intent. Where, for example, the face to face contact of the drawer and impostor was fleeting, it has been held that the impostor's indorsement was ineffective.[107] If the result ought to be different in such case from what it is when the contact is more substantial, perhaps the uncertainty which we now have is warranted. The difference in result is justifiable once we accept the basic approach in terms of intent; so that the inquiry becomes whether this

[104] Montgomery Garage Co. v. Manufacturer's Liab. Ins. Co., 94 N.J.L. 152, 109 A. 296 (1920); BEUTEL'S BRANNAN, NEGOTIABLE INSTRUMENTS LAW, 7th ed., 470, 476 (1948).

[105] In cases involving passage of title on a sale of goods this distinction is usually made. Phelps v. McQuade, 220 N.Y. 232, 115 N.E. 441 (1917); VOLD, SALES 375 (1931). Abel concludes from his study that the distinction has not been observed in the negotiable instruments cases. Abel, "The Impostor Payee; or, Rhode Island Was Right," 1940 WIS. L. REV. 161 at 173. However, there are several decisions, holding that the intended payee was not the impostor, which are best explained by the fact that the dealings were by mail. Rossi v. National Bank of Commerce, 71 Mo. App. 150 (1897); Mercantile Nat. Bank v. Silverman, 148 A.D. 1, 132 N.Y.S. 1017 (1911); American Surety Co. v. Empire Trust Co., 262 N.Y. 181, 186 N.E. 436 (1933).

[106] The leading case for the position that the indorsement is a forgery is Tolman v. American Nat. Bank, 22 R.I. 462, 48 A. 480 (1901).

[107] Simpson v. Denver & Rio Grande R. Co., 43 Utah 105, 134 P. 883 (1913).

approach furnishes an acceptable basis for decision. It is believed that it does not.

We start with the legal fact that a forged indorsement is ineffective to pass title. In many instances this leads almost inescapably to solution by looking for intent. If a check payable to John Smith can be effectively indorsed by any person of that name, the rule concerning forged indorsements begins to look ridiculous. There is good reason for the general position that there is only one payee and he is the John Smith whom the drawer had in mind.[108] However, the practical necessity for inquiry into intent in this case does not mean that intent needs to control in all cases involving the effectiveness of an indorsement. The impostor case is a recurring type situation, varying in detail but highlighted by the fact that a person, usually a drawer, has been hoodwinked by a scoundrel. Broadly, the law must decide whether the resulting loss should be borne by the drawer on the one hand or a good faith purchaser or payor on the other. If the drawer has been negligent it is possible to burden him with the loss on an estoppel theory.[109] The intent analysis would make sense if the drawer's carefulness were even roughly measured by the extent of his dealings with the impostor; if it could be said, that is, that the more extensive his dealings are with the impostor, the more careless he is in being taken in. Such a correlation is not obvious and in fact just as good a case could be made for the converse proposition. On the whole it seems preferable in all cases to place the loss on the drawer who, in the words of the revision, "allowed himself to be tricked."[110]

The revision applies only when the impostor indorses in the payee's name, and this is the sort of case which usually gets into the books. But in one of the important cases on the subject the impostor obtained the special indorsement of a check which he then indorsed in the name of the special indorsee.[111] On the issue as to the effectiveness of the indorsement, the court rightly assumed that there was no significant difference between indorsement in the name of a specified in-

[108] A bill payable to "Henry Davis" got into the hands of another Henry Davis than the one intended by the drawer. His indorsement of his own name was held to be ineffective to pass title. Mead v. Young, 4 T.R. 28, 100 Eng. Rep. 876 (1790).

[109] The effect of negligence is discussed by Abel, "The Impostor Payee; or, Rhode Island was Right," 1940 WIS. L. REV. 161 at 187 et seq.

[110] Official comment to §404.

[111] Cohen v. Lincoln Sav. Bank, 275 N.Y. 399, 10 N.E. (2d) 457 (1937).

dorsee and one in the name of a specified payee. The case is not covered by the present section but could be decided by analogy.[112]

2. The method of handling the fictitious payee case is a contribution to clarity of thinking on the subject. It is treated as presenting essentially the same problem as the impostor situation; that is, the effectiveness of an indorsement by one who is in some measure responsible for the naming of the fictitious payee. Accordingly, paper payable to a fictitious payee is not to be bearer paper, as it is under NIL section 9, when "such fact was known to the person making it so payable." It is to be order paper, but with respect to a holder in due course or a good faith payor certain persons can effectively indorse.

In the main the results will be no different than at present, but one important change is proposed. An employee pads his employer's payroll and secures checks drawn by the employer payable to persons whom the employee does not intend shall have any interest therein. He indorses the checks in the name of the fictitious payee and either negotiates or obtains payment from the drawee. It is generally agreed under the NIL that the knowledge of the employee is not that of "the person making [the check] so payable." Hence, the checks are not payable to bearer, the indorsements are ineffective and neither the purchaser nor the paying drawee is protected.[113] This will be changed by the provision that "an indorsement is effective" when made by "an agent or employee of the drawer who has supplied him with the name of the payee intending the latter to have no . . . [interest in the instrument]." A few states already have amended the NIL along the same lines.[114]

The provision just quoted applies only where the check is indorsed. A drawee might pay the wrongdoer without indorsement though of course this is unusual. Under the NIL, if section 9 applied to make the check payable to bearer, the drawee would be protected if it paid in good faith. The result under the revision is uncertain. Similarly, the language covering impostors applies only where there is an indorsement. Today, if the court concludes that the intended payee

[112] It is a good instance for extension of the principle of the statute "to apply to a situation outside of the statute's explicit scope where reason and policy justify such extension." Supra, note 76.

[113] American Sash & Door Co. v. Commerce Trust Co., 332 Mo. 98, 56 S.W. (2d) 1034 (1932); Kessler, "Forged Indorsements," 47 YALE L. J. 863 at 887 (1938).

[114] See citations to statutes in 2 PATON'S DIGEST 1867 (1942).

is the impostor, the paying drawee will be protected by a good faith payment to the impostor without an indorsement. An indorsement is not necessary so long as the drawee in fact pays the holder.[115] Again, the result under the revision is uncertain. Each case should be decided by analogy to the present section.

Section 408—Consideration. The record of changes in this section suggests that the necessity of consideration has been one of the most controversial problems presented to the revisers. The Reporter originally proposed that the requirement of consideration be completely eliminated.[116] The next stage was a proposal that no consideration be required for (a) an acceptance, (b) any obligation given in payment of or as security for an antecedent obligation, or (c) a check intended as a gift.[117] The check proposal was then abandoned, with a new proposal made that no consideration be required for any instrument given as a charitable subscription.[118] In the latest draft this has been eliminated along with the proposal relating to an acceptance. In substance, no changes are to be made in present law except as embodied in the statement that "[n]o consideration is necessary for an instrument or obligation thereon given in payment of or as security for an antecedent obligation of any kind."

This should eliminate an existing confusion in suretyship cases. If *A*, being indebted to *B*, gives *B* his note to pay or secure the debt, it is generally agreed that there is consideration for the note.[119] If *A*, being indebted to *B* on a note, induces *C* gratuitously to give his (*C*'s) note to *B* to secure *A*'s debt, the courts disagree on whether *C*'s promise is supported by consideration.[120] If *A*, being indebted to *B* on a note, induces *C* gratuitously to indorse the note after delivery to *B*, the courts are generally agreed that *C*'s promise is not binding for want of consideration.[121] It seems preferable to treat the

115 Bell v. Murchison Nat. Bank, 196 N.C. 233, 745 S.E. 241 (1928).

116 Tentative Draft No. 1 (1946) §16.

117 Tentative Draft No. 3 (1947) §19.

118 Proposed Final Draft No. 2 (1948) §501.

119 This represents general understanding but it is difficult to find satisfactory case authority. See comment, 46 MICH. L. REV. 211 (1947).

120 West Rutland Trust Co. v Houston, 104 Vt. 204, 158 A. 69 (1932) (consideration); Kiess v. Baldwin (App. D.C. 1934) 74 F. (2d) 470 (no consideration).

121 Bank of Carrollton v. Latting, 37 Okla. 8, 130 P. 144 (1913); BRITTON, BILLS AND NOTES 377 (1943). Otherwise, if the surety signed pursuant to a prior understanding.

surety cases alike and to hold that C is bound in each instance. This is what the revision proposes to do.[122]

It is unfortunate that the section does nothing to remedy the unsatisfactory situation as to acceptance. It means that courts and lawyers will continue to waste time trying to fit a number of ordinary acceptance situations into contracts notions of consideration.[123] The present general understanding should at least be recognized: On the issue of consideration, an acceptor is bound to a holder for value whether the value was given before, at the time of, or after, the acceptance, that is, regardless of whether it was "bargained for and given in exchange for the promise."[124] It is true, however, that the need for such recognition is lessened by the provision that a payee may be a holder in due course.

Sections 410 and 411—Acceptance and Certification. It is proposed to eliminate virtual, extrinsic and constructive acceptances, following the scheme of the English Bills of Exchange Act. The proposal appears desirable; somewhat greater simplicity will be achieved without the loss of any needed legal devices.[125] As to constructive acceptances, the tendency of the decisions under the NIL has been to treat a mere failure to return a check within the prescribed time as an acceptance, even though the check was presented for payment rather than acceptance.[126] This has been done without much regard to the language of the statute, but has had the desirable effect of forcing the drawee to act promptly so that the holder knows where he stands. Although somewhat ambiguous, the revision apparently intends to

[122] At least this is what is intended and will be accomplished if §408 is found controlling. But in an attempt in §424 to button up this solution the draftsman uses too many buttons. That section provides in part that "[w]hen the instrument has been taken for consideration before it is due . . . [an accommodation party] is liable in the capacity in which he signed. . . ." Suppose the note in the third case was given by *A* to *B* for a prior obligation. Sec. 408 does not treat this as consideration but binds *A* without consideration. When *C* signs as surety after delivery to *B*, he is liable under §424 if the instrument was "taken for consideration." Was it, under §408?

[123] Considerable ingenuity has been exercised, as in Commercial Bank of Lake Erie v. Norton and Fox, 1 Hill (N.Y.) 501 (1841), where consideration for acceptance of a time bill was found in the holder's forbearance of immediate recourse against the drawer, which he would have had in the event of dishonor by non-acceptance.

[124] The quotation is from the CONTRACTS RESTATEMENT §75 (1932). On the negotiable instruments aspect, see comment, 36 YALE L. J. 245 at 251 (1926).

[125] Letters of credit are covered in a separate article of the Code.

[126] Wisner v. First Nat. Bank of Gallitzin, 220 Pa. 21, 68 A. 955 (1908); BEUTEL'S BRANNAN, NEGOTIABLE INSTRUMENTS LAW, 7th ed., 1249 (1948).

treat a failure to pay within the prescribed period as a dishonor.[127] This should adequately accomplish the same purpose.

Section 411 provides that certification of a check "discharges the drawer and indorsers from all prior liability on the check." This is the effect under the NIL when certification is at the request of the holder but not when it is requested by the drawer.[128] The official comment makes it clear that this distinction is to be eliminated and the drawer is to be "discharged" in either case. The language of the section is rather awkward, however. A check certified at the request of the drawer usually is certified before delivery, that is before the drawer has assumed any "prior liability" of which he can be "discharged." The real meaning of the section in this common situation is that the drawer never becomes obligated on an instrument which he signs and delivers. This is a bit startling. One justification given in the official comment is that certified checks "are normally taken on the credit of the bank alone." It would be difficult either to prove or disprove the statement. Certification before delivery usually is obtained because the payee is not satisfied to take the drawer's obligation alone. It does not follow that he intends to dispense with the drawer's obligation. The check is formally issued as two name paper and it seems likely that the payee takes with that understanding.

Section 414—Contract between Drawer and Drawee. The NIL scarcely touches on the relation between drawer and drawee, an omission which the revisers are proposing to remedy. The general objective is to cover those situations which arise in connection with negotiable instruments. The general effect is to put the drawee who pays in good faith in the same relative position as a holder in due course. We have seen this done already, under section 404, in the fictitious payee and impostor situations. The present section does the same thing, for example, in the case of incomplete instruments. The drawee may

[127] Sec. 507 says in part that "payment of an instrument may be deferred without dishonor pending reasonable examination to determine whether it is properly payable, but payment must be made in any event before the close of business on the day of presentment. . . ." This fairly implies that longer inaction constitutes dishonor. Sec. 508 provides in part that "an instrument is dishonored when . . . presentment is duly made and due acceptance or payment is refused or cannot be obtained. . . ." Unless the words "cannot be obtained" are read to mean "is not obtained" the inference just made from §507 is not warranted.

[128] NIL, §188; Seager v. Dauphinee, 284 Mass. 96, 187 N.E. 94 (1933). The distinction was formulated before the NIL; see Minot v. Russ, 156 Mass. 458, 31 N.E. 489 (1892). It was criticized at the time in Jones, "The Liability of the Maker of a Check after Certification," 6 HARV. L. REV. 138 (1892). The arguments made by Jones against the distinction were much the same as those found in the official comment to §411.

charge the drawer's account "according to the tenor of a completed instrument," even though it was completed in excess of authority and apparently even though it was stolen in incomplete form.[129]

In one respect the revision shows considerably more solicitude for the paying drawee than for the purchaser. By section 304 a check is to be regarded generally as overdue when it has been outstanding more than thirty days. A purchaser thereafter will not be a holder in due course. But it seems that the drawee will be able to make payment in due course, so that it can charge the drawer's account, regardless of the length of time the check has been outstanding. Subsection (7) provides:

> "The undertaking of a bank to pay a check is limited to a period of six months after its date unless its terms extend the period. In the absence of an effective stop order the bank may thereafter pay the check at its option."

The first sentence is the substance of a statute which has been adopted in many states, although the usual period is one year.[130] It permits a drawee bank to dishonor a stale check without incurring liability to its depositor. The second sentence is new and apparently authorizes the bank to pay and charge its depositor's account regardless of how stale the check is. It gives protection to banks which even the American Bankers Association has not asked for, at least prior to the undertaking of the revision.[131]

In explanation of the adoption of the six-month period, the Reporter's Notes state:[132]

> "The shorter time limit of six months is adopted here because the bankers at the Cleveland meeting were all agreed in the belief that *any check outstanding for more than six months is*

[129] The latter conclusion is stated with some hesitation for the section is ambiguous.

[130] The Reporter's notes state that one year is used in fifteen jurisdictions, six months in eleven jurisdictions. Notes to Proposed Final Draft No. 1 (1948) 21. The Michigan statute reads:

> "Where a check or other instrument payable on demand at any bank or trust company doing business in this state is presented for payment more than one [1] year from its date, such bank or trust company may, unless expressly instructed by the drawer or maker to pay the same, refuse payment thereof and no liability shall thereby be incurred to the drawer or maker for dishonoring the instrument by non-payment." Mich. Stat. Ann. (1943) §23.401; Mich. Comp. Laws (1929) §12077.

This is identical with the form recommended by the American Bankers Association. 1 PATON'S DIGEST 1110 (1940).

[131] See the statute quoted in note 130.

[132] Notes to Proposed Final Draft No. 1 (1948) 22.

open to suspicion; that a bank will not pay it without consulting the depositor, and that it should not be required to do so." [Emphasis added]

Yet it is proposed to free the bank of liability for payment of a check which is "open to suspicion," unless there is an effective stop payment order. In order for a stop payment order to be effective under the revision renewal in writing will be required every six months.[133] There is merit in placing responsibility on the drawer to give a stop payment order if he wishes to prevent payment during the period within which payment reasonably can be made. There is little justification for placing on him the burden of renewals during an indefinite period in order to protect himself against payment which is not in due course.[134]

Section 418—Drawer's Duty to Drawee as to Forged Instruments. This section provides in full:

"(1) Where a bank sends to its customer a statement of account accompanied by instruments paid in good faith which support the debit entries, or sends notice to him that such a statement is ready for delivery

(a) the customer must exercise reasonable care to examine the statement and instruments to discover his unauthorized signature or any alteration and to notify the bank thereof, and is liable to the bank for any loss resulting from his failure to do so; and

(b) subject to subsection (2) a customer who does not within ninety days discover and report his unauthorized signature or any alteration on any such instrument is precluded from asserting against the bank such unauthorized signature or alteration and any unauthorized signature or alteration by the same person on any instrument subsequently paid by the bank.

(2) A customer unable for good cause to examine such statement and instruments may within thirty days after such inability ceases demand recredit or repayment for material alteration or his unauthorized signature."

[133] This is contained in §415.

[134] Although there is not much authority, the drawee probably takes the risk of payment after a check has been outstanding an unreasonably long time. If the drawer had a defense which could have been asserted against the holder, his account may not be charged. The Lancaster Bank v. Woodward, 18 Pa. 357 (1852); 1 PATON'S DIGEST 1107-8 (1940).

A better understanding of its provisions will be gained by considering first the effects of section 407, which provides:

> "Any person who by his negligence contributes to material alteration of the instrument or to the making of an unauthorized signature is precluded from asserting the alteration or lack of authority against a holder in due course or a drawee who pays the instrument in good faith."

When a carefully drawn check is fraudulently raised and paid in the raised amount by the drawee, the latter can charge the drawer's account only for the original amount. This has been settled for a long time and will be true under the revision. The risk of loss from payment of an altered (or forged) check has become a banker's risk. If the drawer negligently leaves blank spaces which facilitate the alteration of the check, it has been felt that, as against the drawee, he should bear the loss caused by his negligence. The loss is the raised amount, laying aside the possibility of recovery from the forger or some other party. It seems fair to hold that the drawee can charge the drawer's account in the raised amount, thereby placing on the drawer the burden of obtaining satisfaction from the forger. Generally this is what the courts have done.[135] It is the effect of section 407 with its provision that the drawer is "precluded from asserting the alteration."

The same facts may raise a controversy between the drawer and a holder in due course, as where the alteration is discovered before payment, payment is refused, and the holder sues the drawer. Absent negligence of the drawer, the holder's position is the same as that of the paying drawee. The alteration is a real defense so that his recovery is limited to the original amount of the check. This is left unchanged by the revision. If the drawer has been negligent in drawing the check courts have differed on whether this affects his liability to the holder. Some hold that it does, that the drawer is in effect precluded from asserting the alteration.[136] Perhaps a majority have on one theory or another held that the negligence is immaterial.[137] The reasons given could also be used to demonstrate immateriality of the negligence when the issue is between drawer and drawee, if the court were so

[135] Young v. Grote, 4 Bing. 253, 130 Eng. Rep. 764 (1827); Timbel v. Garfield Nat. Bank, 121 App. Div. 870, 106 N.Y.S. 497 (1907).

[136] Hackett v. First Nat. Bank of Louisville, 114 Ky. 193, 70 S.W. 664 (1902).

[137] Nat. Exchange Bank of Albany v. Lester, 194 N.Y. 461, 87 N.E. 779 (1909); BRITTON, BILLS AND NOTES 1069 (1943).

minded: that the drawer owed no duty to prospective purchasers to use care in issuing his checks;[138] or that his lack of care was not the proximate cause of the loss because of the intervening criminal act of a third person.[139] The distinction between holder and drawee is better rejected, which is what the revision does in section 407.

Turning to section 418, only the legal relations of drawer and drawee are included. Subsection 1(a) covers situations in which the drawer is negligent, but the negligence is after alteration and payment in the altered amount, rather than before the alteration as in the situation just considered. Negligence after alteration and payment can harm the bank only if the drawer's delay in discovering or reporting the alteration prejudices the bank's recovery from another party, particularly the forger. Courts have differed, some holding that the drawee must bear the loss except to the extent that the negligence actually caused a loss,[140] others holding that the drawer is precluded from asserting the alteration.[141] The effect of the second view is that a banker's risk is shifted to the depositor because of his negligence without regard to whether this negligence actually affected the situation; or, as sometimes qualified, some loss to the bank must appear but once it does the drawer is estopped irrespective of the extent of loss.[142] Considering the difficulties of proof, this would be acceptable if in general there were a reasonably high probability that the delay prevented full or substantially full recovery from the forger. Common experience suggests otherwise. In this aspect the revisers have wisely chosen the "negligence" instead of the "estoppel" theory.

Subsection 1(b) is based upon a provision which has had the backing of the American Bankers Association and has been enacted with some variations in approximately two-thirds of the states.[143] The bankers, however, have asked only for a six-month limitation; this gives them ninety days. The subsection requires no showing of negligence in the particular case. After ninety days without a report of the alteration, the loss is borne by the drawer. It is an exceedingly short statute of limitations, directed, however, at the giving of notice

[138] Nat. Exchange Bank of Albany v. Lester, 194 N.Y. 461, 87 N.E. 779 (1909).

[139] Sav. Bank of Richmond v. Nat. Bank of Goldsboro, (C.C.A. 4th, 1925) 3 F. (2d) 970.

[140] Critten v. Chemical Nat. Bank, 171 N.Y. 219, 63 N.E. 969 (1902); BRITTON, BILLS AND NOTES 601 (1943).

[141] Leather Manufacturers' Bank v. Morgan, 117 U.S. 96 (1886); Arant, "Forged Checks—The Duty of the Depositor to His Bank," 31 YALE L. J. 598 at 612 et seq. (1922).

[142] Arant, supra note 141, at 616.

[143] 2 PATON'S DIGEST 1882-3 (1942).

rather than the commencement of an action. One reason given for the provision is that such a delay is "clearly negligent" and that the bank after such a lapse of time has little chance of recovery from the forger. There is little reason to quarrel with either statement; they are valid generalizations for statutory purposes. But the important point is: would earlier discovery, in general, have led to full or substantially full recovery from the forger? As suggested above, there is insufficient reason to believe that it would. Insofar as the second subsection rests on assumed negligence, the considerations are the same as those which enter into the framing of the first subsection. Yet the revisers are adopting the estoppel theory here after having rejected it in the first subsection.

The other reason given is the desirability of "terminating bank transactions after a relatively short period."[144] This value is significant but not sufficiently so to justify shifting the bank's loss to the depositor after such a short period. Recovery of a money judgment is unsettling to most defendants. It is difficult to believe that the banking business is so different from other businesses as to require a ninety-day statute of limitations.[145]

Section 420—Finality of Payment or Acceptance. This section covers *Price v. Neal*[146] and related problems, stating the general position that "payment or acceptance of any instrument is final in favor of a holder in due course, and so far as concerns direction to stop payment or the sufficiency of the drawer's account is final in favor of any holder."

The common law rule of *Price v. Neal* was generally understood to be that a drawee who accepted or paid a check or other bill on which the drawer's signature was forged was bound on the acceptance and could not recover the payment. This was adopted by NIL section 62 with respect to acceptance but the statute is silent as to payment. On one theory or another nearly all courts have continued to recognize finality of payment.[147] The proposed section will eliminate the need

[144] The reasons discussed in the text appear in the official comment to §418.

[145] This description of the ninety-day period was not originated by the writer; the official comment to the section describes it as a "short statute of limitations."

[146] 3 Burr. 1354, 97 Eng. Rep. 871 (1762).

[147] According to the Wisconsin court, NIL §62 covers payment because "payment plainly constitutes an acceptance." Fidelity & Casualty Co. v. Planenscheck, 200 Wis. 304, 227 N.W. 387 (1929). According to the Massachusetts court, NIL §62 does not cover the case nor does any other part of the statute, hence the case is to be decided on common law authority. South Boston Tr. Co. v. Levin, 249 Mass. 45, 143 N.E. 816 (1924).

for further judicial gymnastics by its explicit inclusion of payment.

It is commonly said[148] that finality of acceptance or payment operates only in favor of a holder in due course, a view which has been vigorously assailed by some writers.[149] After rejection in earlier drafts,[150] the latest draft has adopted this view. The holding in due course concept was developed for another purpose and is inapt here at least as applied to payment. Its use means, for example, that results may differ depending upon whether the holder of a check who has received payment took before or after maturity, which usually will be thirty days after issuance under the revision.[151] Purchase after maturity has a rational bearing on the holder's right to recover free of prior defenses, but it should be irrelevant to the question whether payment is final.[152]

The record reveals an interesting change of position on the group of problems raised by *Wells Fargo Bank, etc. v. Bank of Italy*.[153] In that case a check payable to Albert Meyer & Co. was fraudulently altered by some unknown person by erasing the payee's name and substituting the name Behling. It was then certified by the drawee, presumably at the request of the same unknown person; indorsed in the name of Behling, also presumably by the same unknown person; and cashed by the Bank of Italy. The latter bank obtained payment

148 South Boston Tr. Co. v. Levin, 249 Mass. 45, 49, 143 N.E. 816 (1924); American Surety Co. v. Industrial Sav. Bank, 242 Mich. 581, 219 N.W. 689, noted 27 MICH. L. REV. 100 (1928).

149 Aigler, "The Doctrine of Price v. Neal," 24 MICH. L. REV. 809 at 823-4 (1926); BRITTON, BILLS AND NOTES 632 et seq. (1943).

150 By §512 of Proposed Final Draft No. 2 (1948) acceptance or payment was to be final "to the extent that any party has paid for the instrument in good faith." Acceptance of the holding in due course requirement apparently means a rejection of the view that negligence of the holder takes the case outside the Price v. Neal rule. See Comment, 43 ILL. L. REV. 823 (1949).

151 Sec. 304. The holding in due course requirement does not necessarily mean that payment may be recovered from one who took after maturity. If payment on a forged check is made to an innocent payee who gave value for the check, the drawee is not entitled to recover since the payee is a holder in due course. Under §201, transfer of an instrument "vests in the transferee . . . such rights as the transferor has therein." If the absence of right in the drawee to recover from the payee can be considered a "right" of the payee under §201, it would seem that the drawee cannot recover from a holder who took the check from the payee after maturity and received payment.

152 If it be said that taking an instrument after it is overdue (or stale in the case of a demand instrument such as a check) should warn the purchaser of possible defenses including forgery, it needs to be remembered that the drawee pays at a still later date. The inappropriateness of the holding in due course test is recognized by the revisers in their treatment of a case in which a purchaser *is* a holder in due course but learns of the forgery before he obtains payment or certification. Clearly finality should not apply nor will it under the revision (§419).

153 214 Cal. 156, 4 P. (2d) 781 (1931).

from the drawee and when the facts were discovered the drawee sought recovery from the Bank of Italy. Recovery was denied on the ground that the certification was a promise to pay the check in accordance with its tenor at the time of certification. This was in conflict with the common law rule and the decisions under the NIL up to 1921 when a similar decision appeared in Illinois.[154]

Two principal unsettled problems are suggested by the *Wells Fargo* decision. First, will it be limited to a case in which there was a purchase after the certification? The court put some emphasis on this fact, but its major ground of decision would require the same holding if the issue arose between the certifying bank and the holder who obtained certification. It concluded that the certification was binding in favor of the Bank of Italy because NIL section 62 obligates the acceptor to pay "according to the tenor of his acceptance." Accepting the court's debatable interpretation of this phrase,[155] it would seem that change of position after certification is irrelevant—just as it is under *Price v. Neal.*

Earlier drafts of the revision made change of position irrelevant,[156] but the latest draft proposes to limit finality to the case of purchase after certification. This is accomplished by section 419 under which one who obtains acceptance or payment warrants to the drawee

> ". . . that the instrument has not been materially altered, and that he has no knowledge that the signature of the maker or drawer is unauthorized, except that such warranties are not given by a holder in due course who has taken an instrument accepted after such alteration or signature. This exception applies even though a draft has been accepted 'payable as originally drawn' or in equivalent terms."[157]

[154] The Nat. City Bank of Chicago v. The Nat. Bank of the Republic of Chicago, 300 Ill. 103, 132 N.E. 832 (1921).

[155] For a criticism of the decision, see Greeley, "The Effect of Acceptance of an Altered Bill," 27 ILL. L. REV. 519 (1933).

[156] Proposed Final Draft No. 2 (1948) §512.

[157] The proposal to provide for warranties by a holder to the drawee is new. (The warranties under §419 are given by "any person who obtains payment or acceptance," but under §421 the same warranties are made by a prior transferor.) The NIL contains no comparable section and most authority is to the effect that no warranties are given: Louisa Nat. Bank v. Kentucky Nat. Bank, 239 Ky. 302, 29 S.W. (2d) 497 (1931); BRANNAN, NEGOTIABLE INSTRUMENTS LAW, 6th ed., 816-7 (1938). Contra, United States v. Nat. Exchange Bank, 214 U.S. 302, 29 S.Ct. 665 (1908).

The last sentence of the quoted portion of §419 will make inoperative the attempt sometimes made by banks to escape the effects of the Wells Fargo decision by limiting certification to the original terms of the instrument. See 1 PATON'S DIGEST 800 (1940), for the form approved by the American Bankers Association.

This means in effect that a holder, even one in due course, who obtains certification of a previously altered check, will be able to recover from the certifying bank only according to the original terms of the instrument. If the check has been raised in amount, recovery will be limited to the original amount. If the name of the payee has been altered, as in *Wells Fargo*, recovery will be wholly denied. In either case, however, if the instrument is negotiated after certification to a holder in due course, the latter makes no warranty respecting alteration and under section 420 will be entitled to recover from the bank on the instrument as altered.[158]

Another unsettled problem suggested by the *Wells Fargo* case concerns finality of payment of an altered check which has not been certified. Some years ago the Chief Reporter for the Commercial Code, Professor Llewellyn, expressed the opinion that adherence to the *Wells Fargo* view called "almost necessarily" for finality of payment.[159] As a question of interpretation of the NIL the conclusion is untenable and the chances are slight that it would be accepted. But that has limited significance on the problem of how to write the law in the revision. In earlier drafts payment was made final on the instrument

[158] At least this is the objective of the two sections. Ambiguity is created by the fact that under §419 the presenting holder also warrants "that he has a good title to the instrument." In the Wells Fargo situation, involving alteration of the payee's name and indorsement by the wrongdoer in the altered name, the subsequent holder has no title according to usual analysis. The indorsement is no more effective to transfer title than an ordinary forged indorsement. Arguably therefore, the presenting holder has breached a warranty of title even though he has not breached a warranty with respect to alteration. If it were so held, the effect of the revision would be to repudiate the Wells Fargo decision; whereas the official comment shows that the purpose is to codify the holding, limited as seen to change of position. The Wells Fargo case disposed of the warranty of title argument on the ground that the presenting holder makes no warranties to the drawee. But that is to be changed by the revision (supra, note 157). It is not suggested that a court ought to apply the title warranty. To the contrary, good construction in the light of the purpose of the sections would be that the alteration warranty is controlling. It is only suggested that the sections should be written, if feasible, so that the problem does not arise.

The title analysis raises another problem on the Wells Fargo facts. Certification is final in favor of a holder in due course who took after certification but literally the purchaser after certification cannot be a holder in due course because by definition he is not a holder. A necessary indorsement is lacking. This throws upon the courts the burden of escaping this argument in order to achieve the obvious objective. The escape lies, I suppose, in holding that as between the certifying bank and the subsequent purchaser the indorsement is effective even though it may not be for other purposes as between other parties.

[159] Breckenridge and Llewellyn, comment, 31 YALE L. J. 522 at 527 (1931). Ames reached the same conclusion much earlier in "The Negotiable Instruments Law," 14 HARV. L. REV. 241 at 242 (1900).

as altered,[160] but the latest draft abandons this. Under section 419 the holder who obtains payment warrants that the instrument has not been altered. This, of course, is in line with the decision to limit finality of certification to the case of purchase in reliance thereon.

The revisers' shift of position on these two problems is indicative of a situation in almost even balance. The choice is fairly arbitrary and the dominant value is to get the question settled one way or the other. The solutions proposed in the latest draft provide a fair distribution of risks between drawee and holder.[161]

One consequence of the provisions dealing with alterations is clearly undesirable. *After* certification a check is fraudulently raised and negotiated to a holder in due course who obtains payment from the drawee in the raised amount. Under section 419 the drawee will be able to recover from the holder for breach of warranty. But the certifying bank should be held responsible for knowing the scope of its own contract, that is, the amount of the check at the time of certification.[162] Similarly, if a note has been fraudulently raised after issuance and paid by the maker in the raised amount the payment should be final. This is regarded as settled law,[163] yet it will be changed by the revision. The policies underlying *Price v. Neal* are fully applicable to each case. To paraphrase the language of the Supreme Court, a person is bound to know his own instrument.[164]

Sections 421 and 422—Warranties. These sections are an improvement on NIL sections 65 and 66, which they are designed to replace, but there is still room for improvement. Under the present statute there is considerable uncertainty as to the persons to whom warranties run.[165] The revision will remove most but not all of the uncertainty.

[160] Proposed Final Draft No. 2 (1948) §512.

[161] See Steffen and Starr, "A Blue Print for the Certified Check," 13 N.C. L. REV. 450 at 478 (1935).

[162] Contra, however, is Nat. Bank of Commerce in New York v. Nat. Mechanics' Banking Assn., 55 N.Y. 211 (1873).

[163] Bank of the United States v. Bank of Georgia, 10 Wheat. (23 U.S.) 333 (1825); United States v. Nat. Exchange Bank, 270 U.S. 527, 46 S.Ct. 388, 70 L. Ed. 717 (1926).

[164] In United States v. Nat. Exchange Bank, 270 U.S. 527, 46 S.Ct. 388 (1926), a check drawn by the United States upon itself was fraudulently raised and paid in the raised amount. Recovery of the overpayment was denied: "If the drawer and drawee are the same the drawer cannot recover for an overpayment to an innocent payee because he is bound to know his own checks." 270 U.S. at 534.

[165] By NIL, §65, one who negotiates by delivery or qualified indorsement makes certain warranties with no suggestion that they run only to a holder in due course. But §66 provides that an unqualified indorser warrants "to all subsequent holders in due course" and then refers to §65 for a description of most of the warranties. Certainly there is no rational basis for lesser

Every transferor for consideration makes the described warranties "to his transferee or any subsequent holder if such person takes the instrument in good faith." With respect to the persons who may take advantage of a warranty it is believed that the revisers intend to make no distinction between a qualified indorsement, an unqualified indorsement, and a transfer without indorsement of either order or bearer paper.[166] Identity of treatment will not be easy to achieve, however, because of the use of the term "holder." By definition one can be a holder only if the paper bears all necessary indorsements. In consequence, the warranties of a transferor without indorsement of order paper literally will run only to the immediate transferee.

The effect of this interpretation will be undesirable where there is a forged indorsement. The payee's indorsement is forged to a note which is then sold to *A*, indorsed by him to *B*, and by *B* to *C*. Literally *A's* warranties as a transferor by indorsement will run only to *B*. A necessary genuine indorsement is lacking in order to make *C* a holder. If the payee's indorsement was genuine but the maker's signature was forged, the warranty of *A* would run to both *B* and *C*. There is no sound basis for a different result because the forgery is of an indorsement. Although a court may be able to escape this literal interpretation,[167] this does not remove the fact that the language is not well chosen.

The sections will eliminate present uncertainties as to the scope of warranty regarding defenses. All transferors except a qualified indorser[168] warrant "that no defense of any party is good against the transferor." This means that there is a warranty against all real defenses, and against personal defenses if the transferor is not a holder in due course. But one who indorses "without recourse" warrants that he "has no knowledge of any defense of any party good against him." Under the NIL a qualified indorser and a transferor without indorse-

liability on the part of an unqualified indorser than that imposed on a qualified indorser. A satisfactory construction of the sections has not been worked out by decisions. BRITTON, BILLS AND NOTES 1024 (1943).

166 The official comment to §421 states that the section applies to transfer without indorsement "whether the instrument is then payable to order or to bearer." There is no hint that differences are intended in the two cases with respect to the persons to whom warranties run. The Reporter's notes to earlier drafts also tend to suggest that the results described in the text are unintended. Notes to Proposed Final Draft No. 1 (1948) 36.

167 See Queensboro Nat. Bank of City of New York v. Kelly, (C.C.A. 2d, 1931) 48 F. (2d) 574.

168 The revision drops the term "qualified indorsement" and simply describes the scope of the undertaking of one who indorses "without recourse" or with other "words of similar import." §422.

ment make the same warranties.[169] It is difficult to find any reason for imposing more extensive warranties on the latter than on the former, as the revision does. Each has refused to assume secondary liability, in one case by failing to indorse and in the other by qualifying his indorsement. Each should be held to such warranties as reasonably may be imposed upon the seller of negotiable paper.[170]

Sections 501, 502 and 503—Presentment. These sections cover the necessity of presentment and notice of dishonor (section 501), the time limits for such acts (section 503), and the effects of unexcused delay (section 502). The most striking change made by section 501 is to eliminate the necessity of presentment for payment and notice of dishonor in order to charge the indorser of a note. The curious reason given for this proposal is that most notes contain a waiver clause anyway.[171]

The present rules on time for presentment of checks are radically changed. In order to charge the drawer, a check must now (usually) be started through banking channels not later than the next business day after receipt by the payee. Under the revision this may be done within thirty days after issue.[172] The period allowed for presentment in order to fix the liability of an indorser of a check or other bill is now uncertain. Read literally, as one court has,[173] NIL section 71

[169] Sec. 65.

[170] Of course the meaning of an indorsement "without recourse" is not self-evident. An indorser can limit his obligation as he chooses, and the meaning of the words he uses should in general correspond to commercial understanding. It seems undisputed that one meaning of "without recourse" is to disclaim secondary liability. Beyond that, the official comment asserts that "one good reason for an indorsement without recourse is that the indorser knows nothing about the transaction in which such instrument was issued and is unwilling to . . . [warrant against the existence of a defense of which he does not know]." So far as I know there is just as much (or as little) factual basis for saying the same as to one who transfers without indorsement.

[171] ". . . it is incorporated in all note forms. The only notes without a waiver now encountered are those drawn by attorneys for a particular transaction." Official comment to §501. It might have been added that the attorneys will not succeed in their purpose if they merely omit the waiver clause. The section requires that the indorser *add to his signature* the words "presentment required" or their equivalent. Perhaps the draftsman also has overlooked the possibility that parties (who may not be attorneys) will strike the waiver clause from a note form.

[172] The general rule of §503 is that presentment of a demand instrument must be made within a reasonable time "after date or issue whichever is later." However,

> "In the case of an uncertified check which is drawn and payable within the United States and which is not a bank draft the following are presumed to be reasonable periods within which to present for payment or to initiate bank collection if there is no delay in the collection:
> (a) with respect to the liability of the drawer, thirty days after issue; and
> (b) with respect to the liability of an indorser, seven days after his indorsement."

[173] Columbian Banking Co. v. Bowen, 134 Wis. 218, 114 N.W. 451 (1908). A good discussion of the case appears in NORTON, BILLS AND NOTES, 4th ed., 497, note 96 (1914).

requires only that the instrument be presented promptly after the "last negotiation." This means that the liability of a first indorser may be unduly prolonged by a second indorser who holds the instrument an unreasonably long time before negotiating it. The revision works out a satisfactory solution for ordinary checks by the provision that a reasonable time for presentment "with respect to the liability of an indorser . . . [is presumed to be] seven days after his indorsement." The delay of the second indorser will operate to discharge the first indorser but will not affect his own liability.

For some reason which escapes the writer this rule as to indorsers does not apply to certified checks, bank drafts or demand bills which are not checks (i.e., are not drawn on a bank). As to these instruments there is the unsatisfactory proposal that presentment to charge the drawer and all indorsers must be within a reasonable time after issue. One example will suffice to show the shortcomings of this rule: A demand bank draft was issued on April 1 to Crawford as payee, indorsed to Llewellyn on April 26 and to Prosser on April 28. Prosser presented for payment on May 2 and the draft was dishonored. Assuming that a reasonable time for presentment is thirty days,[174] both Crawford and Llewellyn are discharged. But if the instrument were an ordinary check they would not be, since presentment was made within seven days after their indorsements. There is no justification for such consequences. It is desirable to provide that an indorser of a bank draft shall remain liable during a reasonable period after issuance, but he should also be liable during a reasonable period after his own indorsement.

Where presentment or notice of dishonor is late, section 502 provides that "a drawer who because the drawee becomes insolvent during the delay is deprived of funds maintained with the drawee to cover the instrument may discharge his liability by written assignment to the holder of his rights against the drawee in respect of such funds."

[174] Actually, if thirty days is a reasonable time for presentment of an ordinary check, it is too short for a bank draft or certified check. This may be the reason for excluding such instruments from the ordinary check rule, though it does not explain why an indorser of such an instrument should not be held for a reasonable time after his indorsement. If the revision intends to recognize differences in these instruments, it is unfortunate that the recognition has not been carried over to the rule on when a check is overdue for the purpose of holding in due course. Section 304 applies a thirty day period to *all* checks, and presumably this includes bank drafts, certified checks and cashiers' checks. It is reasonably clear that in common understanding a check carrying the obligation of a bank does not become stale as soon as an ordinary check. This has been recognized as to certified checks in Nat. Mechanics Bank v. Schmelz Nat. Bank, 136 Va. 33, 116 S.E. 380 (1923); Nolan v. Bank of N.Y. Nat. Banking Assn., 67 Barb. (N.Y.) 24, 31 (1873).

This is to replace NIL section 186, by which the drawer of a check is discharged "to the extent of the loss caused" by delay in making presentment for payment. The revision gives the same effect to late notice of dishonor as to late presentment, whereas section 186 applies only to the latter. It applies to all bills and not merely to checks as does section 186. And it provides a convenient means of settling the extent of loss caused by the delay. These are meritorious changes.

Nothing is done to resolve a conflict of decision in the case of domiciled notes. Where a note is payable at a bank, so that it is "equivalent to an order to the bank to pay the same for the account of" the maker (NIL, section 87) courts have disagreed on whether the maker is to be treated as a drawer for purposes of presentment and discharge through late presentment. The issue arises when the bank has failed with funds of the maker on deposit which would have been available to pay the note had it been properly presented. There is a little authority for the view that the maker is for this purpose a drawer who is discharged to the extent of the loss caused by the delay.[175] Most courts have concluded that the maker is a primary party, that presentment is never required in order to charge a primary party, and that NIL section 186 therefore has no application.[176] The revision contains a section which is the equivalent of NIL section 87.[177] The possibility of conflict will remain.

Section 703—Discharge by Payment. The first subsection reads:

> "The liability of any party is discharged to the extent of his payment or satisfaction to the holder even though it is made with the knowledge of the right of another person to the instrument."

This will work an important change in the law. Today, if the maker of a note pays the holder with knowledge that the note was procured from a prior holder by fraud, the payment is not in due course and does not discharge the maker.[178] Presumably he remains liable to the prior holder

[175] See Baldwin's Bank of Penn Yan v. Smith, 215 N.Y. 76, 109 N.E. 138 (1915). This view is approved in BEUTEL'S BRANNAN, NEGOTIABLE INSTRUMENTS LAW, 7th ed., 1025 (1948).

[176] Binghampton Pharmacy v. First Nat. Bank, 131 Tenn. 711, 176 S.W. 1038 (1915).

[177] Sec. 122. The revisers have presented alternative forms of this section. One makes the note the "equivalent of a bill drawn on the bank." It is stated in the official comment that this fits commercial and banking understanding in New York and "surrounding states." The other form provides that the domiciled note is not "of itself an order or authorization to the bank to pay it." This is said to be the understanding in western and southern states.

[178] "Payment is made in due course when it is made at or after the maturity of the instrument to the holder thereof in good faith and without notice that his title is defective." NIL, §88.

who has a valid title claim against the later holder.[179] The present section will change this result. The problem is related to the defense of the *jus tertii,* that is, the defense that a third person has title claim superior to that of the plaintiff.[180] The maker is not permitted to defend the holder's action on the ground that the plaintiff has a voidable title which could be set aside at suit of the defrauded prior holder. At the same time if he pays voluntarily with notice of this claim he is not discharged. In short, he is not privileged to make voluntary payment but may be forced by legal processes to pay when action is brought.

On first thought these seem to be odd results but actually they are not devoid of sense. The principal reason for rejecting the defense of the *jus tertii* is that a decision on the title issue would not bind the third person, who is not before the court.[181] If the third person has been made a party to the litigation, or participates therein to such extent that he will be bound by the judgment, his title claim may be asserted as a defense.[182] If the maker is not privileged to pay when he has notice of the claim, he is put under pressure to give the third person an opportunity to defend. On the whole this seems desirable. There is no indication that existing rules have worked badly. It seems preferable to leave them unchanged—although it would be desirable to provide the maker the remedy of interpleader.[183]

Even if the change proposed in this section be generally accepted, surely it goes too far in its application to a stolen instrument. The language seems to mean that the maker may discharge his liability although he knows that the note was stolen (in bearer form) and that the holder is the thief. Theft is made an exception to the general rule of section 306, so that it may be asserted as a defense. It was concluded that the overriding policy was not to aid a thief.[184] The same policy should be overriding under the present section.

179 Hinckley v. Union Pac. R. Co., 129 Mass. 52 (1880) (theft).

180 This has been discussed supra under section 306.

181 "An adjudication upon such defense would not bind the persons defrauded, as they are not parties hereto, and it would be idle." Bowles v. Oakman, 246 Mich. 674 at 678, 225 N.W. 613 (1929).

182 Bowles v. Oakman, 246 Mich. 674, 225 N.W. 613 (1929); Horrigan v. Wyman, 90 Mich. 121, 51 N.W. 187 (1892).

183 The factor mentioned in the text was considered by the drafting group. Notes to Tentative Draft No. 3 (1947) 102. For a fuller criticism of the section, see comment, 44 ILL. L. REV. 88 (1949).

184 "The one exception made in the case of theft is based on the policy which refuses to aid a proved thief to recover, and refuses to aid him indirectly by permitting his transferee to recover unless the transferee is a holder in due course." Official comment to §306.

Section 706—Discharge of Surety. The first subsection, which is to replace NIL section 120, reads as follows:

"(1) The holder discharges any party to the instrument to the extent that without such party's consent the holder

(a) without express reservation of rights releases or agrees not to sue any person against whom the party has to the knowledge of the holder a right of recourse on the instrument, or by any act or agreement postpones the right to enforce the instrument against such person; or

(b) otherwise discharges such person, except that failure to give notice of dishonor to any such person does not discharge any party to whom notice is duly given; or

(c) unjustifiably impairs any security for the instrument given by or on behalf of the party or any person against whom he has a right of recourse."

This contains a number of needed changes designed generally to bring negotiable instruments rules into conformity with suretyship law.

A release or extension of time to a principal who is a party to the instrument will operate equally to discharge a surety whether his liability on the instrument is primary or secondary.[185] Neither a release nor an extension of time which is made with the consent of the surety will discharge him and this is true even though the holder does not expressly reserve his rights against the surety.[186] As is now the case, an express reservation of rights against the surety will preserve his obligation when made in connection with either a release or an extension of time. At least this is stated in the official comment. The section itself is mildly ambiguous as regards extension of time.[187] In no case does a

[185] The limitation of the scope of NIL, §120 to persons "secondarily liable on the instrument" has resulted in a conflict of decision. According to most courts the section is exhaustive and since a surety maker is primarily liable on the instrument an extension of time to the principal does not release the surety. Cellers v. Meachem, 49 Ore. 186, 89 P. 426 (1907). Contra: Fullerton Lumber Co. v. Snouffer, 139 Iowa 176, 117 N.W. 50 (1908). Further citations appear in BRITTON, BILLS AND NOTES 1124-5 (1943).

[186] This is also true under NIL §120 (6) as to extension of time. But the cases are in conflict with respect to a release, conflict created by the fact that §120 (5) provides for a discharge upon release of the principal without reservation of rights and makes no express exception where the surety consents. Some courts have held that the surety is released even though he consented to the release of the principal. Phenix Nat. Bank of New York v. Hanlon, 183 Mo. App. 243, 166 S.W. 830 (1914); Howard Nat. Bank & Tr. Co. v. Newman (Vermont, 1947) 50 A. (2d) 896. Contra: Arlington Nat. Bank v. Bennett, 214 Mass. 352, 101 N.E. 982 (1913).

[187] The ambiguity is in whether the "reservation of rights" language in subsection 1(a) qualifies the whole of that subsection. Undoubtedly it will be construed to do so. There would be some justification for eliminating the reservation of rights provision as to both releases and extensions and in fact this was proposed at one stage of the revision. Notes to

release or extension discharge a party whose liability is in fact secondary unless the holder has knowledge of that fact.[188] An omission in the present statute is supplied by the provision on impairment of security. Evidently this provision is intended to mean that an impairment of security without the consent of the surety discharges him to the extent of the impairment. In spite of the silence of the NIL, courts generally have reached this conclusion.[189]

The section does not cover cases in which a release or extension of time is given to a principal who is not a party to the instrument. The release or extension must be given to a person against whom the surety has a right of recourse "on the instrument." This leaves uncovered the common situation of a conveyance of mortgaged land to a grantee who takes subject to the mortgage debt and perhaps expressly assumes it. In either case the relation of principal and surety arises between the grantor (maker of the note) and the grantee, and the usual suretyship rules should apply. The failure of the NIL to deal with the problem has led to a difference of opinion.[190] Unfortunately, the conflict is apt to continue under the revision. A good part of the uncertainty and conflict under the NIL has been due to the enactment of some suretyship rules with no clear indication as to whether other possibly applicable rules have been abrogated. The revision has the same fault.

Section 802—Payment by Negotiable Instrument. The first subsection provides:

> "Unless otherwise agreed an instrument taken for the full amount of an obligation suspends such obligation until the instrument is due, or if payable on demand until it is duly presented, and an instrument taken for a part of the amount suspends the

Tentative Draft No. 2 (1947) 108, 109. But the great weight of the argument for such elimination applies to release. There would be no rational basis for retaining the provision as to releases while eliminating it for extensions.

188 The situation covered is where an accommodation party signs in the position of a primary party on the instrument and the fact of accommodation is unknown to the holder. The NIL is silent on the point.

189 Frazier v. First Nat. Bank of Ellwood City, 2 Ohio App. 159 (1913); BEUTEL'S BRANNAN, NEGOTIABLE INSTRUMENTS LAW, 7th ed., 1159 et seq. (1948). Contra: Merchants' Nat. Bank of Billings v. Smith, 59 Mont. 280, 196 P. 523 (1921).

190 Where the grantee expressly assumed the mortgage debt, it was held in Industrial Trust Co. v. Goldman, 59 R.I. 11, 193 A. 852 (1937) that an extension of time to the grantee discharged the maker of the note. Contra: Peter v. Finzer, 116 Neb. 380 (1928). Where the grantee did not assume the mortgage debt it was held in Mutual Benefit Life Ins. Co. v. Lindley, 97 Ind. App. 575, 183 N.E. 127 (1933) that an extension of time to the grantee discharged the maker to the extent of the value of the mortgaged land at the time of the extension. Contra: Mortgage Guarantee Co. v. Chotiner, 8 Cal. (2d) 110, 64 P. (2d) 138 (1936).

obligation pro tanto. When the instrument is dishonored action may be maintained on either the instrument or the original obligation. When the instrument is negotiated otherwise than for collection or when due presentment is not made or excused, such obligation or the proportionate amount thereof is discharged."

The general problem is whether a negotiable instrument given to a creditor is absolute or only conditional payment. If absolute, the underlying obligation is satisfied; if conditional, it is said to be suspended.

It is generally recognized that an instrument to which the debtor is not a party, given for an obligation which arises in the same transaction (a "present" debt, as the cases say) is presumptively taken by the creditor as absolute payment. On the other hand the same type of instrument presumptively is taken only as conditional payment of a precedent debt. The distinction appeared as early as Lord Holt's time: in *Ward v. Evans*[191] he observed that "taking a note . . . [of a third person] for goods sold is a payment, because it was part of the original contract; but paper is no payment where there is a precedent debt. For when such a note is given in payment, it is always intended to be taken under this condition, to be payment if the money be paid thereon in convenient time." Although sometimes ignored, the distinction has been made in modern times, as in a relatively recent decision of the Second Circuit Court of Appeals. Bonds were delivered to a buyer who gave a cashier's check of the Harriman Bank for the price. The bank failed to open the next day, its check was not paid, and the seller sought to recover the price from the buyer. Recovery was denied; the parties were presumed to have understood that the check was "taken as the equivalent of absolute performance"; hence the risk of bank failure was on the seller instead of the buyer.[192]

[191] 2 Ld. Raym. 929, 92 Eng. Rep. 120 (1702). Holt had made the same distinction in Clark v. Mundal, 1 Salk. 124, 91 Eng. Rep. 116 (1692).

[192] "No doubt the general rule is that, where the seller takes the buyer's check in payment without more, the check is taken only as conditional payment of the debt which is not discharged unless, upon presentation for payment in due course, the check is paid. . . . But there is a variation of the general rule where the debt is created simultaneously with the obligation to make immediate payment and the creditor then takes the credit of a third party instead of insisting upon receiving payment in cash though his contract gives him that right." Hamilton v. R. S. Dickson & Co., (C.C.A. 2d, 1936) 85 F. (2d) 107 at 108.

To the same effect are: Atlas S.S. Co. v. Colombian Land Co., (C.C.A. 2d, 1900) 102 F. 358 (third party draft was conditional payment of precedent debt); New York & Cuba Mail S.S. Co. v. Texas Co., (C.C.A. 2d, 1922) 282 F. 221 (third party draft was absolute payment of present debt); Whitbeck v. Van Ness, 11 Johns (N.Y.) 409 (1814) (third party note was absolute payment of present debt); Hall v. Stevens, 116 N.Y. 201, 22 N.E. 394 (1889) (third party bank draft was absolute payment of present debt; the "question depends upon whether the draft was taken for a present or a precedent debt").

The cases emphasize the importance of two factors: whether the instrument is taken for a precedent debt or one arising in the same transaction, and whether the debtor is a party to the instrument. If the debtor is a party, either as maker,[193] drawer,[194] acceptor[195] or indorser,[196] the tendency is to hold that the instrument in all cases is only conditional payment. The revision ignores these factors and treats the instrument as only conditional payment in every case unless a contrary understanding appears. The official comment to the section states that it is "intended to settle conflicts," with no suggestion that it also may effect an important change in the law.

Possibly the courts will feel free to preserve existing rules through use of a slightly different technique than has been used heretofore. The accepted approach has been that the understanding of the parties controls, but in the absence of any other evidence on the matter certain presumptions are made depending upon the variables already noted. In the case, for example, of a buyer's remittance of a bank draft payable to his seller, "the presumption is that it was agreed to be taken in payment."[197] A court which is inclined to reach the same result under the revision can do so by finding such an agreement in fact. The finding, of course, will rest upon the conclusion that this is the probable understanding in this type of transaction.[198]

Whether existing distinctions should be perpetuated is another question. Movement should not be in the direction of making all payments conditional. If there is to be change it should be in the direction of according finality to payment by certain types of instruments, specifically bank drafts and cashiers' checks, without regard to whether the obligation is precedent or present.[199] These instruments come close

[193] Segrist v. Crabtree, 131 U.S. 287 (1889).

[194] Bassett v. The Merchants Trust Co., 118 Conn. 586, 173 A. 777 (1934).

[195] No case has been found but it would seem that the situation is analogous to the taking of the debtor's note. See Kessler, Levi and Ferguson, "Some Aspects of Payment by Negotiable Instrument: A Comparative Study," 45 YALE L. J. 1373 at 1381 (1936).

[196] This is more doubtful but is supported by the following cases: Whitney v. Goin, 20 N.H. 354 (1850); Butler v. Haight, 8 Wend. (N.Y.) 535 (1832); Monroe v. Hoff, 5 Denio (N.Y.) 360 (1848). Accord: NORTON, BILLS AND NOTES, 4th ed., 27 (1914); 6 WILLISTON, CONTRACTS, rev. ed., 5275 (1938).

[197] Hall v. Stevens, 116 N.Y. 201 at 206 (1899). The obligation was treated as present rather than precedent, as is usual in sales of goods cases.

[198] There is some suggestion in the official comment to section 802 that this approach is contemplated.

[199] On the difficulty of drawing the distinction between a present and a precedent obligation, compare the Atlas and Cuba Mail cases, supra note 192.

enough to money in their use that payment thereby could well be treated as the equivalent of a cash payment.[200]

The subsection provides that a failure to make due presentment of the instrument discharges the underlying obligation. Generalization regarding present law is hazardous, but it is believed that the decisions fit loosely into this pattern: the debtor is discharged on the underlying debt only to the extent that he is discharged on the instrument; when he is not a party to the instrument he is discharged to the extent of the loss caused by the delay, which in the situations usually presented means a complete discharge.[201] The revision, of course, does not follow this pattern. However, this will have significant consequences only in a few situations. The debtor-drawer of a check will be discharged on the underlying obligation by the delay but will in effect remain liable on the check except to the extent that the delay harmed him. The debtor-drawer of a bill which is not a check will be in the same position; whereas under present law he probably is discharged both on the bill and the debt regardless of loss. The debtor-indorser of a third party note will remain liable on the note for the reason that the revision eliminates the necessity of presentment to fix such liability. The debtor-indorser of a check or other bill will be completely discharged on both the instrument and the debt. This is a situation which has troubled some courts. Departing from the pattern suggested above, there are a few holdings that, although the debtor is discharged as an indorser, he remains liable on the debt unless the delay harmed him.[202]

Turning to the situation in which the debtor is not a party to the instrument, the common case is where he buys a bank draft payable to his creditor and remits it in payment of his debt. If the draft is given for a present debt and the court follows the view that it is taken in absolute payment, there is of course no problem as to the effect of delayed presentment on the debt. The problem does arise, however, if the draft initially constituted only conditional payment. In the cases presenting the problem the drawer failed and the draft was dishonored. The analogy to the case in which the drawer gives his own check and the drawee fails is obvious. In that case the drawer is discharged on

200 Query, however, where the bank is paying its own obligation by its own instrument. This situation was presented in Bassett v. Merchants Trust Co., 118 Conn. 586, 173 A. 777 (1934).

201 The authorities are cited in the article by Kessler, Levi and Ferguson, supra note 195, at 1378-1400. The writers do not reach any such generalization as is made above.

202 Cases cited by Kessler, Levi and Ferguson, supra note 195, at 1397, note 109.

the instrument to the extent of the loss caused by the delay, and probably to the same extent on the debt. This is in substance the result which has been reached in the case of remittance by bank draft. The judgment, however, has been that the drawer is wholly discharged, since the creditor holds the bank draft and can file a claim against the failed drawer in the liquidation proceeding.[203]

The revision will have significant consequences in the remittance situation. In the case just described, if the drawer failed before the time for due presentment had run out, the late presentment did not cause the loss. On these facts it is believed that the debtor would now remain liable on his debt, though no holding can be cited.[204] Certainly this should be true if the court accepts the analogy of the ordinary check case. Under the revision, however, the debtor will be discharged where the late presentment does not harm him. In fact, he will be discharged even though the drawer has not failed. This clearly is contrary to present understanding. The best justification for these consequences is that mentioned above, that is, probably remittance by bank draft should be treated as final payment whether the debt is present or precedent.

In spite of the length of this paper many significant aspects of the revision have not been mentioned. Enactment by the states will mean that judges and lawyers will have to face anew many problems which are now settled in the jurisdiction. There will be new language to read, in most instances intended to preserve existing rules but still calling for fresh consideration. This, of course, is a part of the price of a thoroughgoing revision. The advantages to be gained far outweigh this disadvantage. Great improvements have been made through resolving numerous uncertainties and conflicts and through changing some undesirable rules. It will be unfortunate, however, if Article 3 is adopted by the Institute and Commissioners without change. The criticisms in this paper fall roughly into two groups. Some are directed primarily at shortcomings of draftsmanship (which on the whole is superb), where the possible or probable results may not be intended. Others are in the realm of judgment and policy on which men can reasonably differ. The writer believes that there are better solutions.

[203] Commercial Investment Trust v. Lundgren-Wittensten Co., 173 Minn. 83, 216 N.W. 531 (1927). Other cases are cited by Kessler, Levi and Ferguson, supra note 195, at 1400, note 123.

[204] It is significant, however, that in the Commercial Investment Trust case, supra note 203, the court pointed out that the drawer had failed after the expiration of a reasonable time for presentment.