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NEGOTIABLE INSTRUMENTS

EDWARD D. RE †

I. INTRODUCTION

The uniformity envisioned by the draftsmen of the original Negotiable Instruments Law over half a century ago, has, to a large extent, vanished from the American legal scene. Indeed, its passing began even before it had reached maturity, for the Law, itself, was never adopted in identical form in all the states. Furthermore, such of its substance, as was uniformly accepted, has been subject to more than fifty years of amendment, modification, and divergent interpretation in the various jurisdictions.1

In addition, it has become increasingly obvious that the statute, as originally drafted and presently in force, contains certain basic defects which render substantial revision both necessary and desirable.2 The proposed Commercial Code, in the article on "Commercial Paper," is designed to achieve

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1 An example is the construction placed on Section 62 of the Uniform Negotiable Instruments Law. See Wells Fargo Bank and Union Trust Co. v. Bank of Italy, 214 Cal. 156, 4 P. 2d 781 (1931); National City Bank of Chicago v. National Bank, etc., 300 Ill. 103, 132 N. E. 832 (1921); National Reserve Bank v. Corn Exchange Bank, 177 App. Div. 195, 157 N. Y. Supp. 316 (1st Dep't 1916). On the varying methods of interpretation of the Negotiable Instruments Law and for many "erroneous decisions due to failure to cite the Act," see BRANNAN, NEGOTIABLE INSTRUMENTS LAW 80 et seq. (7th ed., Beutel, 1948).

the uniformity once envisioned and, in addition, to cure the defects now extant in the present law of negotiable instruments.

II. Scope of Code Article Three

Article Three of the Code, entitled "Commercial Paper," is to all intents and purposes a complete revision of the Negotiable Instruments Law. From the outset, however, it should be noted that, like the N.I.L., it does not purport to encompass every commercial transaction involving an element of negotiability. For example, it does not deal with investment paper or investment securities such as bearer or registered bonds. Nor does it embrace the regulation of warehouse receipts, bills of lading, and other documents of title. Many of these latter transactions are dealt with elsewhere in the Code, but there has been a total deletion of some existing provisions relating to commercial paper. Thus, the Code eliminates the sections of the Uniform Negotiable Instruments Law dealing with acceptance for honor and payment for honor which, over a period of years, have become obsolete.

Uncertainty as to the proper location of provisions dealing with bank collections can be discerned from an examination of the several decisions made by Code draftsmen in relation to these sections. Whereas the May, 1949, draft of the Uniform Commercial Code had included bank collections in the article on "Commercial Paper," the 1950 draft relegated such provisions to a different article of the Code (Article Four). The 1951 revision, except for some sections to be reworded and inserted into Article Three, deleted the Bank Collections parts of Article Four from the Code. The

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3 Investment paper and investment securities are treated in Article Eight of the Code. Warehouse receipts, bills of lading and other documents of title are regulated by the provisions of Article Seven.
5 This was pursuant to a resolution made at the May 1951 meeting. The Foreword to the June 1951 revisions states that "[s]ince the meeting there has been some pretty well considered opinion saying that Article 4 should not have been so completely deleted but should have been cut down to take out some of the detail. It may well be that we shall hear more about Article 4." See June 1951 Revision, Page 3.
resolution, pursuant to which Article Four was eliminated, contemplated that the omitted portions of the article would be redrafted into a separate act. This separate act is to be in such form that any state which adopts the Code can also adopt this separate legislation as a supplement to the Code. In view of what seems to be a rather uncertain future for the provisions dealing with Bank Collections and Deposits, this article, with a few exceptions, is limited to a treatment of those provisions of Article Three which deal with the conventional note, draft, check and certificate of deposit.

It should be noted, however, that Article Three cannot properly be treated in vacuo; its provisions are part of an overall codification which regards the commercial transaction as a single subject of the law, notwithstanding the fact that it may contain several distinct phases. Hence, the provisions of the article on "Commercial Paper" must be examined in the light of certain other Code provisions which express the general rules applicable to commercial transactions. An interesting section, which should be read at the outset, is the one dealing with the applicability of other principles of law to commercial transactions. The section provides:

Unless displaced by the particular provisions of this Act, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions.\(^6\)

Although the listing given in the above section is merely illustrative and not exhaustive, and hence the express reference to some fields of law is not intended to suggest the negation of the general application of other fields of law, the section is surely more explicit and comprehensive than the comparable provision in the Uniform Negotiable Instruments Law. The latter merely states that, "[i]n any case not provided for in this chapter the rules of the law merchant shall govern."\(^7\) The Code provision clearly urges the continued application to commercial contracts of all of the sup-

\(^6\) *Uniform Commercial Code* § 1-103 (Spring 1951).
\(^7\) *Negotiable Instruments Law* § 196; *N. Y. Neg. Inst. Law* § 7.
plemental bodies of law except insofar as they are expressly displaced by the Code. Thus, subject to commercial standards, the Uniform Commercial Code introduces equitable principles into the law governing commercial transactions.

III. NATURE OF THE "ORDER" IN A DRAFT AND THE "PROMISE" IN A NOTE

The Negotiable Instruments Law codified the law merchant to the effect that an instrument to be negotiable must contain either a "promise" or an "order." In several cases, the question has arisen whether the language used constituted an "order" or "promise" sufficient to satisfy the requirement of negotiability. Under the existing law, even though the words, "order" or "promise," are not expressly used in an instrument, if the language used is such as reasonably to permit the implication of an "order" or "promise," the instrument is generally deemed to meet the statutory requirement. Under this relaxed policy of construction, some courts have held an "I.O.U." to be a negotiable promissory note. One writer would resolve the question of negotiability by an inference as to the intention of the debtor. He states: "If a debtor give a mere due-bill to his creditor containing nothing but an acknowledgment of the debt, it is fair to presume that he merely designed to furnish him with evidence of its existence." Although the law implies a promise to pay from the existence of the debt, this promise implied in law is insufficient to convert the due-bill into a

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8 Negotiable Instruments Law § 1; N. Y. Neg. Inst. Law § 20.
10 The conflict of authority concerning the negotiability of an I.O.U. or a due bill also existed prior to the enactment of the English Bills of Exchange Act of 1882 and the Uniform Negotiable Instruments Law in the United States. It was, however, settled in England that an I.O.U. or due bill was not a negotiable promissory note. Fisher v. Leslie, 1 Esp. 425 (1795) ("I.O.U. eight guineas" was held not to be a promissory note and therefore required no stamp under the English stamp acts.); Israel v. Israel, 1 Camp. 499, 170 Eng. Rep. 1035 (1808) ("I owe my father £470."). Although this view was also shared by the majority of American Courts, there are decisions to the contrary. Fleming v. Burge, 6 Ala. 373 (1944); Cummings v. Freeman, 2 Humph. 143 (Tenn. 1840).
11 Daniel, Negotiable Instruments § 37 (1891).
12 Ibid.
promissory note, since the promise required for the existence of a promissory note should be expressed or necessarily implied from the words used in the instrument itself.\textsuperscript{13}

Notwithstanding the statement in \textit{Shimel v. Williams} \textsuperscript{14} to the effect that four prior New York decisions \textsuperscript{15} had established the rule that in New York an "I.O.U." was not negotiable, no such certainty existed on the point. Although the court in the \textit{Shimel} case uttered the dictum that "[t]his instrument, not made payable to bearer or order, is not a negotiable promissory note for which in the absence of evidence to the contrary, a consideration would be presumed," \textsuperscript{16} it nevertheless held that an "I.O.U." was an acknowledgment of debt sufficient to import a consideration.

The Uniform Commercial Code resolves these conflicts by its definition of "order" and "promise." It provides that "[a]n 'order' is a direction to pay and must be more than an authorization or request . . . ;" \textsuperscript{17} and "[a] 'promise' is an undertaking to pay and must be more than an acknowledgment of an obligation." \textsuperscript{18} The Code definitions intend to make it clear that neither the "I.O.U." nor the other examples cited are to be deemed negotiable instruments within the Commercial Code.

In this connection it is interesting to note that the Code has omitted the section of the Negotiable Instruments Law which provides that "[t]he instrument need not follow the language of this act, but any terms are sufficient which clearly indicate an intention to conform to the requirements

\textsuperscript{13} Although in varying language, this thought has been expressed by all of the authors on Negotiable Instruments. \textit{Story, Promissory Notes} § 14 (1845); \textit{DANIEL, NEGOTIABLE INSTRUMENTS} §§ 36, 37 (1891); \textit{Britton, Bills and Notes} § 10 (1943).


\textsuperscript{15} Hegeman \textit{v. Moon}, 131 N. Y. 462, 30 N. E. 487 (1892); Sheldon \textit{v. Heaton}, 88 Hun 535, 34 N. Y. Supp. 856 (Sup. Ct. 1895); Kimball \textit{v. Huntington}, 10 Wend. 675 (N. Y. Sup. Ct. 1833); Russell \textit{v. Whipple}, 2 Cow. 536 (N. Y. Sup. Ct. 1824). The cited cases are in fact persuasive authority for the contrary proposition. See also Luqueer \textit{v. Prosser}, 1 Hill. 256 (N. Y. Sup. Ct. 1841), wherein the court citing \textit{Kimball v. Huntington, supra}, said "... a common due bill is a note."


\textsuperscript{17} \textit{Uniform Commercial Code} § 3-102(1)(b) (Spring 1951).

\textsuperscript{18} Id. § 3-102(1)(c).
hereof." The draftsmen justify this omission by stating that the provision served no useful purpose, encouraged bad drafting and caused courts to hold questionable paper to be negotiable. Actually, the omission does not mean that an instrument must follow the language of the section that defines a draft, check, certificate of deposit, and note.\textsuperscript{20} One term may still be deemed the equivalent of another as in the case of "I undertake" instead of "I promise," or "Pay to holder," instead of "Pay to bearer." However, the omission to re-enact the provision of the Negotiable Instruments Law does mean that if neither the language of the new definition, nor a "clear equivalent," is found, the case becomes doubtful and ". . . in doubtful cases the decision should be against negotiability."\textsuperscript{21}

IV. FORM OF NEGOTIABLE INSTRUMENTS

Section 3-104 of the Uniform Commercial Code establishes the requisites of negotiability as follows:

(1) Any writing to be a negotiable instrument within this Article must

(a) be signed by the maker or drawer; and

(b) 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; and

(c) be payable on demand or at a definite time; and

(d) be payable to order or to bearer.

(2) A writing which complies with the requirements of this section is

(a) a "draft" ("bill of exchange") if it is an order;

(b) a "check" if it is a draft drawn on a bank and payable on demand;

\textsuperscript{19} \textit{Negotiable Instruments Law} § 10; N. Y. Neg. Inst. Law § 29. See \textit{Britton, Bills and Notes} § 35 (1943).

\textsuperscript{20} \textit{Uniform Commercial Code} § 3-104(2) (a), (b), (c), (d) (Spring 1951).

\textsuperscript{21} \textit{Uniform Commercial Code} § 3-104, Comment 6 (Spring 1950). \textit{Cf. 1 Daniel, Negotiable Instruments} § 106 (1891).
(c) a "certificate of deposit" if it is an acknowledgment by a bank of receipt of money with an engagement to repay it;

(d) a "note" if it is a promise other than a certificate of deposit.

The now classical definition that a negotiable instrument is a "'courier without luggage,' whose countenance is its passport" 22 (i.e., must express all of its terms on its face), is equally descriptive under the Code. It is clear that an instrument to be negotiable within the meaning of the Code must comply with all the requirements established by Section 3-104. Furthermore, the intention of the draftsmen is now clear that a writing does not become negotiable by the insertion of a clause agreeing that it shall be one. 23 Although Section 3-112 permits the insertion of certain obligations and powers in addition to the simple promise or order to pay money, subdivision 1(b) of Section 3-104 declares that the instrument cannot carry any others. 24

Under existing law, the negotiable character of an instrument is not affected by a provision which "... authorizes the sale of collateral securities in case the instrument be not paid at maturity..." 25 The Code does not limit the power of sale to a case of default at maturity. The Code language states simply that the negotiability of an instrument is not affected by a statement that "... in case of default on the instrument the collateral may be sold..." 26 Hence, the Code permits a clause which authorizes the sale of collateral upon any default in the instrument, and this is intended to include a default in the payment of any installment as well as a default in the payment of interest. 27

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22 1 DANIEL, NEGOTIABLE INSTRUMENTS § 303 (1891); Heaton v. Meyers, 34 Colo. 59, 62 (1878).
23 "... a contract ... does not become a negotiable instrument by the mere insertion of a clause agreeing that it shall be one." UNIFORM COMMERCIAL CODE § 3-104, Comment 2 (Spring 1950).
24 UNIFORM COMMERCIAL CODE § 3-104, Comment 4 (Spring 1950). Examples of provisions that would destroy negotiability would be: an undertaking to insure mortgaged property, or an authority to sell any property not given as security for the instrument.
26 UNIFORM COMMERCIAL CODE § 3-112(1)(b) (Spring 1951).
27 UNIFORM COMMERCIAL CODE § 3-112, Comment 1 (Spring 1950).
Under the Negotiable Instruments Law questions have arisen concerning the negotiability of instruments which contain a clause requiring that the obligor furnish additional collateral to absorb a depreciation in value of the collateral originally pledged. Although some courts have held that such a clause does not destroy the negotiability of the instrument, those courts have found difficulty in reconciling the holdings with the provision that "[a]n instrument which contains an order or promise to do any act in addition to the payment of money is not negotiable." The New York Court of Appeals has explained that such a clause does not involve a promise to do an act "in addition to the payment of money," but rather is simply a promise to do something in aid of, and incidental to, the payment of money. The Code resolves the conflict in authority in favor of the view taken by the New York Court, and renders unnecessary any further struggle with semantics by providing expressly that the negotiability of an instrument is not affected by a "promise to give additional collateral on demand."

A. When Promise or Order is Unconditional

The Code provisions make it clear that the conditional or unconditional character of the promise or order is to be determined by what is expressed in the instrument itself. This rejects those decisions which have held that an instrument which recites that it was issued for an executory promise gives rise to implied conditions which destroy nego-

28 Finley v. Smith, 165 Ky. 445, 177 S. W. 262 (1915); City Nat. Bank v. Roberts, 266 Mass. 239, 165 N. E. 470 (1929); Sommers v. Goulden, 147 Okla. 51, 294 Pac. 175 (1930). Contra: Holliday State Bank v. Hoffman, 85 Kan. 71, 116 Pac. 239 (1911); Nussear v. Hazard, 148 Md. 345, 129 Atl. 506 (1925). The author of BRANAN, NEGOTIABLE INSTRUMENTS LAW submits that the cases which hold such a note to be negotiable are in "... direct conflict with the plain meaning of this section." (NEGOTIABLE INSTRUMENTS LAW § 5.)

29 NEGOTIABLE INSTRUMENTS LAW § 6; N. Y. NEG. INST. LAW § 24 (first sentence).


31 UNIFORM COMMERCIAL CODE § 3-112(1)(c) (Spring 1951).

32 Id. § 5-105.

33 Sacred Heart Church Building Committee v. Manson, 203 Ala. 256, 82 So. 498 (1919); Robbins v. Life Ins. Co., 169 Tenn. 507, 89 S. W. 2d 340 (1936).
tiability. Of course, the Code retains the rule that if an instrument contains language *subjecting* payment to the terms of another agreement the promise to pay is not unconditional.\(^{34}\) The distinction, which must be made, is between a reference to a separate agreement, and language which requires the holder to look to the separate instrument for the terms of payment. Under the Code, an instrument is not negotiable unless the holder can know all of its terms from the instrument itself.\(^{35}\)

On the other hand, an otherwise unconditional promise or order is not made conditional by the fact that the instrument “...is subject to implied or constructive conditions.”\(^{36}\) This latter provision would seem to resolve the doubt concerning the negotiability of rent notes even in those states which have a statute similar to Section 227 of the New York Real Property Law, which permits a tenant to surrender the premises and relieves him from liability for future rent in the event that the premises become unfit for occupancy. Furthermore, in the absence of express language to the contrary, under the Code, the negotiability of the rent note is not destroyed by the fact that it states that it is given in payment for future rent. In this respect the Code adopts the sound policy that the negotiability of an instrument is not affected by “implied or constructive conditions,” and overturns cases such as *Robbins v. Life Ins. Co. of Virginia*,\(^{37}\) where the court stated that “...there can be no doubt that this contract, although a promise to pay in form otherwise negotiable, is rendered conditional by the statute.”\(^{38}\)

In relation to recitals such as “[t]his note is given in payment for the purchase of goods as per contract of this date,” the Code\(^ {39}\) continues the existing construction placed

\(^{34}\) *Uniform Commercial Code* § 3-105(2)(a) (Spring 1951).

\(^{35}\) *Uniform Commercial Code* § 3-105, Comment (Spring 1950). See Williamson v. Craig, 204 Iowa 555, 215 N. W. 664 (1927); Hubbard v. Wallace Co., 201 Iowa 1143, 208 N. W. 730 (1926); Fayetteville Building and Loan Ass’n v. Crouch, 115 W. Va. 651, 177 S. E. 532 (1934).

\(^{36}\) *Uniform Commercial Code* § 3-105(2)(a) (Spring 1951).


\(^{38}\) *Id.* at 341. See *Whitney, Bills and Notes* 26 (1948). “Since thousands of rent notes are in circulation in reliance on their being negotiable, it would seem that only a condition expressed on the face of the instrument should prevent their being negotiable.”

\(^{39}\) *Uniform Commercial Code* § 3-105 (Spring 1951). “A promise or order
upon the Negotiable Instruments Law that such recitals are merely statements as to the origin of the instrument and do not affect negotiability.\textsuperscript{40} Such references are merely informational in nature and do not condition payment according to the terms of the agreement to which it refers.

B. Instrument Issued by Unincorporated Association

A conflict has existed concerning the negotiability of instruments issued by unincorporated associations, when payment is expressly limited to the assets of the association, and liability of the individual members is excluded. The same problem is presented when an instrument, issued by a trust estate, excludes the personal liability of the trustee.\textsuperscript{41} Under the Code, both of the above types of instruments would be treated as negotiable, as would similar instruments issued by partnerships and estates.\textsuperscript{42} The Code goes further, and declares negotiable, instruments which limit payment to a particular fund or to proceeds from a particular source “... if the instrument is issued by a government or governmental agency or unit. ...” \textsuperscript{43}

C. Certainty as to Sum

The section of the Code dealing with certainty as to sum clarifies doubts that arose under the Negotiable Instruments Law\textsuperscript{44} as to interest, discounts or additions, exchange, costs and attorneys' fees, and matters of acceleration or extension. The change effected by the Code is to reject those decisions which have denied negotiability to instruments providing for otherwise unconditional is not made conditional by the fact that the instrument ...

\textsuperscript{40} Negotiable Instruments Law § 3(2); N. Y. Neg. Inst. Law § 22(2).
\textsuperscript{42} Uniform Commercial Code § 3-105(1)(b) (Spring 1951); Uniform Commercial Code § 3-105, Comment 7 (Spring 1950).
\textsuperscript{43} Uniform Commercial Code § 3-105(1)(e) (Spring 1951).
\textsuperscript{44} Negotiable Instruments Law § 2; N. Y. Neg. Inst. Law § 21.
a discount of the principal in the event of a payment prior to the ultimate date of maturity.\textsuperscript{45} The basis for such decisions was the assumption that the provision for a discount rendered the sum payable uncertain. The Code categorically declares that the sum payable is a sum certain even though it is to be paid "... with a stated discount or addition if paid before or after the date fixed for payment."\textsuperscript{46} Under the Code, there would be no difference of treatment between a clause which increases the interest rate upon default or decreases the interest rate if the instrument is paid at maturity\textsuperscript{47} and one which provides for a discount of the principal sum. In all cases it is sufficient that at the time of payment, from the instrument itself, with the necessary arithmetic computation, the holder is able to determine the amount payable on the instrument.\textsuperscript{48}

D. \textit{Instrument must be Payable in Money}

Although there has never been any question concerning the negotiability of an instrument payable in the circulating medium of exchange which is legal tender at the place of payment, there has existed a conflict of authority concerning instruments calling for the payment of foreign money such as francs, lira, pounds, or other recognized currency of a foreign government.\textsuperscript{49} In view of the uncertainty of the law in New York on this question, one author has remarked: "... strange to say, in a world financial center such as New

\textsuperscript{45} See Waterhouse v. Chouinard, 128 Me. 505, 149 Atl. 21 (1930); Frolick v. Norton, 2 Mich. 130 (1851); First National Bank v. Watson, 56 Okla. 495, 155 Pac. 1152 (1916); Farmers' Loan Trust Co. v. McCoy & Spivey Bros., 32 Okla. 277, 122 Pac. 125 (1912); National Bank of Commerce v. Feeney, 12 S. D. 156, 80 N. W. 186 (1899). See also Notes, 23 WASH. U. L. Q. 385 (1948), 39 YALE L. J. 1205 (1930).

\textsuperscript{46} \textsc{Uniform Commercial Code} § 3-106(1) (c) (Spring 1951).

\textsuperscript{47} See Hutson v. Rankin, 36 Idaho 169, 213 Pac. 345 (1922); Farm Mortgage and Loan Co. v. Martin, 51 S. D. 424, 214 N. W. 816 (1927).

\textsuperscript{48} \textsc{Uniform Commercial Code} § 3-106 (Spring 1951); \textsc{Uniform Commercial Code} § 3-106, Comment (Spring 1950).

York, the law is not definitely settled on this momentous point." 50 In recognition of the international nature of the laws of commerce and of the needs of international trade, the Code provides that an instrument calling for payment of a stated sum in a foreign currency is payable in a "sum certain in money," and, "... unless a different medium of payment is specified in the instrument, may be satisfied in payment of that number of dollars which the stated foreign currency will purchase at the buying sight rate for that currency on the day of demand." 51 If the instrument specifies a definite foreign currency as the medium of payment, the instrument is negotiable and "is payable in that currency." 52

While the Code rejects the view that "money" is limited to legal tender, it also rejects the contention that "money" would include any medium of exchange that is current or acceptable in the particular community, such as "gold dust, beaver pelts, or cigarettes in occupied Germany." 53 The test prescribed is that of governmental sanction which recognizes the circulating medium as a part of the official currency of the government. The Code provides: "An instrument is payable in money if the medium of exchange in which it is payable is money at the time the instrument is made." 54 To avoid subjecting the Code to any unnecessary judicial construction it adds that an instrument payable in "currency" or "current funds" is payable in money. 55

E. Instrument must be Payable at a Definite Time

1. Instrument payable after death. The change of policy effected by the Code in relation to the requirement of

50 NUSSBAUM, MONEY IN THE LAW NATIONAL AND INTERNATIONAL 346 (1950).
51 UNIFORM COMMERCIAL CODE § 3-107(2) (Spring 1951). It is to be noticed that the Code establishes the "day of demand" rule of conversion from the foreign currency to dollars. On the discharge of foreign currency debts in local money and the various rules regarding the time of conversion, see NUSSBAUM, MONEY IN THE LAW NATIONAL AND INTERNATIONAL 360 et seq. (1950).
52 UNIFORM COMMERCIAL CODE § 3-107(2) (Spring 1951).
54 UNIFORM COMMERCIAL CODE § 3-107(1) (Spring 1951).
55 Ibid.
certainty as to time of payment is evidenced by the substitution of the words “definite time” for the “fixed, or determinable future time” terminology of the Negotiable Instruments Law. Excepting an instrument payable on demand, under the Code the time of payment is definite only if it can be determined from the face of the instrument. This changes the law concerning instruments payable after events certain to happen although the time of happening be uncertain. Hence, an instrument payable a fixed period of time after the death of the maker or of some other person will no longer be negotiable under the Code.

2. **Effect of acceleration clauses.** Existing doubts concerning the effect of certain acceleration clauses upon the certainty of time of payment of an otherwise negotiable instrument would be removed by the Code. The pertinent section provides that an instrument is payable at a definite time if by its terms it is payable at a definite time subject to any acceleration. This provision eliminates the distinction formerly made between acceleration provisions conditioned upon the happening of an event which is either within the control of the **maker** or not within the control of the parties, and those giving the **holder** an unrestricted power to accelerate. At common law, and by majority rule under the Negotiable Instruments Law, if the clause was construed to give the holder the option to accelerate at his “whim or caprice,” the instrument was generally held to be non-negotiable. While the New York courts have been in agree-

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56 *Uniform Commercial Code* § 3-109 (Spring 1951).
57 *Negotiable Instruments Law* §§ 1, 4; N. Y. Neg. Inst. Law §§ 20, 23.
58 *Uniform Commercial Code* § 3-108 (Spring 1951). “Instruments payable on demand include those payable at sight or on presentation and those in which no time for payment is stated.”
59 *Negotiable Instruments Law* § 4(3); N. Y. Neg. Inst. Law § 23(3).
60 *Uniform Commercial Code* § 3-109(2) (Spring 1951). Instruments payable at or after death, if otherwise negotiable, have almost universally been held to be negotiable. Murrell v. Gibbs' Adm'r, 275 Ky. 124, 120 S. W. 2d 1018 (1938); Keeler v. Hiles' Estate, 103 Neb. 465, 172 N. W. 363 (1919); but cf. Kerr v. Smith, 156 App. Div. 807, 142 N. Y. Supp. 57 (1st Dep't 1913).
61 *Uniform Commercial Code* § 3-109(1)(c) (Spring 1951).
63 Murrell v. Exchange Bank, 168 Ark. 645, 271 S. W. 21 (1925); American
ment with the majority of states that an acceleration clause contingent upon a non-payment of installments, the death of the maker, or any other objectively ascertainable event, does not destroy the negotiability of an instrument, they have not agreed that an acceleration clause that is subjective with the holder destroys negotiability. Since the New York courts have not drawn the “distinction between the objective and subjective tests of acceleration,” in New York a clause whereby a holder could accelerate the date of maturity “if he deems himself insecure” would not destroy negotiability.

Although it may at first appear that the Code adopts the New York view by providing that an instrument is payable at a definite time if by its terms it is payable “at a definite time subject to any acceleration,” a reading of Section 1-208 of the Code indicates that the power of the holder to accelerate payment is limited by what may come to be termed a “good faith” standard. The section provides:

A term providing that one party may accelerate payment or performance or require collateral or additional collateral not on stated contingencies but “at will” or “when he deems himself insecure” or

Finance Corp. v. Bourne, 190 Okla. 332, 123 P. 2d 671 (1942); First State Bank of Cheyenne v. Barton, 129 Okla. 67, 263 Pac. 142 (1928); accord, Kimpton v. Studebaker Bros. Co., 14 Idaho 552, 94 Pac. 1039 (1908). Prior to the Negotiable Instruments Law it was held in Massachusetts that an instrument payable “on demand or in three years” was non-negotiable. Mahoney v. Fitzpatrick, 133 Mass. 151 (1882).


Lincoln Nat. Bank v. Marsh, 24 N. Y. S. 2d 281 (1940). In the Marsh case the note contained several accelerating events and also provided “... or if there be such a change in the condition or affairs (financial or otherwise) of any of the undersigned as in the opinion of the holder thereof will increase its risk, this note shall, at the option of its holder, become immediately due and payable, without demand or notice. ...” The court said, “I am unable to agree with the defendants’ contention that the note is not negotiable. ... As I view it, there is no logical basis for distinguishing between an acceleration clause which becomes operative when the holder determines that the maker’s financial affairs increase the holder’s risk and a clause which becomes operative in the event of death, insolvency or bankruptcy of the maker. ... To hold that an instrument payable at a fixed time but accelerateable at the option of the holder destroys its negotiability seems to me to be directly contrary to the plain meaning of Section 23. ... To hold such an instrument is suitable for circulation, more so than the ordinary note without an acceleration clause. The value is certain and the danger of insolvency is to some extent overcome.” Id. at 285.

UNIFORM COMMERCIAL CODE § 3-109(1)(c) (Spring 1951) (emphasis added).
in words of similar import means that he has power to do so only in
the good faith belief that the prospect of payment or performance is
impaired but the burden of establishing lack of good faith is on the
party against whom the power is to be exercised.

Since the true reason why courts have refused to uphold
the negotiability of an instrument which gives the holder an
uncontrolled power of acceleration is the feeling that such
arbitrary power would give him an unfair advantage over
the maker, the Code, rather than destroy the commercially
desirable clause, adopts an equitable and common sense
standard for the exercise of the power. The power to accele-
rate, however worded, under the Code is in fact controlled
for it can only be exercised "... in the good faith belief that
the prospect of payment or performance is impaired..." Although as a matter of evidence and procedure the burden
of establishing lack of good faith is on the party against
whom the power is to be exercised (the maker), the Code
significantly provides that "... 'good faith' means honesty in
fact in the conduct or transaction concerned." The estab-
ishment of the requirement of good faith is the manner in
which the Code prevents a holder from accelerating payment
solely to oppress a debtor.

3. Extension of time provisions. The existing confu-
sion in the decisions arising out of extension clauses is
eliminated by the Code provision which declares that an in-
strument is payable at a definite time if, by its terms, it is
payable 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 or
after a specified act or event." However, in order to pre-
vent a holder from refusing payment in an attempt to keep

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69 Uniform Commercial Code § 1-208 (Spring 1951).
70 Ibid.
71 Ibid. § 1-201(19).
73 Uniform Commercial Code § 3-109(d) (Spring 1951).
negotiable instruments

interest running, the Code provides that "[n]otwithstanding any term of the instrument, the holder may extend it only with the consent of the maker at the time of the extension." 74 It also states that, unless otherwise specified, consent to extension authorizes a single extension for not longer than the original period. 75

F. Words of Negotiability

1. Substitutes for words "Order Of." Although it has always been clear that an instrument could not be negotiable without words of negotiability, problems have arisen when the words used were words other than the usual "or order" or "bearer." For example, when an instrument states that it is "payable on return of this certificate properly indorsed," some courts have held that the instrument does contain words of negotiability and hence is negotiable. 76 To a certain extent such decisions find support in the provision of the Negotiable Instruments Law which states: "The instrument need not follow the language of this act, but any terms are sufficient which clearly indicate an intention to conform to the requirements thereof." 77 Not only has the Code eliminated this Negotiable Instruments Law provision, but Section 3-110 expressly changes the result of the cases referred to by providing that "[a]n instrument not payable to order is not made so payable by such words as 'payable upon return of this instrument properly indorsed.'"

Regarding the negotiability of an instrument payable to "Jones or assigns" or to the "assigns of Jones," the Code resolves whatever conflict may have existed 78 in favor of the

74 Id. § 3-118(f).
75 Ibid.
76 Felton v. Commercial National Bank, 39 Ohio App. 24, 177 N. E. 52 (1930); Klauber v. Biggerstaff, 47 Wis. 551, 3 N. W. 357 (1879). Writing before the enactment of the Negotiable Instruments Law, Daniel states: "No precise form of words is necessary to impart negotiability. ... 'order' or 'bearer' are convenient and expressive but clearly not the only words which will communicate the quality of negotiability." 1 DANIEL, NEGOTIABLE INSTRUMENTS § 106 (1st ed. 1891). Nelson v. Citizens' Bank, 191 App. Div. 19, 180 N. Y. Supp. 747 (1st Dep't 1920), aff'd, 232 N. Y. 581, 134 N. E. 580 (1922). The Nelson case has been criticized in 20 COI. L. REV. 621 (1920).
77 NEGOTIABLE INSTRUMENTS LAW § 10; N. Y. NEG. INST. LAW § 29.
78 Compare Zander v. N. Y. Security and Trust Co., 178 N. Y. 203, 211,
negotiability of such instrument. It provides that "[a]n instrument is payable to order when by its terms it is payable to the order or assigns of any person therein specified with reasonable certainty, or to him or his order, or when it is conspicuously designated on its face as 'exchange' or the like and names a payee. . . ." 70

2. Payable to "Bearer." Under the Code, an instrument is payable to bearer when by its terms it is payable to:

(a) bearer or the order of bearer, or
(b) a specified person or bearer, or
(c) "cash" or the order of "cash," or any other indication which does not purport to designate a specific payee. 80

The above language indicates clearly that an instrument payable "to the order of bearer" is bearer paper and not order paper. 81 It is also clear that under the Code if an instrument is payable "to the order of _______," there being no mark or other designation in the blank space, the instrument is simply incomplete and is not bearer paper. 82 The problem presented in Gordon v. Lansing State Savings Bank 83 however, remains unsolved. There the instrument was payable "to the order of _______." Since there appeared a line through the blank space, the court held that there was no implied authority to fill in, nor did the line represent an impersonal payee. Although it is believed that such an instrument is probably bearer paper under the Code, such a conclusion can only be justified by holding that the line through the blank space is "any other indication which does not purport to designate a specific payee." 84

79 Uniform Commercial Code § 3-110(1) (Spring 1951).
80 Id. § 3-111.
82 Uniform Commercial Code § 3-115 (Spring 1951) (incomplete instruments).
83 133 Mich. 143, 94 N. W. 741 (1903).
84 Uniform Commercial Code § 3-111(c) (Spring 1951).
G. Effect of Promise to Do Something in Addition To or in Lieu Of the Payment of Money

Section 3-112 of the Code states as follows:

(1) The negotiability of an instrument is not affected by
   (a) the omission of a statement of any consideration or of the place where the instrument is drawn or payable; or
   (b) a statement that collateral has been given for the instrument or in case of default on the instrument the collateral may be sold; or
   (c) a promise to give additional collateral on demand; or
   (d) a term authorizing a confession of judgment on the instrument if it is not paid when due; or
   (e) a term purporting to waive the benefit of any law intended for the advantage or protection of any obligor; or
   (f) a term in a draft providing that the payee by indorsing or cashing it acknowledges full satisfaction of an obligation of the maker or drawer.

Under present law, the negotiability of an otherwise negotiable instrument is not affected by a provision which gives the holder an election to require something to be done in lieu of the payment of money. Under the Code, however, such an instrument would not be negotiable. Since such a provision has been of importance only in connection with bonds and other investment securities, the matter is properly covered in Article Eight of the Code.

Subdivision (c) of Section 3-112, which permits a "promise to give additional collateral on demand," goes beyond the reasoning of the New York case of First National Bank of Bridgeport v. Blackman, and supports the inclu-

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85 NEGOTIABLE INSTRUMENTS LAW § 5; N. Y. NEG. INST. LAW § 24 (negotiability not affected by a provision which "Gives the holder an election to require something to be done in lieu of payment of money").
87 "An option to require something to be done in lieu of payment of money is uncommon and not desirable in commercial paper." UNIFORM COMMERCIAL CODE § 3-112, Comment (Spring 1950). See Cosway, Innovations in Articles Three and Four of the Uniform Commercial Code, 16 LAW & CONTEMP. PROB. 284, 286 (1951).
88 249 N. Y. 322, 164 N. E. 113 (1928).
sion in a note of a clause to give additional collateral "on demand" without limiting the right to make demand to cases where the collateral originally pledged depreciates in value. 89

H. Incomplete, Undelivered Instruments

The existing law concerning incomplete instruments may be stated briefly as follows: Where an instrument is signed and is delivered with blanks, i.e., lacking in any essential terms, if subsequently completed and negotiated to a holder in due course such instrument is "valid and effectual for all purposes," 90 even if it had been previously completed in excess of authority. Since there was an actual delivery of the instrument, there exists in favor of the holder in due course the conclusive presumption that it was filled in accordance with authority. 91 Similarly, if an instrument, complete and regular on its face, is stolen prior to delivery, in the hands of a holder in due course, a valid delivery is "conclusively presumed." 92 Of course, in this latter situation, the holder in due course would recover against the maker only if the paper was bearer paper, or, if order paper, only if it had been actually indorsed by the payee. Excepting the case of a forgery 93 of a necessary indorsement, the holder in due course recovers by virtue of the conclusive presumption of delivery of the completed instrument.

Although none of the above is changed under the Code, 94

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90 Negotiable Instruments Law § 14; N. Y. Neg. Inst. Law § 33.
93 Negotiable Instruments Law § 23; N. Y. Neg. Inst. Law § 42.
94 Uniform Commercial Code §§ 3-301 to 3-321 (Spring 1951) (incomplete instruments). Uniform Commercial Code §§ 3-305 (Spring 1951) (Rights of Holder in Due Course).
the Code does effect an extremely important change in a third situation, where the instrument is *neither complete nor delivered*. Under the existing law, “[w]hen an incomplete instrument has not been delivered it will not, if completed and negotiated without authority, be a valid contract in the hands of any holder, as against any person whose signature was placed thereon before delivery.” 95 Therefore, although either incompleteness or lack of delivery is a “personal” defense not assertable against a holder in due course, the presence of both factors constitutes a “real” defense assertable even against a holder in due course. This result is changed by the Code, and the holder in due course is protected in all three situations. 96 The comments to the Code explain that, since neither nondelivery nor unauthorized completion is a defense against a holder in due course, “. . . it has always been illogical that the two together should invalidate the instrument in his hands.” 97 It is stated that in each case the holder in due course relies on the maker’s signature, and the loss, under the Code, is made to fall upon the party whose conduct in signing blank paper has made the loss possible — rather than upon the holder in due course. This result is in harmony with the equitable principle that as between two innocent parties the loss should fall upon the one who made the loss possible.

Subdivision Two of Section 4-501 of Article Four on Bank Deposits and Collections, which is scheduled for inclusion in Article Three on Commercial Paper, 98 parallels the above provisions which protect a holder in due course and extends the same protection to banks. It provides:


96 “If the completion is unauthorized the rules as to material alteration apply (Section 3-407), even though the paper was not delivered by the maker or drawer. . . .” (emphasis supplied). UNIFORM COMMERCIAL CODE § 3-115(2) (Spring 1951). “A subsequent holder in due course may in all cases enforce the instrument according to its original tenor, and when an incomplete instrument has been completed, he may enforce it as completed.” Id. § 3-407(3).

97 UNIFORM COMMERCIAL CODE § 3-116, Comment 5 (Spring 1950).

98 See June 1951 Revision, Page 7.
A bank which in good faith makes payment to a holder may charge the indicated account of its customer according to
(a) the original tenor of his altered item; or
(b) the tenor of his completed item, even though the bank knew it was incomplete when delivered.

There is dicta in New York to the effect that if the drawer of a check signed in blank were to sue the drawee bank for restitution, in a case where the check had been stolen and completed, the drawer would not recover since the loss was presumably caused by the depositor's failure to exercise due care; such dicta is clearly in accord with the policy of the Code which affords the depositary bank maximum protection.

V. TRANSFER AND NEGOTIATION

A. Transfer of Instrument; Reacquisition

Section 3-201 of the Code, dealing with transfer and right to indorsement, brings together widely scattered provisions of the Negotiable Instruments Law. It contains three provisions:

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

(2) A transfer of a security interest in an instrument vests the foregoing rights in the transferee to the extent of the interest transferred.

(3) Unless otherwise agreed any transfer for value of an instrument not then payable to bearer gives the transferee the specifically enforceable right to have the unqualified indorsement of the transferor. Negotiation takes effect only when the indorsement is made and until that time there is no presumption that the transferee is the owner.

Pursuant to the above section, any person who transfers an instrument, whether or not a “holder,” transfers whatever rights he had therein, and such rights are acquired by the transferee even though they do not amount to the legally protected interest called “title.” Furthermore, the transfer of rights, to be effective, is not limited to transfers for value but would include an ordinary gift of the instrument.

The manifest clarity of the section can leave no doubt that, whereas value is not required to confer upon the transferee the “rights” of the transferor, value is required if the transferee is to possess the specifically enforceable power to have the unqualified indorsement of the transferor. By eliminating the ambiguity of the existing statute concerning the requirement for “value,” courts can no longer reach the aberrational result whereby the transferee of a negotiable instrument was not accorded the rudimentary rights possessed by any assignee of an assignable chose in action.

The derivative taker provision of the Negotiable Instruments Law, which assured a holder of negotiable paper a free market for the paper, is, under the Code, only one phase of a broader policy which would enable anyone to transfer whatever rights he may have.

Concerning the rights and status of a reacquirer, the Code clarifies a situation which is not covered by the Negotiable Instruments Law. For example, what is the answer to the following problem under the existing law? A payee fraudulently induced a maker to issue a note, and the payee negotiated the note to B who had in no way “participated” in the fraud, although he took with notice of the fraud of the payee. B then negotiated the instrument to H, a holder in due course, who thereafter negotiated the note back to B.

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100 Negotiable Instruments Law § 49; N.Y. Neg. Inst. Law § 79 states: “Where the holder of an instrument payable to his order transfers it for value without indorsing it, the transfer vests in the transferee such title as the transferrer had therein, and the transferee acquires, in addition, the right to have the indorsement of the transferrer.” (Italics added.) The Negotiable Instruments Law § 49 speaks of “transferor,” not “transferrer.”


102 Negotiable Instruments Law § 58; N.Y. Neg. Inst. Law § 97.
Does B under the Negotiable Instruments Law acquire the rights of H as a holder in due course? It is difficult indeed to say that B was a party to the fraud. The Code has specifically resolved the problem by the addition of the clause “... 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.” Under the Code, B does not succeed to the rights of the holder in due course.

B. Negotiation; Partial Assignment

The Code restates the existing law that an indorsement, to be effective for negotiation, must convey the entire instrument or any unpaid residue. Stemming from the premise that the obligation on an instrument is single and entire, it has been held that a transfer of part of the instrument is ineffective to create a cause of action in the partial transferee. However, the Code provides that if the indorsement “... purports to be of less it operates only as a partial assignment.” Although such an indorsement under the Code operates as a partial assignment of the cause of action, it does not attempt to state the legal effect of such an assignment. The effect of the partial or equitable assignment is a matter of local law.

C. Special Indorsement of Bearer Paper

Under the Negotiable Instruments Law, “[w]here an instrument, payable to bearer, is indorsed specially, it may nevertheless be further negotiated by delivery...” Con-

103 Ibid.
105 Uniform Commercial Code § 3-201(1) (Spring 1951) (italics added).
106 Id. § 3-202(3).
108 Uniform Commercial Code § 3-202(3) (Spring 1951).
109 See Offenstein v. Waggant, 89 Kan. 739, 132 Pac. 991 (1913); Dozier v. Leary, 196 N. C. 12, 144 S. E. 368 (1928); Edgar v. Haines, 109 Ohio St. 159, 141 N. E. 837 (1923); Restatement, Contracts § 156 (1932).
110 Negotiable Instruments Law § 40; N. Y. Neg. Inst. Law § 70.
siderable doubts have arisen as to the applicability of this section to an instrument drawn payable to order but subsequently indorsed in blank,—thus becoming "bearer" paper. Some have sought to resolve the conflict by suggesting that the instrument could be negotiated by delivery alone, notwithstanding the special indorsement, only if the instrument were initially bearer paper. The Code not only rejects the suggested solution, but also completely eliminates the pertinent provision of the Negotiable Instruments Law. Under the Code, the special indorsement controls in all cases and the instrument may be further negotiated only by the indorsement of the special indorsee.

D. Restrictive Indorsements

The difficulties created by the Negotiable Instruments Law in grouping in the same section as "restrictive indorsements" three substantially different types of indorsements are well known. The problem is further complicated by Section 47 of the Uniform Negotiable Instruments Law which provides that "[a]n instrument negotiable in its origin continues to be negotiable until it has been restrictively indorsed or discharged by payment or otherwise." The Code has eliminated this provision, and has completely abandoned the term "restrictive indorsements." It now properly classifies these various indorsements into two separate sections.

Section 3-205, dealing with a conditional indorsement or one prohibiting further transfer, states that "[n]either a

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113 Uniform Commercial Code § 3-204(1) (Spring 1951). "Any instrument specially indorsed becomes payable to the order of the special indorsee and may be further negotiated only by his indorsement."
conditional indorsement nor one purporting to prohibit further transfer of the instrument prevents its further transfer or negotiation, and the transferee may enforce payment in disregard of the limitation; but the indorsee and any other subsequent transferee except a collecting or payor bank takes the instrument or its proceeds subject to any rights of the indorser.” Hence, under the Code, an indorser has no power to alter the negotiable character of the original obligation, and the indorsement, “Pay to A only,” would be treated like any other conditional indorsement. Such indorsement is to be construed as if it read “Pay A on condition that he does not transfer.”  

Section 3-206 provides:

When an indorsement, whether blank or special, states that it is “for collection,” “for deposit,” or otherwise for the benefit or account or use of the indorser or of another person

(a) the first taker under that indorsement must apply any value given by him for or on the security of the instrument in the manner and to the person or account directed by the indorsement;

(b) to the extent that he does so he becomes a holder for value;

(c) later holders for value are not affected by the direction contained in the indorsement unless they have reasonable grounds to believe that a fiduciary has negotiated the instrument in breach of duty (Section 3-304(2)(b)).

The inherent difficulty in drafting legislation dealing with the foregoing indorsements is made evident by a comparison of Section 3-206 as it appeared in the spring 1950 draft of the Code with the spring 1951 provisions reproduced above.

Under the present section, the indorsee under this type of indorsement is bound to comply with the specific instructions contained in the indorsement. Subdivision (b), however, makes it clear that to the extent that such an indorsee applies “any value” on the instrument “he becomes a holder for value.” Hence, even a collecting agent could be a “holder for value” under such an indorsement if he advances money.

116 Uniform Commercial Code § 3-205, Comment 1 (Spring 1950).
and acquires a lien on the instrument without notice of any defect. To this extent the Code will change the result of decisions such as *Gulbranson-Dickinson Co. v. Hopkins.* Of course, the indorsee under any of the indorsements formerly denominated "restrictive" may now negotiate the instrument further. He remains personally liable, however, for any breach of the fiduciary relationship.

Subdivision (c) of Section 3-206 effects a major change in the existing law by freeing subsequent "holders for value" from the direction or instruction contained in the indorsement "... unless they have reasonable grounds to believe that a fiduciary has negotiated the instrument in breach of duty." Section 3-304(2)(b) declares that a purchaser has notice of a claim "... when he has reasonable grounds to believe that a fiduciary has negotiated the instrument in payment of or as security for his own debt or in any transaction for his own benefit or otherwise in breach of duty." It should be noticed, however, that knowledge that any person negotiating the instrument is or was a fiduciary does not, of itself, give a purchaser notice of a defense or claim.

VI. RIGHTS OF A HOLDER

A. Holder in Due Course

Section 3-302(1) of the Code describes the holder in due course as a holder who takes the instrument:

(a) for value; and

119 UNIFORM COMMERCIAL CODE § 3-303 (Spring 1951) (Taking for Value).
120 UNIFORM COMMERCIAL CODE § 3-304(5)(e) (Spring 1951).
121 Id. § 1-201(20). "'Holder' means a person who is in possession of a document of title or an instrument or an investment security drawn, issued or indorsed to him or to bearer or in blank." Cf. NEGOTIABLE INSTRUMENTS LAW § 191; N. Y. NEG. INST. LAW § 2. On the definitions of the Code, see Beutel, The Proposed Uniform Commercial Code as a Problem in Codification, 16 LAW & CONTEMP. PROB. 141, 145 et seq. (1951).
(b) in good faith including observance of the reasonable commercial standards of any business in which the holder may be engaged; and

(c) without notice that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person.

1. Value. The Code separates the section on "value" from that on "consideration." Section 3-303, dealing with value, leaves no doubt that the agreed consideration for the instrument shall not constitute "value" unless the consideration has been performed. Hence, an executory promise to give value is not of itself "value." The usual illustration is that of bank credit not drawn upon and which can be revoked or withdrawn when a claim or defense is asserted. The other subdivisions of Section 3-303 restate generally accepted principles concerning the requirement of "value" for due course holding.

2. Good faith. Since "good faith" under the Code means "honesty in fact in the conduct or transaction concerned," the language of Section 3-302(1)(b) indicates that more than the "honesty in fact" standard is required for due course holding. The provision envisages the formulation of a standard of good faith possessing an objective test of honesty and mercantile prudence. Pursuant to the Code standard, a holder cannot claim to have taken an instrument in "good faith" unless he has observed the reasonable commercial standards of the business in which he is engaged. To this extent, the Code changes the "actual bad faith" standard that is generally applied by the courts.

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122 Uniform Commercial Code § 3-303 (Spring 1951).
123 Id. § 3-408. See Note, Consideration in Negotiable Instruments Law; The Commercial Code Article III, Section 501, 57 Yale L. J. 1408 (1948).
125 Uniform Commercial Code § 1-201(19) (Spring 1951).
126 The Negotiable Instruments Law states simply: "That he took it in good faith and for value...." Negotiable Instruments Law § 52(3); N. Y. Neg. Inst. Law § 91(3).
127 Negotiable Instruments Law § 55; N. Y. Neg. Inst. Law § 95 ("actual knowledge" of infirmity or facts to constitute "bad faith"). See Bigelow, Bills, Notes and Checks 362 et seq. (1928). Cf. Fehr v. Campbell, 288 Pa. 549, 137 Atl. 113 (1927) (commercial bad faith); Gereta Corp. v. Wessex-Campbell Silk Co., 3 F. 2d 236 (2d Cir. 1924) ("commercially honest men").
3. **Overdue paper.** In order to make it clear that the purchaser of an instrument which is in fact overdue may, nevertheless, be a holder in due course, the Code changes the wording of the Negotiable Instruments Law from "... that he became the holder of it before it was overdue"\textsuperscript{128} to "... without notice that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person."\textsuperscript{129}

4. **Payee holder in due course.** A serious conflict of authority exists as to whether a payee may be a holder in due course under the Negotiable Instruments Law. The difficulty is primarily caused by subdivision four of Section 52 of the Uniform Negotiable Instruments Law;\textsuperscript{130} from its language there has been drawn the inference that the instrument must be "negotiated" to a holder in order to meet the requirements of due course holding. Although Professor Brannan has argued that such a construction does violence to the Negotiable Instruments Law, many courts have held that a payee cannot be a holder in due course.\textsuperscript{131} It is probably accurate to state that in New York a payee may be a holder in due course if he meets the requirements of due course holding.\textsuperscript{132} The Code eliminates the language of the Negotiable Instruments Law that the instrument must be

\textsuperscript{128} \textbf{NEGOTIABLE INSTRUMENTS LAW} § 52(2); \textbf{N. Y. NEG. INST. LAW} § 91(2).

\textsuperscript{129} \textbf{UNIFORM COMMERCIAL CODE} § 3-302(1)(c) (Spring 1951).

\textsuperscript{130} \textbf{NEGOTIABLE INSTRUMENTS LAW} § 52(4); \textbf{N. Y. NEG. INST. LAW} § 91(4).

\textsuperscript{131} \textbf{BRANNAN, NEGOTIABLE INSTRUMENTS LAW} 675 et seq. (7th ed., Beutel, 1948).

"negotiated" to a holder, and affirmatively declares: "A payee may be a holder in due course." 133

B. Notice to Purchaser

1. When instrument is "irregular." The Code section on notice is quite lengthy and deals with some of the more frequent and important problems that have come before the courts on the question of notice. The requirement that an instrument must be "complete and regular upon its face" 134 has been taken out of the Code section on holder in due course and now appears in the section on "notice." 135 It provides that the purchaser has notice of a claim or defense if "... the instrument is so incomplete, bears such visible evidence of forgery or alteration, or is otherwise so irregular as to call into question its validity, terms or ownership or to create an ambiguity as to the party to pay." 136 The Code adds, however, that knowledge "that an incomplete instrument has been completed" does not of itself give the purchaser notice of a defense or claim, unless he has "notice of any improper completion." 137

2. Notice that instrument is overdue. The Code provides that the purchaser has notice that an instrument is overdue if he has reasonable grounds to believe:

(a) that any part of the principal amount is overdue or that there is an uncured default in payment of another instrument of the same series; or

(b) that acceleration of the instrument has been made; or

(c) that he is taking a demand instrument after demand has been made or more than a reasonable length of time after its issue ... 138

The Code provision restates the majority view that a purchaser is not a holder in due course if he purchases with

133 Uniform Commercial Code § 3-302(2) (Spring 1951).
134 Negotiable Instruments Law § 52(1); N. Y. Neg. Inst. Law § 91(1).
135 Uniform Commercial Code § 3-304 (Spring 1951).
136 Id. § 3-304(1)(a).
137 Id. § 3-304(5)(d).
138 Id. § 3-304(4).
notice that an installment of principal is overdue.\textsuperscript{139} The Code, however, would change the law of many jurisdictions where the purchase of a note before it is overdue is not deemed a bad faith purchase by reason of notice of default in the payment of another note of the same series.\textsuperscript{140} The innovation of the Code consists of the distinction between a default and an un cured default. The inference is inescapable that if the default in the payment of another instrument of the same series has been cured, the purchaser may be a holder in due course. The Code codifies the majority rule that notice of a default in the payment of interest is insufficient to give the purchaser notice of a defense or claim.\textsuperscript{141}

Although the Code makes no general pronouncement on "reasonable length of time," and hence leaves unchanged the decisions that have applied the Negotiable Instruments Law provision,\textsuperscript{142} concerning domestic checks, it establishes the presumption that they are overdue after 30 days.\textsuperscript{143}

3. When notice effective. The section on notice expressly provides that, in order for the notice of a claim or defense to be effective, the notice "... must be received at such time and in such manner as to give reasonable opportunity to act on it."\textsuperscript{144} For example, notice to a bank manager would not be effective to prevent the bank from being a holder in due course if a moment thereafter the bank's teller cashed a check before the manager had reasonable time to notify the tellers.

4. Is standard of notice subjective or objective? Under the existing law, it is generally agreed that the standard for due course holding is simply that of "good faith." The test is said to be a subjective one, meaning simply the absence of

\textsuperscript{139} General Motors Acceptance Corp. v. Talbott, 39 Idaho 707, 230 Pac. 30 (1924); Hibbard v. Collins, 127 Me. 383, 143 Atl. 600 (1928).

\textsuperscript{140} Morgan v. Farmington Coal and Coke Co., 97 W. Va. 83, 124 S. E. 591 (1924).

\textsuperscript{141} Uniform Commercial Code § 3-304(5) (f) (Spring 1951).


\textsuperscript{143} Uniform Commercial Code § 3-304(4) (c) (Spring 1951).

\textsuperscript{144} Id. § 3-304(7).
actual bad faith, and not the objective standard of “due care.” The Code states that “good faith” means *honesty in fact* in the conduct or transaction concerned. For due course holding, however, it adds the necessity for the “... observance of the reasonable commercial standards of any business in which the holder may be engaged.” This must be read together with the definition of “notice” applicable to a purchaser or holder, which is stated to mean that “from all the facts and circumstances known to him at the time of purchase or taking he had reason to know.”

Although it is probably intended by the framers that the court is to inquire as to whether a particular commercial standard is reasonable, the definitions in the Code will still raise questions of fact for a jury.

The above definitions, together with the language of Section 3-304, that a purchaser has notice of a claim “when he has reasonable grounds to believe,” would seem to indicate that the Code seeks to establish an objective standard rather than a subjective test of honesty. One thing is clear. The Code provisions differ from the existing legislation and may therefore have the effect of introducing a commercially reasonably prudent man test into the law of negotiable instruments. By virtue of the retrogression evidenced by the Code in the segregation of merchants from non-merchants, the observations made concerning the objective standard of commercial honesty are limited to the professional business-

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146 *Uniform Commercial Code* § 1-201(19) (Spring 1951).
147 Id. § 3-302(1)(b).
148 Id. § 1-201(25).
149 *Uniform Commercial Code* § 1-201, Comment 18 (Spring 1950). The definition was changed in the 1951 draft. See *Uniform Commercial Code* § 3-302(1)(b) (Spring 1951).
150 *Negotiable Instruments Law* § 55; *N. Y. Neg. Inst. Law* § 95.
151 See Gerseta Corp. v. Wessex-Campbell Silk Co., 3 F. 2d 236, 238 (2d Cir. 1924). See also Fidelity and Deposit Co. v. Queens County Trust Co., 226 N. Y. 225, 123 N. E. 370 (1919). Some courts have already used the commercially honest man test as enunciated in the *Gerseta Corp.* case. See note 127 supra.
152 For example, Article Two on Sales has a separate definition for “good faith” in the case of merchants. For the merchant “good faith” includes “observance of reasonable commercial standards.” *Uniform Commercial Code* § 2-104 (Spring 1951). See also §§ 2-104(3), 2-103(8).
man. For the non-professional, the test of *honesty in fact* will probably continue to prevail.

C. Rights of Holder in Due Course

Section 3-305, dealing with the rights of a holder in due course, enumerates and codifies the generally accepted “real” defenses assertable against a holder in due course. The section states:

To the extent that a holder is a holder in due course he takes the instrument free from

1. all claims to it on the part of any person; and
2. all defenses of any party to the instrument with whom the holder has not dealt except
   (a) infancy, to the extent that it is a defense to a simple contract; and
   (b) such other incapacity, or duress, or illegality of the transaction, as renders the obligation of the party a nullity; and
   (c) such misrepresentation as has induced the party to sign the instrument with neither knowledge nor reasonable opportunity to obtain knowledge of its character or its essential terms; and
   (d) discharge in insolvency proceedings; and
   (e) any other discharge of which the holder has notice when he takes the instrument.

The Code substitutes “all claims to it on the part of any person” for the language “any defect of title of prior parties” of the present Negotiable Instruments Law to make it clear that the holder in due course takes the instrument free of not only any claim of title, but also of all liens, equities or other claims of any kind whatever. “All defenses” includes non-delivery or delivery for a special purpose. The foregoing defenses may, however, be asserted against one not a holder in due course. Hence, the defense of non-delivery

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153 Negotiable Instruments Law § 57; N. Y. Neg. Inst. Law § 96.
154 See notes 94, 96 supra.
155 Uniform Commercial Code § 3-306 (Spring 1951).
of an incomplete instrument would no longer be available against a holder in due course.\textsuperscript{156}

Subdivision (b) recognizes duress in the factum or in the execution,\textsuperscript{157} and defenses that may arise under gambling or usury statutes.\textsuperscript{158} Subdivision (c) codifies the rule followed by those well-reasoned cases which have recognized fraud in the execution as a real defense assertable against a holder in due course.\textsuperscript{159} The test under the Code is that the party was fraudulently induced to sign the instrument with neither knowledge nor reason able opportunity to obtain knowledge of its character or its essential terms. It is to be noticed that the defense would also be available to one who signed knowing that he signed a negotiable instrument, provided he had no knowledge of its essential terms. Hence, it is not limited to the cases of surreptitious substitution or the signing of an autograph or other signature specimen. The test is one of "excusable ignorance."\textsuperscript{160} Ignorance alone is not enough. The party asserting the defense must show that there was no reasonable opportunity to obtain knowledge. The comments to the Code make it perfectly clear that in determining this factual question all factors must be taken into account.\textsuperscript{161}

D. Rights of One Not a Holder in Due Course

1. Personal defenses. Unless a person has the rights of a holder in due course, all valid claims and defenses which would be available in an action on a simple contract, including want or failure of consideration, nonperformance of any

\textsuperscript{156} \textit{Negotiable Instruments Law} § 15; N. Y. Neg. Inst. Law § 34.

\textsuperscript{157} See Fairbanks v. Snow, 145 Mass. 153, 13 N. E. 596 (1887); Whitney, \textit{Bills and Notes} 117 (1948); \textit{Restatement, Contracts} § 494, illustration 2 (1932). See also Loomis v. Ruck, 56 N. Y. 462 (1874).


\textsuperscript{159} Bigelow, \textit{Bills, Notes and Checks} 403 et seq. (1928); Ogden, \textit{Negotiable Instruments} 344 et seq. (1947). "The Negotiable Instruments Law has no provision as to fraud in factum. Such fraud was a real defense at common law and is perhaps a real defense by the weight of present authority." \textit{Id.} at 346.

\textsuperscript{160} \textit{Uniform Commercial Code} § 3-305, Comment 7 (Spring 1950).

\textsuperscript{161} \textit{Ibid.} See Walker v. Ebert, 29 Wis. 194 (1871).
condition precedent, nondelivery or delivery for a special purpose, may be asserted against him in an action on a negotiable instrument. These matters, although firmly established under the Negotiable Instruments Law,\textsuperscript{162} are happily combined into one section in the Uniform Commercial Code.\textsuperscript{163}

2. \textit{Jus tertii}. At common law, considerable confusion existed in the law concerning the right of a party, who had no defense of his own, to set up as a defense an outstanding equity of ownership or other right of restitution of a third party who was not a party to the litigation. It seems to have been the weight of authority, both at common law and under the Negotiable Instruments Law, that a party to a negotiable instrument, when sued thereon, could not establish, in defense of the action, an equity of ownership or right of restitution in a third party who was not a party to the action.\textsuperscript{164} Furthermore, such party could not successfully defend by showing that the plaintiff acquired title in an illegal transaction.\textsuperscript{165} However, this latter view probably does not represent the New York view under the Negotiable Instruments Law and New York Penal Law.\textsuperscript{166} One New York court held that the provisions of the Penal Law declaring that gambling contracts "shall be utterly void" renders the indorsement void, and hence whatever interest in the instrument passed to the plaintiff was insufficient to permit him to sue thereon.\textsuperscript{167}

\textsuperscript{162}Negotiable Instruments Law §§ 28, 58; N. Y. Neg. Inst. Law §§ 54, 98.
\textsuperscript{163}Uniform Commercial Code § 3-306 (Spring 1951).
\textsuperscript{164}See Bowles v. Oakman, 246 Mich. 674, 225 N. W. 613 (1929); Baird v. Lorenz, 57 N. D. 804, 224 N. W. 206 (1929); Brown v. Penfield, 36 N. Y. 473 (1867); Fehr v. Campbell, 288 Pa. 549, 137 Atl. 113 (1927); cf. Hays v. Hathorn, 74 N. Y. 486 (1878). See also Britton, Bills and Notes 759 et seq. (1943).
\textsuperscript{166}N. Y. Penal Law §§ 991-993; see Hurley v. Union Trust Co., 244 App. Div. 590, 280 N. Y. Supp. 474 (3d Dep't 1935); Hays v. Hathorn, 74 N. Y. 486 (1878).
\textsuperscript{167}Hurley v. Union Trust Co., 244 App. Div. 590, 280 N. Y. Supp. 474 (3d Dep't 1935). "If defendant's [drawer of checks] version of the facts is true, [that plaintiff acquired checks in gambling transaction with the payee, Dicks]
In the case of a plaintiff who acquired the instrument by theft, neither at common law nor under the Negotiable Instruments Law, would the courts permit such a recovery.\textsuperscript{168} In such cases, the courts have permitted the defendant to assert the \textit{jus tertii} of the third party from whom the instrument had been stolen. Of course, if the plaintiff is a holder in due course of bearer paper stolen by a thief, under the Negotiable Instruments Law he would hold the instrument "free from any defect of title of prior parties,"\textsuperscript{169} and under the Code would take free from "all claims to it on the part of any person."\textsuperscript{170}

The unsettled \textit{jus tertii} problems discussed above are resolved as follows by the Code:

Unless a person has the rights of a holder in due course, he takes the instrument subject to:

\ldots the defense that the plaintiff or a person through whom he holds the instrument acquired it by theft. The claim of any third person to the instrument is not otherwise available as a defense to any party liable thereon unless the third person himself defends the action for such party.\textsuperscript{171}

If this latter provision were to prevail over the strong public policy announced in the applicable sections of the Penal Law, it would effect a change in the New York law insofar as it would categorically eliminate \textit{jus tertii} as a defense unless the third party himself chooses to become a litigant and defend the action.

The one exception to the above policy as enunciated in the Code is found in the case of a theft of the instrument. In such case, the thief will not be aided directly or indirectly. Hence, even the transferee from the thief will not prevail unless he has the rights of a holder in due course.

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the transactions between plaintiff and Dicks were unlawful, and the attempt to pass title thereby was a nullity."\textsuperscript{168}

\textsuperscript{168} Britton, Bills and Notes 765 (1943); Chafee, Rights in Overdue Paper, 31 Harv. L. Rev. 1104, 1112-1119 (1918).

\textsuperscript{169} Negotiable Instruments Law § 57; N. Y. Neg. Inst. Law § 96.

\textsuperscript{170} Uniform Commercial Code § 3-305(1) (Spring 1951).

\textsuperscript{171} Id. § 3-306(d).
E. Matters of Evidence and Pleading

The Code provides that unless a signature is specifically denied in the pleadings it is deemed admitted. This provision would change the New York law and would make a general denial ineffective to raise the issue of the genuineness of a signature. The specific denial may be on information and belief or it may be a denial of knowledge or information sufficient to form a belief.

When a signature is put in issue, the "burden of establishing" it is on the party claiming under the signature. However, the Code establishes the "presumption" that a signature is genuine or authorized "... except where the action is to enforce the obligation of a purported signer who has died or become incompetent before proof is required." Once signatures are admitted or proven, a holder makes out his case simply by the production of the instrument, and must recover in the absence of any defense. The defendant has the burden of establishing all defenses by a preponderance of the evidence.

Further innovations effected by the Code may be summarized as follows:

At the trial of a cause on a negotiable instrument, the issue as to whether a holder is a holder in due course does not arise until evidence of a defense has been introduced. If the defendant introduces evidence of a defense, the plaintiff may elect to "cut off" the defense by establishing either that he is a holder in due course or that he has acquired the rights of a prior holder in due course. On this issue the holder has the burden of proof by a preponderance of the evidence

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172 Id. § 3-307(1).
174 Uniform Commercial Code § 1-201(8) (Spring 1951). ("... means the burden of persuading the triers of fact that the existence of the fact is more probable than its non-existence.")
175 Id. § 3-307(1)(a).
176 Id. § 1-201(31). ("'Presumption' or 'presumed' means that the trier of fact must find the existence of the fact presumed unless and until evidence is introduced which would support a finding of its non-existence.")
177 Id. § 3-307(1)(b).
178 Id. § 3-201(1).
on all of the essential elements of due course holding.\textsuperscript{179} Of course, as a matter of trial practice, the plaintiff may elect not to introduce evidence regarding his status as a holder in due course and may stand or fall on the issue of the defense. If the evidence is not such as to justify the direction of a verdict, the issue of the defense will go to the jury. Therefore, a holder who might have difficulty establishing his due course holding is likely to concentrate on disproving the defendant's defense. Obviously, the plaintiff will lose in any event if the defendant succeeds in establishing a "real" defense.\textsuperscript{180}

VII. LIABILITY OF PARTIES

A. Signature

Although nothing in the Code is intended to prevent any liability that may arise apart from the instrument, the Code retains the language of the Negotiable Instruments Law that "[n]o person is liable on an instrument unless his signature appears thereon."\textsuperscript{181} The Code eliminates the two exceptions to the above provisions that were found in the Negotiable Instruments Law, \textit{viz.}, acceptance by separate instrument,\textsuperscript{182} and a promise to accept.\textsuperscript{183}

Regarding signatures, the Code restates the existing law that "[a] signature is made by use of any name, including any trade or assumed name, upon an instrument, or by any word or mark used in lieu of a written signature."\textsuperscript{184} Nowhere does the Code require that an instrument be "subscribed."

Regarding a signature in an ambiguous capacity, the Code codifies the existing law that "[u]nless the instrument

\begin{itemize}
\item \textsuperscript{179} Id. § 3-302; see Uniform Commercial Code § 3-307, Comment 3 (Spring 1950); Kelso v. Ellis, 224 N. Y. 528, 121 N. E. 364 (1918).
\item \textsuperscript{180} Uniform Commercial Code § 3-305(2) (Spring 1951).
\item \textsuperscript{181} Id. § 3-401(1); Negotiable Instruments Law § 18; N. Y. Neg. Inst. Law § 37.
\item \textsuperscript{182} Negotiable Instruments Law § 134; N. Y. Neg. Inst. Law § 222.
\item \textsuperscript{183} In view of the commercial fact that the "virtual" and "collateral" acceptances are now almost entirely obsolete, they were properly omitted from the Code. See Report of the Committee on the Proposed Commercial Code, Section of Corporation, Banking and Business Law, A.B.A. Proceedings 205, 209 (1950); 6 The Business Lawyer 123 (May 1951).
\item \textsuperscript{184} Uniform Commercial Code § 3-401(2) (Spring 1951).
\end{itemize}
clearly indicates that a signature is made in some other capacity it is an indorsement.”

B. Signature by Authorized Representative

The Code eliminates the Negotiable Instruments Law section dealing with signature “by procuration.” The latter provision had been based upon the English practice which put a third party on notice that the agent was acting under a power of attorney. This meaning of the expression “per procuration” was almost unknown in the United States where it has meant simply that the signer was acting as agent.

Under a minority New York rule, where an authorized agent orally discloses his principal and signs “Albert Andrews, agent,” in order to escape personal liability, in an action by one not a holder in due course, the agent may show by parol that he had orally disclosed the name of his principal. Under the Code, the New York rule would be changed and would be made to conform with the generally accepted standard of liability of an agent who signs negotiable paper. The Code provides:

(2) An authorized representative who signs his own name to an instrument is also personally obligated unless the instrument names the person represented and shows that the signature is made in a representative capacity. The name of an organization preceded or followed by the name and office of an authorized individual is a signature made in a representative capacity.

Whereas in New York, in an action by one not a holder in due course, although “agent” or a similar word is now sufficient to permit the agent to introduce evidence that he in fact orally disclosed the name of the principal, under the

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185 Id. § 3-402 (italics added); Negotiable Instruments Law § 17(6); N. Y. Neg. Inst. Law § 36(6).
186 Negotiable Instruments Law § 21; N. Y. Neg. Inst. Law § 40.
187 Megowan v. Peterson, 173 N. Y. 1, 65 N. E. 738 (1902); Whitney, Bills and Notes 19 (1948).
188 Uniform Commercial Code § 3-403(2) (Spring 1951) (italics added).
Code the word "agent," without disclosing the principal on the instrument, would be insufficient. No distinction is made between a plaintiff who is a holder in due course and an action by any other party.\textsuperscript{189}

C. Unauthorized Signatures

The Code states the generally accepted rule that an unauthorized signature, like a forgery, is wholly inoperative unless adopted or ratified. It is effective solely to impose liability on the actual signer who is not liable in damages for breach of warranty of authority, but on the instrument in the capacity in which he signed.\textsuperscript{190}

D. Fictitious Payees and Impostors

1. Fictitious payees. Under the Negotiable Instruments Law, an instrument is payable to bearer “[w]hen it is payable to the order of a fictitious or non-existing person, and such fact was known to the person making it so payable.” \textsuperscript{191} The Code has reworded the above section and has included much-needed provisions to cope with the “impostor” cases.\textsuperscript{192}

Section 3-405 of the Code provides that an indorsement by any person in the name of a named payee is effective if:

(a) an impostor by use of 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 intends the payee to have no interest in the instrument;

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

\textsuperscript{189} Uniform Commercial Code § 3-403, Comment 3 (Spring 1950).
\textsuperscript{190} Uniform Commercial Code § 3-404 (Spring 1951); Negotiable Instruments Law § 23; N. Y. Neg. Inst. Law § 42.
\textsuperscript{191} Negotiable Instruments Law § 9(3); N. Y. Neg. Inst. Law § 28(3).
The result of the Code provisions is to give effect to an indorsement made in the name of the payee by any of the persons specified in the section and thereby to protect a holder in due course or a good faith payor. This is accomplished by treating the indorsement as a valid negotiation, and not by treating the paper as "bearer" paper. This, of course, changes the existing law, because under the Code approach, subsequent indorsements are not dispensed with if necessary for negotiation.

2. *Impostors.* In cases where an impostor induces a maker of a note or a drawer of a check to issue an instrument payable to the impostor in the name of an existing or non-existing person, it is the policy of the Code that the instrument is *in fact payable to the impostor* under an assumed name. Hence, he may effectively indorse in that name.

The courts have tried to solve the various impostor cases by ascertaining the "dominant" intent of the drawer. In face to face transactions, generally, the dominant intent has been said to be to name the person, while in dealing by mail the dominant intent has been held to be to deal with the name rather than with the person. ¹⁹³

The Code rejects the distinction as being unreal inasmuch as the two intentions cannot be separated, since the maker or drawer really intends the two to be the one and the same person. Hence, the indorsement of the impostor is effective whether the transaction has been face to face or through the mails. This would change the result of a decision such as *Mercantile National Bank v. Silverman.* ¹⁹⁴ Again, by the application of an equitable principle the loss is made to fall on the maker or drawer and not upon the holder in due course or good faith payor. ¹⁹⁵ The Code section properly adds that nothing in the impostor section affects the criminal or civil liability of the person so indorsing. ¹⁹⁶

¹⁹³ Ibid.
¹⁹⁵ Uniform Commercial Code § 3-405(1) (Spring 1951).
¹⁹⁶ Id. § 3-405(2).
E. Alteration: Negligence Contributing to Alteration or Unauthorized Signature

It is the law of New York that the maker of a note is not bound to draw the note in such a manner as to prevent a material alteration of the instrument. Hence, even if the instrument was so drawn as to have facilitated a material alteration, the holder in due course can only recover according to the original tenor. However, if a depositor draws a check in such manner as to facilitate alteration, he will be denied recovery in an action against the drawee bank for funds debited on his account. This distinction is predicated on the basis of a duty of care owing from the depositor to the drawee-bank.

The distinction found in the New York decisions is abolished by the Code. The Code adopts the reasoning of Young v. Grote, which held that a drawer of an instrument so negligently drawn as to facilitate its material alteration is liable to the drawee who pays the altered instrument in good faith.

Under the rules governing material alteration, the holder in due course may enforce the altered instrument according to its original tenor. However, where the negligence of the maker or drawer "substantially contributes" to the alteration, or the making of an unauthorized signature, the Code provides that such person is "... precluded from asserting the alteration or lack of authority against a holder in due course or a drawee or other payor who pays the instrument in good faith and in accordance with the reasonable commercial standards of the drawee's or payor's business." This

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197 National Exchange Bank v. Lester, 194 N. Y. 461, 87 N. E. 779 (1909); NEGOTIABLE INSTRUMENTS LAW § 124; N. Y. NEG. INST. LAW § 205.
200 UNIFORM COMMERCIAL CODE § 3-407 (SPRING 1951); NEGOTIABLE INSTRUMENTS LAW § 124; N. Y. NEG. INST. LAW § 205.
201 UNIFORM COMMERCIAL CODE § 3-406 (SPRING 1951).
section will overturn the reasoning of the *Lester* case, and would apply the special protection now afforded only to banks to all holders in due course or good faith payors. The Code section also applies to negligence which "substantially contributes" to a forgery or other unauthorized signature, as in the case where a drawer who makes use of a signature stamp is negligent in guarding such stamp, and to negligence contributing to a forgery of the signature of another, as in a case where a check is negligently mailed to the wrong person having the same name as the payee.

**F. Acceptance**

1. **Generally.** The Code eliminates the sections of the Negotiable Instruments Law dealing with acceptance for honor and the sections dealing with acceptance by separate instrument and the promise to accept.

2. **Acceptor’s liability on altered draft.** In New York, as in the majority of states, where a draft has been altered before acceptance, and the drawee accepts the draft in its altered form without knowledge that it had been altered, the acceptor is not held liable on the instrument as altered. The acceptor or certifying bank is liable only according to the original tenor, and, if payment is made before discovery of the alteration, such payor can recover the surplus from any holder to whom payment was made. If the alteration consisted in the substitution of a new payee for the original payee, the drawee bank can recover the amount so paid from a bona fide holder for value. In Illinois and California,

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202 See note 197 supra.
205 *Negotiable Instruments Law* § 134; *N. Y. Neg. Inst. Law* § 222.
206 *Negotiable Instruments Law* § 135; *N. Y. Neg. Inst. Law* § 223.
208 *Interstate Trust Co. v. United States Nat. Bank*, 67 Colo. 6, 185 Pac. 260 (1919).
under the Negotiable Instruments Law, the courts held that the certifying bank could not recover from the holder to whom it made payment on an altered check.\textsuperscript{209} In cases involving a holder in due course, the Code rejects the New York view, and adopts the Illinois and California view, upon the reasoning that the acceptance is an undertaking relied upon in good faith by an innocent party.\textsuperscript{210} Furthermore, the attempt to avoid the above responsibility by certifying checks or by accepting drafts "payable as originally drawn" is ineffective to defeat the rights of a subsequent holder in due course.\textsuperscript{211} It should be noticed, however, that, under the Code, a person obtaining an acceptance warrants that the instrument has not been altered before acceptance. Hence, the Code continues the rule which permits a party paying a materially altered instrument in good faith to recover, and a party who accepts such instrument to avoid his acceptance. The exception which changes the New York rule applies only to a holder in due course who has taken the instrument subsequent to the alteration.\textsuperscript{212}

3. Certification of a check. Under the Negotiable Instruments Law, where the holder of a check procures it to be accepted or certified, the drawer and all indorsers are discharged from liability.\textsuperscript{213} The negative implication is clear from the language of the Negotiable Instruments Law, and the courts have held that the certification of a check at the request of the drawer does not operate to discharge either the drawer or the indorsers.\textsuperscript{214}

Whereas the 1950 draft of the Code removed the negative implication by providing that certification discharged

\textsuperscript{210} \textit{Uniform Commercial Code} § 3-417 (Spring 1951) (Warranties on Presentment and Transfer).
\textsuperscript{211} \textit{Id.} § 3-417(b).
\textsuperscript{212} \textit{Ibid.}
\textsuperscript{213} \textit{Negotiable Instruments Law} § 189; N. Y. Neg. Inst. Law § 324.
all prior liability on a check (except that of a drawer who had also indorsed), the 1951 draft reverts to the existing law and provides that "[w]here a holder procures certification the drawer and all prior indorsers are discharged." The Code also codifies existing law by providing that "[u]nless otherwise agreed a bank has no obligation to certify a check." 216

4. "Qualified" acceptance. The Code eliminates the terminology "qualified" acceptance and substitutes the phrase, "Acceptance Varying Draft." It provides:

   (1) Where the drawee's proffered acceptance in any manner varies the draft as presented the holder may refuse the acceptance and treat the draft as dishonored in which case the drawee is entitled to have his acceptance cancelled.

   (2) Where the holder assents to such an acceptance each drawer and indorser who does not affirmatively assent is discharged except where the variance is that payment shall be made only at a particular place.217

Under the Negotiable Instruments Law, when a drawer or indorser received notice of a "qualified" acceptance, within a reasonable time he had to express his dissent to the holder or he would have been deemed to have assented thereto. This is changed by the provision of the Code pursuant to which, if a drawer or indorser does not affirmatively assent to the acceptance which varies the draft, he will be discharged.218

VIII. MISCELLANEOUS PROVISIONS

A. Presentment, Notice of Dishonor and Protest

The Code eliminates the requirement of protest except upon dishonor of a draft which on its face appears to be drawn or payable outside of the United States. Concerning

215 UNIFORM COMMERCIAL CODE § 3-411(1) (Spring 1951) (italics added).
216 Id. § 3-411(2). Watchel v. Rosen, 249 N. Y. 386, 164 N. E. 326 (1928).
217 Id. § 3-412.
218 NEGOTIABLE INSTRUMENTS LAW § 142; N. Y. NEG. INST. LAW § 230.
219 UNIFORM COMMERCIAL CODE § 3-412(2) (Spring 1951).
220 Id. § 3-501(3). See when protest is excused. Id. § 3-511.
presentment, it eliminates the technical requirement of exhibition of the instrument and provides that presentment is sufficient if made by mail or through a clearing house.

Whereas the 1950 draft of the Code sought to effect a revolutionary change by the elimination of the requirement of presentment and notice of dishonor in order to charge the indorser of a note, the 1951 draft retains both requirements, unless excused, in order to charge any indorser.

B. Discharge

The Negotiable Instruments Law speaks of the discharge of a negotiable instrument. Since this created uncertainties concerning the rights of a subsequent holder in due course, the language of the Negotiable Instruments Law is eliminated and the Code distinguishes between the discharge of a single party and the discharge of all parties. The Code expressly provides that "[n]o discharge of any party provided by this Article is effective against a subsequent holder in due course unless he has notice thereof when he takes the instrument." 226

The Negotiable Instruments Law provides that "[p]ayment 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." 227 This approach is entirely changed by the Code which substitutes a new provision entitled "Payment or Satisfaction." It provides:

(1) The liability of any party is discharged to the extent of his payment or satisfaction to the holder even though it is made with knowledge of a claim of another person to the instrument unless prior to such payment or satisfaction the person making the claim either supplies indemnity deemed adequate by the party seeking the dis-

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221 Negotiable Instruments Law § 142; N. Y. Neg. Inst. Law § 230.
222 Uniform Commercial Code § 3-504(2) (a) (Spring 1951). These subsections are to be rearranged. See June 1951 Revision, Page 7.
223 Uniform Commercial Code §§ 3-501(1) (b), 3-501(2) (a) (Spring 1951).
225 Uniform Commercial Code § 3-601 (Spring 1951).
226 Id. § 3-602.
charge or enjoins payment or satisfaction by order of a court of com-
petent jurisdiction in an action in which the adverse claimant and the
holder are parties.228

IX. CONCLUSIONS

The far-reaching effects and ramifications of a codifica-
tion which has been accurately referred to as "of the greatest
importance in the history of American law" 229 cannot be
completely discussed or even presented in a single article or
symposium.

Surely an article on the law of negotiable instruments
could have profitably treated sections such as 3-702, dealing
with the effect of a negotiable instrument on the obligation
for which it was given, Section 3-703, dealing with the tech-
nique of vouching in a third party 230 who is or may be liable
on the instrument, Section 3-704, dealing with lost, destroyed
or stolen instruments,231 and many other important and in-
teresting sections. Nevertheless, in this article an effort has
been made to present some of the more important changes
and codifications that would be effected by the adoption of
the Code. Not only does the Code resolve existing doubts
and conflicts of authority, but also makes a major contribu-
tion by legislating in many fields where the present statute
law is silent.232

228 Uniform Commercial Code § 3-603(1) (Spring 1951).
229 Franklin, On the Legal Method of the Uniform Commercial Code, 16 Law
231 See id. § 333.
232 See Emblidge, Commercial Paper Under the Proposed Uniform Code,
23 N. Y. State Bar Bull. 371, 373 (1951); Report, Corporation, Banking and
Business Law Section (A.B.A.) on the Proposed Uniform Commercial Code,
Sept. 1951; Schnader, The New Commercial Code: Modernizing Our Uniform