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## PROBLEMS WITH THE 1990 REVISION OF ARTICLES 3 AND 4 OF THE UNIFORM COMMERCIAL CODE

*D. Fenton Adams\**

In 1990 the sponsors of the Uniform Commercial Code<sup>1</sup> approved a completely rewritten Article 3<sup>2</sup> and a substantially amended Article 4,<sup>3</sup> along with some conforming amendments to Article 1. The officially stated purposes of the revisions were “to accommodate . . . changing [business] practices and modern technologies, the needs of a rapidly expanding national and international economy, the requirement for more rapid funds availability, and the need for more clarity and certainty.”<sup>4</sup> Other motivations were apparently at work as well: a desire to eliminate any suggestion of gender bias in the statutory language<sup>5</sup> and indulgence of the revisers’ stylistic

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1. The sponsors were the American Law Institute and the National Conference of Commissioners on Uniform State Laws.

2. Article 3 was captioned “Commercial Paper” in the previous text. U.C.C. § 3-101 (1989). It is titled “Negotiable Instruments” in the revision. U.C.C. § 3-101 (1990).

3. Article 4 is captioned “Bank Deposits and Collections” in both versions. U.C.C. § 4-101 (1989); U.C.C. § 4-101 (1990). The 1990 revisions of Articles 3 and 4 had been adopted in 26 states by the Spring of 1993. U.C.C. *Committee Update*, 1992 A.B.A. BUS. L. SEC. 14-15 (June 1993). The changes were made in Arkansas in 1991. Act of Mar. 15, 1991, No. 572, § 5, 1991 Ark. Acts 572 (codified at ARK. CODE ANN. §§ 4-3-101 to 4-4-111 (Michie 1991)).

4. AMERICAN LAW INSTITUTE & NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS, UNIFORM COMMERCIAL CODE, Prefatory Note to Article 3 (1990).

5. The use of the pronoun “he” and its variants as referring to a person of either sex, common in the former versions of Articles 3 and 4, has been eliminated from the revisions. For example, § 3-203 of the previous text read as follows:

Where an instrument is made payable to a person under a misspelled name or one other than his own he may indorse in that name or his own or both; but signature in both names may be required by a person paying or giving value for the instrument.

U.C.C. § 3-203 (1989). In the revision, the subsection dealing with the same problem reads:

If an instrument is payable to a holder under a name that is not the name of the holder, indorsement may be made by the holder in the name stated in the instrument or in the holder’s name or both, but signature in both names may be required by a person paying or taking the instrument for value or collection.

U.C.C. § 3-204(d) (1990). While the wording of the revision appears to differ from the former version partly to effect a slight change in the substance of the rule, the major objective of the revision appears to have been to substitute for “he” and “his” the gender-neutral noun “holder” and its possessive. The substitutions cannot be said to do much for the elegance of the prose, but all suggestion of sexual preference has been rooted out.

tastes.<sup>6</sup>

The result, particularly in Article 3, has been to raise many new problems of interpretation. Variations in language between the former version of the official text and the new version may or may not reflect intended changes in the substance of the law, but the purposes of the new wording are not always clear. Even where a change in the legal rule seems clearly signaled, its scope or reason may not be apparent, raising questions of the correct application of the new rule or perhaps arousing suspicion whether a change in substance really is intended.

The drafters of the revision encourage readers to rely on the revised official comments for answers to such questions.<sup>7</sup> These comments do explain some intended changes, but they fall well short of explaining all of the discrepancies between the two official texts. Additional enlightenment, the draftsmen have suggested, may be found by comparing the official comments of the old and new versions, for the draftsmen contend that all of the former comments which are still pertinent have been carried forward to the comments on the revised text, at least in substance.<sup>8</sup> It may therefore be assumed, presumably, that if the official comments to the revision do not echo the former comments on any particular point, the law with which those comments dealt has been changed.

Notwithstanding these guides to correct interpretation, this writer has encountered a number of areas of uncertainty with regard to the effect of the 1990 revisions of Articles 3 and 4 on the law of negotiable instruments and bank deposits and collections. Some of these problems are discussed below.

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6. A notable example of this is the conversion of section subdivision designations from numbers to letters to designate subsections and from letters to numbers for subsection divisions. Thus, for example, § 3-104(1)(a) of the 1989 Official Text has become § 3-104(a)(1) in the 1990 Official Text. Since these changes have been made only in Articles 3 and 4, they have produced an inconsistency of style within the code. Article 4A, an Article added to the Official Text in 1989, conforms, in this respect, to the revised versions of Articles 3 and 4. However, Article 2A, added in 1987, does not.

Some of the new language has been motivated by a desire to replace what was considered archaic usage. See Robert L. Jordan & William D. Warren, *Introduction, Symposium: Revised U.C.C. Articles 3 & 4 and New Article 4A*, 42 ALA. L. REV. 373, 385 (1991). Professors Jordan and Warren, of the UCLA School of Law, were the reporters for the revision project. *Id.* at 373.

7. See Jordan & Warren, *supra* note 6, at 386.

8. Jordan & Warren, *supra* note 6, at 386. See also *Continuation of Discussion of Uniform Commercial Code, Articles 3 and 4*, 67 A.L.I. PROC. 452 (1990) (presenting statement by Professor Robert Jordan, reporter).

## I. DELIVERY

Under the former version of Article 3, it was assumed that contractual liability on a negotiable instrument depended not only on the contracting party's signing of the instrument but also on his or her delivery of it. Section 3-306, in listing defenses to which a taker of an instrument who did not have the rights of a holder in due course would be subject, included "the defenses of . . . non-performance of any condition precedent, nondelivery, or delivery for a special purpose."<sup>9</sup> The section did not say what parties could use these defenses, but the official comments indicated that any signer of a negotiable instrument could,<sup>10</sup> although acceptors were subject to a special rule that permitted a notification to serve as a substitute for delivery.<sup>11</sup>

Revised Article 3 appears to limit nondelivery and conditional delivery defenses to makers, drawers, and acceptors of negotiable instruments. As to makers and drawers, revised section 3-105, which deals with "Issue of Instrument", defines "issue" in subsection (a) as "the first delivery of an instrument by the maker or drawer . . ."<sup>12</sup> The next subsection provides:

An unissued instrument, or an unissued incomplete instrument that is completed, is binding on the maker or drawer, but non-issuance is a defense. An instrument that is conditionally issued or is issued for a special purpose is binding on the maker or drawer, but failure of the condition or special purpose to be fulfilled is a defense.<sup>13</sup>

With regard to acceptors, the section defining "acceptance"<sup>14</sup> provides that "[a]cceptance . . . becomes effective when notification pursuant to instructions is given or the accepted draft is delivered for the purpose of giving rights on the acceptance to any person."<sup>15</sup> This appears to preserve the nondelivery (and perhaps the conditional

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9. U.C.C. § 3-306(c) (1989).

10. *See id.* § 3-410 cmt. 5 (referring to "the usual rule that no obligation on an instrument is effective until delivery."). The doctrine is long standing. The Uniform Negotiable Instruments Law, predecessor of Article 3 of the U.C.C., provided in § 16 that "[e]very contract on a negotiable instrument is incomplete and revocable until delivery of the instrument for the purpose of giving effect thereto." *See also* WILLIAM E. BRITTON, HANDBOOK ON THE LAW OF BILLS AND NOTES § 50 (2d ed. 1961).

11. U.C.C. § 3-410(1) (1989).

12. U.C.C. § 3-105(a) (1990).

13. *Id.* § 3-105(b).

14. *Id.* § 3-409.

15. *Id.* § 3-409(a).

delivery) defense in much the same modified form as the previous version of Article 3.<sup>16</sup>

In dealing with the obligations of indorsers, however, the text of revised Article 3 contains no hint that delivery is necessary to make an indorser's obligation effective or that the indorser may use defenses of nondelivery and conditional delivery. The comments suggest that the defenses are not available to an indorser, for a comment to section 3-305,<sup>17</sup> discussing defenses that are "cut off by a holder in due course," makes no mention of delivery related defenses other than "nonissuance of the instrument, conditional issuance, and issuance for a special purpose."<sup>18</sup>

Is one to conclude that there is no delivery requirement applicable to the obligations of indorsers under revised Article 3? The best one can say in defense of continuance of the requirement is that neither the text nor the comments of the revision say that the old rule has been abandoned. It might be regarded as a matter on which the text of the revision is silent, opening the door to importation of the traditional rule by resort to the law merchant by authority of section 1-103;<sup>19</sup> however, the very fact that the revision explicitly recognizes delivery requirements for the obligations of makers, drawers, and acceptors argues for treating the silence of the text as to the obligations of indorsers as carrying a negative implication. Moreover, the former comment that "no obligation on an instrument is effective until delivery"<sup>20</sup> is not included in the comments of the revision.<sup>21</sup>

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16. See *supra* text accompanying note 11.

17. U.C.C. § 3-305 cmt. 2 (1990).

18. *Id.* This comment does not even acknowledge that an acceptor could have a defense of this nature. However, the provision in revised § 3-409 that acceptance "becomes effective" when notification is given or when the instrument is delivered, would be meaningless unless the acceptor would have a defense based on the lack of notification or delivery, which would at least be valid against one who did not have the rights of a holder in due course. U.C.C. § 3-409 (1990).

The defenses of nondelivery and conditional delivery were "personal defenses," defenses to which holders in due course are generally immune under former Article 3. Compare U.C.C. § 3-306(c) (1989) with § 3-305(2) (1989). They appear to be personal defenses under revised Article 3 as well, insofar as the obligations of makers and drawers are concerned and are probably so as to the obligations of acceptors. See U.C.C. § 3-305 cmt. 2 (1990). Compare *id.* § 3-305(a) with § 3-305(b).

19. U.C.C. § 1-103 (1990) states: "Unless displaced by the particular provisions of this Act, the principles of law and equity, including the law merchant . . . shall supplement its provisions." This section was not changed in the 1990 Official Text. Cf. U.C.C. § 1-103 (1989).

20. See *supra* note 10.

21. See *supra* text accompanying note 8.

A possible alternative solution would be to reason that the explicit rules regarding delivery by makers, drawers, and acceptors reflect an underlying policy that delivery is normally a requirement for an effective contract on a negotiable instrument. The implication is that the requirement applies to indorsers as well by reliance on the injunction of section 1-102(1) that "[t]his Act shall be liberally construed and applied to promote its underlying purposes and policies."<sup>22</sup> Is there such an underlying policy, however? The elimination from the comments of the statement to that effect<sup>23</sup> argues against it.

## II. VALUE

One of the traditional requirements for "holder in due course" status has been that the candidate have taken the instrument "for value." This was true under the former version of Article 3,<sup>24</sup> and it remains true under the revision.<sup>25</sup> The concept of value has required definition, and the definition in revised Article 3 differs from that of its predecessor. The difference raises a startling question of whether a payment of cash for an instrument qualifies as value. Suppose, for example, that a bank cashes a check drawn on another bank for the payee, who is not already a customer of the cashing bank. Could the bank qualify as a holder for value, so as to be a holder in due course of the check?

Former section 3-303 fairly clearly yielded the "yes" answer dictated by common sense. It provided that "[a] holder takes the instrument for value (a) to the extent that the agreed consideration has been performed."<sup>26</sup> The most nearly equivalent passage in revised

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22. U.C.C. § 1-102(1) (1990). This provision was the same in the pre-1990 Official Text. A comment to the section explains:

The text of each section should be read in the light of the purpose and policy of the rule or principle in question, as also of the Act as a whole, and the application of the language should be construed narrowly or broadly, as the case may be, in conformity with the purposes and policies involved.

*Id.* cmt. 1. See also ROBERT A. HILLMAN ET AL., COMMON LAW AND EQUITY UNDER THE UNIFORM COMMERCIAL CODE 1-8 (1985).

23. See *supra* text accompanying notes 20-21.

24. U.C.C. § 3-302(1) (1989) states: "A holder in due course is a holder who takes the instrument (a) for value . . . ."

25. U.C.C. § 3-302(a) (1990) states: "'holder in due course' means the holder of an instrument if: . . . (2) the holder took the instrument (i) for value."

26. U.C.C. § 3-303(a) (1989). The phrase "agreed consideration" did not necessarily call for an agreement prior to the performance. In informal contract terminology, "[t]o constitute consideration, a performance or a return promise must be bargained for." RESTATEMENT (SECOND) OF CONTRACTS § 71(1) (1979). "A

section 3-303, however, provides that "[a]n instrument is issued or transferred for value if: (1) the instrument is issued or transferred for a promise of performance, to the extent the promise has been performed."<sup>27</sup> Under this wording a payment of money would be value only if it was done in performance of a prior promise; cashing a check for a stranger, without any previous bargain between the parties, would not qualify.<sup>28</sup>

Can this be so? It is a seemingly ridiculous proposition, yet revised Article 3 expressly treats performance as value only if there has been a prior promise of such performance, and the very fact that the wording has been revised suggests an intention to change the law. If such a bizarre change were intended, one would expect to find some reference to it in the official comments, but they are silent on the question.

In this instance, it is probably legitimate to infer an underlying policy that would treat actual performance as value, whether preceded by a promise of such performance or not, and on that basis to read section 3-303(a) as implying that a payment of money in circumstances such as those of the hypothetical case would qualify as value, by authority of section 1-102(1).<sup>29</sup> The revised comment to section 3-303 explains the "policy basis" for the rule of subsection (a)(1) as being "that the holder who gives an executory promise of performance will not suffer an out-of-pocket loss to the extent the executory promise is unperformed at the time the holder learns of

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performance or return promise is bargained for if it is sought by the promisor in exchange for his promise and is given by the promisee in exchange for that promise." *Id.* § 71(2). An "agreed consideration" would be something bargained for and given in exchange, and it may take the form of either a performance or a promise.

27. U.C.C. § 3-303(a)(1) (1990).

28. Revised § 3-303(a) defines situations involving transfer "for value," but none of those situations is as helpful as the prior version stated in the text. The subsection, in its entirety, provides:

(a) An instrument is issued or transferred for value if:

- (1) the instrument is issued or transferred for a promise of performance, to the extent the promise has been performed;
- (2) the transferee acquires a security interest or other lien in the instrument other than a lien obtained by judicial proceeding;
- (3) the instrument is issued or transferred as payment of, or as security for, an antecedent claim against any person, whether or not the claim is due;
- (4) the instrument is issued or transferred in exchange for a negotiable instrument; or
- (5) the instrument is issued or transferred in exchange for the incurring of an irrevocable obligation to a third party by the person taking the instrument.

U.C.C. § 3-303(a) (1990).

29. *Id.* § 1-102(1); see *supra* text accompanying note 22.

[the] dishonor of the instrument” because the holder will be excused from his obligation to perform his promise, and in such circumstances “[h]older-in-due-course status is not necessary to protect” the holder.<sup>30</sup> The reasoning is obviously inapplicable to a case where a holder has rendered a performance in exchange for an instrument, even if it is not preceded by a promise to perform. Hence, construction of section 3-303 to promote its underlying purposes and policies calls for extending its reach to the case supposed.

Another route to the same end would be to read section 3-303(a) as not dealing comprehensively with the meaning of value; it asserts that value is to be found in specified situations but does not imply that these are the only situations in which value can be found.<sup>31</sup> This would give courts discretion to fall back on traditional law merchant concepts to identify the other situations. Still, one wonders why the drafters of the revision chose to deal less clearly with the subject than did the version of Article 3 which they were superseding.

### III. CERTIFICATION

Revised section 3-401(a)<sup>32</sup> in substance continues the rule of former section 3-401(1)<sup>33</sup> that no person is liable on a negotiable instrument unless his signature (made personally or by an agent) appears on the instrument. Consistent with this rule, revised section 3-409(a) defines “acceptance” as “the drawee’s signed agreement to pay a draft as presented. It must be written on the draft and may consist of the drawee’s signature alone.”<sup>34</sup>

“Certified check” is defined in revised section 3-409(d) as “a check accepted by the bank on which it is drawn. Acceptance may be made as stated in subsection (a) or by a writing on the check which indicates that the check is certified.”<sup>35</sup> The latter sentence

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30. *Id.* § 3-303 cmt. 2.

31. However, at least one commentator on revised Article 3 assumes that § 3-303(a) is a comprehensive definition of “value” for purposes of determining whether a purchaser of an instrument qualifies as a holder in due course. See Milton Copeland, *A Statutory Primer: Revised Article 3 of the U.C.C. — Negotiable Instruments*, ARK. L. NOTES 67, 76 n.35 (1992). Professor Copeland does not discuss the specific question raised in the text of this article. Henry J. Bailey and Richard B. Hagedorn, the authors of *Brady on Bank Checks*, see no substantial difference between the definitions of “value” in former § 3-303 and the 1990 revision. HENRY J. BAILEY & RICHARD B. HAGEDORN, *BRADY ON BANK CHECKS* 6-6 n.24 (7th ed. 1992).

32. U.C.C. § 3-401(a) (1990).

33. U.C.C. § 3-401(1) (1989).

34. U.C.C. § 3-409(a) (1990).

35. *Id.* § 3-409(d).



could be read to mean that if certification takes the form of "a writing on the check which indicates that the check is certified," then the drawee's signature need not appear on the instrument, since this method of certification is distinguished from "acceptance" as defined in subsection (a), which requires signature on the instrument.

Is this reading correct? The comments to section 3-409 do not discuss the matter. It is not apparent why there should be any exception to the signature requirement for cases where a drawee of a check stamps it "Certified,"<sup>36</sup> and the unqualified statement of the signature requirement in section 3-401 argues for a reading of section 3-409(d) consistent with it. The distinction between the acceptance in section 3-409(a) and a writing on the check indicating that it is certified can be understood to mean that an express indication that a check is certified is to be taken as the equivalent of an "agreement to pay [the] draft as presented."<sup>37</sup>

#### IV. PAYMENT OR ACCEPTANCE BY MISTAKE

Section 3-418 of former Article 3 declared that, with certain exceptions, "payment or acceptance of any instrument is final in favor of a holder in due course, or a person who has in good faith changed his position in reliance on the payment."<sup>38</sup> The official comments explained that the section was meant to codify "the rule of *Price v. Neal* . . . , under which a drawee who accepts or pays an instrument on which the signature of the drawer is forged is bound on his acceptance and cannot recover back his payment"<sup>39</sup> and to follow decisions under prior law which applied the doctrine of *Price v. Neal* to some other kinds of erroneous payments.<sup>40</sup>

Section 3-418 of revised Article 3<sup>41</sup> contains a more elaborate body of rules, but the thrust of the section is much the same. A

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36. It is true that revised Section 3-401(b) provides that "[a] signature may be made . . . by the use of any name . . . or by a word, mark, or symbol executed or adopted by a person with present intention to authenticate a writing," and arguably, a bank's "certified" stamp is treated as its signature by Section 3-409(b). *Id.* § 3-401(b). However, if any such novel treatment of the "signature" concept were intended, surely the comments to Section 3-409(b) would so indicate.

37. Bailey and Hagedorn assert that both the pre-1990 and 1990 Official Texts of the U.C.C. require certifications to be signed, and they cite a case decided under the pre-1990 version. *See supra* note 31, at 10-4, 10-7. In this case, the court held that a bank's certification stamp did not constitute a certification under the code because it was not signed by any official of the bank. *Menke v. Board of Educ.*, 211 N.W.2d 601 (Iowa 1973). Bailey and Hagedorn apparently regarded this holding as a sound decision under either version of Article 3.

38. U.C.C. § 3-418 (1989).

39. *Id.* § 3-418 cmt. 1.

40. *Id.* § 3-418 cmt. 2.

41. U.C.C. § 3-418 (1990).

good deal of the new language is designed to make explicit what was assumed by former section 3-418, that payment or acceptance by mistake is involved and that the remedies for such mistake rest on the law of mistake in contracting and the law of restitution.<sup>42</sup> Subsection (a) explicitly confers a right on the drawee of a draft to avoid an acceptance or recover a payment made in the two most frequent instances in which the problem presents itself: in the mistaken belief that payment of the draft had not been stopped or that the signature of the drawer was authorized.<sup>43</sup> Subsection (b) refers to "the law governing mistake and restitution" for rules granting rights of avoidance or restitution in other mistake situations.<sup>44</sup> Subsection (c) then provides a rule overriding both of the previous subsections: "The remedies provided by subsections (a) or (b) may not be asserted against a person who took the instrument in good faith and for value or who in good faith changed position in reliance on the payment or acceptance."<sup>45</sup> The comment indicates that subsections (a) and (c), taken together, "are consistent with former section 3-418 and the rule of *Price v. Neal*,"<sup>46</sup> and subsections (b) and (c), taken together, are presumably thought to be consistent with prior law extending the principle of *Price v. Neal* to other mistake situations.

Although there is general consistency between the old and new versions of section 3-418, there are some differences. For example, whereas the former version protected a holder in due course, subsection (c) of the revision substitutes the expression "person who took the instrument in good faith and for value," a broader category. And whereas the old version protected a person who changed position in good faith only if he did so in reliance on a payment, the new version also protects one who changes position in good faith in reliance on acceptance.

The comments to the earlier version of section 3-418 indicated that there was a third category of persons protected under the rule of that section, that the "finality" rule also applied in favor of "a transferee who has the rights of a holder in due course under the shelter principle."<sup>47</sup> The reference there was apparently to the rule of section 3-201(1) that "[t]ransfer of an instrument vests in the

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42. *Id.* § 3-418 cmt. 1.

43. *Id.*

44. See U.C.C. § 3-418 cmt. 3 (1990).

45. *Id.* § 3-418(c).

46. *Id.* § 3-418 cmt. 1.

47. U.C.C. § 3-418 cmt. 3 (1989).

transferee such rights as the transferor has therein . . . ,"<sup>48</sup> though the comment to section 3-418<sup>49</sup> seemed to read section 3-201(1) broadly as giving a transferee of an instrument the transferor's immunities as well as the transferor's rights.

This extension of the rule of finality of section 3-418 could be of considerable importance. Suppose a collecting bank handled a forged check on behalf of a customer who was a holder in due course, but the bank was not a holder in due course itself because it did not give value. If it collected payment from the drawee bank, which paid without discovering that the drawer's signature was not genuine, in a suit by the drawee to recover the payment from the collecting bank the defendant bank might not be able to show that it had changed its position in reliance on the payment. In that event the collecting bank would have no defense unless it could invoke protection under the "shelter principle," as suggested by the comment to section 3-418. If that comment were not followed, the collecting bank would have to try to pass its loss back to its customer, and it would apparently have a right to do so by suing for breach of transfer warranty under section 3-417(2)(b).<sup>50</sup> The customer would thus be deprived of the immunity from liability which the customer would have had if sued directly by the drawee bank. The applicability of the shelter principle in this context was thus necessary to avoid undercutting the finality principle of section 3-418.

Much the same problem could arise under revised section 3-418, if the collecting bank took the instrument from a customer who had acquired it in good faith and for value, but the bank did not itself take the instrument for value. Would the shelter principle protect the bank by giving it the same immunity to a restitutionary claim of the drawee bank that its customer would have if the customer were being sued by the drawee? That is more doubtful.

In the first place, it is not clear how much of the shelter principle has survived the transition from the pre-1990 Official Text to the present one. The section dealing with the effect of "transfer of an instrument"<sup>51</sup> says that a transfer "vests in the transferee *any*

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48. *Id.* § 3-201(1). The rule had its exceptions: a transferee of a security interest in an instrument acquired the transferor's rights only "to the extent of the interest transferred," and "a party to any fraud or illegality affecting the instrument or who as a prior holder had notice of a defense or claim [could not] improve his position by taking from a later holder in due course." *Id.* § 3-201(1)-(2).

49. *See supra* note 47.

50. U.C.C. § 3-417(2) (1989) states: "Any person who transfers an instrument and receives consideration warrants to his transferee . . . that . . . (b) all signatures are genuine or authorized; . . ."

51. U.C.C. § 3-203 (1990).

*right of the transferor to enforce the instrument*, including any right as a holder in due course," with one exception.<sup>52</sup> A "person who took the instrument in good faith and for value," thus qualifying for protection under revised section 3-418(c), might not have a "right to enforce the instrument,"<sup>53</sup> so this "transfer" rule could be completely inoperative.

Even if the transferor had a right to enforce the instrument, section 3-203(b) seems to be authority for his transferee's acquisition of nothing more than that right.<sup>54</sup> It apparently carries with it not only standing to sue on the instrument but also such substantive immunities from defenses as the transferor may have,<sup>55</sup> but it is difficult to read "right . . . to enforce the instrument" as extending so far as to include an immunity which the transferor may have from a restitution claim asserted by a bank which never assumed an obligation on the instrument.<sup>56</sup>

In addition, neither the text nor the comments to revised section 3-418 suggest that a transferor who accepted the instrument "in good faith and for value" could transfer his immunity to another. Indeed, the comments seem to preclude that possibility:

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52. *Id.* § 3-203(b) (emphasis added). The exception is made in the case of a transferee who engaged in fraud or illegality affecting the instrument; such a transferee cannot acquire the rights of a holder in due course. *Id.*

53. *Id.* § 3-301 defines "[p]erson entitled to enforce an instrument" as meaning "(i) the holder of the instrument, (ii) a nonholder in possession of the instrument who has the rights of a holder, or (iii) a person not in possession of the instrument who is entitled to enforce the instrument pursuant to section 3-309 or 3-418(d)." Section 3-309 relates to cases involving lost, destroyed and stolen instruments. Section 3-418(d) confers a right to enforce an instrument on a person who is compelled to make restitution to a drawee or other payor who paid the instrument by mistake. The person in the example who took the instrument in good faith and for value might not fit any of these categories. Consequently, it seems that there would be no transfer of rights at all under revised § 3-203.

54. Indeed, subsection (a) of revised § 3-203 defines transfer of an instrument very narrowly: "An instrument is transferred when it is delivered by a person other than its issuer for the purpose of giving to the person receiving delivery the right to enforce the instrument." U.C.C. § 3-203(a) (1990).

55. This is suggested by the specific reference to "holder in due course" in the rule as to the effect of transfer of an instrument, "Transfer . . . vests in the transferee any right of the transferor to enforce the instrument, *including any right as a holder in due course . . .*" *Id.* § 3-203(b) (emphasis added). It is further suggested by a statement in the comments that, "Under subsection (b) a holder in due course that transfers an instrument transfers those rights as a holder in due course to the purchaser. The policy is to assure the holder in due course a free market for the instrument." *Id.* § 3-203 cmt. 2. See also *Id.* § 3-203 cmt. 4, "Case #1."

56. Henry J. Bailey and Richard B. Hagedorn appear to assume that the "shelter" principle is carried over into the 1990 text of Article 3 without change, although they do not address its specific application as discussed in the text of this article. BAILEY & HAGEDORN, *supra* note 31, at 7-46.

If a check has been paid by mistake and the payee receiving payment did not give value for the check or did not change position in reliance on the payment, the drawee bank is entitled to recover the amount of the check under subsection (a) regardless of how the check was paid.<sup>57</sup>

There is a possibility of finding such a transfer of immunity by resort to common law. The comments to revised section 3-203 suggest that possibility.<sup>58</sup> They indicate that the broader rule as to the effect of "transfer of an instrument" in the former version of Article 3 was thought by the drafters of the revision too broad to be reliable, and they emphasize the confinement of attention under revised section 3-203 to the question of whether rights of enforcement are passed to transferees and abstention from any attempt to deal with whether transfers convey ownership of the instruments. "Ownership rights in instruments may be determined by principles of the law of property, independent of Article 3, which do not depend on whether the instrument was transferred under section 3-203."<sup>59</sup> By extension of this reasoning, the question of whether an immunity enjoyed by one person passes to another as a result of some sort of voluntary transaction between the two is outside the scope of Article 3's rules and, in the absence of other applicable statutes, is controlled by common law principles.<sup>60</sup> By this route the collecting bank could be protected under revised section 3-418 and the purpose of its subsection (c) effectuated.

It could also be argued that the underlying policy of subsection (c) of section 3-418 would be undermined unless a transferee from a taker in good faith and for value were given the same immunity as the transferor,<sup>61</sup> so that a reading of the subsection to extend protection to such a transferee is called for under section 1-102(1).<sup>62</sup> The legitimacy of such a reading is debatable, however, in view of the deletion from the comments to section 3-418 of any reference to application of the shelter principle in this context.

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57. U.C.C. § 3-418 cmt. 2 (1990). It must be conceded that the quoted comment is not addressed to the question of the status of a transferee. Therefore, the wording may not have been intended to be applicable to that question.

58. *Id.* § 3-203 cmt. 1.

59. *Id.*

60. Pre-Code cases applying the rule of *Price v. Neal* and extensions of its principle would presumably be relevant precedents, but no reason is apparent why courts could not frame an appropriate rule simply to advance the purpose of revised § 3-418(c).

61. *Cf. supra* text accompanying note 49.

62. *See supra* text accompanying note 22.

## V. PAYOR BANK'S RIGHTS TO CHARGE CUSTOMER'S ACCOUNT

Revised section 4-401(a) continues, in slightly modified form, the rule of former section 4-401(1), that a bank may charge against its customer's account any item which is "properly payable," including an item which overdraws the account.<sup>63</sup> However, the revision defines "properly payable," while its predecessor did not. Unfortunately, the definition is somewhat misleading.

"An item is properly payable if it is authorized by the customer and is in accordance with any agreement between the customer and the bank."<sup>64</sup> An "item" would presumably be "authorized by the customer" if the customer had signed it, even though the item was drawn payable to the order of a specified person and the item bore the forged signature of the payee. If the bank paid the item, section 4-401(a), taken literally, would authorize the bank to charge the payment to the customer's account.

Such a result would be contrary to prior law,<sup>65</sup> and the comments to the revision indicate that it would be contrary to the drafters' intention as well. A comment states that "[a]n item is properly payable from a customer's account if the customer has authorized the payment and the payment does not violate any agreement that may exist between the bank and its customer. . . . An item containing a forged drawer's signature or forged indorsement is not properly payable."<sup>66</sup> The comment thus contains a more accurate statement of the intended rule than does the statute itself: an "item" is "properly payable" if the *payment* has been authorized by the customer, *i.e.*, if it is the customer's genuine order and the payment is in accordance with the terms of the order, and if the *payment* is in accordance with any agreement between the bank and the customer; it is not enough, however, for only the *item* to be authorized by the customer and in accord with any agreement between bank and customer.

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63. U.C.C. § 4-401(1) (1989) states: "As against its customer, a bank may charge against his account any item which is otherwise properly payable from that account even though the charge creates an overdraft." U.C.C. § 4-401(a) (1990) states: "A bank may charge against the account of a customer an item that is properly payable from the account even though the charge creates an overdraft."

64. U.C.C. § 4-401(a) (1990).

65. See, *e.g.*, BARKLEY CLARK, *THE LAW OF BANK DEPOSITS, COLLECTIONS AND CREDIT CARDS* 8-71 (3d ed. 1990). "Since the forged indorsement is wholly inoperative under § 3-404, the bank has failed to follow the customer's directive to pay to the order of the intended payee. . . . Therefore, the drawee bank must recredit the [customer's] account for the full amount of the 'improperly payable' item under § 4-401(1)." *Id.* (*The Code references are to the pre-revision versions of Articles 3 and 4.*)

66. U.C.C. § 4-401 cmt. 1 (1990).

## VI. NEGOTIABILITY: INCORPORATION BY REFERENCE OF OUTSIDE AGREEMENT

Assume that a time note, otherwise negotiable, made by *A* and issued to *B* as payee, states that the maker's promise is subject to the terms of an oral agreement made between *A* and *B* contemporaneously with the issuance of the note, but the note does not reveal the terms of the oral agreement. Assume further that the oral agreement includes a term that *A* need not pay the note until he succeeds in selling his farm Blackacre. Is this note negotiable? What is the effect of the oral agreement?

As to negotiability, the most nearly applicable provision in revised Article 3 is that of section 3-106(a), dealing with when a promise or order is to be treated as unconditional for purposes of section 3-104(a). Section 3-104(a) defines negotiable instrument as "an unconditional promise or order" having certain additional characteristics.<sup>67</sup> The rule stated is that, except as otherwise provided in the same section, "a promise or order is unconditional unless it states (i) an express condition to payment, (ii) that the promise or order is subject to or governed by another writing, or (iii) that rights or obligations with respect to the promise or order are stated in another writing."<sup>68</sup> Since the hypothetical note states no condition to payment and refers to no other writing, and the section contains no other pertinent rule, it appears clear that the note is to be treated as unconditional for purposes of negotiability.<sup>69</sup> This is a change in the law, for the prior version of Article 3 treated as "not unconditional," and as non-negotiable, an instrument which "states that it is subject to or governed by any other agreement."<sup>70</sup>

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67. *Id.* § 3-104(a).

68. *Id.* § 3-106(a).

69. It is not possible to reason here that the Code is silent on the question of whether incorporation by reference of the terms of an oral agreement renders it "conditional" and thus non-negotiable, since revised § 3-106(a) affirmatively declares that, "a promise or order is *unconditional* unless" it contains one of the types of provisions there specified or another rule of the same section would treat it as conditional, and nothing in the section can be read as referring to this type of provision as making a promise or order conditional. U.C.C. § 3-106(a) (1990) (emphasis added). Nevertheless, Henry J. Bailey and Richard B. Hagedorn assert that, "An instrument clearly is conditional and nonnegotiable if it is made expressly subject to or governed by *another agreement* or writing." BAILEY & HAGEDORN, *supra* note 31, at 2-7. (emphasis added) (citing § 3-105(2)(a) of the former version of Article 3 and § 3-106(a) of the revision.)

70. U.C.C. § 3-105(2)(a) (1989) provided that, "A promise or order is not unconditional if the instrument (a) states that it is subject to or governed by any other agreement," and U.C.C. § 3-104(1)(b) (1989) required that a writing "to be a negotiable instrument within this Article . . . contain an unconditional promise or order . . . ."

The oral agreement might destroy negotiability by rendering the time of payment of the instrument indefinite.<sup>71</sup> However, it may be that its terms are not to be considered in judging the negotiability of the note. The traditional rule has been that the negotiability of a writing is to be determined by inspection of the writing alone,<sup>72</sup> the so-called "four-corners" rule.<sup>73</sup> It is unclear what has happened to this doctrine under revised Article 3. The forthright statement of it<sup>74</sup> has disappeared from the official comments,<sup>75</sup> along with a statutory rule which was derived from it.<sup>76</sup> Still, the rule is not expressly repudiated in either the text or the comments, the requirements for negotiability are stated in language not inconsistent with it, and at least one comment can be thought to give the doctrine oblique recognition.<sup>77</sup>

If it be assumed that the note is negotiable, the effect of the oral agreement on the enforceability of the note when it gets into

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71. U.C.C. § 3-104(a)(2) (1990) requires that a negotiable instrument be "payable on demand or at a definite time," and the oral agreement seems to render the note not payable on demand, yet very indefinite as to when it will be payable.

72. U.C.C. § 3-119 cmt. 5 (1989) states: "The negotiability of an instrument is always to be determined by what appears on the face of the instrument alone. . . ." See also BAILEY & HAGEDORN, *supra* note 31, at 2-3. "Negotiability must be determined solely by what is written on the face of the instrument itself. As was said in one well-known early American case: 'A negotiable bill or note is a courier without luggage.'" *Overton v. Tyler*, 3 Pa. 346, 45 Am. Dec. 645 (1846) (Gibson, C.J.).

73. See M.B.W. Sinclair, *Codification of Negotiable Instruments Law: A Tale of Reiterated Anachronism*, 21 U. TOLEDO L. REV. 625, 630 n.21 (1990). See also WILLIAM D. HAWKLAND & LARY LAWRENCE, UNIFORM COMMERCIAL CODE SERIES, § 3-104:06 (Art. 3) (1984) (stating "Negotiability is determined solely by reference to the four corners of the instrument.").

74. See *supra* note 72.

75. This is a fact of some significance in view of public statements made by the drafters of revised Article 3 that the comments to the revision carry forward, at least in substance, all previous comments considered relevant to the revision. See *supra* text accompanying note 8.

76. U.C.C. § 3-119(2) (1989) states: "A separate agreement does not affect the negotiability of an instrument." The comment quoted in note 72 was made with reference to this subsection.

77. Section 3-106(a) treats a promise or order stating that the note subject to or governed by another writing or that the rights or obligations are stated in another writing as conditional. The comment states that "[i]t is not relevant whether any condition to payment is or is not stated in the writing to which reference is made. The rationale is that the holder of a negotiable instrument should not be required to examine another document to determine rights with respect to payment." U.C.C. § 3-106 cmt. 1 (1990). Some writers on revised Article 3 appear to assume that the four-corners rule has survived the transition intact. See Milton Copeland, *A Statutory Primer: Revised Article 3 of the U.C.C. — Negotiable Instruments*, 67 ARK. L. NOTES 67, at n.35 (1992); BAILEY & HAGEDORN, *supra* note 31, at 2-3.



the hands of a holder in due course presents a problem.<sup>78</sup> If *C* were to acquire *A*'s note as a holder in due course, the maturity date specified in the note not yet having arrived, and *A* was unable to sell Blackacre by the maturity date, would *C* be able to enforce the note against *A* despite the oral agreement? Could it not be argued that the defense is a "personal"<sup>79</sup> one,<sup>80</sup> and so *C* is immune to it,

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78. As between the original parties to the note, the oral agreement should be controlling. Revised § 3-117 provides:

Subject to applicable law regarding exclusion of proof of contemporaneous or previous agreements, the obligation of a party to an instrument to pay the instrument may be modified, supplemented, or nullified by a separate agreement of the obligor and a person entitled to enforce the instrument, if the instrument is issued or the obligation is incurred in reliance on the agreement or as part of the same transaction giving rise to the agreement. To the extent an obligation is modified, supplemented or nullified by an agreement under this section, the agreement is a defense to the obligation.

U.C.C. § 3-117 (1990). This rule is not limited to separate *written* agreements. The parol evidence rule should not affect the case posed; since the text of the note incorporates the oral agreement by reference, evidence of the oral agreement would be consistent with the terms of the note.

The oral agreement would also be controlling in any case where a subsequent transferee was not a holder in due course and did not derive his rights from a holder in due course who would be immune to a defense based on the oral agreement. Section 3-305(a) of revised Article 3 declares that, as a general rule, "the right to enforce the obligation of a party to pay an instrument is subject to . . . (2) a defense of the obligor stated in another section of this Article . . . ." U.C.C. § 3-305(a)(2) (1990). Subsection (b) of the same section makes an exception in favor of "a holder in due course." *Id.* § 3-305(b).

If *B* himself were a holder in due course, he would presumably be subject to the terms of the oral agreement. Revised § 3-305(b) omits the language that appeared in the former version of the section which immunized a holder in due course only from defenses set up by "a party to the instrument with whom the holder has not dealt." U.C.C. § 3-305(2) (1989). The revision, however, states that a holder in due course is "not subject to defenses of the obligor . . . against a person other than the holder," seemingly implying that if a defense arises from dealings between the obligor and the holder in due course, the latter is subject to the defense. U.C.C. § 3-305(b). The official comment to revised § 3-305 indicates that the intent is to limit holder in due course immunities to cases where the defenses in question arise from dealings between the obligor and a third party. U.C.C. § 3-305 cmt. 2 (1990). See generally Milton Copeland, *A Statutory Primer: Revised Article 3 of the U.C.C. — Negotiable Instruments*, ARK. L. NOTES 68 at n.46 (1992).

79. The term "personal" refers to a defense to which a holder in due course may be immune. See *supra* note 18.

80. Revised § 3-305(a), laying down general rules as to defenses to which persons suing on negotiable instruments are subject, specifies several defenses in paragraph (1), then, in paragraph (2), refers to "a defense of the obligor stated in another section of this Article or a defense of the obligor that would be available if the person entitled to enforce the instrument were enforcing a right to payment under a simple contract." U.C.C. § 3-305(a)(1) - (2) (1990). Subsection (b) of the same section provides: "The right of a holder in due course to enforce the obligation of a party to pay the instrument is subject to defenses of the obligor stated in subsection (a)(1), but is not subject to defenses of the obligor stated in subsection

despite the fact that the note he holds expressly states that it is subject to the terms of the oral agreement? What would be the policy justification for that result?

A possible response to the argument is that *C* could not be a holder in due course of this note, nor could anyone else, since it carries notice of a defense on its face. To be a holder in due course one must have taken the instrument "without notice that any party has a defense . . . described in section 3-305(a)."<sup>81</sup> Surely *C* would have taken the note with notice of the existence of the oral agreement since the note expressly referred to it.<sup>82</sup> It can further be argued that *C* took with notice of the terms of the oral agreement, whether he actually knew them or not, since the note expressly subordinated its terms to those of the oral agreement.<sup>83</sup> If he did, it can be reasoned that he would have notice of a defense since revised section 3-117 provides: "To the extent an obligation is modified, supplemented, or nullified by [a separate] agreement . . . the agreement is a defense to the obligation."<sup>84</sup>

That reasoning seems weak, however. Section 3-302(a) requires that a holder in due course have taken the instrument without notice that any party to it *has* a defense.<sup>85</sup> There is surely a difference between notice that a person has a defense and notice that a person *may* have a defense, and there is an even greater difference between notice that a person has a defense and notice that a person may acquire a defense in the future. In the hypothetical case posed, *C* would have reason to know, at most, that *A* might acquire a defense

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(a)(2) . . . ." *Id.* § 3-305(b). (The defenses listed in (2) of subsection (a) would thus be "personal defenses"). *A*'s defense based on his oral agreement with *B* cannot be fitted into paragraph (1), which lists only infancy, duress, lack of legal capacity, illegality, fraud and discharge in insolvency proceedings, so it must be a "personal defense."

81. *Id.* § 3-302(a)(2)(vi).

82. "Notice" is defined in Article 1 of the code as follows: "A person has 'notice' of a fact when (a) he has actual knowledge of it; or (b) he has received a notice or notification of it; or (c) from all the facts and circumstances known to him at the time in question he has reason to know that it exists." *Id.* § 1-201(25). (This definition was not changed by the 1990 changes in the official text.) While "reason to know" is not defined, it is hard to imagine any reasonable meaning that would not treat a purchaser of a negotiable instrument to whom the instrument is delivered as having "reason to know" of what appears on its face.

83. This conclusion requires an extension of the "reason to know" concept, but this extension seems well within rational bounds.

84. U.C.C. § 3-117 (1990); see *supra* note 78 for the full text of § 3-117.

85. See *supra* text accompanying note 81. This is a change from the ambiguous version of the prior text, which provided that in order for a holder to be a holder in due course, the holder had to take the instrument "without notice . . . of any defense against . . . it on the part of any person." U.C.C. § 3-302(1)(c) (1989).

in the future if it turns out that *A* has been unable to sell Blackacre by the note's maturity date. As to section 3-117, the rule stated there does not treat the oral agreement as a defense except "[t]o the extent [the obligation on the instrument] is modified, supplemented or nullified by [the] agreement."<sup>86</sup> It would be a sensible reading of that language to treat it as meaning that if the outside agreement would give the obligor a defense, the obligor has, to the same extent, a defense to the obligation on the instrument.

There is, on the other hand, one basis for reading section 3-117 as treating notice of the possibility of a defense arising from an outside agreement as such notice of a defense as would prevent a purchaser of the instrument from becoming a holder in due course. In the pre-1990 text of the Uniform Commercial Code, it was expressly provided that "[k]nowledge of the following facts does not of itself give the purchaser notice of a defense or claim . . . (b) that it was issued or negotiated in return for an executory promise or accompanied by a separate agreement, unless the purchaser has notice that a defense or claim has arisen from the terms thereof. . . ."<sup>87</sup> That language made it quite clear that it was only notice of an existing defense that would prevent a taker of an instrument from becoming a holder in due course, and the point was underlined by a comment to the same effect.<sup>88</sup> No similar rule appears in the 1990 Official Text, nor is there any similar comment. Was a change in the law intended? The comments do not say. Arguably, the point is now covered in the clearer language of section 3-302(a)(2)(vi),<sup>89</sup> and no change in the law has been made.

However, if *C* can be a holder in due course, then it would seem that he can claim immunity from *A*'s defense, despite the explicit provision in the note making it subject to the terms of the oral agreement, and that does not make much sense. The answer, in principle, should be that the note is not negotiable, and for that reason there can be no holder in due course. One could argue that the underlying policy of revised section 3-106 calls for reading subsection (a) as if it read "another writing or agreement," but the fact that the rule now mandates a finding that a promise or order is unconditional unless it contains language of a type specified in the section appears to preclude a reading that is completely contrary to its express provisions. It is likely that courts encountering the problem will simply ignore the statutory wording to reach a satis-

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86. See *supra* note 78.

87. U.C.C. § 3-304(4)(b) (1989).

88. *Id.* § 3-304 cmt. 9.

89. See *supra* text accompanying note 85.

factory result, but it is unfortunate that such manhandling of the statute should be necessary.

## VII. A TRANSFEROR'S WARRANTY OF TITLE

In the pre-1990 versions of Articles 3 and 4, a person who transferred an instrument for consideration was usually treated as warranting to the transferee, and sometimes to subsequent transferees, that the transferor had a "good title" to the paper or represented one who had good title, and that the transfer was "otherwise rightful."<sup>90</sup> Both articles also provided for a similar, but not identical, warranty given to a person to whom an instrument was presented for payment or acceptance by the person obtaining payment or acceptance and prior transferors. This was a warranty that the warrantor had a good title to the instrument or represented one who had good title, but it did not include language comparable to the "otherwise rightful" portion of a transferor's warranty.<sup>91</sup>

That was a substantial difference. The "presentment warranty" was little more than a warranty that all indorsements necessary to the presenter's status as holder of the instrument (or to his principal's status as holder if the presenter was representing another) were on

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90. U.C.C. § 3-417(2) (1989) provided:

Any person who transfers an instrument and receives consideration warrants to his transferee and if the transfer is by indorsement to any subsequent holder who takes the instrument in good faith that . . . (a) he has a good title to the instrument or is authorized to obtain payment or acceptance on behalf of one who has a good title and the transfer is otherwise rightful . . . .

An identical warranty was given under § 4-207(2), which provided that when a "customer and collecting bank . . . transfers an item and receives a settlement or other consideration for it," the warranty runs to the immediate transferee "and to any subsequent collecting bank who takes the item in good faith." *Id.* § 4-207(2). Both warranty provisions could apply to the same fact situation, although the two rules differed in several regards: (1) the types of paper to which they applied; (2) who gave the warranty; and (3) to whom the warranty ran. These differences are of little significance in relation to the problem discussed in the text of this article.

91. U.C.C. § 3-417(1)(a) (1989) stated: "Any person who obtains payment or acceptance and any prior transferor warrants to a person who in good faith pays or accepts that . . . he has a good title to the instrument or is authorized to obtain payment or acceptance on behalf of one who has a good title . . . ." Article 4 provided for an identical warranty, given by "[e]ach customer or collecting bank who obtains payment or acceptance of an item and each prior customer and collecting bank" to "the payor bank or other payor who in good faith pays or accepts the item." *Id.* § 4-207(1)(a). As in the case of the transfer warranty, the differences in the scope of the two rules as to presentment warranties are of little significance for purposes of this article. *See supra* note 90.

the instrument and genuine.<sup>92</sup> The "transfer warranty" went considerably further than that. The warrantor's assurance that the transfer was otherwise rightful amounted to a warranty that the instrument was not subject to any adverse property claim which was good against the transferor.<sup>93</sup>

The 1990 versions of Articles 3 and 4 also make provisions for warranties accompanying transfers of instruments and warranties running to persons who pay or accept instruments, but these warranties do not refer to good title or rightful transfer. The nearest equivalent in the 1990 official text is a warranty that the warrantor is, or was, "a person entitled to enforce the instrument" or a

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92. See U.C.C. § 3-417 cmt. 3 (1989), which states: "Subsection (1)(a) retains the generally accepted rule that the party who accepts or pays does not 'admit' the genuineness of indorsements and may recover from the person presenting the instrument when they turn out to be forged." See, e.g., *Sun 'N Sand, Inc. v. United California Bank*, 582 P.2d 920 (Cal. 1978) (holding that warranty of good title is not a warranty of delivery and permits very limited inquiry into whether the instrument contains all necessary indorsements and whether they are genuine or otherwise effective). See also JAMES J. WHITE & ROBERT S. SUMMERS, *UNIFORM COMMERCIAL CODE* § 15-9 at n.4 (3rd ed. 1988) (commenting on § 4-207(1)(a): "In nine-tenths of the cases that lawyers will see, 'good title' will mean no more than: 'this check bears no forged indorsements.'"). See also BRADFORD STONE, *UNIFORM COMMERCIAL CODE IN A NUTSHELL* 301 (3d ed. 1989) (discussing the drawee's recourse against the presenter after payment of a check bearing a forged indorsement).

The rationale of this restricted concept of "good title" is that since a person obligated on a negotiable instrument can discharge the obligation by paying the holder, even if the holder does not have a perfect title to the instrument, and a drawee bank is entitled to charge the drawer's account with a payment made to a holder, even if the holder is not the owner of the instrument, a person paying an instrument needs protection only against the possibility that an apparent holder is not a real holder because one or more indorsements necessary to his status as "holder" are forged or unauthorized. WILLIAM D. HAWKLAND & LARY LAWRENCE, *UNIFORM COMMERCIAL CODE SERIES* § 3-417:06 (1984).

93. In some cases, however, the warranty is broken even though the transferor is actually the holder. Thus, an instrument that is payable to bearer or to the order of the transferor might have been found or stolen by him or acquired by him as agent and transferred without authority of the owner. In cases of this kind, although the transferor is a holder because the instrument runs to him, he breaks the warranty of title because he is not the owner and does not have authority from the owner.

CHARLES M. WEBER & RICHARD E. SPEIDEL, *COMMERCIAL PAPER IN A NUTSHELL* 211 (3d ed. 1982) (discussing § 3-417(2)(a)). The warranty of rightful transfer is breached by "transfer of a stolen instrument payable to bearer, transfer by a trustee in violation of his trust, and transfer by a holder of an instrument which is subject to an equitable claim of a previous owner." Hawkland & Lawrence, *supra* note 92, § 3-417-13.

The rationale of this broader warranty was, presumably, that purchasers of instruments need greater protection than payors. Purchasers may be injured if instruments they have paid for are taken away from them by third parties with superior property rights, and purchasers are not protected merely because they have dealt with holders.

representative of such a person, and transferors give no broader warranties than presenters do.<sup>94</sup> The comments to the new text

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94. Warranties given by transferors are set forth in §§ 3-416(a) and 4-207(a). U.C.C. § 3-416(a) (1990) states: "A person who transfers an instrument for consideration warrants to the transferee and, if the transfer is by indorsement, to any subsequent transferee that: (1) the warrantor is a person entitled to enforce the instrument . . . ." U.C.C. § 4-207(a) states: "A customer or collecting bank that transfers an item and receives a settlement or other consideration warrants to the transferee and to any subsequent collecting bank that: (1) the warrantor is a person entitled to enforce the item . . . ."

The provisions as to the warranties given to persons paying or accepting instruments are more numerous and are dealt with in §§ 3-417 and 4-208. In each section there are separate subsections dealing with presentments to drawees of unaccepted drafts, either for acceptance or for payment, and other presentments for payment. In all of them, however, the warranty given is that the warrantor is, or was when the warrantor transferred the instrument, "a person entitled to enforce the instrument or authorized to obtain payment [or acceptance, in a case of presentment for acceptance] on behalf of a person entitled to enforce the instrument." Those provisions read as follows:

If an unaccepted draft is presented to the drawee for payment or acceptance and the drawee pays or accepts the draft, (i) the person obtaining payment or acceptance, at the time of presentment, and (ii) a previous transferor of the draft, at the time of transfer, warrant to the drawee making payment or accepting the draft in good faith that: (1) the warrantor is, or was, at the time the warrantor transferred the draft, a person entitled to enforce the draft or authorized to obtain payment or acceptance of the draft on behalf of a person entitled to enforce the draft . . . .

U.C.C. § 3-417(a) (1990).

If (i) a dishonored draft is presented for payment to the drawer or an indorser or (ii) any other instrument is presented for payment to a party obliged to pay the instrument, and (iii) payment is received, the following rules apply: (1) The person obtaining payment and a prior transferor of the instrument warrant to the person making payment in good faith that the warrantor is, or was, at the time the warrantor transferred the instrument, a person entitled to enforce the instrument or authorized to obtain payment on behalf of a person entitled to enforce the instrument. . . .

*Id.* § 3-417(d).

If an unaccepted draft is presented to the drawee for payment or acceptance and the drawee pays or accepts the draft, (i) the person obtaining payment or acceptance, at the time of presentment, and (ii) a previous transferor of the draft, at the time of transfer, warrant to the drawee that pays or accepts the draft in good faith that: (1) the warrantor is, or was, at the time the warrantor transferred the draft, a person entitled to enforce the draft or authorized to obtain payment or acceptance of the draft on behalf of a person entitled to enforce the draft . . . .

*Id.* § 4-208(a).

If (i) a dishonored draft is presented for payment to the drawer or an indorser or (ii) any other item is presented for payment to a party obliged to pay the item, and the item is paid, the person obtaining payment and a prior transferor of the item warrant to the person making payment in good faith that the warrantor is, or was, at the time the warrantor transferred the item, a person entitled to enforce the item or authorized to obtain payment on behalf of a person entitled to enforce the item. . . .

*Id.* § 4-208(d).

describe the warranty as being, in effect, a warranty against unauthorized or missing indorsements.<sup>95</sup>

Understanding why that is so requires understanding of the phrase "person entitled to enforce" an instrument, a term of art in the 1990 Official Text. It is defined as follows: "'Person entitled to enforce' an instrument means (i) the holder of the instrument, (ii) a nonholder in possession of the instrument who has the rights of a holder, or (iii) a person not in possession of the instrument who is entitled to enforce the instrument pursuant to section 3-309 or 3-418(d)."<sup>96</sup> The central idea of this concept is "holder."<sup>97</sup> With the possible exception of a person whose right to enforce the instrument is conferred by section 3-418(d),<sup>98</sup> a person entitled to enforce an instrument refers to a holder of the instrument,<sup>99</sup> a successor to a holder's rights by transfer or operation of law,<sup>100</sup> or

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95. U.C.C. § 3-416 cmt. 2 (1990). *See also id.* § 3-417 cmt. 2 (stating that "[s]ubsection (a)(1) in effect is a warranty that there are no unauthorized or missing indorsements"); *id.* § 4-207 cmt. (stating that "[e]xcept for subsection (b), this section conforms to section 3-416 and extends its coverage to items"); *id.* § 4-208 cmt. (stating that "[t]his section conforms to section 3-417 and extends its coverage to items.>").

96. U.C.C. § 3-301 (1990).

97. To be the "holder" of an instrument, one must be "in possession" of the instrument and the instrument must be "payable to bearer or, in the case of an instrument payable to an identified person," payable to the person in possession. *Id.* § 1-201(20). If an instrument, as originally drawn or as subsequently indorsed, is payable to an identified person, no one else can become the holder of the instrument without the indorsement of the identified person. *Id.* § 3-205(a). Although the indorsement may be made by an agent, an "unauthorized signature is ineffective" as the signature of the person whose signature it purports to be. *Id.* §§ 3-402 and 403(a).

98. U.C.C. § 3-418(d) (1990) states:

Notwithstanding section 4-215, if an instrument is paid or accepted by mistake and the payor or acceptor recovers payment or revokes acceptance under subsection (a) or (b), the instrument is deemed not to have been paid or accepted and is treated as dishonored, and the person from whom payment is recovered has rights as a person entitled to enforce the dishonored instrument.

Subsections (a) and (b) of § 3-418 deal with possibilities of restitutionary recovery of payments made under mistake of fact and avoidance of acceptances made under mistake of fact. *See supra* text accompanying notes 43-44. In most instances, this rule probably operates simply to reinstate the "holder" status which the person required to repay had before obtaining payment, although it could apparently confer a right to enforce the instrument on one who was never a holder.

99. U.C.C. § 3-301(i) (1990).

100. *Id.* § 3-301(ii). The comment explains that "[a] nonholder in possession of an instrument includes a person that acquired rights of a holder by subrogation or under section 3-203(a) [i.e., by transfer of the instrument]. It also includes any other person who under applicable law is a successor to the holder or otherwise acquires the holder's rights." *Id.* § 3-301 cmt.

a former holder or successor to a holder who has lost possession of the instrument by accident or theft.<sup>101</sup>

In cases of presentment of instruments for payment, a warranty that the person obtaining payment is a person entitled to enforce the instrument probably provides the payor with as much protection against defects in title as the payor needs. Under section 3-602, a person obligated on a negotiable instrument can discharge the obligation by making payment to a "person entitled to enforce the instrument," and that is true even if the payor is aware that some third party claims a better right to the instrument or its proceeds than the holder has.<sup>102</sup> Furthermore, a drawee of an unaccepted check can usually discharge its obligation to the drawer by paying the holder even if the holder does not have good title to the instrument, at least if the drawee acts in good faith and without negligence.<sup>103</sup>

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101. Section 3-301(iii) refers to "a person not in possession of an instrument who is entitled to enforce the instrument pursuant to section 3-309 . . ." This section permits such a person to enforce the instrument, subject to special requirements of proof and security against adverse claims.

102. See U.C.C. § 3-602(a) (1990):

Subject to subsection (b), an instrument is paid to the extent payment is made (i) by or on behalf of a party obliged to pay the instrument, and (ii) to a person entitled to enforce the instrument. To the extent of the payment, the obligation of the party obliged to pay the instrument is discharged even though payment is made with knowledge of a claim to the instrument under section 3-306 by another person.

Subsection (b) excepts from this discharge rule cases where a rival claimant has, to the knowledge of the payor, obtained a court order prohibiting payment; the payor of an instrument other than a cashier's, teller's or certified check has accepted from a rival claimant an indemnity against loss resulting from refusal to pay the person entitled to enforce the instrument; or the person making payment knows that the instrument has been stolen and knows the person obtaining payment is in wrongful possession. *Id.* § 3-602(b).

103. At least that has been the law, despite the fact that the Uniform Commercial Code did not expressly so provide. See *supra* note 31, Bailey and Hagedorn at 16-45 to -46. The Code provisions dealing with a payor bank's right to charge its customer's account with payments made in accordance with the customer's orders have usually been cited as the principal authority for the doctrine. Presumably, the 1990 revisions do not prescribe a different rule. U.C.C. § 4-401(a) (1990) provides that,

A bank may charge against the account of a customer an item that is properly payable from the account even though the charge creates an overdraft. An item is properly payable if it is authorized by the customer and is in accordance with any agreement between the customer and bank.

A comment defines "properly payable" as follows: "[a]n item is properly payable from a customer's account if the customer has authorized the payment and the payment does not violate any agreement that may exist between the bank and its customer. . . . An item containing a forged drawer's signature or forged indorsement is not properly payable. . . ." *Id.* § 4-401 cmt. 1. An obligation of the bank to act in good faith is probably imposed by § 1-203: "Every contract or duty within



Moreover, the crucial element of the warranty that the presenter is a person entitled to enforce the instrument is the assurance that the instrument bears genuine indorsements of all persons whose indorsements are necessary to the presenter's status as one entitled to enforce the instrument. It is probable that, in the great majority of cases, persons asked to pay instruments will not do so unless the persons asking for payment appear to be holders, and the main need of a payor in that situation is for assurance of the authenticity of indorsements appearing on the instrument which are essential to the presenter's "holder" status. Thus, the warranty boils down to one of the genuineness of indorsements,<sup>104</sup> and a presenter's warranty of entitlement to enforce the instrument differs very little from the presenter's warranty of good title of the prior versions of Articles 3 and 4.<sup>105</sup>

Limiting the transferor's warranty relating to title to a warranty that the transferor is a person entitled to enforce the instrument, on the other hand, represents a change in the law, and it is a change of dubious merit. A person buying an instrument or taking it as security for a debt will have a legitimate desire for protection against the possibility of having the instrument, or its proceeds, taken away from him by a person who has a property interest in the instrument which is superior to that of the transferor. A warranty that the transferor has a right to enforce the instrument does not satisfy that need for protection, for an assurance that the transferor is a holder or has the rights of one is not an assurance that there is no third person with a superior claim to the instrument.<sup>106</sup> If the transferee becomes a holder in due course the problem disappears, because a holder in due course takes the instrument free of adverse claims.<sup>107</sup> However, if the transferee does not become a holder in

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this Act imposes an obligation of good faith in its performance or enforcement." Additionally, case law prior to the 1990 revisions of Articles 3 and 4 imposed a duty of ordinary care on drawee banks in paying checks. See BARKLEY CLARK, *THE LAW OF BANK DEPOSITS, COLLECTIONS AND CREDIT CARDS 2-13 et seq.* (3d ed. 1990). The 1990 Official Text does not appear to relieve the banks of such duty.

104. See *supra* text accompanying note 95.

105. See *supra* text accompanying note 92.

106. This is underscored by a provision in revised Article 3 that "[a] person may be a person entitled to enforce the instrument even though the person is not the owner of the instrument or is in wrongful possession of the instrument." U.C.C. § 3-301 (1990).

107. *Id.* § 3-306. Section 3-306 states:

A person taking an instrument, other than a person having rights of a holder in due course, is subject to a claim of property or possessory right in the instrument or its proceeds, including a claim to rescind a negotiation and to recover the instrument or its proceeds. A person having rights of a holder in due course takes free of the claim to the instrument.

due course, there is no such immunity.<sup>108</sup> One who is not a holder in due course may, nevertheless, be a good faith purchaser who stands to suffer loss if deprived of the instrument or its proceeds, and arguably the law should protect such a purchaser by giving him recourse against his transferor if it turns out that the title conveyed was defective. The pre-1990 Official Text did provide such protection, with its warranty that transfer was otherwise rightful,<sup>109</sup> but there is no equivalent in the revision.<sup>110</sup>

Consider, for example, the case of a person who buys an instrument from a holder, promising to pay the agreed price at a later time. Assume that before the buyer has paid any part of the price, a third party asserts a claim to the instrument which turns out to be a valid claim. The buyer is not immune from that claim as a holder in due course because the executory promise given to the seller is not value.<sup>111</sup> Assume, further, that the seller was not a holder in due course either and had no immunity to the claim. The buyer must, therefore, give up the instrument to its owner. What recourse does he have against his seller? He has none, judging from the 1990 Official Text of the Uniform Commercial Code.

Under the former version of Article 3, the buyer would have been able to rescind his promise of payment as a remedy for the seller's breach of warranty that the transfer was rightful.<sup>112</sup> The buyer might even have had an additional right to recover the value of the bargain as damages for breach of the warranty.<sup>113</sup> Under the

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108. *Id.*

109. *See supra* text at note 93.

110. Bailey and Hagedorn assert that the warranties given by transferors under the 1990 Official Text "are substantially those of the 1962 UCC that . . . the warrantor is entitled to enforce the instrument, or has good title or authority to obtain payment or acceptance, *and the transfer is otherwise rightful . . .*" *See supra* note 31, at 7-60. However, Bailey and Hagedorn do not explain how they reach that conclusion.

111. *See supra* text accompanying notes 29-30.

112. A comment to former § 3-417 stated: "Warranty terms . . . are used with the intention of bringing in all the usual rules of law applicable to warranties, and in particular . . . the availability of all remedies for breach of warranty, such as rescission of the transaction or an action for damages." U.C.C. § 3-417 cmt. 1 (1989). Moreover, the buyer in the hypothetical case posed would have received a warranty that "transfer is . . . rightful," because the warranty was given by anyone who transferred an instrument and received "consideration," not "value." *Id.* § 3-417(2)(a).

113. The comment to former § 3-417, which is quoted above in note 112, suggests that rescission and damages would be alternative remedies, but the comment also refers to "the usual rules of law applicable to warranties." If Article 2 is consulted for the "usual rules," it would allow a buyer, in circumstances comparable to this, to cancel his obligation to perform his own promise and have damages against his seller for breach of warranty. *See* U.C.C. § 2-711 (1990). Article 2 was not modified by the 1990 amendments of the Official Text.

1990 Official Text, it is not apparent that the buyer has any legal excuse for failing to pay the agreed price, let alone a claim for damages against the seller.<sup>114</sup>

The comments to the 1990 text offer as a reason for the change only that the more restricted warranty given by transferors conforms to the narrower definition of transfer adopted by the 1990 text.<sup>115</sup> That falls short of explaining why the restriction of the warranty was considered sound policy.

Perhaps the intention of the drafters was to leave it to the courts to determine whether and in what circumstances transferors should be considered to give broader warranties of title than those for which the Uniform Commercial Code provides or to find other ways to protect disappointed purchasers against harm from title defects.<sup>116</sup> The adoption of the narrow definition of transfer in the 1990 Official Text appears to have been motivated by a desire to leave questions of property rights, other than rights to enforce

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114. Another illustration of the impact of the change in the title warranty given by transferors would be a case similar in all respects to the hypothetical case posed above *supra* in the text accompanying note 111 except that the buyer has actually paid the agreed price before learning of an adverse claim, but the buyer is not a holder in due course because the buyer purchased the instrument with notice that it was overdue. *See* U.C.C. § 3-302(a)(2)(iii) (1990) (stating that “‘holder in due course’ means the holder of an instrument if: . . . the holder took the instrument . . . without notice that the instrument is overdue . . .”). Even though the buyer would have no immunity to the adverse property claim, the buyer unquestionably suffers a net loss unless the loss can be shifted to the seller of the instrument, and if the buyer made the purchase in good faith, justice would be promoted by allowing such recourse. The prior version of Article 3 would have protected the buyer by raising a warranty of rightful transfer running from the seller, but the 1990 Official Text would not. The change in the law is especially ironic in view of the fact that, in some other parts of Article 3, rules which formerly protected only holders in due course now protect persons taking instruments in good faith and for value. *Compare* U.C.C. § 3-407(3) (1989) with U.C.C. § 3-407(c) (1990); *compare* U.C.C. § 3-418 (1989) with U.C.C. § 3-418(c) (1990).

115. U.C.C. § 3-416 cmt. 2 (1990) states: “Since the purpose of transfer (Section 3-203(a)) is to give the transferee the right to enforce the instrument, subsection (a)(1) is a warranty that the transferor is a person entitled to enforce the instrument (Section 3-301).” “Transfer” is defined in the revision as follows: “An instrument is transferred when it is delivered by a person other than its issuer for the purpose of giving to the person receiving delivery the right to enforce the instrument.” *Id.* § 3-203(a).

116. In the hypothetical case posed in the text above at note 111, the common law concept of “failure of consideration” might be deemed to excuse the purchaser of the instrument from the executory obligation, though finding a common law basis for allowing the purchaser damages for loss of bargain would be more difficult. In the case supposed in note 114, it may be that restitutionary principles could be invoked to enable the purchaser to recover the payment made, but there remains the question of whether the purchaser did not assume the risk of defects in title. If the courts found that not to be so, they would, in effect, be reinventing the warranty of rightful transfer.

instruments, to non-code law.<sup>117</sup> It may be that the intent was to leave the consequences of defective titles to non-code law as well. If that is the intended message, it does not emerge clearly, and courts may well reason that since the revised version of the warranty sections drops the distinction between the scope of a transfer warranty and that of a presentment warranty that appeared in the pre-1990 text, the code implies that a transferor's responsibilities relating to title can go no further than the warranty of entitlement to enforce the instrument.<sup>118</sup>

### VIII. VALUE REVISITED

The abolition of the warranty of rightful transfer discussed above<sup>119</sup> has a worrisome side-effect. Under both versions of the Uniform Commercial Code, an executory promise is not treated as value for purposes of due course holding.<sup>120</sup> The comment to former section 3-303 explained that,

[t]he underlying reason of policy is that when the purchaser learns of a defense against the instrument or of a defect in the title he is not required to enforce the instrument, but is free to rescind the transaction for breach of the transferor's warranty (section 3-417). There is thus not the same necessity for giving him the status of a holder in due course, cutting off claims and defenses, as where he has actually paid value.<sup>121</sup>

In other words, if the purchaser found that the instrument was unenforceable or that another person had a superior claim to it and

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117. The comments to revised § 3-203 explain that the former section dealing with transfers was "confusing," apparently because it attempted to deal with the subject too comprehensively and fell into error in doing so. The solution adopted by the revision was to abstain from dealing with any aspect of transfer except that of its effect on the right to enforce the instrument.

Although transfer of an instrument might mean in a particular case that title to the instrument passes to the transferee, that result does not follow in all cases. The right to enforce an instrument and ownership of the instrument are two different concepts. . . . Ownership rights in instruments may be determined by principles of the law of property, independent of Article 3, which do not depend on whether the instrument was transferred under Section 3-203.

U.C.C. § 3-203 cmt. 1 (1990).

118. Section 1-102(1), with its mandate to construe and apply the code so as to give effect to its underlying purposes and policies, is likely to be of little help with this problem as no purpose or policy to provide broader protection against title defects than the transfer warranties expressly stated is evident from either the text or comments of the revision.

119. *Supra* text accompanying notes 90-118.

120. *See* U.C.C. § 3-303(a) (1989); U.C.C. § 3-303(a)(1) (1990).

121. U.C.C. § 3-303 cmt. 3 (1989).

the purchaser had not yet performed the promise to give value, the purchaser could simply call off the deal with the transferor and thus be left no worse off than before taking the instrument. The justification for rescission of that transaction was that the transferor would have breached a transfer warranty in any such case,<sup>122</sup> and rescission was one of the remedies for such breach.<sup>123</sup>

The explanation offered by the comments to the 1990 revision of Article 3 for the rule that an executory promise is not value is different. It is asserted, much as in the comment to the earlier version, that "the policy basis [for the rule] is that the holder who gives an executory promise of performance will not suffer an out-of-pocket loss to the extent the executory promise is unperformed at the time the holder learns of dishonor of the instrument,"<sup>124</sup> but this comment does not refer to the warranty provisions of the article as the basis for saying that the holder can avoid out-of-pocket loss. The point is illustrated by a hypothetical case involving a sale of goods, in which a seller who has taken a third-party check from the buyer as a down payment on the price of goods to be delivered later finds that he is unable to collect payment of the check because the drawer of the check stopped payment on it, the drawer having a defense to liability on the instrument. The comment maintains that even if the seller is not immune to the drawer's defense, the seller need suffer no out-of-pocket loss because the dishonor of the check excuses the seller from his obligation to deliver the goods *under Article 2* of the Code.<sup>125</sup>

The illustration given in the comment is, indeed, a case where the transferee of the negotiable instrument does not need holder in due course status to avoid out-of-pocket loss, so it may be that the

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122. In the case of any defect in title, the broad transfer warranty of title of pre-1990 Articles 3 and 4 protected the purchaser. *See supra* text accompanying note 109. If the purchaser was unable to enforce the instrument because of some defense, the purchaser was protected in most instances by a broad transfer warranty against defenses. U.C.C. § 3-417(2) (1989) states: "Any person who transfers an instrument and receives consideration warrants to his transferee and if the transfer is by indorsement to any subsequent holder who takes the instrument in good faith that . . . (d) no defense of any party is good against him . . ." If the transfer was by qualified indorsement, this warranty was reduced to a warranty that the indorser "had no knowledge of such a defense." *Id.* § 3-417(3). Article 4 provided that "[e]ach customer and collecting bank who transfers an item and receives a settlement or other consideration for it warrants to his transferee and to any subsequent collecting bank who takes the item in good faith that . . . (d) no defense of any party is good against him . . ." There was no provision reducing the scope of this warranty in cases of qualified indorsements. *Id.* § 4-207(2).

123. *See supra* note 112.

124. U.C.C. § 3-303 cmt. 2 (1990).

125. *Id.*

purchaser should not have holder in due course status. At any rate, the purchaser of the instrument gets no less protection than was true under the pre-1990 version of Article 3. But what of purchasers of negotiable instruments who are not excused from having to perform their promises by the provisions of Article 2? The official comment is silent about the source of their protection.

A purchaser who discovers that a party to the instrument has a defense which would be good against anyone but a holder in due course may be adequately protected by the transferor's warranty against defenses, which is at least as broad under the 1990 Official Text as it was before.<sup>126</sup> When a superior property claim surfaces, however, the purchaser may have no warranty protection against it, since a transferor now warrants only that he is a "person entitled to enforce" the instrument, and it is not at all clear that the purchaser can avoid out-of-pocket loss by rescission of the purchase or otherwise.<sup>127</sup>

In summary, the 1990 version of Article 3 continues the rule that a promise is value for holder in due course purposes only to the extent that the promise has been performed. The same reason for the rule is offered in the revised comments as appeared in the comments to the earlier text, but the warranty provisions of the prior text which validated the reasoning no longer fully support it, and full support cannot be found in the text of the revised code.

There are two possible solutions to this problem. One is to resort to the common law for authority that a purchaser who has given an executory promise and learns of a defect in title before

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126. *Id.* § 3-416(a)(4) states: "A person who transfers an instrument for consideration warrants to the transferee and, if the transfer is by indorsement, to any subsequent transferee that . . . the instrument is not subject to a defense or claim in recoupment of any party which can be asserted against the warrantor . . . ." Section 4-207(a)(4) indicates that

[a] customer or collecting bank that transfers an item and receives a settlement or other consideration warrants to the transferee and to any subsequent collecting bank that . . . the item is not subject to a defense or claim in recoupment (Section 3-305(a)) of any party that can be asserted against the warrantor . . . .

*Id.* § 4-207(a)(4). The warranty is arguably broader than the prior warranty against defenses because it expressly extends to claims in recoupment.

However, it is not clear that the purchaser is as well protected as before since neither the revised text of the code nor the official comments refer to rescission, cancellation, or any similar remedy as being available for breach of warranty. Compare the comment to the prior text quoted *supra* note 112. The only remedy mentioned is one of damages, which may be a less satisfactory remedy than simply calling off the purchase transaction. U.C.C. § 3-416(b), 4-207(c) (1990). Perhaps, however, a court could recognize a right of rescission as a matter of common law.

127. See *supra* text accompanying notes 106-110.

performing can cancel his obligation to perform. The second solution is to use the assertion in the comment to revised section 3-303 that the purchaser can avoid out-of-pocket loss by escaping his obligation to perform as reflective of an underlying policy either to provide such protection in all cases or to treat an executory promise as value whenever other Uniform Commercial Code rules do not excuse the purchaser from his obligation to perform, and then to find implications in the section to such effect by authority of section 1-102(1).<sup>128</sup> The first course invites the courts to reinvent the warranty of rightful transfer which the revisers of the code deleted from its text, a very roundabout and uncertain solution to the problem. The second course extends the scope of section 3-303 well beyond the natural meaning of its language, and courts may balk at reading so much into it.

### IX. CONCLUSION

It is perhaps inevitable that an extensive revision of a statute will raise problems of interpretation unanticipated by the drafters and produce results they did not foresee. Most of the anomalies discussed in the foregoing text are probably of this nature. They are troublesome, nonetheless.

It may be contended that the problems discussed in this article are unlikely to arise in real life and that the revisers of the code were concerned with more practical issues and answers. It is not impossible for such problems to arise, however, and to the extent that the 1990 revisions of Articles 3 and 4 make it more difficult to resolve them satisfactorily than did the previous versions of these articles, the revisions can legitimately be found wanting.

Of the eight problems discussed in this article, two can be resolved by sound construction of the text of the revised code.<sup>129</sup> A third problem is quite intractable, and a sensible solution can be achieved only by ignoring express language of the code.<sup>130</sup> The solutions to the other five problems must be found, it seems, either outside the code or by finding underlying purposes or policies in

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128. *See supra* text accompanying note 22.

129. The question of whether a certification of a check must include the signature of the acceptor involves an ambiguity in statutory language, which can be overcome by reference to related and clearer rules in the same article. *See supra* text accompanying notes 32-37. The misleading definition of "properly payable" in revised § 4-401(a) should yield to a sounder reading in the light of the official comments to the section. *See supra* text accompanying notes 63-66.

130. *See supra* text accompanying notes 67-89 (discussing the negotiability of an instrument which incorporates by reference the terms of an oral agreement).

Article 3 rules which can serve as bases for inferring code provisions supplementary to the express text. The pre-revision text of Article 3 yielded satisfactory answers to all of these problems.

The narrowed scope of the revised text of Article 3 seems to be the result of an effort to provide clearer and more precise rules to govern the situations the drafters had in mind as the typical applications of the rules. A by-product of that effort, however, was leaving a larger number of atypical situations adrift than did the former version of Article 3.

None of the problems discussed here are so serious that they should lead legislatures to refuse adoption of the changes embodied in the 1990 Official Text, which do clarify many code rules and effect real improvements in the law. However, there are loose ends, and it is believed that the changes do little to promote the cause of uniformity of the law or to give the courts guidance in dealing with them. It would be preferable for the code's sponsors to amend either the official text or the comments to deal with the problems posed by the 1990 revisions, and to point the way to sound and satisfying solutions regarding them.



