ARTICLE 3 OF THE UNIFORM COMMERCIAL CODE

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I. INTRODUCTION

A hallmark of this quarter century has been the burgeoning growth of commercial interests, accompanied by increasingly interdependent business relationships. On the immediate horizon is the imminent possibility of a "check-less" society with real-time, on-line access by individuals and firms to computerized depositories with the transfer of funds and negotiation of "instruments" being effected at the speed of light. With that prospect verging on reality, one rightly might wonder about the relevancy of the concepts with which we now concern ourselves: presentment, reasonable time, notice of dishonor, and protest. Assuming that the millennium will not be achieved tomorrow, we will treat with Article 3 of the Uniform Commercial Code (the Code) in the hope that uniformity in understanding might be promoted, potential problems identified, and support for the goal of orderly review and uniform amendment engendered.[1]

II. THE HISTORY OF THE CODE

The Code was adopted by The American Law Institute and the National Conference of Commissioners on Uniform State Laws in

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1 The author, not being admitted to the bar of the State of Washington, obviously cannot opine with authority respecting the particular law of Washington. It is hoped, however, that the view from the East will be of some value in promoting the lodestar of the Code: uniformity in statutory language and decisional interpretation.

[An added benefit derives from the author's extensive work with the Code in its most experienced jurisdiction. (The Code took effect in Pennsylvania on July 1, 1954). Mr. Farley has written several related articles for the BANKING LAW JOURNAL.—Ed.]

1952. The main objective was to achieve some degree of uniformity among the jurisdictions in matters relating to "commercial transactions," *e.g.*, sales, commercial paper, bank deposits and collections, documents of title, investment securities and secured transactions.[2]

This "adventure" began at the behest of that venerable member of the Pennsylvania bar, William A. Schnader.[3] General Schnader recorded that:

> . . . It was I who in the fall of 1940, proposed that the National Conference of Commissioners on Uniform State Laws undertake the preparations of a uniform commercial code to replace the several uniform acts which had been prepared by the Conference in years gone by, and which had been widely adopted but were in need of drastic revision.
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> The Conference accepted my challenge . . . .[4]

Then, following years of study and analysis, the Code, in an approved form, was made available for consideration by the states. In 1953 the Pennsylvania General Assembly considered and unanimously enacted the Code, the first state so to do. In terms of the purpose sought to be achieved it is noteworthy that: (1) During the period until the revised Code, or the so-called "Massachusetts revision," not a single amendment was made to the Pennsylvania version without the *prior approval* of the Code's Editorial Board, and (2) as General Schnader elsewhere has observed:

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[2] THE UNIFORM COMMERCIAL CODE (hereafter U.C.C.), § 1-102(2), provides that the: "Underlying purposes and policies of the Act are

(a) to simplify, clarify and modernize the law governing commercial transactions;

(b) to permit the continued expansion of commercial practices through custom, usage and agreement of the parties;

(c) to make uniform the law among the various jurisdictions."

1 UNIFORM LAWS ANNOTATED: UNIFORM COMMERCIAL CODE § 1-102(2) (Master ed. 1968) (hereafter, ULA-UCC). As required, specific reference to Washington variations will be to WASH. REV. CODE, title 62A.

[3] William A. Schnader was one of the stalwarts of the Pennsylvania bar:—Attorney General of Pennsylvania under two governors; Vice President of the American Law Institute for 20 years; a Commissioner for Pennsylvania in the National Conference of Commissioners on Uniform State Laws for a like period of time and President of the Conference in 1939; Chairman of the Securities Laws and Regulations Commission for four years; the principal author of the Pennsylvania Administrative Code and then of the Pennsylvania Fiscal Code; architect of the Philadelphia Home Rule City Charter; Chairman of the Board and then Chancellor of Franklin and Marshall College; and, at age 75, President of the Pennsylvania Bar Association for seven years. As the result of his singular leadership as President of the Pennsylvania Bar Association, the Association accomplished what others had failed to do on five separate occasions between 1891 and 1953—successfully rewriting the Pennsylvania Constitution, the first comprehensive reform of that document for more than a century. However, it was said of him that at the age of 54 he "launched the greatest and most imaginative of his public services, his proposal of the single, all-inclusive Uniform Commercial Code . . . ." Bernard G. Segal and Gilbert W. Oswald, *William A. Schnader —the Lawyer and the Man*, 40 PA. B. ASS'N Q. 10, 13 (1968). General Schnader died March 18, 1968.

[4] 1 ULA:UCC ix.

> Unfortunately, none of the other states followed the example of Pennsylvania in enacting the Code. None of them enacted the Code exactly as promulgated by the Code's Editorial Board. All of the remaining states made some amendments. Some states, for example Illinois and Georgia, made only a few amendments, while others made many more than should have been made.[5]

The Code began with recognition of the fact that negotiability was the basic economic factor of contemporary society. Implicit in this was an awareness of mobility and expanding channels of commerce, necessitating uniformity among the jurisdictions in the governance of commercial relationships. The Code thus had to fulfill three specific objectives beyond the conceptualization of "uniformity." First, the Code had to reflect accurately the customary nuances governing commercial transactions. Second, basic principles relating to or arising from such transactions had to be stated as succinctly and cogently as possible. Finally, the Code should promote the resolution of commercial disputes in order best to benefit the needs and interests of the community.

The Code became effective in Washington at midnight of June 30, 1967.[6] Article 3 replaced the Uniform Negotiable Instruments Law,[7] and was made applicable "to transactions entered into and events occurring after" the effective date. A review of the Washington localizer[8] indicates that, with respect to Article 3, the Washington legislature accepted Schnader's *obiter* and made few amendments in the text of the official Code and, in fact, adopted the 1962 Officially Recommended Amendments in six instances.[9] Although Article 3 retains, in significant part, the substance of the N.I.L., conceptual changes are evident, as will be seen in the following discussion.[10]

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[5] *Id.* xi. In Report No. 1 of the Permanent Editorial Board for the Uniform Commercial Code, dated October 31, 1962, General Schnader, Acting Chairman, observed that ". . . [by 1961] almost every state enacting the Code was making its own amendments, thus very largely imperilling the primary object of the Code which is UNIFORMITY in the laws of the various states regulating commercial Transaction." 1 ULA:UCC xxvi. In the next biennial report of the Board, William Schnader, then Chairman, argued that ". . . experience has taught those interested in the *uniformity* of our statutory law that it has been much easier to get 'uniform laws' on the books in the first instance than it has been to interest legislatures in bringing them up to date by amendment." (Emphasis added). Report No. 2 of the Permanent Editorial Board for the Uniform Commercial Code, dated October 31, 1964 *in* 1 ULA:UCC xxx.

[6] 1965 1st Ex. Sess., c. 157, § 10-101; WASH. REV. CODE § 62A.1-101 to 10-104.

[7] WASH. REV. CODE § 62A.10-102(1)(a)(xi).

[8] *See* ANDERSON'S UNIFORM COMMERCIAL CODE, *Washington Code Localizer*, 185-87 (1968).

[9] U.C.C. §§ 3-105, 3-112, 3-121, 3-122, 3-412 and 3-504.

[10] Obviously, a detailed, section-by-section treatment of Washington's Article 3 would be beyond the author's present intention. For that purpose, Professor Richard Cosway's extended analysis, anticipating adoption of the Code in the State of Wash-

III. Article Three

A. *General*

Article 3 does not purport to cover all forms of negotiable instruments. Section 3-104(2) provides that the writings encompassed by the Article are: (i) a draft or bill of exchange, if it is an order; (ii) a check, if it is a draft drawn on a bank and payable on demand; (iii) a certificate of deposit, so long as it is an acknowledgment by a bank of receipt of money with the engagement to repay; or (iv) a note, if it is a promise other than a certificate of deposit. Excluded, by definition, are money, documents of title and investment securities.[11]

Under the Code, any writing must meet certain formal prerequisites in order to be a negotiable instrument. It must:

> (a) Be signed by the maker or drawer; and
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> (b) Contain an unconditional promise or order to pay a sum certain in money and no other promise, order, obligation or power given by the maker or drawer except as authorized by this Article; and
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> (c) Be payable on demand or at a definite time; and
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> (d) Be payable to order or to bearer.[12]

A succeeding subsection warns that the descriptive words of Section 3-104(1) may refer to instruments which are not negotiable as well as to instruments which are negotiable, as the context may require. The net result, however, is that, in doubtful cases, a decision should be made against negotiability of an instrument which does not meet or "tract" the prerequisites. Each of the concepts contained in Section 3-104(1) are then considered in detail in subsequent sections.[13]

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ington, is invaluable. Cosway, *Negotiable Instruments—A Comparison of Washington Law and the Uniform Commercial Code, Article 3*: Part I, 38 Wash. L. Rev. 501 (1963); Part II, 38 Wash. L. Rev. 719 (1963); and Part III, 40 Wash. L. Rev. 281 (1965).

For those interested in statistics, Professor Roy L. Steinheimer records that, ". . . from 1950 to date, there have been at least forty symposia and 300 leading articles published about the Uniform Commercial Code. In addition, there are more than 150 student notes and comments." Steinheimer, *The Uniform Commercial Code Comes of Age*, 1 U.C.C.L.J. 1, 5, and n.13 (1968).

11 U.C.C. § 3-103.

12 U.C.C. § 3-104(1). In the absence of compliance in respect of subparagraph (d) of U.C.C. § 3-104(1), an instrument which otherwise is transferrable and negotiable may be subject to Article 3 *except* that there can be no holder in due course of such an instrument. U.C.C. § 3-805.

13 U.C.C. §§ 3-105 through and including 3-114. *See e.g.*, Comet Check Cashing Serv. Inc. v. Hanover Ins. Group—Civ. Ct. N.Y. County—(1968), commented upon in 2 UCC L. Letter No. 10, p. 2 (Dec. 1968).

The balance of Part 1 of this Article is essentially interpretive rules and rules of construction. These sections deal with incomplete instruments, instruments payable with words of description or payable to two or more persons, writings extraneous to the instrument itself, instruments payable through or at a bank, and ambiguous terms.[14] The final section, 3-122, establishes rules with respect to the accrual of causes of action under the Article.[15]

B. *Transfer and Negotiation*

Part 2 of the Article is concerned with the question of transfer and negotiation. Transfer[16] is a concept broadly drawn to include practically every situation where one party vests his right to an instrument in another. Negotiation is then defined as ". . . the *transfer* of an instrument in such form that the transferee becomes a holder."[17] As has been the fairly universal prior practice, bearer instruments are negotiated by delivery; instruments to order are negotiated by delivery subject to the requisite indorsement. In this connection, it should be noted that unlike the Negotiable Instrument Law, the Code requires that ". . . Any instrument specially indorsed [to become] . . . payable to the order of the special indorsee [can] . . . be further negotiated only by his indorsement."[18] The Code also elaborates upon terms and omissions which will not affect the negotiability of an instrument:

> (a) the omission of a statement of any consideration or of the place where the instrument is drawn or payable; or
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> (b) a statement that collateral has been given to secure obligations either on the instrument or otherwise of an obligor on the instrument or that in the case of default on those obligations the holder may realize on or dispose of the collateral; or
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> (c) a promise or power to maintain or protect collateral or to give additional collateral; or
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> (d) a term authorizing a confession of judgment on the instrument if it is not paid when due; or
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> (e) a term purporting to waive the benefit of any law intended for the advantage or protection of any obligor; or
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> (f) a term in a draft providing that the payee by indorsing or cashing it acknowledges full satisfaction of an obligation of the drawer; or

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[14] *See generally,* U.C.C. § 3-115 through and including 3-121.

[15] U.C.C. § 3-122.

[16] U.C.C. § 3-201.

[17] U.C.C. § 3-202(1).

[18] U.C.C. § 3-204(1).

> (g) a statement in a draft down in a set of parts . . . to the effect that the order is effective only if no other part has been honored.[19]

One of the forward-looking changes effected by the Code relates to the imposter situation and to those involving an untrustworthy employee. Under the Code an indorsement by *any* person in the name of a named payee is effective if the imposter induces the drawer to issue the instrument to him or a confederate or if a person signing on behalf of the drawer intends the payee to have no interest in the instrument. The cases antedating the Code advanced the general rule that where an employee prevailed upon his employer to issue checks payable to fictitious persons, but unknown to the employer to be fictitious, and the employee cashed such instrument upon the forged indorsement by him of the names of such persons, the depository paying on the indorsement bore the loss. This rule has been reversed so that the risk of loss is borne by the person or party better in a position to thwart the criminal act of an employee.[20]

The new approach obviates the necessity of determining whether the instrument involved was in fact payable to a fictitious payee and therefore was a type of bearer paper. The Code comments aptly express the governing principle:

> . . . the loss should fall upon the employer as a risk of his business enterprise . . . . [he] is normally in a better position to prevent such forgeries by reasonable care in the selection and supervision of his employees, or, if he is not, is at least in a better position to cover the loss by fidelity insurance [which] . . . is properly an expense of his business . . . .[21]

In a Pennsylvania case, the distinction implicit in Section 3-405(1) (a) between the drawer duped by an impersonator communicating *directly* with him, *e.g.*, by mail, face to face, or by telephone, and the drawer duped by an impersonator communicating *indirectly* with him through third persons was erased.[22] The facts of this case are significant. The wife of an administrator and sole heir, without her husband's knowledge, arranged for a mortgage on certain real estate, the estate being administered. In advance of the settlement date, she and another, then alleged to be her husband, appeared in the office of their legal counsel and represented his inability to be present at the settlement. Pursuant to their request, she and the imposter accompanying her executed a deed for the property from the estate to her husband (administrator) and herself

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19 U.C.C. § 3-112.

20 U.C.C. § 3-405(1)(c).

21 U.C.C. § 3-405, Comment 4.

22 Philadelphia Title Ins. Co. v. Fidelity-Philadelphia Trust Co., 419 Pa. 78, 212 A.2d 222 (1965).

as tenants by the entireties and simultaneously executed a mortgage, bond and warrant.

On the day set for settlement, the administrator's wife, accompanied by her counsel, met at the office of plaintiff title company for the settlement. The title company's settlement clerk accepted counsel's word that the deed and mortgage had been signed by the administrator-husband. Plaintiff's clerk, though he had not seen the signature affixed, notarized the documents. In due course the administrator's wife, one of the payees, presented the check then issued, with purported endorsements of all payees, to a New Jersey bank for cash. The check eventually cleared defendant Trust Company which charged the deposit account of plaintiff.

At trial, it was conceded that the man introduced to counsel as the husband-administrator was an imposter; that the husband-administrator's endorsement was forged; and that, as between the payor bank and its customer, the usual rule is that the former must bear the loss occasioned by the forgery of the payee's endorsement under Section 3-404. Plaintiff premised its argument for repayment on grounds that the imposter did not consummate the swindle "by use of the mails or otherwise." The Pennsylvania Supreme Court did not concur, observing that an imposter who induces the drawer to issue a check to him or his confederate is within the meaning of the section. It is not necessary that the imposter carry out his impersonation before the very eyes of the drawer.

It should be noted that this section is not intended to affect the criminal or civil liability of the person so endorsing[23] and that any unauthorized signature is rendered fully inoperative as that of the person whose name is signed, *unless he ratifies it or is precluded from denying it*, although such unauthorized signature will operate as the signature of the unauthorized signer in favor of any person who in good faith pays the instrument or takes it for value.[24]

Section 3-404(2) permits the ratification of any unauthorized signature, an act not contemplated by the N.I.L. but recognized by decisional law. Two cases will illustrate the beneficial effect of this codification. In *Rehrig v. Fortunak*,[25] there was a petition to open a judgment confessed on a note on the ground that petitioners' signatures were not signed by them but by the deceased husband of one of the petitioners, who did so without authorization from the petitioners. It was held that since the evidence was that the deceased husband managed the property purchased by the note for petitioners

23 U.C.C. § 3-405(2).
24 U.C.C. § 3-404(1).
25 39 Pa. D.&C.2d 20 (C.P. Carbon, 1966).

as well as for himself for over eight years with the petitioners' full knowledge and acquiescence, the petition would be *dismissed* because (1) the case was governed by Section 3-403(1) which provides that a signature may be made by an agent, and (2) assuming, *arguendo*, that the deceased husband acted without authority, under Section 3-404(2) *the subsequent conduct of the petitioners would ratify the unauthorized signatures of petitioners.*

Perhaps more relevant to contemporary corporate practices is the situation involving an imprest account established and the use of facimile signatures authorized by appropriate corporate resolution. Such resolutions generally specify that depositaries may accept checks against the imprest account when "signed" in facsimile, and then excuse inquiry by the depositary into the circumstances of issue of the instrument. Difficulties arise when the customer asserts that counterfeit checks, bearing the facsimile signature, have been erroneously paid. The usual rule is that a drawee who accepts or pays an instrument on which the signature of the drawer is forged is bound and cannot recover back.[26] The rationale behind this view is that the drawee is in a superior position to detect a forgery because he has the maker's signature and is expected to know and compare it. However, the standard form of corporate resolution respecting facsimile signatures—and the drawee's acceptance of that instruction—may preclude the corporation from denying that even a counterfeit facsimile signature was authorized!

In *Phoenix Die Casting Co. v. Manufacturers and Traders Trust Co.*,[27] the instrument involved was one of the customer's regular corporate checks bearing the signature of Braun, a duly authorized officer, as drawer, affixed by a facsimile plate, and payable to Braun individually. The facisimile signature had not been affixed by Braun, but by an employee of Phoenix acting without authority. Phoenix had adopted and presented to the defendant a resolution directing the bank to honor any instrument bearing the facsimile signature of Braun, regardless of and by whom affixed. On appeal from a denial of the defendant's motion for summary judgment dismissing the complaint, the Appellate Division of the New York Supreme Court reversed, absolving the defendant from liability to its customer by reason of the resolution Phoenix had filed.[28]

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26 U.C.C. § 3-418.

27 289 N.Y.S.2d 254 (1968).

28 The case arose under the New York Negotiable Instrument Law, Section 42, which provided, in pertinent part, as follows: "Where a signature is forged or made without authority of the person whose signature it purports to be, it is wholly inoperative . . . unless the party, against whom it is sought to enforce such right, is precluded from setting up the forgery or want of authority." The same result would obtain under U.C.C. § 3-404.

The Code also attempts a much more definitive and detailed examination of the rights of parties *inter se* on an instrument. For example, Section 3-406 had no counterpart in the Negotiable Instruments Law. This section holds that a drawer who is negligent in the preparation of an instrument so as to permit its alteration or making of an unauthorized signature is precluded from asserting the alteration or the lack of authority against a holder in due course or against a drawee or other payer who pays the instrument in good faith and in accordance with reasonable commercial standards. The question of negligence is left, however, to judicial determination.

In a case of first impression, a Pennsylvania court has affirmed a rather broad interpretation of the statutory language: ". . . the company's course of conduct, viewed in its entirety, is surely sufficient to support [the lower court's] . . . determination that it substantially contributed to the making of the unauthorized signatures."[29] The scheme giving rise to the controversy in this case was the practice of plaintiff corporation to leave blank sets of "scaling slips" readily accessible on the company's premises. Newly delivered logs, hauled to the mill by local truckers, were judged by mill personnel as to quantity and grade, and the "scaling slip," properly completed, was the office work copy from which checks in payment of the trucker's service were drawn. One Albers procured such a blank set and completed them to show substantial, but wholly fictitious, deliveries of logs, together with the names of local suppliers. The company's bookkeeper, upon delivery of these slips by Albers, prepared checks payable to the purported owners and entrusted the checks to Albers for delivery—a customary practice. As might be expected, Albers then forged the payee's signature and negotiated the instruments at defendant bank where he regularly dealt. Plaintiff instituted the action against the drawee bank, asserting that the bank had breached its contract of deposit by paying checks over forged endorsements.

The superior court affirmed the trial court's conclusion that the plaintiff's conduct precluded recourse to the usual rule[30] by reason of Section 3-406:

> Any person who *by his negligence* substantially contributes to . . . the making of an unauthorized signature is precluded from asserting the . . . lack of authority against . . . a drawee or other payor who pays the instrument in good faith and in accordance with the reasonable commercial standards of [its] . . . business. (Emphasis supplied.)

The net result is that the Code has abandoned the language of older cases, *i.e.*, negligence which "directly and proximately affects the

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[29] Thompson Maple Products, Inc. v. Citizens Nat'l. Bank, 211 Pa. Super. 42, 50, 234 A.2d 32, 36 (1967).

[30] U.C.C. § 3-404.

bank in passing the forgery," and shortened the chain of causation which the defendant bank must establish.

Notwithstanding this change in emphasis, the drafters of the Code were reluctant to expand the scope of the section. The Official Comment advises that the section is not intended, ". . . to change decisions holding that the drawer of a bill is under no duty to use sensitized paper, indelible ink or a protectograph . . . ."[31] The author is of the view that negotiability and transfer in this highly mobile society of which we are a part can only be enhanced by considering it negligence *per se* to fail properly to use devices which would significantly contribute to protection.

C. *The Parties* Inter Se

The sections which relate to the contract between the parties commence at Section 3-413. The maker or acceptor engages that he will pay the instrument according to its tenor or as completed.[32] The drawer engages that, upon dishonor of the draft and pursuant to any necessary notice of either dishonor or protest, he will pay the face amount of the draft to the holder or any indorser, subject to his right to disclaim such a liability.[33] By drawing or accepting an instrument, a party admits—as against all subsequent parties, including the drawee—(i) the existence of the payee and (ii) his then capacity to endorse.

Unlike the former law, the Code requires an acceptance or certification to be written on the instrument itself. Acceptance is defined as the drawee's "signed engagement . . . written on the draft" to honor the instrument as presented; "certification," as to a check, by definition includes "acceptance."[34] In this connection, observe that a drawee to whom an instrument is delivered, who fails either to return it on demand or neglects to "accept" it, is considered to have converted the instrument.[35]

The contract of the indorser is likewise stated with specificity.[36] If an instrument is dishonored and protest or notice thereof properly given as required,[37] the indorser is obliged to pay the instrument "according to its tenor *at the time of his indorsement.*" (Emphasis supplied.)[38] This engagement inures to the benefit of the holder or any subsequent indorser who takes the instrument up, even though not

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31 U.C.C. § 3-406, Comment 3.

32 U.C.C. § 3-115, 3-407. A subsequent holder in due course is afforded the same protection. U.C.C. § 3-407(3).

33 U.C.C. § 3-413(2).

34 U.C.C. § 3-410, 3-411(1).

35 U.C.C. § 3-419(1).

36 U.C.C. § 3-414.

37 U.C.C. § 3-501.

38 U.C.C. § 3-414(1).

obligated so to do.[39] The section also establishes the sequence in which the obligation of parties liable on the instrument is to be assumed:

> Unless they otherwise agree, indorsers are liable to one another in the order in which they indorse, which is presumed to be the order in which their signatures appear on the instrument.[40]

An indorser obviously may disclaim liability, but such disclaimer will be ineffective unless written on the instrument itself.

With respect to accommodation parties, the Code clarifies what has been, in most jurisdictions, a morass of confusion. The Code establishes that an accommodation party is a surety—a more inclusive concept than simply a "guarantor." However, the obligation of a surety has reference to a specific instrument and, therefore, when an instrument has been taken for value, an accommodation party is liable in the *capacity* in which he has signed the instrument.[41] An indorsement, which on its face indicates that it is not in the regular chain of title, is notice of its accommodation character.[42] Finally, inasmuch as an accommodation party is a surety, there is no liability on his part to the party accommodated. Section 3-415(5), therefore, states the obvious: if the accommodation party pays the instrument he has a right of recourse on the instrument against the party accommodated.[43] Excepting the holder in due course without notice of the accommodation, the section varies the parol evidence rule and permits oral proof of the contract of accommodation.[44]

The next succeeeding section, 3-416, is new, stating the commercial understanding with respect to words of guaranty added to a signature. Words of guaranty do not affect the character of the indorsement *per se* but do affect the *quality* of the liability of the indorser. The contract of a guarantor renders the indorser's liability indistinguishable from that of a co-maker.[45] The words "collection guaranteed" is an engagement by the signer that if the instrument is not paid when due he will pay it according to its face, but only if the holder has first proceeded against the maker or acceptor by suit and execution or has shown that to do so would be a futile act.[46]

The intention of the drafters of the Code, with respect to warranties on presentment and transfer,[47] was to introduce a uniform

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39 U.C.C. § 3-414(1).
40 U.C.C. § 3-414(2).
41 U.C.C. § 3-415(2).
42 U.C.C. § 3-415(4).
43 U.C.C. § 3-415(5).
44 U.C.C. § 3-415(3).
45 U.C.C. § 3-416.
46 U.C.C. § 3-416(2).
47 U.C.C. § 3-417.

concept with respect to rules of law relating to warranties, to bring commercial transactions into conformance with such rules and ". . . in particular [with] the necessity of reliance in good faith and the availability of all remedies for breach of warranty . . . ."[48] Such warranties may be disclaimed by agreement between the parties, although in the case of an indorser such disclaimer, to be effective, must appear in the indorsement itself.

The Washington Code annotations indicate that subsection 3-417(1) is new, although there appear to be cases inferentially involving the concept. The subsection is intended to state the obligation either of a person who obtains payment or acceptance or of any prior transferor. The warranties here involved are interrelated with those in the succeeding section, whereby payment or acceptance of any instrument, subject to two enumerated exceptions, is final in favor of a holder in due course of a person who has in good faith changed his position in reliance on the payment.[49] The warranties are uncomplicated: (a) good title to the instrument or proper authorization to obtain payment or acceptance thereof by a party having good title, and (b) the absence of knowledge that the signature of the maker or drawer is unauthorized.[50] The latter warranty is not given by a holder in due course,

> . . . acting in good faith
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> (i) to a maker with respect to the maker's own signature; or
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> (ii) to a drawer with respect to the drawer's own signature, whether or not the drawer is also the drawee; or
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> (iii) to an acceptor of a draft if the holder in due course took the draft after the acceptance or obtained the acceptance without knowledge that the drawer's signature was unauthorized . . . .[51]

The final representation made by a person obtaining payment or acceptance or by any prior transferor is that the instrument has not been materially altered. This warranty, however, is not given by a holder in due course,

> . . . acting in good faith
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> (i) to the maker of a note; or
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> (ii) to the drawer of a draft whether or not the drawer is also the drawee; or

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48 U.C.C. § 3-417, Comment, 1.

49 U.C.C. § 3-418. The two exceptions: (i) recovery of bank payments under Article 4, and (ii) liability for breach of warranty on presentment under U.C.C. § 3-417.

50 U.C.C. § 3-417(1).

51 U.C.C. § 3-417(1)(b).

(iii) to the acceptor of a draft with respect to an alteration made after the acceptance.[52]

These subsections recognize the competing equities of the parties *inter se*, and, as drawn, adhere to the historical principles enunciated in *Price v. Neal.* The exceptions here stated apply only in favor of a holder in due course or *his* subsequent transferees.[53] Inasmuch as a holder in due course, to attain that status, must take an instrument without notice of any defense against it,[54] the warranty of this subsection will be relevant in those few cases where the holder in due course acquires knowledge of an "unauthorized signature" after taking the instrument, but before presentment. It is also to be observed that parties claiming under a holder in due course must themselves act in good faith and be free from the infirmities of fraud, illegality or notice.[55]

Code subsections 3-417(2) and (3) state the warranties made by a party transferring an instrument to subsequent holders:

> (2) 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
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> (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; and
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> (b) all signatures are genuine or authorized; and
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> (c) the instrument has not been materially altered; and
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> (d) no defense of any party is good against him; and
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> (e) he has no knowledge of any insolvency proceeding instituted with respect to the maker or acceptor or the drawer of an unaccepted instrument.
>
> (3) By transferring 'without recourse' the transferor limits the obligation stated in subsection (2) (d) to a warranty that he has no knowledge of such a defense.[56]

The significant condition to the aforesaid warranties is that the transferor of an instrument must have received consideration. Presumably, an accommodation party would not be obliged under these warranties, because such parties infrequently receive consideration for their act of accommodation. A second salient feature of these two subsections is that, if the transfer is by indorsement and the subsequent holder takes the instrument in good faith, the transferor-indorser is liable under the warranties, notwithstanding the use of a

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52 U.C.C. § 3-417(1)(c).
53 U.C.C. § 3-201.
54 U.C.C. § 3-302(1).
55 U.C.C. § 3-201(1).
56 U.C.C. § 3-417(2), (3).

qualified indorsement.[57] The "without recourse" indorsement merely converts one of the warranties from an absolute statement that no defense of any party is good against the transferor to a more qualified statement that the transferor has no knowledge of such a defense.[58]

The codification of *Price v. Neal* with respect to payment and acceptance is also a salutary achievement:

> Except for recovery of bank payments . . . and except for liability for breach of warranty on presentment . . . 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.[59]

This section is especially noteworthy in its recognition of the necessity of there being a definite point in time when the life of a transaction involving a negotiable instrument comes to an end.

D. *The Holder in Due Course*

The Code defines a holder as a party in possession of an instrument "drawn, issued or indorsed to him or his order or to bearer or in blank."[60] For a holder to attain the status of a holder in due course,[61] he must have taken the instrument for value,[62] in good faith,[63] and without notice either that it is overdue or has been dishonored or of any defense against or claim to the instrument by another.[64]

Certain restrictions further preclude attainment of this status:

> (3) A holder does not become a holder in due course of an instrument:
>
> (a) by purchase of it at judicial sale or by taking it under legal process; or
>
> (b) by acquiring it in taking over an estate; or
>
> (c) by purchasing it as part of a bulk transaction not in regular course of business of the transferor.[65]

In conformance with the general principle that the transferee of a negotiable instrument succeeds to the rights of his transferor,[66] a purchaser of a "limited interest" in an instrument can be a holder

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[57] U.C.C. § 3-417(3).
[58] U.C.C. § 3-417(2)(d), (3).
[59] U.C.C. § 3-418.
[60] U.C.C. § 1-201(20).
[61] U.C.C. § 3-302.
[62] U.C.C. § 3-302(1)(a).
[63] U.C.C. § 3-302(1)(b).
[64] U.C.C. § 3-302(1)(c).
[65] U.C.C. § 3-302(3).
[66] U.C.C. § 3-201.

in due course ". . . to the extent of the interest purchased."[67] The Code likewise settles the controversy as to whether a payee may be a holder in due course. He may.[68]

The next succeeding two sections[69] under Part 3 of the Article, regulating rights of a holder, represent contemporary commercial practice and do not merit extended comment. Two points deserve specific note, however. First, the purchaser of an instrument is deemed to have notice of a claim or defense *if* the instrument on its face is *so* incomplete or irregular ". . . as to call into question its validity, terms, or ownership or to create an ambiguity as to the party to pay."[70] This view reverses that of the N.I.L. to the effect that the instrument must be *complete and regular* on its face, so as to enhance the holder's protection. The Code does not allow a minor error in the instrument to serve as notice of some claim or defense. Second, following this same rationale, a holder's knowledge that an incomplete instrument has been completed is not such notice of a claim or defense to preclude his being a holder in due course unless he has notice of an *improper* completion.[71]

Section 3-305 considers the rights of a holder in due course:

> To the extent that a holder is a holder in due course he takes the instrument free from
>
> (1) all claims to it on the part of any person; and
>
> (2) all defenses of any party to the instrument with whom the holder has not dealt except
>
> (a) infancy, to the extent that it is a defense to a simple contract; and
>
> (b) such other incapacity, or duress, or illegality of the transaction, as renders the obligation of the party a nullity; and
>
> (c) such misrepresentation as has induced the party to sign the instrument with neither knowledge nor reasonable opportunity to obtain knowledge of its character or its essential terms; and
>
> (d) discharge in insolvency proceedings; and
>
> (e) any other discharge of which the holder has notice when he takes the instrument.[72]

While the Code treats defenses and claims differently, there is no

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67 U.C.C. § 3-302(4).

68 U.C.C. § 3-302(2).

69 U.C.C. § 3-303 as to taking an instrument for value, and U.C.C. § 3-304 enumerating notice of a claim or defense adequate to preclude a purchaser from becoming a holder in due course.

70 U.C.C. § 3-304(1)(a).

71 U.C.C. § 3-304(4)(d).

72 U.C.C. § 3-305.

drastic departure from pre-Code statutory and decisional law principles. This section does illustrate one slight problem which codification failed to resolve: the enunciation of the defenses which a holder in due course may avoid is not exclusive. Other defenses, such as the effect of collateral writings,[73] personal defenses,[74] alteration,[75] and problems of consideration,[76] will be unavailable against the holder in due course.

Section 3-306 follows with a restatement of the rights of a party *not* a holder in due course:

> Unless he has the rights of a holder in due course any person takes the instrument subject to
>
> (a) all valid claims to it on the part of any person; and
>
> (b) all defenses of any party which would be available in an action on a simple contract; and
>
> (c) the defense of want or failure of consideration, nonperformance of any condition precedent, non-delivery, or delivery for a special purpose (Section 3-408); and
>
> (d) the defense that he or a person through whom he holds the instrument acquired it by theft, or that payment or satisfaction to such holder would be inconsistent with the terms of a restrictive indorsement. The claim of any third person to the instrument is not otherwise available as a defense to any party liable thereon unless the third person himself defends the action for such party.[77]

This section is a salutory clarification of the past rule that a person *not* a holder in due course takes an instrument subject to equities of ownership and defense. The Washington annotations indicate that decisional law has not previously harmonized with the rule asserted by this section.[78]

The authors of the Code were concerned with uniformity of commercial practice beyond domestic jurisdictions. For example, letters of advice and the implications surrounding their use required that American practices conform to the more universal European commercial and banking concepts. This was done. A letter of advice (from drawer to drawee) that a particular instrument has been drawn permits a payor bank, acting in good faith, to charge the drawer's account notwithstanding a forgery of a necessary indorsement.[79] In similar fashion, the codifiers were not remiss in their attempt to have the Code function in the evolving matrix of proce-

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73 U.C.C. § 3-119.
74 U.C.C. § 3-306.
75 U.C.C. § 3-407.
76 U.C.C. § 3-408.
77 U.C.C. § 3-306.
78 WASH. REV. CODE 62A.3-306, Washington Comments, par. 1.
79 U.C.C. § 3-701.

dure. Thus, one of the miscellany of Part 8 of the Code supplements the rules of procedure with respect of joinder and interpleader.[80]

IV. CONCLUSION

In Pennsylvania, litigation under the Code has tended to center upon Article 2, *Sales*, and Article 9, *Secured Transactions*. The definitive issues raised respecting Article 3 have primarily concerned the liability of parties on an instrument and the burden of proof respecting a holder in due course. This tendency may be the natural result of decisional legislation of the law merchant, and probably is proof of the fact that the drafters of Article 3 of the Code were faithful to customary commercial practices. The dearth of *significant* substantive controversy likewise means that the adoption of Article 3 has yielded greater precision and certainty in commercial transactions.

One final observation should be made: The Code is not intended to preclude evolution. To the contrary, there is every indication that the Code will supply the flexibility required for meaningful transition in commercial practices and mechanisms. The defense rests its case for Article 3 upon the prophetic observation of Gerald T. Dunne:

> . . . In the evolution of the checkless society through check-speeded and less-check stages, Articles 3 and 4, particularly the latter, will both facilitate the thrust of the future and be consumed as that future unfolds. On the first point, I would like to pay tribute to that perceptive genius who took the first step in splitting the atom of negotiable instruments, into what we may call the credit devices of Article 4. This prophetic differentiation is the key part of a group of related and converging circumstances—rising financial sophistication, ongoing elaboration of financial relationships, ever-increasing volume of transactions, and finally, continuously spreading computer technology—factors which when taken together will eventually eliminate the time-lag between purchase and payment or permit that interval to be explicitly structured and priced as a credit transaction.[81]

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80 U.C.C. § 3-803.

81 Dunne, *The Checkless Society and Articles 3 and 4*, 24 BUS. LAWYER 127-28 (1968). Mr. Dunne is the Vice President, Federal Reserve Bank of St. Louis. The problem of which Mr. Dunne writes is beyond the scope of our immediate concerns, but, for future reference, is adequately summarized in the following extract from the Senate Report on the Bank Service Corporation Act of 1962: "Testimony indicated that the volume of checks in circulation has increased tremendously during the past two decades. It was estimated that the check volume in 1939 was 3.5 billion. The volume is increasing at the rate of about one-half billion items per year. By 1970 the number of checks is expected to be at an annual rate of 22 billion. In addition to check handling, there is a need for automation of other bank services. Some banks are now processing their savings accounts, computing payrolls, calculating other credits and charges, and preparing and mailing statements through the use of automatic equipment." S. Rep. No. 2105, 87th Cong., 2d Sess. (1962).