return can ultimately be determined only by permitting the new carrier to operate. The effect of a given rate upon traffic and income cannot be finally discovered until the rate is put into operation. Postponing agency action in these situations may facilitate accumulation of some additional facts, but will not obviate the necessity to speculate when a decision is eventually made.

The distinguishing feature of the *RCA* case, then, is that agency action based on speculation foreclosed rather than fostered further experimentation. There is thus no ready-made formula which can be applied with equal propriety in passing upon all eventualities. When this predicament presents itself the final judgment must be adapted to the circumstances of the particular case. The Supreme Court's approach to this perplexing problem is perhaps defensible because of its reluctance to interfere with administrative judgment. However, administrative agencies should be extremely cautious in their reliance upon predictions when functioning in this problematic area.

The *American Airlines* case cannot fairly be said to represent a departure from principles governing this realm of the regulatory process. The significance of the opinion lies in its flexible and practical approach to the operation of the administrative system. There is no reason to believe that the decision is an invitation to regulatory agencies to discard traditional methods of supporting conclusions. The resort to intelligent speculation remains a necessity to sound prospective action, rather than an expedient for the avoidance of the factual core present in all situations confronting the administrative process.

## WARRANTIES TO A PAYOR OR ACCEPTOR UNDER THE UNIFORM COMMERCIAL CODE § 3-417(1)

Endeavoring to erect a basic legal structure upon which business transactions can be predicated, the draftsmen of the proposed Uniform Commercial Code have not only reiterated many concepts previously incorporated in uniform commercial acts, other statutes, and judicial decisions, but they have also introduced numerous significant innovations.[1] The aggregate of these provisions purports to simplify, modernize, and consolidate the entire body of rules of commercial law. As the Nego-

1. References to sections of the Code are to the Final Text Edition (November, 1951), as approved by the American Law Institute, the National Conference of Commissioners on Uniform State Laws, and the House of Delegates of the American Bar Association; references to comments by the Commissioners are to the Proposed Final Draft (Spring, 1950).

tiable Instruments Law stimulated legal scholars to debate its merits and shortcomings, so the Code has provoked scholarly disputation.[2]

Article Three of the Code deals with commercial paper. Among the most important innovations introduced by Article Three is a recasting of the remedies of a drawee against persons who obtain payment or acceptance of negotiable instruments. Basic to an understanding of the import of the Code provisions is a knowledge of the steps through which negotiable instruments payable to order pass in their journey to the drawee. The check is representative of these instruments. The drawer delivers the check to the payee, usually in satisfaction of an account due. The payee may present the check to the drawee for immediate payment or he may deposit it in his bank, which would thrust it into the bank collection process, or he may obtain cash by negotiating the check to one who would become a holder in due course.[3] The holder might, in turn, transfer the instrument to another purchaser; such transmission can be repeated, but ultimately a holder will present the check to the drawee for payment. At any stage of this procedure the check may be presented

2. Professor Ames led the critics of the NIL, while Judge Brewster, who supervised drafting of the Act, was its most stalwart supporter. Ames, *The Negotiable Instruments Law,* 14 HARV. L. REV. 241 (1900); Ames, *The Negotiable Instruments Law. A Word More,* 14 HARV. L. REV. 442 (1901); Ames, *The Negotiable Instruments Law—Necessary Amendments,* 16 HARV. L. REV. 255 (1903); Brewster, *A Defense of the Negotiable Instruments Law,* 10 YALE L.J. 84 (1901); Brewster, *The Negotiable Instruments Law—A Rejoinder to Dean Ames,* 15 HARV. L. REV. 26 (1901).

Similarly, Professor Beutel is outspoken in his criticism of the Code, while Professor Gilmore, one of its draftsmen, has defended it. Beutel, *The Proposed Uniform Commercial Code as a Problem in Codification,* 16 LAW & CONTEMP. PROB. 141 (1951); Beutel, *Comparison of the Proposed Commercial Code, Art. 3, and the Negotiable Instruments Law,* 30 NEB. L. REV. 531 (1951); Beutel, *The Proposed Uniform* [?] *Commercial Code Should Not Be Adopted,* 61 YALE L.J. 334 (1952); Gilmore, *On the Difficulties of Codifying Commercial Law,* 57 YALE L.J. 1341 (1948); Gilmore, *The Secured Transaction Article of the Commercial Code,* 16 LAW & CONTEMP. PROB. 27 (1951); Gilmore, *The Uniform Commercial Code: A Reply to Professor Beutel,* 61 YALE L.J. 364 (1952).

See also Corbin, *The Uniform Commercial Code—Sales; Should It Be Enacted?,* 59 YALE L.J. 821 (1950); Dunham, *The New Commercial Code,* 55 COM. L.J. 197 (1950); Goodrich, *Proposed Uniform Commercial Code,* 50 COM. L.J. 293 (1945); Lewis, *Proposed New Commercial Code,* 20 PA. BAR ASS'N Q. 131 (1949); Llewellyn *Problems of Codifying Security Law,* 13 LAW & CONTEMP. PROB. 687 (1948); Williston, *The Law of Sales in the Proposed Uniform Commercial Code,* 63 HARV. L. REV. 561 (1950); Witherspoon, *Why a New Commercial Code?,* 54 COM. L.J. 291 (1949). The articles cited do not constitute an exhaustive bibliography, but do contain some of the most pointed arguments on each side of the controversy.

3. Figures on the number of checks normally handled by banks tend to indicate that the most frequent disposition of a check is by deposit in the payee's or holder's bank. Leary, *Deferred Posting & Delayed Returns—the Current Check Collection Problem,* 62 HARV. L. REV. 905, 909 (1949). Questions are thus raised concerning the movement of the check from bank to bank, through the collection process. This institutional aspect of negotiable instruments problems must be recognized, but for the purpose of clarity, this paper will treat check transactions as involving an individual check.

for acceptance to the drawee, by the drawer, payee, or holder, to enhance its security and facilitate negotiation. The check is vulnerable to chicanery while progressing toward the drawee.

After paying a defective instrument the drawee generally is unsuccessful in attempting to charge the drawer's account.[4] Ordinarily the drawee must look to the presentor for recovery. Should the drawee recover from a collecting bank that presented the check for payment, the collecting bank can in turn go back against the forwarding bank,[5] which may be able to charge its depositor's account.[6] Thus, even where the check has traveled through the bank collection system, the ultimate liability usually rests upon an individual holder.

*Section 3-418.* Malefaction may occur in the drawing of a check by forgery of a drawer's name. Obviously the person whose name has been exploited without his sanction should not sustain any loss; neither did he contribute to the misconduct of the forger nor could he have thwarted it. A holder in due course who purchases the instrument is likewise inculpable. As a matter of fact the only party who could detect the imperfection, in most instances, is the drawee bank that pays the check. A bank is in a position to know the authentic signature of depositors; upon receipt of a forged document a cursory inspection of bank records should reveal the defect to the trained eye of the paying agent, who can then refuse payment. Having paid, the bank must bear the loss. This was the decision in the renowned English case, *Price v. Neal*,[7] creating an exception to the general rule that the drawee can recover from a person obtaining payment on a defective instrument. The same principles inspired NIL Section 62, which adapts the *Price v. Neal* rule

4. Concerning payment of an altered instrument, obviously the depositor cannot be liable for unauthorized payment by the drawee. As to forged indorsements, see Jordan Marsh Co. v. National Shawmut Bank, 201 Mass. 397, 87 N.E. 740 (1909); National Surety Co. v. President and Directors of Manhattan Co., 252 N.Y. 247, 169 N.E. 372 (1929). The result is the same where a drawee pays over the drawer's stop order. Calamita v. Tradesmen's Nat. Bank, 135 Conn. 326, 64 A.2d 46 (1949); Speroff v. First-Central Trust Co., 149 Ohio St. 415, 79 N.E.2d 119 (1948).

5. "Each holder may . . . recover in turn from his indorser. . . ." Security Savings Bank v. First National Bank, 106 F.2d 542, 545 (6th Cir. 1939).

6. *Ibid.*

7. 3 Burr. 1354, 97 Eng. Rep. 871 (1762). The rule of *Price v. Neal* is generally applied in the United States. Bank of United States v. Bank of Georgia, 10 Wheat. 333 (U.S. 1825); Gloucester Bank v. Salem Bank, 17 Mass. 33 (1820); Frank v. Chemical Nat. Bank, 84 N.Y. 209 (1881); Ames, *The Doctrine of Price v. Neal*, 4 HARV. L. REV. 297 (1891).

An exception imposes liability upon a depositor where he could have learned of the forgeries and prevented repetition of the forger's misconduct. First Nat. Bank v. Allen, 100 Ala. 476, 14 So. 335 (1893). The court recognized a duty on the depositor to carefully examine the checks periodically returned to him by his bank, and the obligation to detect and report any errors, including forgeries.

to the liability of an acceptor.[8] By declaring that "payment or acceptance of any instrument is final in favor of a holder in due course," Code Section 3-418 reaffirms the opinion and the statute; a payor or acceptor cannot retract upon discovering the forgery.[9] A contributing factor may have been a desire to assure permanence of check transactions and termination of the vitality of an instrument upon arrival at the drawee bank.

The finality in Section 3-418 is not without qualification.[10] Exceptions are dependent upon the remaining hazards to which a check is subject: forged indorsement of the name of the payee or a subsequent holder; alteration in the body by changing the name of the payee or raising the amount; and issuance of a stop payment order by the drawer. In each instance, the drawee and the ultimate holder may be singularly irreproachable. In the first two situations a miscreant has tampered with the paper, sold it, and fled to a warmer climate. In the case of revocation of payment the drawer is the acting party. The underlying problem relates to the treatment of innocent parties as against one another. Can the person obtaining payment retain it or enforce acceptance, or is the drawee, upon later discovery of its error, entitled to recover funds mistakenly paid out? Can a holder exact payment from a drawee reluctant to pay on the instrument? A collateral inquiry is necessary to determine the relative degree of innocence of each party.

*Section 3-417(1).* Resolution of the rights of the parties at present depends upon a determination of whether or not the drawee should be allowed to recover the payment made on a theory of money had and received. A different legal device is utilized by Code Section 3-417(1), that of imposing warranty obligations upon all presentors of the instrument.[11] Since this Section is unparalleled in any existing statute, a fair

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8. "The acceptor . . . admits—

"1. The existence of the drawer, the genuineness of his signature, and his capacity and authority to draw the instrument; . . . ."

NEGOTIABLE INSTRUMENTS LAW § 62.

9. This provision also codifies the rule that the drawee must know the state of the drawer's account, *i.e.*, whether he has sufficient funds to pay the check. First Nat. Bank v. Burkhardt, 100 U.S. 686 (1879); Smith v. Hubbard, 205 Mich. 44, 171 N.W. 546 (1919); Oddie v. National City Bank, 45 N.Y. 735 (1871).

10. ". . . [A]nd except for liability for breach of warranty on presentment under the preceding section. . . ." CODE § 3-418.

11. "(1) Unless otherwise agreed any person who obtains payment or acceptance and any prior transferor warrants to a party who pays or accepts in good faith

"(a) 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; and

"(b) that he has no knowledge of any effective direction to stop payment; and

"(c) that the instrument has not been materially altered, and that he has no knowledge that the signature of the maker or drawer is analysis and evaluation is contingent upon estimation of its practical effects as well as theoretical ramifications. Adoption of this provision would affect banking institutions and their clientele throughout the country.

A few general stipulations in Section 3-417(1) are worthy of note. The Section commences with "Unless otherwise agreed." The parties are thus allowed freedom to contract out of the obligations imposed. Such indulgence is readily acceptable in dealing with commercial paper; only the parties immediately involved in a transaction are capable of determining the value of the paper with or without the warranties and thus bargaining for their inclusion or exclusion. The warranties run to the drawee from the presentor and "any prior transferor," in effect repudiating the existing law that only the immediate presentor is subject to an action for recovery of the money paid out by the drawee.[12] Although proposed warranties in a sale where transfer is by delivery do not run to subsequent holders,[13] in a presentment situation such a provision is quite practical. If a holder deposits a defective check in his bank for collection, neither the depository bank nor a subsequent collecting bank should be liable to the drawee; the obligation rightfully falls upon the holder, a "prior transferor."[14] The paying or accepting bank receives the warranties in Section 3-417(1) only if in "good faith." Payment or acceptance disregarding knowledge of an infirmity in an instrument will bind a bank notwithstanding a defect against which the presentor would otherwise

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> unauthorized, except that such warranties are not given by a holder in due course who has taken a draft drawn on and accepted by a bank after such alteration or signature or by a holder in due course of a note. This exception applies even though a draft has been accepted 'payable as originally drawn' or in equivalent terms."

CODE § 3-417(1).

CODE § 4-207(1), in which "A customer warrants to his depository bank and a customer and a collecting bank warrants to all subsequent intermediary banks and to the payor," contains substantially the same warranties as CODE § 3-417(1). Article 4 governs the bank collection system.

12. The drawee cannot recover back against prior transferors because its action is based on a quasi-contract theory, not a warranty running from prior transferors to subsequent holders as established by NIL §§ 65, 66. See State Planters Bank & Trust Co. v. Fifth-Third Union Trust Co., 56 Ohio App. 309, 10 N.E.2d 935 (1937).

13. This is true under both the NEGOTIABLE INSTRUMENTS LAW and the CODE. ". . . [W]hen the negotiation is by delivery only, the warranty extends in favor of no holder other than the immediate transferee." NEGOTIABLE INSTRUMENTS LAW § 65. ". . . [A]ny party who transfers an instrument for consideration warrants to his transferee. . . ." CODE § 3-417(2).

14. The drawee is not prevented from acting against the immediate presentor; in such case the presenting bank could go against his transferor and so on back down the line of transfer to the holder. The burden of litigation can be decreased by action directly against the holder.

warrant. The Code fails to resolve the question whether or not negligence precludes good faith.[15]

*Section 3-417(1)(b).* Code Section 3-417(1)(b) establishes a warranty to the drawee that the presentor has "no knowledge of any effective direction to stop payment." Enactment of this provision would dispel the variegation presently existing in the law of the several American jurisdictions. Whether the draftsmen have adopted the best formula available can be questioned; they have relied solely on the hypothesis that presentment with knowledge of a stop order is fraudulent on the part of the presentor.

Numerically, the rule presently receiving the most widespread approval denies a bank recovery of funds inadvertently paid out over a drawer's stop order when the person obtaining payment is a holder in good faith and for value.[16] Recovery cannot be grounded upon mutual mistake; any discernible mistake is unilateral by the drawee and its negligent employee who pays the holder. Banks are bound to know the state of their depositor's account, including a revocation of payment. Under this rule knowledge is only one factor in determining whether or not the presentor acted in good faith; under Section 3-417(1)(b) knowledge is the only determinant. It is doubtful that this proposal is an improvement.

Whatever advantage may be gained by the definiteness of this subsection is offset by its lack of flexibility. By using the presentor's knowledge as the sole prerequisite to recovery by the payor, significant criteria are eliminated. That is not to suggest, as held in *National Loan & Exchange Bank v. Lachovitz*,[17] that an innocent purchaser for value may be under a duty of restitution simply because he is "charged with knowledge" that payment of the instrument is subject to a condition that there be no stop order. Nor should recovery be based entirely upon whether or not the holder has changed his position, requiring some change to preclude restitution.[18] Such requisites are excessively burdensome on the holder; but, more should be required than lack of knowledge. The holder should prove that he, or his depositor if the check has been deposited with

15. Negligence generally does not bar restitution under present law. National Bank of Commerce v. National Mechanics' Banking Association, 55 N.Y. 211 (1873).

16. Bank of Moulton v. Rankin, 24 Ala. App. 110, 131 So. 450 (1930); National Bank v. Berrall, 70 N.J.L. 757, 58 Atl. 189 (1904); National Commercial Bank & Trust Co. v. Madison, 270 App. Div. 437, 60 N.Y.S.2d 832 (3d Dep't 1946); Miller v. Chatham & Phoenix Nat. Bank, 126 Misc. 559, 214 N.Y. Supp. 76 (Sup. Ct. 1926); Central Nat. Bank v. International Sales Co., 87 Ohio App. 207, 91 N.E. 532 (1950); RESTATEMENT, RESTITUTION §§ 14, 33 (1937).

17. 131 S. C. 430, 128 S.E. 10 (1925).

18. *Cf.* Foster v. Federal Reserve Bank, 29 F. Supp. 716, 718 (E.D. Pa. 1939), *aff'd*, 113 F.2d 326 (3d Cir. 1940).

him for collection, is a purchaser for valid consideration.[19] He should further specify that he has not been unjustly enriched by receipt of payment.[20] When the presentor can warrant these things to the drawee, in addition to his lack of knowledge of a stop payment order, then there should be no obligation to repay money received on the check. The bank should suffer the loss caused by its own negligence. Here again, the concept of terminating the consequences of a negotiable instrument, when it reaches the drawee, is served.

*Section 3-417(1)(a).* The warranty that the individual obtaining payment or acceptance has a good title to the instrument retains the rule that the drawee can recover from the presentor in the event that any indorsement has been forged.[21] *Security Savings Bank v. First National Bank of Michigan City*[22] presents a typical situation: *A* Company purchased goods from *B* Company; *A's* treasurer executed duplicate checks in payment of some of *B's* invoices and forged *B's* indorsement; he then surreptitiously deposited the checks in defendant bank in *B's* name, claiming to be *B's* treasurer authorized to draw on the account; defendant-forwarding bank relayed the paper to plaintiff, drawee bank, for collection; unaware of the forged indorsements, plaintiff-drawee paid the checks; upon discovery of the forgery plaintiff-drawee sued to recover the money paid out. The court ordered restoration of the funds on common law authority that the defendant-presentor represents the genuineness of the instrument.[23] Two bases for restitution were scrutinized: mutual mistake of fact and implied warranty.

The theory that the parties have made a mutual mistake of a material fact is espoused by many cases in which a payor has reclaimed money paid a presentor of a bill with a forged indorsement,[24] usually without adequate exposition of the nature of the mistake. The only apparent misunderstanding would be an assumption by both parties that all indorsements are authorized and legitimate. Several courts have declared that a holder impliedly warrants to the drawee that the indorsements are

19. In Murfreesboro Bank & Trust Co. v. Travis, 190 Tenn. 429, 230 S.W.2d 658 (1950), recovery was allowed because the check had been given to the holder in discharge of a gambling debt, therefore he was not a holder for value.

20. At the time of presentment of the check for payment the holder knew the debt had previously been paid in Smith & McCrorken v. Chatham Phenix Nat. Bank & Trust Co., 239 App. Div. 318, 267 N.Y.Supp. 153 (1st Dep't 1933). The drawee bank was allowed to recover on an unjust enrichment theory.

21. Comment, p. 391.

22. 106 F.2d 542 (6th Cir. 1939).

23. Leather Manufacturers Nat. Bank v. Merchants Nat. Bank, 128 U.S. 26 (1888); Yatesville Banking Co. v. Fourth Nat. Bank, 10 Ga. App. 1, 72 S.E. 528 (1911).

24. *E.g.,* Allen v. Sharpe, 37 Ind. 67 (1871); National Bank of Commerce v. National Mechanics' Banking Ass'n, 55 N.Y. 211 (1873); RESTATEMENT, RESTITUTION § 35 (1937).

genuine.[25] Undoubtedly an express warranty exists when the presentor indorses "prior indorsements guaranteed."[26] Since most checks passing through the bank collection process are so guaranteed,[27] ordinarily such an express warranty is available under existing law. Lacking such voluntary undertaking, however, a warranty is difficult to establish. Indorsers' warranties are prescribed in Sections 65 and 66, NIL.[28] Since the drawee is not a holder and instruments are not negotiated to him, he cannot be protected by application of these sections. The presentor's signature merely indicates receipt of payment, not an indorsement from which warranties may be implied.[29]

Without providing any theoretical basis, some judges have merely proclaimed as law that a drawee does not concede the genuineness of previous indorsements.[30] This widely accepted statement of the law may be rationalized by distinguishing the factual background involved from that of *Price v. Neal.* Although the payor or acceptor is presumed to know the signature of the drawer, there is no occasion for acquaintance with the handwriting of indorsers. Although a predilection for finality of payment could have persuaded the drafters of the Code to deny re-

25. Wellington Nat. Bank v. Robbins, 71 Kan. 748, 81 Pac. 487 (1905); American Exchange Nat. Bank v. Yorkville Bank, 122 Misc. 616, 204 N.Y.Supp. 621 (Sup. Ct. 1924), and cases cited therein.

26. Bank of America Nat. Trust & Savings Ass'n v. Security-First Nat. Bank, 32 Cal. App.2d 647, 90 P.2d 335 (1939); Second Nat. Bank v. Guarantee Trust & Safe Deposit Co., 206 Pa. 616, 56 Atl. 72 (1903). Clearing house regulations generally require such an indorsement. Andrews, *The City Clearing House: Payment, Returns, and Reimbursement,* 27 IND. L.J. 155, 173 (1952).

An unusual case has held that a drawee could not recover on an altered instrument because the specific guarantee of prior indorsements excluded the possibility of recovery on altered paper. Crocker-Woolworth Nat. Bank v. Nevada Bank, 139 Cal. 564, 73 Pac. 456 (1903). In a jurisdiction in which recovery is ordinarily allowed on altered instruments, a guarantee of prior indorsements certainly should not hinder such recovery. Andrews, *supra,* at 175.

See also Townsend, *The Bank Collection Code of the American Bankers' Association,* 8 TULANE L. REV. 21, 36 (1933), for a criticism of BANK COLLECTION CODE § 4, which treats such guarantees.

27. Andrews, *supra* note 26, at 173; BRITTON, BILLS AND NOTES 649 (1943).

28. "Every person negotiating an instrument by delivery or by a qualified indorsement, warrants—

"1. That the instrument is genuine. . . ."

NEGOTIABLE INSTRUMENTS LAW § 65.

"Every indorser who indorses without qualification, warrants to all subsequent holders in due course:

"1. The matters and things mentioned in subdivision one . . . of the next preceding section;"

NEGOTIABLE INSTRUMENTS LAW § 66.

29. First Nat. Bank v. City Nat. Bank, 182 Mass. 130, 65 N.E. 24 (1902); First Nat. Bank v. United States Nat. Bank, 100 Ore. 264, 197 Pac. 547 (1921).

30. Farmers' Bank & Trust Co. v. Farmers State Bank, 148 Ark. 599, 231 S.W. 7 (1921), and cases cited therein; National Union Fire Ins. Co. v. Mellon Nat. Bank, 276 Pa. 212, 119 Atl. 910 (1923).

covery from presentors, judicial experience favored the drawee. Also, if the payor bank is made to bear the burden in every instance the economic consequences may be more detrimental to the use of negotiable instruments than permitting the drawee to reverse its original action and recover the amount paid.

Under the Code provision recovery is based upon a warranty similar to that presently imposed upon indorsers.[31] The effect of recasting the foundation of recovery is subject to speculation. Warranties are ordinarily appended to sales, whether of goods or paper. Presentment has never been regarded as a sale to the drawee, and it is unlikely that the Commissioners intended such an interpretation.[32] In all probability they contemplated extension of the use of warranty beyond sale transactions. This proposal is salutary in clearly delineating the basis of the drawee's action and in revealing the possibility of recovering any consequential damages suffered.[33] The prospect of recovery may also be increased by elimination of the quasi-contractual defense of material change of position now available to a presentor.[34]

*Section 3-417(1)(c).* Treatment of the problem of altered instruments in Section 3-417(1)(c) of the Code parallels the disposition of the forged indorsement cases in the previous clause.[35] Decisions at common law and under the NIL usually subscribed to the proposition that a payor could recover money paid to the presentor of materially altered paper.[36]

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31. *Compare* CODE § 3-417(1)(a), *supra* note 11, *with* NEGOTIABLE INSTRUMENTS LAW §§ 65, 66, *supra* note 28.

32. This view may be substantiated by CODE § 3-504, which defines presentment as "a demand for acceptance or payment." Thus, the concept of presentment has not been modified.

33. If analogy can be drawn to warranties in sales of goods the warrantor will be liable for all damages reasonably within the contemplation of the parties. *Cf.* Dushane v. Benedict, 120 U.S. 630 (1886); Ryan v. Progressive Grocery Stores, Inc., 255 N.Y. 388, 175 N.E. 105 (1931); Brown v. Chicago, M. & St. P. Ry., 54 Wis. 342, 11 NW. 356 (1882).

34. WOODWARD, QUASI CONTRACTS §§ 25, 26 (1913). Whether or not this consequence is conducive to justice is arguable.

35. NEGOTIABLE INSTRUMENTS LAW §§ 124 and 125 define a material alteration and prescribe its effect upon the liability of a maker, drawer, and indorser. These sections are combined and modified in CODE § 3-407, which provides that "(1) Any alteration of an instrument is material which changes the contract of any party thereto in any respect, including any such change in (a) the number or relations of the parties; or (b) an incomplete instrument, by completing it otherwise than as authorized; or (c) the writing as signed, by adding to it or by removing any part of it." CODE § 3-406 introduces the effect of a party's negligence in contributing to a material alteration.

The problem of incomplete instruments is handled separately from variations in the name of the payee or amount of the instrument in both the NIL and the CODE. See NEGOTIABLE INSTRUMENTS LAW §§ 14, 15, 52(1); CODE § 3-115.

36. Interstate Trust Co. v. United States Nat. Bank, 67 Colo. 6, 185 Pac. 260 (1919); McClendon v. Bank of Advance, 188 Mo. App. 417, 174 S.W. 203 (1915); Bank of Commerce v. Union Bank, 3 Comst. 230 (N.Y. 1850).

The only prerequisite was a prompt request for redemption upon discovery of a discrepancy.[37]

The extant rule allowing recovery of money paid out on an altered instrument has been incorporated into the Code, but the legal basis has been modified. Rather than affirming the payor's right to recover in quasi-contract for money paid out under mutual mistake of material fact, Section 3-417(1)(c) imposes upon the presentor, and prior transferors, the obligation to warrant to the drawee "that the instrument has not been materially altered." Upon detection of an alteration a drawee who has paid the face amount of a check could presumably recover any excess over the original amount (or, if alteration is of the payee's name, the entire payment) as damages for breach of warranty. An exception to the present rule was made in *United States v. National Exchange Bank.*[38] Since the Federal Government was both drawer and drawee of the instrument involved, it was bound to know the contents of the check and could not recover as a drawee from an innocent holder. Immensity of operations conferred no immunity from responsibility. Under the Code a drawee would probably receive the presentor's warranties regardless of the fact that he is also drawer. Since the permutation from previous law and the considerations involved are identical, the observations made above relative to forged indorsements are applicable here to altered instruments.[39]

When a negotiable instrument is presented for acceptance or certification, some perplexing questions are raised.[40] If the amount of a check is increased after certification, the certifying bank cannot be held liable for the excess over the original figure.[41] The bank has no more control over the instrument than a drawer has after delivering a check to the payee; and, as the drawer is not liable for more than the amount he has ordered paid, so the drawee need not pay more than the amount certified.

The situation may be different, however, where the modification occurred prior to the acceptance. A preponderance of authority favors the rule limiting liability to the holder even when an instrument is certified as changed, on the ground that the acceptor only agrees that the drawer's signature is genuine and that he has sufficient funds deposited

37. The payor has a reasonable time to detect the forgery and demand restitution; what is a reasonable time depends upon the particular circumstances of each case. Third Nat. Bank v. Allen, 59 Mo. 310 (1875).

38. 1 F.2d 888 (4th Cir. 1924), *aff'd,* 270 U.S. 527 (1926).

39. See notes 31-34 *supra,* and accompanying text.

40. Certification is equivalent to acceptance under NEGOTIABLE INSTRUMENTS LAW § 187 and CODE § 3-411.

41. Ozark Savings Bank v. Bank of Bradleyville, 204 S.W. 570 (Mo. App. 1918).

with the drawee to meet the instrument, not that the body of the bill is genuine.[42] But a pair of notable decisions, *National City Bank v. National Bank of the Republic*[43] and *Wells Fargo Bank & Union Trust Co. v. Bank of Italy*,[44] have contradicted the position of the majority. In each of these cases, a forger altered the name of the original payee, the instruments were then accepted by the plaintiff bank and were later paid as certified. Recovery was not allowed against the holders in due course who received payment of the instruments. Construing Section 62 of the NIL literally, the courts ruled that an acceptor agrees to pay the instrument precisely as it appears at the time of certification.[45] Emphasis was placed upon the fact that the presentors were innocent holders in due course who had purchased the instruments in reliance upon the acceptance. These decisions, imposing strict liability upon a drawee who accepts or certifies a bill or check, have been codified as exceptions to the general rule of Section 3-417(1)(c).[46]

Criticisms of the *National City Bank* and the *Wells Fargo* cases can be utilized in evaluating the Code provision ordaining these decisions as law. The principal technical attack on them was based upon sections of the NIL—disregarded by the Illinois and California courts—which are thought to conflict with a strict interpretation of Section 62.

In accepting a bill the drawee assents to "the order of the drawer," according to NIL Section 132. Thus, the contention is that an acceptor cannot be held liable for material variations not made by the drawer. Though perhaps a valid objection to the cases, this argument has been dealt with by Section 3-410(1) of the Code, which defines acceptance as the drawee's "engagement to honor the draft *as presented*."[47]

Professor Greeley, also dissenting from the minority rule established by the two cases, suggested that, in the light of previous usage, the phrase, "according to the tenor of his acceptance" in Section 62, NIL,

42. COMMON LAW: Parke v. Roser, 67 Ind. 500 (1879); Security Bank v. National Bank of the Republic, 67 N.Y. 458 (1876).

NEGOTIABLE INSTRUMENTS LAW § 62: National Reserve Bank v. Corn Exchange Bank, 171 App. Div. 195, 157 N.Y. Supp. 316 (1st Dep't 1916).

Cases after adoption of NIL, but not citing it: Interstate Trust Co. v. United States Nat. Bank, 67 Colo. 6, 185 Pac. 260 (1919); Central Nat. Bank v. F. W. Drosten Jewelry Co., 203 Mo. App. 646, 220 S.W. 511 (1920); McClendon v. Bank of Advance, 188 Mo. App. 417, 174 S.W. 203 (1915).

43. 300 Ill. 103, 132 N.E. 832 (1921).

44. 214 Cal. 156, 4 P.2d 781 (1931).

45. "The acceptor by accepting the instrument engages that he will pay it *according to the tenor of his acceptance;*" (Italics added). NEGOTIABLE INSTRUMENTS LAW § 62.

46. ". . . [S]uch warranties are not given by a holder in due course who has taken a draft drawn on and accepted by a bank after such alteration. . . ." CODE § 3-417(1)(c).

47. Italics added.

should be construed to mean "according to whether the acceptance is general or qualified."[48] In *Wells Fargo* the phrase was interpreted to refer to the condition of the instrument when accepted. Professor Greeley's contention is met by Code Section 3-413(1), prescribing the acceptor's obligation. Though obscure in retaining a promise to pay the instrument "according to its tenor," the provision lucidly annexes "at the time of his engagement." The Code thus makes it clear that upon certifying a check the drawee bank becomes liable to pay the face amount at the time of certification to any innocent holder.

Among the methods banks devised for protection against the consequences of the *Wells Fargo* rule is the use of a qualified acceptance, *i.e.*, "payable as originally drawn." Section 3-417(1)(c) specifically negates the utility of such terms. Refusal to certify, forgery insurance, use of special paper making alterations obvious, and a greater amount of vigilance are to be the safeguards available after enactment of the Code.

The question remains whether such burdens can justifiably be placed upon a drawee, sometimes handling as many as 700,000 checks in one business day.[49] A bank, in certifying a check, performs a gratuitous service to the depositor; there is no obligation to certify.[50] The presentor, on the other hand, has likely profited from the transaction, and, frequently, has trusted the fraudulent party. A bill altered after acceptance may be relied on by a purchaser as readily as one changed before, yet in the former instance the holder is never protected.[51] A drawee paying an instrument acquires a more favorable position than one who accepts under the minority rule, thus discouraging acceptance. Finally, where an original indorsement is forged an accepting bank can recover,[52] while recovery is restricted where the original payee's name is replaced and then the bill is indorsed as modified.

In the face of these facts, is there justification for exempting a presentor from warranting to a payor that there have been no alterations of the accepted bill prior to acceptance? The continued use of the certified check as a document of commercial utility resembling cash demands an affirmative answer. Although certification is gratuitous, the bank is operating for profit and can be expected to assume certain business risks

48. Greeley discussed NIL §§ 139 to 142 and English and American text-writers in reaching this conclusion. Greeley, *The Effect of Acceptance of an Altered Bill*, 27 Ill. L. Rev. 519 (1933).

49. Leary, *supra* note 3, at 909.

50. Wachtel v. Rosen, 249 N.Y. 386, 164 N.E. 326 (1928); Code § 3-411(2).

51. Ozark Savings Bank v. Bank of Bradleyville, 204 S.W. 570 (Mo. App. 1918).

52. Leather Manufacturers Nat. Bank v. Merchants Nat. Bank, 128 U.S. 26 (1888); Security Savings Bank v. First Nat. Bank, 106 F.2d 542 (6th Cir. 1939); Allen v. Sharpe, 37 Ind. 67 (1871); National Union Fire Ins. Co. v. Mellon Nat. Bank, 276 Pa. 212, 119 Atl. 910 (1923).

the cost of which can be passed on to all customers. When a check is varied after acceptance the bank has not certified the alteration; but certification after the alteration may be characterized as assent to the change. More importantly, there is a vital distinction between making payment and accepting an instrument; a certified check may be relied upon by a payee or subsequent holder, while a check after payment is dead. Certification serves a useful purpose only by magnifying the security of a check, so that a high degree of negotiability can be obtained.[53]

The Commissioners, in codifying the minority rule, may have been influenced by a feeling that a similarity to *Price v. Neal* justifies achieving finality of payment in this area. By employing more careful detection procedures, certifying banks could often prevent the situation in which the holder of a check altered before acceptance is placed. Evidence of this belief is the fact that the *Wells Fargo* rule was not extended to certification of checks bearing forged indorsements.[54] The only apparent distinction between forged indorsements and alterations, insofar as recovery by an acceptor from a holder is concerned, is that ordinarily detection of alterations is much easier than is discovery of forged indorsements.

Although Section 3-417(1) is only one small element of the entire proposed Uniform Code, it indicates progress toward a modern body of rules of commercial law. All critical problems may not be resolved, but this Section surely eliminates some and decreases the breadth of others. Codification of the *Wells Fargo* rule represents an extension of the finality of payment concept initiated by *Price v. Neal* and pursued in stop payment order cases. An increased desire for cessation of the consequences of negotiable instruments at a specific time or place could conceivably lead to further extension of the drawee's liability where a bank has paid in ignorance of a forged indorsement or material alteration. If this were ever to occur, the original doctrine shall have been completely reversed. The Code Commissioners exhibited a natural reluctance to accomplish the total overthrow of an established principle. Moreover, the economic effect of shifting the burden of loss to the drawee in all cases where loss must fall upon an innocent drawee or holder remains in the realm of speculation. After enactment of the Code, reaction of banks to the imposition of additional liability upon them may provide an effective forecast of the future of the finality concept.

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53. See Steffen and Starr, *A Blue Print for the Certified Check*, 13 N.C.L. Rev. 450 (1935).

54. See Britton, Bills and Notes 658 (1943).