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Roy L. Steinheimer, Jr.

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IMPACT OF THE COMMERCIAL CODE ON LIABILITY OF PARTIES TO NEGOTIABLE INSTRUMENTS IN MICHIGAN

*Roy L. Steinheimer, Jr.**

SINCE the Uniform Commercial Code is now effective in Pennsylvania and is under active consideration by official bodies in other states, it seems appropriate to investigate in some detail the impacts which this proposed legislation would have upon the accumulated business, legislative and judicial understanding and experience in the commercial law area in a specific jurisdiction. As an illustration of the problems which will be faced by judges, lawyers and businessmen in any jurisdiction which adopts the code, the writer has chosen to analyze some impacts which the code would have on commercial law in Michigan. Space limitations make it necessary to select some small part of the code for this analysis. To this end, the writer has chosen the subject of liability of parties to negotiable instruments.¹ It is hoped that this section-by-section study of an important segment of the code against the backdrop of over one hundred years of commercial experience in Michigan will give some appreciation of the problems involved and the ends to be achieved by adoption of the code.

Section 3-401. Signature.

(1) *No person is liable on an instrument unless his signature appears thereon.*

(2) *A signature is made by use of any name, including any trade or assumed name, upon an instrument, or by any word or mark used in lieu of a written signature.*

*Associate Professor of Law, University of Michigan.—Ed.

¹ Article 3, Part 4 of the code.

This section of the code is simply a restatement of the provisions of section 18 of the Uniform Negotiable Instruments Law² and would work no changes in Michigan law.³

Section 3-402. Signature in Ambiguous Capacity.

Unless the instrument clearly indicates that a signature is made in some other capacity it is an indorsement.

Section 17 (6) of the NIL⁴ provides that "where a signature is so placed upon an instrument that it is not clear in what capacity the person making the same intended to sign, he is to be deemed an indorser." Section 63 of the NIL⁵ provides that "[a] person placing his signature upon an instrument, otherwise than as maker, drawer or acceptor is deemed to be an indorser, unless he clearly indicates by appropriate words his intention to be bound in some other capacity."⁶ Under these statutory provisions, the Michigan courts have held that one who signs a note in the lower right-hand corner, apparently as co-maker, cannot offer parol evidence, even as between the original parties to the instrument, to show that he signed as accommodation indorser.⁷ However, a co-signer who adds the word "indorsed" to his signature in the lower right-hand corner of a note is deemed an indorser.⁸ On a note reading "John Johnson . . . does promise to pay . . ." and signed by John Johnson and Mike Gunter in the lower right-hand corner, Gunter was held to be an indorser.⁹ The foregoing holdings would also be appropriate under section 3-402.

Section 3-403. Signature by Authorized Representative.

(1) *A signature may be made by an agent or other representative, and his authority to make it may be established as in other cases of*

² Hereinafter usually referred to as "NIL." Mich. Comp. Laws (1948) §439.20, Mich. Stat. Ann. (1937) §19.60.

³ See, e.g., Peoples State Bank v. Trombly, 241 Mich. 199, 217 N.W. 47 (1928).

⁴ Mich. Comp. Laws (1948) §439.19, Mich. Stat. Ann. (1937) §19.59.

⁵ Mich. Comp. Laws (1948) §439.65, Mich. Stat. Ann. (1937) §19.105.

⁶ At common law in Michigan, an irregular indorser who placed his indorsement on an instrument before delivery of the instrument to the payee was liable as a co-maker. Wetherwax v. Paine, 2 Mich. 555 (1853); Rothschild v. Grix, 31 Mich. 150 (1875); Smith v. Long, 40 Mich. 555 (1879) (distinguishing the Wetherwax and Rothschild cases); Marine Trust Co. of Buffalo v. Roden, 218 Mich. 693, 188 N.W. 397 (1922) (discussing change in the rule under the NIL).

⁷ Price v. Klett, 255 Mich. 354, 238 N.W. 253 (1931). See also Cook v. Brown, 62 Mich. 473, 29 N.W. 46 (1886).

⁸ Peoples Nat. Bank v. Dicks, 258 Mich. 441, 242 N.W. 825 (1932).

⁹ O'Dess v. Gunter, 258 Mich. 667 at 668, 242 N.W. 804 (1932). See also Fox v. Mitchell, 302 Mich. 201, 4 N.W. (2d) 518 (1942).

representation. No particular form of appointment is necessary to establish such authority.

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

Section 3-403(1) is simply a restatement of section 19 of the NIL.¹⁰ Michigan cases dealing with the problem of establishing agency to sign negotiable instruments would be unaffected.¹¹

Section 3-403 (2) attempts to solve this problem—when an agent, acting with authority from his principal, signs an instrument “A, agent,” who is liable on the instrument? A similar question is presented when a representative signs “T, Trustee.” This problem in its infinite factual variations has constantly plagued our courts. At common law the holdings were varied and confusing. Some predictability of results in this area was sought by adoption of section 20 of the NIL.¹² However, reluctance of some courts to depart from common law holdings and failure of others to apply section 20 realistically have left much to be desired.

For example, at common law in Michigan, when an authorized agent signed an instrument “A, agent,” the rule was that “as between one of the original parties and a third party, the addition of the word

¹⁰ Mich. Comp. Laws (1948) §439.21, Mich. Stat. Ann. (1937) §19.61.

¹¹ The following cases involve various phases of express and implied authority to sign negotiable instruments and of agency by estoppel. Reichert v. State Sav. Bank, 274 Mich. 126, 264 N.W. 315 (1936); Kay v. County of Wayne, 274 Mich. 90, 264 N.W. 300 (1936); McIntosh v. Detroit Sav. Bank, 247 Mich. 10, 225 N.W. 628 (1929); Lonier v. Ann Arbor Sav. Bank, 162 Mich. 541, 127 N.W. 685 (1910); Quinn v. Quinn Mfg. Co., 201 Mich. 664, 167 N.W. 898 (1918); Armstrong v. Stearns, 156 Mich. 597, 121 N.W. 312 (1909); Stevens v. McLachlan, 120 Mich. 285, 79 N.W. 627 (1899); First Nat. Bank v. Stone, 106 Mich. 367, 64 N.W. 487 (1895); Davenport v. Stone, 104 Mich. 521, 62 N.W. 722 (1895); Merchants' Nat. Bank v. Detroit Knitting and Corset Works, 68 Mich. 620 (1888); Genesee Sav. Bank v. Michigan Barge Co., 52 Mich. 438 (1884); Shipman v. Byles, 65 Mich. 690, 32 N.W. 898 (1887); New York Iron Mine v. First Nat. Bank of Negaunee, 39 Mich. 644 (1878); Stroh v. Hinchman, 37 Mich. 490 (1877); Carrier v. Cameron, 31 Mich. 373 (1875); Littell v. Fitch, 11 Mich. 523 (1863); Kimball v. Cleveland, 4 Mich. 606 (1857); Farmers and Mechanics' Bank v. Troy City Bank, 1 Doug. (Mich.) 457 (1844).

¹² “Where the instrument contains, or a person adds to his signature, words indicating that he signs for or on behalf of a principal, or in a representative capacity, he is not liable on the instrument if he was duly authorized, but the mere addition of words describing him as an agent, or as filling a representative character, without disclosing his principal, does not exempt him from personal liability.” Mich. Comp. Laws (1948) §439.22, Mich. Stat. Ann. (1937) §19.62.

'agent' is not sufficient to put such third party upon inquiry" but "as between the immediate parties to the instrument, parol evidence is admissible to show the real character of the transaction."¹³ In other words, as between the immediate parties, the agent could avoid personal liability on the instrument by introducing parol evidence showing that he had signed for a principal.¹⁴ It is obvious that section 20 of the NIL was intended to change this result and to charge the agent with personal liability on the instrument even though the dispute arose between the immediate parties to the instrument. However, the Michigan courts have blithely ignored section 20 and continue to adhere to the common law rule.¹⁵

The code would again attempt to establish a uniform rule of personal liability on the agent who signs his name to an instrument "*unless the instrument names the person represented and shows that the signature is made in a representative capacity.*"¹⁶ The code is thus designed to put an end to the use of parol evidence in the "A, agent" situation in Michigan.

Another facet of this signature problem which has caused difficulty involves corporate signatures on instruments. Ideally, such an instrument would be signed "Y Co., by A, Pres." thus indicating that only Y Co. is to be bound. As a matter of common sense and business usage, no different intention is indicated where the instrument is signed "Y Co., A, Pres." or "A, Pres., Y Co." or where an instrument reading "Y Co. promises to pay" is signed "A, Pres." Yet, not infrequently, the courts have found A personally liable on the instrument in these situations.¹⁷

In Michigan, a note reading "We promise" and signed

"Drury Petroleum Corp.
Executive Board: J. E. Anderson,
Chas. G. Walker"

¹³ Keidan v. Winegar, 95 Mich. 430 at 432, 54 N.W. 901 (1893). However, when the authorized agent simply signed the instrument "A," parol evidence was not admissible under any circumstances to show agency. Finan v. Babcock, 58 Mich. 301, 25 N.W. 294 (1885).

¹⁴ The common law rule varied in other jurisdictions "from the refusal of such courts as the one in Maine to admit such evidence, even in actions between original parties, to the practice, like that in New Jersey, to allow the evidence even in actions by holders in due course." AIGLER, CASES ON BILLS AND NOTES 31, n. 25 (1947).

¹⁵ Lexington State Bank v. Rose City Creamery Co., 207 Mich. 81, 173 N.W. 481 (1919) (decided without even a reference to the NIL); Parker v. Parker, 282 Mich. 158, 275 N.W. 803 (1937). Since "no person is liable on the instrument whose signature does not appear thereon" (NIL, §20), is anyone bound on the instrument as a result of the holding in these cases?

¹⁶ Code, §3-403(2). Italics added.

¹⁷ See cases cited in BEUTEL'S BRANNON NEGOTIABLE INSTRUMENTS LAW 413 (1948).

was held not binding on the individuals.¹⁸ On the other hand, the court admitted parol evidence to establish personal liability on a note reading "we promise" and signed "Edmund Tropp, Boulevard Terrace Co., Pres."¹⁹

In an effort to avoid some of this confusion, section 3-403 (2) provides that "The name of an organization preceded or followed by the name and office of an authorized individual is a signature made in a representative capacity."

*Section 3-404. Unauthorized Signatures.*²⁰

(1) *Any unauthorized signature is wholly inoperative as that of the person whose name is signed unless he ratifies it or is precluded from denying it; but it operates as the signature of the unauthorized signer in favor of any person who in good faith pays the instrument or takes it for value.*

(2) *Any unauthorized signature may be ratified for all purposes of this Article. Such ratification does not of itself affect any rights of the person ratifying against the actual signer.*

Difficulties have arisen under the NIL when an unauthorized agent purports to sign for a principal. Obviously the purported principal has no liability on the instrument. But is the unauthorized agent liable? The present law provides that the agent "is not liable on the instrument if he was duly authorized,"²¹ but does this warrant the implication that the agent, if not authorized, is liable? Cardozo, C. J., in a decision which has been widely followed, concluded that the unauthorized agent is liable.²²

In *Annis v. Pfeiffer*,²³ a guardian who executed a note in a representative capacity to secure money for her ward was relieved of personal liability to the payee despite lack of authority to sign as guardian. The court found that the payee did not intend the guardian to be personally liable and believed, knowing all the facts but mistaking the law, that

¹⁸Wright v. Drury Petroleum Corp., 229 Mich. 542 at 543, 201 N.W. 484 (1924). See also Farmers and Mechanics' Bank v. Troy City Bank, 1 Doug. 457 (1844); Traverse City Depositors' Corp. v. Case, 297 Mich. 304, 297 N.W. 501 (1941).

¹⁹Simon v. Tropp, 252 Mich. 559 at 560, 233 N.W. 415 (1930). See also Tilden v. Barnard, 43 Mich. 376, 5 N.W. 420 (1880); Cooper v. Sonk, 201 Mich. 655, 167 N.W. 842 (1918).

²⁰"Unauthorized signature" means a signature made without actual, implied or apparent authority and includes a forgery. Sec. 1-201 (43).

²¹NIL, §20; Mich. Comp. Laws (1948) §439.22, Mich. Stat. Ann. (1937) §19.62.

²²New Georgia Nat. Bank of Albany, Ga. v. J. & G. Lippman, 249 N.Y. 307, 164 N.E. 108 (1928).

²³278 Mich. 692 at 694 and 695, 271 N.W. 568 (1937).

the guardian was authorized. In reaching this result, the Michigan court recognized that under section 20 of the NIL, "[t]he courts generally have construed the section to carry the converse of the statutory declaration of lack of personal liability, i.e., that one who signs in a representative capacity is personally liable if he is not duly authorized." However, the court decided that "such converse construction does not establish an absolute rule" and in this situation would constitute an "unwarranted extension of the inference of liability."

Under the code, liability of the unauthorized agent is not left to inference. Section 3-404 (1) provides that any unauthorized signature ". . . operates as the signature of the unauthorized signer in favor of any person who in good faith pays the instrument or takes it for value." Would *Annis v. Pfeiffer* be decided differently under the code? Probably so. The signature as guardian was unauthorized. Payee took the instrument for value in the mistaken but good faith belief that the signature was authorized. It would seem far-fetched to say that since payee knew all of the facts but was mistaken as to the guardian's legal authority on the facts, he took in bad faith. Of course, one who takes an instrument knowing that the signature was unauthorized acts in bad faith and should not recover.

In line with section 23 of the NIL,²⁴ section 3-404 (1) provides that "[a]ny unauthorized signature is wholly inoperative as that of the person whose name is signed unless he ratifies it or is precluded from denying it." Section 3-404 (2) provides that "[a]ny unauthorized signature may be ratified for all purposes of this Article." Decisions in Michigan dealing with ratification of unauthorized signatures would be unchanged.²⁵ The provision that a person may be "precluded from

²⁴ Mich. Comp. Laws (1948) §439.25, Mich. Stat. Ann. (1937) §19.65.

²⁵ *McDonough v. Heyman*, 38 Mich. 334 (1878); *Schmid v. Village of Frankfort*, 141 Mich. 291, 104 N.W. 668 (1905); *Furlong v. Manufacturers Nat. Bank*, 285 Mich. 517, 281 N.W. 309 (1938). See also *McLellan v. Detroit File Works*, 56 Mich. 579 (1885). Cf. *Houseman-Spitzley Corp. v. American State Bank*, 205 Mich. 268, 171 N.W. 543 (1919); *Metropolitan Cas. Ins. Co. v. First Nat. Bank*, 261 Mich. 450, 246 N.W. 178 (1933).

In the *Furlong* case, *supra*, K forged indorsements on checks drawn by his employers (plaintiffs) and received payment of the checks from the drawee banks (defendants). Defendant banks argued ratification of the forgeries based on the fact that plaintiffs accepted partial restitution from K and took K's promissory note for the balance of the monies he had wrongfully obtained. Also, plaintiffs retained K in their employ. In denying that these facts established ratification of the forgeries, the court distinguished *Union Guardian Trust Co. v. First Nat. Bank*, 271 Mich. 323, 259 N.W. 912 (1935), which held that where plaintiff prosecuted its claim to final judgment against the forger, there was an election of remedies and no recovery could later be had against the bank. The doctrine of the *Union Guardian Trust Co.* case, which is closely akin to theories of ratification, has been followed in *Ielmini v. Bessemer Nat. Bank*, 298 Mich. 59, 298 N.W. 404 (1941) and *Weaver v. Detroit Bank*, 330 Mich. 366, 47 N.W. (2d) 650 (1951).

denying" authenticity of his signature contemplates the result in Michigan cases which have estopped the maker of a note from denying the genuineness of his signature because of delay in notifying the holder of the forgery.²⁶ Also, it would encompass the result in cases which have estopped the owner of a check from denying the genuineness of a forged indorsement because of delay in notifying the cashing bank, against whom recovery was sought, of the forgery.²⁷

Section 3-405. Imposters; Signature in Name of Payee.

(1) *An indorsement by any person in the name of a named payee is effective if*

- (a) *an imposter by use of the mails or otherwise has induced the maker or drawer to issue the instrument to him or his confederate in the name of the payee; or*
- (b) *a person signing as or on behalf of a drawer intends the payee to have no interest in the instrument; or*
- (c) *an agent or employee of the drawer has supplied him with the name of the payee intending the latter to have no such interest.*

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

The NIL does not deal with the imposter problem. Where A poses as B and receives an instrument payable to the order of B, is A's indorsement of B's name a forgery? The answer in many jurisdictions hinges on whether the "dominant intent" of the maker or drawer was to pay to the physical person A who was posing as B or to pay to B. In other jurisdictions, A's indorsement of B's name is a forgery without regard to the maker's or the drawer's intention.²⁸ Section 3-405 would eliminate speculation about intention and establish the uniform rule that in the imposter situation, indorsement of the payee's name "by any person" would be effective.

²⁶ *Kole v. Lampen*, 191 Mich. 156, 157 N.W. 392 (1916). See also *Clark v. Detroit Curling Club*, 298 Mich. 339, 299 N.W. 99 (1941).

²⁷ *Brown v. People's Nat. Bank*, 170 Mich. 416, 136 N.W. 506 (1912); *National Production Co. v. Guardian Nat. Bank of Commerce*, 281 Mich. 230, 274 N.W. 774 (1937). In the latter case the court raised the estoppel even though the cashing bank was found to have paid out the monies negligently on the check bearing the forged indorsement. Neither case mentions NIL, §23. See also dictum of Cooley, C.J., in *Stroh v. Hinchman*, 37 Mich. 490 at 497 (1877), indicating that failure to prosecute for unauthorized signature on negotiable paper would estop one from "disputing any paper made without authority subsequently."

²⁸ For a discussion of the problem, see Abel, "The Imposter Payee: or, Rhode Island Was Right," 1940 Wis. L. Rev. 161.

There is a dearth of imposter cases in Michigan and from the few cases reported it is impossible to say which of the above approaches to the problem the Michigan courts would follow. In *Peninsular State Bank v. First National Bank*²⁹ one Hunchik had a savings account (\$2,700) with plaintiff. Plaintiff received a request through the mails from a party claiming to be Hunchik for withdrawal of the \$2,700 deposit. Plaintiff issued its manager's check for \$2,700 payable to Hunchik. The check, bearing what purported to be Hunchik's indorsement, was paid to defendant by plaintiff. The court found that "the party claiming to be Hunchik was an imposter and his indorsement on the check was a forgery." Plaintiff would have recovered but for a finding of negligence giving rise to estoppel. Under section 3-405, the imposter's indorsement of Hunchik's name would not be a forgery, indicating that the code would change Michigan law in this area.³⁰

As to the fictitious payee problem, section 9 (3) of the NIL³¹ provides that an instrument payable to the order of a "fictitious or non-existing" person is payable to bearer where "such fact was known to the person making it so payable." This provision fails to give protection to a drawee or to purchasers of an instrument in the common situation where a dishonest agent or employee causes his principal or employer to draw an instrument payable to the order of a fictitious payee and then indorses in the name of a fictitious payee. Since the principal or employer, as drawer, has no knowledge that the instrument is payable to a fictitious payee, the Michigan courts have consistently treated such instruments as payable to order rather than to bearer.³² As a result, the drawee and purchasers of the instrument must take the consequences of having dealt with an instrument bearing a forged indorsement.

Under the code, the analysis in these cases would be changed. Section 3-405 provides that an indorsement "by any person" in the name of a named payee is effective if "an agent or employee of the drawer³³ has supplied him with the name of the payee intending the latter to have no" interest in the instrument. This provision would

²⁹ 245 Mich. 179 at 181, 222 N.W. 157 (1928).

³⁰ Compare *Beckwith v. Webber*, 78 Mich. 390, 44 N.W. 330 (1889).

³¹ Mich. Comp. Laws (1948) §439.11, Mich. Stat. Ann. (1937) §19.51.

³² *Metropolitan Cas. Ins. Co. v. First Nat. Bank*, 261 Mich. 450, 246 N.W. 178 (1933); *Detroit Piston Ring Co. v. Wayne County Bank*, 252 Mich. 163, 233 N.W. 185 (1930); *Houseman-Spitzley Corp. v. American State Bank*, 205 Mich. 268, 171 N.W. 543 (1919); *Harmon v. Old Detroit Nat. Bank*, 153 Mich. 73, 116 N.W. 617 (1908). See also *Shaw, Kendall & Co. v. Brown*, 128 Mich. 573, 87 N.W. 757 (1901).

³³ Note that the provision is limited to drafts. "Draft" is defined by §3-104 as "an order."

validate indorsements which have been customarily treated as forged indorsements in Michigan thus working substantial changes in liability.³⁴

Neither the NIL nor the code specifically covers the problem of fictitious indorsees.³⁵

Section 3-406. Negligence Contributing to Alteration of Unauthorized Signature.

Any person who by his negligence substantially contributes to a material alteration of the instrument or to the making of an unauthorized signature is precluded from asserting the alteration or lack of authority against a holder in due course or against a drawee or other payor who pays the instrument in good faith and in accordance with the reasonable commercial standards of the drawee's or payor's business.

At common law an instrument which was materially altered was completely void even in the hands of a holder in due course.³⁶ This harsh rule was modified by section 124 of the NIL³⁷ which gives a holder in due course the right to enforce payment of the altered instrument "according to its original tenor." However, section 124 of the NIL still leaves open to doubt the question of what effect negligence in drawing the instrument so as to invite alteration should have upon liability.

The English courts decided in *Young v. Grote*,³⁸ that as between bank and depositor the drawee bank could properly debit the account of the drawer for the amount of a check negligently drawn so as to invite alteration. In the limited context of the bank-depositor relationship, the doctrine of *Young v. Grote* has been generally accepted in this country.³⁹ But should negligence which facilitates alteration play any part in questions of liability on negotiable instruments generally? For example, should the good faith holder of a note or bill of exchange negligently drawn so as to invite alteration be enforceable against the drawer or maker in its altered form? Also, what effect does section 124 have on the problem? The courts of this country have disagreed.

³⁴ While the fictitious payee question was not discussed in *Nat. Bank of Detroit v. Fidelity & Deposit Co.*, 291 Mich. 36, 288 N.W. 325 (1939), the facts indicate that under the code the question could probably have been effectively raised to alter the result.

³⁵ The New York courts recently faced this interesting problem in *Hall v. Bank of Bladell*, 306 N.Y. 336, 118 N.E. (2d) 464 (1954).

³⁶ See, for example, *Wait v. Pomeroy*, 20 Mich. 425 (1870); *Holmes v. Trumper*, 22 Mich. 427 (1871).

³⁷ Mich. Comp. Laws (1948) §439.126, Mich. Stat. Ann. (1937) §19.166

³⁸ 4 Bing. 253 (1827).

³⁹ See 23 MICH. L. REV. 775, 777 (1925).

In Michigan, the problem was raised at common law in the early case of *Holmes v. Trumper*⁴⁰ where the maker executed a time note. The promise ended with the printed words "with interest at" Payee or a subsequent holder filled in the words "10 per cent" after these printed words. A good faith holder sought recovery against the maker on the note as altered. The court found that it was "a complete and valid note, drawing the legal rate of . . . seven per cent." The holder contended, however, that the maker was negligent in issuing the note in this form and should be required to pay according to its altered terms. Even assuming that the maker was negligent, the court refused to depart from the common law doctrine that an altered instrument was void and denied recovery as a result. "Whenever a party in good faith signs a complete promissory note, however awkwardly drawn, he should, we think, be equally protected from its alteration by forgery in whatever mode it may be accomplished"⁴¹ In distinguishing *Young v. Grote*, the court confined its application to disputes between bank and depositor over payment of altered checks.

In the recent case of *Commonwealth Bank v. Dunn*⁴² the question of the effect of negligence facilitating alteration was raised under the NIL. Defendant-drawer drew a typewritten check because the payee, an employee of drawer, said that the check-writing machine was not working. The employee-payee raised the amount of the check from \$4.98 to \$504.98 and deposited it in plaintiff-bank. Defendant-drawer stopped payment on the check. Plaintiff-bank, as a holder in due course, sued defendant-drawer for the altered amount of the check, claiming defendant-drawer was estopped to deny liability on the altered contract because of negligence in the manner of drawing the check.

⁴⁰ 22 Mich. 427 at 429 (1871).

⁴¹ *Id.* at 435. The same result was reached in *Bradley v. Mann*, 37 Mich. 1 (1877), on substantially similar facts. See also *Graham v. Sinderman*, 238 Mich. 210, 213 N.W. 200 (1927).

If the court had found in *Holmes v. Trumper* that the note was incomplete, i.e., contained blank spaces, when issued, the negligence of the maker in so issuing the instrument would have rendered him liable on the note in its completed form. See *Weidman v. Symes*, 120 Mich. 657 at 660, 79 N.W. 894 (1899), in which there was a promise to pay "one hundred dollars at ———. Value received with interest at ——— percent per annum." Without authority, the blanks were filled in with the words "ten (10) percent" and the figure "10" respectively. The court treated this as an incomplete instrument containing blank spaces and held the maker liable on the note in its completed form to a good faith purchaser. The court based liability on the finding that it was negligent to issue an incomplete instrument containing blank spaces. The court distinguished *Holmes v. Trumper* on the ground that "there was no blank space left to be filled. The words '10 percent' were added at the end of the note." *Accord*, *First State Sav. Bank v. Webster*, 121 Mich. 149, 79 N.W. 1068 (1899). Cf. *First Nat. Bank v. Carson*, 60 Mich. 432, 27 N.W. 589 (1886). NIL, §14 contemplates the result reached in the *Weidman* case.

⁴² 335 Mich. 665, 57 N.W. (2d) 294 (1953).

The court allowed recovery according to the original tenor of the instrument, i.e., \$4.98. It thus recognized that section 124⁴³ of the NIL had changed the common law rule voiding altered instruments entirely but, in line with *Holmes v. Trumper*, it decided that negligence in drawing the instrument would not affect liability on the altered instrument.

Under the code, "[a]ny person who by his negligence substantially contributes to a material alteration of the instrument . . . is precluded from asserting the alteration . . . against a holder in due course. . . ." Whereas negligence of the drawer or maker is now immaterial in Michigan in alteration situations,⁴⁴ the code would make such negligence a material fact and if the judge or jury should find that the negligence substantially contributed to the alteration, the maker or drawer would be estopped to deny liability to a holder in due course on the instrument as altered.

Section 3-406 also provides that the drawer of a bill or check whose negligence "substantially contributes" to the alteration cannot assert such alteration against his drawee who has paid the instrument according to its altered terms "in good faith and in accordance with the reasonable commercial standards of the drawee's . . . business." Since the Michigan courts have approved the doctrine of *Young v. Grote* this provision would work no significant change in the law.

Section 3-406 would also operate where negligence substantially contributed "to the making of an unauthorized signature." For example, a drawer or maker who used a signature stamp would be estopped to deny liability on the instrument to a holder in due course if his negligent manner of keeping the stamp substantially contributed to the forgery of his signature. And in such circumstances, the drawer could not object to his account being charged by the drawee who paid the forged instrument. Similarly, if the negligence of the drawer or

⁴³ Mich. Comp. Laws (1948) §439.126, Mich. Stat. Ann. (1937) §19.166.

⁴⁴ Of course, the fact that inviting open spaces are left in the otherwise complete instrument may be material to the question of whether an alteration could actually have been made. In *Pearson v. Hardin*, 95 Mich. 360, 54 N.W. 904 (1893), the fact of whether the instrument had been altered was disputed. The court upheld a line of questioning intended to show that open spaces had been left before the statements of the principal amount in the instrument. The purpose of such testimony was carefully limited, however, as follows (at p. 367):

"It was important to ascertain whether such spaces were left when the note was executed. If not, the note could not easily have been raised, and the probability of its genuineness was greater. Defendant stated unequivocally that such spaces were left, and the questions were within the range of legitimate cross-examination. The language of the [trial] court, in overruling the objection, carefully pointed out the bearing of the testimony, and expressly disavowed any purpose to treat the evidence as tending to establish a legal liability, by reason of defendant's negligence in failing to fill such blanks." Italics added.

maker substantially contributed to the making of an unauthorized indorsement, he would be precluded from questioning the title of a holder in due course and the drawer could not prevent the drawee from making a charge to his account upon good faith payment of the instrument. Such negligence might be found where the drawer or maker negligently mailed the instrument to a person having the same name as the intended payee; where the drawer otherwise negligently placed the instrument in the forger's hands with the means of misleading others as to the forger's right to indorse;⁴⁵ or where the drawer was negligent in failing to discover and stop the continued issuance of fraudulent checks bearing forged indorsements.⁴⁶ Apparently a payee who negligently contributed to a forgery of his indorsement by careless control over a signature stamp would be estopped to deny the title of a subsequent holder in due course or to deny liability as an indorser. Also, the payee could not recover monies received by the holder in due course on theories of conversion or assumpsit. Similarly, it would seem that the negligent payee would be denied recovery on theories of conversion or assumpsit against the drawee who paid the instrument.

Section 3-407. Alteration.

(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 of 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.*

(2) *As against any person other than a subsequent holder in due course*

- (a) *alteration by the holder which is both fraudulent and material discharges any party whose contract is thereby changed unless that party assents or is precluded from asserting the defense;*
- (b) *no other alteration discharges any party and the instrument may be enforced according to its original tenor,*

⁴⁵ See *Peninsular State Bank of Detroit v. First Nat. Bank*, 245 Mich. 179, 222 N.W. 157 (1928).

⁴⁶ See *Detroit Piston Ring Co. v. Wayne County & Home Sav. Bank*, 252 Mich. 163 at 175-179, 233 N.W. 185 (1930). Cf. *Harmon v. Old Detroit Nat. Bank*, 153 Mich. 73, 116 N.W. 617 (1908).

or as to incomplete instruments according to the authority given.

(3) *A subsequent holder in due course may in all cases enforce the instrument according to its original tenor, and when an incomplete instrument has been completed, he may enforce it as completed.*

Section 3-407 (1) defines material alteration as one which "changes the contract of any party thereto in any respect."⁴⁷ This provision is generally in accord with the approach of the Michigan courts to the problem of material alteration. Under the code, as now, alteration of the principal amount,⁴⁸ change of the interest rate,⁴⁹ change of the maturity date,⁵⁰ erasure of part of the contract terms,⁵¹ addition of an interest provision,⁵² and change of the name of the payee⁵³ would be material alterations. Under the code, as at present, the addition of words not affecting the contract would not be material alterations.⁵⁴

The provision of section 3-407 (1) (a) that a change in the "number or relations of the parties" shall constitute a material alteration if it changes the contract of any party is in accord with existing Michigan law. Insertion of the name of an additional payee would continue to be a material alteration.⁵⁵ However, as is presently the case, addition of the signature of a co-maker,⁵⁶ signature by an anomalous indorser,⁵⁷ or substitution of one form of security for another⁵⁸ would not be material alterations.

⁴⁷ Compare NIL, §125 [Mich. Comp. Laws (1948) §439.127, Mich. Stat. Ann. (1937) §19.167] which lists items that constitute material alteration.

⁴⁸ *Commonwealth Bank v. Dunn*, 335 Mich. 665, 57 N.W. (2d) 294 (1953); *Graham v. Sinderman*, 238 Mich. 210, 231 N.W. 200 (1927); *Pearson v. Hardin*, 95 Mich. 360, 54 N.W. 904 (1893). See also *Baird v. Salnave*, 174 Mich. 409, 140 N.W. 650 (1913).

⁴⁹ *Bradley v. Mann*, 37 Mich. 1 (1877); *Holmes v. Trumper*, 22 Mich. 427 (1871); *Sheldon v. Hawes*, 15 Mich. 518 (1867).

⁵⁰ *Jourden v. Boyce*, 33 Mich. 302 (1876). See also *Ensign v. Fogg*, 177 Mich. 317, 143 N.W. 82 (1913).

⁵¹ *Nelson v. Dutton*, 51 Mich. 416, 16 N.W. 791 (1883).

⁵² *Swift v. Barber*, 28 Mich. 503 (1874).

⁵³ *Graham v. Sinderman*, 238 Mich. 210, 213 N.W. 200 (1927).

⁵⁴ *Garwood v. Burton*, 265 Mich. 408, 251 N.W. 564 (1933) (dictum); *Leonard v. Phillips*, 39 Mich. 182 (1878).

⁵⁵ *Aldrich v. Smith*, 37 Mich. 468 (1877).

⁵⁶ *Gano v. Heath*, 36 Mich. 441 (1877); *Miller v. Finley*, 26 Mich. 249 (1872). In the latter case the court suggested however (at 253), that where several co-makers stand in the relation of sureties for one co-maker as principal, their contracts might be injuriously affected by the later addition of other sureties. For example, if one of the sureties becomes bankrupt, a solvent surety's "obligation to pay may be increased, and his right of contribution against co-sureties diminished, by the change."

⁵⁷ *Ensign v. Fogg*, 177 Mich. 317, 143 N.W. 82 (1913).

⁵⁸ *Dart Nat. Bank v. Burton*, 258 Mich. 283, 241 N.W. 858 (1932).

Section 3-407 (1) (b), which makes unauthorized completion of an incomplete instrument a material alteration,⁵⁹ seems to be consistent with Michigan common law.⁶⁰ Under the NIL, however, the subject of incomplete instruments is treated separately from material alteration of instruments.⁶¹ To this extent there would be a change under the code but it is without real significance.

Sections 3-407 (1) (c) provides that material alteration shall include a change in the contract of any party which results from "adding to . . . or by removing any part of" the writing as signed. This provision is in accord with the Michigan cases holding that unauthorized removal of a memorandum from the bottom of a note is a material alteration.⁶² Similarly, unauthorized separation of a note from a conditional sale contract⁶³ or from any other form of contract⁶⁴ would continue to be material alterations.

Rights of holder of an altered instrument who is not a holder in due course: While the code definition of material alteration does not significantly change existing Michigan law, there would be important changes in the legal consequences flowing from such alteration. Under section 124⁶⁵ of the NIL the altered instrument in the hands of a holder other than a holder in due course is "avoided" as to *all parties* except one who "made, authorized, or assented to the alteration, and subsequent indorsers." Under section 3-407 (2) (b), such a holder could enforce the altered instrument "according to its original tenor, or as to incomplete instruments according to the authority given" against any party whose contract was not actually changed by the alteration. Thus, under the code, discharge of a party because of material alteration becomes a personal defense of the party whose contract is changed thereby and anyone whose contract is not affected by the alteration is liable to the extent indicated. The *instrument* is not "avoided" as under the NIL.

⁵⁹ See also §3-115 of the code.

⁶⁰ *Weidman v. Symes*, 120 Mich. 657, 79 N.W. 894 (1899); *First State Sav. Bank v. Webster*, 121 Mich. 149, 79 N.W. 1068 (1899).

⁶¹ Incomplete instruments, NIL, §§14 and 15 [Mich. Comp. Laws (1948) §§439.16 and 439.17, Mich. Stat. Ann. (1937) §§19.56 and 19.57]. Alteration, NIL, §§124 and 125 [Mich. Comp. Laws (1948) §§439.126 and 439.127, Mich. Stat. Ann. (1937) §§19.166 and 19.167].

⁶² *Wait v. Pomeroy*, 20 Mich. 425 (1870); *First Nat. Bank v. Carter*, 138 Mich. 421, 101 N.W. 585 (1904).

⁶³ *Toledo Scale Co. v. Gogo*, 186 Mich. 442, 152 N.W. 1046 (1915); *Stevens v. Venema*, 202 Mich. 232, 168 N.W. 531 (1918).

⁶⁴ *Keweenaw Utilities Co. v. Runzel*, 256 Mich. 345, 239 N.W. 325 (1931); *Muskegon Citizens Loan & Investment Co. v. Champayne*, 257 Mich. 427, 241 N.W. 135 (1932).

⁶⁵ Mich. Comp. Laws (1948) §439.126, Mich. Stat. Ann. (1937) §19.166.

Furthermore, such discharge occurs only if: (1) the material alteration is made by "the holder"; (2) the material alteration is "fraudulent"; and (3) the party claiming discharge has neither assented to the alteration nor has precluded himself from asserting the defense of alteration.

(1) What is meant by the provision that the alteration must be made by "the holder"? Does this expression refer to *any* holder of the instrument or only to the holder *at the time claim is made and the defense asserted*?⁶⁶ If it means the latter, this would represent a change in Michigan law.⁶⁷ If it means the former, this provision would still be an innovation in Michigan law.⁶⁸ While in some Michigan cases the alteration seems to have been made by a holder there is no indication that a finding of this fact was necessary to the result.⁶⁹ Sometimes there is no finding as to who made the alteration⁷⁰ or there is an actual finding that the alteration was not made by a holder.⁷¹ Nevertheless, the parties to the instrument are held to be discharged by the alteration. Under the code, absent a finding that the alteration was made by "the holder" (whatever this means), the parties would be liable according to the original tenor of the instrument or, if an incomplete instrument, according to the authority actually given to complete it.

Do the words "the holder" include acts of agents of the holder? The drafters' comment indicates "that the acts of the holder's authorized agent or employee or of his confederates, are to be attributed to him."⁷² In Michigan, alteration of an instrument by an agent of a holder is regarded as "spoliation" by a stranger unless the holder knows

⁶⁶ The drafters' comment is of little help here. It simply states that "[s]poliation by any meddling stranger does not affect the rights of the holder." (Comment 3a.) So far as the holder who finally asserts a claim on the instrument is concerned, a prior holder who altered the instrument would seem to be a "meddling stranger." Nor does the definition of the word "holder" clarify the situation. "Holder" is defined as "a person who is in possession of . . . an instrument . . . drawn, issued or indorsed to him or to his order or to bearer or in blank." Sec. 1-201(20).

⁶⁷ *Stevens v. Venema*, 202 Mich. 232, 168 N.W. 531 (1918).

⁶⁸ Prior to the NIL, courts often distinguished between alteration by a party to the instrument and "spoliation" by accident or by a stranger. The NIL, however, seemed to abandon this distinction. 16 HARV. L. REV. 255 at 260 (1903). Perhaps the code intends to restore this distinction.

⁶⁹ *Swift v. Barber*, 28 Mich. 503 (1874); *Johnson v. Johnson Estate*, 66 Mich. 525, 33 N. W. 413 (1887). See also *Stewart v. First Nat. Bank*, 40 Mich. 348 (1879).

⁷⁰ *Toledo Scale Co. v. Gogo*, 186 Mich. 442, 152 N.W. 1046 (1915).

⁷¹ Since the code makes unauthorized completion of an incomplete instrument a material alteration, see *Bronson v. Stetson*, 252 Mich. 6, 232 N.W. 741 (1930), where the unauthorized completion was made by an agent of the maker of a note.

⁷² Sec. 3-407, comment 3a.

of or consents to the alteration.⁷³ Such a result would seem to violate the spirit of the code.

(2) The alteration must be "fraudulent" as well as material. Blanks filled in the honest belief that the completion is made with authority and alterations favorable to the obligor are not likely to be fraudulent.⁷⁴ Beyond this, it is difficult to say what would constitute fraudulent intent. In some cases, of course, fraudulent intent will be fairly evident as, for example, where the principal amount is raised or the interest rate is increased or the name of the payee is changed.⁷⁵

Whether this requirement that the alteration be "fraudulent" would add a new element to alteration cases in Michigan is difficult to say. In *Aldrich v. Smith*⁷⁶ the alteration was made in the belief that it was "only supplying an oversight . . . and with no dishonest purpose." The court held that whether the alteration was made honestly or dishonestly was immaterial.⁷⁷ But in *Johnson v. Johnson Estate*⁷⁸ lack of fraudulent intent in the alteration influenced the court in its decision. Ordinarily, however, there is no discussion of the intentions motivating the alteration. To the extent that proof of fraudulent intent would become an essential element of the defense of alteration under the code, there would seem to be a change in Michigan law.

(3) Once *material* alteration by *the holder with fraudulent intent* is shown, the *party* whose contract was changed by the alteration is discharged *unless* "that party assents or is precluded from asserting the defense." The concept of assent to alteration would not be new to Michigan law.⁷⁹ One interesting question should be noted, however. In *Stevens v. Venema*⁸⁰ defendant signed a conditional sale contract and promissory note attached together by a perforated line. The note was separated from the contract and was transferred to plaintiff who

⁷³ *Owosso Sugar Co. v. Armtz*, 244 Mich. 351, 221 N.W. 179 (1928).

⁷⁴ Comment 3b. See *Ensign v. Fogg*, 177 Mich. 317, 143 N.W. 82 (1913), where the principal amount of a note was payable one year after date and date of note was changed from April 14, 1909 to May 14, 1909.

⁷⁵ *Stevens v. Venema*, 202 Mich. 232, 168 N.W. 531 (1918), indicates that detachment of a promissory note from a conditional sale contract will be regarded as presumptively fraudulent.

⁷⁶ 37 Mich. 468 (1877).

⁷⁷ Dictum in *Wait v. Pomeroy*, 20 Mich. 425 at 428 (1870), states: "And if the alteration is material, it makes no difference whether apparently favorable or prejudicial."

⁷⁸ 66 Mich. 525, 33 N.W. 413 (1887).

⁷⁹ NIL, §124 [Mich. Comp. Laws (1948) §439.126, Mich. Stat. Ann. (1937) §19.166]. *Swift v. Barber*, 28 Mich. 503 (1874); *Stewart v. First Nat. Bank of Port Huron*, 40 Mich. 348 (1879). See also *Nelson v. Dutton*, 51 Mich. 416, 16 N.W. 791 (1883).

⁸⁰ 202 Mich. 232 at 236 and 239, 168 N.W. 531 (1918).

had notice of these circumstances. Defendant set up the defense of alteration by separation of the note from the contract. Plaintiff countered with the assertion that defendant had assented to the separation of the documents. The alleged assent consisted of this statement which appeared just above the perforation: "The attached note is tendered in settlement of this order and the company is authorized to detach same when this order is approved and shipped." The court refused to find assent because the "natural inference to be drawn from incorporating a detachable promissory note in such an instrument in a transaction of this nature is a purpose to deceive." Under the code conditional sale transactions would be fully recognized in Michigan. Would this sufficiently disperse the clouds of suspicion which have obscured conditional sale transactions in Michigan so that such assents would become effective?⁸¹

The provision that a party may be precluded from asserting the defense of alteration would apparently not be new to Michigan law.⁸² Should a person who issues an instrument in incomplete form be precluded because of negligence from asserting the defense of alteration by unauthorized completion?⁸³ Presumably if there is either assent or preclusion under section 3-407 (2), the instrument can be enforced in its altered form.

Rights of holder in due course of altered instrument: Since, under section 3-407(3), an altered instrument cannot be avoided as to a subsequent holder in due course but, instead, can "in all cases" be enforced by such holder "according to its original tenor," it would make no difference, as under section 3-407(2), whether the alteration was made by "the holder" or was "fraudulent." This is in line with Michigan law.⁸⁴

⁸¹ In *Muskegon Citizens Loan & Investment Co. v. Champayne*, 257 Mich. 427, 241 N.W. 135 (1932), assent to alteration by detachment of a note from an advertising contract was found simply from the fact that the "perforation between that portion of the paper on which the note was printed and the portion which contained the terms of the advertising contract . . . was ample notice to defendants that the note as such could be and probably would be detached and used in regular course as negotiable instruments are used." (p. 429) Unlike *Stevens v. Venema*, plaintiff was a holder in due course in this case. However, why shouldn't this same approach be used in applying the assent provisions of §3-407(2)? See also *Kewanee Private Utilities Co. v. Runzel*, 256 Mich. 345, 239 N.W. 325 (1931).

⁸² See *Acme Food Co. v. Tousey*, 148 Mich. 697, 112 N.W. 484 (1907).

⁸³ Compare §3-406.

⁸⁴ See NIL, §124 [Mich. Comp. Laws (1948) §439.226, Mich. Stat. Ann. (1937) §19.166.

Under sections 14⁸⁵ and 15⁸⁶ of the NIL a distinction is drawn between the rights of recovery by a holder in due course on an incomplete instrument which is delivered into the channels of commerce by authority of the maker or drawer and an incomplete instrument which is not so delivered. In the former case, the holder in due course can enforce the instrument as completed.⁸⁷ In the latter case, the instrument is unenforceable. The code would abolish this distinction as to incomplete instruments delivered with or without authority. Section 3-115(2), which deals with incomplete instruments, provides that if the "completion is unauthorized the rules as to material alteration apply (Section 3-407), *even though the paper was not delivered by the maker or drawer.*"⁸⁸ Section 3-407(3) provides that "when an incomplete instrument has been completed, he [the holder in due course] may enforce it as completed." Hence the holder in due course⁸⁹ could recover on the instrument as completed whether or not the maker or drawer of the incomplete instrument had authorized its delivery into the channels of commerce.

In some circumstances the holder in due course could recover on an instrument in its altered form rather than according to its original tenor. This would be true where, under section 3-406, a party's negligence has substantially contributed to the alteration. Also, while section 3-407(3) makes no provision for the rights of a holder in due course when a party has *assented* to the alteration, it seems that he should be allowed to enforce the instrument against such party according to its altered terms rather than according to its original tenor.⁹⁰

Section 3-408. *Consideration.*

Want or failure of consideration is a defense as against any person not having the rights of a holder in due course (Section 3-305), except that no consideration is necessary for an instrument or obligation there-

⁸⁵ Mich. Comp. Laws (1948) §439.16, Mich. Stat. Ann. (1937) §19.56.

⁸⁶ Mich. Comp. Laws (1948) §439.17, Mich. Stat. Ann. (1937) §19.57.

⁸⁷ See *Weidman v. Symes*, 120 Mich. 657, 79 N.W. 894 (1899); *First State Savings Bank v. Webster*, 121 Mich. 149, 79 N.W. 1068 (1899); *Simon v. Mittelman*, 258 Mich. 266, 241 N.W. 816 (1932).

⁸⁸ Italics added. See also §3-305(2).

⁸⁹ It should be observed that the question of who may be a holder in due course of such an instrument would be treated somewhat differently under the code than under present Michigan law. See *Bronson v. Stetson*, 252 Mich. 6, 232 N.W. 741 (1930), and §§3-302(2) and 3-304(5)(d).

⁹⁰ Compare §3-407(2)(a). See *Muskegon Citizens Loan & Investment Co. v. Cham-payne*, 257 Mich. 427, 241 N.W. 135 (1932).

*on given in payment of or as security for an antecedent obligation of any kind.*⁹¹

Since want or failure of consideration is now a defense against persons other than holders in due course, holdings on this subject would not be disturbed.⁹² However, the provision that "no consideration is

⁹¹ For the evolution of this provision, see Palmer, "Negotiable Instruments under the Uniform Commercial Code," 48 MICH. L. REV. 255 at 288 (1950). Presumption of consideration and burden of proof of the defense of want or failure of consideration are covered by §3-307.

⁹² Forbearance from assertion of claim as consideration: *Rood v. Jones*, 1 Doug. 188 (1843); *Taylor v. Weeks*, 129 Mich. 233, 88 N.W. 466 (1901) (claim invalid because barred by statute of limitations); *Thornton v. Damm*, 120 Mich. 510, 79 N.W. 797 (1899) (claim invalid). See also *Cawthorpe v. Clark*, 173 Mich. 267, 138 N.W. 1075 (1912); *Steepe v. Harpham*, 241 Mich. 652, 217 N.W. 787 (1928). Relinquishment of dower as consideration: *Kennedy v. Shaw*, 43 Mich. 359, 5 N.W. 396 (1880). Note given by father to son to cover son's share in father's estate as consideration: *Conrad v. Manning's Estate*, 125 Mich. 77, 83 N.W. 1038 (1900). See also *In re Barth's Estate*, 301 Mich. 186, 3 N.W. (2d) 56 (1942). Worthless property as consideration: *Miller v. Finley*, 26 Mich. 249 (1872); *McCabe v. Caner*, 68 Mich. 182, 35 N.W. 901 (1888); *Crampton v. Newton's Estate*, 132 Mich. 149, 93 N.W. 250 (1903). But see *Newman and Snell's State Bank v. Hunter*, 243 Mich. 331, 220 N.W. 665 (1928) (worthless note not consideration). Promises against public policy as consideration: *Buck v. First Nat. Bank*, 27 Mich. 293 (1873); *Barden v. A. Heller Sawdust Co.*, 240 Mich. 549, 215 N.W. 364 (1927); *Tinker v. Hurst*, 70 Mich. 159, 38 N.W. 16 (1888); *O'Hara v. Carpenter*, 23 Mich. 410 (1871); *East Side Trust & Savings Bank v. McGinnis*, 197 Mich. 432, 163 N.W. 949 (1917); *Hubbard v. Freiburger*, 133 Mich. 139, 94 N.W. 727 (1903). *Case v. Smith*, 107 Mich. 416, 65 N.W. 279 (1895); *Comstock v. Draper*, 1 Mich. 481 (1850); *McNamara v. Gargett*, 68 Mich. 454, 36 N.W. 218 (1888). Moral obligation arising out of oral promise void under statute of frauds or barred by statute of limitations as consideration: *Bagaeff v. Prokopik*, 212 Mich. 265, 180 N.W. 427 (1920), and *Koons v. Vauconsant*, 129 Mich. 260, 88 N.W. 630 (1902) (dictum). Services as consideration: *In re Dunnigan's Estate*, 282 Mich. 500, 276 N.W. 532 (1937); *Garwood v. Burton*, 265 Mich. 408, 251 N.W. 564 (1933). Promise of marriage as consideration where promisee dies before marriage: *In re Roy's Estate*, 278 Mich. 6, 270 N.W. 196 (1936). Settlement of claims or controversies as consideration: *Walton v. Mason*, 109 Mich. 486, 67 N.W. 692 (1896); *Barger v. Farnham*, 130 Mich. 487, 90 N.W. 281 (1902); *Young v. Shepard's Estate*, 124 Mich. 552, 83 N.W. 403 (1900); *Gates v. Shutts*, 7 Mich. 126 (1859). Novation: *American Commercial Alcohol Corp. v. Don G. McAfee, Inc.*, 274 Mich. 689, 265 N.W. 504 (1936); *Littshire Clothes, Inc. v. Detroit Hub Clothes, Inc.*, 294 Mich. 661, 294 N.W. 69 (1940). Cf. *Compton v. Blair*, 27 Mich. 397 (1873). Detrimental reliance: *Farnsworth v. Fraser*, 137 Mich. 296, 100 N.W. 400 (1904). Failure of consideration: *Gottesman v. Rheinfrank*, 303 Mich. 153, 5 N.W. (2d) 701 (1942); *Perkins v. Brown*, 115 Mich. 41, 72 N.W. 1095 (1897); *Fink v. Chambers*, 95 Mich. 508, 55 N.W. 375 (1893); *Horner v. Townsend*, 208 Mich. 612, 175 N.W. 385 (1920); *Sutton v. Beckwith*, 68 Mich. 303, 36 N.W. 79 (1888); *Green v. Ostrander*, 160 Mich. 662, 125 N.W. 735 (1910); *Maltz v. Fletcher*, 52 Mich. 484, 18 N.W. 228 (1884); *Lanphere v. Ackdes*, 220 Mich. 300, 189 N.W. 845 (1922). Want of consideration (miscellaneous): *Roy v. Leonard*, 340 Mich. 15, 64 N.W. (2d) 646 (1954); *Smith v. Baubie*, 256 Mich. 335, 239 N.W. 396 (1931); *Nowack v. Lehmann*, 139 Mich. 474, 102 N.W. 992 (1905); *Graham v. Alexander*, 123 Mich. 168, 81 N.W. 1084 (1900); *Rickey v. Morrison*, 69 Mich. 139, 37 N.W. 56 (1888); *Kelley v. Guy*, 116 Mich. 43, 74 N.W. 291 (1898); *Thorp v. Deming*, 78 Mich. 124, 43 N.W. 1097 (1889).

Enforceability of married women's promises on negotiable instruments is sometimes discussed in terms of consideration rather than coverture. For cases, see annotation following Mich. Stat. Ann. (1937) §26.161.

necessary for an instrument or obligation thereon given in payment of or as security for an antecedent obligation of any kind" would work some changes in Michigan law. If A, being indebted to B, gives his note to pay or secure the debt, there is consideration for the note.⁹³ Under the code, the finding of consideration would be unnecessary to the result. If A, being indebted to B, induces C gratuitously to furnish his (C's) note for use as collateral security for A's debt, apparently C's note is without consideration and cannot be enforced against C by one not a holder in due course.⁹⁴ Under the code, consideration would not be necessary and C's note would be enforceable against him. If A is indebted to B on a note which C is induced to sign gratuitously, either as co-maker or indorser, *after* delivery of the note to B, C's promise is not binding for want of consideration when the instrument is in the hands of a person other than a holder in due course.⁹⁵ Under the code, consideration would not be necessary and C's promise would be enforceable.

Section 3-409. Draft Not an Assignment.

(1) *A check or other draft does not of itself operate as an assignment of any funds in the hands of the drawee available for its payment, and the drawee is not liable on the instrument until he accepts it.*

(2) *Nothing in this section shall affect any liability in contract, tort or otherwise arising from any letter of credit or other obligation or representation which is not an acceptance.*

Section 3-409(1) would combine sections 127⁹⁶ and 189⁹⁷ of the NIL and restate the present provisions that a check or a bill does not, of itself, operate as an assignment of the drawer's funds in the hands of the drawee. An assignment of funds in the hands of a drawee could, however, still be found from other facts in the transaction out of which the instrument arose indicating an intention by the drawer to make an

⁹³ *Traverse City Depositors' Corp. v. Case*, 297 Mich. 304, 297 N.W. 501 (1941); *W. T. Rawleigh Co. v. Bowen*, 308 Mich. 122, 13 N.W. (2d) 230 (1944).

⁹⁴ See *Brown v. Smedley*, 136 Mich. 65, 98 N.W. 856 (1904). The courts generally have disagreed on this question. *West Rutland Trust Co. v. Houston*, 104 Vt. 204, 158 A. 69 (1932) (consideration); *Kiess v. Baldwin*, (D.C. Cir. 1934) 74 F. (2d) 470 (no consideration).

⁹⁵ *Manistee National Bank v. Seymour*, 64 Mich. 59, 31 N.W. 140 (1887); *Kulenkamp v. Groff*, 71 Mich. 675, 40 N.W. 57 (1888). See also *Steers v. Holmes*, 79 Mich. 430, 44 N.W. 922 (1890).

⁹⁶ Mich. Comp. Laws (1948) §439.129, Mich. Stat. Ann. (1937) §19.169.

⁹⁷ Mich. Comp. Laws (1948) §439.191, Mich. Stat. Ann. (1937) §19.231.

assignment. For example, the Michigan courts could still properly find that where a draft is drawn for the exact amount of an account owing by the drawee and the documentary evidence of the account is attached to the draft, there is sufficient showing of drawer's intent to assign his interests to the payee or holder of the instrument.⁹⁸ It might also be found that a check or draft plus peculiar circumstances in the transaction justify impressing a trust on funds in the hands of the drawee for the benefit of the payee or holder of the instrument.⁹⁹

Section 3-409 would eliminate a potentially confusing inconsistency which now exists in the wording of sections 127 (relating to bills of exchange) and 189 (relating to checks) of the NIL. Section 127 provides that the drawee is not liable "on the bill" until acceptance, whereas section 189 provides that the drawee bank is not liable "to the holder" until acceptance or certification. The possibility of confusion is readily apparent. Was it intended that the drawee of a bill of exchange, while having no liability "on the bill" until acceptance, should be subject to other forms of liability to the holder, e.g., in tort for conversion, while the drawee of an uncertified check would be free from liability "to the holder" on any theory? This difference in language becomes important where an uncertified check bearing a forged indorsement is paid by the drawee bank. Since the check has not been certified, the drawee bank cannot be liable to the rightful holder *on the instrument*. But is the drawee bank liable to the rightful holder in tort for conversion? Arguably not, because the drawee bank is not liable *to the holder* (apparently on any theory) until acceptance or certification.¹⁰⁰ Section 3-409 would make it clear that there is no intention to control liabilities of the drawee of bills and checks aside

⁹⁸ Moore v. Davis, 57 Mich. 251, 23 N.W. 800 (1885).

⁹⁹ Gillen v. Wakefield State Bank, 246 Mich. 158, 224 N.W. 761 (1929). Cf. Reichert v. Midland Co. Sav. Bank, 254 Mich. 551, 236 N.W. 859 (1931); Borgess Hospital v. Union Industrial Trust and Sav. Bank, 265 Mich. 156, 251 N.W. 363 (1933); Union Guardian Trust Co. v. Emery, 292 Mich. 394, 290 N.W. 841 (1940). For an excellent discussion of drawee's liability to holders of checks or drafts on theories of assignment or trust, see Aigler, "Rights of Holder of Bill of Exchange against the Drawee," 38 HARV. L. REV. 857 (1925).

¹⁰⁰ The Ohio court, construing this provision, so held in Elyria Savings & Banking Co. v. Walker Bin Co., 92 Ohio St. 406, 111 N.E. 147 (1915). Other courts in this situation have ignored the precise language of the statute and have found the drawee bank liable to the rightful holder on a theory of conversion. State v. First Nat. Bank of Albuquerque, 38 N.M. 225, 30 P. (2d) 728 (1934). In such jurisdictions should the holder of the check be able to waive the tort and sue the drawee bank in assumpsit? See A. Paul Goddall Real Estate & Ins. Co. v. North Birmingham American Bank, 225 Ala. 507, 144 S. 7 (1932). For further discussion of the drawee bank's liability in these circumstances, see Aigler, "Rights of Holder of Bill of Exchange against the Drawee," 38 HARV. L. REV. 857 at 881 et seq. (1925).

from the instrument itself. Sub-section (1) provides that the drawee of a "check or other draft . . . is not liable *on the instrument* until he accepts it."¹⁰¹ Sub-section (2) provides that this section shall not affect any liability in contract, tort or otherwise.

In Michigan, a drawee bank which pays an uncertified check bearing a forged indorsement has no liability to the rightful holder on the instrument itself,¹⁰² nor in assumpsit¹⁰³ nor for conversion.¹⁰⁴ However, a cashing or collecting bank is liable to the rightful holder for conversion¹⁰⁵ and in assumpsit¹⁰⁶ if it cashes or collects money on a check bearing a forged indorsement.¹⁰⁷ The drawee bank's freedom from such liability is not, however, based on the peculiar language of section 189 of the NIL precluding liability *to the holder* until acceptance or certification. If such were the basis of decision, a reexamination of existing law on this point would be necessary under the code. Instead, liability is denied because a check does not operate as an assignment to the holder of the drawer's funds in the hands of the drawee bank which would also be true under the code.¹⁰⁸ While section 3-409 would not affect the Michigan law in this regard, there would be important changes worked by section 3-419, which is discussed later.

¹⁰¹ Italics added.

¹⁰² *Brennan v. Merchants' and Manufacturers' Nat. Bank*, 62 Mich. 343, 28 N.W. 881 (1886).

¹⁰³ *Lonier v. State Sav. Bank*, 149 Mich. 483, 112 N.W. 1119 (1907). But see dictum in *Dunnette v. Henry L. Doherty & Co.*, 252 Mich. 597 at 599, 233 N.W. 428 (1930). See also *Weaver v. Detroit Bank*, 330 Mich. 366, 47 N.W. (2d) 650 (1951), where the court could have denied relief on the theory of the *Lonier* case but reached the same result on a theory of election of remedies.

¹⁰⁴ *Gordon Fireworks Co. v. Capital Nat. Bank*, 236 Mich. 271, 210 N.W. 263 (1926), criticized in 25 MICH. L. REV. 454 (1927). See also *Corbett v. Kleinsmith*, (6th Cir. 1940) 112 F. (2d) 511.

¹⁰⁵ *Kaufman v. State Sav. Bank*, 151 Mich. 65, 114 N.W. 863 (1908). See also *Lonier v. Ann Arbor Sav. Bank*, 153 Mich. 253, 116 N.W. 1088 (1908) and 162 Mich. 541, 127 N.W. 685 (1910), involving a conversion action by the payee against a bank which had discounted a note bearing a forged indorsement.

¹⁰⁶ *Brown v. People's Nat. Bank*, 170 Mich. 416, 136 N.W. 506 (1912), in which recovery was denied, however, because the holder's delay in notifying the cashing bank of the forgery had resulted in injury to the bank. See also *National Production Co. v. Guardian Nat. Bank of Commerce*, 281 Mich. 230, 274 N.W. 774 (1937), involving cashing of checks bearing unauthorized indorsements, where the rightful owner was denied recovery, however, because of delay in notifying the cashing bank of the unauthorized indorsements.

¹⁰⁷ On principle, if the action of the cashing or collecting bank amounts to conversion, it would seem that payment by the drawee bank should make it a converter too. In both cases, the holder's enjoyment of his property, i.e., the instrument, is equally interfered with.

¹⁰⁸ It is difficult to see what bearing assignment of funds has on the question of the drawee bank's liability in tort for destruction of the rightful holder's property, i.e., the check, through its act of paying and cancelling the check.

Section 3-410. Definition and Operation of Acceptance.

(1) *Acceptance is the drawee's signed engagement to honor the draft as presented. It must be written on the draft, and may consist of his signature alone. It becomes operative when completed by delivery or notification.*

(2) *A draft may be accepted although it has not been signed by the drawer or is otherwise incomplete or is overdue or has been dishonored.*

(3) *Where the draft is payable at a fixed period after sight and the acceptor fails to date his acceptance the holder may complete it by supplying a date in good faith.*

Under the code, the subject of acceptance of drafts would be greatly simplified. The outmoded subject of acceptance for honor¹⁰⁹ is completely eliminated. Extrinsic¹¹⁰ and virtual¹¹¹ acceptances are likewise eliminated.¹¹² Confusion over the problem of constructive acceptances¹¹³ should be ended. For example, drawee's delay or refusal to return an instrument presented for acceptance or payment should no longer constitute acceptance.¹¹⁴ However, if the drawee refuses to return the instrument on demand when it is delivered for acceptance or to pay or return the instrument when it is delivered for payment, the drawee will be liable for *conversion* of the instrument.¹¹⁵ The measure of damages for the conversion by the drawee is fixed at the face amount of the instrument.¹¹⁶

In short, under the code, acceptance must be "written on the draft" to be effective. It is the drawee's "signed engagement to honor the draft as presented." Section 3-417 gives the drawee-acceptor recourse by action on warranty if the instrument was altered before acceptance.

¹⁰⁹ Now covered by NIL, §§161-170 [Mich. Comp. Laws (1948) §§439.163-439.172, Mich. Stat. Ann. (1937) §§19.203-19.212].

¹¹⁰ NIL, §134 [Mich. Comp. Laws (1948) §439.136, Mich. Stat. Ann. (1937) §19.176].

¹¹¹ NIL, §135 [Mich. Comp. Laws (1948) §439.137, Mich. Stat. Ann. (1937) §19.177]. See *Bissell v. Lewis*, 4 Mich. 450 (1857); *Wilson & Co. v. Niffenegger*, 211 Mich. 311, 178 N.W. 667 (1920).

¹¹² Note, however, that under §3-409(2), a drawee, while not liable as acceptor, may be *otherwise liable* as a result of a writing which might, under present law, constitute an extrinsic or virtual acceptance of the instrument itself.

¹¹³ NIL, §137 [Mich. Comp. Laws (1948) §439.139, Mich. Stat. Ann. (1937) §19.179]. As to the problem of constructive acceptances under the NIL, see Feezer, "Acceptance of Bills of Exchange by Conduct," 12 MINN. L. REV. 129 (1928).

¹¹⁴ Section 3-410, comment 3.

¹¹⁵ See §3-419(1).

¹¹⁶ See §3-419(2).

It "may consist of his [drawee's] signature alone"¹¹⁷ and "becomes operative when completed by delivery or notification."

Sub-sections (2) and (3) of section 3-410 cover the area now encompassed by section 138¹¹⁸ of the NIL. Observe the change worked by sub-section (3) which would allow the holder of a sight draft bearing an undated acceptance to supply the date of presentment for acceptance if done in good faith.

Section 3-411. Certification of a Check.

(1) *Certification of a check is acceptance. Where a holder procures certification the drawer and all prior indorsers are discharged.*

(2) *Unless otherwise agreed a bank has no obligation to certify a check.*

(3) *A bank may certify a check before returning it for lack of proper indorsement. If it does so the drawer is discharged.*

Section 3-411(1) leaves unchanged the provisions of sections 187 and 188¹¹⁹ of the NIL which provide that certification is acceptance and that where the holder procures certification, the drawer and all prior indorsers are discharged.¹²⁰ Section 3-411(2) recognizes the rule that, unless otherwise agreed, a bank has no obligation to certify a check. Section 3-411(3) recognizes the banking practice of certifying a check which is returned for proper indorsement in order to protect the drawer against a longer contingent liability.

Section 3-412. Acceptance Varying Draft.

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

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

¹¹⁷ *Accord*, Peterson v. Hubbard, 28 Mich. 197 (1873).

¹¹⁸ Mich. Comp. Laws (1948) §439.140, Mich. Stat. Ann. (1937) §19.180.

¹¹⁹ Mich. Comp. Laws (1948) §§439.189 and 439.190, Mich. Stat. Ann. (1937) §§19.229 and 19.230.

¹²⁰ *Accord*, First Nat. Bank of Detroit v. Currie, 147 Mich. 72, 110 N.W. 499 (1907). Of course certification at the request of the drawer will not discharge the drawer or indorsers. Railway Express Agency v. Thomas, (D.C. Mich. 1933) 5 F. Supp. 345.

(3) *The terms of the draft are not varied by an acceptance to pay at any bank in the continental United States.*

Sections 139 through 142 of the NIL¹²¹ relating to qualified acceptances are embodied in section 3-412 with some slight changes better adapted to present commercial practices. If the acceptance varies the terms of the draft, the holder, as under present law, may refuse the acceptance and treat the draft as dishonored. If, however, the holder assents to such acceptance each drawer and indorser who does not *affirmatively* assent¹²² is discharged except where the variance is that payment shall be made only at a particular place. However, the terms of the draft are not varied by an acceptance to pay at any bank in the continental United States. For example, where a drawee accepts "payable only at the law offices of A in Detroit, Michigan," this is a variance which the holder could treat as dishonor. If the holder assents to this variance, however, the drawer and indorsers will not be discharged regardless of whether they affirmatively assent. But if the drawee accepts "payable only at X Bank in Detroit, Michigan," there is no variance at all.¹²³

Section 3-413. Contract of Maker, Drawer and Acceptor.

(1) *The maker or acceptor engages that he will pay the instrument according to its tenor at the time of his engagement.*

(2) *The drawer engages that upon dishonor of the draft and any necessary notice of dishonor or protest he will pay the amount of the draft to the holder or to any indorser who takes it up. The drawer may disclaim this liability by drawing without recourse.*

(3) *By making, drawing or accepting the party admits as against all subsequent parties including the drawee the existence of the payee and his then capacity to indorse.*

This section does little more than combine and reword sections 60, 61 and 62¹²⁴ of the NIL. The maker or acceptor incurs a primary liability¹²⁵ to pay the note "according to its tenor at the time of his

¹²¹ Mich. Comp. Laws (1948) §§439.141-439.144, Mich. Stat. Ann. (1937) §§19.181-19.184.

¹²² Eliminates the present possibility of mere failure to object within a reasonable time preventing a discharge. See NIL, §144 [Mich. Comp. Laws (1948) §439.146, Mich. Stat. Ann. (1937) §19.186].

¹²³ See also §3-504(4).

¹²⁴ Mich. Comp. Laws (1948) §§439.62, 439.63 and 439.64, Mich. Stat. Ann. (1937) §§19.102, 19.103 and 19.104.

¹²⁵ Union Bank & Trust Co. v. Pine Ridge Coal Co., 255 Mich. 295, 238 N.W. 261 (1931).

engagement." The quoted phrase should clear up the present conflict as to whether a draft, altered before acceptance, is accepted according to its altered terms or according to its original tenor.¹²⁶ The warranties made upon obtaining acceptance or payment (section 3-417) should be consulted in conjunction with this engagement of the maker or acceptor. The drawer engages that he will be secondarily liable for "the amount of the draft."¹²⁷

The maker, acceptor and drawer admit the existence of the payee and his then capacity to indorse as to all subsequent parties "including the drawee." Thus the drawee clearly gets the benefit of this admission in cases of fictitious payees, infants, incompetents, ultra vires corporate acts, etc.¹²⁸ The acceptor's admission in section 62¹²⁹ of the NIL of the "existence of the drawer, the genuineness of his signature and his capacity and authority to draw the instrument" is eliminated in the code. The problem is dealt with in section 3-418.

Section 3-414. *Contract of Indorser; Order of Liability.*

(1) *Unless the indorsement otherwise specifies (as by such words as "without recourse") every indorser engages that upon dishonor and any necessary notice of dishonor and protest he will pay the instrument according to its tenor at the time of his indorsement to the holder or to any subsequent indorser who takes it up, even though the indorser who takes it up was not obligated to do so.*

(2) *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.*

The code eliminates reference to "qualified indorsements" as such¹³⁰ but recognizes that an indorsement may specify contractual obligations which are different from the usual engagement of the

¹²⁶ See Greeley, "The Effect of Acceptance of an Altered Bill," 27 ILL. L. REV. 519 (1933).

¹²⁷ Of course, the engagements of the maker, acceptor and drawer must be read in connection with the sections on incomplete instruments (§3-115), negligence contributing to alteration or unauthorized signature (§3-406), alteration (§3-407), acceptances varying a draft (§3-412) and finality of payment or acceptance (§3-418).

¹²⁸ For cases dealing with the maker's admission of the existence of the payee, see *Neyens v. Worthington*, 150 Mich. 580, 114 N.W. 404 (1908); *Pontiac Sav. Bank v. Reinforced Concrete Pipe Co.*, 178 Mich. 261, 144 N.W. 486 (1913); *Peoples State Bank v. Trombly*, 241 Mich. 199, 217 N.W. 47 (1928); *Lincoln Investment Co. v. Metros*, 257 Mich. 215, 241 N.W. 166 (1932).

¹²⁹ Mich. Comp. Laws (1948) §439.64, Mich. Stat. Ann. (1937) §19.104.

¹³⁰ NIL, §38 [Mich. Comp. Laws (1948) §439.40, Mich. Stat. Ann. (1937) §19.80]. The provision that a qualified indorsement "does not impair the negotiable character of the instrument" is covered by §3-202(4) of the code.

indorser. When the indorsement specifies that it is "without recourse" there is no doubt that the indorser refuses to assume any responsibility for ultimate payment of the instrument. But where the words accompanying the indorsement are less explicit, there may be difficulty. In Michigan, an indorsement which "assigns all right, title and interest" in an instrument is a qualified indorsement.¹³¹ However, an indorsement which simply "assigns" the instrument is a general indorsement.¹³² Such tenuous distinctions would still be possible under the code for the courts could hold that in the former situation the indorser "otherwise specifies" his intentions whereas in the latter situation he does not. Section 44¹³³ of the NIL, permitting a representative to indorse in such terms as to negative personal liability, would be covered under the code by the right of the indorser to "otherwise specify" his intentions.¹³⁴

The code would change the engagement of the indorser slightly. Consistent with section 3-413, the indorser would engage to pay the instrument "according to its tenor at the time of his indorsement." Under section 66¹³⁵ of the NIL the indorser simply engages to pay "according to its tenor." Hence an indorser of an instrument after alteration would clearly be liable on the instrument as altered. Also, the indorser would be liable to any subsequent indorser who takes it up "even though the indorser who takes it up was not obligated to do so" whereas under section 66 he is liable only to any subsequent indorser "who may be compelled to pay it."

Under the code, every indorser makes an engagement or contract of secondary liability unless *the indorsement* otherwise specifies. Use of parol evidence to vary the terms of the indorser's contract is thus prohibited. This is in accord with Michigan law.¹³⁶

¹³¹ Fecko v. Tarczynski, 281 Mich. 590, 275 N.W. 502 (1937). This is definitely the minority view. 36 MICH. L. REV. 483 (1938). Earlier cases in Michigan seem to hold that use of such words does not even constitute an indorsement. Aniba v. Yeomans, 39 Mich. 171 (1878); Gale v. Mayhew, 161 Mich. 96, 125 N.W. 781 (1910). Compare Stevens v. Hannan, 86 Mich. 305, 48 N.W. 951 (1891). See §3-202(4).

¹³² Markey v. Corey, 108 Mich. 184, 66 N.W. 493 (1895).

¹³³ Mich. Comp. Laws (1948) §439.46, Mich. Stat. Ann. (1937) §19.86.

¹³⁴ See also §3-403; Cooper v. Sonk, 201 Mich. 655, 167 N.W. 842 (1918).

¹³⁵ Mich. Comp. Laws (1948) §439.68, Mich. Stat. Ann. (1937) §19.108. For cases dealing with the indorsers engagement see H. H. Dickinson Co. v. Hickey, 235 Mich. 638, 209 N.W. 848 (1926); McPherson v. Evert State Bank, 239 Mich. 670, 214 N.W. 971 (1927). See also Rogers v. Detroit Sav. Bank, 146 Mich. 639, 110 N.W. 74 (1906).

¹³⁶ Ortmann v. Canadian Bank of Commerce, 39 Mich. 518 (1878); Holland City State Bank v. Meeuwesen, 192 Mich. 326, 158 N.W. 1032 (1916); Nimmo v. Supernaw, 279 Mich. 126, 271 N.W. 705 (1937); Hitchcock v. Frackelton, 116 Mich. 487, 74 N.W. 720 (1898).

However, as might be expected in this area, there is some equivocal indication to the contrary. In Blackwood v. Sakwinski, 221 Mich. 464, 191 N.W. 207 (1922), the court

By providing that *every* indorser assumes a secondary liability on the instrument (unless otherwise specified), the code incorporates the essence of section 67¹⁸⁷ of the NIL which provides that where "a person places his indorsement on an instrument negotiable by delivery he incurs all the liabilities of an indorser."

The code provision relating to order of liability of indorsers (section 3-414(2)) seems to be in harmony with existing Michigan law.¹⁸⁸

Section 3-415. Contract of Accommodation Party.

(1) *An accommodation party is one who signs the instrument in any capacity as surety for another party to it.*

(2) *When the instrument has been taken for value before it is due the accommodation party is liable in the capacity in which he has signed even though the taker knows of the accommodation.*

(3) *As against a holder in due course and without notice of the accommodation oral proof of the accommodation is not admissible to give the accommodation party the benefit of discharges dependent on his character as such. In other cases the accommodation character may be shown by oral proof.*

(4) *An indorsement which shows it is not in the chain of title is notice of its accommodation character.*

(5) *An accommodation party is not liable to the party accommodated, and if he pays the instrument has a right of recourse on the instrument against such party.*

Section 3-415(1) defines "accommodation party." The term includes one who signs an instrument "in any capacity," whether as maker, drawer, acceptor or indorser. This is in accord with section

held that since the agreement for transfer of the mortgage provided that the assignor should merely pass title, the general endorsement of the note secured by the mortgage must be treated as a qualified indorsement. In the two opinions of the court in *Auto Purchase Corp. v. Johnston*, 319 Mich. 634, 30 N.W. (2d) 379 (1948) and 324 Mich. 445, 37 N.W. (2d) 167 (1949), it is not clear whether the court held that parol evidence was admissible to vary the terms of the general indorser's contract or to show that the indorser's contract was induced by fraud. The fact that the court cites *Shaw v. Stein*, 79 Mich. 77, 44 N.W. 419 (1889), as authority in the second opinion indicates that the parol evidence was admissible only to show fraud, which would be perfectly proper.

¹⁸⁷ Mich. Comp. Laws (1948) §439.69, Mich. Stat. Ann. (1937) §19.109.

¹⁸⁸ See NIL, §68 [Mich. Comp. Laws (1948) §439.70, Mich. Stat. Ann. (1937) §19.110]; *Blom v. McBride*, 292 Mich. 153, 289 N.W. 203 (1940); *Harrah v. Doherty*, 111 Mich. 175, 69 N.W. 242 (1896); *McGurk v. Huggett*, 56 Mich. 187, 22 N.W. 308 (1885); *Greusel v. Hubbard*, 51 Mich. 95, 16 N.W. 248 (1883); *Sweet v. Woodin*, 72 Mich. 393, 40 N.W. 471 (1888); *Brewer v. Boynton*, 71 Mich. 254, 39 N.W. 49 (1888). Cf. *Shufelt v. Moore*, 93 Mich. 564, 53 N.W. 722 (1892); *First Nat. Bank of Ludington v. Michigan-Arkansas Oil Corp.*, 231 Mich. 597, 204 N.W. 719 (1925).

29¹³⁹ of the NIL. The signature must be placed on the instrument "as surety¹⁴⁰ for another party to it." Reference to the accommodation party as a surety is simply a frank recognition of what has generally been regarded as the status of an accommodation party in relation to the party accommodated.¹⁴¹ It has the virtue of eliminating the requirement of section 29 that the accommodation party must sign the instrument "without receiving value therefor." Why shouldn't it be possible for an accommodation party to receive compensation for the risks he assumes just as other sureties?¹⁴² The accommodation party must also sign as surety for *another party to the instrument*. Under section 29 the accommodation party must sign the instrument for the purpose of lending his name to "some other person." The code requirement that the person accommodated be a party to the instrument is new.¹⁴³

Section 3-415(2) attempts to eliminate some conflicts which existed at common law and which have persisted under the NIL. The last sentence of section 29 provides that an accommodation party "is liable on the instrument to a holder for value, notwithstanding such holder at the time of taking the instrument knew him to be only an accommodation party." A few courts have construed this language to mean that an accommodation party can assert the defense of lack of consideration against any holder except a holder in due course.¹⁴⁴ Such a result does violence to the language of section 29 and should not be possible under the language of section 3-415(2). The courts have also disagreed on whether the accommodation party is liable on an instrument which is not negotiated for value until after it is due.¹⁴⁵ By providing that the accommodation party is liable when the instru-

¹³⁹ Mich. Comp. Laws (1948) §439.31, Mich. Stat. Ann. (1937) §19.71.

¹⁴⁰ Sec. 1-201(40) provides that "surety" includes "guarantor."

¹⁴¹ See, for example, *Barron v. Cady*, 40 Mich. 259 (1879); *Warner v. Fallon Coal Mines*, 246 Mich. 493, 224 N.W. 601 (1929).

¹⁴² See *Warner v. Fallon Coal Mines*, 246 Mich. 493 at 497, 224 N.W. 601 (1929).

¹⁴³ See BIGELOW, *BILLS, NOTES AND CHECKS*, 3d ed., §442(a). In the following cases the person accommodated was apparently not a party to the instrument: *Irwin v. Wolcott*, 183 Mich. 92, 149 N.W. 1035 (1914); *Columbia Motor Truck & Trailer Co. v. Bamlet*, 227 Mich. 651, 199 N.W. 612 (1924); *Warner v. Fallon Coal Mines Co.*, 246 Mich. 493, 224 N.W. 601 (1929). Cf. *Palmer Nat. Bank v. Van Doren*, 260 Mich. 310, 244 N.W. 485 (1932); *Albrecht v. Pfeiffer*, 298 Mich. 721, 299 N.W. 780 (1941).

¹⁴⁴ *Frank L. Dittmeier Real Estate Co. v. Knox*, (Mo. App. 1924) 259 S.W. 835; *Pacific Southwest Trust & Sav. Bank v. Valley Finance Corp.*, 99 Cal. App. 728, 279 P. 222 (1929). On several occasions the Michigan courts have come dangerously close to this result. *Columbia Motor Truck & Trailer Co. v. Bamlet*, 227 Mich. 651, 199 N.W. 612 (1924); *Krause v. Retty*, 254 Mich. 684, 236 N.W. 906 (1931).

¹⁴⁵ *Liability: Altfillisch v. McCarty*, 49 S.D. 203, 207 N.W. 67 (1926). No liability: *Rylee v. Wilkerson*, 134 Miss. 663, 99 S. 901 (1924). See *Warder, Bushnell & Glessner Co. v. Gibbs*, 92 Mich. 29, 52 N.W. 73 (1892), which was decided before the NIL.

ment "has been taken for value before it is due," the code should resolve this conflict.

Under section 3-415(2), the accommodation party would be "liable in the capacity in which he has signed even though the taker knows of the accommodation."¹⁴⁶ This is substantially in accord with Michigan law. If, for example, he signed as accommodation indorser, he normally would be liable only after presentment, notice of dishonor and protest.¹⁴⁷ *If the taker of accommodation paper were not a holder in due course*, he would take subject to defenses good as against holders not in due course except for the defense of want of consideration.¹⁴⁸ Under the code, as now, such taker would be subject to the defenses of discharge by extension of time to the principal debtor without the consent of the accommodation party where the accommodation relationship was known to the taker,¹⁴⁹ conditions and collateral agreements regarding the paper which are known to the taker¹⁵⁰ and material diversion with knowledge of the taker.¹⁵¹ Absent agreement as to application of security, the accommodation party would not be discharged because the taker applied the security to other debts of the accommodated party.¹⁵² Failure of the taker to enforce the instrument against the accommodated party as requested by the accommodation party would not be a defense.¹⁵³ Where the accommodation signature was induced by fraud, knowledge of the accommodation would not be enough—taker must have notice of the fraud.¹⁵⁴ *If*

¹⁴⁶ Knowledge of the accommodation also makes no difference under NIL, §29. *Union Bank & Trust Co. v. Pine Ridge Coal Co.*, 255 Mich. 295, 238 N.W. 261 (1931). See also *Thatcher v. West River Nat. Bank of Jamaica, Vermont*, 19 Mich. 196 (1869).

¹⁴⁷ See *Home Sav. Bank v. Refior*, 289 Mich. 426, 286 N.W. 669 (1939).

¹⁴⁸ As to the rights of one not a holder in due course, see §3-306.

¹⁴⁹ *Barron v. Cady*, 40 Mich. 259 (1879); *Stevens v. Oaks*, 58 Mich. 343, 25 N.W. 309 (1885); *Westinghouse Electric & Mfg. Co. v. Hupp*, 211 Mich. 698, 179 N.W. 286 (1920); *Gano v. Heath*, 36 Mich. 441 (1877) (accommodation not known to taker). See also *Morse v. Blanchard*, 117 Mich. 37, 75 N.W. 93 (1898); *Hitchcock v. Frackelton*, 116 Mich. 487, 74 N.W. 720 (1898). Sections 3-603, 3-604 and 3-606 relate to problems of discharge of accommodation parties.

¹⁵⁰ *J. A. Fay & Co. v. James Jenks & Co.*, 93 Mich. 130, 53 N.W. 163 (1892); *Clare County Sav. Bank v. Featherly*, 173 Mich. 292, 139 N.W. 61 (1912); *Holland City State Bank v. Ahdawagam Furniture Co.*, 226 Mich. 653, 198 N.W. 202 (1924) (defense not good because condition not known to taker); *First Nat. Bank of Ypsilanti v. Apex Motor Corp.*, 227 Mich. 374, 198 N.W. 925 (1924) (defense not good because condition not known to taker).

¹⁵¹ *Warner v. Fallon Coal Mines Co.*, 246 Mich. 493, 224 N.W. 601 (1929); *Gobles Co-operative Assn. v. Albright*, 248 Mich. 68, 226 N.W. 876 (1929); *Holland City State Bank v. Ahdawagam Furniture Co.*, 226 Mich. 653, 198 N.W. 202 (1924) (defense not good because diversion not known to taker).

¹⁵² *Noble v. Murphy*, 91 Mich. 653, 52 N.W. 148 (1892). See also §§9-207 and 9-501 et seq. which deal with application of security under the code.

¹⁵³ *Inkster v. First Nat. Bank of Marshall*, 30 Mich. 143 (1874).

¹⁵⁴ *Cristy v. Campau*, 107 Mich. 172, 65 N.W. 12 (1895).

*the taker of accommodation paper were a holder in due course with notice of the accommodation, he would take free of those defenses which normally cannot be asserted against a holder in due course*¹⁵⁵ but would be subject to any defenses of the accommodation party based upon the fact that he is a surety, e.g., extension of time to principal debtor without consent of surety. This is implicit in sub-sections 3-415(2) and (3). *If the taker of accommodation paper were a holder in due course without notice of the accommodation, he would even take free of suretyship defenses of the accommodation party.*¹⁵⁶

As against any taker except a holder in due course without notice of the accommodation, parol evidence would be admissible to show the accommodation character of the signer of the instrument. This is in substantial accord with the Michigan law.¹⁵⁷ At this point passing reference should be made to the difference between admission of parol evidence to show the accommodation relationship (which is proper, as indicated above), admission of parol evidence to show conditional delivery or delivery for a specified purpose by the accommodation party (which may be proper)¹⁵⁸ and admission of parol evidence to vary the engagement of the accommodation party in the capacity in which he signed (which is improper).¹⁵⁹

Section 3-415(4) is a new provision which makes an indorsement that shows it is not in the chain of title notice of its accommodation character.¹⁶⁰

Section 3-415(5) provides that an "accommodation party is not liable to the party accommodated,"¹⁶¹ which is in line with Michigan

¹⁵⁵ As to the rights of a holder in due course, see §3-305. See *Armstrong v. Stearns*, 156 Mich. 597, 121 N.W. 312 (1909).

¹⁵⁶ Sec. 3-415(3). See *Stevens v. McLachlan*, 120 Mich. 285, 79 N.W. 627 (1899).

¹⁵⁷ *Canadian Bank of Commerce v. Coumbe*, 47 Mich. 358, 11 N.W. 196 (1882); *Stevens v. Oaks*, 58 Mich. 343, 25 N.W. 309 (1885); *Hitchcock v. Frackelton*, 116 Mich. 487, 74 N.W. 720 (1898); *Lamberson v. Love*, 165 Mich. 460, 130 N.W. 1126 (1911). See also *Colbath v. Jones*, 28 Mich. 280 (1873).

¹⁵⁸ *Clare County Sav. Bank v. Featherly*, 173 Mich. 292, 139 N.W. 61 (1912). See also *Taylor v. Rugenstein*, 245 Mich. 152, 222 N.W. 107 (1928).

¹⁵⁹ *Kulenkamp v. Groff*, 71 Mich. 675, 40 N.W. 57 (1888); *Aultman & Taylor Co. v. Gorham*, 87 Mich. 233, 49 N.W. 486 (1891); *Gumz v. Giegling*, 108 Mich. 295, 66 N.W. 48 (1896); *Union Bank & Trust Co. v. Pine Ridge Coal Co.*, 255 Mich. 295, 238 N.W. 261 (1931). See also *In re Dosker's Estate*, 284 Mich. 597, 280 N.W. 61 (1938).

¹⁶⁰ See *Moynahan v. Hanaford*, 42 Mich. 329, 3 N.W. 944 (1879). See also §3-416(4) which creates a presumption of accommodation where words of guaranty are added to the signature of one of two or more makers or acceptors.

¹⁶¹ This provision plus the provision that the accommodation party is liable on the instrument in the capacity in which he signed would make it possible to eliminate the detailed provisions of NIL, §64 [Mich. Comp. Laws (1948) §439.66, Mich. Stat. Ann. (1937) §19.106].

law.¹⁶² It further provides that if an accommodation party pays the instrument, he has a right of recourse *on the instrument* against the accommodated party. This would reject decisions under section 121¹⁶³ of the NIL which hold that an anomalous indorser who pays the instrument cannot maintain an action on the instrument against the accommodated party since he has no "former rights" to which he can be remitted.¹⁶⁴ Apparently the Michigan courts have not decided this question since adoption of the NIL.¹⁶⁵

Notice that the accommodation party's right of recourse on the instrument under section 3-415(5) is limited to the accommodated party. Suppose an anomalous indorser who signed for the accommodation of the payee pays the instrument and now desires recourse on the instrument against the maker instead of the accommodated payee. He should succeed but the way is devious. Under section 3-603(2), payment of an instrument may be made "by any person, including a stranger to the instrument." Certainly this includes the anomalous indorser. Upon such payment, surrender of the instrument to such indorser "gives him the rights of a transferee." Section 3-201(1) vests in the transferee, with certain exceptions, such rights as his transferor had in the instrument. His right to recourse against the maker of the instrument would thus depend on the rights of the holder to whom payment was made.¹⁶⁶ As a reacquirer of the instrument under section 3-208, his right of recourse would be limited to prior parties on the instrument, i.e., the payee or maker. Also, as a reacquirer he could, of course, reissue or further negotiate the instrument if he chose.

Section 3-416. *Contract of Guarantor.*

(1) "*Payment guaranteed*" or equivalent words added to a signature mean that the signer engages that if the instrument is not paid

¹⁶² Runciman v. Brown, 223 Mich. 298, 193 N.W. 880 (1923); Lamberson v. Love, 165 Mich. 460, 130 N.W. 1126 (1911); Devereaux v. Estate of Phillips, 97 Mich. 104, 56 N.W. 228 (1893). See also Colbath v. Jones, 28 Mich. 280 (1873).

¹⁶³ Mich. Comp. Laws (1948) §439.123, Mich. Stat. Ann. (1937) §19.163.

¹⁶⁴ Quimby v. Varnum, 190 Mass. 211, 76 N.E. 671 (1906). But see Lill v. Gleason, 92 Kan. 754, 142 P. 287 (1914).

¹⁶⁵ For cases decided at common law, see Hanish v. Kennedy, 106 Mich. 455, 64 N.W. 459 (1895); Bliss v. Estate of Plummer, 103 Mich. 181, 61 N.W. 263 (1894); Tredway v. Antisdell, 86 Mich. 82, 48 N.W. 956 (1891); Alderton v. Williams, 130 Mich. 626, 90 N.W. 661 (1902); McClatchie v. Durham, 44 Mich. 435, 7 N.W. 76 (1880).

Of course, the accommodation party who pays may recover from the accommodated party on grounds wholly aside from the instrument, e.g., exoneration. See Schram v. Spivack, (D.C. Mich. 1946) 68 F. Supp. 451.

¹⁶⁶ See Beckwith v. Webber, 78 Mich. 390, 44 N.W. 330 (1889).

when due he will pay it according to its tenor without resort by the holder to any other party.

(2) *"Collection guaranteed" or equivalent words added to a signature mean that the signer engages that if the instrument is not paid when due he will pay it according to its tenor, but only after the holder has reduced his claim against the maker or acceptor to judgment and execution has been returned unsatisfied, or after the maker or acceptor has become insolvent or it is otherwise apparent that it is useless to proceed against him.*

(3) *Words of guaranty which do not otherwise specify guarantee payment.*

(4) *No words of guaranty added to the signature of a sole maker or acceptor affect his liability on the instrument. Such words added to the signature of one of two or more makers or acceptors create a presumption that the signature is for the accommodation of the others.*

(5) *When words of guaranty are used presentment, notice of dishonor and protest are not necessary to charge the user.*

(6) *Any guaranty written on the instrument is enforceable notwithstanding any statute of frauds.*

The NIL contains no provision relating to the liability of persons who sign negotiable instruments as guarantors. The code treats such signers as parties to the instrument and spells out their liability on the instrument in terms of prevailing understanding as to the meaning and effect of words of guaranty added to signatures on negotiable instruments.

Under section 3-416(1), demand upon the maker or drawee is unnecessary to hold an indorser who guarantees payment. Such an indorser waives presentment, notice of dishonor and protest (3-416(5)). Liability of such indorser is indistinguishable from that of a co-maker. This coincides generally with Michigan law.¹⁶⁷

Under section 3-416(2), the guarantor of collection is liable on the instrument only after the holder "has reduced his claim against the maker or acceptor to judgment and execution has been returned unsatisfied, or after the maker or acceptor has become insolvent or it is otherwise apparent that it is useless to proceed against him." This provision also is generally in accord with Michigan law.¹⁶⁸

¹⁶⁷ *National Security & Trust Co. v. Niles Invisible Door Check Co.*, 222 Mich. 510, 193 N.W. 199 (1923). Cf. *Tinker & Webb v. McCauley*, 3 Mich. 188 (1854).

¹⁶⁸ *Aldrich v. Chubb*, 35 Mich. 350 (1877); *Barman v. Carhartt*, 10 Mich. 338 (1862); *Thomas v. Dodge*, 8 Mich. 51 (1860).

In Michigan, a guaranty of payment or collection written on a negotiable instrument is not within the statute of frauds¹⁶⁹ so section 3-416(6) would work no change in existing law.

Section 3-417. Warranties on Presentment and Transfer.

(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 or [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 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.*

(2) *Unless otherwise agreed any party who transfers an instrument for 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) *all signatures are genuine or authorized; and*
- (b) *the instrument has not been materially altered; and*
- (c) *the transfer is rightful; and*
- (d) *no defense of any party is good against him; and*
- (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.*

(4) *A selling agent or broker who does not disclose the fact that he is acting only as such gives the warranties provided in this section,*

¹⁶⁹ Jones v. Palmer, 1 Doug. (Mich.) 379 (1844); Thomas v. Dodge, 8 Mich. 51 (1860).

but if he makes such disclosure warrants only his good faith and authority.

Warranties on *presentment* (section 3-417(1)) work hand in glove with the provision regarding finality of payment or acceptance (section 3-418) and will, therefore, be discussed in connection with the latter section.

Section 3-417, sub-sections (2), (3) and (4), deal with warranties of *vendors* of negotiable instruments. It should clear up a number of uncertainties which exist under sections 65¹⁷⁰ and 66¹⁷¹ of the NIL. Only a person "who transfers an instrument" is a warrantor thus eliminating possible warranty liability of accommodation indorsers under the NIL.¹⁷² Only transfers "for consideration" are included which limits the warranties to transactions involving sales of interests in instruments.¹⁷³ The warranties of an unqualified indorser run to "any subsequent holder who takes the instrument in good faith"¹⁷⁴ rather than to "all subsequent holders in due course" as under NIL, section 66. Presumably the "transferee" who takes by delivery must also have taken in good faith to benefit from the warranties. The language of the code, however, leaves the door open to argument by simply referring to "transferee" in one instance and "holder who takes the instrument in good faith" in the other. This problem could be obviated by judicious use of punctuation.

In stating the warranties, the code has avoided the confusing common law language which was used in sections 65 and 66 of the NIL. The warranty that signatures are "genuine or authorized" covers only situations where the signature of the drawer or maker is forged or made

¹⁷⁰ Mich. Comp. Laws (1948) §439.67, Mich. Stat. Ann. (1937) §19.107.

¹⁷¹ Mich. Comp. Laws (1948) §439.68, Mich. Stat. Ann. (1937) §19.108.

¹⁷² Under NIL, §66, "every indorser who indorses without qualification" is a warrantor. Presumably this includes irregular indorsers, e.g., accommodation parties, who have nothing to do with sale and transfer of the instrument.

¹⁷³ The warranties of NIL, §§65 and 66 are not clearly limited to transactions involving the sale of instruments. The warranties of NIL, §65 are operative against every person "negotiating" an instrument. "Negotiation" is defined in NIL, §30 [Mich. Comp. Laws (1948) §439.32, Mich. Stat. Ann. (1937) §19.72] as transfer of an instrument "from one person to another in such manner as to constitute the transferee the holder thereof." "Holder" is defined in NIL, §191 [Mich. Comp. Laws (1948) §439.2, Mich. Stat. Ann. (1937) §19.42] as "the payee or indorsee of a bill or note, who is in possession of it, or the bearer thereof." Nowhere is there any requirement that value be given. Arguably, then, a donee of an instrument transferred by delivery or qualified indorsement could assert the warranties against his donor. A similar result can be reached under the language of NIL, §66.

¹⁷⁴ "Good faith" is defined in §1-201(19) as "honesty in fact in the conduct or transaction concerned."

without authority.¹⁷⁵ The warranty against material alteration is separately and simply stated.¹⁷⁶ Warranty of title is covered by the warranty that "the transfer is rightful."¹⁷⁷ This warranty would also include the agent who transfers by delivery without authority. All other defenses to the instrument whether real or personal are covered by the warranty that "no defense of any party is good" against the transferor. Note that the transferor who transfers "without recourse" warrants only that he has "no knowledge" of any such defense, which is similar to section 65(4) of the NIL. Observe, however, that under the NIL the transferor by delivery automatically gets the advantages of the "no knowledge" limitation of section 65(4) whereas, under the code, he has this advantage only if he enters into an agreement with the transferee that the transfer is without recourse. A solution to the confusing problem under the NIL as to whether there is a warranty of solvency or collectibility of the maker, drawer or acceptor is attempted by the code. The transferor warrants that "he has no knowledge of any insolvency proceeding"¹⁷⁸ instituted with respect to the maker or acceptor or the drawer of an unaccepted instrument."

The warranty provision as to selling agents or brokers (section 3-417(4)) replaces section 69¹⁷⁹ of the NIL.

Section 3-418. Finality of Payment or Acceptance.

Except for recovery of bank payments as provided in the Article on Bank Deposits and Collections (Article 4) and except for liability for breach of warranty on presentment under the preceding section, payment or acceptance of any instrument is final in favor of a holder in due course.

This section provides in sweeping terms that "payment or acceptance of any instrument is final in favor of a holder in due course." Such a provision would mean that there could be no recovery against a holder in due course where there was payment made or acceptance

¹⁷⁵ "Genuine" is defined by §1-201(18) as "free of forgery or counterfeiting." "Authorized" is not defined. However, "unauthorized signature" is defined in §1-201(43) as "a signature made without actual, implied or apparent authority and includes a forgery."

¹⁷⁶ Under the NIL, material alteration falls under the warranty of genuineness.

¹⁷⁷ See *Nat. Bank of Detroit v. Fidelity & Deposit Co. of Maryland*, 291 Mich. 36, 288 N.W. 325 (1939); *Fish v. First Nat. Bank of Detroit*, 42 Mich. 203, 3 N.W. 849 (1879).

¹⁷⁸ "Insolvency proceeding" is defined in §1-201(22) as including "any assignment for the benefit of creditors or other proceedings intended to liquidate or rehabilitate the estate of the person involved."

¹⁷⁹ Mich. Comp. Laws (1948) §439.71, Mich. Stat. Ann. (1937) §19.111.

given by mistake on an instrument bearing a forged signature of the drawer, a forged indorsement or an alteration of its material terms. This would represent a drastic departure from existing concepts of recovery in this area. However, no such radical changes were intended, for this provision is subject to certain exceptions which are set out in section 3-417 (1).¹⁸⁰ As will be seen in the ensuing discussion, the exceptions in section 3-417 (1) to the finality rule of section 3-418 bring the provisions of the code generally into line with present concepts of recovery of monies paid by mistake in this area.

It is significant, however, that the exceptions to the finality rule of section 3-418 are accomplished by providing for warranties made by "any person who obtains payment or acceptance and any prior transferor . . . to a party who pays or accepts in good faith."¹⁸¹ The warranty theory is a departure from present concepts. Sections 3-417 (1) and 3-418, operating together, seem to eliminate rights of payors and acceptors based on quasi-contract and limit their rights of recovery to theories of warranty. Introduction of the warranty theory changes the elements necessary to support any claim, e.g., proof of reliance in good faith, as well as the remedies available, e.g., rescission as well as damages. Negligence of the payor or acceptor should not be a relevant factor under the code. Applicable statutes of limitations would be affected in many instances.

Payment or acceptance of drafts bearing forged or unauthorized signature of drawer: Under the NIL there has been considerable doubt in the case of a forged drawer's signature whether section 62¹⁸² was intended to codify the rule of finality in *Price v. Neal*,¹⁸³ whether this rule should apply only to payments made to holders in due course, and whether protection of this rule should be denied to a negligent recipient of payment.¹⁸⁴ Section 3-418 attempts to end the un-

¹⁸⁰ The exception relating to recovery of bank payments in the article on Bank Deposits and Collections (§4-301) is not considered here.

¹⁸¹ Sec. 3-417(1). Note that by providing that such warranties are made by "any prior transferor," the payor or acceptor is given rights as to remote parties in the chain of transfer of the instrument. Observe, also, that warranties similar to those in §3-417(1) are made in the bank collection process (§4-207(1)). There are differences, however, in the operation of these two sets of warranties. Under §3-417(1), the warranties are made *only to the payor or acceptor*, whereas under §4-207(1), the warranties are made by the customer to his depository bank and by the customer and a collecting bank to *all subsequent intermediary banks* as well as to the payor. Under §3-417(1) the warranties are made "[u]nless otherwise agreed," thus making it possible to contract against liability on such warranties. There is no such provision in §4-207(1).

¹⁸² Mich. Comp. Laws (1948) §439.64, Mich. Stat. Ann. (1937) §19.104.

¹⁸³ 3 Burr. 1354 (1762).

¹⁸⁴ See Aigler, "The Doctrine of *Price v. Neal*," 24 MICH. L. REV. 809 (1926). Also, 28 MICH. L. REV. 743 (1930).

certainty by codifying the rule of *Price v. Neal*, limiting its operation to protection of holders in due course, and making negligence of the holder irrelevant. Since the Michigan courts have limited the protection of the rule of *Price v. Neal* to holders in due course,¹⁸⁵ section 3-418 would work no significant change in Michigan law.

Suppose, however, that the holder in due course learns of the forgery of the drawer's signature before he procures payment or acceptance from the drawee. The finality rule of section 3-418 will not deny relief to the drawee because of the exception contained in section 3-417 (1) (c). Under this subsection, the holder in due course warrants "that he has no knowledge that the signature of the . . . drawer is unauthorized."¹⁸⁶ Consequently, the drawee can recover payments made or avoid the acceptance on a theory of breach of warranty.

But suppose the instrument bearing the forged drawer's signature has been accepted by the drawee before it comes into the hands of the holder in due course and then the holder learns of the forgery. If he presents the instrument and receives payment from the drawee-acceptor is he liable for breach of warranty? Not if it is a *check*, because the warranty of section 3-417 (1) (c) is not made "by a holder in due course who has taken a draft drawn on and accepted by a bank after such . . . signature." In other words, the finality rule of section 3-418 is operative. Does the reference to drafts "drawn on and accepted by a bank" deny the same protection to holders in due course of other forms of drafts in these circumstances? Although the language certainly so indicates, comment 6 following section 3-417 states that when a holder in due course takes an already accepted draft and then "discovers the unauthorized signature, he is not deprived of his right to enforce the obligation of the certifying bank or other acceptor"¹⁸⁷

Payment or acceptance of drafts under mistake as to condition of drawer's account: Under section 3-418, payment or acceptance would be final as to a holder in due course where the drawee has accepted or paid out money despite insufficient funds in the drawer's account. This is in line with Michigan decisions which have reached this result

¹⁸⁵ *American Surety Co. v. Industrial Sav. Bank*, 242 Mich. 581, 219 N.W. 689 (1928), noted in 27 MICH. L. REV. 100 (1928); *Indemnity Co. v. Bank of Lansing*, 327 Mich. 19, 41 N.W. (2d) 468 (1950); *Peninsular State Bank v. First Nat. Bank*, 245 Mich. 179, 182, 222 N.W. 157 (1928) (dictum). See also *Andrews v. Citizens State Bank*, 251 Mich. 658, 232 N.W. 185 (1930).

¹⁸⁶ For definition of "unauthorized signature" see note 175 *supra*.

¹⁸⁷ Italics added.

where the drawee bank has certified a check despite insufficiency of funds to cover it.¹⁸⁸ Presumably the same result would obtain under section 3-418 where the drawee mistakenly pays to a holder in due course a check against which the drawer has issued a stop payment order.¹⁸⁹ Of course, if a holder in due course knows of the stop payment order when he procures acceptance or payment, some remedy should be available to the drawee. Under the code, the drawee would have a remedy for breach of warranty because one who obtains payment or acceptance warrants to a party who pays or accepts in good faith "that he has no knowledge or [of?] any effective direction to stop payment."

Payment of notes bearing forged or unauthorized signature of maker: The finality rule of section 3-418 is applicable to payment to a holder in due course of a note on which the signature of the maker has been forged. There is one important variation, however, when compared with the operation of the rule on forged drafts. When a holder in due course of a note later learns of the forgery, he may, nevertheless, collect the note and retain the payment. Such a holder does not make the warranties on presentment for payment which are set forth in section 3-417 (1) (c).

Payment or acceptance of instruments bearing forged or unauthorized indorsement: The finality rule of section 3-418 would not apply to payments made on drafts or notes bearing a forged indorsement. This exception to the finality rule is again accomplished through the device of a warranty by the presenter that "he has a good title to the instrument or is authorized to obtain payment or acceptance on behalf of one who has good title."¹⁹⁰ If any indorsement on the instrument is forged or unauthorized, the warranty of title is breached and a claim for damages can be asserted by the payor or acceptor against the recipient of payment or any prior transferor who can be shown to have breached this warranty.

Heretofore, this same result has generally been reached on quasi-contractual theories of recovery of monies paid by mistake.¹⁹¹ However, a few courts have allowed recovery on a breach of warranty

¹⁸⁸ *Union Trust Co. v. Preston Nat. Bank*, 136 Mich. 460, 99 N.W. 399 (1904); *First Nat. Bank v. Union Trust Co.*, 158 Mich. 94, 122 N.W. 547 (1909); *Smith v. Hubbard*, 205 Mich. 44, 171 N.W. 546 (1919).

¹⁸⁹ See §4-407 for broad subrogation rights given to a bank which has paid an item over a stop payment order.

¹⁹⁰ Sec. 3-417(1)(a).

¹⁹¹ See, e.g., *Canal Bank v. Bank of Albany*, 1 Hill (N.Y.) 287 (1841).

theory.¹⁹² In Michigan, recovery has generally been allowed on theories of mistake.¹⁹³ However, in *National Bank v. Fidelity & Deposit Co.*¹⁹⁴ the drawee bank was allowed to recover from the presenter, who signed his name on the back of the checks when he received payment, on the theory that when he "indorsed the checks . . . [he] thereby guaranteed the genuineness of prior indorsements"¹⁹⁵ This sounds like warranty. Despite the *National Bank* case, it seems fair to say that the code would change theories of recovery in Michigan from quasi-contractual concepts of mistake to breach of warranty.

The Michigan courts deny recovery to a drawee bank which fails promptly to notify persons who received payment of the forged indorsement if the delay in notification caused prejudice to the recipient of payment.¹⁹⁶ Also, the drawee bank cannot recover if there is proof of actual negligence on the part of the drawee bank in failing to detect the forged indorsement.¹⁹⁷ Recovery is barred in these cases on theories of *estoppel*. Could the drawee bank be similarly estopped from recovery in these situations where claim is made for breach of warranty under the code?

Since one element of the breach of warranty action under the code would be a showing of damage, attention should be called to the holding of the Michigan court in *Merchant's National Bank v. Federal State Bank*.¹⁹⁸ In this case, drawee bank brought an action in *assumpsit* to recover monies paid by mistake on two checks bearing forged indorsements. The court found that the drawer of the checks had indirectly received benefits from the use of the checks despite the forged indorsements. Therefore, the court speculated, the drawer could not have forced the drawee bank to reimburse its account. As a result, drawee bank had suffered no loss justifying recovery. Questionable as this holding may be,¹⁹⁹ the result would be no different under the

¹⁹² See, e.g., *Clearfield Trust Co. v. United States*, 318 U.S. 363, 63 S.Ct. 573 (1943).

¹⁹³ *Metropolitan Cas. Ins. Co. v. First Nat. Bank*, 261 Mich. 450, 246 N.W. 178 (1933).

¹⁹⁴ 291 Mich. 36 at 40, 288 N.W. 325 (1939).

¹⁹⁵ One might well question whether the court is correct in calling the presenter's signature on the back of the instrument an "indorsement." The bank is payor, not a purchaser, of the instrument and the presenter is not a transferor when he demands payment. At best, his signature on the back of the instrument is a mere receipt of payment.

¹⁹⁶ See discussion in *Merchant's Nat. Bank v. Federal State Bank*, 206 Mich. 8, 172 N.W. 390 (1919).

¹⁹⁷ *Peninsular State Bank v. First Nat. Bank*, 245 Mich. 179, 222 N.W. 157 (1928).

¹⁹⁸ 206 Mich. 8, 172 N.W. 390 (1919).

¹⁹⁹ The holding was criticized in *Pennsylvania Co. v. Federal Reserve Bank*, (D.C. Pa. 1939) 30 F. Supp. 982 at 985.

code, for the rationale of this decision would make it impossible to show damages arising out of the breach of warranty.

Under present theories of recovery of monies paid by mistake on an instrument bearing a forged indorsement, the ultimate loss will normally fall on the person who took the instrument from the forger. For example, payee's indorsement is forged by X, who transfers to A, who transfers to B, who receives payment from drawee. Drawee normally will recover from B, who then will recover from A, who must look to X, the forger, for recovery or bear the loss. The same end result may be reached under the code but not in exactly the manner which might be expected. Under section 3-417(1)(a), both A (as a "prior transferor") and B (as a "person who obtains payment") have breached their warranties of good title to the drawee. Suppose the drawee recovers from B for breach of warranty. Can B then recover from A for breach of warranty under section 3-417(1)(a) as might be expected? No, because A's warranty as a "prior transferor" runs only to the party who pays, i.e., drawee.²⁰⁰ B may, however, be able to recover from A for breach of warranty under section 3-417(2)(a) or (c). Or isn't it possible he might still be able to recover on theories of quasi-contract?

Payment or acceptance of drafts containing material alterations: There is a dearth of Michigan decisions dealing with the right of a drawee to recover monies paid by mistake on a bill or check which has been materially altered. One very early case²⁰¹ indicates, however, that traditional theories of recovery of monies paid by mistake would be followed and the drawee could recover. Broadly speaking, a similar result would obtain under the code by virtue of the warranty, set forth in section 3-417(1)(c), that "the instrument has not been materially altered. . . ." Several problems may arise in connection with the operation of this warranty. Could a drawee who negligently fails to discover the alteration or who fails to give reasonable notification of the discovery of the alteration recover for breach of the warranty? If the drawee recovers from the person to whom he paid, could there then be recovery back along the chain of transfer of the instrument until the forger is reached? In many cases this should be possible but not on the warranty of section 3-417(1)(c). Instead, recovery would depend upon the warranty of section 3-417(2)(b) or quasi-contractual theories.

²⁰⁰ Compare similar warranties in bank collection process which run to all subsequent participants in the process of collection (§4-207(1)).

²⁰¹ Little v. Derby, 7 Mich. 325 (1859).

Observe that the warranty against material alteration would not be made by a "holder in due course who has taken a draft drawn on and accepted by a bank after such alteration."²⁰² Thus the accepting bank would no longer be able to escape the obligation to pay the instrument to a holder in due course according to its altered terms by accepting "payable as originally drawn" or in equivalent terms. Suppose that the check is altered *after* acceptance and then is mistakenly paid by the certifying bank to a holder in due course according to its altered terms. Shouldn't the bank bear the burden of loss resulting from its failure to recognize the alteration just as the maker of a note bears the risk of recognizing alterations under the code? Under section 3-417(1)(c), however, the holder in due course who received payment in these circumstances would be liable for breach of warranty.

Payment of notes containing material alterations: On principle it seems fair to deny the maker of a note the right to recover payments made in error because the note has been altered. As maker, he should detect any forgery altering its terms. This is the result which would prevail under the code as to any holder in due course who received payment of the altered instrument.

Payment of drafts accompanied by forged documents: The situation where a drawee pays a genuine draft accompanied by a forged document, e.g., bill of lading, warehouse receipt, etc., is not covered by the code. The overwhelming weight of authority is that the drawee cannot recover monies so paid on theories of mistake.²⁰³ The courts of Michigan follow this view and could continue to do so under the code.²⁰⁴

Section 3-419. Conversion of Instrument; Innocent Representative.

(1) *An instrument is converted when*

- (a) *a drawee to whom it is delivered for acceptance refuses to return it on demand; or*
- (b) *any person to whom it is delivered for payment refuses on demand either to pay or to return it; or*
- (c) *it is paid on a forged indorsement.*

(2) *In an action against a drawee under subsection (1) the measure of the drawee's liability is the face amount of the instrument. In any*

²⁰² This exception to the warranty against material alteration apparently applies only to checks. Why?

²⁰³ See, e.g., *Springs v. Hanover Nat. Bank*, 209 N.Y. 224, 103 N.E. 156 (1914).

²⁰⁴ *First Nat. Bank of Detroit v. Burkham*, 32 Mich. 328 (1875).

other action under subsection (1) the measure of liability is presumed to be the face amount of the instrument.

(3) A representative, including a depository or collecting bank, who has in good faith and in accordance with the reasonable commercial standards applicable to the business of such representative dealt with an instrument or its proceeds on behalf of one who was not the true owner is not liable in conversion or otherwise to the true owner beyond the amount of any proceeds remaining in his hands.

Since section 3-410 eliminates virtual acceptances, section 3-419(1)(a) gives a remedy of conversion to the holder against a drawee who refuses to return, upon demand, an instrument delivered for acceptance. Under section 3-419(2) the damages in such a conversion action are fixed at the face amount of the instrument. If an instrument is delivered for payment and the drawee or maker, on demand, refuses to pay or return it, there is liability to the holder for conversion under section 3-419(1)(b). Again, under section 3-419(2), the drawee's liability is fixed at the face amount of the instrument; however, the maker's liability is simply presumed²⁰⁵ to be the face amount of the instrument. Under section 3-419(1)(c) an instrument is converted when "it is paid on a forged indorsement."²⁰⁶ The drawee or maker who pays the instrument bearing a forged indorsement is liable to the rightful holder for conversion with the measure of liability determined pursuant to section 3-419(2). This would change the questionable result in *Gordon Fireworks Co. v. Capital National Bank*.²⁰⁷

In Michigan a cashing or collecting bank is liable to the rightful holder for conversion²⁰⁸ and in assumption²⁰⁹ if it cashes or collects money on an instrument bearing a forged indorsement. No distinction is drawn between a bank which is an outright purchaser of the forged instrument and one which simply takes the forged instrument as a depository for collection or along the line in the collection process. For

²⁰⁵ Section 1-201(31) defines "presumed" as meaning "that the trier of fact must find the existence of the fact presumed unless and until evidence is introduced which would support a finding of its non-existence."

²⁰⁶ Section 3-404 declares any "unauthorized signature" wholly inoperative. Section 1-201 defines "unauthorized signature" as one "made without actual, implied or apparent authority and includes a forgery." Since an "unauthorized signature" is inoperative, shouldn't the claim for conversion under §3-419(1)(c) cover a situation where an instrument bearing an unauthorized as well as a forged indorsement is paid? Yet isn't this possibility eliminated by use of the narrower term "forged indorsement" rather than "unauthorized indorsement"?

²⁰⁷ 236 Mich. 271, 210 N.W. 263 (1926).

²⁰⁸ See note 105 supra.

²⁰⁹ See note 106 supra.

example, in *Kaufman v. State Savings Bank*²¹⁰ the defendant bank purchased a draft outright and took a check for collection. Both instruments bore a forged indorsement. When the check was collected the defendant bank paid over the proceeds. The rightful owner recovered from defendant bank for conversion of both instruments. Under the code the result would be different. Section 3-419(3) provides that a representative, "including a depository or collecting bank,"²¹¹ who has "dealt with an instrument or its proceeds on behalf of one who was not the true owner is not liable in conversion or otherwise to the true owner beyond the amount of any proceeds remaining in his hands." Since the defendant bank in the *Kaufman* case purchased the draft rather than taking it for collection, it would be liable for conversion of this item. As to the check, however, the defendant bank would be in the position of a "depository or collecting bank" which had paid over the proceeds, hence it would have no liability for conversion under section 3-419(3). The provision in section 3-419(3) against liability "in conversion or otherwise" would read out liability in assumpsit.²¹²

²¹⁰ 151 Mich. 65, 114 N.W. 863 (1908).

²¹¹ "‘Depository bank’ means the first bank to which an item is transferred for collection even though it is also the payor bank." §4-105(a). "‘Collecting bank’ means any bank handling the item for collection except the payor bank." §4-105(d).

²¹² Compare *Brown v. People’s Nat. Bank*, 170 Mich. 416, 136 N.W. 506 (1912).